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Economic Prospects for Central, East and Southeast Europe

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Animal Spirits still Dimmed: Slow Recovery Expected

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Contents

Executive summary ..... *i*

Animal spirits still dimmed: slow recovery expected 1

Introduction 1

External environment: global and European developments 2

Recession and outlook 5

Better performers 11

The Balkans 12

Big neighbours 13

Dealing with imbalances: EU and its neighbours in good times and bad 15

Policy framework: rules and implementation 21

Investments to the rescue 25

Bonds, spreads, and investments 29

Why is the euro holding up? 35

Is there a liquidity trap? 40

Labour market developments 42

  Unemployment situation of young people further deteriorating 44

  Labour market prospects 46

Revolutions ahead? 46

EU deepening and widening 47

New growth model 48

Conclusion and prospects 48

Special Section I: Macroeconomic conditionality: a threat to cohesion policy transfers from 2014 onwards? 50

Introduction 50

The concept 50

The sanctions 51

Sanctions and the fiscal deficit 53

Sanctions and economic growth 53

Concluding remarks 55

Special Section II: Croatian EU accession and regional trade patterns 56

Country reports

Bulgaria: Economy stalls as politics overshadows policy debates 65
Croatia: Joining EU under difficult conditions 69
The Czech Republic: Deeper in recession 71
Estonia: Consumption should avert a second dip 75
Hungary: Leaving the excessive deficit procedure behind 79
Latvia: Between Scylla and Eurybdis, ready for taking a dive 83
Lithuania: Demand-side policies affect balanced growth 87
Poland: Falling inflation may strengthen GDP growth 91
Romania: Sober optimism 95
Slovakia: Growth slowing down 99
Slovenia: Worsening recession 103
Macedonia: Stagnating on 107
Montenegro: Waiting for investors 109
Serbia: Fiscal and other worries 111
Turkey: Policy challenges of a European emerging economy 115
Albania: Deleveraging and improved business confidence – unity and conflict of opposites 119
Bosnia and Herzegovina: Fear of and hope for Spring 121
Kosovo: Cooperation for integration 125
Kazakhstan: Strong growth and structural reforms 127
Russian Federation: Growth stumbles – how much and for how long? 131
Ukraine: Ample global liquidity helps maintain fragile status quo 135

Appendix: Selected indicators of competitiveness 139

Tables and Figures

Table I	Overview 2011-2012 and outlook 2013-2015	vii
Table II	Central and East European new EU Member States (NMS-11): an overview of economic fundamentals, 2012	viii
Table III	Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2012	ix
Table 1	Fiscal balances, 2010-2014	4
Table 2	The Macroeconomic Imbalance Procedure (MIP) Scoreboard with values for 2012	17
Table 3	Foreign financial position in % of GDP	19
Table 4	Gross fixed capital formation, private sector real change in % against preceding year	25
Table 5	Gross fixed capital formation, public sector real change in % against preceding year	26
Table 6	Results of regressions	34
Table 7	Percent change in trade quantities after Croatian EU accession	61
Table 8	Change in values of trade at world prices after Croatian EU accession, in million USD	61
Table 9	Summary effects of Croatian EU accession	62
Figure 1	Development of GDP, real change in % against preceding year	3
Figure 2	Development of quarterly GDP, real change in % against preceding year	6
Figure 3	Exports of goods (nominal, euro-based), change in % against preceding year, 3-month moving average	7
Figure 4	Imports of goods (nominal, euro-based), change in % against preceding year, 3-month moving average	8
Figure 5	GDP growth in 2012 (in %) and contribution of individual demand components, in percentage points	9
Figure 6	GDP growth in 2013 (in %) and contribution of individual demand components, in percentage points	10
Figure 7	Gross fixed capital formation, real change in % against preceding year	11
Figure 8	Gross industrial production, real change in % against preceding year, 3-month moving average	13
Figure 9	Household consumption, real change in % against preceding year	14
Figure 10	Private sector and public debt in % of GDP, 2002, 2008 and 2012	16
Figure 11	Exchange regime, trade and GDP growth, average p.a., 2009-2012	20
Figure 12	Total fiscal revenues, in % of GDP	22
Figure 13	Total fiscal expenditures, in % of GDP	22
Figure 14	Implicit interest rates compared with GDP growth	24

Figure 15 Interest rates – loans to households for housing, in domestic currency, amount outstanding, maturity >5 years, % p.a. 27
Figure 16 Bank loans to non-financial private sector, change in % against preceding year 27
Figure 17 Interest rates – loans to non-financial corporations, domestic currency, amount outstanding, maturity > 5 years, % p.a. 28
Figure 18 Interest rates – loans to households for housing, in domestic currency, amount outstanding, maturity > 5 years, % p.a. 28
Figure 19 Spreads of 10-year sovereign debt yields to the German equivalent of selected euro area members, % 29
Figure 20 Spreads of 10-year sovereign debt yields to the German equivalent of non-euro area EU members from CESEE, % 30
Figure 21 Spreads of 10-year sovereign debt yields to the German equivalent of SEE countries, % 30
Figure 22 Spreads of 10-year sovereign debt yields to the German equivalent of selected CIS countries, % 31
Figure 23 Spreads of 10-year sovereign debt yields to the German equivalent, % 31
Figure 24 Interest rates on loans to non-financial corporations, value below 1 EUR million, maturity between 1 and 5 years, % 32
Figure 25 Interest rates on loans to non-financial corporations, value above 1 EUR million, maturity above 5 years, % 33
Figure 26 Exchange rates, consumer prices and wages 2005-2013 change in % against preceding year 37
Figure 27 Money M1, change in % against preceding year 40
Figure 28 Money M2, change in % against preceding year 41
Figure 29 Money M3, change in % against preceding year 41
Figure 30 Non-performing loans, in % total loans 42
Figure 31 Employment rates total, employed in % of working-age population (15-64) 43
Figure 32 Croatian exports by trading partners, in % of total 57
Figure 33 Croatian imports by trading partners, in % of total 57
Figure 34 Croatian exports by product groups, in % of total 58
Figure 35 Croatian imports by product groups, in % of total 58

Country reports

Table BG Bulgaria: Selected Economic Indicators 64
Table HR Croatia: Selected Economic Indicators 68
Table CZ Czech Republic: Selected Economic Indicators 72
Table EE Estonia: Selected Economic Indicators 76
Table HU Hungary: Selected Economic Indicators 78
Table LV Latvia: Selected Economic Indicators 82

Table LT Lithuania: Selected Economic Indicators 86
Table PL Poland: Selected Economic Indicators 90
Table RO Romania: Selected Economic Indicators 94
Table SK Slovakia: Selected Economic Indicators 98
Table SI Slovenia: Selected Economic Indicators 102
Table MK Macedonia: Selected Economic Indicators 106
Table ME Montenegro: Selected Economic Indicators 108
Table RS Serbia: Selected Economic Indicators 112
Table TR Turkey: Selected Economic Indicators 114
Table AL Albania: Selected Economic Indicators 118
Table BA Bosnia and Herzegovina: Selected Economic Indicators 122
Table XK Kosovo: Selected Economic Indicators 124
Table KZ Kazakhstan: Selected Economic Indicators 128
Table RU Russia: Selected Economic Indicators 132
Table UA Ukraine: Selected Economic Indicators 136

Appendix on selected indicators of competitiveness

Table A/1 GDP per capita at current PPPs (EUR), from 2012 at constant PPPs and population 140
Table A/2 Indicators of macro-competitiveness, 2008-2015, EUR based, annual averages 141
Table A/3 Indicators of macro-competitiveness, 2008-2015, annual changes in % 148

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Executive summary

The EU and CESEE economies have diverged from global growth developments in 2012 and their recovery appears to be rather slow and lagging rather than leading the world recovery. For the most part this is the consequence of the euro crisis over the period 2011-2012 and the attempted fiscal consolidation as a means of stabilisation. With the intervention of the ECB to stabilise the money market, the risk of the euro area falling apart has lessened, but the remaining policy framework requires more corrections in various imbalances and relies on structural reforms and an eventual investment revival. The latter has yet to happen as foreign investments are still depressed while both domestic public and private investments continue to contract in many countries.

The shift towards recession followed by slow recovery has been remarkably synchronised across the economies of Europe and across the CESEE region in particular. The Central European countries that previously performed better, such as Poland and Slovakia, have seen their growth rates as well as their foreign trade performance come more in line with other countries in the region; the same can be said for Albania and Turkey in the Balkans and Russia and Ukraine to the east. In the Baltic region, the rapid recovery from the steep drop in growth at the height of the crisis has also come to an end, although the Baltic states are still posting higher growth rates than practically any other CESEE country (with the exception of Kosovo). Kazakhstan remains the best performer as it is more closely aligned with the business cycle in global emerging markets.

The Balkan countries are less of outliers now, though some of the worst performers are still to be found in that region or in its neighbourhood. Slovenia is expected to remain in recession this year and next, while Croatia and also the Czech Republic might just manage to extricate themselves from recession next year. Hungary should start to see a low positive growth rate next year. The Balkan countries as a whole are still counting on a recovery of industry with the return of foreign investors. However, the manoeuvring space for domestic policy is quite limited and relatively restrictive measures will continue to be a drag on recovery in the medium term.

The larger neighbours to the east and the south are on diverging courses. Turkey is forecast to continue posting growth rates more in line with global emerging markets. Russia and Ukraine, however, are increasingly in sync with the European economy. This is, in part, a consequence of the slump in global commodity markets, but it also reflects their inability to come to grips with domestic policy challenges. The process of modernisation, loudly heralded in Russia a few years back, has yet to take off. Both countries can still rely on growth in household consumption, but that is having an impact on their trade balances, which are decreasing the current account surplus in Russia's and increasing it in Ukraine.

The recovery strategy, based as it is on the revival of investments, is being buffeted by strong head winds. Problems persist in the banking sector and there are few signs of increased credit activity. Furthermore, private investments are not increasing, while public investments are still mostly declining. Moreover, the indications are that conditions for small and medium-size enterprises have diverged in a negative manner, even though interest rates have come down to pre-crisis levels – except for those countries that are still in distress. However, interest rates are still relatively high given the prospects for growth in terms of both sales and incomes. Perhaps a further relaxation of the monetary policy by the ECB would be helpful, while central banks outside of the euro area have but limited scope to do much more even though policy rates are dropping almost everywhere. The overall increase in monetary aggregates is minimal while foreign currency reserves are accumulating in the respective central banks.

Labour market developments are markedly negative, especially where young people are concerned. Given the current projections for recovery, prospects will probably worsen in the medium term. Anticipating the social consequences of all this is not an easy task, given that those tend to lag behind economic developments, both negative and positive. Similarly, political changes are still in the offing. In any event and under the current circumstances, neither stability nor even sustainability of the current political set-ups can be assumed in the Balkans and the neighbouring countries in particular.

Reforms aimed at the deepening of the EU are still taking time to emerge. Some reforms, especially those aimed at correcting external imbalances, are directed more towards renationalisation than a higher degree of integration. Those trends also suggest a move towards a new growth model based more on the alignment of domestic savings and investments rather than on cross-border capital movements. It may prove especially difficult to introduce this new growth model in the Balkans and the Baltic region. By way of contrast, the EU integration process proceeds apace with Croatia joining as the 28th Member State and Serbia all set to start negotiating with the EU at the very beginning of next year. Moreover, Kosovo should also be starting the negotiations on the Stabilisation and Association Agreement. The Balkan region can thus be seen to be moving, albeit slowly, towards integration with the EU.

Overall, prospects point to slow initial recovery that may well accelerate somewhat over the medium term.

Country summaries

In the first months of the current year, public debate in **Bulgaria** was dominated entirely by expectations of early elections in May, while economic policy *per se* was largely sidelined. The economy was left with no clear sense of direction and lacked both internal and external driving forces. Although the new government, which took office at the end of May, has pledged to lay greater emphasis on counter-cyclical policy measures, the impact of those measures is unlikely to be felt in the course of 2013.

Croatia faces yet another year of recession extending throughout 2013. Growth should finally rebound in 2014, provided investments pick up and external demand strengthens. Owing to rising and persistently high unemployment, private consumption will remain suppressed. Fiscal consolidation and structural reforms will remain the major challenge in the years ahead. Joining the EU may help to increase foreign investor confidence, while regional trade will suffer.

A deep recession in the country’s major export markets could have the most debilitating effect on the economy in the **Czech Republic**. Fiscal consolidation, which in all likelihood will continue in 2013, offers no promise of rapid recovery. Other risks do not seem serious. Monetary policy is unlikely to make irresponsible moves as long as the country’s banks, as well as the corporate non-financial and household sectors, are financially sound and resilient enough to withstand any conceivable ruptures.

In **Estonia** the ongoing recessionary economic environment in the EU in general and stagnation in the Scandinavian countries placed a strain on the country’s growth prospects. Thus, the mood of entrepreneurs to invest remains subdued, while public investment activity has been sharply curtailed compared to the recent recovery phase. Only household consumption is fuelling GDP growth thanks to real wages increasing more than productivity.

In **Hungary** GDP data (year-on-year) for the first quarter show a further decline in consumption and investment. Only foreign trade has contributed positively to the change in GDP. Over the year, good performance in agriculture and construction may help to secure zero growth. The major obstacles to a return to a higher growth rate are uncertainties in the legal and fiscal environment and the lack of confidence among domestic and foreign investors, as well as faltering financial intermediation.

Latvia is joining the euro area in 2014 at a time when the euro project itself is in deep trouble, the reason being that the country’s ruling elites deem it a safer haven compared to the present hard peg regime. The short-lived ‘success story’ of internal devaluation is souring again, given the lack of investments, ongoing austerity policies and the impossibility of running an ‘export-driven’ beggar-thy-neighbour growth model in a phase marked by an EU-wide economic and social crisis. However, wage increases exceeding those of productivity may well bolster economic growth, at least temporarily.

In **Lithuania** the new centre-left coalition government seems to have put into effect an appropriate policy-mix combining demand-side measures and growth-enhancing supply-side instruments. Raising minimum wages has not increased consumer inflation; it has, however, bolstered household consumption, while investments in transport infrastructure have boosted prospects of growth in the medium term. At the same time, surprisingly high export growth has kept the current account deficit low. One of the dangers to economic growth and the current rebound in welfare after the bust is that the government might resort to austerity in order to aim at too early an accession to the euro area in 2015.

In **Poland**, it is likely that growth will appear very weak in the initial stages. However, fast-falling inflation may lend a boost to real disposable incomes and consumption. Public spending is likely to be increased on a temporary basis, even if it is incompatible with the declared fiscal consolidation strategies. Some growth acceleration in the second half of 2013 may also follow in the wake of improvements in foreign trade (primarily rising exports, driven by growth picking up speed in the euro area and a probable corrective weakening of the Polish zloty).

In **Romania**, 2.2% GDP growth in the first quarter of 2013 was driven solely by net exports. Industrial production and exports recovered at a remarkable pace in the first four months of the year, thus justifying a revision of the wiiw GDP forecast to 1.9% for 2013, with a slight downturn in both 2014 and 2015 owing to continuing bad performance in the euro area.

Export-led growth in **Slovakia** continued in the first quarter of 2013, although it was considerably slower than the previous year when automotive production and exports surged. Owing to this base effect, GDP growth slowed down to a mere 0.6%. GDP should grow moderately throughout the current year depending, however, on external demand in the euro area and the resolution of the latter's debt crisis.

In **Slovenia** the economy will remain in recession in 2013 and only bounce back slowly in the years to come. Household consumption will remain subdued on account of rising unemployment. Restructuring of the banking sector, fiscal consolidation and, ultimately, the implementation of the long overdue reform measures recently adopted will remain the most challenging tasks for the Slovenian authorities.

In the short run, some recovery can be expected in **Macedonia** due to some pick-up in investments, public and private, and the continuing positive contribution of net exports. In the medium run growth should speed up a bit on the assumption that both the EU and the local markets will improve. Additional fiscal consolidation is not contemplated, though fiscal stimulus is not to be expected either. The policy-makers will continue to take care of internal stability and wait for the tide, when and if it comes, to lift their boat too.

In the short term **Montenegro's** economy should get out of recession and in the medium term recovery should speed up, but still at a relatively slow pace. It will take a much more pronounced return of foreign investors to get the economy back to growth rates experienced before the crisis.

In **Serbia**, prospect for this year will depend on the measures that will be taken before the summer recess. If the intended cuts in public spending materialise, that will affect negatively this year's growth, which in any case was not projected to be much faster than 2% and may be lower now. In the medium term, persistent fiscal and current account worries will make growth depend on exports and foreign investments. Those may keep recovering slowly, but a significant speed-up of growth is not very likely.

Thus far in 2013 **Turkey** has been recovering from the dramatic growth slowdown in 2012. The Central Bank of Turkey (CBRT) had induced that slowdown by shifting perceptibly towards tight monetary policy. Any recovery since then has been associated with a certain loosening of that stance, but the bank is still using tools designed to control credit growth. Apart from the above, the CBRT has had to undertake attempts to discourage too strong an inflow of capital (short-term in nature) by reducing interest rates. Recent political developments, as well as the announcement of possible shifts in the US Fed's policy with respect to quantitative easing, have added an additional element of uncertainty regarding the nature of possible instabilities (e.g. leading to capital outflows rather than inflows) and the country's policy response to the same. Those uncertainties notwithstanding, Turkey is expected to grow at 3.5% in 2013 and 4.5% in 2014.

In **Albania** the deleveraging process will act as a drag on economic development in the years to come. This is also one of the reasons for having corrected downwards our GDP growth forecast for 2014: from 3.3% to a mere 2.5%. Interestingly, the most recent business and consumer confidence survey results for the first quarter of 2013 show a further improvement in the overall economic sentiment indicator. The construction sector, in particular, has recently experienced a substantial improvement in confidence after years of deterioration. The above contradictory developments lead us to expect a GDP trend growth rate of around 3% for 2015 and beyond.

In the short run, the policy framework will remain restrictive in **Bosnia and Herzegovina** because of the currency board and the pressure, by the IMF among others, for fiscal consolidation. If industrial production continues to improve and exports hold up, that should spur more investment and some speed-up of the recovery of growth. But the needed policy turnaround is hardly possible without some kind of political Spring arriving to this country.

Our forecast for **Kosovo** is a robust 3% GDP growth for 2013 and a reinforced growth of 5% in 2014. For 2015 and the medium term, growth prospects are expected to hover around a trend growth rate of about 4%. Expansion in 2014 will not only be due to improved external factors, but also to parliamentary elections that are likely to be held in early 2014. Thus, a fiscal stimulus can be expected to boost both consumption and investment. The budget deficit will not necessarily be overly affected given the inflow of funds in the wake of the privatisation of the Post and Telecom of Kosovo (PTK). At the end of April 2013, 75% of PTK, comprising two business units, Telecom (fixed-line telephony) and Vala (mobile telephony), were sold at a relatively low price of EUR 277 million to ACP Axos Capital, an international consortium from Hamburg.

In **Kazakhstan** real GDP will grow by 5% to 6.5% over the period 2013-2015, in particular owing to the increase in oil production with the start of operations in the Kashagan oil field. The country will thus assume the lead in terms of economic growth in the region covered by our analysis. While the banking system continues to struggle with high non-performing loans, the government has decided to reduce significantly its support to the finance sector. At the same time, the government plans to change drastically the landscape of the pension funds sector by nationalising existing private pension funds and merging their assets into one state pension fund, constituting the mandatory pension pillar.

In **Russia** economic growth has been slowing down as industrial production and investment stagnate. A drop in energy prices and export revenues owing to the expected 'shale gas price shock' has cast a dark shadow over Russia's growth prospects. Together with the persistent crisis in the euro area, all those factors point to the urgency of the attempts to diversify, modernise and restructure the Russian economy. wiiw has revised its GDP growth forecast downwards and continues to expect an unspectacular GDP growth rate during 2014-2015. Simultaneously, the annual CPI inflation will settle down at 5% p.a., the budget will remain balanced and the rate of unemployment stable at some 6%.

In **Ukraine** improved access to global capital markets has markedly reduced devaluation pressures and secured financial stability without any need for a new IMF package. However, the economy is expected to come close to stagnation in 2013, although external imbalances are likely to improve somewhat on account of the newly introduced policies relating to protectionism and the energy sector. In the medium term, a return to economic growth hinges on the extent of recovery in the global metals markets and on growth performance improving in neighbouring Russia.

Keywords: Central and East European new EU Member States, Southeast Europe, financial crisis, Balkans, Russia, Ukraine, Kazakhstan, Turkey, economic forecasts, employment, foreign trade, competitiveness, debt, deleveraging, exchange rates, fiscal consolidation

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Table I

Overview 2011-2012 and outlook 2013-2015

	GDP real change in % against previous year					**Consumer prices** change in % against previous year					**Unemployment, based on LFS** rate in %, annual average					**Current account** in % of GDP				
	2011	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**
			Forecast					**Forecast**					**Forecast**					**Forecast**		
NMS-11																				
Bulgaria	1.8	0.8	0.9	2.0	3.0	3.4	2.4	2.5	3.0	3.0	11.2	12.3	12.5	12.0	11.5	0.1	-1.3	-1.7	-2.3	-2.8
Croatia	0.0	-2.0	-1.0	1.0	2.0	2.3	3.4	3.5	2.5	2.0	13.5	15.8	17.5	17.0	17.5	-0.9	0.1	0.1	-0.6	-1.0
Czech Republic	1.9	-1.3	-0.8	1.4	2.4	2.2	3.5	1.9	2.0	1.8	6.7	7.0	7.6	7.7	7.3	-2.7	-2.5	-1.7	-1.6	-1.9
Estonia	8.3	3.2	2.0	3.2	3.5	5.1	4.2	3.4	4.0	4.5	12.5	10.2	9.5	9.0	8.0	2.1	-1.2	-3.1	-3.6	-4.3
Hungary	1.6	-1.7	0.0	1.2	2.3	3.9	5.7	2.5	2.9	3.0	10.9	10.9	11.0	10.8	10.6	0.8	1.6	1.5	1.2	0.4
Latvia	5.5	5.6	2.8	3.1	3.5	4.2	2.3	1.0	1.5	2.0	15.4	14.9	13.2	12.5	11.5	-2.1	-1.7	-2.9	-3.8	-4.4
Lithuania	5.9	3.7	3.5	3.8	4.2	4.1	3.2	2.0	2.5	3.6	15.4	13.3	12.0	11.0	10.0	-3.7	-0.5	-2.9	-3.0	-3.0
Poland	4.5	1.9	1.2	2.7	3.5	3.9	3.7	1.5	2.0	2.0	9.7	10.1	11.0	10.8	10.5	-4.8	-3.5	-3.1	-3.6	-3.8
Romania	2.2	0.7	1.9	2.0	2.1	5.8	3.4	4.2	3.5	3.5	7.4	7.0	7.0	7.0	6.5	-4.5	-4.0	-3.5	-3.6	-3.7
Slovakia	3.2	2.0	1.0	2.4	3.0	4.1	3.7	2.0	3.0	3.0	13.5	14.0	14.5	14.0	13.0	-2.1	2.3	2.0	1.9	1.0
Slovenia	0.6	-2.3	-3.3	-0.4	1.0	2.1	2.8	2.5	2.0	2.0	8.2	8.9	11.5	11.5	10.0	0.0	2.3	1.7	0.8	0.5
NMS-11 1)	*3.1*	*0.8*	*0.8*	*2.1*	*2.9*	*3.9*	*3.7*	*2.3*	*2.5*	*2.5*	*9.8*	*9.9*	*10.4*	*10.2*	*9.8*	*-3.0*	*-1.9*	*-1.8*	*-2.2*	*-2.5*
EA-17 2)	*1.4*	*-0.6*	*-0.4*	*1.2*	.	*2.7*	*2.5*	*1.6*	*1.5*	.	*10.2*	*11.4*	*12.2*	*12.1*	.	*0.3*	*1.8*	*2.5*	*2.7*	.
EU-28 1)2)	*1.7*	*-0.2*	*-0.1*	*1.5*	.	*3.1*	*2.6*	*1.8*	*1.7*	.	*9.7*	*10.5*	*11.1*	*11.1*	.	*0.4*	*1.0*	.	.	.
Candidate countries																				
Macedonia	2.8	-0.2	1.2	2.2	2.6	3.9	3.3	3.0	3.0	3.0	31.4	31.0	31.0	31.0	30.0	-3.0	-3.9	-4.0	-6.0	-6.0
Montenegro	3.2	-0.5	1.3	2.0	3.0	3.1	4.1	3.0	3.0	3.0	19.7	19.7	20.0	19.0	19.0	-17.7	-17.9	-15.0	-15.0	-15.0
Serbia	1.6	-1.7	1.0	2.0	3.0	11.0	7.8	6.0	5.0	5.0	23.0	24.0	25.0	25.0	25.0	-9.1	-10.5	-9.0	-9.0	-8.0
Turkey	8.8	2.2	3.4	4.5	5.0	6.5	9.0	6.6	6.0	6.0	8.8	8.2	9.2	9.0	8.8	-9.7	-5.9	-7.3	-7.5	-7.7
Potential candidate countries																				
Albania	3.1	1.5	3.5	2.5	3.0	3.4	2.0	3.0	2.0	2.0	14.3	14.0	14.0	13.0	13.0	-13.0	-10.6	-8.7	-7.3	-6.8
Bosnia and Herzegovina	1.0	-0.7	0.8	2.0	3.0	3.7	2.1	1.5	2.0	2.0	27.6	28.0	28.0	28.0	27.0	-8.7	-9.4	-9.6	-9.9	-10.1
Kosovo	4.5	2.1	3.0	5.0	4.0	7.3	2.5	3.0	4.0	4.0	44.8	44.0	43.0	41.0	39.0	-13.8	-7.6	-11.3	-15.5	-12.7
Kazakhstan	7.5	5.0	5.0	6.0	6.5	8.3	5.2	7.0	6.5	6.0	5.4	5.3	5.0	5.0	5.0	6.5	3.8	4.0	5.0	5.1
Russia	4.3	3.4	2.4	3.1	3.2	8.5	5.1	7.0	6.0	5.0	6.5	5.5	6.0	6.0	6.0	5.2	4.0	2.7	2.2	1.8
Ukraine	5.2	0.2	0.5	2.5	3.5	8.0	0.6	0.5	4.5	4.0	7.9	7.5	7.8	7.7	7.5	-6.3	-8.4	-5.9	-6.9	-6.7

Note: LFS: Labour Force Survey. NMS: the new EU Member States. EA: euro area 17 countries.

1) wiiw estimate. - 2) Current account data include transactions within the region (sum over individual countries).

Source: wiiw (June 2013), Eurostat. Forecasts by wiiw and European Commission for euro area (Spring Report, April 2013).

Table II

Central and East European new EU Member States (NMS-11): an overview of economic fundamentals, 2012

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-11* [1]	*EU-28* [2]
GDP in EUR at exchange rates, EUR bn	39.67	43.93	152.31	17.00	97.76	22.26	32.86	381.21	131.75	71.46	35.47	*1025.7*	*12945.4*
GDP in EUR at PPP, EUR bn	88.05	64.89	215.03	24.08	163.58	32.84	53.76	654.32	260.47	103.25	42.93	*1703.2*	*12945.4*
GDP in EUR at PPP, EU-28=100	0.7	0.5	1.7	0.2	1.3	0.3	0.4	5.1	2.0	0.8	0.3	*13.2*	*100.0*
GDP in EUR at PPP, per capita	12100	15200	20500	18700	16500	16100	18000	17000	13700	19100	20900	*16500*	*25600*
GDP in EUR at PPP per capita, EU-28=100	47	59	80	73	64	63	70	66	54	75	82	*64*	*100*
GDP at constant prices, 1990=100	130.8	106.8	146.5	152.8	124.5	112.2	122.5	200.3 [3]	136.0	171.7	153.9	*164.4*	*145.9*
GDP at constant prices, 2007=100	103.4	91.0	101.5	95.1	95.2	87.8	97.7	118.2	102.0	110.5	94.8	*106.5*	*99.7*
Industrial production real, 2007=100 [4]	88.5	84.5	96.8	106.7	94.3	105.3	106.0	118.5	112.6	119.0	90.8	*107.9*	*92.1*
Population, thousands, average	7305	4267	10509	1290	9919	2035	2994	38560	19000	5410	2056	*103345*	*506061*
Employed persons, LFS, thousands, average	2934	1446	4890	624	3878	886	1279	15591	9263	2329	924	*44043*	*217505*
Unemployment rate, LFS, in %	12.3	15.8	7.0	10.2	10.9	14.9	13.3	10.1	7.0	14.0	8.9	*9.9*	*10.5*
General gov. revenues, EU-def., in % of GDP	34.9	36.8	40.3	40.2	46.5	35.2	32.9	38.4	33.5	33.1	45.0	*38.3*	*45.4*
General gov. expenditures, EU-def., in % of GDP	35.7	40.6	44.6	40.5	48.5	36.5	36.2	42.3	36.4	37.4	49.0	*41.7*	*49.4*
General gov. balance, EU-def., in % of GDP	-0.8	-3.8	-4.4	-0.3	-2.0	-1.2	-3.3	-3.9	-2.9	-4.3	-4.0	*-3.4*	*-4.0*
Public debt, EU def., in % of GDP	18.5	53.0	45.9	10.1	79.2	40.7	40.7	55.6	37.8	52.1	54.1	*50.7*	*85.2*
Price level, EU-28=100 (PPP/exch. rate)	45	68	71	71	60	68	61	58	51	69	83	*60*	*100*
Compensation per employee, monthly, in EUR [5]	515	1048	1326	1216	1023	957	848	909	645	1183	2028	*956*	*2927*
Compensation per employee, monthly, EU-28=100	17.6	35.8	45.3	41.5	35.0	32.7	29.0	31.1	22.0	40.4	69.3	*32.7*	*100.0*
Exports of goods in % of GDP	52.4	22.3	67.3	73.9	78.3	44.6	70.2	38.5	34.2	87.9	60.5	*51.8* [6]	*34.4* [6]
Imports of goods in % of GDP	61.5	36.0	63.5	78.2	74.2	54.4	73.4	39.8	39.8	82.9	61.4	*53.2* [6]	*34.4* [6]
Exports of services in % of GDP	14.3	21.2	11.3	25.0	16.2	15.9	14.0	7.7	5.8	7.8	14.4	*18.9* [6]	*11.3* [6]
Imports of services in % of GDP	8.2	6.7	10.0	17.8	12.7	9.1	10.2	6.4	5.4	7.4	9.6	*7.9* [6]	*9.3* [6]
Current account in % of GDP	-1.3	0.1	-2.5	-1.2	1.6	-1.7	-0.5	-3.5	-4.0	2.3	2.3	*-1.9* [6]	*1.0* [6]
FDI stock per capita in EUR, 2012	5191	5615	9834	11091	7929	4935	3999	4339	2963	7762	5718	*5394*	*10570* [7]

NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-28 working day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-11 and EU-28 include transactions within the region (sum over individual countries). - 7) For EU-28: 2011.

Source: wiiw Annual Database, Eurostat, AMECO.

Table III

Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2012

	Macedonia	Monte-negro	Serbia	Turkey	Albania	Bosnia - Herzegovina	Kosovo	Kazakhstan	Russia	Ukraine	*NMS-11 1)*	*EU-28 2)*
GDP in EUR at exchange rates, EUR bn	7.49	3.28	29.97	612.41	9.64	13.29	5.00	157.66	1567.33	137.18	*1025.7*	*12945.4*
GDP in EUR at PPP, EUR bn	18.30	6.52	64.06	999.02	22.33	25.62	10.7	184.95	2007.81	268.92	*1703.2*	*12945.4*
GDP in EUR at PPP, EU-28=100	0.1	0.05	0.5	7.7	0.2	0.2	0.1	1.4	15.5	2.1	*13.2*	*100.0*
GDP in EUR at PPP, per capita	8900	10500	9000	13300	8000	6700	6000	11000	14000	5900	*16500*	*25600*
GDP in EUR at PPP per capita, EU-28=100	35	41	35	52	31	26	23	43	55	23	*64*	*100*
GDP at constant prices, 1990=100	120.5	.	.	236.2	206.7	.	.	173.5	116.2	69.3	*164.4*	*145.9*
GDP at constant prices, 2007=100	109.8	106.2	101.0	113.7	120.6	103.7	113.4	126.6	109.4	95.6	*106.5*	*99.7*
Industrial production real, 2007=100	95.0	65.1	90.0	114.1	138.3	113.9	105.3	120.5	107.6	87.0	*107.9*	*92.1*
Population, thousands, average	2065	621	7130	74885	2802	3843	1816	16791	143202	45593	*103345*	*506061*
Employed persons, LFS, thousands, average	651	200	2228	24819	1200	814	.	8507	71545	20354	*44043*	*217505*
Unemployment rate, LFS, in %	31.0	19.7	24.0	8.2	14.0	28.0	44.0	5.3	5.5	7.5	*9.9*	*10.5*
General gov. revenues, nat. def., in % of GDP	30.0	39.6	41.3	37.5 3)	24.7	43.5	35.2	19.2	37.0	31.6	*38.3 3)*	*45.4 3)*
General gov. expenditures, nat. def., in % of GDP	33.8	43.7	47.7	39.8 3)	28.1	46.5	36.3	22.2	26.6	35.2	*41.7 3)*	*49.4 3)*
General gov. balance, nat. def., in % of GDP	-3.9	-0.4	-6.4	-2.3 3)	-3.4	-3.0	-1.2	-2.9	0.4	-3.6	*-3.4 3)*	*-4.0 3)*
Public debt, nat. def., in % of GDP	36.0	51.9	58.9	36.8 3)	58.6	43.1	6.2	12.7	9.6	36.6	*50.7 3)*	*85.2 3)*
Price level, EU-28=100 (PPP/exch. rate)	41	50	47	61	43	52	47	85	78	51	*60*	*100*
Average gross monthly wages, EUR at exchange rate	498	727	508	655 4)	283	660	360 5)	527	668	295	*956 4)*	*2927 4)*
Average gross monthly wages, EU-28=100	17.0	24.8	17.4	22.4 4)	9.7	22.5	12.3	18.0	22.8	10.1	*32.7 4)*	*100 4)*
Exports of goods in % of GDP	41.3	12.0	29.4	20.8	15.8	19.4	5.7	45.4	26.3	39.6	*51.8 6)*	*34.4 6)*
Imports of goods in % of GDP	65.2	54.4	47.6	29.1	36.6	51.8	47.2	23.4	16.6	51.2	*53.2 6)*	*34.4 6)*
Exports of services in % of GDP	11.1	30.4	10.3	5.7	17.2	11.0	12.7	2.4	3.1	11.3	*18.9 6)*	*11.3 6)*
Imports of services in % of GDP	10.8	11.8	9.8	2.6	15.1	3.0	5.8	6.3	5.4	8.1	*7.9 6)*	*9.3 6)*
Current account in % of GDP	-3.9	-17.9	-10.5	-5.9	-10.6	-9.4	-7.6	3.8	4.0	-8.4	*-1.9 6)*	*1.0 6)*
FDI stock per capita in EUR, 2012	1772	5325	2462	1467	1078	1405	.	4428	2463	1113	*5394*	*10570 7)*

NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Albania, Bosnia and Herzegovina, Montenegro, Serbia, Kazakhstan, Russia, Ukraine; IMF for Kosovo.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 4) Gross wages plus indirect labour costs, according to national account concept. - 5) Average net monthly wages. - 6) Data for NMS-11 and EU-28 include transactions within the region. - 7) For EU-28: 2011.

Source: wiiw Annual Database, Eurostat, AMECO.

*Vladimir Gligorov**

Animal spirits still dimmed: slow recovery expected

Introduction

'If, however, we suppose that, by agreement with the Reichsbank, deflation is enforced, how will this help? Only if, by curtailing the activity of business, it throws men out of work, so that, when a sufficient number of millions are out of work, they will then accept the requisite reduction of their money-wages. Whether this is politically or humanly feasible is another matter.'

J. M. Keynes in 'The German Transfer Problem'

The EU and the CESEEE countries find themselves in slow recovery mode this year, with a few still in recession, and an unimpressive speed-up of growth in the medium term. In this Report we go through the reasons for these developments.

The EU and CESEE economies have diverged from global growth developments in 2012 and their recovery appears to be rather slow and lagging rather than leading the world recovery. For the most part this is the consequence of the euro crisis over the period 2011-2012 and the attempted fiscal consolidation as a means of stabilisation. With the intervention of the ECB to stabilise the money market, the risk of the euro area falling apart has lessened, but the remaining policy framework requires more corrections in various imbalances and relies on structural reforms and an eventual investment revival. The latter has yet to happen as foreign investments are still depressed while both domestic public and private investments continue to contract in many countries.

This recovery strategy, based as it is on the revival of investments, is being buffeted by strong head winds. Problems persist in the banking sector and there are few signs of increased credit activity. Furthermore, private investments are not increasing, while public investments are still mostly declining. Moreover, the indications are that conditions for small and medium-sized enterprises have diverged in a negative manner, even though interest rates have come down to pre-crisis levels – except for those countries that are still in distress. However, interest rates are still relatively high given the prospects for growth in terms of both sales and incomes. Perhaps a further relaxation of the monetary policy by the ECB would be helpful, while central banks outside of the euro area have but limited scope to do much more even though policy rates are dropping almost everywhere. The overall increase in monetary aggregates is minimal while foreign currency reserves are accumulating in the respective central banks.

Reforms aimed at the deepening of the EU are still taking time to emerge. Some reforms, especially those aimed at correcting external imbalances, are directed more towards renationalisation than a higher degree of integration. Those trends also suggest a move towards a new growth model based more on the alignment of domestic savings and investments rather than on cross-border capital

* The author wishes to thank the contributors to the overview and special topics, and all colleagues from wiiw for contributions and comments.

movements. It may prove especially difficult to introduce this new growth model in the Balkans and the Baltic region. By way of contrast, the EU integration process proceeds apace with Croatia joining as the 28th Member State and Serbia all set to start negotiating with the EU at the very beginning of next year. Moreover, Kosovo should also be starting the negotiations on the Stabilisation and Association Agreement. The Balkan region can thus be seen to be moving, albeit slowly, towards integration with the EU.

External environment: global and European developments[1]

The prospects for the international economy have started to pick up in 2013, largely on account of developments in the United States and Japan, as well as on account of the continued robust growth in most emerging and developing economies despite some considerable policy challenges they face. After a dip in global trade growth (global trade in goods and services grew at 2.5% in 2012 down from 6.0% in 2011), global trade is currently projected to increase once more, rising to 3.6% in 2013 and 5.3% in 2014 (IMF, World Economic Outlook, April 2013). These overall global growth conditions are reflected in the figures for extra-EU export market growth that dropped significantly in 2012 (0.8%) compared to previous years (2010: 13.7%; 2011: 7.9%). It is now projected to rise to 2.0% in 2013 and 5.3% in 2014 (EC, Spring Forecast, 2013; p. 15).

Whereas the international environment for the European economy is improving, it is questionable whether the European economy itself is improving. That is the central issue addressed in this report with the customary wiiw focus on the outlook for the countries in Central, Eastern and Southeast Europe (CESEE).

First, let us dwell a little longer on the prospects for non-European growth. Forecasts for global non-EU growth stand at 4% for 2013 and 4.5% for 2014 (ibid, p. 14). That growth will be driven by; (i) solid growth in emerging market economies (2013 marks the year in which emerging and developing economies for the first time account for more than half of global GDP); and (ii) the pick-up in growth across a range of non-EU advanced economies, notably the United States and Japan (see Figure 1). With regard to the latter two countries, growth in the United States has shifted towards a robust recovery path despite fiscal sequestration as private demand has stabilized, while Japan is conducting a policy experiment entailing massive quantitative easing in an attempt to overcome long-term stagnation of the Japanese economy. The outcome of the experiment is still unclear.

Figure 1 shows that European developments diverged sharply from both developments in other advanced economies and global developments in 2012 and 2013 (quarterly figures would indicate that the divergence had already started in the latter half of 2011). It is almost certain that this divergence will continue throughout 2013, while quite a few analysts (see, for example, Buiter and Rahbari, 2013) point to it persisting throughout 2014 and beyond. As we are not making any forecasts for the euro area as a whole, we have taken as our benchmark the EU Commission forecasts for the European region, which remains by far the most important trading area for all the countries covered in this report. Figure 1 reflects the current projections for the major economies and economic group-

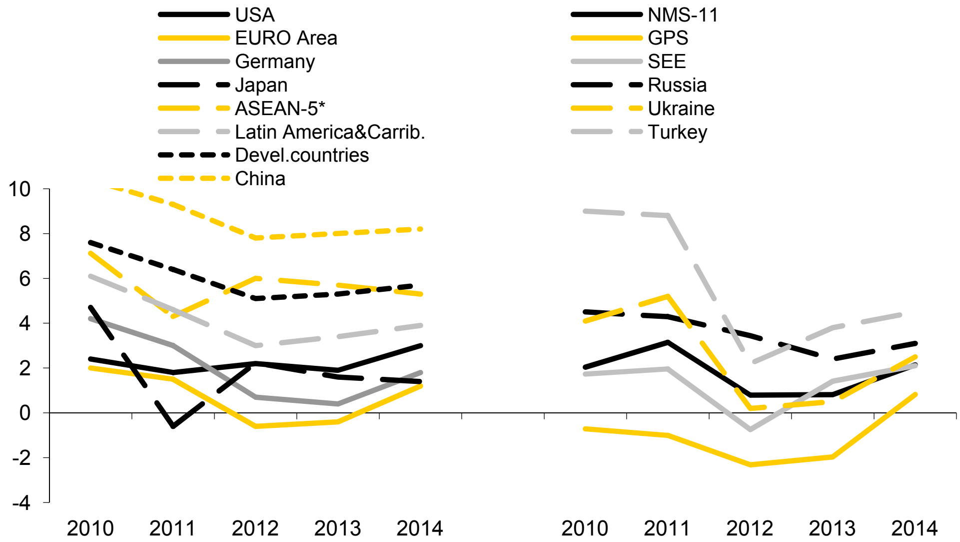
1 This subsection was written by Michael Landesmann.

ings by major international organisations (EC, OECD, IMF), while the projections for the CESEE region are wiiw forecasts based on that 'external environment'.

Figure 1

Development of GDP

real change in % against preceding year



GPS: Greece, Portugal, Spain. ASEAN-5: Indonesia, Malaysia, Philippines, Thailand and Vietnam. NMS-11 incl. Croatia.

Source: wiiw Database incorporating national and Eurostat statistics. IMF, World Economic Outlook, April 2013. European Commission, Spring Report, April 2013. wiiw forecast.

The figures relating to the divergence issue are most revealing. In 2010 and 2011, growth differentials between the United States and the euro area were still small: 2.4% and 1.8% in 2010 and 2011 respectively in the United States, and 1.9% and 1.5% in the euro area. From that point on, the differential increased sharply. Having grown by 2.2% in 2012, the US economy is forecast to grow by 1.9% and 2.7% in 2013 and 2014, respectively (see IMF, 2013b, for its latest forecast). By way of comparison, the growth rate for the euro area was 0.5% in 2012 and the current projections are -0.6% in 2013 and 1.1% in 2014. The reasons for this divergence have been extensively discussed in the literature (see IMF, 2013a; OECD, 2013a; EC, 2013), as has the likelihood of such marked growth differentials between the US and European economies possibly coming to an end and by which date.

In the course of this overview, we will touch on the factors that account for this divergence; however, at this stage we shall simply list them:

- The lingering banking crisis in Europe resulted in the lack of or extensive delays in consolidation, as well as continued fragmentation along national lines, whereas in the United States bank restructuring and bank consolidation were tackled at a much earlier juncture during the crisis.
- The impact of debt positions building up in the balance sheets of the household and corporate sectors combined with extremely cautious behaviour on the part of European banks towards new lending and debt restructuring led to protracted processes of deleveraging - and thus re-

duced spending. In tandem with the stabilisation of the financial and housing markets, both investment and consumption expenditure in the United States, on the other hand, has returned with positive knock-on effects on the labour market.

- The fiscal policy pursued in the euro area has proceeded along a quite different path compared to other advanced economies (see Table 1). Apart from the well-known austerity policy applied in the southern countries of the EU, a remarkable feature has been the massive fiscal consolidation process in Germany (the general government fiscal deficit moved from -4.1% in 2010 to -0.8% in 2011 and then to +0.2% in 2012; the cyclically adjusted figures are -3.5%, -1.0% and +0.1%). This contrasts strongly with the development of fiscal balances in the United States, Japan or the United Kingdom.
- The incomplete architecture of the euro system as well as the convoluted political processes and interests amongst the Union's main players have failed to unwind the external imbalances and debt positions that have built up on its 'southern periphery' without inducing major and prolonged contractions of their economies. This has since led to negative feedback effects on the economies in the 'EU's North' via trade and the persistent weaknesses of the European banking system as a whole.

Table 1

Fiscal balances, 2010-2014

				Projections	
Advanced economies	2010	2011	2012	2013	2014
United States	-11.1	-10.0	-8.5	-5.9*	-4.8*
Euro area	-6.2	-4.1	-3.6	-2.9	-2.6
Germany	-4.1	-0.8	0.2	-0.3	-0.1
Japan	-9.3	-9.9	-10.2	-9.8	-7.0
United Kingdom	-10.1	-7.9	-8.3	-7.0	-6.4

Source: World Economic and Financial Surveys, April 2013, Table 1. *The US figures for 2013 and 2014 are updated from IMF (2013b), June 2013.

While immediate fears of a break-up of the euro system and an uncontrolled default have markedly receded, as reflected in a narrowing of sovereign bond yields, the internal factors enumerated above are not going to disappear in the near future. Recovery of the euro area is going to be a very slow process. Reforms of EU governance structures are in the offing, in particular in the form of a 'banking union' which, over the next year or so, is not going to extend beyond a more centralised system of bank supervision and will fall short of a centralised system of bank resolution or deposit insurance schemes. This means that for the most part resolution of the European banking and debt crisis will continue to proceed along nationally fragmented lines - with the exception of interventions as we have already seen in Greece and Cyprus.

All major international forecasts predict low positive growth (around 1%) for the euro area as a whole in 2014 (as against 2.7% in the United States). The interpretation of this recovery is based on: an easing of financial market tensions; a measure of relaxation in the fiscal deficit targets set by the EU Commission in its latest review (see EC, 2013b); a return to positive growth in most of the countries in Southern Europe after a period of prolonged contraction. However, the downside risks of that recovery scenario (which is supposed to pick up speed in 2015) are still quite strong as the currently weak economies are hardly able to face any additional shocks, some of which could emanate from political responses to the crisis itself.

Recession and outlook for CESEE

Recovery from the 2009 crash seems to have come to an end in the first half of 2011, with a second dip recession starting somewhere around mid-2012. Practically all macroeconomic indicators point south. Quarterly GDP shows a continuous slowdown or flattening of growth, with a few countries finding themselves in negative territory (Figure 2). Similar trends are to be observed in the development of household consumption, although, as is to be expected, the fluctuations are much smoother. Big countries in the neighbourhood are partial exceptions. Investment recovered somewhat in the Baltic countries, but has since stalled. Industrial production reveals similar patterns, as does export performance and that of imports (Figures 3 and 4). There are, of course, some variations between countries, which in some cases and in certain respects are significant. This business cycle alignment, however, is quite remarkable.

Looking ahead, relatively slow recovery is forecast for the current year and somewhat accelerated growth is expected in the medium term - over the next two years or so. These expectations, shared by most observers, are predicated on a modest increase in consumption, a somewhat stronger pick-up of investment and a positive contribution in terms of net exports (Figures 5 and 6). In addition, medium-term growth should be pushed by structural changes and perhaps some development policy measures. This might, for example, take the form of increased funding by development banks and a somewhat greater reliance on industrial policies, which together should contribute to public investments or lend support to private investments, especially in countries that are going through a period of structural and financial adjustment.

Unlike the initial recovery that followed the deep recession, not to speak of depression, throughout Europe, the forecast recovery in the short and medium term is not expected to be very strong; it may still disappoint because the risks are still on the downside. To a very large extent, that uncertainty is for want of hard evidence that investments essential to accelerated recovery will turn around. For a variety of reasons, animal spirits are still dim throughout Europe; it is hard to predict when those spirits will be awakened again (Gligorov, 2012).

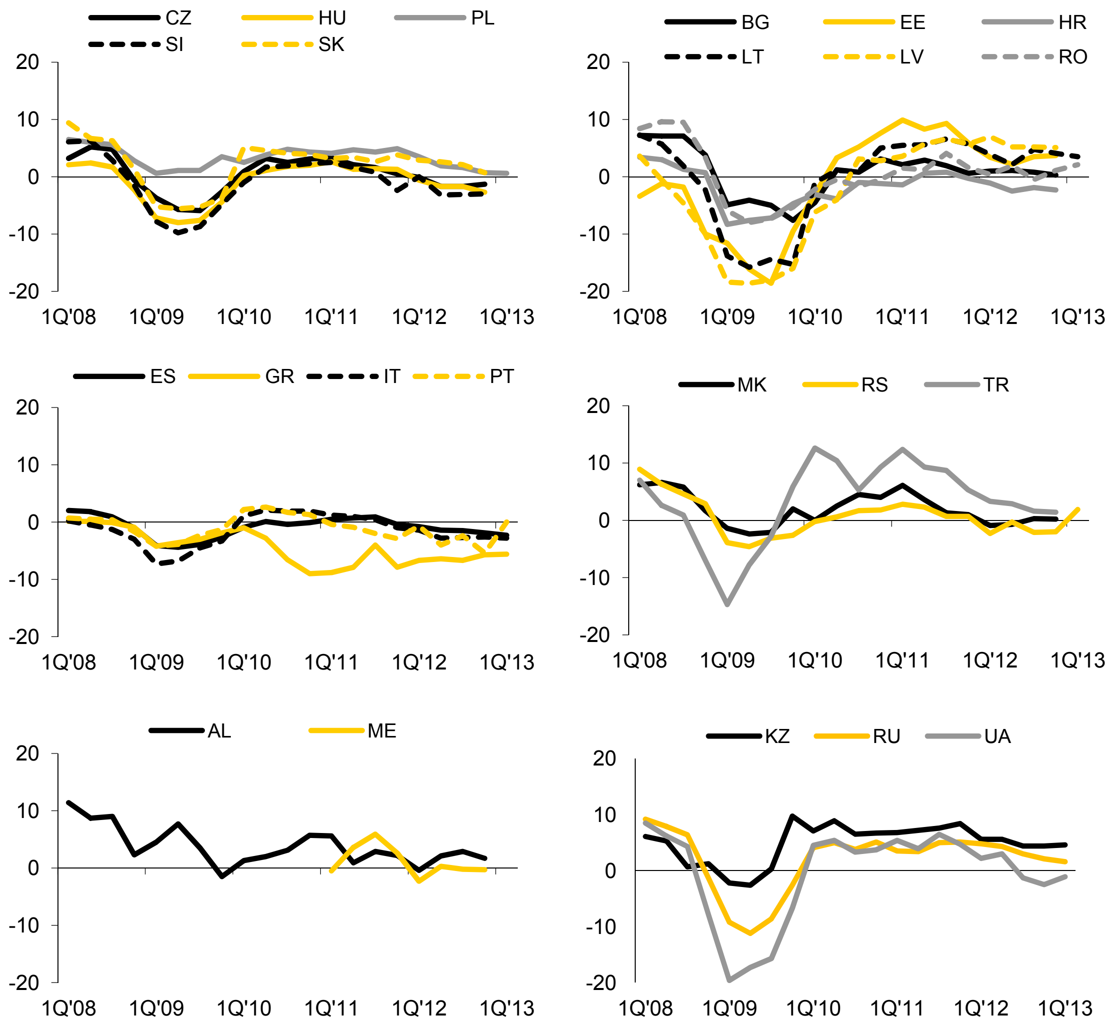
Whereas a year or so ago it looked as though the European Union was on the cusp of disintegration and the euro currency union on the verge of collapse, those risks have since declined. In addition, institution building within the EU has been quite staggering and various attempts at improved governance have been made. Prominent among the latter has been the increased assertiveness of the European Central Bank (ECB) that has helped to stabilise the common currency. These changes have still fallen short of addressing the key deficiencies of the EU and the EMU, which relate to common stabilisation policy, financial integration and effective control over the systemic risks and, last but not least, democratic legitimacy.

The social and political costs of the crisis and slow recovery are yet to be assessed in full. In Member States as well as in the countries with close ties to the EU, in particular those in the Balkans, social problems have influenced political developments that have not necessarily enhanced the ability of those countries to deal with the crisis either in an efficient manner or with the necessary degree of democratic ownership. As social and political changes tend to follow somewhat belatedly in the train of an economic crisis, as well as in instances of high growth, they can only be expected to unfold in the years to come. Some indication of what lies in store can be found in the social and political turbulence besetting Southeast Europe. As labour market conditions will not improve in the near future and may well take quite a long time to turn around decisively, social and political stability may continue to pose a challenge in several countries.

Figure 2

Development of quarterly GDP

real change in % against preceding year

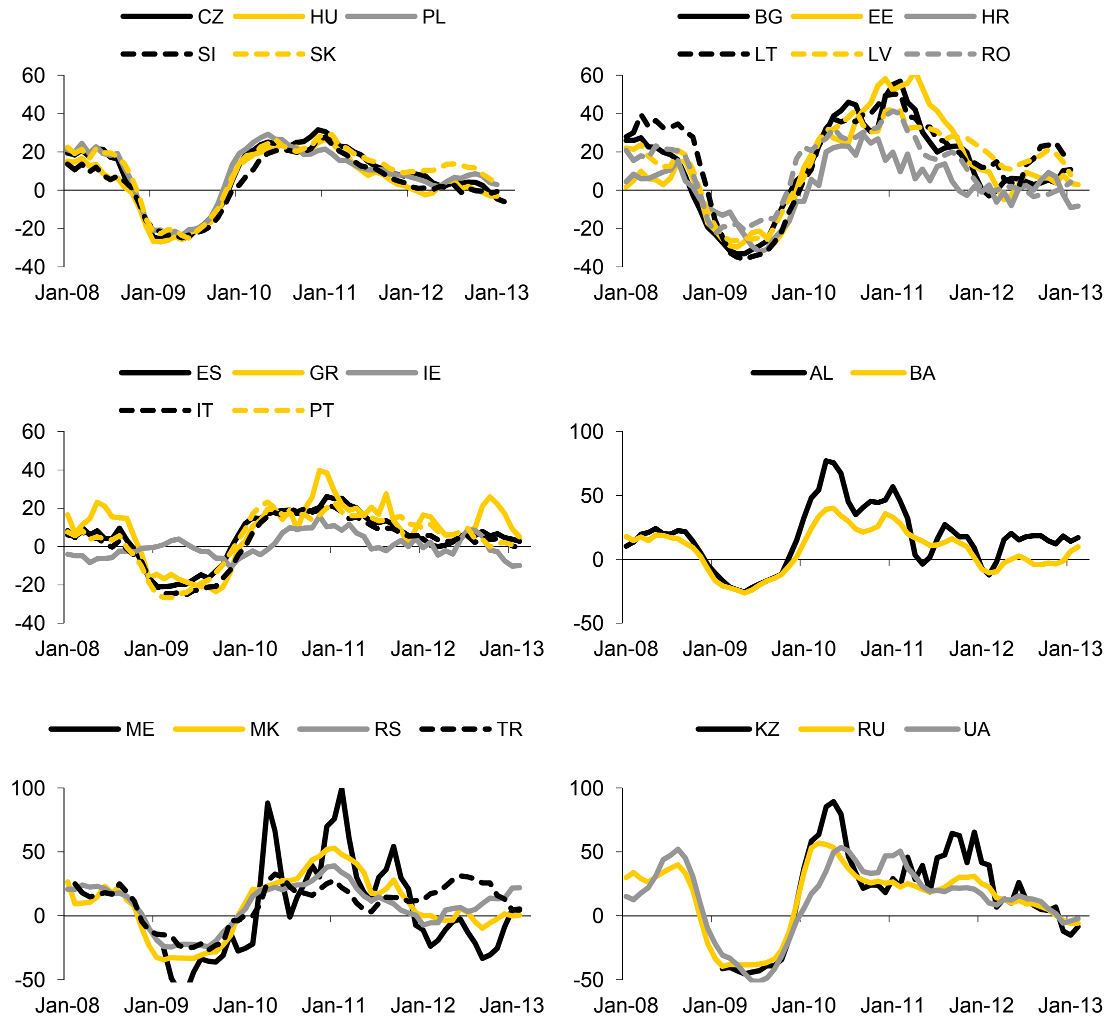


Source: Eurostat and national statistics.

Figure 3

Exports of goods (nominal, euro-based)

change in % against preceding year, 3-month moving average

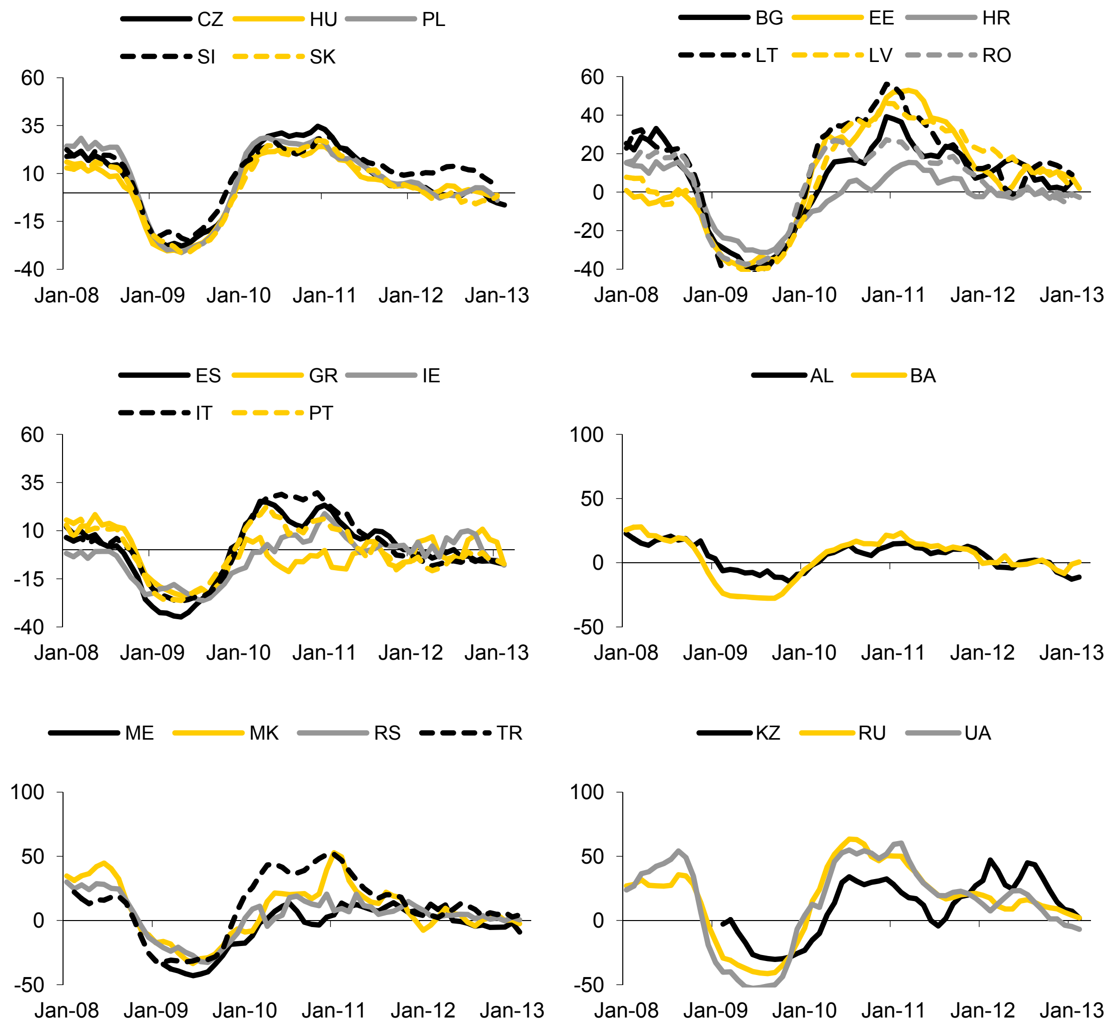


Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 4

Imports of goods (nominal, euro-based)

change in % against preceding year, 3-month moving average

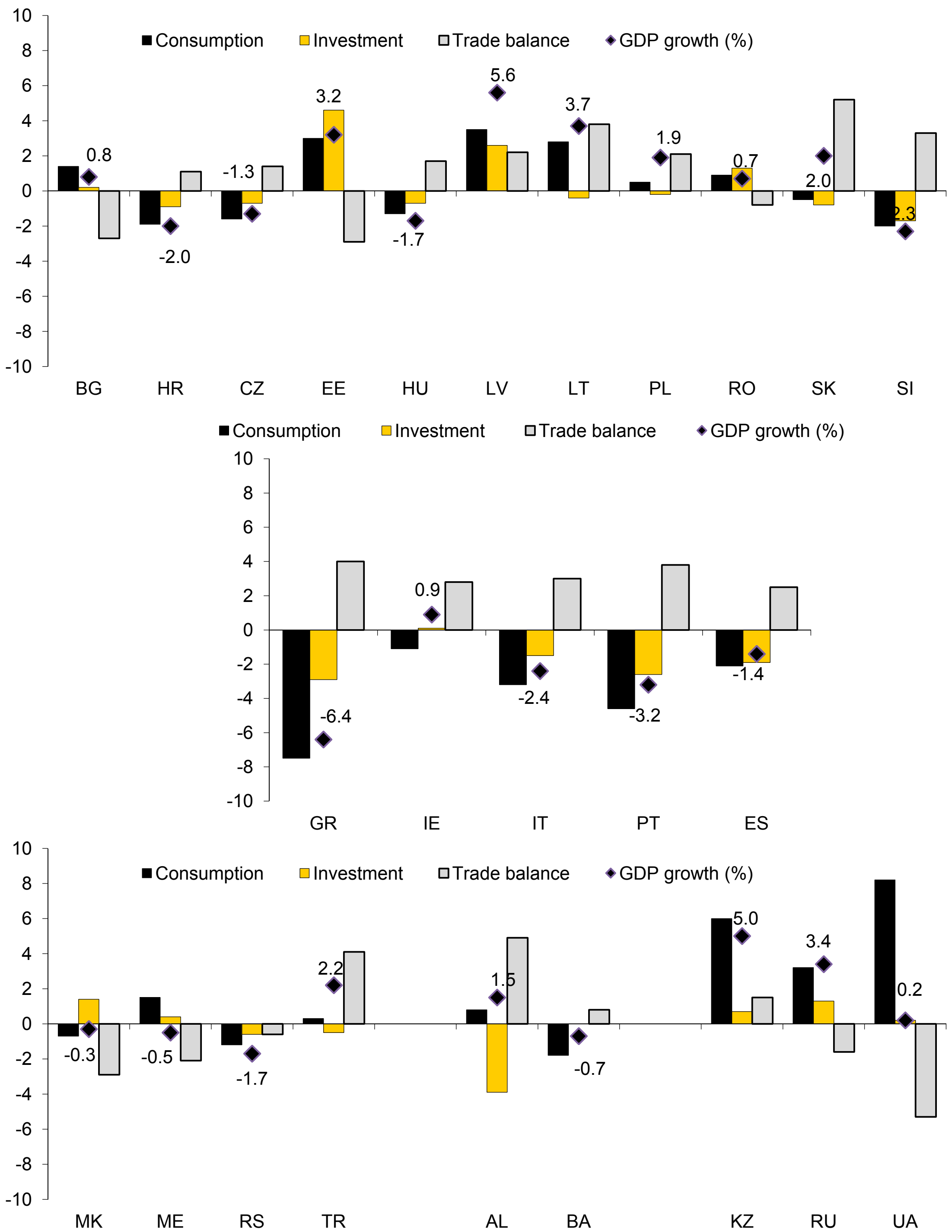


Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 5

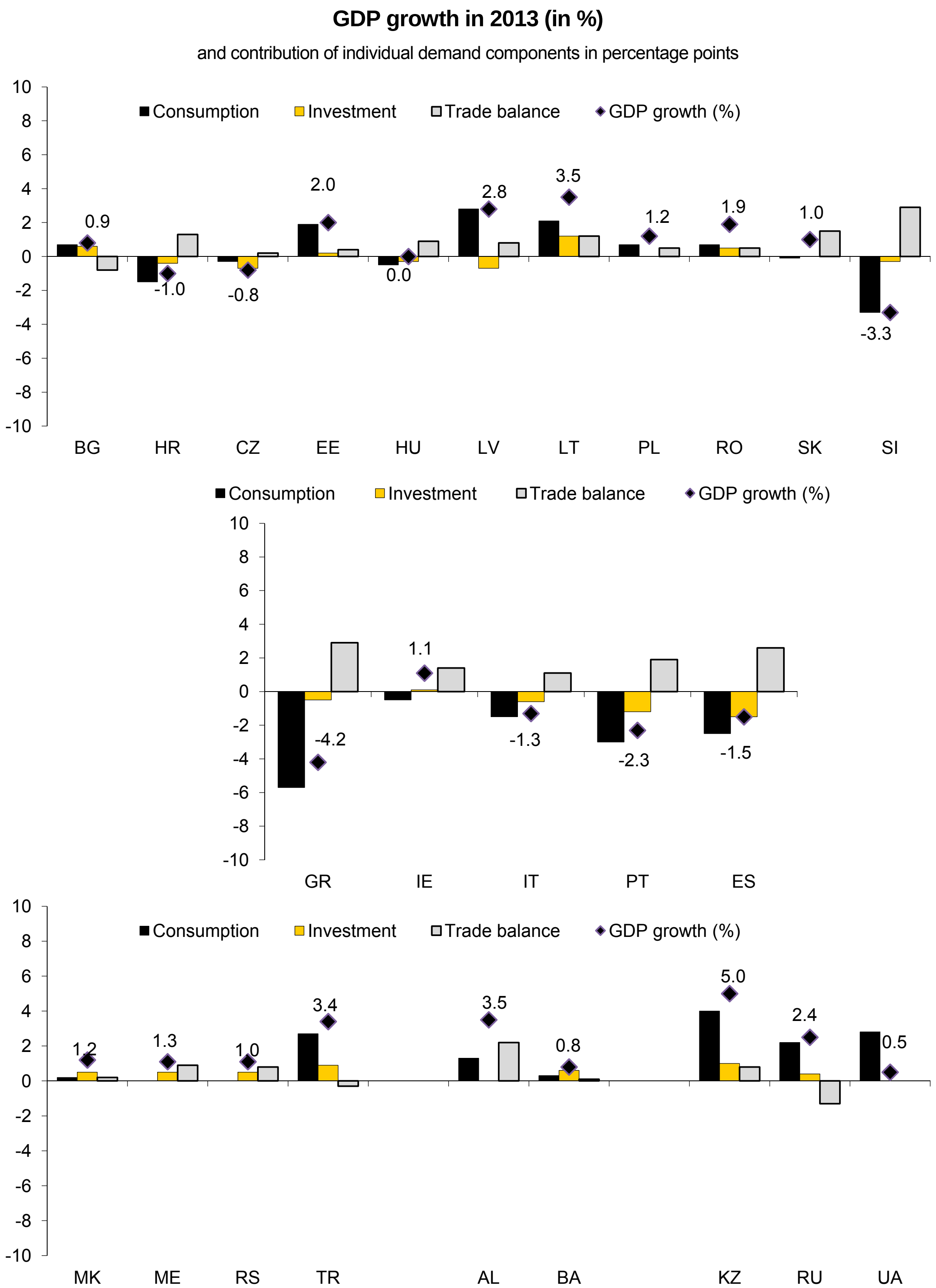
GDP growth in 2012 (in %)

and contribution of individual demand components in percentage points



Source: wiiw forecast (July 2013). European Commission, Spring Report 2013.

Figure 6



Source: wiiw forecast (July 2013). European Commission, Spring Report 2013.

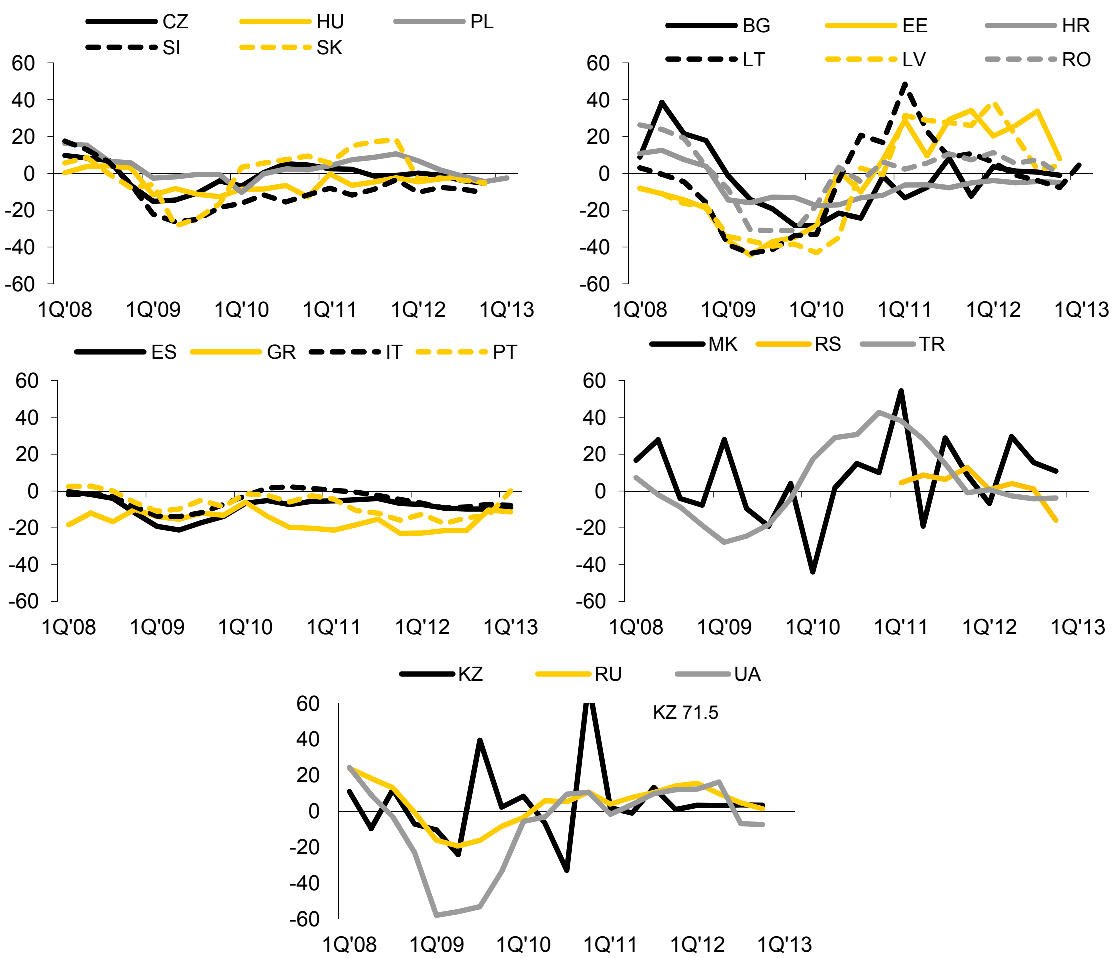
Better performers

The group of better performers is forever chopping and changing. In the post-2009 recovery phase, a number of countries in Central Europe benefited from the strong performance by Germany. In addition, Poland and Slovakia were able to rely on deficit financing to fund their budgets and support domestic demand. Growth in both countries, however, has fallen in line with the stagnating German economy and their projected recovery is also not expected to be much faster than that of most other countries while Czech Republic is back in recession. Further to the east, Russia is experiencing a remarkable slowdown and the country's prospects are not very optimistic, given that they hinge on energy and the prices of metals and extraction that may well not improve - not only for want of additional demand, but also on account of changes in supply patterns. Obviously, Kazakhstan is an exception as it continues to post strong growth and so is Turkey. Also, Albania and Kosovo continue to stay out of recession and should do better than most other countries this year. In addition, recent growth acceleration in Romania is raising hopes for somewhat faster recovery in that country.

Figure 7

Gross fixed capital formation

real change in % against preceding year



Source: Eurostat and national statistics.

In addition to falling external demand and the stress on fiscal adjustment there has been a continuous slump in investment with little recovery in sight practically everywhere (Figure 7).

The Baltic countries have now taken the lead in recovery to the extent that they are still posting comparatively better growth figures. However, the slowdown has also been remarkable in that region. Seen against the background of the declines in depression levels in the midst of the crisis in 2009, the positive growth rates in the current period and in the medium term may not look all that surprising. In addition, social costs are quite high, which makes the preservation of stability that much more remarkable. The region also experienced a very deep transitional recession and sharp deterioration during the Russian crisis in 1998 with similar resilience and social and political stability. They have also continued their quest to join the European monetary union. Latvia is now set to adopt the euro on 1 January 2014, following Estonia which joined at the beginning of 2013.

The Balkans

Some of the worst performers are still to be found in the Balkans and their immediate vicinity, except for Turkey. That notwithstanding, the current (second) recession has not proven exceptional. The previous recovery was rather less convincing, as are the forecasts for the next few years. What perhaps distinguishes this region in the medium term is the anticipation of sustained growth in terms of industrial production (Figure 8) and exports (Figure 3). By way of contrast, private and public consumption will remain subdued. Moreover, it would not be unreasonable to expect some increase in investments, thanks to improved competitiveness and increased savings - but that is not yet evident.

However, apart from Greece, the two worst performers are currently to be found in the Balkan region: Croatia and Slovenia (both, of course, are also Central European countries, political geographies not being exclusive). The reasons for their poor performance differ. Slovenia's banking sector has collapsed, while Croatia is combating the lack of competitiveness. Slovenia has some experience in the resolution of banking problems in the nineties, which led to the domination of state-owned banks up until their current solvency problems. Croatia gave up on domestically-owned banks after repeated attempts to bail them out in the nineties. The same fate now seems to be in store for Slovenia. There is also some indication that Slovenia incurred a competitiveness problem after joining the euro area. Whereas the country's previous policy had been to manipulate the exchange rate and guard against macro-imbalances in order to preserve its competitiveness, reliance on export growth, the core of Slovenia's previous strategy, appears to be failing this time around.

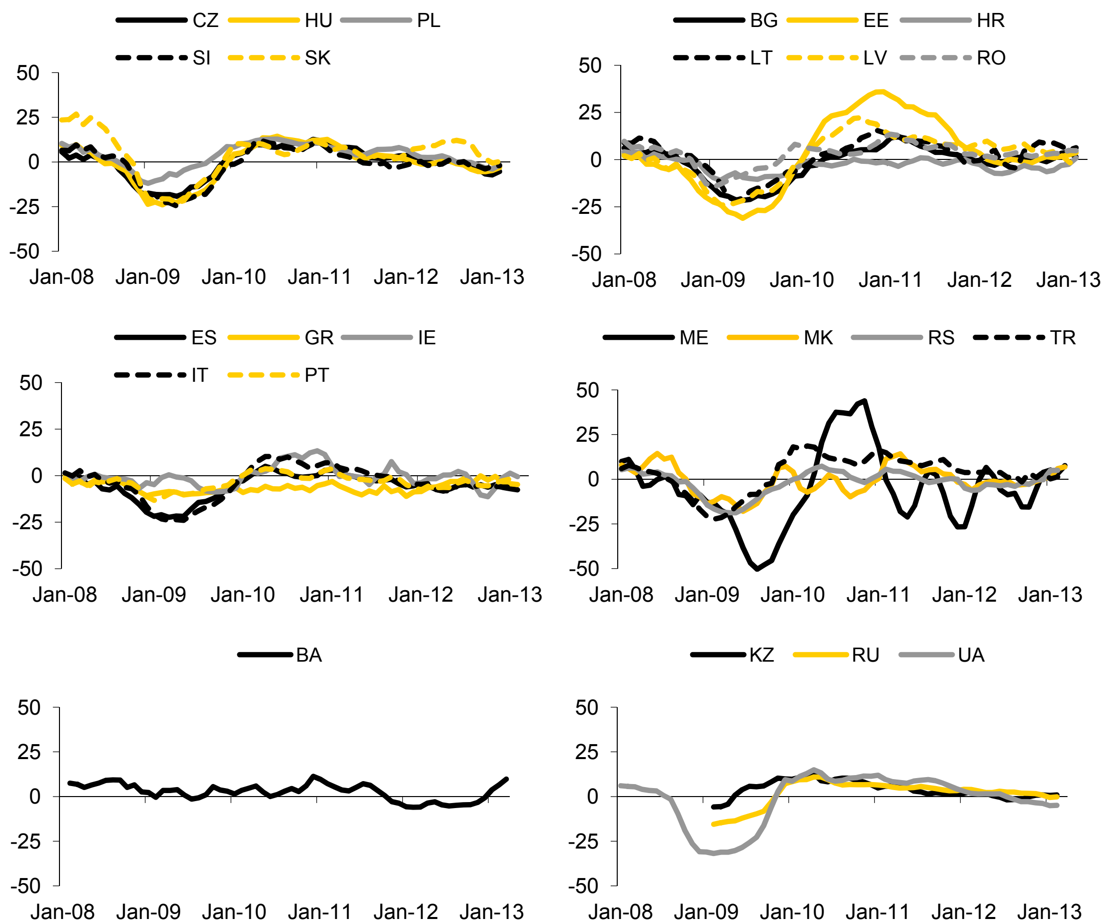
In marked contrast, Croatia is trying to deal with internal devaluation mainly via adjustments in the labour market. This is similar to the manner in which it dealt with a financial and exchange crisis at the turn of the century. The massive decline in employment is relied on to put pressure on wages with the aim of achieving improved competitiveness as an outcome. The most evident feature is adjustment through recession. Improved competitiveness and a pick-up in investments, as a consequence thereof, have yet to emerge.

Other Balkan countries are dealing with their problems through a combination of internal devaluation measures and reliance on export growth. There is some indication that this strategy is delivering the goods in respect of the latter, at least in Bulgaria and Serbia. It also holds true for Romania, although the country has a different policy framework as it relies on inflation targeting, whereas the rest of the Balkans is basically geared towards fixed exchange rates (Serbia and Albania managing them a lot), unless they are openly using the euro.

Figure 8

Gross industrial production

real change in % against preceding year, 3-month moving average



Remark: Data refer to NACE Rev. 2. BA, ME, RU and UA until 2011 refer to NACE Rev. 1. Ireland: Seasonally adjusted data.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Given the adjustment strategy, which also requires significant structural reform measures in practically all markets, a number of relatively stagnant or slow recovery years lie ahead of the region.

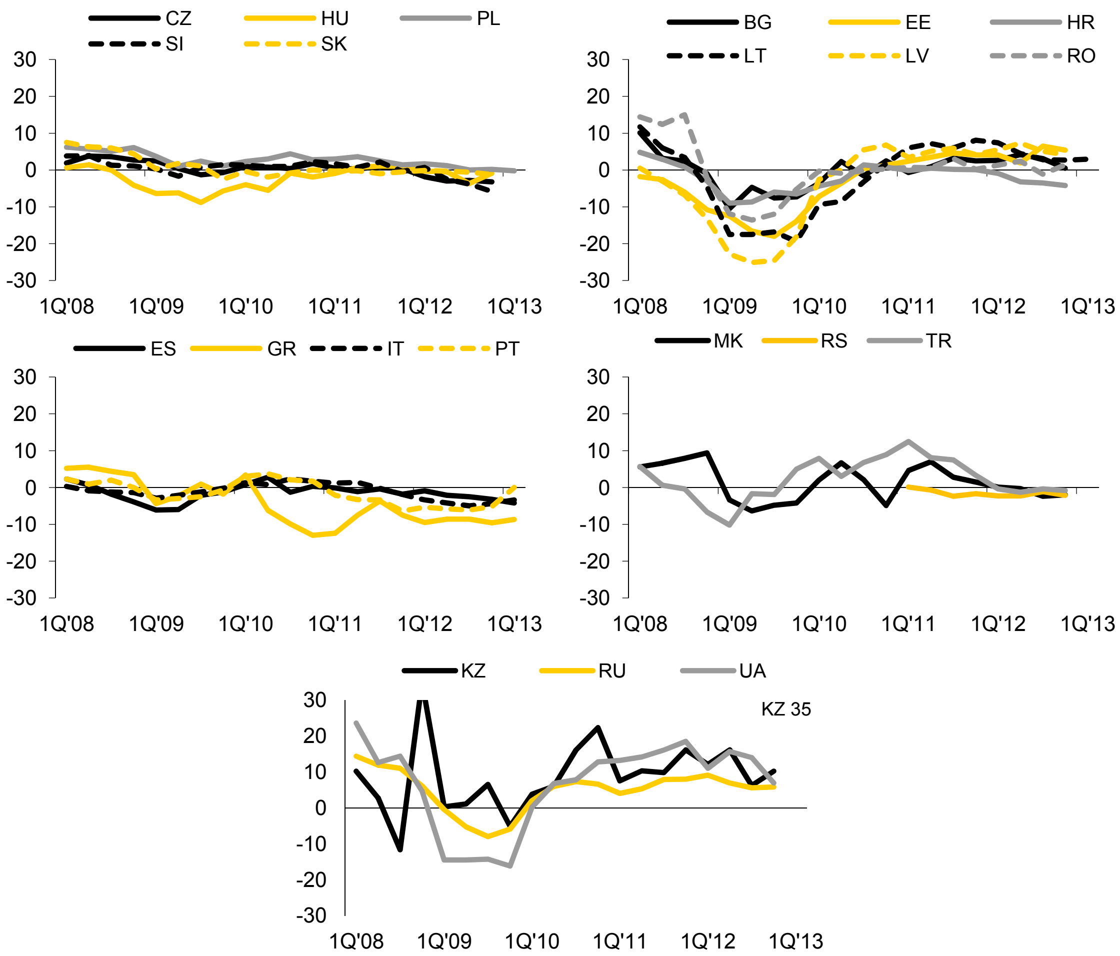
Big neighbours

Whereas developments in Central and Southeast Europe hinge quite heavily on the EU and the euro area business cycle, albeit to a varying degree, one could expect Russia, Ukraine and Turkey to be more closely aligned with emerging markets outside Europe. However, the initial shock in 2009 left a lasting impression on the first two countries. Although recovery was relatively robust in all three countries, growth slowed down once again in 2012. It will continue to be moderate in Russia and practically stagnant in Ukraine, while remaining comparatively swift in Turkey. The developments in Russia and Ukraine are partly linked to the low prices for energy and metal exports, whereas Kazakhstan keeps rolling ahead on the strength of its oil industry. Russia and Ukraine have experienced negative contributions from net exports, while investments and consumption are declining. Clearly, recovery in the prices of their exports would help, but there appear to be significant supply side problems that may stand in the way of any palpable recovery of investments in other sectors of production. Turkey by contrast may be more of an emerging market economy and should continue to do well, although it has to deal with pressures and uncertainty with regard to international capital inflows. Russia, Ukraine and Kazakhstan have been able to support growth of consumption, though this seems to be slowing down significantly in the former two countries (Figure 9). Turkey is expected to benefit from increased consumption also this year and possibly in the medium term too (Figure 6).

Figure 9

Household consumption

real change in % against preceding year



Source: Eurostat and national statistics.

Dealing with imbalances: EU and its neighbours in good times and bad

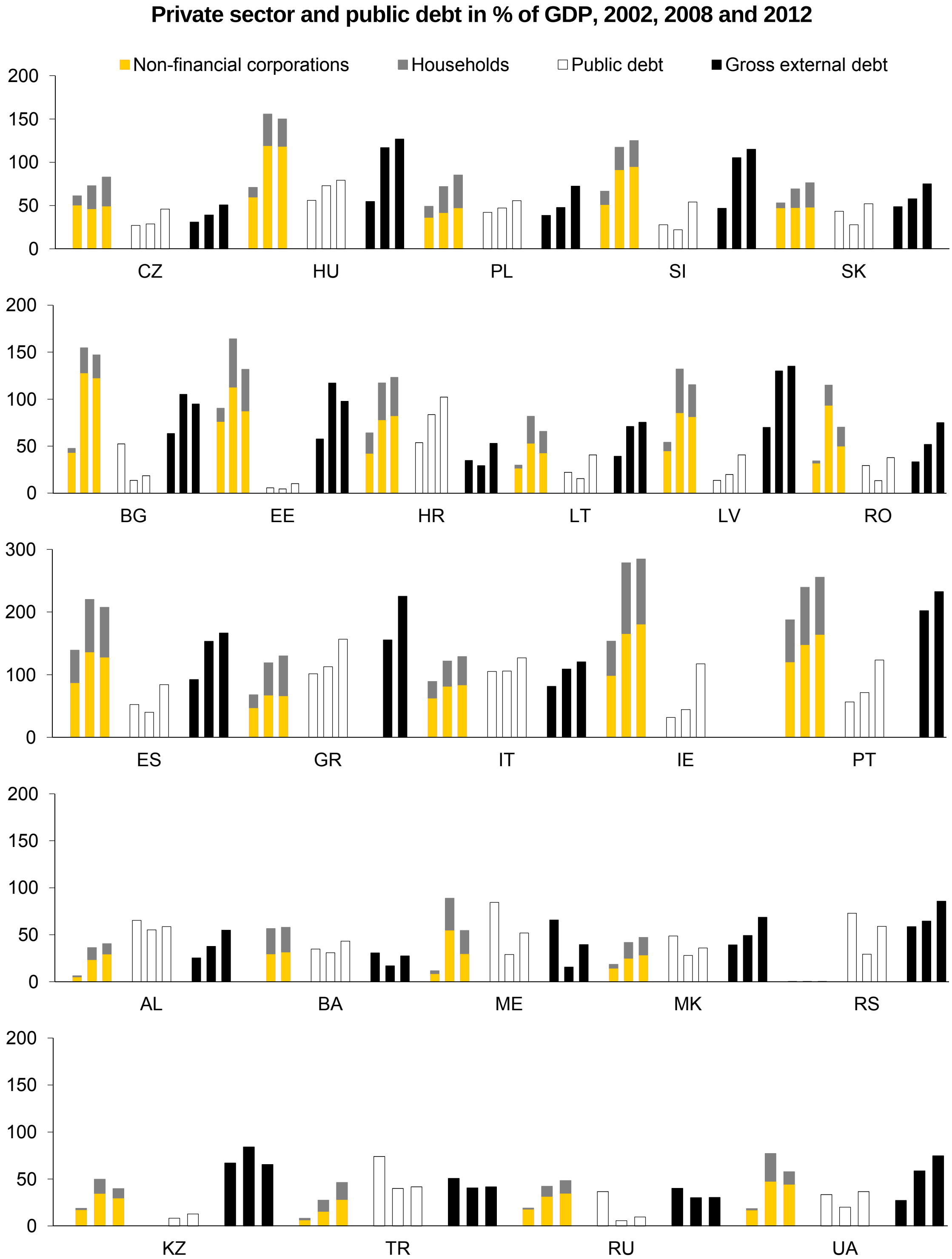
Given the strong influence of the developments in the EU and the euro area, clearly the changes in the institutional and policy framework play a major role. EU and the currency union are, *inter alia,* intended as instruments not only of growth but also of development. Customs and currency unions, as well as the common market should spur growth, while institutional and policy changes should support development. In a way, sustainability of the growth strategy is conditional on the success of institutional and policy development. Perhaps the crucial example of how this should work or not work is provided by the currency union itself, more specifically by the manner in which the euro area functions.

With the introduction of the euro, less developed countries in the currency union, together with countries that use euro as their reserve currency, gain access to cheaper credits through significant interest rate compression. This spurs growth because the difference between high marginal efficiency of capital and low cost of credit provides a boost to investments which tend to flow from the developed west or north to the less developed east or south. This can be seen in the rapid increase in private debt among both households and corporations (Figure 10). The expectation is that this will also lead to the redistribution of debt between the public and private sectors. Indeed for the most part, that has happened: that is the growth-development nexus with the private sector gaining access to much larger markets (of goods, capital, services and labour) and the public sector redesigning its institutional and policy roles and interventions (so-called structural reforms). The outcome should be faster growth in less developed countries, i.e. convergence growth. However, owing to policy choices or lack of institutional reforms, continuous faster growth may be upset by a steep increase in debts, mainly private, but in some cases also public.

The risks connected with the accumulation of these debts is that investments will be misallocated and the imbalances that emerge, primarily on the external accounts (Table 3), but also in the internal balances and the labour markets, may ultimately prove unsustainable. That produces a policy challenge that may not be easy to meet. Putting aside political issues, designing the proper distribution between the policies left to Member States and those that are delegated to the level of the European Union is not a straightforward task. The policy response strategy pursued to date could be described as setting rules at the Union level and implementing policies at the national level. The most recent strategy can be found in the Macroeconomic Imbalances Procedure (MIP) scoreboard approach to imbalances (see Table 2).

What motivates the indicators and some of the thresholds? In good times, more developed countries may encounter problems that are the consequence of slow growth due in part to anaemic private investments, which may be going abroad to less developed countries. That may put pressure on fiscal balances owing to the fact that even if monetary policy supplies low interest rates, those will still be too high for slow growing economies. By contrast, less developed countries may experience significant external imbalances owing to the inflow of investments from more developed countries. Thus, in good times, fiscal rules, if followed, may prove binding for more developed countries, while rules governing the sustainability of external accounts may still have to be developed for the less developed countries. It is, however, rather hard to design and follow through on the implementation of those rules.

Figure 10



Remark : MK, ME: data for private sector debt 2002 refer to 2003. IE: For a better readability other private debt and gross external debt is not shown (e.g. gross external debt 2010 would be 946.2% and in 2012 1002.3% of GDP).

Source: Eurostat, IMF, wiiw own calculations.

Table 2

The Macroeconomic Imbalance Procedure (MIP) Scoreboard with values for 2012

Year 2012	3 year average of Current Account Balance as % of GDP	Net International Investment Position as % of GDP	% Change (3 years) of Real Effective Exchange Rate with HICP deflators	% Change (5 years) in Export Market Shares	% Change (3 years) in Nominal unit labour cost	% y-o-y change in deflated House Prices	Private Sector Credit Flow as % of GDP	Private Sector Debt as % of GDP	General Government Debt as % of GDP	Unemployment rate 3-year average	y-o-y % change in Total Financial Sector Liabilities, non-consolidated data
Thresholds	**-4%/-6%**	**-35%**	**±5% & ±11%**	**-5%**	**+9% & +12%**	**+6%**	**+15%**	**160%**	**60%**	**10%**	**16.5%**
Bulgaria	-0.9	-80.8	3.1 [1)]	5.0	9.0	-5.3	-6.7 [1)]	146.0 [1)]	18.5	11.3	5.6 [1)]
Croatia	-0.6	-88.1	-3.3 [2)]	-24.1	-3.9 [3)]	. [4)]	. [5)]	144.2	53.0	13.7	2.9 [1)]
Czech Republic	-3.0	-49.7	0.3 [1)]	-3.8	3.3	-3.6	2.8 [1)]	78.6 [1)]	45.8	7.0	4.4 [1)]
Estonia	1.3	-53.0	0.8 [1)]	6.8	-2.3	3.7	6.8 [1)]	132.9 [1)]	10.1	13.1	-4.4 [1)]
Hungary	1.2	-103.3	-3.3 [1)]	-16.6	5.7	-8.5	-7.8	150.1	79.2	11.0	-7.5
Latvia	-0.3	-65.1	-0.6 [1)]	12.0	-5.9	0.7	-2.5 [1)]	125.1 [1)]	40.7	16.7	-4.5 [1)]
Lithuania	-1.4	-52.2	3.6 [1)]	30.0	-5.2	-3.4	-0.8 [1)]	70.1 [1)]	40.7	15.5	8.9 [1)]
Poland	-4.5	-65.7	-10.9 [1)]	0.6	3.3	-5.8 [1)]	7.1 [1)]	79.5 [1)]	55.6	9.8	4.4 [1)]
Romania	-4.3	-64.5	-2.4 [1)]	4.9	4.8	-9.2	1.8 [1)]	71.8 [1)]	37.8	7.2	4.3 [1)]
Slovakia	-1.2	-63.8	4.3 [1)]	4.7	-1.2	-5.7	3.3 [1)]	76.3 [1)]	52.1	14.0	1.2 [1)]
Slovenia	0.6	-44.6	-0.3 [1)]	-19.5	0.5	-8.6	-4.1	125.2	54.1	8.1	-0.8
Austria	2.2	0.5	-1.0 [1)]	-20.5	4.1	-7.9 [1)]	4.1 [1)]	160.7 [1)]	73.4	4.3	-0.3 [1)]
Belgium	-0.2	66.8	-0.5 [1)]	-15.7	6.2	-0.4	9.4	241.3	99.6	7.7	-4.2
Germany	6.5	40.5	-3.9 [1)]	-12.7	3.2	1.4 [1)]	4.8 [1)]	127.8 [1)]	81.9	6.2	2.1 [1)]
Greece	-7.7	-114.1	3.1 [1)]	-27.0	-8.1	-5.1 [1)]	-6.4	130.3	156.9	18.2	-3.9
Ireland	2.4	-95.8	-9.1 [1)]	-15.7	-9.4	-12.8	4.0 [1)]	309.5 [1)]	117.6	14.4	-0.7 [1)]
Italy	-2.4	-24.4	-2.1 [1)]	-23.4	3.0	-5.3	2.6 [1)]	128.6 [1)]	127.0	9.2	3.8 [1)]
Portugal	-6.4	-116.7	-1.9 [1)]	-15.5	-5.7	-9.1	-6.1	255.6	123.6	13.3	-3.6
Spain	-3.1	-93.0	-1.3 [1)]	-14.2	-6.7	-15.8	-4.1 [1)]	218.1 [1)]	84.2	22.3	3.7 [1)]
Macedonia	-3.0	-55.8	0.6 [2)]	-7.3	0.4 [3)]	. [4)]	. [5)]	47.1	36.0	31.5	4.9
Montenegro	-19.5	.	-0.1 [2)]	-12.8	0.2 [3)]	. [4)]	. [5)]	54.7	51.9	19.7	7.0
Serbia	-9.0	-92.5	-1.6 [2)]	-0.5	9.8 [3)]	. [4)]	. [5)]	56.3	58.9	22.1	10.2
Turkey	-7.3	-51.3	.	11.9	.	.	.	46.3	36.8	9.2	14.4
Albania	-11.7	-41.4 [1)]	-3.9 [2)]	4.5	3.7 [3)]	. [4)]	. [5)]	41.3	58.6	14.2	5.1
Bosnia and Herzegovina	-7.9	-59.3 [1)]	0.1 [2)]	-29.6	0.5 [3)]	. [4)]	. [5)]	58.1	43.1	27.6	4.2

(Table 2 ctd.)

Table 2 (ctd.)

Year 2012	3 year average of Current Account Balance as % of GDP	Net International Investment Position as % of GDP	% Change (3 years) of Real Effective Exchange Rate with HICP deflators	% Change (5 years) in Export Market Shares	% Change (3 years) in Nominal unit labour cost	% y-o-y change in deflated House Prices	Private Sector Credit Flow as % of GDP	Private Sector Debt as % of GDP	General Government Debt as % of GDP	Unemployment rate 3-year average	y-o-y % change in Total Financial Sector Liabilities, non-consolidated data
Thresholds	**-4%/-6%**	**-35%**	**±5% & ±11%**	**-5%**	**+9% & +12%**	**+6%**	**+15%**	**160%**	**60%**	**10%**	**16.5%**
Kazakhstan	3.8	-12.2	21.2 2)	44.4	33.8 3)	.	.	39.5	12.7	5.5	10.2
Russia	4.6	7.8 1)	24.7 2)	16.6	30.9 3)	.	.	49.9	9.6	6.4	21.5 1)
Ukraine	-5.6	-32.9	16.4 2)	8.5	45.7 3)	.	.	56.0	36.6	7.8	13.1 1)

1) Year 2011. - 2) Real exchange rate with CPI deflators. - 3) Gross wages per employee relative to labour productivity (real GDP per employed person, LFS). - 4) We do not have data, but it is likely that house prices have fallen. - 5) We don't have the data, but it is highly likely that private credit flows are well below the threshold.

Sources: Eurostat, National Statistics, wiiw calculations.

Table 3

Foreign financial position

in % of GDP

	Trade Balance (BOP)						Current account						Gross external debt				
	2008	2009	2010	2011	2012 [1)]	2013 Forecast	2008	2009	2010	2011	2012 [1)]	2013 Forecast	2008	2009	2010	2011	2012 [1)]
Bulgaria	-24.3	-12.0	-7.7	-5.6	-9.1	-9.5	-23.1	-8.9	-1.5	0.1	-1.3	-1.7	105.1	108.3	102.7	94.1	94.8
Croatia	-22.4	-16.1	-12.9	-13.8	-13.7	-13.7	-8.9	-5.1	-1.1	-0.9	0.1	0.1	83.6	97.7	104.6	103.0	102.3
Czech Republic	0.7	2.3	1.4	2.4	3.8	5.4	-2.1	-2.4	-3.9	-2.7	-2.5	-1.7	39.2	43.6	47.0	46.8	50.7
Estonia	-12.6	-4.3	-1.9	-1.4	-4.3	-3.9	-9.2	3.4	2.9	2.1	-1.2	-3.1	117.2	125.0	114.6	95.6	97.8
Hungary	-1.1	2.6	3.3	3.4	4.2	4.7	-7.3	-0.2	1.1	0.8	1.6	1.5	117.0	150.0	143.1	132.6	126.9
Latvia	-17.8	-7.1	-7.0	-10.8	-9.8	-11.4	-13.2	8.6	2.9	-2.1	-1.7	-2.9	130.0	157.1	166.2	145.8	135.1
Lithuania	-13.0	-3.3	-4.9	-5.9	-3.2	-0.3	-12.9	3.7	0.1	-3.7	-0.5	-2.9	71.0	83.9	83.2	77.8	75.4
Poland	-5.8	-1.7	-2.5	-2.7	-1.4	-0.2	-6.6	-3.9	-5.1	-4.8	-3.5	-3.1	47.8	62.6	66.9	66.9	72.4
Romania	-13.6	-5.8	-6.1	-5.6	-5.6	-4.6	-11.6	-4.2	-4.4	-4.5	-4.0	-3.5	51.8	68.7	74.4	75.2	75.1
Slovakia	-1.2	1.5	1.2	1.4	5.1	5.4	-6.2	-2.6	-3.7	-2.1	2.3	2.0	57.9	72.2	74.8	76.6	75.2
Slovenia	-6.4	-1.4	-2.8	-2.9	-0.9	0.0	-6.2	-0.7	-0.6	0.0	2.3	1.7	105.3	113.3	114.4	111.2	115.1
Austria	-0.2	-0.9	-1.1	-2.5	-2.2	.	4.9	2.7	3.4	1.4	1.8	.	211.6	209.0	214.8	202.0	197.6
Belgium	-3.2	-1.3	-0.9	-2.3	-2.0	.	-2.9	-2.0	-3.5	-3.1	-0.7	.	334.7	302.3	285.2	296.0	286.9
Germany	7.3	5.5	6.3	5.9	6.7	.	6.2	6.0	6.2	6.2	7.0	.	148.9	149.5	156.5	159.1	163.9
Greece	-18.9	-13.3	-12.7	-13.1	-10.1	.	-14.9	-11.2	-10.1	-9.9	-3.1	.	155.5	176.5	183.2	177.4	225.6
Ireland	13.3	20.1	22.8	22.7	22.2	.	-5.7	-2.3	1.1	1.1	4.9	.	946.2	1089.9	1102.7	1062.2	1002.3
Italy	-0.1	0.1	-1.3	-1.1	1.1	.	-2.9	-2.0	-3.5	-3.1	-0.7	.	109.3	116.5	117.4	115.0	120.7
Portugal	-13.4	-10.6	-11.1	-8.3	-5.2	.	-12.6	-10.9	-10.6	-7.0	-1.5	.	202.5	226.2	228.9	217.9	232.9
Spain	-7.9	-4.0	-4.6	-4.0	-2.5	.	-9.6	-4.8	-4.5	-3.7	-1.1	.	153.7	167.7	163.5	164.9	166.9
Macedonia	-26.2	-23.3	-20.5	-22.5	-23.8	-21.5	-12.8	-6.8	-2.0	-3.0	-3.9	-4.0	49.2	56.4	58.2	64.9	69.0
Montenegro	-65.6	-44.3	-40.8	-40.4	-42.4	-40.0	-49.8	-27.9	-22.9	-17.7	-17.9	-15.0	15.6	23.5	29.4	32.9	39.5
Serbia	-26.0	-17.7	-17.0	-16.9	-18.2	-17.7	-21.6	-7.2	-7.4	-9.1	-10.5	-9.0	64.6	77.7	84.9	76.7	85.8
Turkey	-7.1	-4.0	-7.8	-11.5	-8.3	-8.2	-5.6	-2.2	-6.2	-9.7	-5.9	-7.3	40.5	42.4	39.7	42.4	41.7
Albania	-27.4	-26.5	-23.5	-24.5	-20.7	-17.0	-15.6	-15.3	-11.5	-13.0	-10.6	-8.7	37.6	41.3	46.2	52.5	54.9
Bosnia and Herzegovina	-37.9	-27.6	-25.5	-27.7	-32.5	-31.6	-13.9	-6.3	-5.7	-8.7	-9.4	-9.6	17.0	21.6	25.4	26.0	27.5
Kosovo	-41.9	-41.2	-40.8	-43.1	-41.5	-40.4	-11.7	-9.3	-12.0	-13.8	-7.6	-11.3	17.9	28.6	31.4	29.9	30.4
Kazakhstan	25.1	13.0	19.2	24.9	22.0	20.7	4.7	-3.6	0.9	6.5	3.8	4.0	84.1	95.1	80.1	71.7	65.5
Russia	10.8	9.1	10.0	10.4	9.7	8.3	6.2	4.0	4.7	5.2	4.0	2.7	30.1	37.0	32.1	30.5	30.4
Ukraine	-8.9	-3.7	-6.1	-9.9	-11.6	-9.6	-7.1	-1.5	-2.2	-6.3	-8.4	-5.9	58.6	85.8	86.0	83.4	74.7

1) Preliminary and wiiw estimates.

Source: wiiw Annual Database incorporating national and Eurostat statistics, World Bank – Quarterly External Debt Statistics. Forecasts by wiiw.

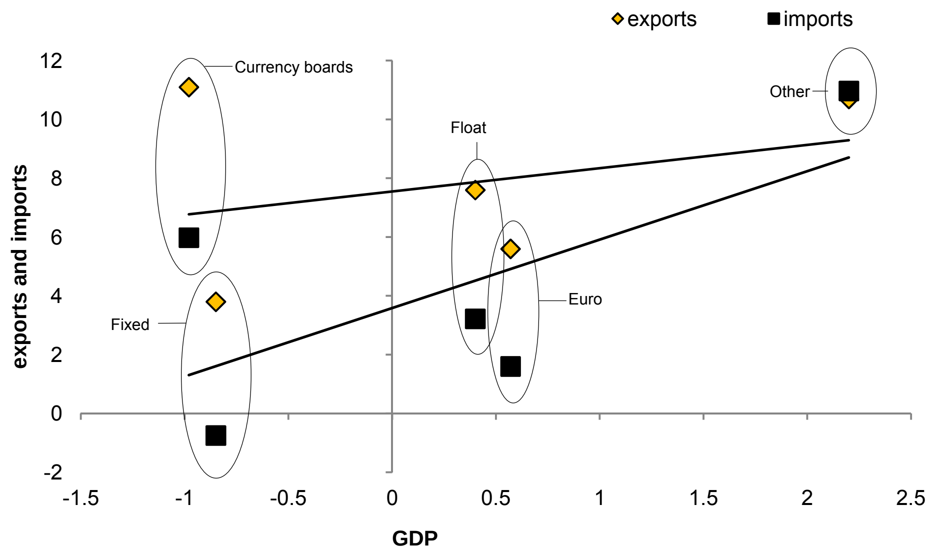
All that may not be of great consequence as long as it does not give rise to problems for the sustainability of the currency union and then, by implication, that of the common market or elements thereof that, for example, might lead to a financial crisis. As a currency crisis can erupt on account of practically any unsustainable macro-imbalance, the scoreboard with its early warning system that has been introduced tries basically to cover all these persistent imbalances. This confirms that external imbalances and especially financial positions and labour market inefficiencies are major problems for less developed countries in bad times and financial, fiscal and labour market problems are more of a problem for developed counties in both good times and bad (Table 2).

Are these imbalances being corrected? When it comes to external imbalances, current account deficits have been narrowed or eliminated mainly on account of the persistent slump in imports, though trade deficits are still quite high in the Balkans (Table 3). Some countries have also managed to increase their exports significantly. Those turnarounds are not necessarily conditional on exchange rate policies. It could be argued that countries with flexible exchange rates have been able to improve their external balances with less loss to GDP, whereas some countries with fixed exchange rates have perhaps managed to increase their exports more dramatically with less of a decline in imports, but with higher losses in terms of GDP (Figure 11).

Figure 11

Exchange regime, trade and GDP growth,

average p.a., 2009-2012



Note: Currency boards (BG, LT, LV, BA); Fixed (HR, MK); Float (CZ, PL, HU, RS, AL); Euro (EE, SI, SK); Other (KZ, UA; RU, TR).

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

Overall, recessions in countries with fixed exchange rates tend to be reversed with either a drop in prices or a fall in employment or a certain proportion of both. In countries with flexible exchange rates, which are not unduly euroised, real exchange rate correction may prove to be sufficient as long as exports can be increased and domestic demand sustained. However, most countries outside the euro area are sufficiently euroised so that the exchange rate policy, at least of itself, does not to make too much difference.

Given these constraints, hopes are being pinned on the recovery of investments. Given the concern with external imbalances, the importance of the revival of domestic investment is increased. With fiscal balances coming under persistent scrutiny, the chances for recovery and for its speed depend on private investments. The data does not indicate that those are surging though there is some anticipation that that may happen in the medium run at least. Much of this report is about the conditions that are influencing the prospects for the recovery of investments.

Policy framework: rules and implementation

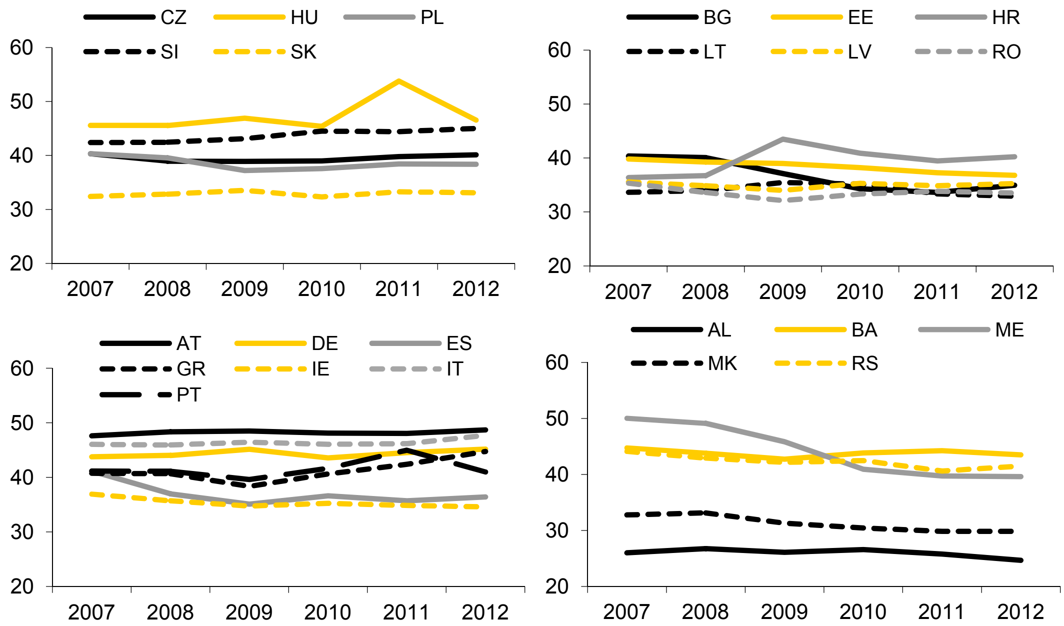
In bad times more so than in good, rules tend to be hard to implement, while it is the policy framework that matters. The return to a slowdown and ultimately to the recession that started in the first half of 2011 was for the most part probably the effect of the major decompression of interest rates and the subsequent fiscal policy reaction, entailing the introduction of various measures to reduce fiscal deficits and thus the issuance of public bonds. This policy mix culminated in increasing the risk of the euro area collapsing because it not only supported the run on banks in countries with high interest rates, but it also provoked the renationalisation of the banking sector in most other countries and a rift in the common financial market. The high spreads in both yields on sovereigns and interest rates for private sector loans were tantamount to wagers on the exchange rates that were to be established once the euro area had collapsed. In mid-2012 the ECB intervened and put a stop to those developments: a move that enjoyed both explicit and implicit political support. As a consequence, interest rates underwent significant compression, though not to a point where they were completely erased, which had been the state of affairs in good times.

The issue of fiscal austerity thus remains to be tackled. Here again, the data on changes in public expenditures and revenues suggest that fiscal policies changed in the course of 2011. The expenditure to GDP ratios declined, while the revenues to GDP ratios held up or, in some cases, actually increased (Figure 12 and 13). It could be argued, however, that the workings of the automatic stabilisers would require that the elasticity of public expenditures to potential GDP be equal to 1, with the elasticity of public revenues to actual GDP also being equal to 1. The latter condition has by and large been met, but the former not at all. In other words, as the output gap increases, public expenditure to GDP ratio increases in line with the gap; the public revenue to GDP ratio does not change and falls in relation to the potential GDP. If the increase in public expenditures does not offset the broader output gap, that difference, i.e. elasticity less than 1, is a measure of the rigidity of fiscal policy. That could be mitigated by a decline in the public revenues to GDP ratio, as that would indicate a decline in the overall fiscal burden in the private sector. The opposite is true, if the public revenue to GDP ratio increases. Putting the two together provides a measure of the fiscal response – tightening or loosening – in the business cycle.

Assuming for instance that the output gap was on average at least 2 percentage points per year, the yearly shortfall of public expenditures would on average be about the same. In worse performing

Figure 12

Total fiscal revenues, in % of GDP

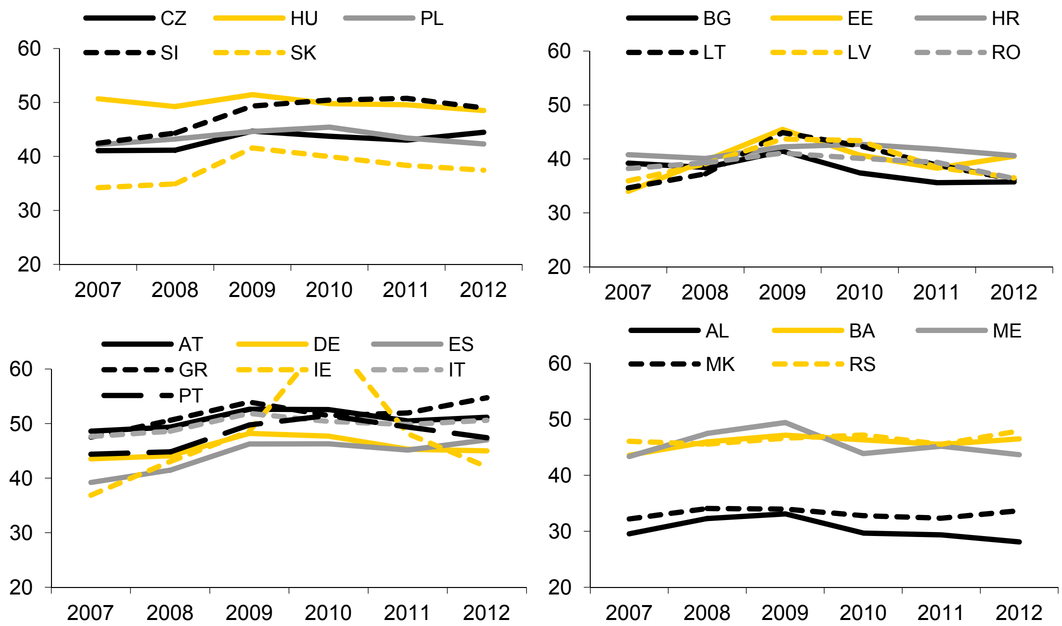


ESA'95 definition for all EU countries, national definition for the rest of the countries.

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

Figure 13

Total fiscal expenditures, in % of GDP



Remark; Ireland: 2010 66.1%.

ESA'95 definition for all EU countries, national definition for the rest of the countries.

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

countries the gap was much wider. Even in countries that pursued a policy of fiscal relaxation in the worst year or for a couple of years during the current crisis (2009 and 2010), they shifted towards fiscal tightening after 2011 (Figures 12 and 13). That policy stance has since remained in place and is not expected to change significantly over the next few years, although some relaxation is probable. Thus, one could expect fiscal policy to continue to act as a drag on growth in the short and medium term. The extent of that drag will depend on what happens in terms of monetary policy and structural reforms, i.e. in terms of the changes in the fiscal system and in the regulation of markets.

Because official consolidation policy is predicated on the sustainability of public debts, it is interesting to see what is happening in that regard, given the changes in the monetary stance. In the main, that means checking the relationship between the implicit interest rate on public debts and the nominal growth rate of GDP. In good times, the interest rate tended to be lower than the growth rate in less developed countries and higher in the more developed countries (examples of both in Figure 14). In other words, developed countries needed to run primary surpluses in order to stabilise their debt to GDP ratios, whereas less developed countries could achieve the same degree of stabilisation by means of fiscal deficits. Indeed, before the crisis, most of the latter countries had declining public debt to GDP ratios, even though they also relied on deficit financing.

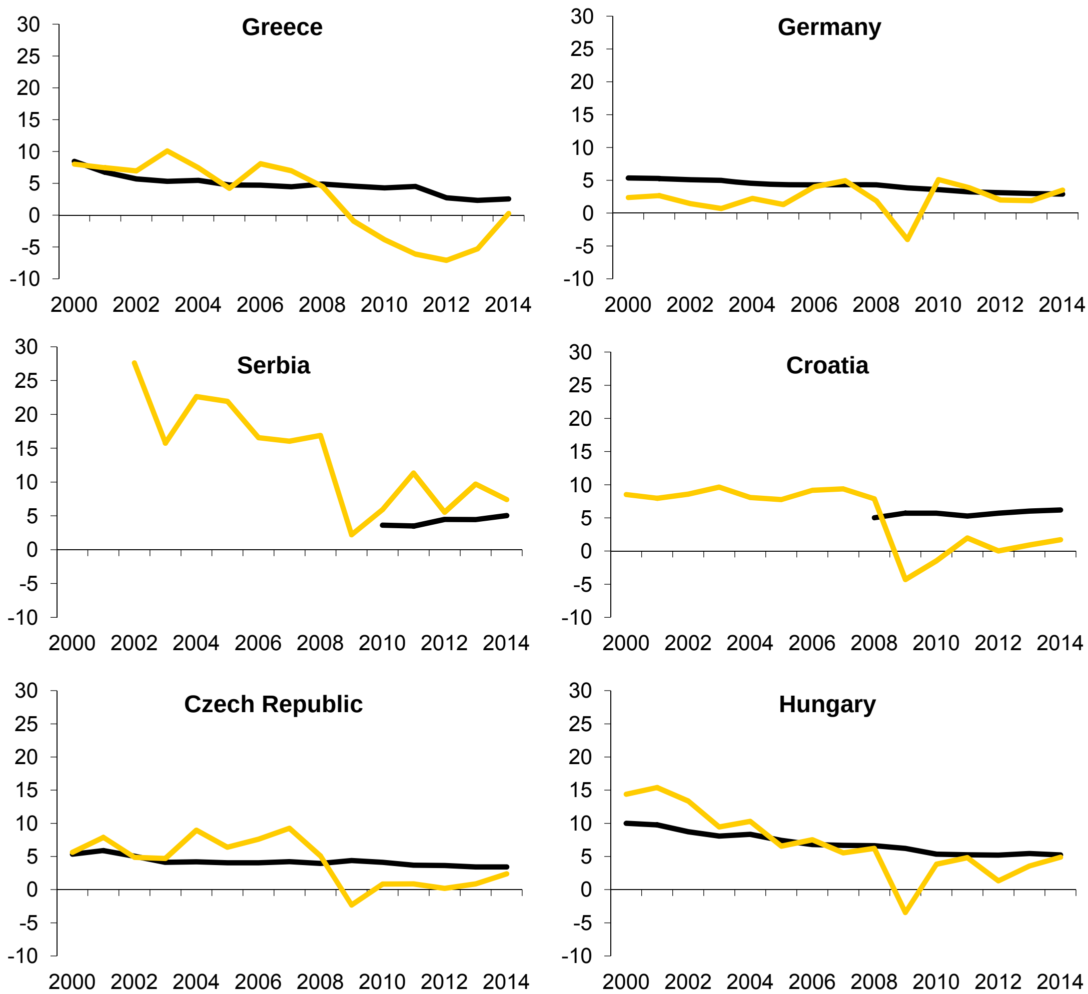
This has changed with the decline in the growth rate, even though the implicit interest rate has not increased all that much and has more often than not decreased (Figure 14). Thus, the threat to the sustainability of public debts comes almost entirely from low growth rates. As a rule, interest rates are lower for euro members than for those outside the euro area, at least when it comes to the new Member States and the candidate countries in the Balkans. Turkey is facing a very high implicit interest rate, while the interest rate in Greece has dropped to comparatively low levels as a consequence of all the various bail-out schemes. Given that these interest rates are between 2% and 5.5%, nominal GDP growth rates of 4% or 5% would basically stabilise public debt to GDP ratios – except for stock-flow adjustments that might be of importance to countries that do not use the euro but borrow in foreign currencies. Of course, some primary surpluses may be needed, if those debt levels are to come down as desired or comply with EU or home-grown fiscal rules: a drop to 60% of GDP or less.

A number of countries adopted rules based fiscal policy and set up fiscal councils to keep checking how these rules are being respected. Less developed countries and some of the candidate countries adopted public debt ceilings lower than required by the Maastricht criteria, e.g. around 40% or 45% of GDP. As the majority of these countries are very close or above the thus set ceiling, they face a dilemma either to float the rules or introduce stricter fiscal savings measures. As in the case of the observation of the Maastricht Criteria, these public debt ceilings and implied fiscal deficits have by and large proved non binding and have threatened the reputation of the fiscal councils in the process (Hungary not being the only example).

The international financial institutions as well the EU ones stress the role of structural reforms which comprise the fiscal reforms, both of the taxation systems and of the distribution of expenditures, together with institutional changes or the changes in the way various markets are regulated. These reforms have distributional consequences, some of which address the social compact types of issues, e.g. when it comes to practically all types of social security and also the design of the distribution of the tax burden, and thus the reforms require that the political process assures their legitimacy. That can take a while and the political processes in Europe have a hard time dealing with these changes. In the meantime, the adjustment is mainly taking place via the labour markets.

Figure 14

Implicit interest rates compared with GDP growth



Source: Eurostat, AMCEO.

Changing the way markets are regulated is a different political matter and their introduction depends more on the existence of blocking powers by various interest groups or coalitions. The process of EU integration has been one way to erode various rents in product markets, through trade, and in financial markets, through cross-border capital mobility. However, the emerging imbalances push the process in the opposite direction and increase the influence of the vested interests. That makes for a slow and uncertain process of market reforms. Indeed, more have been announced than implemented.

Investments to the rescue

With these constraints, hopes are being pinned on the recovery of investments. Given the concern with external imbalances, the importance of the revival of domestic investment is increased. With fiscal balances coming under persistent scrutiny, the chances for recovery and for its speed depend on private investments. The data does not indicate that those are surging (Table 4) though there is some anticipation that that may happen in the medium run at least. Much of this report is about the conditions that are influencing the prospects for the recovery of investments.

Table 4

Gross fixed capital formation, private sector

real change in % against preceding year

	2006	2007	2008	2009	2010	2011	2012
Bulgaria	10.1	9.5	24.5	-18.3	-19.4	.	.
Croatia	12.8	5.4	.	.	.	.	.
Czech Republic	4.2	16.3	1.3	-14.3	4.8	1.6	0.8
Estonia	21.7	8.1	-17.4	-43.1	-3.3	26.4	17.2
Hungary	-6.1	8.0	7.4	-13.0	-13.1	-2.3	.
Latvia	10.9	7.1	-14.7	-39.2	-21.3	32.7	.
Lithuania	17.1	19.3	-7.0	-42.4	-4.5	24.4	.
Poland	13.2	18.4	8.2	-6.1	-4.9	9.5	5.7
Romania	14.6	32.3	18.3	-31.5	-10.1	9.4	13.2
Slovakia	8.5	10.6	0.0	-22.2	5.1	16.6	.
Slovenia	9.6	10.6	7.9	-27.5	-16.9	-4.8	.
Austria	0.9	4.4	0.5	-8.5	1.2	8.1	.
Germany	9.3	5.0	0.2	-13.4	6.4	6.8	-1.9
Greece	13.1	26.5	-18.2	-13.1	-12.2	-17.9	-21.8
Italy	4.0	1.6	-3.9	-13.6	2.8	-1.1	-8.1
Ireland	3.1	-3.3	-16.4	-27.4	-28.9	-7.4	.
Portugal	-2.4	5.9	-0.6	-9.6	-8.4	-5.8	-11.9
Spain	6.1	4.8	-7.6	-24.1	-3.8	-1.4	-4.0
Macedonia	7.1	17.9	1.3	-3.8	-1.0	0.7	.
Montenegro	.	.	.	.	.	.	.
Serbia	.	.	.	.	.	.	.
Turkey	15.0	2.6	-9.0	-22.5	33.6	22.3	-4.5
Kazakhstan	31.8	12.4	1.5	10.8	-13.7	6.1	.
Russia	.	.	.	.	.	.	.
Ukraine	21.6	20.8	1.9	-49.0	1.7	8.0	.

Source: National and Eurostat statistics, wiiw own calculations.

Why are investments not picking up? One reason is clearly the poor growth prospect due to the institutional and policy issue that affect domestic and cross-border demand negatively. The other is declining public investments (Table 5) which also influences private investments (Figure 15). Finally and most importantly, there is the failure in market coordination that is particularly due to continued financial stress that leads to prolonged slump in the supply of credit.

Table 5

Gross fixed capital formation, public sector

real change in % against preceding year

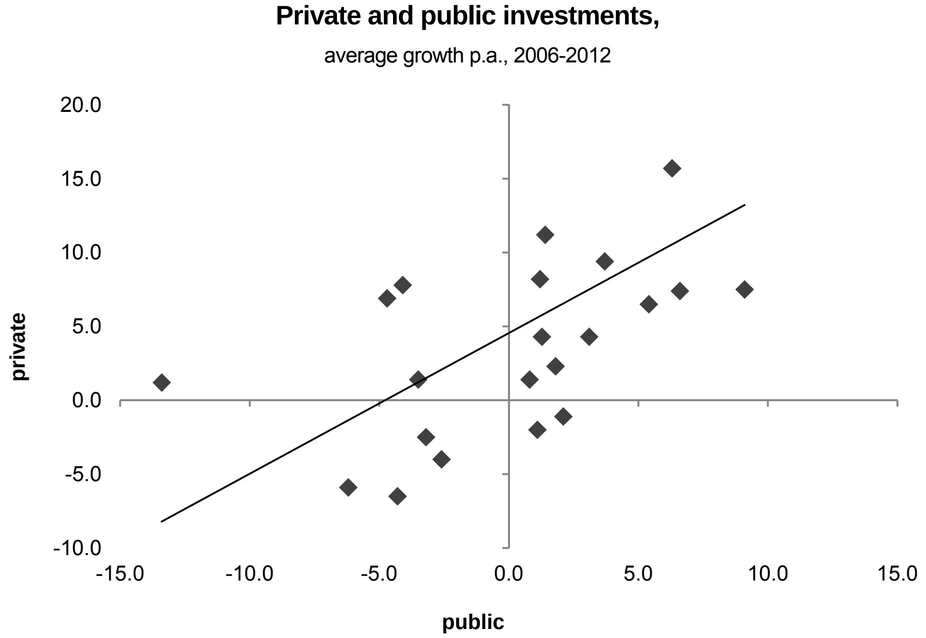
	2006	2007	2008	2009	2010	2011	2012
Bulgaria	22.2	41.7	10.6	-15.0	-0.3	-26.8	-2.5
Croatia	-1.7	16.7	.	.	.	.	.
Czech Republic	12.4	-0.1	15.1	7.9	-14.1	-13.6	-15.7
Estonia	29.6	19.4	8.4	-16.8	-21.8	19.9	39.7
Hungary	15.4	-15.4	-18.1	1.0	9.8	-11.1	0.8
Latvia	62.9	28.5	-15.4	-24.2	-15.7	23.8	-5.4
Lithuania	29.3	36.6	-0.2	-29.6	25.9	4.2	-8.4
Poland	22.2	14.3	17.1	18.0	14.4	8.4	.
Romania	47.2	22.2	6.7	-10.2	0.1	2.2	-16.1
Slovakia	14.1	-5.2	12.1	13.8	17.4	-8.4	-14.0
Slovenia	22.5	24.1	8.2	-0.9	-4.1	-19.3	-20.8
Austria	-1.9	-2.1	6.6	0.0	-6.7	-7.9	.
Germany	7.0	4.2	6.6	6.3	0.3	0.2	-8.8
Greece	26.6	3.3	10.3	-16.7	-30.8	-32.3	-1.7
Italy	0.6	0.2	-5.1	7.7	-16.7	-7.2	-7.5
Ireland	10.8	33.9	18.5	-28.9	-2.7	-24.7	.
Portugal	-19.3	-1.7	7.2	2.1	27.1	-32.4	-31.2
Spain	8.1	12.8	1.2	10.8	-11.3	-27.3	-40.0
Macedonia	8.9	15.5	29.0	-9.3	-8.5	21.0	.
Montenegro	.	.	.	.	.	.	.
Serbia	.	.	.	.	.	.	.
Turkey	2.6	6.3	12.7	-0.6	17.7	-2.2	8.9
Kazakhstan	18.1	45.0	-1.1	-58.0	212.5	-0.4	.
Russia	.	.	.	.	.	.	.
Ukraine	16.5	40.6	-17.9	-61.6	26.0	5.1	.

Source: National and Eurostat statistics, wiiw own calculations.

In addition, there is no sign of increased demand for credits (Figure 16) even though credit conditions for both corporations and households have not changed significantly except in the countries that are in crisis. It is, however, true that the interest rates have not declined enough to account for the slowdown in growth. So, given the difference between growth prospects and available interest rates, the latter are proving to be inaccessibly high. Especially badly affected are the small and medium-sized enterprises.

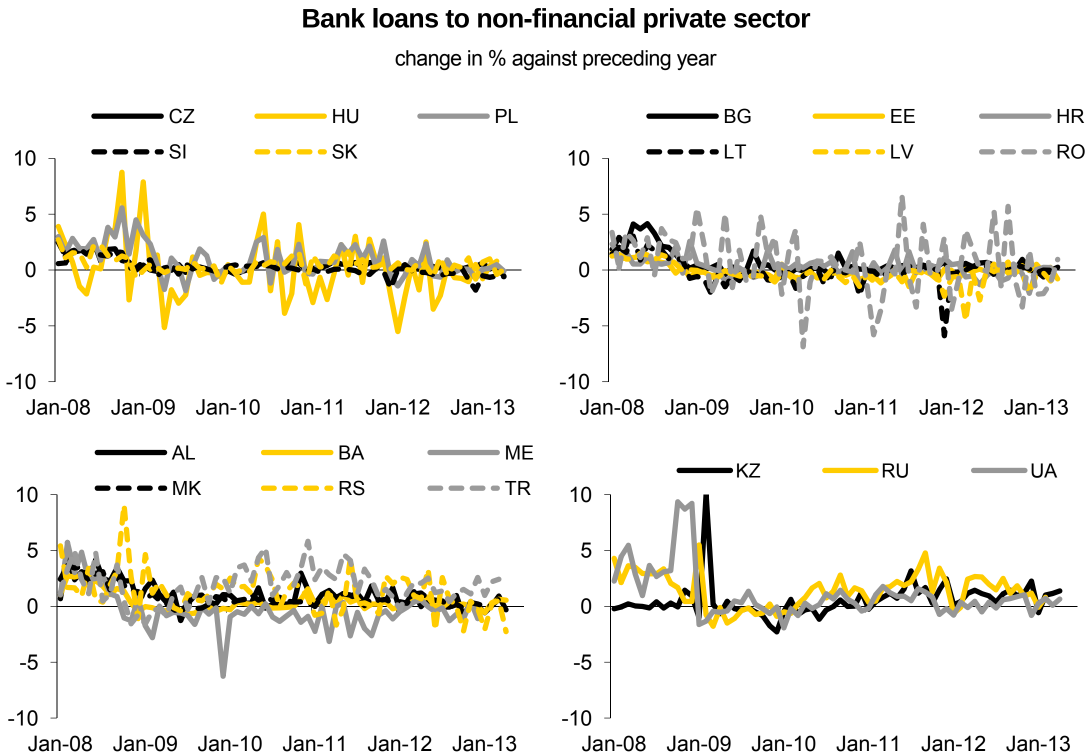
Though current yields on government bonds seem somewhat high in many countries while interest rates for private credit have for the most part settled down to their pre-crisis levels (Figures 17-18), actual burdens for interest payments given the current growth prospects are probably worse for private than for public debts.

Figure 15



Source: Eurostat, wiiw own calculations.

Figure 16

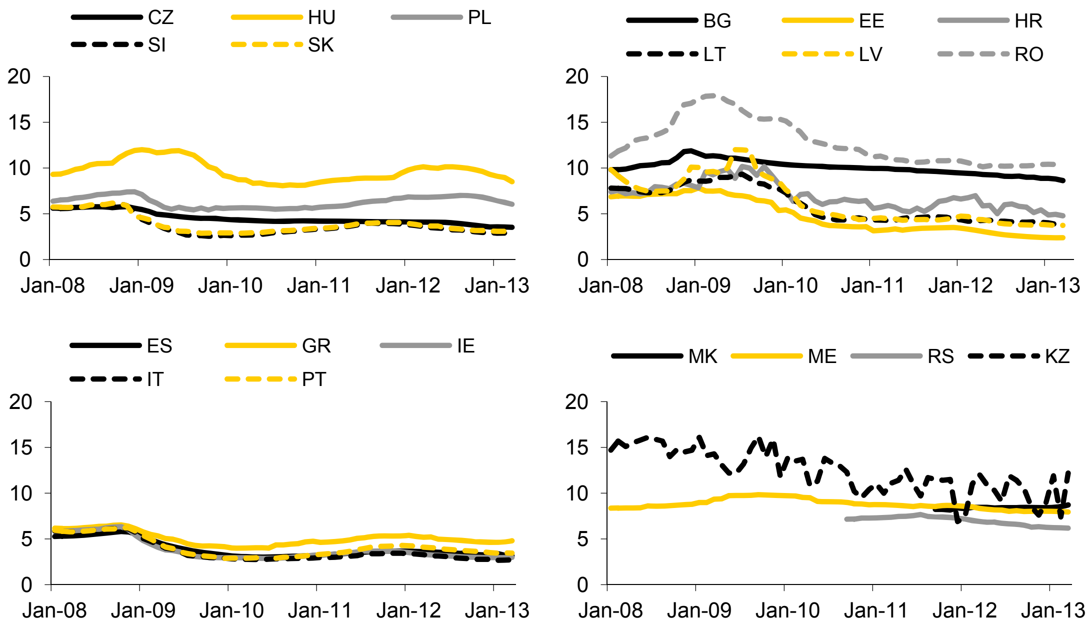


Source: National Bank statistics.

Figure 17

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

maturity > 5 years, % p.a.

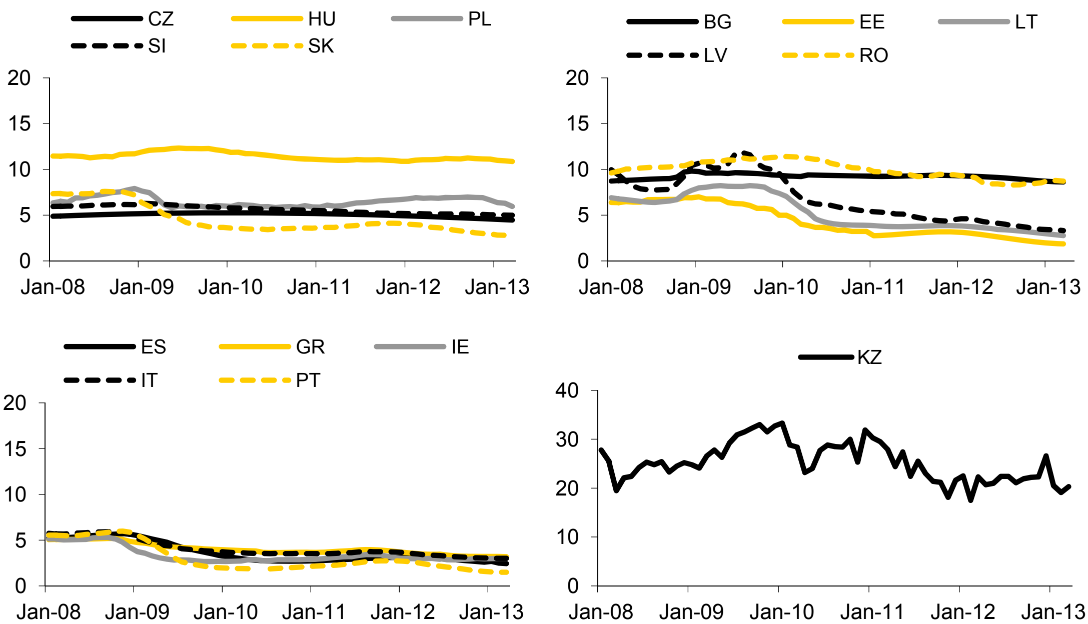


Remark: Croatia: Long-term. Montenegro: Over one year. Serbia: Refers to all currencies.
Source: Eurostat, National Bank statistics.

Figure 18

Interest rates – loans to households for housing, in domestic currency, amount outstanding

maturity >5 years, % p.a.



Remark: Kazakhstan: Loans to individuals.
Source: Eurostat, National Bank statistics.

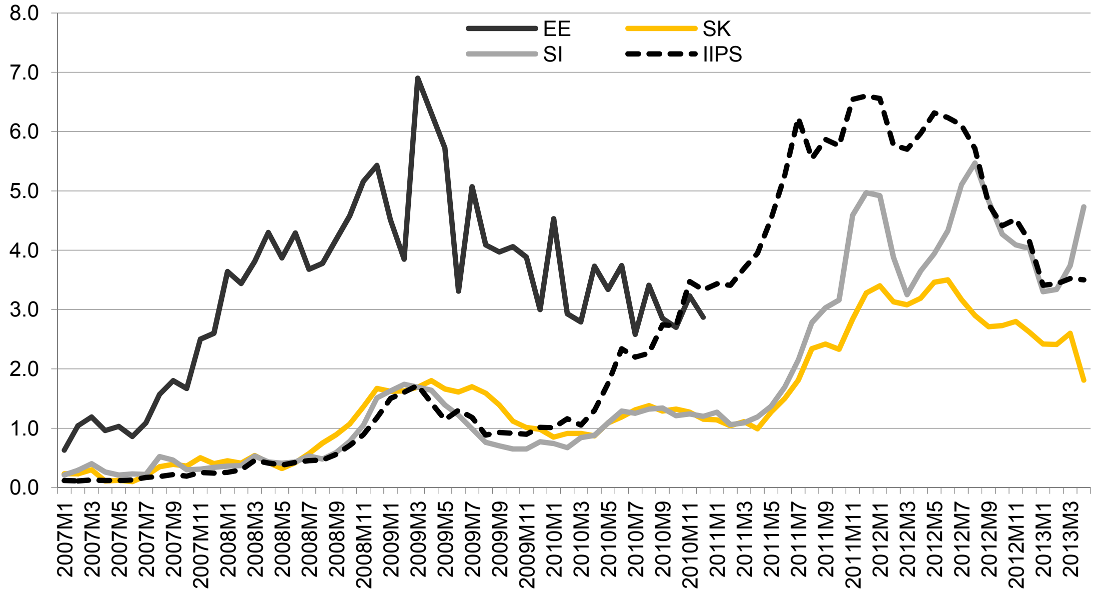
Bonds, spreads, and investments[2]

Spreads of 10-year sovereign debt yields to the German equivalent demonstrate a double-peak pattern during the crisis in practically all countries in the CESEE region. The first peak occurred at the beginning of 2009, several months after the crisis unravelled. The second peak occurred at the beginning of 2012, following an escalation of the European sovereign debt crisis primarily on account of the poor performance in Greece, Ireland, Italy, Portugal and Spain (GIIPS).

Figures 19-23 below show the dynamics of the spreads of 10-year sovereign debt yields to the German equivalent for the countries in the region using IIPS countries (GIIPS without Greece) as a benchmark[3]. During the first peak, two members of the euro area in Central and Eastern Europe, Slovakia and Slovenia, appeared to benefit from membership as their yields rose only moderately – up to 1.7%, while the performance of all other countries in the region was far worse – in particular in Turkey, Ukraine, the Baltic states, Romania and Hungary. In Slovakia and Slovenia the spreads exceeded 20%, while the Czech Republic, which had had the lowest (even negative) spreads prior to the crisis, had slightly higher spreads than either country at the beginning of 2009.

Figure 19

Spreads of 10-year sovereign debt yields to the German equivalent of selected euro area members, %



Source: ECB, National Banks; wiiw calculations.

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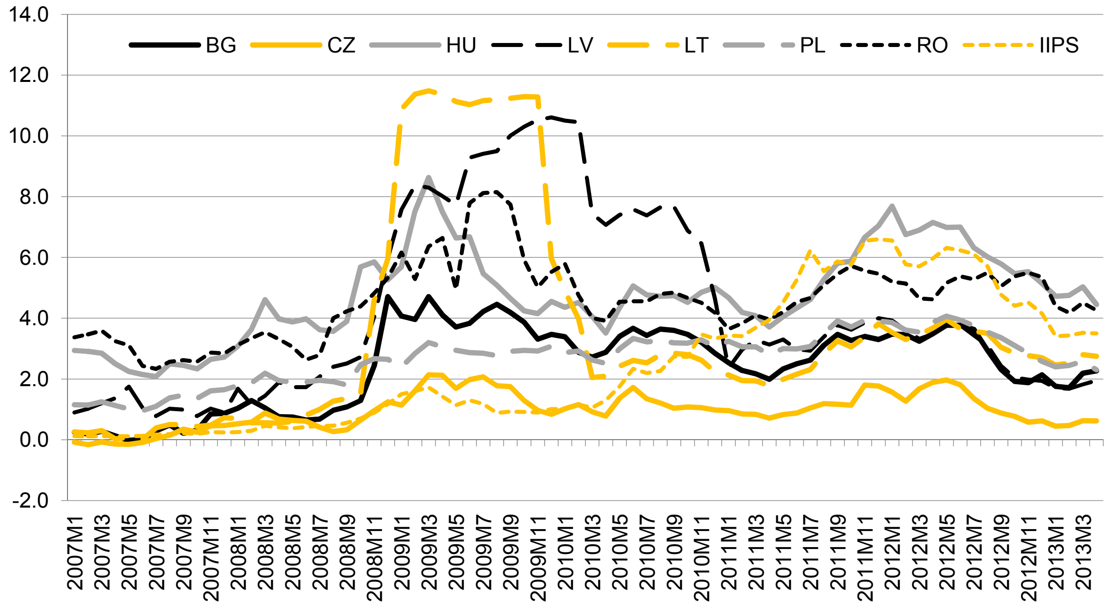
2 This subsection was written by Olga Pindyuk.

3 Yields for IIPS are calculated as a simple average. Greece was excluded from the benchmark as an outlier because its yields shot up much higher than in any other troubled euro area economy.

Figure 20

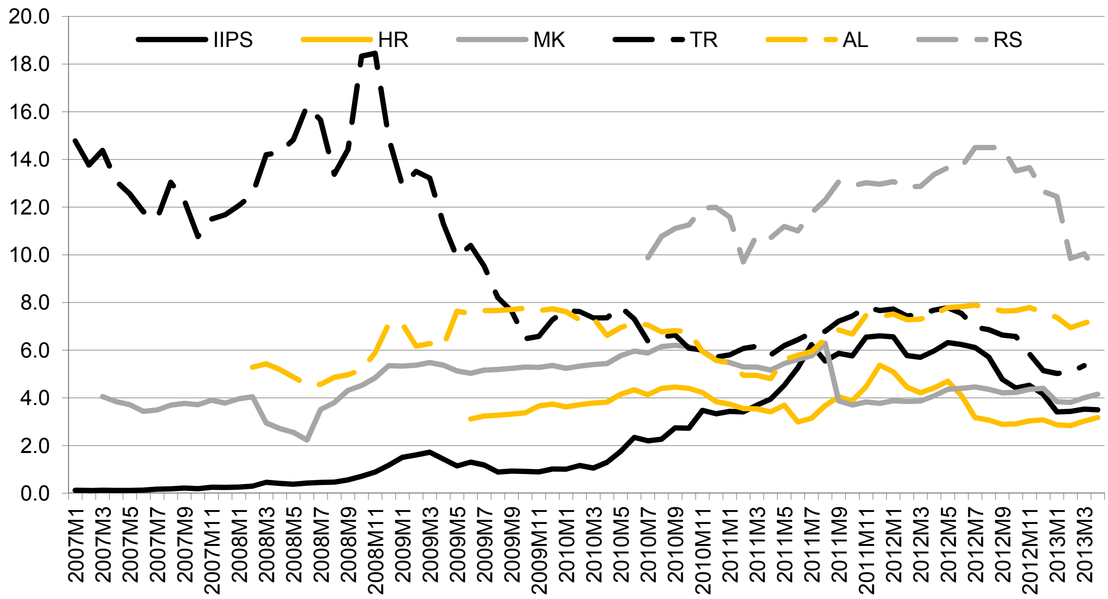
Spreads of 10-year sovereign debt yields to the German equivalent of non-euro area EU members from CESEE, %



Source: ECB, National Banks; wiiw calculations.

Figure 21

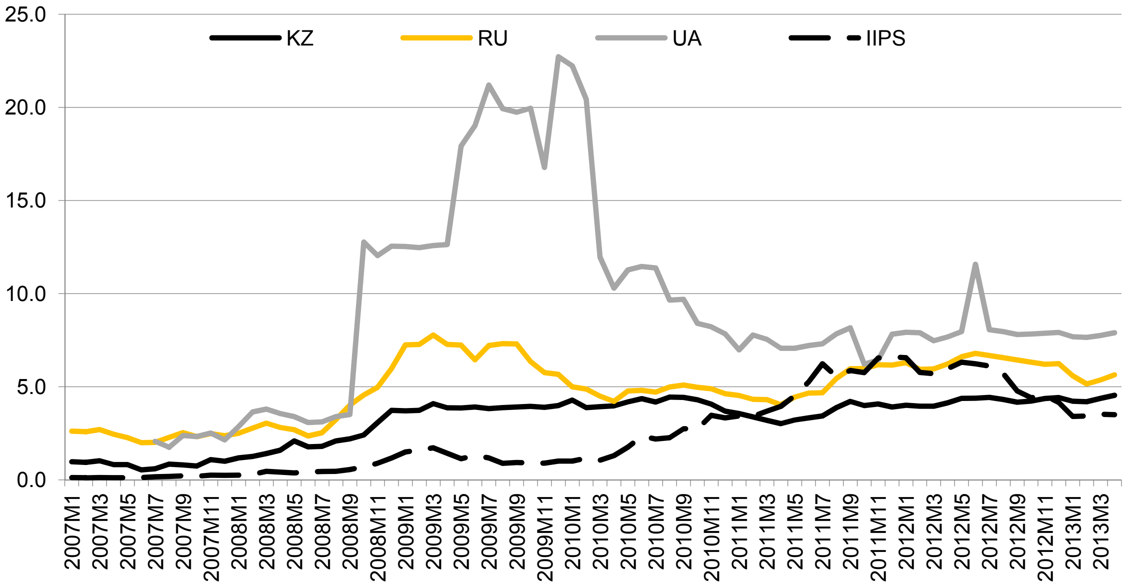
Spreads of 10-year sovereign debt yields to the German equivalent of SEE countries, %



Source: ECB, National Banks; wiiw calculations.

Figure 22

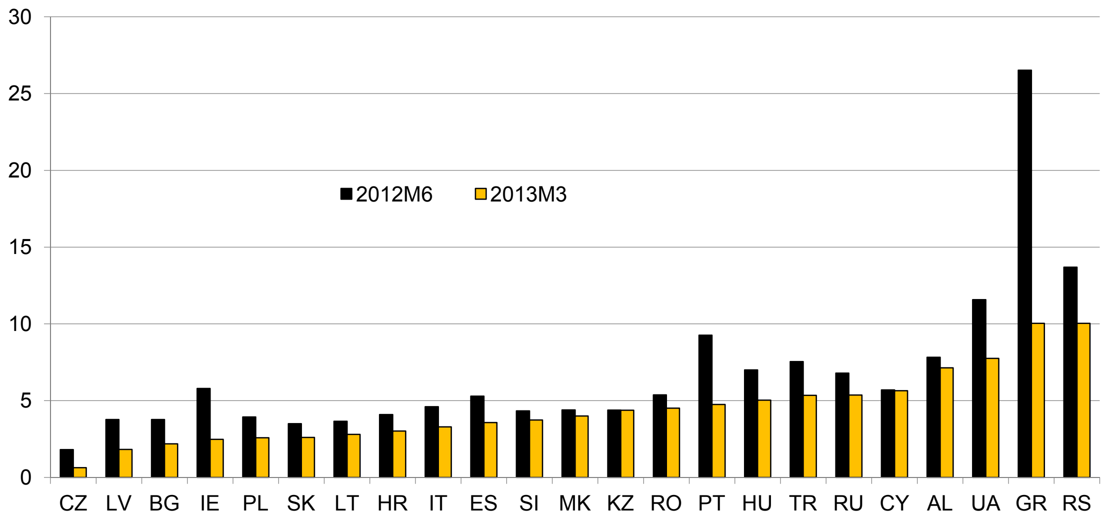
Spreads of 10-year sovereign debt yields to the German equivalent of selected CIS countries, %



Source: ECB, National Banks; wiiw calculations.

Figure 23

Spreads of 10-year sovereign debt yields to the German equivalent, %



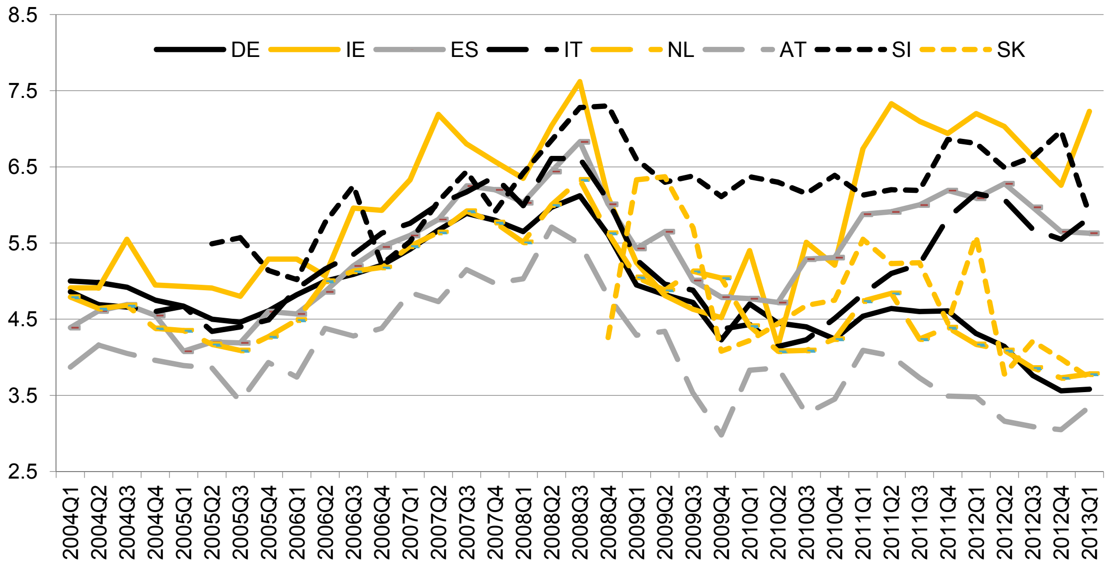
Source: ECB, National Banks; wiiw calculations.

In all the non-euro area countries in the EU, the second peak at the beginning of 2012 was much lower than the first, while the performance of Slovenia and Slovakia closely followed that of the IIPS countries. Slovene spreads rose higher than those in Slovakia (5% as against 3.4%) owing to a relatively worse macroeconomic situation. Only Turkey, Albania, Serbia, Ukraine, and Romania had higher spreads than IIPS during the second peak. ECB intervention in mid-2012 appears to have had a significant impact on the market. Since then the spreads of 10-year sovereign debt yields to the German equivalent dropped significantly in the euro area – only Slovenia has experienced a rise in spreads in the current year on account of the banking crisis and overall poor macroeconomic performance. A downward trend was also to be observed in the non-euro area countries in the EU riding on the back of relatively better economic situation that was probably attributable to some spill-over effects from the euro area. By April 2013, all the countries in Central and Eastern Europe were reporting lower spreads than IIPS, except for Hungary and Romania. By way of contrast, all the countries in Southeast Europe and the CIS countries, except Croatia, reported higher spreads than IIPS.

Although ECB interventions appear to be efficient in curbing the long-term interest rates of sovereign debt, there have been growing concerns that the transmission of lower sovereign debt yields to private credit market has not been functioning properly. Figures 24 and 25 below show the dynamics of interest rates on loans to non-financial corporations valued at less than EUR 1 million (Figure 24) with maturity ranging between 1 and 5 years[4], as well as loans valued at more than EUR 1 million with maturity of more than 5 years (Figure 25). Given the data limitations, we use loans valued at less than EUR 1 million as a proxy for loans to small and medium-sized enterprises (SMEs). For SMEs, banking loans in their home country are a primary source of external financing. Therefore, they are considered to be more affected by the banking market fragmentation inside the euro area as compared to large companies that can secure access to stock markets and foreign banking markets.

Figure 24

Interest rates on loans to non-financial corporations, value below 1 EUR million, maturity between 1 and 5 years, %



Source: ECB, National Banks; wiiw calculations.

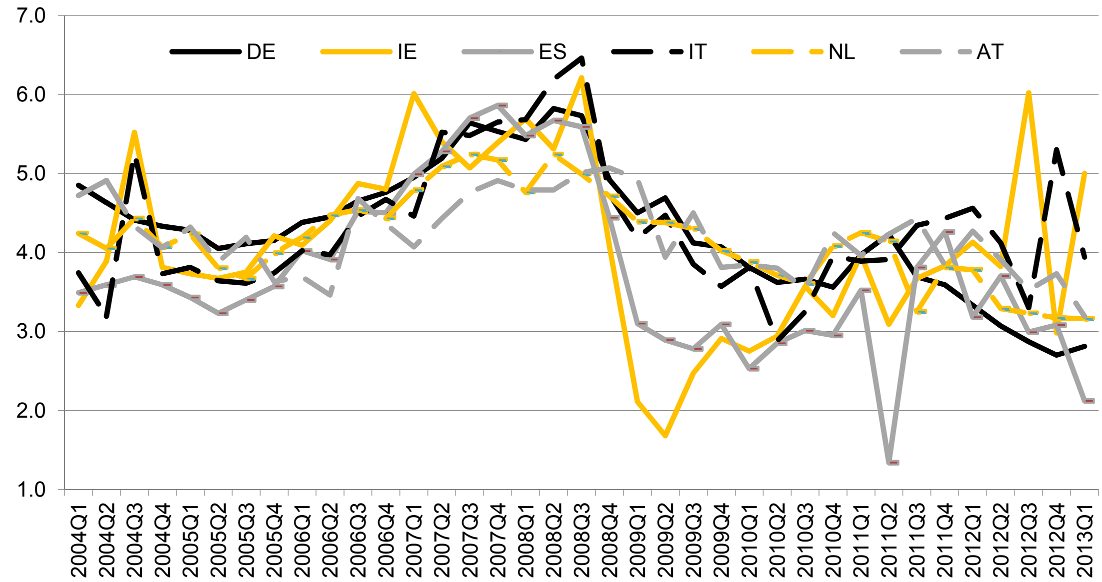
4 This maturity is most common for loans to SMEs. See, e.g., Hernandez-Canovas and Koeter-Kant (2011), 'SME Financing in Europe: Cross-Country Determinants of Debt Maturity', *Small Business Journal*, Vol. 29, No. 5, pp. 489-507.

As Figure 24 shows, up until 2011, interest rates on loan in almost all the euro area countries tended to move more or less in concert – rising up until mid-2008, then dropping until mid-2010 (although in Slovenia the drop was rather mild). However, starting from 2011, the interest rates started to diverge: in the GIIPS countries and Slovenia, they continued to display an upward trend, while in the better performing economies interest rates started to decline. The steps taken by the ECB in the second half of 2012 did not seem to have any great effect on interest rates in the GIIPS countries and Slovenia; a slight decline was to be discerned, but it was quite mild and seemingly short-lived. As a result of the divergent trends between the two country groupings, the interest rates differential in respect of loans widened noticeably within the euro area. In 2004, the interest rates ranged between 4% and 5.5%; at the beginning of 2013, the range had increased to 3% - 7.5%.

Figure 25 shows that the interest rates on loans to non-financial corporations valued at more than EUR 1 million moved somewhat differently. Overall, the trends seem to be less divergent; interest rates over the period 2012-2013Q1 were on average lower compared to the smaller loans. The interest rates differential between the countries is also narrower than in the case of smaller loans.

Figure 25

Interest rates on loans to non-financial corporations, value above 1 EUR million, maturity above 5 years, %



Source: ECB, National Banks; wiiw calculations.
Slovenia and Slovak Republic were excluded due to the bad coverage.

We applied a regression analysis to check the relationship between sovereign debt yields dynamics and private credit. We also wanted to check the extent to which loan interest rates correlated with gross fixed capital formation dynamics. We used quarterly data for the period 2007Q1 – 2013Q1 for the euro area members. The data come from Eurostat, ECB and national banks.

The variables are defined as follows:

- spread – spreads of 10-year sovereign debt yields to the German equivalent, %
- gfcf – change in gross fixed capital formation year on year, %
- big-loan – interest rates on newly issued loans to non-financial corporations with maturity above 5 years, valued at more than EUR 1 million,, %
- small-loan – interest rates on newly issued loans to non-financial corporations with maturity of 1-5 years valued at less than EUR 1 million, %
- crisis – a dummy variable to account for the sovereign debt crisis that takes 1 for the period starting from 2009Q1
- ecb – a dummy variable to account for the ECB interventions that takes the value of 1 for the period starting from 2012Q3
- ecb*giips – interaction of *ecb* with a dummy taking the value of 1 for GIIPS + Slovenia

We estimated the fixed effects panel using the robust variance estimator. We took the first lag of interest rates and spread variables and used them as explanatory variables – to account for possible inertia and limit the extent of potential endogeneity. The results of the estimations are presented in the table below:

Table 6

Results of regressions

	big-loan	**small-loan**	**gfcf**	**gfcf**
spread_lag	0.060*** (0.018)	0.140*** (0.036)		
big-loan_lag			-1.460*** (0.405)	
small-loan_lag				-1.713*** (0.939)
crisis	-1.298*** (0.250)	-1.046*** (0.183)	-10.455*** (2.278)	-10.320*** (2.125)
ecb	-0.693** (0.324)	-0.342** (0.134)	-0.793 (2.253)	-0.889 (2.180)
const	5.281*** (0.153)	5.498*** (0.171)	10.366*** (1.681)	12.682** (5.200)
Number of observations	253	309	409	491
R^2	0.203	0.313	0.290	0.321

Standard errors are in parentheses;
*** denotes 1% significance, ** 5% significance, * 10% significance

The results show that, quite predictably, the (lagged) spreads of 10-year sovereign debt yields to the German equivalent are positively related to the interest rates on both smaller and larger loans. Small loans seem to have a closer link to sovereign debt developments than large loans. On average, the crisis seems to have had a negative effect on loan interest rates. A dummy for the ECB interventions is significant and has an expected negative sign. The coefficient of *ecb* is significantly higher in the large-loan regression, pointing to possible stronger effects on interest rates of major loans as compared to those of small loans. Interaction of *ecb* with *giipss* dummy has a significant positive coefficient in case of small loans, which confirms the trends observed in Figure 24.

Gross fixed capital formation was negatively affected by the crisis to a pronounced degree. Loan interest rates (for both sizes of loan) also have a significant negative impact. Trends seem to have undergone no major change after 2012Q2 as the coefficient of *ecb* is insignificant in regression (3) and only marginally significant in regression (4). This may be explained by the longer period that gross fixed capital formation required to react.

Why is the euro holding up?

The current crisis has raised the question of the sustainability of the common currency (Gligorov, 2013). There is no doubt that the euro area, not to speak of the EU common market, fails to satisfy the conditions for an optimal currency area. Although the flexibility of wages may have proved to be higher than believed and the same can possibly be said of cross-border labour mobility, it is hard to argue that they suffice to permit the requisite adjustment to asymmetric shocks, let alone adjustment to a systemic crisis.

As for financial integration, it has transpired to be less than it was supposed to have been. Once again, it is not clear that it is tool enough to lend efficient support in smoothing out asymmetric shocks and withstanding the risks of a systemic financial crisis. The situation calls for consumption smoothing: something that is certainly not happening. Although the latter objective has been achieved and measures have been taken to strengthen the banking union, they fall short of what in all probability is needed not only to stabilise the financial sector, but also to enable it to provide for the requisite diversification of risks across the currency union.

Finally, the fiscal system does not allow for cross-border transfers with the exception of funds that target agriculture and cohesion. Those funds, however, are not designed as tools for stabilising economic activity, but they do provide some sort of protective or developmental instruments. No instruments provide insurance coverage against risks to employment or other social risks; no budgetary resources are available for the implementation of stabilisation policies. Thus, on the face of things, it would seem that monetary policy instruments would also have to be renationalised in order to address the issues that arise from the lack of an optimal euro-based currency area within the EU.

Nonetheless, the euro has held up. Even though it might have forgone some of its attractiveness in policy-making circles in countries that have their own currencies, currency substitution does not seem to have declined nor has a search for an alternative reserve currency been launched. Indeed, the number of members in the monetary union is set to increase, albeit not perhaps as speedily as might have been expected in the good times. Interestingly enough, except for the switch from a currency board regime to membership in the euro monetary union, the exchange rate regimes pursued by most countries have not changed in any other way during the crisis. Fixed exchange rates have not collapsed; flexible exchange rates have not been abandoned in favour of fixed rates; those countries that set inflation targets have adhered to the policy regime; and currency boards have fended off all suggestions that they increase their flexibility.

The reason for the euro not losing its attractiveness is that countries with significant levels of currency substitution that use the euro as a reserve currency might well gain more support in terms of monetary policy were they to adopt the euro rather than sticking to their own currencies. Adhering to one's own currency invariably means almost permanent monetary austerity and makes for possible macroeconomic instability. In this context, it is interesting to consider the prices, real exchange rates and real wage-stability that various monetary regimes deliver. Looking at the data (Figure 26), countries that target inflation are often seen to achieve price stability, but with a certain increase in real exchange rates and real wage variability. Countries that use the euro or defend a fixed exchange rate tend to do better in terms of all three macro-stability indicators. By contrast, currency boards seem unable to stabilise prices; they thus experience volatile real exchange rates. The same can be said of the development of real wages.

Thus, for countries with currency boards, adoption of the euro brings about price stability as well as real relative price stability. Countries with fixed exchange rates, however, need to control wages, an additional requirement that may well prove a difficult task in most cases. As a consequence, they may have to rely on various restrictive practices and distortionary interventions in foreign exchange markets. Furthermore, if the country is euroised, a fixed exchange rate does not bring about a decline but tends to nudge domestic currency interest rates upwards. That then necessitates the introduction of various types of capital controls. In any event, the central bank essentially surrenders its claim to monetary policy proper, i.e. complete management of the setting of interest rates, as a tool for stabilisation.

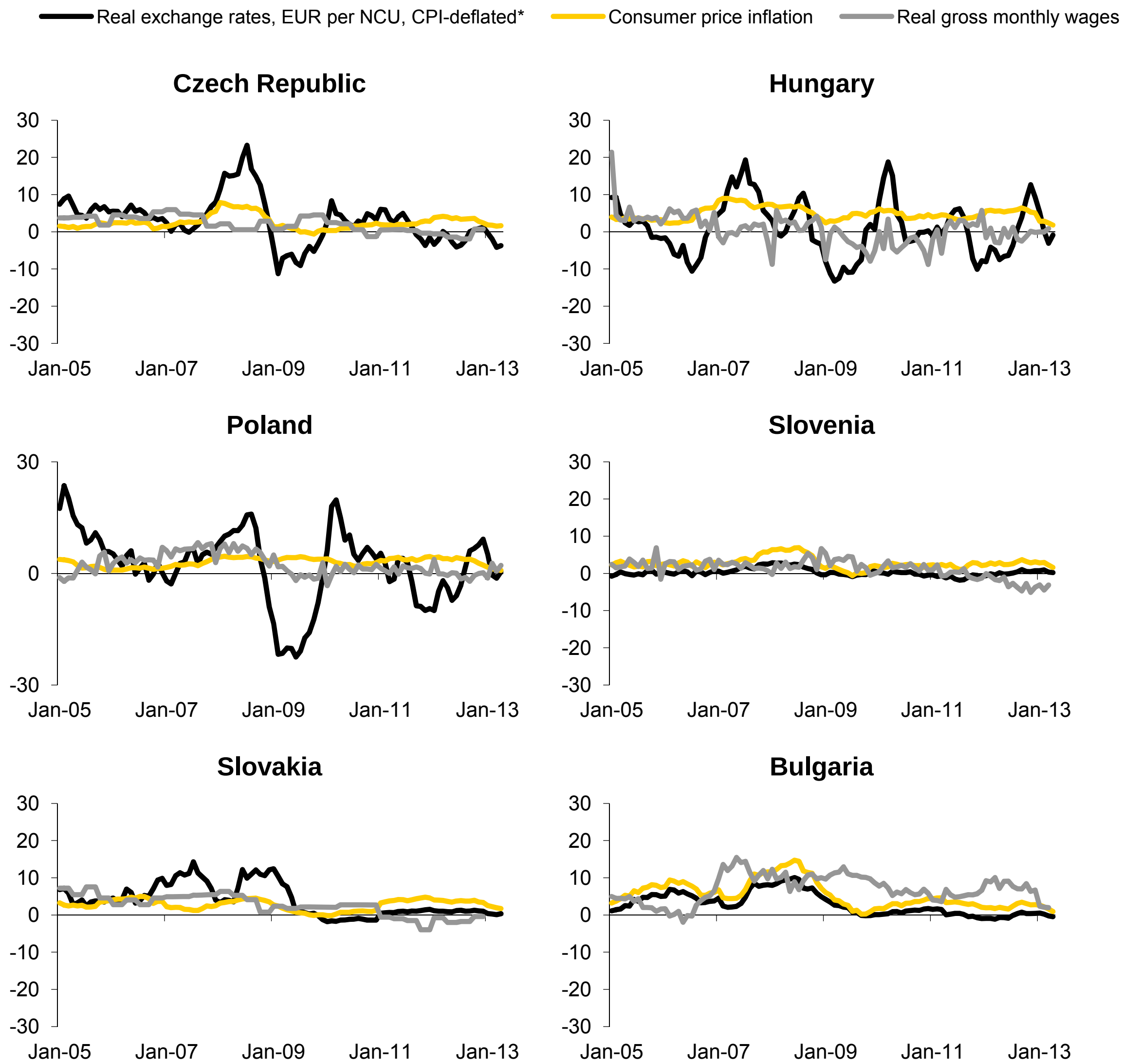
Countries targeting inflation tend to stabilise inflation, some at rates similar to those in the euro area and others at somewhat greater speeds; nominal exchange rate flexibility, however, does make for real exchange and wage rate fluctuations. Apart from external shocks, in most cases wage developments drive exchange rate developments. Serbia is an exception because basically it has a fixed exchange rate regime with periodic devaluations. As a result, none of these values has been stable and macro-stabilisation has been (and will be) a constant problem compounded in this particular case by growing imbalances.

This means that only in a few cases can it be argued that countries have been able to secure monetary sovereignty that allows them to intervene actively, should they so decide (see Woodford, 2010 for how and when this can work). Even in those cases (the Czech Republic comes to mind) the euro remains the reserve currency. That, in turn, puts pressure on the central bank to refrain from running too many risks, for instance, by getting involved in unorthodox measures designed to spur economic activity when the policy rate reaches the zero lower bound. In the case of the Czech Republic, foreign currency reserves are higher than 20% of GDP; they certainly more than cover the relevant monetary aggregates. Similarly, in other countries outside the euro area that use the euro as a reserve currency, foreign currency reserves are quite high irrespective of the exchange rate regime actually used. On average, foreign currency reserves to GDP ratios are around 25% irrespective of the exchange rate regime (currency board, fixed, inflation targeting or managed float; the ratio is lower in countries mostly outside the euro reserve currency area, e.g. Turkey, Russia, Ukraine, and Kazakhstan which are ones we cover in this report). Also, foreign currency reserves have increased, in most case quite strongly, since 2008 and 2009. Serbia and Bosnia and Herzegovina have seen their foreign reserves stagnate, while they have declined in Ukraine between 2010 and 2012.

Figure 26

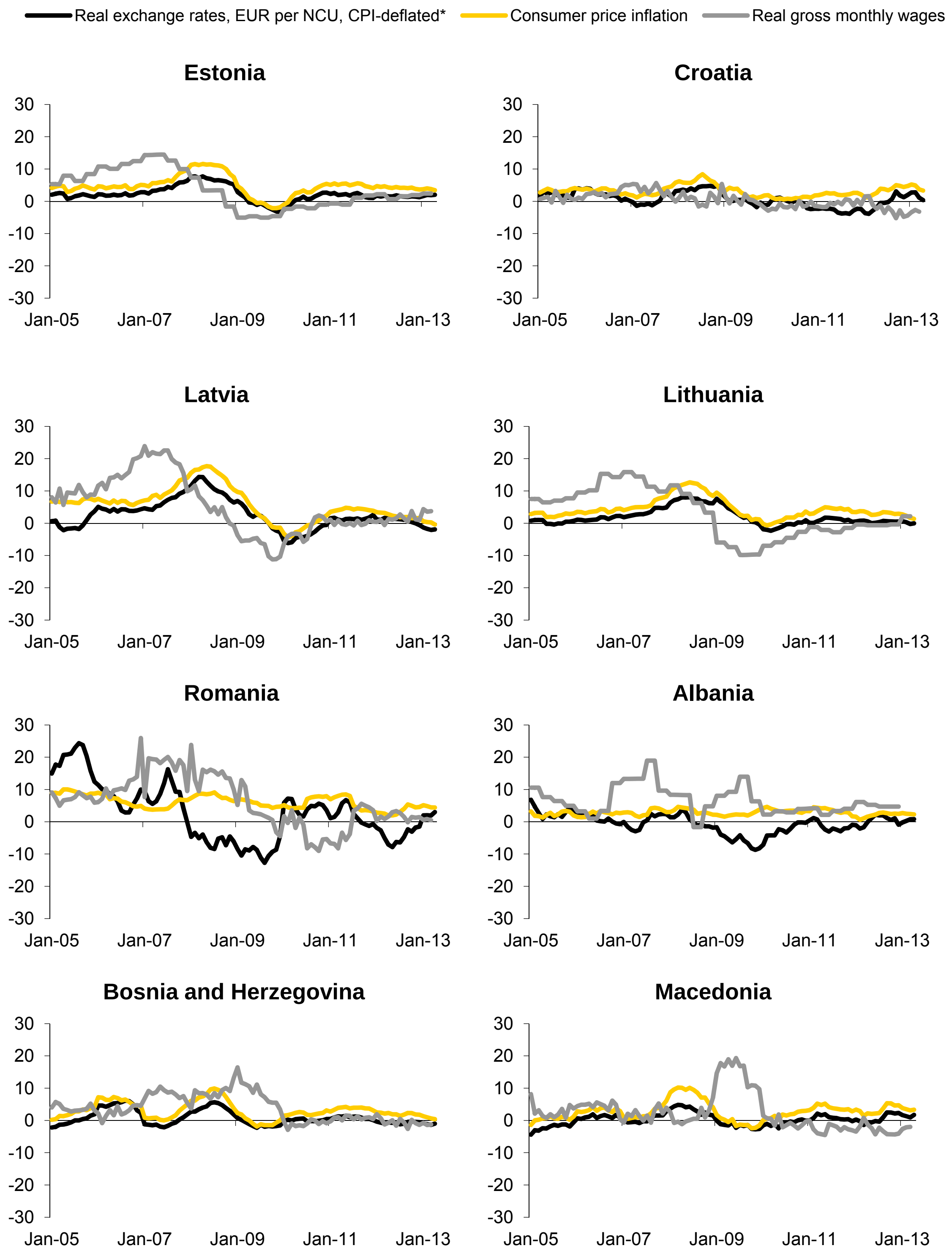
Exchange rates, consumer prices and wages 2005-2013

change in % against preceding year



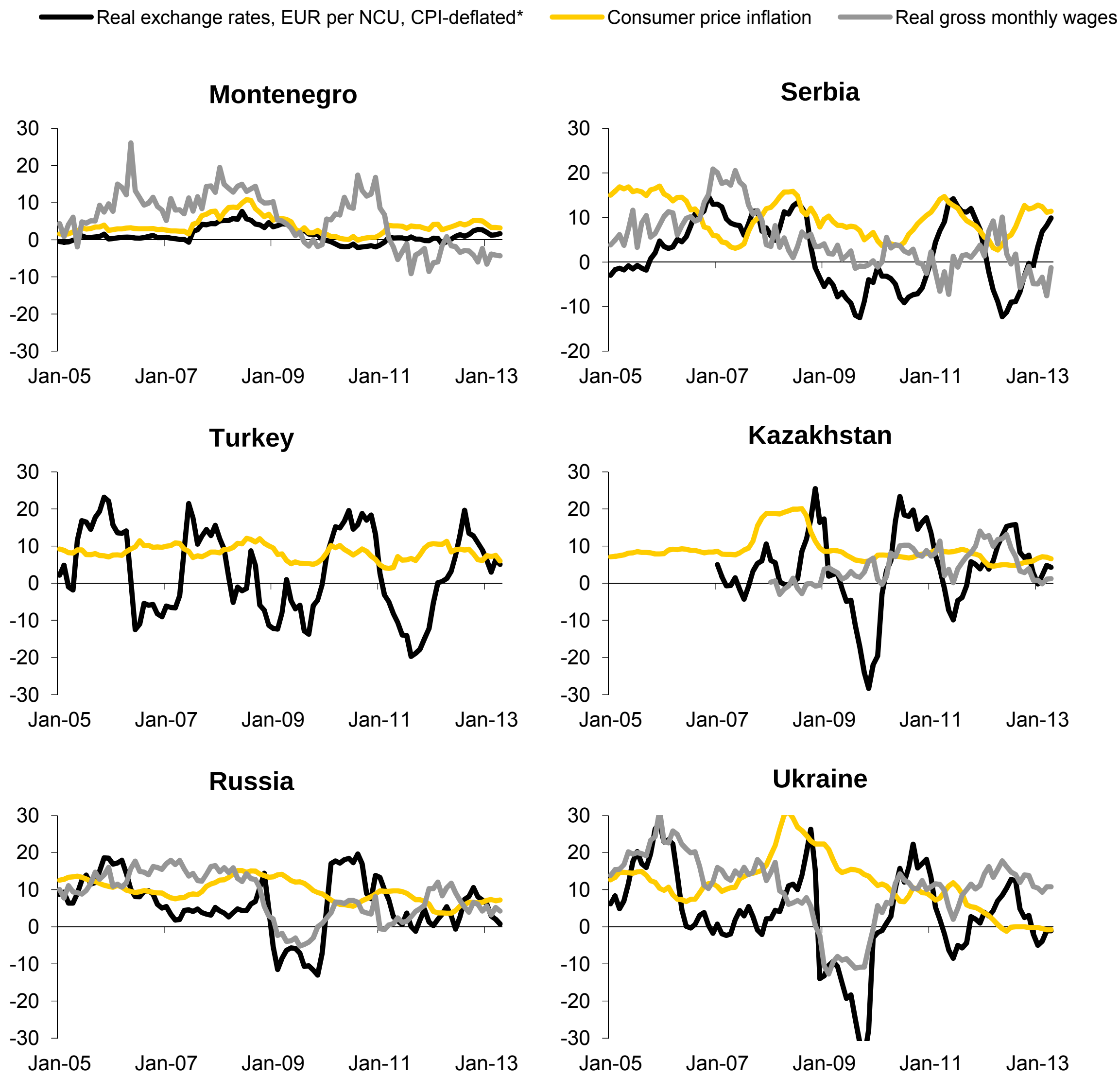
(Figure 26 ctd.)

Figure 26 (ctd.)



(Figure 26 ctd.)

Figure 26 (ctd.)



** positive values indicate real appreciation*

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Thus, for a variety of reasons, the euro is not as unpopular as may be expected because it provides, when the monetary authorities so decide, more of the country's own currency services than do actual or potential monetary sovereignties. For instance, in the oft-quoted comparison between the United Kingdom and Spain, it may be the case that the ECB is more of a proper central bank to Spain, when it decides to act like one, than the Bank of Spain would be, were it to issue pesos and retain the German mark as a reserve currency. Over the past few years this seems to have been the case throughout the euro crisis and in the absence of adverse political interventions, this stability should persist in the next few years. Indeed, stability would be even more pronounced, were the ECB to decide to adopt a more pro-active role in providing monetary support to economic activity than hitherto.

Is there a liquidity trap?

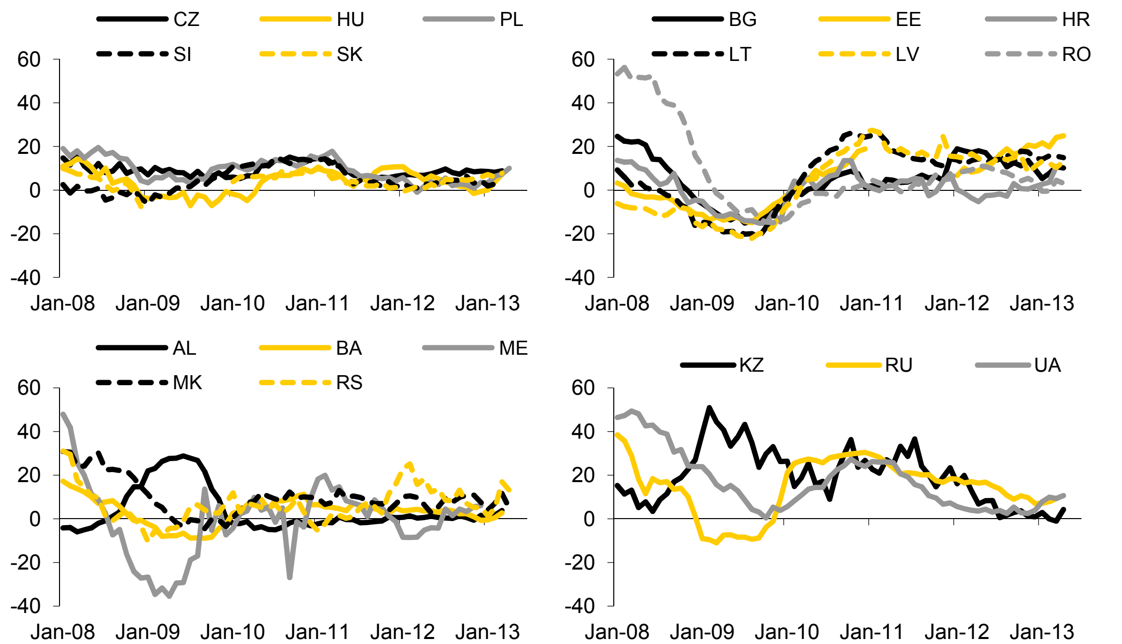
Unlike countries with reserve currencies, which in some way include the euro as well, monetary aggregates show slow growth in respect of M1 as well as in respect of M2 and M3 (Figures 27-29). In the euro area as in the sterling and dollar areas, M1 can be seen to be increasing rapidly, but that is not the case with M2 and M3, i.e. there is an indication for the existence of the liquidity trap. That divergence was the reason for introducing quantitative easing. In countries with both their own currencies and foreign reserve currencies, quantitative easing has apparently not been introduced.

Whereas the interest rates for sovereign loans clearly vary, the interest rates for outstanding corporate and household loans and those for new businesses show hardly any significant change. There is, however, a decline in credit, partly through repatriation and partly on account of the higher provisioning required to deal with non-performing loans that are still increasing as a percentage share of assets (Figure 30).

Figure 27

Money M1

change in % against preceding year



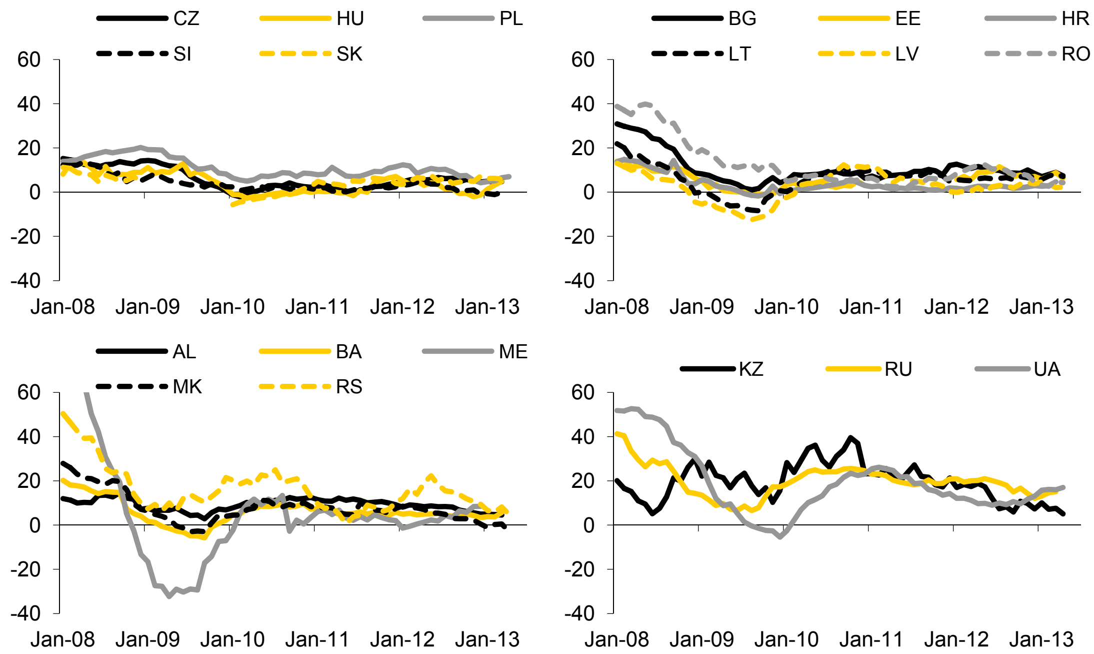
Source: wiiw Monthly Database incorporating National Bank statistics.

The corporate share of the non-performing loans is higher than that of the households often by a wide margin. That suggests that there is a rather widespread problem of solvency in the corporate sector in many countries. This is in particular the case of the countries with large construction industries which have seen dramatic declines in activity and sales. This adds to the need for the banking sector to both lower its asset exposure and to deleverage, which together account for the supply side contribution to the decline in credit activity. The demand side is also weak because of rather dim expectations for new investments as long as the corporate and banking sectors restructurings are not finished.

Figure 28

Money M2

change in % against preceding year

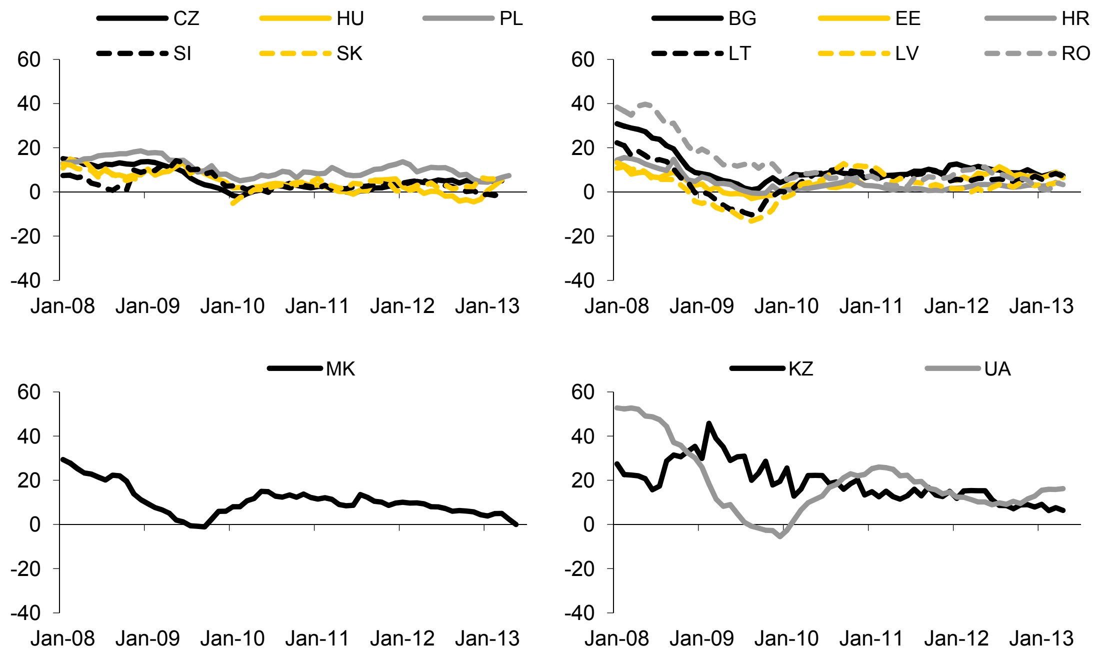


Source: wiiw Monthly Database incorporating National Bank statistics.

Figure 29

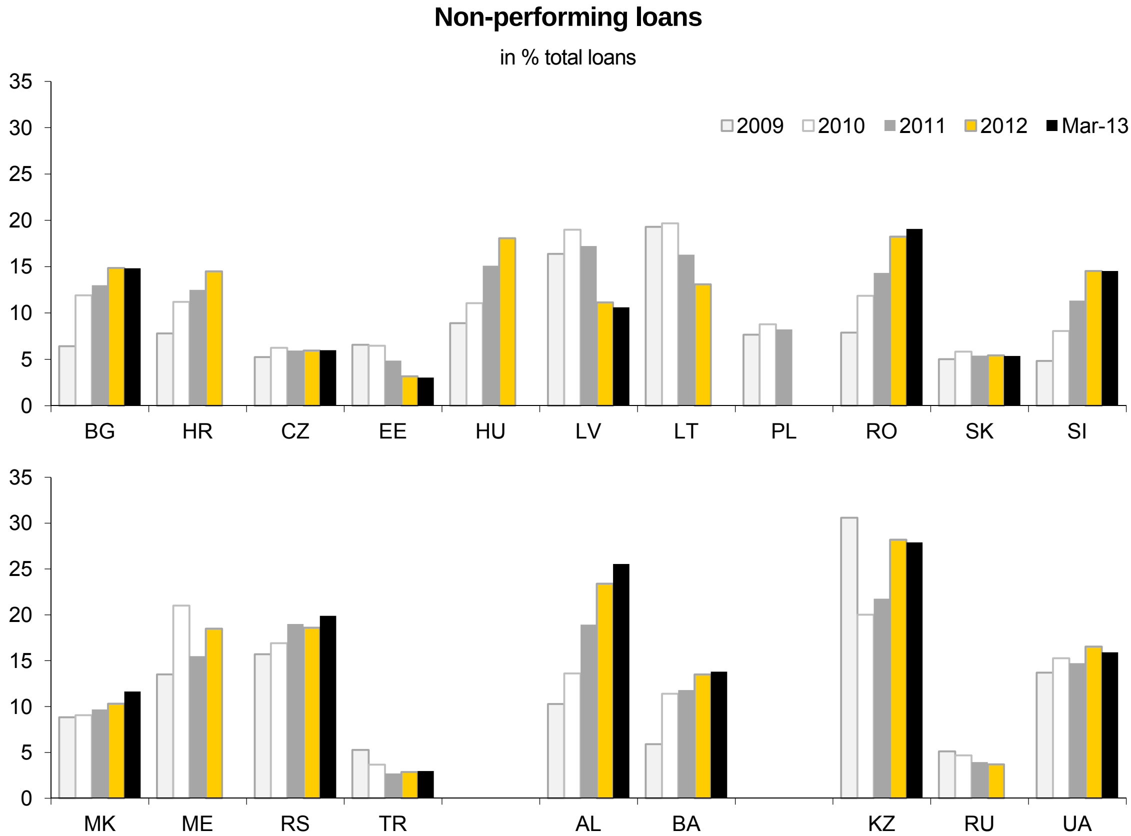
Money M3

change in % against preceding year



Source: wiiw Monthly Database incorporating National Bank statistics.

Figure 30



Source: National Banks statistics, wiiw calculations.

Labour market developments[5]

Employment developments differ substantially across the CESEE region and individual countries. In the Baltic States, which were hit hardest by job reductions during the crisis, employment growth – starting in tandem with GDP growth from the period 2010-2011 onwards - continued during the first quarter of 2013, most pronouncedly in Latvia. After four years of steady job losses, employment decline came to a halt in Bulgaria, while Slovenia suffered from the most severe employment contraction (-4.5%) since the outbreak of the crisis. In the Western Balkan countries, the number of workers continued to shrink, while in Russia and Kazakhstan employment maintained a moderate growth pattern. Employment levels in most new Member States, except Poland, are still below or far below levels reached in the pre-crisis period.

Following the (dramatic) drop over the period 2008-2009, employment rates started growing again in the majority of new Member States over the period 2010-2011 (Figure 31). Noticeable improvements were reported for the three Baltic countries, but they were not enough to permit a return to pre-crisis levels by the beginning of 2013. Employment rates similar to 2008 were reported for the

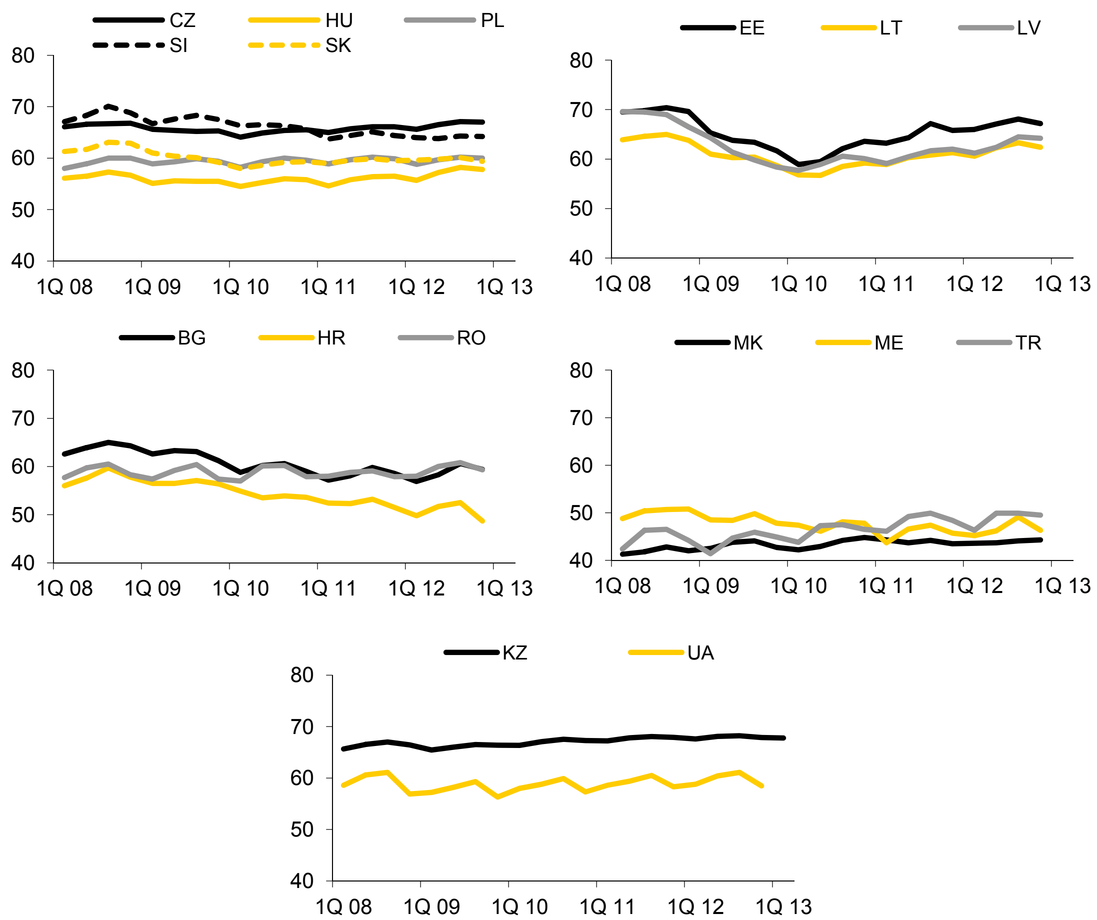
[5] This subsection was written by Hermine Vidovic.

Czech Republic; in all likelihood Romania will report the same. Conversely, in almost all Western Balkan countries (except Macedonia) and Slovenia, which prior to the crisis enjoyed one of the highest employment levels of all new Member States, employment rates continued to shrink throughout 2012 and in the first months of 2013. Croatia experienced an unprecedented drop in the employment rate down to 49%: the lowest ever reported rate - minus 11 percentage points compared to the pre-crisis level. In Serbia the employment rate dropped by 8.5 percentage points over a four-year period: 2008-2012. Bulgaria and Slovenia also reported a severe cutback of 6 percentage points compared to the pre-crisis period. Only in four countries, Turkey, Macedonia, Kazakhstan and Ukraine, did employment rates in 2012 exceed the levels reached in 2008. Seen in gender terms, men have borne the brunt of the slump in employment rates during the crisis; they are still worse off than women compared to the pre-crisis period in all new Member States, except the Czech Republic; a similar situation obtains in Macedonia and Turkey. Consequently, since the onset of the crisis, the gap between male and female employment rates has decreased in all countries.

Figure 31

Employment rates total

employed in % of working age population (15-64)



Remark: KZ, 15+, UA 15-70.

Source: Eurostat, national statistics.

Unemployment situation of young people further deteriorating

With the exception of the Baltic countries, where GDP growth has recovered at remarkable rates over the past two to three years, the rise in unemployment in the new Member States has not yet come to a stop. The labour markets in Slovenia and Croatia have greatly deteriorated, while unemployment has remained stagnant in Hungary and Slovakia; this has in all likelihood been the case in both the majority of Western Balkan countries and in Kazakhstan. The marked rise in unemployment during the crisis has turned somewhat belatedly into burgeoning long-term unemployment (unemployed for more than a year). In the new Member States the share of long-term unemployed in total unemployment increased to about 50% (EU-27: 45%), with the highest value reported for Slovakia and Croatia, where slightly less or slightly more than two thirds of those unemployed are long-term. Only in the Czech Republic and Poland is the share below the EU-average.

In some countries labour migration prevented unemployment from rising much faster. For example in Slovakia, recording an unemployment rate of 14.5%, employment abroad (for less than a year) increased by 19% to 136,000 persons (or almost 6% of total employment) during the first quarter of 2013. As indicated by the recent population census, apart from the natural decrease, migration has played an important role in the reduction of the population in Lithuania, Latvia and in Albania over the past decade. Albania and Lithuania have observed a remarkable return migration recently, owing to the poor economic situation in the main host countries (Italy, Greece) of Albanian labour migrants, while Lithuanians returned due to the improvement of the economic environment in their home country. Also migration from Bulgaria and Romania has gained momentum particularly after EU accession in 2007 and continued even during the crisis. In 2012 the stock of Romanian migrants in the EU-15 totalled 2.5 million persons and that of Bulgarian migrants 486,000. Recent migrants from the NMS are in most cases young and highly qualified people.

In common with most EU-countries young people in the CESEE region have been hit inordinately hard by unemployment; the situation, however, varies across the region and individual countries. During the first quarter of 2013, the unemployment rate for those aged 15-24 years ranged from 19% in the Czech Republic to over 50% in Croatia (the third highest rate in the EU after Greece and Spain). With the exception of Latvia, Lithuania and Bulgaria, the prospects of employment for young people worsened in all new Member States. In most of the Western Balkan countries, the situation turned from (traditionally) bad to still worse, with youth unemployment rates up to almost three times higher than the EU-average. Where young people are concerned, unemployment rates range between 41% in Montenegro and 63% in Bosnia and Herzegovina; the rate for Serbia and Macedonia is somewhere between the two. Anecdotal evidence from Serbia suggests that, given the poor labour market situation, young people are overrepresented in informal sector activities, tending to return back to schooling or leave the country.

Since the group of 15-24 year-olds includes numerous pupils and students, unemployment rates can only partially describe the extent to which young people are excluded. By focusing on the share of persons aged 15-24 who are neither in employment nor in education and training, a concept known as NEETs, a more accurate picture emerges of the vulnerability of young people in the labour market. In the EU NEETs have become an important group, whose predicament was addressed in the *Youth on the Move* initiative within the context of the Union's 2020 strategy as well as in its Employment Package. The NEETs group is highly heterogeneous across the EU, but also in the new Member States. Eurofound (2012) identified four different clusters, including countries with certain similarities.[6] The new Member States are thus represented in three clusters:

Cluster 2: the cluster with the highest NEET rate comprises Bulgaria, Hungary, Poland, Romania and Slovakia alongside Italy and Greece where, compared with the EU-average, the share of women in the work force is higher, the young people have little or no work experience and the share of discouraged workers and those with tertiary education is higher.

Cluster 3: the cluster with an above-average NEET rate comprises the three Baltic countries (and Spain, Ireland and Portugal), where the majority of those unemployed are male, with work experience and highly developed skills, yet the share of discouraged workers is higher than the EU-average. The NEET rate in this cluster of countries is mainly driven by unemployment as a consequence of the crisis.

Cluster 4; The cluster with a below-average NEET rate comprises the Czech Republic and Slovenia (together with Cyprus, Belgium, France and Luxembourg) where most of the unemployed are female with median skills, while despite having work experience the NEETs are mainly unemployed and the share of discouraged workers is below the EU-average.

After a period of decline at the beginning of the present century, the NEET rates in all new Member States started to increase in the wake of the crisis; only in Latvia and Lithuania was a noticeable improvement to be registered that started as of 2011. In 2012, the year for which the most recent data are available, the situation varied remarkably across countries. In both Slovenia and the Czech Republic that reported NEET rates of 9%, as well as in Poland, Estonia and Lithuania, the situation was better than or similar to the EU-15 average (close to 13%). Of all the new Member States, Bulgaria – an outlier throughout the decade – recorded the worst NEET rate: 22%. In Macedonia and Turkey, the NEET rate dropped steadily from initially high levels over the past few years, but in 2012 it still accounted for 24% and 28%, respectively.

Overall, during the crisis the share of people facing the risk of poverty in the EU-27 increased from 23.5% in 2008 to 24.2% in 2011 (the most recent data available). Not only in the NMS but also in the EU as a whole, the highest shares of persons facing the risk of poverty were reported for Bulgaria (49%), Romania and Latvia (both 40%), Lithuania and Croatia (33%), Hungary (31%) and the lowest in the Czech Republic (15%). The share of young people in the EU confronted by the threat of poverty or social exclusion is even higher and stands at almost 30%. By all accounts, poverty increased still further in 2012.

[6] NMS are not represented in Cluster 1 that comprises continental and Nordic countries with low NEET rates.

Labour market prospects

Given the weak economic activity, the labour market in the new Member States is only expected to improve in the medium term. The risk of cyclical unemployment becoming structural is on the rise. With the exception of the Baltic countries, unemployment will further increase in 2013 and drop only gradually thereafter; overall it will stay much above the pre-crisis level. The outlook for the Western Balkan countries remains gloomy. Only in Albania should unemployment decline slowly from 2014 onwards, while joblessness is expected to remain persistently high in most countries in the region, affecting young people in particular. Considering that the share of young people facing the risk of poverty is on the increase, there is every risk of social unrest and political instability increasing in the countries affected most. As for Turkey, we expect a moderate but steady decline in unemployment. Forecasts for Kazakhstan point to unemployment stagnating at a rate of 5%. In Russia and Ukraine, unemployment is expected to stabilise at levels ranging between 6% and 7.5%.

Revolutions ahead?

The impact of the crisis on the labour markets has been especially pronounced in the GIIPS countries and the Balkans. Overall social security and stability have deteriorated especially in the Balkans. In other countries, there have been fewer social conflicts and disturbances. One reason is the minor role played by trade unions and other organisations that could be instrumental in mobilising society. Almost everywhere throughout the region these bodies are generally weak; any clout that they may have is mostly restricted to those areas where government employees can look back on a tradition of actively pursuing their interests. Another reason is linked to the character of the political regime.

By way of example, events show that in a number of countries some party systems have basically collapsed with either new parties emerging or old parties being taken over by newcomers who often subscribe to different ideologies. This collapse has occurred in countries such as Italy or Slovenia while the introduction of changes in old parties and the emergence of new parties is characteristic of Greece and Serbia, but also occurred much earlier in Bulgaria and later on in Hungary. It could well happen in other countries as well. Something along those lines may be taking place in real time in Bosnia and Herzegovina where the party and political systems have all but collapsed. In a way, all this is a legitimacy issue. In other cases, such as Turkey, Hungary, Serbia, Bosnia and Herzegovina, and Macedonia, either authoritarian tendencies have come to the fore or society is disaffected with the stabilisation of authoritarian regimes, Russia perhaps being an example of the latter.

The hypothesis is thus as follows (compare Przeworski, 2008). In democracies, social protests are contained by the political process, except in those instances where the legitimacy of the party system can be challenged. In more authoritarian regimes, social protests have a larger role to play because they can either support or challenge the authoritarian tendencies. Hungary might be a case in point for the former, while Turkey might be a case in point for the latter. In dynamic terms, the collapse of a party system may give rise to authoritarian tendencies, which, in turn, may encounter societal pressures that could ultimately lead to democratisation.

In this context, when interpreting social conflicts and their expression in the form of strikes, demonstrations or manifestations of various kinds, it is useful to know the character of the regime in which those events occur. So far, not unrelated to the influence of the EU, authoritarian challenges have been contained, but not eliminated owing to the collapsing legitimacy of party systems. In other cases, social protests have been aimed at regimes with authoritarian tendencies and have furthered the democratisation process.

In general, the expectations are that social conflicts and political transitions will continue and the issue of maintaining stability may become even more prominent.

EU deepening and widening

The second deep recession and slow recovery in the European economies is not solely attributable to policy constraints, especially in the euro area; however, those constraints have certainly had an impact. The stance adopted by the EU has been to work on reforms that will strengthen various aspects of its governance structure, but the emphasis has been on efforts to check the imbalances that arise on account of the EU and the euro area not being an optimal customs and currency area. In that setting, it is of paramount importance to decide whether surplus or deficit countries should lead the adjustment process, as well as to determine the role of the monetary and fiscal authorities in that process.

Here again, at least two groups of problems present themselves. One group relates to the significant distributional problems that arise for want of an institutional infrastructure capable of delivering appropriate solutions, as well as those political issues that may prove hard to resolve, even if adequate instruments are available. The other group of problems relate to the difficulties associated with engineering the requisite increase in expenditure on both consumption and investment, in the public sector as well as in the private sector. Markets do not necessarily coordinate particularly well, but political coordination has also proven to be just as difficult and disappointing.

The EU should have been solving the inter-Member States distributional problems through the process of the deepening of the union. That means addressing the issues of the banking union and the fiscal union primarily. Their design, however, so far at least has been done under the assumption that distributional effects should be minimised. This is for the fear of the permanent transfer union being established. This approach will prove to be a drag to the process of institution building and to the process of the 'ever deeper union'.

This so far has not made the EU less attractive to prospective members in the Balkans. Indeed, Iceland has given up its bid to join the EU, but that was always to be a special case. Turkey is in two minds as is the EU when it comes to Turkish membership, but that is not a new state of affairs. In the rest of the Balkans, with the decision on the start of negotiations with Serbia, the process of enlargement will get a new momentum. It is hard to predict the effects on Macedonia and Bosnia and Herzegovina in the short run, but in the long run that will boost their interest in joining the EU and also their chances that they will eventually succeed.

New growth model

Convergence growth was characterised by imbalances, which proved sustainable in some cases and unsustainable in others. During the crisis and especially during the scare surrounding the possible disintegration of the euro, targeting those imbalances became the key ingredient in the policy stance adopted by the EU and euro area. This implies that those imbalances will not be allowed to develop even after the current second dip recession has passed. Less developed countries are advised to rebalance their economies and develop a new growth model. It is, however, not clear whether this new growth model is compatible with the customs and currency unions, as well as with the new institutions that are being developed to strengthen the banking and fiscal unions and further liberalise the common market.

The main drivers of growth in the EU have been growing trade and cross-border investments. The new emphasis on sustainable imbalances does not necessarily go against this model. However, it does suggest that Member States should manage their economies in such a way that they will rely more on domestic investments and on domestic demand rather than on the previous convergence growth model. So far, it does not seem that the necessary policy switch has been happening in most of the less developed countries in the EU and in particular in the Balkans. There is also an implicit tension in the intended widening of the institutional infrastructure with the banking and fiscal unions, on the one hand, and the increased stress on more balanced growth within the Member States, on the other.

Conclusion and prospects

The second dip recession in the EU, the euro area and in the countries closely connected with the EU has been mostly the consequence of policy risks and mismanagement. With the fate of the monetary union more secure and with improved prospects in some important foreign markets, e.g. in the USA, slow recovery should be expected which may speed up in the medium term. This is also what can be expected in most CESEE countries. Developments in Turkey, Russia, Ukraine, and Kazakhstan are to a varying degree autonomous from these developments and reflect domestic market and policy challenges. Prospects for Turkey and Kazakhstan are markedly better than for Russia and Ukraine.

These slowly improving conditions are predicated on the improvement in investments. So far those have failed to recover and overall circumstances are not altogether encouraging at least in the near future. That goes not only for public but also for private investments. Given the constraints on the former, there is even more than usual of a dependence on the latter. Those are disadvantaged by the state of the corporate sectors, by the prolonged bank consolidation process, and by the growing emphasis on rebalancing of growth. So, animal spirits may remain dimmed in Europe in the medium term.

Labour markets have taken a severe hit in many countries and some of the social and political consequences have started to emerge. That is going to continue testing the national and the EU institutional and policy frameworks in ways that may not be easy to forecast. That makes pro growth policies even more important, but the overall framework for those is mostly long term and thus not necessarily helpful enough in the short and medium runs.

Overall, slow recovery seems as a safe forecast for the medium run.

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Sándor Richter

Special Section I: Macroeconomic conditionality: a threat to cohesion policy transfers from 2014 onwards?

Introduction

On 19 June the Council of the Finance Ministers of the EU (ECOFIN) abrogated the excessive deficit procedure for five countries: Hungary, Italy, Latvia, Lithuania and Romania. At the same time, ECOFIN opened an excessive deficit procedure for Malta. Currently, 16 Member States are involved in ongoing excessive deficit procedures. So far no sanctions have been imposed on any EU Member State on grounds of a lasting violation of or non-compliance with thresholds set in the Treaty. However, Hungary, which had been subject to an excessive deficit procedure for nine years, came very close to being sanctioned in the form of partial suspension of Cohesion Fund transfers in the biennium 2011-2012.[7]

This may fundamentally change as of next year. As affirmed in a note issued by the European Parliament in 2012, the EU has hitherto been unable to prevent major crises in Member State public financing: a situation which calls for the introduction of wide-scale macroeconomic conditionality. In future, macroeconomic conditionality shall cover all economic governance procedures and apply to both fiscal and macroeconomic issues.[8] In the Multi-annual Financial Framework 2014-2020, as approved by the European Council on 7-8 February 2013, macroeconomic conditionality with respect to transfers from the EU budget will assume an important new role. As conditionality will be linked to budgetary transfers that fund vitally important development projects, especially in the new Member States, this section of the overview looks at the concept, measures and possible impacts of macroeconomic conditionality in the forthcoming Multi-annual Financial Framework 2014-2020. Although the new framework has yet to be approved by the European Parliament and thus changes to the draft may be expected, the known points of conflict between the European Council and the European Parliament do not include macroeconomic conditionality. Thus, no changes in that respect are to be expected.

The concept

In setting the strategic direction for the next financial planning period, the EU established in 2012 the Common Strategic Framework (CSF) that combines various funds including the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund

7 See more on that in the country report on Hungary in this publication.

8 European Parliament (2012), Macro-Economic Conditionalities in Cohesion Policy. A note by the DG for Internal Policies, Policy Department B: Structural and Cohesion Policies, p. 9.

(EMFF).[9] The bulk of the resource redistribution across Member States in the EU is implemented through the funds currently pooled in the CSF. Resources drawn from the funds under the umbrella of the CSF will be made conditional on the recipient countries pursuing 'sound economic policies'.[10]

Suspension of financial support from the Cohesion Fund was one possibility already provided for in the Multi-annual Financial Framework 2007-2013 when a Member State was found to be at an advanced stage in the excessive deficit procedure In fact, that option, sometimes called 'the nuclear option', has never been applied, although in 2012 Hungary came very close. In a last-minute move to avoid sanctions for non-compliance, Hungary adjusted its fiscal policy in order to meet the required deficit target. Another type of conditionality appeared in the macroeconomic adjustment programmes for Greece and Portugal, the two Member States currently enjoying EU financial assistance. A formal commitment of the two countries to accelerating the absorption of resources from the Structural Funds and the Cohesion Fund became part of the conditions laid down in the adjustment programmes.[11]

In the forthcoming Multi-annual Financial Framework 2014-2020, the opportunity to bring closer together the goals of European governance and cohesion policy will enter a new dimension. As a supplement to the already existing requirement to observe fiscal targets as prescribed by the Stability and Growth Pact (Maastricht criteria), compliance with prescriptions of the Macroeconomic Imbalance Procedure (MIP), a pre-emptive surveillance mechanism that aims at identifying potential risks at an early stage, will be added.[12] Once a Member State is found guilty of 'lasting non-compliance', the second, corrective arm of the MIP, known as the Excessive Imbalance Procedure (EIP), is applied. The consequences of non-compliance with the EIP may entail the suspension of CSF funding for the country concerned.[13]

The sanctions

It will be easier in future to reach a decision on sanctions than in the context of the current Multi-annual Financial Framework. The European Council will automatically adopt a proposal put forward by the Commission, unless it is rejected by a qualified majority of Member States within one month.[14] As for the extent of the CSF transfers suspended, no minimum level is set, although an upper level or maximum is stipulated. The Council opted for a 'double capping' methodology:

- 'a capping of maximum 50% of the CSF funds in the first case of an excessive deficit procedure (EDP) and maximum 25% of the CSF funds in the first case of an excessive imbalance procedure (EIP). The level of the suspension should be gradual and increase up to a maximum of 100% of the CSF funds in the case of an excessive deficit procedure and up to 50% of the CSF

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9 European Commission (2012), COM 496 final, Brussels, 11 September.

10 European Council (2013), Conclusions (Multiannual Financial Framework), EUCO 37/13, Brussels, 8 February.

11 Marzinotto, B. (2012), p. 5.

12 For the indicators to be applied for monitoring macroeconomic imbalances see Table 2 on p. 17 in this report.

13 For details see: European Council (2013).

14 European Council (2013), p. 33.

funds in the case of an excessive imbalance procedure, in line with the seriousness of the breach;' or

- 'a capping of a maximum 0.5% of nominal GDP applying to a first breach of an excessive deficit procedure (EDP) … of the CSF regulation and a maximum of 0.25% of nominal GDP applying to a first breach of an excessive imbalance procedure (EIP) … of the CSF regulation. If non-compliance persists, the percentage of this GDP cap should be gradually increased up to a maximum of 1% of nominal GDP applying to a further breach of an excessive deficit procedure (EDP) … and a maximum of 0.5% of nominal GDP applying to a further breach of an excessive imbalance procedure (EIP) … in line with the seriousness of the breach.'[15]

In formal terms, the sanctions introduced in the case of non-compliance are uniform across Member States, but their potential impact is highly asymmetric. It is obvious that the first cap expressed in terms of the CSF funding is tailored to the circumstances of the contributor Member States, while the second cap in terms of GDP to those of the beneficiary Member States. In the former group, CSF transfers play a much smaller relative role in the economy than in the latter. [16] The stimulus threshold must thus be set high so as to jeopardise the whole pool of CSF resources in the event of non-compliance.

By way of contrast, in net beneficiary Member States, CSF transfers compared to the economy as a whole are much more relevant. In a worst-case scenario, the sanction imposed on a Member State is particularly severe: either the 100% suspension of the CSF funding or part thereof amounting to 1.5% of the country's GDP. Even in the second, less severe option, of the 17 potential net beneficiary Member States in the 2014-2020 budgetary period, six would acquire net contributor status (Cyprus, Spain, Ireland, Slovenia, Malta and Greece). The net financial position of a further five countries that originally were net beneficiaries (Portugal, Croatia, the Czech Republic, Slovakia and Poland) would also change. Those countries would have to relinquish a much more favourable foreseeable position without sanctions and would only attain a net financial position in the range of 0-1% of their nominal GDP. Even the three potentially best-positioned Member States, Bulgaria, Hungary and Lithuania, would lose, at a rough estimate, about 40% of their cohesion policy and rural development resources.[17]

Simultaneous with the introduction of macroeconomic conditionality attached to CSF funds, macroeconomic conditionality as part of the European governance will certainly remain in place. In this respect euro area members are distinguished from non-euro area members. Member States belonging to the former group may lose additional CSF transfers and, furthermore, may be obliged to place a deposit ranging from 0.2 to 0.5% of their GDP in the event of their violating the Stability and

[15] European Council (2013), p. 33.

[16] CSF transfers relative to the GNI in the range of 0.06% (Netherlands) to 0.37% (Italy); 2011 data. Cohesion policy 2007-2013 Commentaries and official texts. European Union Regional Policy. Guide January 2007, p. 25; Official Journal of the European Union, 22.9.2006. L 261/32; EU budget 2011 Financial Report, p. 102; own calculations; http://ec.europa.eu/fisheries/documentation/publications/cfp_factsheets/european_fisheries_fund_en.pdf

[17] Calculations based on an estimation of the Ministry of Finance, Austria: 'MFF 2014 bis 2020. Ergebnisse ER 7./8.2.2013', FIW lecture, Vienna, 14 February 2013.

Growth Pact. The fine is imposed annually up until such time as the Council decides that sufficient progress has been made to reverse the fiscal imbalance.[18]

Sanctions and the fiscal deficit

The note published by the European Parliament argues that macroeconomic conditionality has a less immediate effect on the fiscal balances of a sanctioned Member State than the sanctions introduced in the context of European governance, where a deposit must be made from the national budget. Indeed, if a Member State is in breach of the Stability and Growth Pact on account of the fiscal deficit being higher than allowed, it will be penalised and compelled to pay a fine that immediately increases the fiscal deficit, while the original target continues to be aimed at reducing that deficit. By way of contrast, the financial sanctions tied to non-fulfilment of the macroeconomic conditionality in the Multi-annual Financial Framework will not have this immediate deficit-deteriorating effect.[19] Although the impact of sanctions associated with macroeconomic conditionality may be indirect, its extent should not be underestimated. EU co-financed projects constitute a large part of public investment in several new Member States. In Bulgaria 95% of public investment comprises EU co-financed projects[20], anecdotal evidence also suggests a similar proportion in Hungary. That means that a radical reduction in SCF transfers would have to be offset either by increased government expenditure so as to maintain the level of public investment already achieved or it would trigger radical cuts in public investment. Most probably, a combination of the two would occur.

The first option would immediately increase the fiscal deficit, the second would hurt economic growth, leading, *ceteris paribus*, to a deterioration in the fiscal deficit/GDP ratio. Taking into consideration the fact that sanctions tied to conditionality in the Multi-annual Financial Framework are three times as large as the extent of sanctions attached to the violation of the Growth and Stability Pact (assuming worst-case scenarios in both instances), the overall negative budgetary impact of conditionality sanctions in the Multi-annual Financial Framework may thus not be so different after all.

Sanctions and economic growth

In any event, the impact on economic growth is a precarious issue. Major beneficiaries of cohesion policy may easily find themselves confronted by a dilemma that lacks a good outcome. On failing to comply with the Maastricht deficit target in a recessionary state of the economy, the governments in breach will have to choose between: (i) decreasing the deficit and thus cutting aggregate demand with all the consequences that implies in terms of a deterioration in their growth outlook; or (ii) maintaining aggregate demand without cutting the fiscal deficit, thus provoking the imposition of sanctions which in turn worsens the country's growth prospects on account of cuts in public funding and private investment following suspension of a portion of the CSF funding. A country may even enter into a downward spiral starting either in the guise of a decreased deficit followed by slower or negative

[18] European Parliament (2012), p. 25.

[19] European Parliament (2012), p. 42; Tokarski and Verhelst (2012), p. 4.

[20] 'EU Budget 2014-2020: Views from across Europe after 7-8 February 2013', *Bulletin of European and CIS Studies*, Special edition, Moscow, March 2013, p. 6.

growth, or in the form of a decrease or even increase in the deficit followed by a consequent suspension of EU transfers, which once again may diminish growth and worsen the deficit. As discussed above, sanctions attached to the ex-post conditionality of the Multi-annual Financial Framework will be mandatory and automatic; limited space will be left for discretionary interventions that take into consideration the special situation of individual Member States.

In planning and implementing cohesion policy-related projects, due account must be taken of long project cycles and a series of interrelated stages. If macroeconomic conditionality leads to sanctions and transfers are suspended, that may negatively influence the lifecycle of a project and lead to a serious drop in efficiency. In the worst case, economic growth may be negatively influenced by failed projects. This means increased uncertainty leading to a shift in attitude towards planning with EU funds, while co-financed EU projects will become less ambitious. Especially in Member States where suspension of funds is a real possibility, if reliance on EU co-financing is less than potentially possible, it may have negative consequences on the country's growth potential. Finally, suspension of EU funds for cross-border projects in one participating Member State may seriously harm the interests of another, possibly 'innocent' participating country. An interesting contradiction presents itself in the case of Member States under EU assistance programmes. If they fail to comply with the memorandum of understanding they signed with the lenders, those countries face the threat of sanctions, as is the case with Member States involved in the EDP or EIP. That notwithstanding, the European Commission could also opt to increase the EU co-financing rate for Member States under EU assistance programmes from 85% to 95%, as happened recently.[21]

Macroeconomic conditionality may be a new feature in the EU, but it is certainly not a new or unusual feature in an international context. In IMF and World Bank programmes, conditionality, be it reform requirements, have been the cornerstone of agreements. As explained in the note issued by the European Parliament, international organisations today are 'shying away' from pre-defined macroeconomic conditionality. Conditions have become more flexible; both the IMF and the World Bank place more weight on national ownership of programmes.[22] None the less, the usefulness of conditionality has not been borne out by evaluations of international organisations' lending programmes.[23]

If the consequences of a possible suspension of CSF transfers are assumed to be so serious, the question must be raised whether there are other ways of reaching the very same goal: the adjustment of fiscal and economic policy in a Member State. Suspending a Member State's voting rights in the European Council would be one such sanction. The introduction of non-financial sanctions has already been proposed, but to no avail.[24]

[21] European Parliament (2012), p. 39 and Tokarski and Verhelst (2012), p. 4.

[22] European Parliament (2012), p. 44.

[23] Dreher (2009).

[24] European Parliament (2012), p. 42.

Concluding remarks

Member States will find it far more difficult to gain access to CSF funds in the upcoming Multi-annual Financial Framework than is currently the case. The potential impact of sanctions on grounds of non-compliance is asymmetric; net beneficiary Member States may lose substantially more resources than net contributors. While the Union's basic concept is justifiable in the sense that everything must be done to avert a crisis, such as the one that hit the southern periphery countries, the main beneficiaries of the cohesion policy in the nineties and early noughties, particularly hard, the solution proposed may prove counterproductive. Under certain unfortunate circumstances, the suspension of large segments of pre-allocated CSF funding may give rise to further deterioration of the fiscal stance in net beneficiary Member States and their economic growth may well decelerate. Adopting preventative measures so as to avoid sanctions may also lead to a slowdown in economic expansion and a deterioration of fiscal balances. A less painful form of financial sanctions, combining financial and non-financial penalties, incorporating a limitation on automatisms in the process and according a greater role to discretionary decisions where the specific circumstances prevailing in individual Member States situation may take on greater importance, would provide a more satisfactory tool for strengthening discipline than the sanctions foreseen for introduction in 2014.

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Mario Holzner

Special Section II: Croatian EU accession and regional trade patterns

Croatia entered into the Central European Free Trade Agreement (CEFTA) in 2003. Soon thereafter most of the other members of CEFTA withdrew from the agreement and joined the European Union (EU). As a consequence, the Czech Republic, Hungary, Poland, Slovakia and Slovenia left CEFTA in 2004, only to be followed in 2007 by Bulgaria and Romania. The sole country to join the free trade agreement in that period was Macedonia; it entered in 2006. At their summit meeting on 6 April 2006 in Bucharest, the prime ministers of Southeast Europe adopted a joint declaration on the expansion of CEFTA so as to include Albania, Bosnia and Herzegovina, Moldova, Serbia and Montenegro, and Kosovo. A year later those countries joined CEFTA.

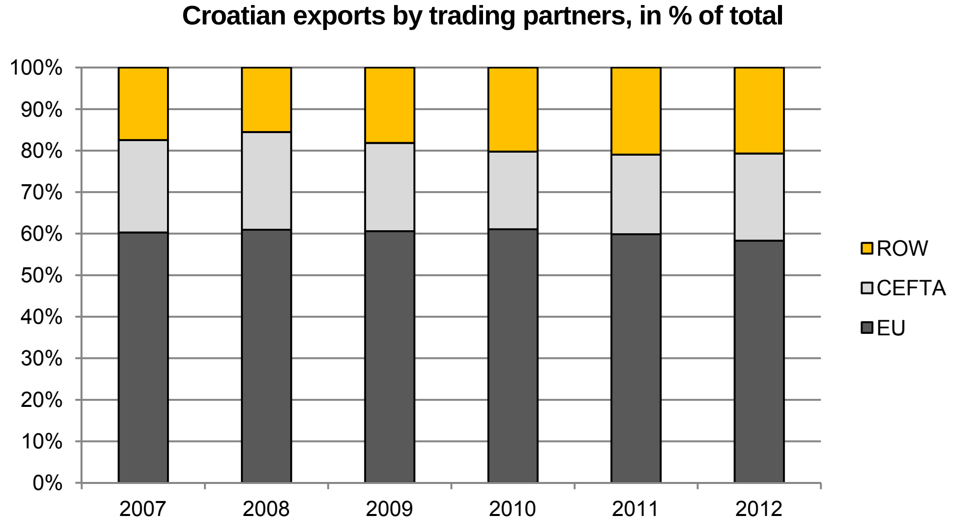
In the past CEFTA mainly served as an antechamber to full EU membership. This also held true for Croatia that concluded its EU accession negotiations on 30 June 2011 and signed the treaty of accession on 9 December 2011. With the ratification process now complete, the accession of Croatia to the EU will take place on 1 July 2013, concurrent with its withdrawal from CEFTA. Applying the global simulation model suggested by Francois and Hall (2003), the present note estimates the impact that Croatian accession to the EU might have on regional trade patterns (a longer version is forthcoming).

The evolution of Croatian trade since the adoption of the expanded CEFTA agreement in 2006 shows a relatively stable regional structure. This applies to both exports and imports. Figure 32 presents the export shares with the EU-27, the CEFTA-countries and the rest of the world (ROW). These shares are almost constant. The EU absorbs about 60% of Croatia's exports, while approximately 20% go to CEFTA-countries and ROW, respectively. This pattern has hardly changed since the expanded CEFTA agreement entered into effect in 2007 and the global recession started in 2009. The situation is quite similar where imports are concerned (see Figure 33). In the latter instance, more than 60% of Croatia's imports stem from the EU and more than 30% from ROW. In recent years, however, only 5 - 6% of Croatian imports have come from other CEFTA countries.

The commodity structure of Croatian exports has also been comparatively stable over the past few years. Figure 34 presents the export shares of aggregated product groups taken from the Standard International Trade Classification (SITC) for the period 2007-2012. Most likely on account of the commodity price bubble across the globe as well as the economic crisis, exports shifted away slightly from machinery and transport equipment to crude materials. The structural re-organisation of the shipyards in Croatia in the run-up to EU accession has certainly had a dampening effect on the production and export of transport equipment.

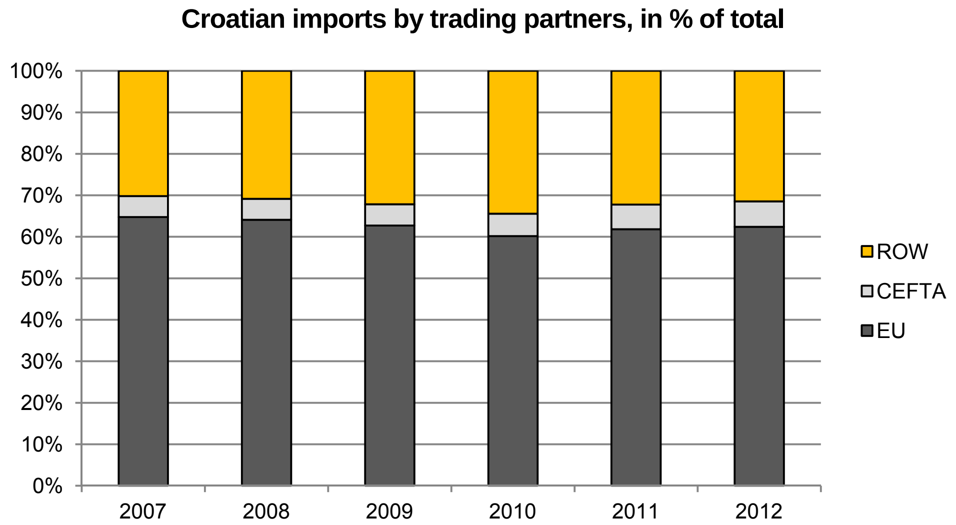
Over the past few years, the shifts in the commodity structure of exports have been even more pronounced in terms of imports (see Figure 35). Over the period 2007-2012, the import share of crude materials and fuels increased by about 6 percentage points. At the same time, that of machinery and transport equipment decreased by as much as 10 percentage points. Undoubtedly, this trend is related to both high global prices for commodities and the severe, persistent domestic depression.

Figure 32



Source: wiiw Annual Database.

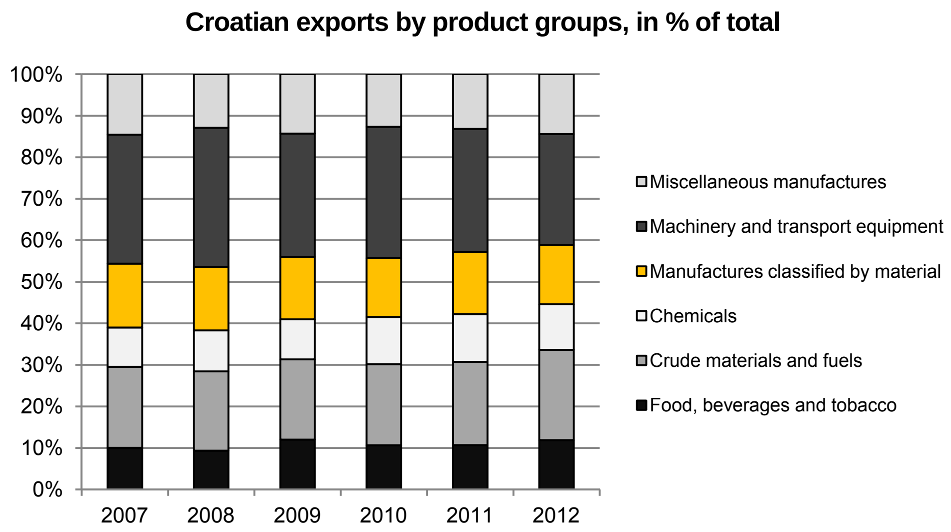
Figure 33



Source: wiiw Annual Database.

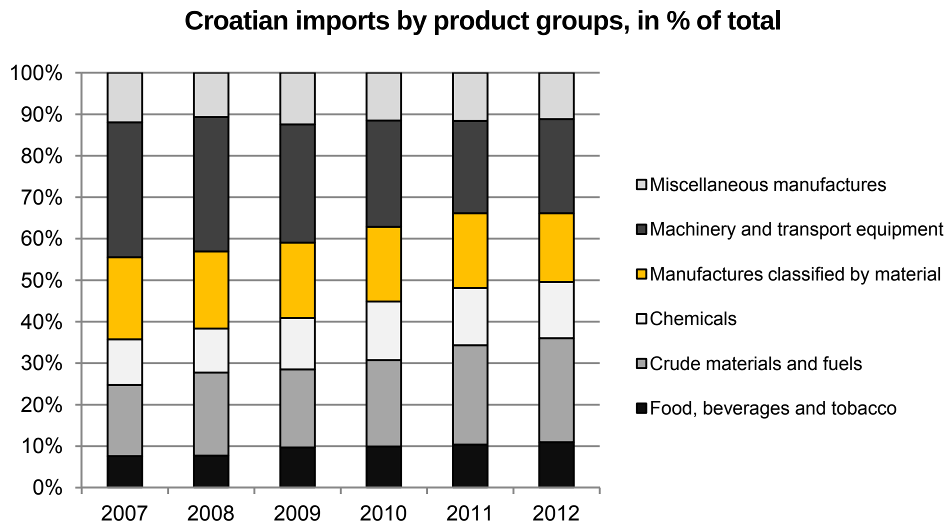
Thus, apart from a certain measure of change in the commodity structure of Croatian trade, which is most likely attributable to global economic developments, not much has changed in the regional composition of trade since 2007 when the expanded CEFTA agreement adopted the year previous took effect. The question is whether the country's access to the EU will have a greater impact?

Figure 34



Source: wiiw Annual Database.

Figure 35



Source: wiiw Annual Database.

The model applied in this study is the global simulation model (GSIM) for the analysis of global, regional and unilateral trade policy changes as proposed by Francois and Hall (2003). That model has been used in a number of trade analysis papers, especially in cases where data are scarce. Our partial equilibrium approach allows for a rapid and transparent analysis of a wide range of trade policy issues with a minimum of data and computational requirements.

Bearing in mind the limitations of the partial equilibrium approach, some useful insights can be gained with regard to complex, multi-country trade policy changes. The GSIM findings permit the assessment of importer- and exporter-effects related to tariff revenues, as well as exporter (producer) surplus and importer (consumer) surplus. The model requires the input of: a bilateral trade matrix at world prices; an initial matrix of bilateral import tariffs in *ad valorem* form; a final matrix of bilateral import tariffs in *ad valorem* form; export supply elasticities; aggregate import demand elasticities; and elasticities of substitution. By drawing on additional data, domestic production effects can also be fitted into the framework.

For the most part, data on total trade as well as simple average applied tariff rates for all CEFTA-countries, the EU and ROW were taken from the UNCTAD TRAINS database, as well as from the UNComtrade database and national sources. In general, the data stem from 2011. With regard to trade with self (gross output less exports) and given the lack of proper data for the majority of countries, we had to employ a crude proxy using value-added data relating to final consumption and gross capital formation taken from the UNSTATS National Accounts Main Aggregates Database.

Non-tariff-barriers (NTBs) such as quotas could not be included. This poses a problem especially where EU data on protection from imports from CEFTA-countries and ROW are concerned. In 2000, the EU granted autonomous trade measures (ATMs) to the countries in the Western Balkans, thereby liberalising 95% of their exports to the EU. The remaining barriers are tariff quotas on imports of wine, baby beef and certain fishery products, as well as a number of NTBs in the textile industry. For many products licensing is mandatory. For a recent description of NTBs in the CEFTA-countries see OECD (2012).

A Croatian EU accession scenario was included in our model calculations. We thus assumed complete liberalisation of trade between Croatia and the EU, as well as the adoption by Croatia of EU tariffs vis-à-vis the CEFTA countries and ROW.

Changes in the *ad valorem* tariff rates were found to be relatively minor as most of Croatia's trade with both the EU and the CEFTA-countries is already highly liberalised. Only a few trade barriers were seen to remain. Hence, Croatian tariff protection vis-à-vis Bosnia and Herzegovina as well as Montenegro is expected to change only minimally (it remains at a rate of almost 0%). Croatian tariff protection vis-**à**-vis Kosovo, Macedonia, Moldova and the EU, it is estimated, will be reduced by about half a percentage point. Protection vis-**à**-vis ROW and Albania will decline by around one percentage point and finally the largest reduction in simple average tariff rates will occur in the case of with Serbia - a drop in the order of -1.5 percentage points.

Looking at the post-accession changes in average tariff rates in other countries and regions vis-**à**-vis Croatia, we find a reduction of -0.3 and -0.4 percentage points for Albania and Montenegro, respectively. Other countries display either a slight increase in protection (0.5 percentage points for Bosnia and Herzegovina and Macedonia) or a more substantial shift (between 3 and 4 percentage points for Serbia, Moldova and the ROW). By far the most pronounced increase can be expected in the case of Kosovo (8.1 percentage points).

To a large extent, the change in simulated trade flows is determined by (i) the degree of previous and simulated trade protection and (ii) the volume of previous trade flows . Table 7 presents the percentage change in trade quantities. In general, real changes in most trade flows are minuscule (if at all). Somewhat larger changes are estimated (not surprisingly) for trade with Croatia. Croatian exports to Montenegro (+3.1%), Albania (+2.8%) and the EU (+1.6%) are expected to grow, while Croatian exports to Kosovo (-38.5%), Moldova (-19.1%), Serbia (-14.3%), Macedonia (-1%), Bosnia and Herzegovina (-0.9%) and the ROW (-17.5%) are expected to decrease in real terms. Domestic sales in Croatia are expected to decrease by 0.1%. Croatian imports from Serbia (+5.4%), Albania (+3.5%), Moldova (+1.2%), the EU (+0.8%), Kosovo (+0.5%) and ROW (+2.6%) are expected to increase slightly, whereas those from Bosnia and Herzegovina (-1.3%), Montenegro (-1.3%) and Macedonia (-0.7%) are expected to drop by a narrow margin.

If one looks at the change in trade values expressed in USD millions, all of the above changes are relatively small (see Table 8). In terms of Croatia's trade with CEFTA-countries, it is only the country's loss of exports to Serbia (USD 71 million) and Kosovo (USD 34 million) that appears somewhat more substantial. Certainly the drop in exports to ROW (USD 180 million) and the increase in exports to the EU (USD 104 million), as well as the drop in domestic sales (USD 130 million) are much more impressive. Croatian output is expected to fall by as much as USD 326 million; this corresponds to about 0.7% in nominal terms. In terms of nominal changes in imports, the effects are marginal. The simulation results suggest a somewhat more pronounced drop in Croatian imports from Bosnia and Herzegovina (by about USD 10 million) and an increase in imports from Serbia (by about USD 22 million). The shifts in the value of imports from the EU (an increase in excess of USD 110 million) and ROW (an increase in USD 190 million) are more substantial.

Overall, we find the simulated Croatian exports to be geared more towards the EU after accession (once the final trade barriers fall), while exports to the remaining CEFTA countries and ROW will decline (owing to somewhat higher trade barriers following accession). The share of Croatian exports to the EU is estimated to increase by 2.2 percentage, while those to the CEFTA-countries and ROW are expected to drop by 0.7 and 1.5 percentage points, respectively. Even smaller changes with regard to simulated Croatian import shares in the post-accession period are to be expected. The EU share decreases by about 0.4 percentage points, most of which moves to ROW. The share of the CEFTA-countries decreases by less than 0.1 percentage points.

In terms of welfare effects (see Table 9), we can observe some minimal, but positive net welfare effects on most CEFTA economies as a result of Croatia's accession to the EU. This is mainly due to minimal changes in those countries' price structure, as well as marginal changes in real output. Only for Croatia does the simulation suggest that overall consumer prices and real output might fall by about 0.4%. This is mainly the impact of the slight reduction in tariff protection for Croatia in the wake of EU accession. As a consequence, the Croatian producer surplus drops by about USD 130 million. However, that drop is more than outweighed by an increase in consumer surplus in the order of about USD 230 million. A further loss of USD 127 million, however, is incurred through tariff revenues forgone. This yields an overall negative net welfare effect for Croatia of USD 26 million. However, it is to be expected that EU support funds will offset that loss many times over.

Table 7

Percent change in trade quantities after Croatian EU accession

origin \ destination	AL	BA	HR	XK	MK	MD	ME	RS	EU	ROW
Albania	0.0	0.0	3.5	0.4	0.0	0.0	-0.1	0.2	0.0	0.0
Bosnia and Herzegovina	0.0	0.1	-1.3	0.4	0.0	0.0	0.0	0.2	0.0	0.0
Croatia	2.8	-0.9	-0.1	-38.5	-1.0	-19.1	3.1	-14.3	1.6	-17.5
Kosovo	-0.3	-0.3	0.5	0.1	-0.3	-0.3	-0.4	-0.1	-0.3	-0.3
Macedonia	0.0	0.0	-0.7	0.4	0.0	0.0	-0.1	0.2	0.0	0.0
Moldova	0.0	0.0	1.2	0.4	0.0	0.0	-0.1	0.2	0.0	0.0
Montenegro	0.0	0.1	-1.3	0.5	0.0	0.0	0.0	0.2	0.0	0.0
Serbia	-0.2	-0.1	5.4	0.3	-0.1	-0.1	-0.2	0.0	-0.1	-0.1
EU	0.0	0.0	0.8	0.4	0.0	0.0	-0.1	0.2	0.0	0.0
ROW	0.0	0.0	2.6	0.4	0.0	0.0	-0.1	0.2	0.0	0.0

Source: own calculations.

Table 8

Change in values of trade at world prices after Croatian EU accession, in million USD

origin \ destination	AL	BA	HR	XK	MK	MD	ME	RS	EU	ROW
Albania	-0.7	0.0	0.2	0.6	0.0	0.0	-0.0	0.0	-0.0	0.0
Bosnia and Herzegovina	0.0	7.2	-10.2	0.5	0.0	0.0	-0.1	1.2	0.3	0.1
Croatia	1.7	-18.2	-129.8	-34.4	-1.6	-0.4	3.5	-71.0	104.2	-179.7
Kosovo	-0.1	-0.0	0.0	10.1	-0.1	-0.0	-0.0	-0.0	-0.5	-0.3
Macedonia	-0.0	0.0	-1.2	2.1	0.2	-0.0	-0.0	0.5	-0.5	-0.0
Moldova	-0.0	0.0	0.1	0.1	0.0	0.1	-0.0	0.1	-0.1	-0.0
Montenegro	0.0	0.0	-0.1	0.1	0.0	-	-0.8	0.3	0.1	0.0
Serbia	-0.3	-0.7	21.8	1.2	-0.5	-0.0	-1.2	15.0	-8.0	-0.7
EU	-0.3	2.3	110.5	5.6	0.8	0.1	-0.5	19.3	-72.7	6.3
ROW	-0.1	1.5	190.5	3.8	0.5	0.1	-0.3	12.4	-20.8	95.0

Source: own calculations.

Table 9

Summary effects of Croatian EU accession

	Welfare effects in mn USD				Other effects			
	Producer surplus	Consumer surplus	Tariff revenue	Net welfare effect	Change in overall consumer prices	Change in output	Producer price for home goods	Market price for home goods
	A	B	C	D= A+B+C	per cent	per cent	per cent	per cent
Albania	0.0	0.2	-0.2	0.1	0.00%	0.00%	0.00%	0.00%
Bosnia and Herzegovina	-0.4	-3.0	7.2	3.8	0.01%	0.00%	0.00%	0.00%
Croatia	-130.2	230.4	-126.6	-26.4	-0.39%	-0.41%	-0.27%	-0.27%
Kosovo	3.6	-10.5	5.1	-1.8	0.11%	0.09%	0.06%	0.06%
Macedonia	0.4	-0.7	0.6	0.3	0.01%	0.01%	0.00%	0.00%
Moldova	0.1	-0.1	0.1	0.0	0.00%	0.00%	0.00%	0.00%
Montenegro	-0.2	0.7	-0.5	0.0	-0.01%	-0.01%	0.00%	0.00%
Serbia	10.6	-21.7	14.7	3.6	0.05%	0.04%	0.03%	0.03%
EU	389.2	-8.9	-4.5	375.7	0.00%	0.00%	0.00%	0.00%
ROW	1805.3	-153.7	34.6	1686.3	0.00%	0.00%	0.00%	0.00%

Source: own calculations.

Given the minor changes simulated for the remaining CEFTA-countries, no particular policy recommendations seem to be applicable at the macroeconomic level. Further research might be needed to establish whether specific industries or even products are hurt by regional changes in trade policy so that appropriate compensation policies can be developed. Furthermore, the issue of the NTBs remaining needs to be addressed. When it comes to Croatia, the effects of the country’s accession to the EU are somewhat more marked and generally worrisome with regard to a simulated reduction in output, at least in the short term. Given Croatia’s fixed exchange rate regime and its desire to join the euro area at the earliest possible juncture, devaluation of the nominal exchange rate is most likely not an option for offsetting the short-term negative impact of EU accession on domestic production. An increase in value-added tax and a uniform decrease in payroll tax would, however, offer a kind of fiscal policy equivalent to devaluation (see Farhi, Gopinath and Itskhoki, 2011). Apart from that, were a more coordinated incomes policy to be introduced involving an augmentation of the institutional power of employers’ and employees’ organisations and an enhancement of collective bargaining, it could have the potential to make for a more manageable real exchange rate in Croatia over the long term.

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Table BG

Bulgaria: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2]	7585.1	7534.3	7348.3	7304.6	.	.	7300	7270	7250
Gross domestic product, BGN mn, nom.	68322	70511	75308	77582	15750	16577	80200	84300	89400
annual change in % (real)	-5.5	0.4	1.8	0.8	1.0	0.8	0.9	2.0	3.0
GDP/capita (EUR at exchange rate)	4600	4800	5200	5400	.	.	5600	5900	6300
GDP/capita (EUR at PPP)	10300	10700	11600	12100	.	.	.	.	.
Consumption of households, BGN mn, nom.	42942	43990	46725	49595	11203	11534	.	.	.
annual change in % (real)	-7.6	0.0	1.5	2.5	2.6	0.0	0.8	2.5	3.5
Gross fixed capital form., BGN mn, nom.	19724	16077	16225	16600	2893	3024	.	.	.
annual change in % (real)	-17.6	-18.3	-6.5	0.8	3.6	1.8	3.0	5.0	6.0
Gross industrial production [3]									
annual change in % (real)	-18.2	2.1	5.8	-0.3	-2.2	1.4	2.0	4.0	6.0
Gross agricultural production (EAA)									
annual change in % (real)	-1.6	-6.0	-2.5	-9.0	.	.	.	.	.
Construction industry [4]									
annual change in % (real)	-14.5	-14.9	-12.8	-0.7	-1.8	-1.4	.	.	.
Employed persons, LFS, th, average [5]	3253.6	3052.8	2949.6	2934.0	2853.2	2855.0	2940	2950	2970
annual change in % [5]	-3.2	-6.2	-3.4	-1.1	-1.8	0.1	0.3	0.5	0.8
Unemployed persons, LFS, th, average [5]	238.0	348.0	372.3	410.3	421.4	456.4	420	400	390
Unemployment rate, LFS, in %, average [5]	6.8	10.2	11.2	12.3	12.9	13.8	12.5	12.0	11.5
Reg. unemployment rate, in %, end of period [5]	9.1	9.2	10.4	11.4	11.5	11.8	.	.	.
Average gross monthly wages, BGN [6]	609.1	648.1	707.3	777.0	746.0	778.3	.	.	.
annual change in % (real, gross)	8.8	3.9	4.7	6.9	9.3	0.7	.	.	.
Consumer prices (HICP), % p.a.	2.5	3.0	3.4	2.4	1.9	2.1	2.5	3.0	3.0
Producer prices in industry, % p.a.	-5.9	8.5	9.2	4.4	3.8	1.7	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	37.1	34.3	33.6	34.9	39.1	.	.	.	.
Expenditures	41.4	37.4	35.6	35.7	39.8	.	.	.	.
Net lending (+) / net borrowing (-)	-4.3	-3.1	-2.0	-0.8	-0.6	.	-2.0	-2.0	-2.0
Public debt, EU-def., % of GDP	14.6	16.2	16.3	18.5	16.7	.	20.0	21.0	22.0
Central bank policy rate, % p.a., end of period [7]	0.55	0.18	0.22	0.03	0.15	0.01	.	.	.
Current account, EUR mn	-3116	-534	40	-527	-561	-421	-700	-1000	-1300
Current account, % of GDP	-8.9	-1.5	0.1	-1.3	-7.0	-5.0	-1.7	-2.3	-2.8
Exports of goods, BOP, EUR mn	11699	15562	20265	20793	4620	5217	21600	22700	24000
annual change in %	-23.0	33.0	30.2	2.6	-2.9	12.9	3.9	5.1	5.7
Imports of goods, BOP, EUR mn	15874	18326	22421	24415	5561	5695	25500	27000	28700
annual change in %	-33.3	15.4	22.3	8.9	10.2	2.4	4.4	5.9	6.3
Exports of services, BOP, EUR mn	4916	5012	5354	5661	839	754	6000	6400	6800
annual change in %	-8.2	2.0	6.8	5.7	2.7	-10.2	6.0	6.7	6.3
Imports of services, BOP, EUR mn	3617	3143	3031	3264	749	681	3350	3500	3700
annual change in %	-10.6	-13.1	-3.6	7.7	11.5	-9.1	2.6	4.5	5.7
FDI inflow, EUR mn	2438	1152	1314	1479	673	257	1500	1800	2000
FDI outflow, EUR mn	-68	174	116	177	32.0	10.0	.	.	.
Gross reserves of NB excl. gold, EUR mn	11943	11612	11788	13936	11594	12893	.	.	.
Gross external debt, EUR mn	37816	37026	36228	37592	36604	37346	.	.	.
Gross external debt, % of GDP	108.3	102.7	94.1	94.8	92.3	91.1	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.8738	0.8746	0.8839	0.8812	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census February 2011. - 3) Enterprises with 10 and more employees. - 4) All enterprises in public sector, private enterprises with 5 and more employees. - 5) From 2012 according to census February 2011. - 6) From 2012 based on new exhaustive enterprises survey. - 7) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board).

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

Rumen Dobrinsky

Bulgaria:
Economy stalls as politics overshadows policy debates

The early elections held in May 2013 shifted completely the focus of public debates in Bulgaria away from economic policy issues. The caretaker government did not engage in any meaningful policy measures, leaving that task to the forthcoming new cabinet. As a result, since the beginning of the year 2013, the economy has been basically left in an ‘autopilot mode’, with no clear policy signals or directions. The external environment did not generate any visible positive growth impetus either.

Consequently, with GDP growing by just 0.3% year-on-year in the first quarter of 2013, the Bulgarian economy remained close to the freezing point. Flash estimates based on seasonally adjusted data even suggest deceleration compared to the previous quarter but at very low absolute levels of the growth figures. On the supply side, manufacturing posted a modest recovery, mostly thanks to an upturn in exports to both EU and non-EU markets. On the demand side, private consumption fell 2.4% year-on-year in the first quarter, reinforcing the downward trend that started in the second half of 2012. The only positive signal regarding the state of domestic demand in the first quarter was the modest upturn year-on-year in gross fixed capital formation.

In effect, the economy was seemingly motionless at the macroeconomic level, most of the performance changes recorded in the first months of the year (both positive and negative) being so marginal that they could hardly make any perceptible difference. The only possible exception was the labour market where LFS data suggest a modest trend of reintegration of previously discouraged job seekers into the labour market. In consequence, while the number of employed in the first quarter of 2013 was virtually unchanged from a year earlier, there was a rise by about one percentage point in the rate of LFS unemployment over the same period. Inflation subsided further in the first months of the year both as regards consumer and producer prices. The downward pressure on consumer prices came both from the weak consumer demand and also from forced downward adjustment in some regulated prices (such as electricity) triggered by the protests at the beginning of the year.

The modest upturn in exports which had started around the middle of 2012 continued in the first months of 2013 as well, while imports were losing steam, curbed by the weakening private consumption. These developments were putting a brake on the trade and current account deficits which probably will turn out to be lower in 2013 than earlier expected. Public finances in general seem to be under control but there has been some deterioration on the revenue side compared to a year earlier. Corporate credit was on a downward trend while substandard and non-performing loans in the banking system resumed their growth in April 2013 after a brief period when it appeared that they had peaked off.

The resignation of the GERB[25] government in February and the early elections held in May 2013 dominated the political scene in Bulgaria. The political turmoil that led to the resignation of the government was all but helpful for the conduct of a meaningful policy course. The protests of the beginning of the year brought to the forefront of public debates the accumulated public discontent with a range of chronic problems that politicians have been unable or unwilling to address over years and even decades, such as the regulation of public monopolies, the state of the health care system, the dysfunctionality of some public institutions, the lack of transparency in public decision-making and corruption. Public expectations remain high as regards future policy actions on some of these fronts.

However, the early elections did not produce any results that could support more resolute moves and policies in implementing major reforms. The protest movements that had brought down the GERB government did not transform into political entities capable of challenging the existing political establishment. Somewhat surprisingly, GERB remained the leading party in terms of the share of votes received at the early elections. However, lacking a parliamentary majority, they were not able to form a government as all other parliamentary parties rejected a coalition with GERB. The Bulgarian Socialist Party (BSP) came as the second leading party in the new parliament. The other political parties that managed to surpass the parliamentary threshold (4% of the votes) were the Movement for Rights and Freedoms (MRF) supported by the Turkish minority and the nationalist Ataka; these parties are on two ideological extremes.

On the other hand, the election results do reflect the heterogeneous state of the Bulgarian society which is split among values and yearnings that are hardly compatible with each other. The outcome of the post-election political bargaining was a government proclaimed as technocratic but openly supported by BSP and MRF while Ataka for the time being has remained neutral but not openly opposing the formation of the above government. The new prime minister, Plamen Oresharski, is a respected and pragmatic financial expert and a former minister of finance. The government itself is mostly composed of experts; only a few of the new cabinet members can be traced to have clear political roots in the BSP and MRF establishment.

The new government has pledged to deal with some of the issues that have been in the focus of public attention such as the efficient regulation of monopolies, boosting the transparency and efficiency of the public administration, measures to invigorate the labour market, and reversal of the negative trends in pensions, minimum wages and welfare benefits. The policy stance of the new government is more likely to be leaning towards the centre rather than to the left. The government has declared its commitment to pragmatic economic management and preserving macroeconomic stability while at the same time engaging in some forms of soft industrial policy. Overall, given the high expectations throughout the Bulgarian society of changes towards the better, one could assume a somewhat more lax spending stance, at least in this initial period of the government's term in office.

[25] GERB is the Bulgarian acronym for the party name 'Citizens for European Development in Bulgaria'.

If the new government puts in place some of the envisaged stimulus measures, a number of the current negative economic trends could be reversed in the second half of the year. However, given the weakening of consumer demand already incurred in the first quarter, it is difficult to expect a major turnaround in the short run. No positive surprises are expected from the EU economy in 2013 either. On balance, the GDP growth rate in Bulgaria in 2013 is likely to remain in a range comparable to that recorded in 2012. A more pro-active fiscal policy stance however may push the budget deficit further into the red. A revision of the 2013 budget adopted by the previous government cannot be excluded.

The forecasts for 2014 and 2015 incorporate the assumption that a more supportive policy stance would lead to a gradual improvement in the domestic environment. As regards the external environment, somewhat stronger demand for Bulgarian exports is expected thanks to a recovering global and European economy. These assumptions provide the basis for a slight upward revision of the expected rates of GDP growth in this period which nevertheless would still remain modest.

Table HR

Croatia: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012 1st quarter	2013 1st quarter	2013 Forecast	2014 Forecast	2015 Forecast
Population, th pers., mid-year 2)	4429.1	4417.8	4280.6	4267.0	4267.0	.	4280	4280	4280
Gross domestic product, HRK mn, nom.	328672	323807	330171	330232	75358	75957	338400	350300	364500
annual change in % (real)	-6.9	-2.3	0.0	-2.0	-1.1	-1.5	-1.0	1.0	2.0
GDP/capita (EUR at exchange rate)	10100	10100	10400	10300	.	.	10500	10900	11400
GDP/capita (EUR at PPP)	14500	14300	15200	15200	.	.	.	.	.
Consumption of households, HRK mn, nom.	188859	189314	194518	195355	46427	47004	.	.	.
annual change in % (real)	-7.6	-1.3	0.2	-3.0	-0.9	-3.0	-2.6	-1.0	0.5
Gross fixed capital form., HRK mn, nom.	80367	67254	63286	60740	13887	13736	.	.	.
annual change in % (real)	-14.2	-15.0	-6.4	-4.6	-3.9	-2.3	-2.0	3.0	5.0
Gross industrial production 3)									
annual change in % (real)	-9.2	-1.4	-1.2	-5.5	-5.4	0.9	1.0	2.5	3.0
Gross agricultural production									
annual change in % (real)	-0.8	-8.2	-1.0	.	.	.	.	.	.
Construction output 3)									
annual change in % (real)	-6.6	-15.8	-8.5	-11.1	-11.7	-3.1	.	.	.
Employed persons, LFS, th, average	1605	1541	1493	1446	1394	.	1420	1420	1430
annual change in %	-1.8	-4.0	-3.2	-3.1	-5.6	.	-2.0	0.0	1.0
Unemployed persons, LFS, th, average	160	206	232	272	273	.	.	.	.
Unemployment rate, LFS, in %, average	9.1	11.8	13.5	15.8	16.4	.	17.5	17.0	17.5
Unemployment rate, reg., in %, end of period	16.7	18.8	18.7	21.1	20.0	21.6	21.5	21.0	20.0
Average gross monthly wages, HRK	7711	7679	7796	7875	7835	7941	7900	7950	8000
annual change in % (real, net)	0.2	-0.5	-0.4	-2.6	0.1	-3.4	.	.	.
Consumer prices, % p.a.	2.4	1.1	2.3	3.4	1.5	4.6	3.5	2.5	2.0
Producer prices in industry, % p.a. 4)	-0.4	4.3	7.0	5.4	5.6	2.6	2.5	2.5	2.5
General governm.budget, EU-def., % of GDP 5)									
Revenues	40.9	40.1	40.4	36.8	.	.	.	.	.
Expenditures	45.6	45.3	46.1	40.6	.	.	.	.	.
Net lending (+) / net borrowing (-)	-4.7	-5.2	-5.7	-3.8	.	.	-4.8	-3.5	-3.0
Public debt, EU-def., % of GDP	35.8	42.6	47.2	53.0	.	.	57.0	62.0	64.0
Central bank policy rate, % p.a., end of period 6)	9.0	9.0	7.0	7.0	7.0	7.0	.	.	.
Current account, EUR mn	-2281.8	-468.3	-385.2	35.4	-1585.2	.	50	-300	-500
Current account, % of GDP	-5.1	-1.1	-0.9	0.1	-15.9	.	0.1	-0.6	-1.0
Exports of goods, BOP, EUR mn	7674.5	9063.6	9772.6	9783.0	2287.9	.	9300	9700	10200
annual change in %	-21.3	18.1	7.8	0.1	2.2	.	-5.0	4.0	5.0
Imports of goods, BOP, EUR mn	14881.5	14809.1	15921.9	15804.4	3796.5	.	15500	16300	17300
annual change in %	-27.0	-0.5	7.5	-0.7	2.0	.	-2.0	5.0	6.0
Exports of services, BOP, EUR mn	8640.2	8651.2	9004.8	9317.5	807.3	.	9700	10200	10700
annual change in %	-14.4	0.1	4.1	3.5	6.4	.	4.0	5.0	5.0
Imports of services, BOP, EUR mn	2949.9	2875.7	2818.0	2924.6	-641.6	.	2900	3000	3200
annual change in %	-8.9	-2.5	-2.0	3.8	-1.2	.	0.0	3.0	5.0
FDI inflow, EUR mn	2403.6	326.3	1080.2	973.3	89.5	.	.	.	.
FDI outflow, EUR mn	887.3	-110.3	21.7	-77.3	-216.7	.	.	.	.
Gross reserves of NB excl. gold, EUR mn	10376	10660	11195	11236	11340	11277	.	.	.
Gross external debt, EUR mn 7)	43745	46483	45734	44935	45916	45102	.	.	.
Gross external debt, % of GDP 7)	97.7	104.6	103.0	102.3	104.5	99.6	.	.	.
Exchange rate HRK/EUR, average	7.3396	7.2862	7.4339	7.5175	7.5552	7.5786	7.5	7.5	7.5
Purchasing power parity HRK/EUR	5.1169	5.1309	5.0661	5.0889	.		.	.	.

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

1) Preliminary. - 2) From 2011 according to census April 2011. - 3) Enterprises with 20 and more employees. - 4) Domestic output prices. From 2011 total output prices.- 5) According to ESA'95, excessive deficit procedure. - 6) Discount rate of NB. - 7) From 2009 new reporting system.

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

Hermine Vidovic

Croatia: Joining EU under difficult conditions

Having declined or stagnated since 2008, Croatia's GDP dropped by another 1.5% during the first quarter of 2013 due to a fall in domestic demand. Gross fixed capital formation, which has been on the decline since 2009, continued to drop for yet another year. Household consumption fell as a consequence of shrinking disposable income due to rising unemployment and the high level of household indebtedness, while government consumption increased slightly. Industrial output showed a slight upward trend after having declined for four consecutive years. In manufacturing the worst drop in output occurred in shipbuilding – Croatia's single most important export sector – with production down by half as compared with the first quarter of 2012. On the positive side, the manufacturing of fabricated metal products and basic pharmaceuticals grew most, by 28% and 22% respectively.

Based on customs statistics, external trade contracted significantly during the first quarter of 2013 with exports of goods shrinking by 8.2% and imports by 2.7%. The resultant trade deficit increased by about EUR 100 million (to EUR 1.7 billion) compared to a year earlier. Taking into account the moderately rising trade deficit and assuming no significant change in the services trade surplus – tourist overnight stays developed very favourably during the first three months of the year – the current account deficit has probably remained unchanged or only slightly deteriorated. At the end of March 2013, foreign debt stood at EUR 45.1 billion, thus remaining unchanged compared to December 2012. Both Moody's and Standard & Poor's have downgraded Croatia's debt rating to junk during the first months of 2013, reflecting the stalled recovery, lack of budget discipline and vulnerability to external shocks. It is however interesting to note that the downgrade did not have any major impact on Croatian bond yields.

Labour market conditions have been further worsening during the first quarter of 2013: the number of employed fell by 2%. Registered unemployment soared to 20.9% at the end of April, while preliminary labour force survey data provided by Eurostat indicate an unemployment rate of 18% with youth unemployment standing at over 50%. In the EU only Spain and Greece have higher rates than that.

According to final data, the general government deficit in 2012 amounted to 3.8% of the GDP and the general government debt stood at 53.7% of GDP by the end of the year. As for 2013, the official deficit target of the revised budget adopted in April is 3.6% (assuming 0.7% growth of GDP; the initial version was based on 1.8% GDP growth). But considering rising interest payments as well as the assumption of shipyards' loans by the state, the deficit might reach close to 5% and the public debt may rise to 58%. Overall, even the assumption of a lower GDP growth underlying the budget is overly optimistic since all the forecasts published by international organisations and banks, as well as the country's main economic research institute EIZ, predict a GDP decline for 2013. Since the European Commission expects the public debt to exceed the threshold of 60% in 2014, Croatia may enter an excessive deficit procedure almost as soon as it joins the EU.

Since the beginning of the crisis there have been no large capital injections to the Croatian banking sector, and according to the National Bank there are none to be expected until the end of 2013.[26] At the end of March 2013 the ratio of non-performing loans to total loans was 14.6%. Out of loans provided to the corporate sector, about 26% of loans to trade companies were categorised as non-performing. The ratio of bad loans in total household loans was 9.7%.

Croatia joined the European Union on 1 July 2013. Unlike in the two recent accession waves when candidate countries gained substantial economic benefits already prior to their membership, this time both the EU and Croatia are struggling with the consequences of the economic crisis: shrinking or only modest GDP growth coupled with high and persistent unemployment. Thus, positive economic effects from EU accession, such as intensifying trade and attracting greenfield investments, can be expected only in the medium- and long-term perspective. In the short run Croatia will mainly benefit from its eligibility to structural and cohesion funds provided it develops a sufficient absorption capacity. Expected losses in trade due to leaving the Central European Free Trade Agreement (CEFTA) upon accession will be offset only over time. Croatia's goal of adopting the euro will depend first of all on meeting the Maastricht criteria.

Based on the results for the first months of the year, wiiw has revised its previous GDP forecast for 2013 downwards (to -1%, from previously -0.5%) and expects a slight rebound only in 2014. Prospects have been dampened by the delayed recovery of domestic demand and the poor economic outlook in the EU (particularly in Italy, one of Croatia's most important trading partners, but also in Slovenia) as well as for the other Western Balkan countries. Household consumption will remain subdued as a consequence of high and still growing unemployment and weak credit activity; a certain relaxation on the labour market can be expected only from 2015 onwards. Fiscal consolidation and structural reforms against the background of high unemployment and servicing foreign debt will remain the major challenges for the years ahead. The country's accession to the EU may help to boost foreign investors' confidence.

[26] Croatian National Bank (2013), Financial Stability, No 10, Year 6, p. 42.

Leon Podkaminer

The Czech Republic:
Deeper in recession

In the first quarter of 2013 the GDP decline went on, by a massive 2.8% against the same period of 2012 (seasonally and working-days' unadjusted). The seasonally adjusted decline looks slightly better (by 2.2%) but is worrying all the same. The major negative impulse has come from gross capital formation (and from strong reduction in inventories in particular). The decline in household consumption has actually moderated compared with the declines recorded during the previous four quarters. The volumes of exports and imports of goods and non-factor services declined rather strongly in real terms, with exports falling more than imports (by 3.8% and 3.5% respectively). The expectations that trade would act as a brake on recession have been disappointed. The contribution of foreign trade to GDP growth in the first quarter of 2013 was slightly negative (-0.1 percentage points).

Industrial production contracted throughout the first four months of 2013. In April industrial output was 6% below the level of April 2012. Cumulatively, production fell by 5.4% in the first quarter. Production of capital (investment) goods declined by 9%. Direct industry's export sales fell by 3% in nominal terms. The volumes of orders placed with industry contracted by 7.9% (domestic sales) or 5.8% (export sales). The decline in the construction output seems to be accelerating: in the first quarter it was down almost 11% (but in April already 20.6% below the previous year's April level).

The weakness of household consumption is a natural effect of anaemic labour market developments characterised by stagnant employment and nominal wages. However, after a strong decline in 2012, the decline in household consumption is likely to become less pronounced in the course of 2013. The fiscally motivated increases in the VAT rates and hikes in administered prices (housing rents and utilities) which raised inflation in 2011-2012 by over 1 percentage point will affect the consumer price inflation in 2013 to a much lesser degree. Quite automatically, much lower ensuing 'fiscal inflation' will stop supporting the creeping erosion of real wages and other regular household sector incomes and therefore will result in a more moderate decline in household consumption. On the other hand, even if real disposable income of the household sector does not contract in 2013 as strongly as in both 2011 and 2012, this sector's propensity to save may rise further (from an estimated 9.8% and 12.7% in 2011 and 2012 respectively) to over 14.5% in 2013 and 2014. Such a development is a real possibility given the uncertain income and employment prospects facing the household sector – as well as the contracting availability of services and of transfers delivered by the sector.

The shares of non-performing loans to the corporate and household sectors are low and stable (at 7.4% and 5.3% respectively). Despite this – and despite relatively quite low interest rates on bank lending – the stock of loans to the private sector has remained quite flat (registering a 3.5% growth

Table CZ

Czech Republic: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2]	10487	10520	10496	10509	.	.	10540	10570	10600
Gross domestic product, CZK bn, nom.	3759.0	3790.9	3823.4	3830.5	905.2	891.2	3820	3900	4050
annual change in % (real)	-4.5	2.5	1.9	-1.3	-0.1	-2.8	-0.8	1.4	2.4
GDP/capita (EUR at exchange rate)	13600	14300	14800	14500	.	.	.	.	.
GDP/capita (EUR at PPP)	19400	19500	20100	20500	.	.	.	.	.
Consumption of households, CZK bn, nom.	1874.4	1889.2	1907.7	1899.2	455.3	455.6	.	.	.
annual change in % (real)	0.2	1.0	0.5	-2.7	-1.8	-0.9	-0.5	1.0	2.0
Gross fixed capital form., CZK bn, nom.	926.1	930.5	922.6	902.2	204.5	194.0	.	.	.
annual change in % (real)	-11.0	1.0	0.4	-2.8	0.1	-5.3	-3.0	1.0	3.0
Gross industrial production									
annual change in % (real)	-13.6	8.6	5.9	-0.8	2.7	-5.4	-1.5	2.0	6.0
Gross agricultural production (EAA)									
annual change in % (real)	-3.6	-7.0	8.6	-6.6	.	.	.	.	.
Construction industry									
annual change in % (real)	-0.8	-7.4	-3.6	-7.7	-10.0	-10.9	-5.0	2.0	4.0
Employed persons, LFS, th, average [3]	4934.3	4885.2	4904.0	4890.1	4834.9	4884.0	4890	4900	4910
annual change in % [3]	-1.4	-1.0	0.4	0.4	0.1	1.0	0.0	0.2	0.2
Unemployed persons, LFS, th, average [3]	352.2	383.5	353.6	366.8	369.2	392.8	.	.	.
Unemployment rate, LFS, in %, average [3]	6.7	7.3	6.7	7.0	7.1	7.5	7.6	7.7	7.3
Reg. unemployment rate, in %, end of period [4]	9.2	9.6	8.6	9.4	8.9	8.0	9.5	9.5	9.0
Average gross monthly wages, CZK [5]	23344	23864	24455	25112	24146	24061	.	.	.
annual change in % (real, gross)	2.3	0.7	0.6	-0.6	-0.4	-2.2	0.0	1.0	2.0
Consumer prices (HICP), % p.a.	0.6	1.2	2.2	3.5	4.0	1.7	1.9	2.0	1.8
Producer prices in industry, % p.a.	-1.5	0.1	3.7	2.3	3.8	0.8	0.5	1.5	1.5
General governm. budget, EU-def., % of GDP									
Revenues	38.9	39.1	40.0	40.3	.	.	.	.	.
Expenditures	44.7	43.8	43.2	44.6	.	.	.	.	.
Net lending (+) / net borrowing (-)	-5.8	-4.8	-3.3	-4.4	.	.	-3.5	-3.2	-3.0
Public debt, EU-def., % of GDP	34.2	37.9	41.0	45.9	.	.	46.9	48.5	49.5
Central bank policy rate, % p.a., end of period [6]	1.00	0.75	0.75	0.05	0.75	0.05	0.05	0.25	0.50
Current account, EUR mn	-3428	-5894	-4247	-3735	679	656	-2500	-2500	-3100
Current account, % of GDP	-2.4	-3.9	-2.7	-2.5	1.9	1.9	-1.7	-1.6	-1.9
Exports of goods, BOP, EUR mn	70983	86083	97972	102484	26444	25144	104000	111000	122000
annual change in %	-16.3	21.3	13.8	4.6	8.4	-4.9	1.0	7.0	10.0
Imports of goods, BOP, EUR mn	67684	83991	94298	96686	24381	22991	96000	100000	109000
annual change in %	-19.2	24.1	12.3	2.5	5.9	-5.7	-1.0	4.0	9.0
Exports of services, BOP, EUR mn	13924	15812	16646	17174	4029	4073	18000	19000	21000
annual change in %	-6.6	13.6	5.3	3.2	6.8	1.1	3.0	8.0	9.0
Imports of services, BOP, EUR mn	11126	12839	14262	15191	3443	3394	16000	17000	18000
annual change in %	-6.9	15.4	11.1	6.5	6.7	-1.4	3.0	8.0	8.0
FDI inflow, EUR mn	2082	4644	1632	8244	1460	2194	4800	6000	.
FDI outflow, EUR mn	685	882	-231	1044	237	1084	1300	1300	.
Gross reserves of NB excl. gold, EUR mn	28556	31357	30675	33536	31742	34240	.	.	.
Gross external debt, EUR mn	61940	70498	72770	77205	77555	77078	.	.	.
Gross external debt, % of GDP	43.6	47.0	46.8	50.7	50.9	52.0	.	.	.
Average exchange rate CZK/EUR	26.44	25.28	24.59	25.15	25.08	25.57	25.75	25.50	25.25
Purchasing power parity CZK/EUR	18.46	18.49	18.09	17.81	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) From 2012 according to census March 2011. - 4) From 2013 available job applicants 15-64 in % of working age population 15-64, available job applicants in % of labour force before. - 5) Including part of the Ministry of Defence and the Ministry of the Interior. - 6) Two-week repo rate.

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

annually). The corporate and household sectors' demand for credit remains weak, reflecting the 'real' sector's overall gloomy outlook (but also overabundance of own financial resources of the corporates). The commercial banks' assets rise primarily on account of their net foreign positions expanding (by about 11% annually).

The Czech National Bank has done all it possibly could to ease the strain felt by the economy. Its desperate decision to reduce the policy rate to zero (literally to 0.05%) may have helped to weaken the Czech currency somewhat. But it had no perceptible effect as far as lending by the real sector is concerned – and as far as investment activities are concerned. Of course, it may have strengthened the financial and liquidity position of commercial banks. But, the monetary policy alone, even if competently executed, could not help stop the current recession from deepening. In particular, a 'quantitative easing' would not make much sense in the Czech context. A 'quantitative easing' makes some sense as a way of cheap financing of the public sector 'excessive' deficit. The Czech public sector deficit, though termed 'excessive' by the European Commission officials, is actually quite small, falling and otherwise cheap to finance by orthodox methods. (The interest rate on 10-year Czech government bonds is close to 2%.)

The fiscal policy definitely contributed to the recession in 2012. The fiscal 'effort' (i.e. additional discretionary measures reducing the public sector deficit) is estimated to have reached close to 1% of the GDP in 2012. Despite this the 3% public sector/GDP ratio target was missed by a large margin – not only because the tightening provoked (also through the VAT-induced inflationary erosion of wages) a recession instead of the 'planned' GDP stagnation. Also, the decision to compensate the Churches (primarily the Catholic Church) for the property expropriated during the Communist era is proving costly.

The discretionary measures will continue to have negative effects in 2013, 2014 and 2015, with taxation and expenditure measures bringing 'savings to the public purse' equivalent to 1.4%, 0.3% and 0.5% of GDP respectively. Clearly, fiscal consolidation will – if continued – do nothing to help moderate the recession. This fact does not seem to have dawned on the Czech fiscal authorities so far. While the consolidation may please the European Commission, it is less appreciated by competent macroeconomic experts. A rather unusually open – and critical – evaluation of the need to strive for fiscal consolidation in the Czech Republic has been repeatedly voiced by the IMF. The most recent (dated 20 May 2013[27]) IMF statement concludes that '... pro-cyclical fiscal consolidation set to meet the Excessive Deficit Procedure target this year has induced cautious consumer and business behaviour, while room for further cutting policy interest rates is exhausted by reaching the zero lower band ...'.

Concluding, in 2013 the Czech economy is exposed to a number of risks. Bereft of anti-cyclical fiscal expansion and of meaningful monetary policy, it must rely primarily on external trade. Recession in the major export markets could have the most debilitating effects on the Czech economy. Some weakening of the Czech currency registered in the recent months may prove to be of vital impor-

[27] http://www.imf.org/external/np/ms/2013/052013.htm

tance – not so much as far as the promotion of the Czech exports are concerned, but primarily as providing some protection against competitive imports.

Other risks, possibly essential for other countries, do not seem very serious in the Czech case. The monetary policy is not going to make irresponsible moves while the country's banks, corporate non-financial and household sectors are financially sound and resilient to imaginable disturbances. The same applies to the public sector the debt of which is fairly low and quite cheap to finance.

All in all, the country's economy, free of significant internal and external imbalances, may be well equipped to benefit from a euro area recovery, when this eventually materialises. Of course, the country's growth potential could be mobilised even if euro area stagnation drags on for some time. But such a mobilisation would require a resolute change in the fiscal policy orientation, which is unlikely to happen as long as the present conservative-liberal government stays in power.

Sebastian Leitner

Estonia:
Consumption should avert a second dip

The ongoing recessionary economic environment in the EU in general and stagnation in the Scandinavian countries placed a strain on the country's growth prospects. Thus, the mood of entrepreneurs to invest remains subdued, while public investment activity has been sharply curtailed compared to the recent recovery phase. Only household consumption is fuelling GDP growth thanks to real wages increasing more than productivity.

The euro area and Estonia's second most important trading partner Finland are in recession in 2013, while in Sweden private and public consumption prevent the country's economy from slipping down the same road. As expected, the Estonian export growth will slow down further this year after being already anaemic in 2012, driven by low expectations for short- to medium-term recovery in the Nordic trading partners and the euro area in general. However, most likely the still more lively economic activity in the Baltic neighbours and demand from Russia should prevent Estonian exports from falling nominally, especially in the electronics industry, which had to suffer last year. In the wake of reduced public investments imports are stagnating as well, thus the contribution of net exports to GDP growth will most probably be slightly positive.

The strong impetus to economic growth coming from gross fixed capital formation last year is absent in 2013. It had resulted from public investments in the construction sector, transport and energy infrastructure, financed by EU funds and revenues from the sales of CO_2 emission certificates. Most of these projects have been finalised and the government refrains from applying expansionary fiscal measures to bolster growth. At the same time the corporate sector hesitates to upgrade its equipment given the meagre outlook for external demand. Furthermore, reported capacity utilisation rates remain at a low level of 70% in the manufacturing sector. Enterprises began to increase their loan stock gradually starting already in the second half of 2012. However, we expect enterprises to raise their expenditures for capital replacement only towards the end of the year 2013. Although the real estate market has bottomed out and dwelling prices are slightly rising again, households started to increase their debt burden only very slightly at the beginning of 2013. As a result, investments in the housing sector are still meagre. In general we expect growth in fixed investments to remain stagnant in 2013, given the reduction of public outlays this year.

While throughout 2012 still lively demand on the domestic market resulted in an improved labour market situation, the growth in employment almost came to a halt. The number of jobs in industrial sectors is declining and stagnating in construction while still growing slightly in higher-skilled service sectors. Total employment growth, which still amounted to 2.6% in 2012, is presumably to slow down to 1.5% in 2013. Accordingly, the unemployment rate, which had already fallen to below 10%

Table EE

Estonia: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	1340.3	1340.2	1294.7	1290.5	1294.5	1286.5	1285	1280	1275
Gross domestic product, EUR mn, nom.	13762	14323	15951	16998	3856	4075	17900	19200	20800
annual change in % (real)	-14.1	3.3	8.3	3.2	3.4	1.1	2.0	3.2	3.5
GDP/capita (EUR at exchange rate)	10300	10700	12300	13200	.	.	.	.	.
GDP/capita (EUR at PPP)	14700	15500	17500	18700	.	.	.	.	.
Consumption of households, EUR mn, nom.	7271	7287	7929	8560	2065	2218	.	.	.
annual change in % (real)	-15.2	-2.4	3.6	4.4	4.1	3.6	3.3	3.5	4.0
Gross fixed capital form., EUR mn, nom.	2949	2733	3460	4247	817	801	.	.	.
annual change in % (real)	-38.3	-7.4	25.7	20.9	20.2	-6.5	1.0	5.0	7.0
Gross industrial production									
annual change in % (real)	-24.0	23.6	19.9	-0.2	0.1	3.7	2.8	7.0	9.0
Gross agricultural production (EAA)									
annual change in % (real)	2.8	-4.0	9.7	0.4	.	.	.	.	.
Construction industry									
annual change in % (real)	-29.8	-8.5	27.3	18.4	27.9	1.6	.	.	.
Employed persons, LFS, th, average	595.8	570.9	609.1	624.4	614.3	623.1	634	642	650
annual change in %	-9.2	-4.2	6.7	2.5	3.9	1.4	1.5	1.3	1.2
Unemployed persons, LFS, th, average	95.1	115.9	86.8	70.5	79.6	70.8	66.6	63.5	56.5
Unemployment rate, LFS, in %, average	13.8	16.9	12.5	10.2	11.5	10.2	9.5	9.0	8.0
Reg. unemployment rate, in %, end of period	13.3	10.1	7.3	6.1	7.6	6.7	.	.	.
Average gross monthly wages, EUR	784	792	839	887	846.8	900.4	.	.	.
annual change in % (real, gross)	-4.9	-1.8	0.9	1.7	2.4	2.7	.	.	.
Consumer prices (HICP), % p.a.	0.2	2.7	5.1	4.2	4.6	3.8	3.4	4.0	4.5
Producer prices in industry, % p.a.	1.0	3.2	4.2	2.6	3.6	7.5	.	.	.
General governm. budget, EU-def., % of GDP									
Revenues	43.5	40.9	39.5	40.2	.	.	39.5	39.0	39.0
Expenditures	45.5	40.7	38.3	40.5	.	.	39.8	39.0	38.5
Net lending (+) / net borrowing (-)	-2.0	0.2	1.2	-0.3	.	.	-0.3	0.0	0.5
Public debt, EU-def., % of GDP	7.2	6.7	6.2	10.1	6.8	.	11.0	10.5	9.0
Central bank policy rate, % p.a., end of period 3)	2.83	0.92	1.00	0.75	1.0	0.8	.	.	.
Current account, EUR mn	470	420	339	-205	-108	-122	-550	-700	-900
Current account, % of GDP	3.4	2.9	2.1	-1.2	-2.8	-3.0	-3.1	-3.6	-4.3
Exports of goods, BOP, EUR mn	6460	8770	12056	12565	2994	2945	12800	14000	15500
annual change in %	-23.9	35.8	37.5	4.2	9.2	-1.6	2.0	9.0	11.0
Imports of goods, BOP, EUR mn	7051	9035	12277	13301	3143	3129	13500	15500	18000
annual change in %	-33.0	28.1	35.9	8.3	9.4	-0.5	1.0	15.0	16.0
Exports of services, BOP, EUR mn	3200	3442	3900	4243	901	1001	4650	5300	6200
annual change in %	-11.1	7.6	13.3	8.8	17.5	11.1	10.0	14.0	17.0
Imports of services, BOP, EUR mn	1809	2102	2660	3021	673	765	3350	3800	4500
annual change in %	-20.9	16.2	26.5	13.6	21.0	13.6	11.0	13.0	18.0
FDI inflow, EUR mn	1325	1207	185	1144	141	115	800	.	.
FDI outflow, EUR mn	1115	106	-1049	689	85	67	300	.	.
Gross reserves of NB excl. gold, EUR mn 4)	2758	1904	150	218	202	241	.	.	.
Gross external debt, EUR mn	17204	16420	15250	16622	15610	16054	.	.	.
Gross external debt, % of GDP	125.0	114.6	95.6	97.8	97.0	89.7	.	.	.
Purchasing power parity EUR/EUR	0.6966	0.6906	0.7044	0.7060	.	.	.	.	.

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

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

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

in the second half of 2012, will decrease further only gradually in 2013 and also beyond. The overall level of employment in 2013 is still 5% lower compared to 2007.

In line with a slight amelioration of the labour market in general and quite a favourable situation for highly skilled workers, gross wages continued to rise, by 2.7% in real terms in the first quarter of 2013. We expect the rise in labour costs to act as a driver of overall price developments in 2013. The completion of the opening of the electricity market in January 2013 has already caused a substantial rise in the price of electricity for households. Only in 2014, when the EstLink 2 cable – which will triple the transport capacity of electricity between the Estonian and the Finish grid – is to be launched, a slight fall in electricity prices is to be expected. Due to the low price increases of imports and the expected slight fall of the price of oil and gas, the consumer inflation rate is to fall slightly to 3.4% in 2013.

In spite of stagnant manufacturing and construction output the consumption activity of Estonian households remained rather robust also at the beginning of 2013. Consumer surveys show that spending plans have not deteriorated, while deleveraging of households has bottomed out. Thus we expect that also in 2013 domestic consumption will grow by 3.3% in real terms and thus keep up overall GDP growth.

The final outcome of last year's budget figures was a deficit of 0.3% of GDP, a more favourable than expected result driven by growing tax revenues. On the expenditure side the partial offset of the public wage cuts, executed during the Estonian bust, a small pension increase of about 5% and a capital injection for the national air carrier will be positive drivers, while public investment cuts will lead to a decline in total public outlays. Apart from the increase in excise taxes and a reduction of the unemployment insurance contribution from 4.2% to 3% of labour costs, the 2013 budget approved last December does not foresee any major changes in the tax code. Hence, a lower GDP growth will also bring down the growth rate of government revenues, thus we expect the public deficit to remain close to zero also in 2013. The plan of the Estonian government to attain a budget surplus in 2014 can be effected.

Although the outlook for 2014 is slightly better for the euro area and Estonia's main trading partners, external demand will most probably remain a subdued driver of economic growth. However, we expect that together with stable household consumption it should help renew entrepreneurs' good spirits in order to recover private investments. But given the planned further cuts in public investments, which had supported the overall economic activity in the rebound up to 2012, we expect GDP growth to remain below Estonia's potential not only in 2013 with 2.0% but also in 2014 with 3.2%. The most likely scenario for the subsequent years, given a very restrained revival in the euro area, reckons with near-stagnation in view of austerity and structural reform policies. Thus also in Estonia the economic activity will remain subdued. However, if growth resumes as forecasted in 2014 and thereafter, the country might attain in 2015 the GDP level it had already in 2007 before the economy went bust and 'internal devaluation' policies were implemented.

Table HU

Hungary: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	10023	10000	9945	9919	.	.	9920	9900	9880
Gross domestic product, HUF bn, nom.	25626	26607	27886	28276	6350	6438	29500	31000	32800
annual change in % (real)	-6.8	1.3	1.6	-1.7	-0.6	-0.9	0.0	1.2	2.3
GDP/capita (EUR at exchange rate)	9100	9700	10000	9900	.	.	.	.	.
GDP/capita (EUR at PPP)	15300	15900	16500	16500	.	.	.	.	.
Consumption of households, HUF bn, nom.	13551	13665	14360	14883	3533	3605	.	.	.
annual change in % (real)	-6.8	-3.0	0.5	-1.4	-0.3	-0.6	0.0	0.0	0.0
Gross fixed capital form., HUF bn, nom.	5302	4867	4987	4851	879	835	.	.	.
annual change in % (real)	-11.1	-9.6	-3.6	-3.9	-4.5	-5.6	-2.0	0.0	5.0
Gross industrial production									
annual change in % (real)	-17.6	10.5	5.6	-1.8	-0.1	-3.1	1.0	3.0	5.0
Gross agricultural production (EAA)									
annual change in % (real)	-10.6	-11.1	10.7	-9.2	.	.	.	.	.
Construction industry									
annual change in % (real)	-4.4	-10.4	-7.8	-6.0	-11.1	1.4	1.5	2.0	5.0
Employed persons, LFS, th, average	3781.8	3781.2	3811.9	3877.9	3791.3	3817.7	3890	3900	3920
annual change in %	-2.5	0.0	0.8	1.7	1.6	0.7	0.2	0.2	0.5
Unemployed persons, LFS, th, average	420.7	474.8	467.9	475.6	504.1	508.7	.	.	.
Unemployment rate, LFS, in %, average	10.0	11.2	10.9	10.9	11.7	11.8	11.0	10.8	10.6
Reg. unemployment rate, in %, end of period	13.6	13.3	12.4	12.8	13.3	13.9	.	.	.
Average gross monthly wages, HUF 3)	199837	202525	213094	222990	219131	225566	.	.	.
annual change in % (real, net)	-2.3	1.8	2.4	-3.5	-3.9	1.3	.	.	.
Consumer prices (HICP), % p.a.	4.0	4.7	3.9	5.7	5.6	2.7	2.5	2.9	3.0
Producer prices in industry, % p.a.	4.4	4.0	4.1	4.1	6.8	0.6	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	46.9	45.4	53.8	46.5	.	.	.	.	.
Expenditures	51.4	49.8	49.6	48.5	.	.	.	.	.
Net lending (+) / net borrowing (-) 4)	-4.6	-4.4	4.2	-2.0	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	79.8	81.8	81.4	79.2	.	.	78.0	77.5	77.0
Central bank policy rate, % p.a., end of period 5)	6.25	5.75	7.00	5.75	7.00	5.00	.	.	.
Current account, EUR mn	-176	1063	816	1594	-22	.	1500	1300	500
Current account, % of GDP	-0.2	1.1	0.8	1.6	-0.1	.	1.5	1.2	0.4
Exports of goods, BOP, EUR mn	57397	68964	75238	76554	18858	.	78900	83200	92400
annual change in %	-20.3	20.2	9.1	1.7	-0.1	.	3.1	5.5	11.0
Imports of goods, BOP, EUR mn	55028	65749	71838	72497	17976	.	74200	77500	86000
annual change in %	-24.9	19.5	9.3	0.9	1.6	.	2.4	4.5	11.0
Exports of services, BOP, EUR mn	13305	14634	15800	15868	3519	.	16700	18400	20400
annual change in %	-3.6	10.0	8.0	0.4	1.4	.	5.0	10.0	11.0
Imports of services, BOP, EUR mn	11319	11704	12630	12459	2842	.	13000	14000	15500
annual change in %	-7.9	3.4	7.9	-1.4	-6.0	.	4.0	8.0	11.0
FDI inflow, EUR mn	1475	1626	3771	10478	3823	.	2000	.	.
FDI outflow, EUR mn	1365	871	3141	8183	3337	.	.	.	.
Gross reserves of NB, excl. gold, EUR mn	30648	33667	37242	33640	34697	35344	.	.	.
Gross external debt, EUR mn	137120	138233	132343	124005	131067	.	.	.	.
Gross external debt, % of GDP	150.0	143.1	132.6	126.9	.	.	.	.	.
Average exchange rate HUF/EUR	280.33	275.48	279.37	289.25	296.76	296.58	295	290	285
Purchasing power parity HUF/EUR	166.78	167.48	169.65	172.86	.	.	.	.	.

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

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

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

Sándor Richter

Hungary:
Leaving the excessive deficit procedure behind

On 21 June, ECOFIN decided for the abrogation of the excessive deficit procedure (EDP) for Hungary. With this decision, a nearly decade-long process comes to an end this summer for Hungary. The country entered the EDP upon its accession to the EU in 2004 and, contrary to other new members in the same situation, Hungary proved unable to get out of it. Populist policies kept fiscal deficits high until mid-2006, thereafter the results of the first fiscal consolidation efforts were annihilated by the consequences of the global financial crisis from late 2008 on. The currently ruling Fidesz party had fiercely criticised the consolidation programmes of the previous two governments, then from the opposition. Once in power after the 2010 spring elections, Fidesz tried to stimulate economic growth by relaxing fiscal rigour. In response to this attempt, the Commission announced the possible partial suspension of Cohesion Fund transfers for Hungary, unless the government made resolute steps to bring down the budget deficit below 3% of the GDP. Those transfers have been a vital source of public investment in the past few years. As that loss would have been unbearable for the economy, from that point on the government has had no other choice but to re-start fiscal consolidation. In the past two years several deficit cutting packages have been introduced, but up to the series of measures announced in May 2013 the Commission did not consider the Hungarian government's efforts sufficient to keep the fiscal deficit below the Treaty threshold of 3%.

In the first quarter of 2013 Hungary emerged from technical recession, as GDP increased by 0.7% compared to the last quarter of 2012. This was the first positive growth rate after a four-quarter period characterised by shrinking quarterly GDP and can be explained by the exceptionally strong growth (27.6%) of value added in agriculture at the beginning of 2013.

But year-on-year GDP data give no reason for optimism as they show a further decline (0.9%). Of the main branches of the economy, expansion was registered only in agriculture and construction, and in both cases the basis for comparison (first quarter data in 2012) was very low. Value added in industry dropped by 3.2%, in the services sector by 0.2%. On the distribution side of the GDP both private and public consumption have shrunk, the former by 0.6%, the latter by 2.6%. The most disappointing data were reported for gross fixed capital formation (investment): here the extent of the contraction amounted to 5.6%, indicating that there is no turnaround in the country's growth prospects. Foreign trade data display near-stagnation, nevertheless the marginal expansion of exports was somewhat stronger than that of imports.

Financial intermediation has remained a sore spot of the economy. The stock of credits for businesses is 20% smaller than it was before the crisis. In the first quarter of 2013 (year-on-year) the stock of credits to households dropped by 4% while the number of non-performing loans for households increased by 15%. Decreasing repayment discipline has been recorded for forex as well as HUF credits, and for both mortgage and unsecured loans. Moreover, the share of loans in moderate (less than 90 days) payment delay has been rising as well. All in all, in the first quarter of this year not more than 64.1% of loans were amortised as scheduled in the contract.

The process of deleveraging has carried on. Though the stock of foreign currency loans has significantly declined in the past two years, their share in important aggregates has remained high (55% of total loans or 25.7% relative to the GDP). The Hungarian banking sector has had negative profit indicators in the past two years, and the outlook is bleak for 2013 as well. The banks have to cope with the impact of the persisting bank levy and the newly introduced transaction tax, hostile government rhetoric has been continued and the crowding out or withdrawal of one or more foreign-owned banks from the Hungarian market has become an option.

According to survey results of the research institute Tárki, inequality in Hungary has increased over the past three years.[28] Average household incomes dropped in real terms. Incomes of households in the lowest household income decile declined more strongly than the average while those in the top decile increased even in nominal terms. Per capita income in the highest decile relative to that in the lowest decile jumped from 7.2:1 to 9:1. Simultaneously the share of the lowest decile in total income dropped to 1.6% from 3.1%. In 2007 12.6% of the population lived in relative poverty; this share increased by over 1 percentage point in 2008-2009 and by a further 3 percentage points in 2010-2012. The 17% poverty rate in 2012 is higher than the historically measured peak indicator of 1996.

Now that the sword of Damokles in the form of a suspension of Cohesion Fund transfers has been removed, the room for manoeuvre has become wider for the government. Nevertheless this increased freedom will probably not be large enough for the usual large-scale election pledges expected to be made prior to the forthcoming general elections in early 2014. Although the EDP has been lifted, an abrupt change in the cautious fiscal policy may lead to an unfavourable Commission forecast for Hungary, followed by recommendations for a policy change to be adopted within six, in justified cases within not more than three months. In case of non-compliance a new EDP may be launched, as it occurred in the case of Malta. That means that fiscal stimulation of economic growth will continue to be a limited option in Hungary, unless structural reforms release resources in public finance areas characterised by inefficiency.

As for providing a growth stimulus, the focus is currently on monetary policy. A wave of gradual cuts brought the policy rate to its historically lowest value of 4.25% on 26 June 2013. The central bank, under the new governor György Matolcsy, the former Minister of Economy, has started an offensive to step up crediting the SME sector. The programme, reproducing a Bank of England design, secures loans with zero interest rate for the commercial banks, which in turn may volunteer for providing credits to enterprises in the SME sector at a maximum interest rate of 2.5%. The loans from the

[28] Egyenlötlenség és plarizálódás a magyar társadalomban. Tárki Monitor Jelentések 2012, http://www.tarki.hu/hu/research/hm/monitor2012_teljes.pdf

package may finance investments, operational costs, may be used to co-finance EU projects and for the conversion of forex credits to HUF-denominated credits.

This step in the right direction will, most probably, be not enough to turn around the downward trend in depressed financial intermediation. Non-preferential interest rates have remained high (in January around 8% for loans to businesses, at 1.4% industrial producer price inflation), and both the supply of and the demand for loans is weak. The uncertainty in the banking sector is high concerning the duration of the extraordinary burdens (bank levy, the costs of financial transactions). The business sector is reserved due to flat domestic demand, the bleak growth outlook for the main export markets and, last but not least, the uncertainties of the regulatory and taxation environment in the Hungarian economy. Households have remained cautious concerning both consumption and investment just as about raising new credits. High debt service burden after forex loans, the feared negative impact of a possible deterioration of the forint exchange rate at this juncture, and shaken job security explain this behaviour.

Although there are several positive indicators in the economy – such as the reduced costs of revolving public debt, the decreasing risk surcharge, a likely good harvest this year in agriculture, a turnaround in construction output after a long and steep decline – the recent development in and future prospects for the main components of the GDP and the outlook for external demand do not give hope for more than stagnation of the GDP this year. An exceptionally good agricultural output, and a stronger than currently expected expansion of exports may result in a higher growth performance in the range of 0.3% to 0.5%.

Our scenario for 2014 and 2015 assumes that Hungary gradually returns to a higher, investment- and export-driven growth path. A precondition for that is a political and legal consolidation period, a restoration of domestic and foreign investors' confidence, reconciliation with the banking sector based on observed agreements and fair and feasible burden sharing, and an easing of the extreme centralisation of government decisions. These unavoidable changes will have a minimum probability of implementation unless the currently ruling Fidesz party headed by Viktor Orbán is replaced by an alliance of the democratic opposition parties following the next elections in April 2014. If Mr Orbán remains in power for a further four years, the wiiw reckons with a protracted crisis of confidence and marginal economic growth in a depressed society.

Table LV

Latvia: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	2254.8	2239.0	2058.2	2034.9	2038.7	2024.9	2023	2013	2003
Gross domestic product, LVL mn, nom.	13070	12784	14275	15521	3403	3540	16100	16800	17700
annual change in % (real)	-17.7	-0.9	5.5	5.6	7.0	3.6	2.8	3.1	3.5
GDP/capita (EUR at exchange rate)	8600	8600	9800	10900	.	.	.	.	.
GDP/capita (EUR at PPP)	12700	13200	14700	16100	.	.	.	.	.
Consumption of households, LVL mn, nom.	7889	7947	8725	9496	2186	.	.	.	.
annual change in % (real)	-22.8	2.5	4.7	5.5	5.5	4.7	4.5	4.0	4.5
Gross fixed capital form., LVL mn, nom.	2820	2330	3045	3644	692	.	.	.	.
annual change in % (real)	-37.4	-18.1	27.9	12.3	39.0	-10.6	-3.0	8.0	9.0
Gross industrial production 3)									
annual change in % (real)	-18.1	14.9	9.0	6.1	9.7	-4.0	-2.5	5.0	6.0
Gross agricultural production (EAA)									
annual change in % (real)	-0.7	-2.4	2.8	14.9	.	.	.	.	.
Construction industry									
annual change in % (real)	-34.9	-23.4	12.5	13.5	28.5	9.5	.	.	.
Employed persons, LFS, th, average 4)	983.1	940.9	970.5	885.6	857.6	898.3	905	915	925
annual change in % 4)	-12.6	-4.3	3.1	2.8	2.6	4.7	2.2	1.1	1.1
Unemployed persons, LFS, th, average 4)	203.2	216.1	176.4	155.5	166.7	131.9	140	130	120
Unemployment rate, LFS, in %, average 4)	17.1	18.7	15.4	14.9	16.3	12.8	13.2	12.5	11.5
Reg. unemployment rate, in %, end of period 4)	16.0	14.3	11.5	10.5	11.7	10.8	.	.	.
Average gross monthly wages, LVL	461	445	464	481	466	486	.	.	.
annual change in % (real, net)	-5.6	-6.5	0.3	1.6	0.3	4.8	.	.	.
Consumer prices (HICP), % p.a.	3.3	-1.2	4.2	2.3	3.3	0.4	1.0	1.5	2.0
Producer prices in industry, % p.a.	-3.1	2.4	7.7	4.1	7.3	2.0	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	34.0	35.3	34.9	35.2	.	.	34.6	35.0	34.5
Expenditures	43.7	43.4	38.4	36.5	.	.	36.0	34.2	34.5
Net lending (+) / net borrowing (-)	-9.7	-8.1	-3.6	-1.2	.	.	-1.4	-0.8	0.0
Public debt, EU-def., % of GDP	36.9	44.4	41.9	40.7	41.6	.	43.0	40.5	39.0
Central bank policy rate, % p.a., end of period 5)	4.0	3.5	3.5	2.5	3.5	2.5	.	.	.
Current account, EUR mn	1598	532	-434	-371	-149	-71	-650	-900	-1100
Current account, % of GDP	8.6	2.9	-2.1	-1.7	-3.1	-1.4	-2.9	-3.8	-4.4
Exports of goods, BOP, EUR mn	5253	6813	8578	9921	2186	2341	10800	12000	13500
annual change in %	-19.6	29.7	25.9	15.7	14.5	7.7	8.9	11.1	12.5
Imports of goods, BOP, EUR mn	6575	8084	10765	12107	2772	2891	13400	15000	16800
annual change in %	-38.0	23.0	33.2	12.5	20.8	5.0	10.7	11.9	12.0
Exports of services, BOP, EUR mn	2747	2754	3181	3547	805	845	3750	4200	4750
annual change in %	-11.0	0.3	15.5	11.5	21.4	5.6	5.7	12.0	13.1
Imports of services, BOP, EUR mn	1625	1647	1868	2032	442	451	2150	2400	2700
annual change in %	-25.1	1.4	13.4	8.8	15.1	2.4	5.8	11.6	12.5
FDI inflow, EUR mn	68	284	1039	777	259	136	600	.	.
FDI outflow, EUR mn	-44	14	44	148	31	65	100	.	.
Gross reserves of NB excl. gold, EUR mn	4572	5472	4666	5412	5067	5468	.	.	.
Gross external debt, EUR mn	29097	29978	29459	30078	30023	30980	.	.	.
Gross external debt, % of GDP	157.1	166.2	145.8	135.1	142.6	136.4	.	.	.
Average exchange rate LVL/EUR	0.7057	0.7087	0.7063	0.6973	0.6985	0.6997	0.7087	0.7087	0.7087
Purchasing power parity LVL/EUR	0.4812	0.4632	0.4726	0.4726	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 20 and more employees. - 4) From 2012 according to census March 2011. - 5) Refinancing rate of National Bank.

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

Sebastian Leitner

Latvia:
Between Scylla and Eurybdis, ready for taking a dive

Latvia is joining the euro area in 2014 at a time when the euro project itself is in deep trouble, the reason being that the country's ruling elites deem it a safer haven compared to the present hard peg regime. The short-lived 'success story' of internal devaluation is souring again, given the lack of investments, ongoing austerity policies and the impossibility of running an 'export-driven' beggar-thy-neighbour growth model in a phase marked by an EU-wide economic and social crisis. However, wage increases exceeding those of productivity may well bolster economic growth, at least temporarily.

In June the European Commission, in its 2013 Convergence Report on Latvia, confirmed that the country fulfils all Maastricht criteria by a wide margin and proposed to the Council that Latvia shall adopt the euro on 1 January 2014. The analysis presented by the EC in order to assert if a 'high level of sustainable economic convergence' has been achieved however does not prove the latter, but demonstrates the problematic measurement and supply side-oriented interpretation of economic stability and flexibility by the Commission. At the same time, the most recent opinion polls show that the support of the Latvian population for euro adoption could only be raised to 38% – although the Latvian government campaigned broadly for the project. As the analyses of the IMF shortly after the outbreak of the economic bust in the Baltics and the experience of Iceland have shown, the Latvian government would have had much better alternatives than the one chosen, i.e. maintaining the euro peg, implementing harsh austerity measures named 'internal devaluation' and joining the euro area thereafter.

Latvian exporters improved their competitive position during the crisis period by reducing employment and cutting wages, which led to an increase of their shares in the international markets and in general to a rebound of exports in the period up to the end of 2012. Although Latvia still reports positive growth in nominal trade figures, the increase dropped substantially towards the end of the first quarter of 2013. At the same time industrial production plummeted by 4% compared to the first quarter of 2012. Not only did external demand of most of the EU countries decline, but also a remarkable slowdown of Latvian exports to its Baltic neighbours and Russia has occurred recently. However, reduced growth in investments and restocking resulted in imports evolving less swiftly alike. Thus the current account deficit even declined compared to the first quarter of last year.

As expected, growth in gross fixed capital formation, which was particularly volatile last year, dropped substantially in the first quarter of 2013 and is likely to rebound towards the end of this year only if export and growth prospects change to be better. Although capacity utilisation in the manufacturing sector rose remarkably again after the economic bust, it is still below the pre-crisis level at slightly above 70%. In the run-up to the euro area the government has not taken advantage of the good progress of revenues to increase investments in the public infrastructure. The upcoming elections at the national level in 2014, as well as Riga becoming European Capital of Culture in 2014 however might be drivers of some additional public expenditure.

The economic rebound of the past two years effected employment to grow up to the end of 2012, most prominently in the non-tradable sectors, but also in manufacturing. However, due to the massive layoffs during the crisis and substantial emigration total employment is still more than 15% below the level five years ago, and close to 20% of those aged 15 to 34 years are not in employment or education. Overall job creation already slowed down substantially in the first quarter of 2013 (while employment started to decline in manufacturing) and will continue to do so throughout the year but shall still reach about 2% per annum on average. The unemployment rate is likely to amount to about 13% of the active population in 2013 on average. However, economic growth in 2013 is likely to be too low to bring about further fast improvements on the Latvian labour market.

Latvian employees profit from a renewed upswing in gross wages especially in the service sectors, low inflation rates and the reduction of the income tax rate by 1 percentage point to 24% which took place in January 2013. Altogether this led to an increase in net wages by 4.8% in real terms in the first quarter of 2013. This trend is most likely to hold on throughout this year, given the fall in consumer price inflation. Thus consumption of private households will act as the main driver of economic growth in 2013. However, retail figures of the most recent months indicate that the impetus shall be lower compared to last year.

The lively economic activity of 2012 resulted in increased tax revenues of the government. At the same time public expenditures were kept almost unchanged compared to 2011 in real terms. Thus the budget deficit declined to 1.2% of GDP while at the same time the share of public expenditures in GDP was reduced to 36.5% last year. The reason for following this austerity-oriented fiscal policy stance has been not only the envisaged goal of euro adoption but also the outspoken aim of Prime Minister Valdis Dombrovskis to employ supply-side policies in order to return to a minimum state as soon as possible after the bust. He states that: 'These large cuts made long-delayed structural reforms in the public sector necessary, notably in public administration, health care, and education. These reforms are likely to generate positive supply effects that will contribute to greater growth in the future.' [29] In 2012 the share of the health sector in total employment amounted to 5.8%, while the average of the EU-27 ranges at 10.4%.

Similar to last year's outcome the budget for 2013 also foresees a deficit of 1.2% of GDP. The regressive changes to the income tax law, approved together with the 2013 budget, foresee a further reduction of the personal income tax rate to 22% in 2014 and 20% in 2015. This will reduce the income base of the government, hindering the necessary upgrading of public infrastructure in various fields, but especially in the health sector and the social sphere in general. Moreover, the imple-

[29] Anders Aslund and Valdis Dombrovskis (2011), How Latvia came through the financial crisis, Peterson Institute for International Economics.

mented fiscal policies will further fuel boom-bust cycles, increase the high levels of income inequality and perpetuate the deep scars that the policy of 'internal devaluation' has inflicted on Latvian society.

Looking at the other side of the 'success story' we can see that 26% of the Latvian population are severely materially deprived according to Eurostat statistics in 2012. This share was exceeded in the EU only by Romania (29% in 2011) and Bulgaria (43% in 2011), another currency board country pursuing a minimal state ideology, while the EU-27 average amounted to 8.8% in 2011. Thus it is not surprising that emigration especially of the younger generation, which attained an unprecedented large scale during the phase of 'internal devaluation', is going on according to the Latvian Statistical Office.

The reduction of the VAT rate in 2012 brought the development in prices of consumer goods close to deflation in the first half of 2013. This effect will cease from July this year onwards, however, the fall of import prices should keep inflation at 1% per annum.

The reasons for the European Commission to praise Latvia so loudly as the 'success story' of internal devaluation are manifold and questionable at the same time. First of all, the EC defends its support of the Latvian internal devaluation path, a choice which was substantially and rightly criticised by a number of reputed economists and by the IMF during the design of the rescue package implemented after the bust. The considerably higher economic costs of this choice and the resulting social harm are obvious. However, the EC also defends the Latvian experiment of internal devaluation against the headwinds of international commentators who reason about 'Why the Baltic states are no model'[30], since it is replicating the same procedure on a larger scale in the southern core of the European Union with the same and maybe even more disastrous outcomes. Again the EC is telling us recently that rebalancing (which is effected by crushing domestic demand inter alia via cuts in public expenditures) is showing first signs of success, while EU unemployment levels are at unprecedented levels and escalating further.

Given the stagnant economic development in the euro area and the austerity stance of fiscal policies of the government, GDP growth shall decline substantially also in Latvia, from 5.4% last year to 2.8% in 2013. However, this rather favourable outcome for a period when the EU in general is in recession is driven by household consumption, a demand effect that is still backing overall economic activity. The further outlook is based on the assumption of a slight improvement of economic activity in Europe in 2014, wage growth in the Latvian service sectors above productivity, while on the negative side it is expected that the Dombrovskis government will follow its procyclical fiscal policy track-record. Depending on euro area and also Russian external demand, Latvian producers may develop some optimistic animal spirits and invest in the coming year in order to exploit their export possibilities and expand their capacities. Thus we expect GDP growth to revive to 3.1% in 2014 and 3.5% in 2015.

[30] Comment by Martin Wolf, *Financial Times*, 30 April 2013, http://www.ft.com/cms/s/0/090bd38e-b0c7-11e2-80f9-00144feabdc0.html. Others having pointed to the fact that the Latvian and Baltic experience proves once and again that internal devaluation is one of the costliest alternatives in terms of economic loss and social problems in order to rebalance; to name but a few: Zsolt Darvas, Heiner Flassbeck, Jeffrey Sommers and of course Paul Krugman.

Table LT

Lithuania: Selected Economic Indicators

	2009	2010	2011	2012 [1)]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2)]	3339.5	3286.8	3029.3	2993.5	2998.5	2970.4	2979	2964	2949
Gross domestic product, LTL mn, nom.	92032	95323	106370	113472	25250	26223	119800	127500	137600
annual change in % (real)	-14.8	1.5	5.9	3.7	3.9	3.5	3.5	3.8	4.2
GDP/capita (EUR at exchange rate)	8000	8400	10200	11000	.	.	.	.	.
GDP/capita (EUR at PPP)	12900	14100	16600	18000	.	.	.	.	.
Consumption of households, LTL mn, nom.	62807	60586	67431	72605	16919	17769	.	.	.
annual change in % (real)	-17.8	-4.8	6.8	4.3	7.4	2.9	3.0	4.0	4.5
Gross fixed capital form., LTL mn, nom.	15807	15589	18901	18925	3597	3948	.	.	.
annual change in % (real)	-39.5	1.9	18.4	-2.4	6.1	6.4	7.0	10.0	12.0
Gross industrial production (sales)									
annual change in % (real)	-13.8	6.4	6.4	3.7	2.8	6.3	6.0	8.0	8.0
Gross agricultural production (EAA)									
annual change in % (real)	1.0	-7.2	10.3	14.5	.	.	.	.	.
Construction industry									
annual change in % (real)	-48.3	-7.3	22.1	-7.3	7.9	-4.6	.	.	.
Employed persons, LFS, th, average [3)]	1415.9	1343.7	1370.9	1278.5	1252.2	1267.2	1295	1315	1330
annual change in % [3)]	-6.8	-5.1	2.0	1.8	1.3	1.2	1.3	1.5	1.1
Unemployed persons, LFS, th, average [3)]	225.1	291.1	248.8	195.2	211.6	191.2	177	163	148
Unemployment rate, LFS, in %, average [3)]	13.7	17.8	15.4	13.3	14.5	13.1	12.0	11.0	10.0
Reg. unemployment rate, in %, end of period [4)]	12.5	14.4	11.0	11.4	11.8	12.4	.	.	.
Average gross monthly wages, LTL [5)]	2056.0	1988.1	2045.9	2123.8	2138.1	2239.9	.	.	.
annual change in % (real, net)	-7.2	-4.3	-1.4	0.5	-0.5	2.0	.	.	.
Consumer prices (HICP), % p.a.	4.2	1.2	4.1	3.2	3.6	2.2	2.0	2.5	3.6
Producer prices in industry, % p.a.	-13.5	10.3	13.9	5.0	8.5	-0.1	.	.	.
General goverm.budget, EU-def., % of GDP									
Revenues	35.5	35.2	33.3	32.9	33.3	.	33.0	33.3	34.0
Expenditures	44.9	42.4	38.9	36.2	38.9	.	35.5	35.5	36.0
Net lending (+) / net borrowing (-)	-9.4	-7.2	-5.5	-3.3	-5.5	.	-2.5	-2.2	-2.0
Public debt, EU-def., % of GDP	29.3	37.9	38.5	40.7	42.7	.	40.2	39.0	37.0
Central bank policy rate, % p.a., end of period [6)]	1.57	1.07	1.24	0.52	0.79	0.34	.	.	.
Current account, EUR mn	996	20	-1151	-167	-782	-386	-1000	-1100	-1200
Current account, % of GDP	3.7	0.1	-3.7	-0.5	-10.7	-5.1	-2.9	-3.0	-3.0
Exports of goods, BOP, EUR mn	11797	15651	20151	23071	5125	5988	26000	29000	32000
annual change in %	-26.6	32.7	28.8	14.5	12.0	16.8	12.7	11.5	10.3
Imports of goods, BOP, EUR mn	12688	16990	21958	24131	5759	6132	26100	29500	33500
annual change in %	-37.4	33.9	29.2	9.9	13.6	6.5	8.2	13.0	13.6
Exports of services, BOP, EUR mn	2629	3088	3738	4587	909	1013	5300	6350	7800
annual change in %	-18.9	17.5	21.0	22.7	19.1	11.5	15.5	19.8	22.8
Imports of services, BOP, EUR mn	2192	2274	2742	3340	739	895	4000	4700	5500
annual change in %	-22.7	3.7	20.6	21.8	21.9	21.1	19.8	17.5	17.0
FDI inflow, EUR mn	-9	604	1040	650	280	478	1400	.	.
FDI outflow, EUR mn	143	-4	40	312	59	44	250	.	.
Gross reserves of NB excl. gold, EUR mn	4472	4788	6120	6203	5755	5401	.	.	.
Gross external debt, EUR mn	22363	22976	23976	24784	25302	.	.	.	.
Gross external debt, % of GDP	83.9	83.2	77.8	75.4	77.0	.	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/EUR	2.1363	2.0627	2.1198	2.1108	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) From 2012 according to census March 2011. - 4) In % of working age population. - 5) Annual data include earnings of sole proprietors. - 6) VILIBOR one-month interbank offered rate (Lithuania has a currency board).

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

Sebastian Leitner

Lithuania:
Demand-side policies affect balanced growth

Lithuania's new centre-left coalition government seems to have put into effect an appropriate policy-mix combining demand-side measures and growth-enhancing supply-side instruments. Raising minimum wages has not increased consumer inflation; it has, however, bolstered household consumption, while investments in transport infrastructure have boosted prospects of growth in the medium term. At the same time, surprisingly high export growth has kept the current account deficit low. One of the dangers to economic growth and the current rebound in welfare after the bust is that the government might resort to austerity in order to aim at too early an accession to the euro area in 2015.

Growth of goods exports speeded up as expected also in the first quarter of 2013 contrary to the situation in the Baltic neighbours. However, one should keep in mind that two major effects drive the favourable nominal export increase. First, the abundant harvest of last year, which was 25% higher than a year earlier, and second, higher revenues of the Mazeiku Nafta refinery resulting inter alia from new export destinations for its refined petroleum such as Iran, Algeria and more intensive export activity towards Belarus, the United States, Poland and also Russia. Nevertheless, since the positive effect of crops and fuel exports will most likely recede throughout this year and external demand from the Baltic neighbours is likely to weaken, we expect Lithuania's growth in goods exports to decline somewhat compared to 2012. However, falling crude oil prices also reduce the nominal growth of imports and thus the contribution of net exports to overall GDP growth will still remain balanced and the deficit of the current account at a low level in 2013.

The new government led by the Social Democratic party is stepping up investments in the public infrastructure. Considerable investments in the energy and transport infrastructure started to be realised, such as the international container distribution centre in Klaipeda, the most important Lithuanian port, and the LNG terminal at the same site. In the future it will cover up to 25% of Lithuania's gas demand. Both projects shall be finalised in 2015 and will remain drivers of strong investment activity thereupon. At the same time however entrepreneurs are still reluctant to expand investments given the uncertain prospects for external demand for most manufactured goods in the euro area. Households and companies have started taking up more credits but are still deleveraging slightly. Investments are reported to be financed much more out of earnings or, in the case of household investment in dwellings, out of accumulated savings. Dwellings construction is increasing, while overall construction activities are still on the decline. As the Lithuanian refinery still reduced its stock of crude oil due to high prices, overall investment activity even declined. However, this year private but much more so public gross fixed capital investments shall develop at high pace.

After a substantial rise in employment in 2012, job increases slightly slowed down in the first quarter of 2013. However, growth in employment continues in manufacturing and high-skill service sectors. The unemployment rate fell in the first quarter of 2013. Although employment shall continue to grow in 2013, we also expect labour supply to increase more strongly this year. Although employment rates for the younger generation have increased considerably in the past few year, the unemployment rate for those aged 15-24 still amounts to 23%, double the figure before the economic bust. Emigration declined remarkably and immigration is increasing; net migration is still negative. The improving situation of the labour market has changed the situation for the better and attracts more migrant workers to return to their home country.

The necessary step to raise the minimum gross wage of employees to EUR 289 after the parliamentary election in late 2012 did not result in higher inflation but is a first step in recuperating the living conditions of low-income groups to a decent level, necessary to prevent further emigration of the much needed workforce. The increase in the purchasing power of low-income earners will further support the growth of domestic demand this year, while consumer sentiments are improving. The expert group established by the new government in order to deliver recommendations for changes in the personal income tax system has not presented final suggestions yet. It is still unclear if the envisaged redistribution of the tax burden shall be realised within the existing flat tax system or via introduction of progressive income taxation. A decision on the issue may be expected towards the end of the year. The anticipated changes shall serve two purposes. First, as the Finance Minister pointed out (and the EC and OECD have done for a long time already) the tax wedge of low-wage earners should be lowered to allow for higher employment growth for low-skilled workers. Second, it would give Lithuania the chance to take the necessary steps towards an increase of the meagre government share of below 36% in 2013, while at the same time reducing its debt burden, if required. Lithuania would need to increase its public expenditures in the social sphere in general but especially for health purposes. As in the other Baltic states the share of employees in the public social sectors in total employment is substantially below the EU-27 average and too small to deliver reasonable health outcomes.

Given the favourable economic developments, tax revenues will expand rather favourably. At the same time the share of public expenditures declined strongly also due to the still effective pay freezes for medium to high wage earning public servants. Since refinancing costs of public debt are likely to fall further, we expect a reduction of the budget deficit to 2.5% of GDP in 2013. Thereafter the Lithuanian government may opt for a slower pace in further reducing the budget deficit. The new centre-left government announced the aim of joining the euro area at the beginning of 2015, yet consumer inflation will most probably exceed the Maastricht criteria unless 'unorthodox measures' are to be introduced (the Latvian government e.g. lowered the value added tax by 1 percentage point). A danger to the momentarily positive economic developments in the country is that the Lithuanian government might aim at too early euro accession. As can be seen from the cases of Latvia and Estonia (but also other small open economies such as Ireland and Slovenia) the euro area neither is a safe haven nor does it deliver the right instruments and policies for economic and social cohesion. Early entry would in the case of Lithuania hamper economic growth and thus welfare developments, which alienates international investors much more than a reasonable delay of the entry date towards the euro area. Moreover, the government would risk to lose the support of the electorate that ousted austerity-driven ‘internal devaluation’ policies. As in Latvia, the project of euro accession is supported only by a minority of the population.

A still rather favourable development of external demand, the ongoing upswing in investments and robustly evolving household demand is expected to result in GDP growth by 3.5% in 2013. The scenario for the years to come is based on the assumptions of a slight weakening of external demand in the euro area, while domestic demand, including expenditures for the public wage bill and investments, will further speed up. Thus, we expect GDP growth to increase to 3.8% in 2014 and 4.2% in 2015.

Table PL

Poland: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	38152	38184	38534	38560	38207	38521	38540	38530	38525
Gross domestic product, PLN bn, nom.	1344.5	1416.6	1528.1	1595.3	370.2	377.8	1640	1720	1820
annual change in % (real)	1.6	3.9	4.5	1.9	3.5	0.5	1.2	2.7	3.5
GDP/capita (EUR at exchange rate)	8100	9200	9600	9900	.	.	.	.	.
GDP/capita (EUR at PPP)	14200	15300	16200	17000	.	.	.	.	.
Consumption of households, PLN bn, nom.	809.7	856.2	921.6	962.7	247.4	249.3	990	1030	1090
annual change in % (real)	2.1	3.1	2.7	0.8	1.7	0.0	1.2	2.0	3.5
Gross fixed capital form., PLN bn, nom.	284.6	281.3	308.7	309.3	46.6	45.0	310	330	360
annual change in % (real)	-1.3	-0.4	8.5	-0.8	6.8	-2.0	0.0	4.0	6.0
Gross industrial production (sales) 3)									
annual change in % (real)	-3.8	11.1	6.7	1.2	4.4	-1.6	0.6	2.5	6.0
Gross agricultural production (EAA)									
annual change in % (real)	6.1	-3.2	-1.0	2.3	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	4.7	3.9	15.3	-5.3	13.6	-15.6	.	.	.
Employed persons, LFS, th, average 4)	15868.0	15960.5	16130.5	15590.7	15398.0	15291.0	15590	15620	15700
annual change in % 4)	0.4	0.6	1.1	0.2	0.2	-0.7	0.0	0.2	0.5
Unemployed persons, LFS, th, average 4)	1411.1	1699.3	1722.6	1749.2	1809.0	1944.0	1800	1780	1750
Unemployment rate, LFS, in %, average 4)	8.2	9.6	9.7	10.1	10.5	11.3	11.0	10.8	10.5
Reg. unemployment rate, in %, end of period	11.9	12.3	12.5	13.4	13.3	14.3	13.8	13.3	13.0
Average gross monthly wages, PLN 5)	3101.7	3224.1	3403.5	3540.0	3664.2	3740.8	3620	3720	3850
annual change in % (real, gross) 5)	2.0	1.4	1.4	0.0	1.3	0.8	0.8	0.8	1.5
Consumer prices (HICP), % p.a.	4.0	2.7	3.9	3.7	4.2	1.3	1.5	2.0	2.0
Producer prices in industry, % p.a.	3.1	1.8	7.3	3.3	5.8	-0.5	0.0	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	37.2	37.6	38.4	38.4	.	.	37.6	36.9	.
Expenditures	44.6	45.4	43.4	42.3	.	.	41.6	41.0	.
Net lending (+) / net borrowing (-)	-7.4	-7.9	-5.0	-3.9	.	.	-3.9	-3.6	-3.3
Public debt, EU-def., % of GDP	50.9	54.8	56.2	55.6	.	.	56.5	57.0	57.0
Central bank policy rate, % p.a., end of period 6)	3.5	3.5	4.5	4.3	4.5	3.3	2.25	2.5	2.5
Current account, EUR mn 7)	-12153	-18121	-17974	-13484	-4488	-2645	-12000	-14900	-16500
Current account, % of GDP 7)	-3.9	-5.1	-4.8	-3.5	-5.1	-2.9	-3.1	-3.6	-3.8
Exports of goods, BOP, EUR mn 7)	101715	124998	140137	146595	35823	37284	152500	160600	172600
annual change in %	-15.9	22.9	12.1	4.6	4.3	4.1	4.0	5.3	7.5
Imports of goods, BOP, EUR mn 7)	107140	133893	150193	151908	37937	36889	153400	162600	175600
annual change in %	-24.5	25.0	12.2	1.1	4.5	-2.8	1.0	6.0	8.0
Exports of services, BOP, EUR mn 7)	20717	24718	26950	29381	6444	6549	30600	33000	36300
annual change in %	-14.4	19.3	9.0	9.0	10.8	1.6	4.0	8.0	10.0
Imports of services, BOP, EUR mn 7)	17294	22381	22905	24566	5358	5473	25300	27300	30600
annual change in %	-16.6	29.4	2.3	7.3	9.4	2.1	3.0	8.0	12.0
FDI inflow, EUR mn 7)	9339	10518	13642	2663	1054	883	.	.	.
FDI outflow, EUR mn 7)	3331	5489	5280	-647	1830	-2132	.	.	.
Gross reserves of NB excl. gold, EUR mn	52734	66253	71028	78676	70626	80809	.	.	.
Gross external debt, EUR mn	194396	237359	248085	276101	261015	.	280000	290000	310000
Gross external debt, % of GDP	62.6	66.9	66.9	72.4	68.5	.	.	.	.
Average exchange rate PLN/EUR	4.3276	3.9947	4.1206	4.1847	4.2322	4.1563	4.25	4.20	4.15
Purchasing power parity PLN/EUR	2.4767	2.4040	2.4424	2.4380	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 10 and more employees. - 4) From 2012 according to census March 2011. - 5) Quarterly data refer to enterprises with 10 and more employees. - 6) Reference rate (7-day open market operation rate). - 7) Including Special Purpose Entities (SPEs).

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

Leon Podkaminer

Poland:
Not so soft landing ahead

In the first quarter of 2013 GDP growth continued, albeit at a low speed. Consumption, both private and public, remained essentially flat. Gross fixed capital formation, which still looked strong in the first quarter of 2012 when it increased by 6.7%, fell 2% – still not as strongly as in the fourth quarter of 2012 when it had fallen by over 4%. But the decline in inventories has accelerated. All in all, the decline in domestic demand (by 0.9%) in the first quarter of 2013 was yet less pronounced than generally expected – and less steep than in the fourth quarter of 2012. External trade in goods and non-factor services saved the day, with the volume of imports reduced by 1.7% and the volume of exports still rising, by 1.3%. The contribution of external trade to GDP growth in the first quarter of 2013 was 1.4 percentage points.

Fast disinflation has continued during the first four months of 2013. The consumer price index rose only 0.8% in April (year-on-year). Further CPI contractions are quite likely. The current disinflation emerged, fairly automatically, once the one-off hikes in the rates of indirect taxation (effective as of January 2011) and in regulated prices of some utilities (effective as of mid-2011) had been passed through into the consumer prices. The outright deflation in industrial producer prices (which set in in the third quarter of 2012) is naturally supporting a gradual consumer price disinflation as well. (Deflation in the construction sector's producer prices started even earlier, at mid-2012.) It is quite obvious that both disinflation (in consumer prices) and deflation (in producer prices) could only have developed under the weak pace of growth in household incomes – and the domestic demand generally. On the other hand, the continuing strength of the Polish currency, for about a year now, may have also been supporting disinflation/deflation.

The National Bank of Poland, taken aback by the speed of disinflation, is responding to the current developments by delayed cuts of its interest rates. The long overdue relaxation of the monetary policy may not, at present, have much of the expected impact as far as a mobilisation of lending from commercial banks is concerned. Commercial banks are likely to drag their feet. It will take time before the interest rates on loans to their clients are reduced. And even effectively lower market interest rates need not contribute meaningfully to stronger investment or consumption. Besides, to the creditworthy domestic borrowers the cost of credit may not matter all that much because the uncertainties about the future income streams are still excessive.[31] Of course, the monetary policy

[31] The corporate and household sectors' demand for loans has been stagnant. The credit liabilities of these two sectors rose by 2.6% and 3% (March 2013 over March 2012) respectively. But their deposits in the commercial banks rose, over the same period, by 6.8% and 9.7% respectively. Currently the private sector prefers liquidity to spending. The opposite is true for the public sector, which absorbs – through steeply expanding bank borrowing – the money balances saved by the private sector.

relaxation may help weaken the Polish currency. So far the Polish zloty has been remarkably strong vis-à-vis the euro, arguably also on account of high interest rates prevailing in Poland. The real hope might be that with somewhat lesser interest rate differentials against the international markets, the carry trade (or short-term foreign financial investment in PLN-denominated assets) would become less lucrative to the international financial investors, or more risky than it is at present. Consequently, the Polish currency might weaken more markedly (as it did back in 2009, when a strong depreciation of the Polish currency saved the country – through effects on exports and imports – from being engulfed by recession).

While inflation recedes, nominal wages are still creeping up, albeit at a slow pace. This is a clear sign of incomplete labour market flexibility (the other sign being the limited responsiveness of nominal wages to rising unemployment). In effect, after falling in the second half of 2012, *real* wages started to recover in the first quarter of 2013. The total wage bill did not fall in real terms in the first quarter of 2013 (as the decrease in employment was quite marginal). The positive effects of the current disinflation are even more pronounced with respect to the mandatory social security payments (retirement pays in the first place). All in all, the real value of household incomes has been increasing – creating the space for possibly increased consumer spending.

The financial situation of the enterprise sector (non-financial firms operating outside agriculture and employing 49 persons or more) has been progressively worsening since the second quarter of 2012. The entire net (post-tax) profit of the sector earned in the first quarter of 2013 reached PLN 17.6 billion (approximately EUR 4.2 billion), down from PLN 23.6 billion earned during the first quarter of 2012. The weakening of profits has much to do with weak demand and fiercer competition (both showing up in producer price deflation) – as well as with higher nominal wages. Profits have been also weakening in the banking sector. In the first quarter of 2013 banks' net profits reached PLN 4 billion (6.7% down on profits earned a year earlier).

Despite the contraction of profits, the corporate sector disposes of huge (and still rising) own financial resources much of which are idly resting on deposit accounts. These resources, supported by bank loans or other external funds if necessary, could support higher investment in fixed assets – should the future become less uncertain – and promising higher sales. At the moment the uncertainties dictate a 'wait-and-see' tactics especially with respect to investment. Consequently, the corporate sector's investment outlays fell 1.6% in the first quarter of 2013. On the other hand, most recent information does not suggest a further deterioration of investment sentiments among the corporate sector's managers. Overall quite optimistic moods seem to prevail among the export-oriented firms whose investments were not reduced in the first quarter of 2013[32].

The first big boom in infrastructure investment (financed out of the public purse and supported by EU transfers) is already over. But the next one, to be co-financed out of the ample means to be provided by the forthcoming EU Multiannual Financial Framework for 2014-2020, is already on the horizon. Public investment is likely to start growing anew in the second half of 2013, even if at the cost of

32 As reported by the recent Business Climate Survey: http://www.nbp.pl/publikacje/koniunktura/raport_2_kw_2013.pdf

higher public sector deficits. Similarly, it is quite likely that the government will refrain from moves that could restrict the rise in public sector deficits. Rather, one could expect further unplanned 'concessions' to the public. The substantial extension of the (paid) maternity leave, legislated recently, is just one example of changing official priorities. While officially the economic policy is still chasing the fiscal consolidation goals, in practice it is again (as back in 2009) becoming less restrictive. The new wave of official generosity may have come too late to prevent a further decline in the popularity of Donald Tusk (and of his government). But it may help prevent the advent of outright recession.[33]

All in all, the Polish economy still faces rather tough times in 2013. Growth seems likely to be very weak at first – but falling inflation could give some boost to real disposable incomes and consumption. Moreover, public spending is likely to be increased and should provide some additional defence against recession. Foreign trade developments may prove helpful too, especially if a (likely) corrective weakening of the national currency is retained for some time. Of course, the scale of external trade's positive impulses will depend on what happens to the euro area. But even if the euro area does not avoid recession in 2013, Poland's GDP growth should still be positive. Later on, with growth resuming in the euro area (and in Germany in particular), growth – to a greater degree driven by expanding investment – should also accelerate in Poland.

[33] The European Commission has recently recommended extending the deadline for Poland's fiscal consolidation (as defined in the Excessive Deficit Procedure) by two years, to 2014 'at the latest'. 'The Commission postulates that Poland should reach a headline deficit target of 3.6% and 3.0% of GDP in 2013 and 2014 …'

Table RO

Romania: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	21480	21438	19070	19000	.	.	18950	18900	18900
Gross domestic product, RON mn, nom.	501139	523693	556708	587499	112819	121448	632100	675700	724400
annual change in % (real)	-6.6	-1.1	2.2	0.7	0.4	2.2	1.9	2.0	2.1
GDP/capita (EUR at exchange rate)	5500	5800	6900	6900	.	.	.	.	.
GDP/capita (EUR at PPP)	11100	11400	13300	13700	.	.	.	.	.
Consumption of households, RON mn, nom.	304667	327242	345047	358514	76303	75808	.	.	.
annual change in % (real)	-10.4	-0.3	1.2	1.0	1.3	-0.3	0.8	1.0	1.5
Gross fixed capital formation, RON mn, nom.	122442	129422	144558	156928	21980	22155	.	.	.
annual change in % (real)	-28.1	-1.8	7.3	5.0	11.3	-0.7	2.0	4.0	4.0
Gross industrial production 3)									
annual change in % (real)	-5.5	5.5	7.4	2.4	1.8	4.7	3.0	4.0	5.0
Gross agricultural production (EAA)									
annual change in % (real)	-2.2	1.0	8.9	-21.8	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	-15.0	-13.2	2.8	1.2	6.2	-4.1	.	.	.
Employed persons, LFS, th, average	9243.5	9239.4	9137.7	9262.8	9018.8	.	9300	9300	9400
annual change in %	-1.3	0.0	-1.1	1.4	-0.6	.	0.4	0.0	1.1
Unemployed persons, LFS, th, average	680.7	725.1	730.2	701.2	740.1	.	.	.	.
Unemployment rate, LFS, in %, average	6.9	7.3	7.4	7.0	7.6	.	7.0	7.0	6.5
Reg. unemployment rate, in %, end of period	7.8	7.0	5.2	5.6	5.2	5.6	.	.	.
Average gross monthly wages, RON 4)	1845	1902	1980	2079	2059	2171	.	.	.
annual change in % (real, net)	-1.5	-3.7	-1.9	1.5	0.9	-0.3	.	.	.
Consumer prices (HICP), % p.a.	5.6	6.1	5.8	3.4	2.7	4.8	4.2	3.5	3.5
Producer prices in industry, % p.a.	2.4	4.4	7.1	5.3	4.8	5.2	.	.	.
General governm.budget, EU-def., % of GDP									
Revenues	32.1	33.3	33.8	33.5	.	.	34.1	.	.
Expenditures	41.1	40.1	39.4	36.4	.	.	36.6	.	.
Net lending (+) / net borrowing (-)	-9.0	-6.8	-5.6	-2.9	.	.	-2.6	-2.4	-2.2
Public debt, EU-def., % of GDP	23.6	30.5	34.7	37.8	.	.	36.0	37.0	37.0
Central bank policy rate, % p.a., end of period 5)	8.00	6.25	6.00	5.25	5.25	5.25	.	.	.
Current account, EUR mn	-4938	-5476	-5936	-5264	-795	69	-5000	-5500	-6000
Current account, % of GDP	-4.2	-4.4	-4.5	-4.0	-3.1	0.2	-3.5	-3.6	-3.7
Exports of goods, BOP, EUR mn	29091	37333	45264	45007	11073	11579	46400	49600	53100
annual change in %	-13.6	28.3	21.2	-0.6	0.0	4.6	3.0	7.0	7.0
Imports of goods, BOP, EUR mn	35959	44901	52661	52375	12265	12131	53400	56900	60900
annual change in %	-31.8	24.9	17.3	-0.5	1.9	-1.1	2.0	6.5	7.0
Exports of services, BOP, EUR mn	7061	6622	7253	7632	1632	1641	8000	8500	9000
annual change in %	-19.3	-6.2	9.5	5.2	10.0	0.6	5.0	6.0	6.0
Imports of services, BOP, EUR mn	7352	6216	6911	7090	1711	1488	7400	7800	8300
annual change in %	-9.1	-15.5	11.2	2.6	18.5	-13.0	4.0	6.0	6.0
FDI inflow, EUR mn	3490	2227	1798	1861	358	211	1800	.	.
FDI outflow, EUR mn	-61	-12	-25	31	34	95	0	.	.
Gross reserves of NB excl. gold, EUR mn	28249	32606	33166	31095	34582	32208	.	.	.
Gross external debt, EUR mn	81206	92458	98724	98969	99867	101087	.	.	.
Gross external debt, % of GDP	68.7	74.4	75.2	75.1	75.8	70.4	.	.	.
Average exchange rate RON/EUR	4.2399	4.2122	4.2391	4.4593	4.3533	4.3866	4.40	4.42	4.45
Purchasing power parity RON/EUR	2.1047	2.1414	2.2031	2.2555	.	.	.	.	.

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

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

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

Gábor Hunya

Romania:
Sober optimism

The first quarter 2013 GDP was as much as 2.2% above the level of the same period in the previous year which is one of the best results among the EU-27. Growth was driven solely by net exports while consumption and investments declined. The latter indicates a dire state of the economy. But April data for foreign trade and production indicate a continuing boom and also the prospects for agriculture look good. Therefore the wiiw GDP forecast is increased from 1.5% to 1.9% for 2013 and has been revised downwards for 2014 and 2015 due to continuing bad performance in the euro area.

Industrial production underwent a remarkable recovery in the first quarter of 2013 (+4.7) driven by manufacturing (+6.1%) and held back by the energy sector (-5.4%). The best performing manufacturing sectors with more than 10% increase were the production of other transport equipment, electrical equipment, pharmaceuticals, non-metallic minerals and chemicals. Exports were one of the driving forces behind most of these results, but also domestic demand increased, e.g. for pharmaceuticals due to higher healthcare expenditure and for waggons due to rail transport modernisation. Declines were reported in the production of beverages, tobacco, coke and refined petroleum and basic metals. The reasons for those declines can be related to weak export markets for metals and increased excise taxes for tobacco products. The outlook for industrial production is encouraging. New orders for exports rose in the first few months of 2013 while domestic orders stagnated. The industrial manager index has been positive through May including in some industries which reported declining production in the first quarter.

In contrast to industry, other economic activities showed less favourable results (with the exception of agriculture). Construction output and the value of services rendered to the population declined. Numerous SMEs went bankrupt in these sectors. The corporate risk assessment company Coface reported for Romania the second highest insolvency rate of companies (5.57%) in Central Europe (after Serbia) in 2012 and forecasts a further increase of insolvencies in 2013. In this respect the European Council recommendations of 29 May 2013 stressed the need for improving and simplifying the business environment by reducing the administrative burden. The related Progress Report of the Romanian government from March 2013 reveals that the country is in big delay with the implementation of the Small Business Act although it has introduced some SME support programmes earlier this year. The dire condition of the corporate sector is reflected in the development of financial indicators. As of end-April, non-government loans decreased by 2.1% (down 7.0% in real terms) year on year, on the back of a 3.8% increase in RON-denominated loans (down 1.5% in real terms) and a 5.4% decline in foreign currency-denominated loans expressed in RON.

The external sector was doing unexpectedly well in the first few months of the year. A current account surplus was achieved in the first three month of 2013 which is an absolute novelty for this country. Not only did the deficit in goods trade contract but also the incomes balance improved while the services balance turned positive. These improving balances compensated for the lower amounts of current transfers. Exports increased by 4.6% in the first quarter of 2013 following declines in the previous year (in current euro terms). There was a modest structural shift to new markets and medium-high-technology goods. A share of 70% of exports went to the EU, 1.6 percentage points less than in the first quarter of 2012, which points to some market diversification. For instance, a larger part of the Dacia cars was sold in the Mediterranean area than before. The export share of transport equipment increased by close to one percentage point, to 42.5% year on year. The contraction of imports by 1.1% can be related to lower domestic demand for energy carriers on account of the relatively mild winter. The share of these products in imports declined by more than three percentage points, to 8.8%, while the share of transport equipment rose by one percentage point to 34.6%. Longer-term and more detailed indicators also reveal rapidly growing intra-industry trade between Romania and the EU-15.

The fiscal stance was sound as observed by the EU Commission in its latest (May 2013) assessment. Only modest adjustments were suggested to bring down the general government deficit from 2.9% of GDP in 2012 to 2.6% in 2013 and 2.4% in 2014. Both revenues and expenditures are expected to increase albeit at a slower pace than GDP. At the same time, the EU Commission has requested Romania to step up efforts to support economic growth and poverty reduction. While the IMF shares the Commission's view on deficit reduction, its additional requests are more detailed in terms of measures which may increase competitiveness. The latter refer first of all to fiscal arrears of municipalities and the loss reduction in state-owned companies for which detailed management and privatisation targets have been set. As the government was in delay with meeting these requirements by the deadline of end-March 2013, the programme was extended until the end of June. Progress has been sluggish and most likely several of the targets will not be met in due time. The non-transparent financial situation of state-owned companies such as the Romanian Post and the rail transport company CFR Marfa deter high bids for the privatisation tenders which have therefore been repeatedly modified to attract interest. In other instances, private management under state ownership was thought to be a viable option but the line ministries have been reluctant to give up their control. A problematic point is that any restructuring, with or without privatisation, would entail layoffs and even the possibility of this brings workers to the street which then calls for a political solution.

Earlier this year the government expressed its wish to sign a new stand-by precautionary agreement with the IMF but may refrain from it in view of protracted problems with fulfilling the current accord and its improved international financial position. Abundant liquidity on capital markets and increasing trust in the stability of the Romanian government may further bring down the cost of market financing. But a row with the IMF may undermine this expectation. As a constructive solution, the IMF may declare the current accord as technically closed in July even if conditions are not fully met.

The National Bank of Romania continued its cautious policy and did not decrease the policy rate from the 5.25 fixed a year earlier. Still there was an important monetary easing by narrowing the interest rate band around the policy rate by one percentage point to +/-3% for deposits and borrowing, thus reducing the costs of banks. The main reason for keeping the policy rate in place was the relatively high rate of inflation, 4.8% in the first quarter of 2013. This was the result of hikes in energy prices and excise duties at the beginning of the year and food price increases in the second half of 2012. Gas price hikes are scheduled for July while food prices are not expected to rise on account of a good harvest. The strengthening domestic currency contributed to sobering inflation.

Based on the performance in the first four months of the year, the 2013 GDP growth forecast has been revised upwards. Arguments are numerous: household consumption may revive in the wake of a good harvest, fiscal austerity eases, there are signs of improved access to EU Cohesion Funds, and also net exports contribute positively to growth. But there are also some sobering arguments: financial difficulties in the enterprise sector, low capacity of the government to implement consistent policies, and sluggish demand in the euro area. The protracted recession in the latter may hinder exports growth which will impact on industrial production and wages also in the medium run. Therefore we scaled back the expectations for 2014 and 2015 as improvements in the domestic economy may not proceed fast enough and even less so in the external environment.

Table SK

Slovakia: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2]	5418.6	5430.1	5398.4	5410.0	.	.	5420	5430	5440
Gross domestic product, EUR mn, nom.	62794	65870	69108	71463	16550	16811	73600	77600	82300
annual change in % (real)	-4.9	4.4	3.2	2.0	2.9	0.6	1.0	2.4	3.0
GDP/capita (EUR at exchange rate)	11600	12100	12800	13200	.	.	13600	14300	15100
GDP/capita (EUR at PPP)	17100	17900	18500	19100	.	.	.	.	.
Consumption of households, EUR mn, nom.	37637	37735	39003	40215	9893	10005	.	.	.
annual change in % (real)	0.1	-0.8	-0.5	-0.5	-0.1	-0.9	0.0	1.0	3.0
Gross fixed capital form., EUR mn, nom.	13025	13851	15957	15392	3391	3171	.	.	.
annual change in % (real)	-19.7	6.5	14.2	-3.6	-3.3	-8.4	0.0	3.0	4.0
Gross industrial production									
annual change in % (real)	-15.6	8.2	5.2	8.1	7.3	0.3	3.0	4.0	4.0
Gross agricultural production (EAA)									
annual change in % (real)	-12.3	-8.2	8.7	-9.2	.	.	.	.	.
Construction industry									
annual change in % (real)	-11.3	-4.6	-1.8	-12.6	-9.3	-12.0	.	.	.
Employed persons, LFS, th, average [3]	2366.3	2317.5	2351.4	2329.0	2324.7	2327.7	2330	2350	2370
annual change in % [3]	-2.8	-2.1	1.5	0.6	1.2	0.1	0.0	1.0	1.0
Unemployed persons, LFS, th, average [3]	323.5	389.2	368.3	378.0	380.3	395.5	.	.	.
Unemployment rate, LFS, in %, average [3]	12.0	14.4	13.5	14.0	14.1	14.5	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	12.7	12.5	13.6	14.4	13.7	14.7	14.5	14.0	13.0
Average gross monthly wages, EUR	745	769	786	805	770	789	.	.	.
annual change in % (real, gross)	1.4	2.2	-1.6	-1.2	-0.6	0.3	.	.	.
Consumer prices (HICP), % p.a.	0.9	0.7	4.1	3.7	4.0	2.2	2.0	3.0	3.0
Producer prices in industry, % p.a.	-6.9	0.4	4.5	1.9	2.3	0.4	0.2	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	33.5	32.3	33.3	33.1	.	.	.	.	.
Expenditures	41.6	40.0	38.3	37.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	-8.0	-7.7	-5.1	-4.3	.	.	-3.0	-3.0	-2.5
Public debt, EU-def., % of GDP	35.6	41.0	43.3	52.1	.	.	54.8	56.5	56.2
Central bank policy rate, % p.a., end of period [4]	1.00	1.00	1.00	0.75	1.00	0.75	.	.	.
Current account, EUR mn	-1627	-2454	-1428	1613	372	790	1500	1500	800
Current account, % of GDP	-2.6	-3.7	-2.1	2.3	2.2	4.7	2.0	1.9	1.0
Exports of goods, BOP, EUR mn	39721	48273	56960	62833	14760	15135	64000	66000	68000
annual change in %	-19.8	21.5	18.0	10.3	9.0	2.5	2.0	3.0	3.0
Imports of goods, BOP, EUR mn	38775	47494	55985	59224	13996	13784	60000	62000	65000
annual change in %	-22.9	22.5	17.9	5.8	6.2	-1.5	1.8	4.0	4.5
Exports of services, BOP, EUR mn	4342	4396	4750	5569	1253	1204	5600	5900	6200
annual change in %	-27.6	1.2	8.1	17.2	17.5	-3.9	0.0	5.0	5.0
Imports of services, BOP, EUR mn	5367	5140	5120	5264	1192	1246	5300	5700	6100
annual change in %	-17.3	-4.2	-0.4	2.8	-0.1	4.5	1.0	7.0	7.0
FDI inflow, EUR mn	-4	1336	1541	2199	771	-54	1000	.	.
FDI outflow, EUR mn	652	715	353	-58	-4	-497	200	.	.
Gross reserves of NB excl. gold, EUR mn [5]	481	541	659	620	612	683	.	.	.
Gross external debt, EUR mn	45338	49262	52934	53755	54235	57470 Feb	.	.	.
Gross external debt, % of GDP	72.2	74.8	76.6	75.2	75.9	78.1	.	.	.
Purchasing power parity EUR/EUR	0.6790	0.6790	0.6910	0.6921	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census May 2011. - 3) From 2012 data according to census May 2011. - 4) Official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 5) From January 2009 (euro introduction) foreign currency reserves denominated in non-euro currencies only.

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

Doris Hanzl-Weiss

Slovakia: Growth slowing down

Slovakia experienced a positive growth performance with 2% GDP growth in 2012. This was largely due to an increase in automotive production and exports. However, GDP growth significantly slowed down in the first quarter of 2013 and only reached 0.6%. This was still better as compared to most countries of the European Union. As in 2012, this year's growth has so far come solely from net exports, with goods and services exports rising by 4% and imports by 1.6%. However, goods exports to the main trading partners Germany and the Czech Republic fell (for the first time) when compared to the same quarter of the previous year. This was due to low growth in Germany and the homemade crisis in the Czech Republic. All domestic demand components were flat or slightly declining: domestic consumption declined by 1% (retail trade fell by 1.3% in the first quarter of 2013) because of persistently high unemployment, low consumer confidence and falling wages. Growth of inflation slowed down and is now at 2.2%, about half the average value for 2012. Government consumption declined as well due to fiscal consolidation. The downward trend in gross fixed capital formation and capital formation continued, decreasing by nearly 15% and 8.4% respectively.

As regards the branch structure of GDP growth, industrial production grew at the beginning of 2013, although less than expected. Changing the base year from 2005 to 2010 contributed to a statistical downward revision, i.e. the exceptional industrial growth of 2012 of 10.3% changed to 8.1%. Thus in the first quarter of 2013, industrial production increased by merely 0.3% partly due to this statistical revision, partly due to the base effect. The important transport equipment industry still recorded growth of 5.6%, electrical equipment of 10.5% and textiles even of 12.4%. The basic metals and fabricated metal products industry also grew by 3.3%. Construction still suffered and continued its strong downward trend, falling by 12%. Recently, the main construction company Doprastav has come under trouble. Value added of the service sector contributed positively and increased in the first quarter.

The labour market remains in poor shape: employment stagnated in the first quarter of 2013 and unemployment increased to 14.5% (LFS data). Major problems are the high youth and long-term unemployment (the latter being amongst the highest in the EU – across all Slovak regions), as well as large regional disparities (huge unemployment in the East, in particular within the Roma community, while the main car companies and job opportunities are located in the West). The main employer in Eastern Slovakia is the US Steel plant in Košice with a workforce of 11,000 people. At the beginning of the year the investor allegedly considered leaving Slovakia, but on 26 March a memorandum was signed stating that US Steel will stay in Slovakia for another five years. The government agreed to provide concessions on energy costs and environmental protection (electricity prices for industrial customers are among the highest in the EU in Slovakia). Despite the crisis in the European steel industry, US Steel Košice earned a net profit in 2012, after a loss in 2011. The main investment obstacle for Eastern Slovakia is still the missing highway connection to Košice. A recent landslide after heavy rains has postponed its completion further until 2020-2021.

Fiscal consolidation efforts have been successful in 2012 and continue this year. As against the original 2012 budget deficit target of 4.6%, the actual deficit reached 4.3% only. The public debt level climbed to 52% of GDP in 2012, however (up as much as 8.8 percentage points from 2011), also due to ESM contribution payments. Thus, the 50% threshold stipulated in the Constitutional Law on Budgetary Responsibility ('debt brake law') introduced in 2011 was surpassed and the finance minister will have to inform the parliament of this issue. Major measures introduced at the beginning of this year were the increase in corporate tax from 19% to 23% and the rise in the income tax rate to 25% for individuals with monthly salaries topping EUR 3246. The flat tax has thus been scrapped. For 2013, the government strives to observe a budget deficit target of less than 3%, in order to meet the requirements of the EU's Excessive Deficit Procedure. For the coming two years, the government's targets a 2.6% deficit in 2014 and 2.0% in 2015 – by 0.3 pp more than announced last year. Proposals for the next years include, for example, changes in the social benefits system, which would mean less support for families. The introduction of the tax on financial transactions, on the other hand, seems to have been postponed.

The car industry has been the main driver of Slovak growth for several years already. All three foreign-owned major car producers – VW Bratislava, PSA Peugeot-Citroën and Kia of South Korea – are located in the more prosperous Western part of the country and benefit from competitive unit labour costs. As all of them introduced a third shift at the beginning of 2012, the number of cars produced in Slovakia increased by 45% in that year, with Volkswagen Bratislava even doubling its numbers. Overall more than 900,000 cars were produced, 171 automobiles per 1000 inhabitants, making Slovakia the largest producer in the world in per capita terms (the Czech Republic ranking second). However, the slowdown has already left its mark on the three car manufacturers as could be observed at the beginning of this year (either shortening of the working week or stopping of production for a few days). Good news still prevails, including the announcements for launching new models by all three companies. Overall, car production this year will be about the same as in 2012. Generally, the investment environment for new foreign investment is less promising: While the government grants incentives to selective companies (e.g. to Continental – the German tyre company is investing EUR 250 million in the Slovak plant in Púchov while receiving EUR 20 million in tax relief for two years), on the one hand, corporate taxes increased at the beginning of the year and the Labour Code has become stricter, on the other. New rules for investment aid came into force on 1 May 2013, setting stricter rules for the creation of jobs.

Overall, this year's GDP growth forecast for Slovakia is positive, but lower than last year. This is owing to the exceptionally strong growth in car production and exports last year, which will not be repeated this year. The economic confidence indicator shows an improving trend since the beginning of the year. Thus, for 2013, we expect GDP growth of about 1%, which again only comes from net exports, as household as well as public consumption still stagnate or even decrease due to the ongoing fiscal consolidation process. Yet there are a number of risks to this scenario: the overall

European growth performance, in particular that of Slovakia's main trading partners Germany and the Czech Republic, will be of importance. However, also certain export markets within the EU (e.g. Poland) or countries outside the EU, while only constituting a share of 16% of total exports, in particular Russia or Asia, might be important future export destinations with higher growth potential.

Table SI

Slovenia: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	2039.7	2048.6	2052.8	2056.4	2055.5	2058.8	2055	2055	2055
Gross domestic product, EUR mn, nom.	35556	35607	36172	35466	8529	8340	35150	35710	36790
annual change in % (real)	-7.8	1.2	0.6	-2.3	0.0	-4.8	-3.3	-0.4	1.0
GDP/capita (EUR at exchange rate)	17400	17400	17600	17200	.	.	17100	17400	17900
GDP/capita (EUR at PPP)	20300	20500	21000	20900	.	.	.	.	.
Consumption of households, EUR mn, nom.	19547	20112	20675	20452	4793	4660	.	.	.
annual change in % (real)	0.2	1.4	1.0	-2.9	0.7	-5.4	-5.0	-2.0	1.0
Gross fixed capital form., EUR mn, nom.	8225	7169	6694	6157	1416	1420	.	.	.
annual change in % (real)	-23.2	-13.7	-8.1	-9.2	-10.3	-2.0	-2.0	0.0	2.0
Gross industrial production									
annual change in % (real)	-17.3	7.2	1.3	-1.2	-0.3	-2.0	-1.5	2.0	2.0
Gross agricultural production (EAA)									
annual change in % (real)	0.0	0.1	-0.5	-9.9	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	-20.9	-16.9	-24.9	-16.9	-15.3	-24.0	.	.	.
Employed persons, LFS, th, average	981	966	936	924	927	888	880	860	860
annual change in %	-1.5	-1.5	-3.1	-1.3	-0.2	-4.2	-4.5	-2.0	0.0
Unemployed persons, LFS, th, average	61	75	83	90	87	111	.	.	.
Unemployment rate, LFS, in %, average	5.9	7.3	8.2	8.9	8.6	11.1	11.5	11.5	10.0
Reg. unemployment rate, in %, end of period	10.3	11.8	12.1	12.8	12.0	13.4	13.5	14.0	13.5
Average gross monthly wages, EUR	1439	1495	1525	1525	1529	1514	.	.	.
annual change in % (real, net)	2.5	2.1	0.3	-2.1	-0.8	-2.4	.	.	.
Consumer prices (HICP), % p.a.	0.9	2.1	2.1	2.8	2.5	2.7	2.5	2.0	2.0
Producer prices in industry, % p.a.	-1.4	2.0	4.6	0.9	1.3	0.7	2.0	2.5	2.5
General governm.budget, EU-def., % of GDP									
Revenues	43.1	44.5	44.4	45.0	.	.	.	.	.
Expenditures	49.3	50.4	50.8	49.0	.	.	.	.	.
Net lending (+) / net borrowing (-)	-6.2	-5.9	-6.4	-4.0	.	.	-8.0	-3.5	-3.0
Public debt, EU-def., % of GDP	35.0	38.6	46.9	54.1	.	.	62.0	64.0	66.0
Central bank policy rate, % p.a., end of period 4)	1.00	1.00	1.00	0.75	1.00	0.75	.	.	.
Current account, EUR mn	-246	-210	1	817	28	221	600	300	200
Current account, % of GDP	-0.7	-0.6	0.0	2.3	0.3	2.7	1.7	0.8	0.5
Exports of goods, BOP, EUR mn	16410	18762	21264	21454	5329	5382	21800	22300	22900
annual change in %	-19.1	14.3	13.3	0.9	2.9	1.0	1.5	2.5	2.5
Imports of goods, BOP, EUR mn	16909	19760	22307	21788	5495	5426	21800	22500	23100
annual change in %	-25.4	16.9	12.9	-2.3	1.6	-1.3	0.0	3.0	2.5
Exports of services, BOP, EUR mn	4347	4616	4838	5095	1113	1211	5500	5900	6300
annual change in %	-12.3	6.2	4.8	5.3	5.8	8.8	7.0	7.0	7.0
Imports of services, BOP, EUR mn	3182	3331	3395	3395	709	727	3500	3600	3700
annual change in %	-9.9	4.7	1.9	0.0	-3.7	2.4	2.0	3.0	4.0
FDI inflow, EUR mn	-470	271	719	112	197	70	.	.	.
FDI outflow, EUR mn	187	-160	81	-73	8	83	.	.	.
Gross reserves of NB excl. gold, EUR mn	671	695	642	593	583	528	.	.	.
Gross external debt, EUR mn	40294	40723	40241	40838	42386	40517	.	.	.
Gross external debt, % of GDP	113.3	114.4	111.2	114.6	119.5	115.3	.	.	.
Purchasing power parity EUR/EUR	0.8561	0.8467	0.8387	0.8261	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to register-based census 2011. - 3) Enterprises with 20 and more employees and output of some non-construction enterprises. - 4) Official refinancing operation rates for euro area (ECB).

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

Hermine Vidovic

Slovenia:
Worsening recession

Slovenia's GDP continued to shrink in the first quarter of 2013 year-on-year, down by 4.8% owing to a substantial drop in domestic demand. Both household and government consumption declined, by 5.4% and 2% respectively. Gross fixed capital formation contracted by 2%. Only foreign trade did contribute positively to GDP growth. The construction sector is still in dire straits; output continued to decline dramatically (24%). Since the outbreak of the crisis construction has contracted by almost 60%, many large companies of the sector went bankrupt and a recovery is not in sight yet.

Industrial production continued to decline in the first quarter of 2013. Output decreased in almost all branches and the fall was particularly strong (minus 20%) in the automotive sector, one of Slovenia's major export industries. Only five out of 21 reporting industrial branches recorded an increase in production, the most remarkable of which in the manufacture of computers and optical products. Also energy-related industries registered output increases.

In foreign trade the weak performance prevailing in 2012 carried on, with exports of goods up by a mere 1% and imports contracting. As a result the trade deficit was almost eliminated. Along with a rising surplus in the trade of services, the current account closed with a remarkably higher surplus than in the first three months of 2012. The inflow of FDI was significantly lower than in the corresponding quarter a year earlier.

The labour market situation deteriorated significantly in the first quarter of 2013. Based on labour force survey data, employment fell by 4% in the first quarter of 2013; the unemployment rate soared to 11.1%, the highest rate ever reported. In terms of age, unemployment grew most for the age group 34 and over, while youth unemployment even decreased slightly during the first months of 2013. Inactivity was on the rise as well, indicating the highest level ever since LFS conducting began. Unemployment based on registration data soared to 13.4%. Following protracted negotiations the Slovenian parliament adopted a labour market reform which became effective from April 2013. In order to reduce the segmentation of the labour market, the new law envisages making temporary fixed-term contracts – which are very common particularly in the case of young people – less attractive. The law caps the allowed number of temporary agency workers in companies to 25% and employers have to pay higher contributions for unemployment benefit insurance for employees with fixed-term contracts. In addition, the law foresees a simplification of hiring and firing procedures: notice periods for permanent employees will be reduced from 120 to 80 days, severance pay is reduced depending on the years of service, and the obligation to register every job vacancy at the employment agency has been removed. Retirement allowances, special payments employees are entitled to when they retire, will be restricted to those who have worked in a company for at least five years. Contrary to initial announcements, unemployment benefits have remained unchanged. Moreover, the new law regulates the employment of pensioners, who may work up to 60 hours per month and earn up to EUR 6300 per year.

In 2012 the Slovenian banks posted losses for the third consecutive year, amounting to EUR 770 million; according to the central bank this trend will continue also in 2013. In March 2013 the share of non-performing loans in total loans stood at 14.6% (similarly as in December 2012); 24.3% out of loans provided to the enterprise sector fell under this category.

Following allegations of corruption, Slovenia's parliament dismissed Prime Minister Janez Janša's government by a vote of no-confidence by the end of February. He was replaced by Alenka Bratušek, the interim leader of the centre-left Positive Slovenia party, who formed a coalition government with the Civic List (Gregor Virant), the Pensioners party DeSUS and the Social Democrats which took over in late March.

In May 2013 the new Slovenian government adopted a new austerity package outlined in the Stability Programme 2013 and the National Reform Programme which was sent to the European Commission for approval as part of the excessive deficit procedure. Some of the proposed measures have already been approved by the parliament such as the permanent increase of the VAT from 20% to 22% and of the reduced rate from 8.5% to 9.5% (effective from 1 July 2013) as well as the further reduction of public sector wages agreed upon with the trade unions. The new regulation, which affects 155 thousand public sector employees and envisages wage cuts between 0.5% and 5%, came into force at the beginning of June 2013. Moreover, the Slovenian parliament approved constitutional amendments capping government budget spending (fiscal rule) and tightening rules on holding referenda. The fiscal rule will become effective from the beginning of 2015, against the initial plan of the Prime Minister to postpone it until 2017. Regarding referenda – which have been used by political parties and trade unions to block reforms in the past (only in 2011 four laws including the pension reform were rejected by a referendum) – laws on taxes, customs duties and other levies or legislation needed to implement the budget cannot be subject to a referendum. A request for a referendum can only be submitted by 40,000 citizens eligible to vote, and no longer by (a third of) MPs and state councillors.

In addition, the government announced the privatisation of 15 companies including Telekom Slovenija, Nova Kreditna Banka Maribor, the country's second largest bank, the national airline Adria Airways and the Ljubljana airport. According to the Minister of Finance, the state will completely withdraw from all these companies and not maintain a controlling share in any of them. The bad bank, a major issue during coalition negotiations, should become operational in June, when first assets are to be transferred to the bank. The initial idea to impose a general crisis tax on all incomes was abandoned.

After reviewing both the national reform and the stability programmes, the European Commission recommended extending the deadline for Slovenia by two years to reduce its budget deficit to below 3%. This step was explained by the fact that Slovenia has sped up the pace of reforms and made additional commitments for getting its finances in order (such as working closely with the Commission and ECB to ensure asset quality reviews as well as the readiness of the Slovenian government to cover any additional capital shortfalls revealed in the process of asset transfers to the bad bank).

According to the final figures, the general government deficit in 2012 stood at 4% of GDP. The dynamics of public debt growth, although still lower than in a number of other euro area countries, has become a matter of major concern over the past few years, having risen from 22% in 2008 to 54% in 2012. Considering the further need of bank recapitalisation (at an estimated EUR 900 million by the end of July) the general government deficit is expected by the government to increase to 7.9% of GDP in the current year and should gradually decrease in the coming years. Thus, public debt as a percentage of the GDP will exceed the 60% mark already in 2013 and should be gradually reduced to below 55% through the sale or liquidation of assets acquired by the bad bank. In response to the high budget deficit during the first four months of the year, the government decided to adopt a supplementary budget which should be passed in mid-July. In April 2012, the yield of a ten-year Slovenian government bond was close to the psychological barrier of 7%. A successful USD 3.5 billion bond issue in late April has helped cooling off slightly with the yield on Slovenian government bonds returning to 5.8% in May and has also temporarily staved off the risk of bailout. Only two days prior to the issuance Moody's downgraded Slovenia's sovereign rating to junk, a downgrade by Fitch followed in mid-May.

Given the need of fiscal consolidation and the economic downturn among Slovenia's most important trading partners, Slovenia's economy will remain in recession in 2013. wiiw expects the GDP to decline by about 3% in 2013 (more than double the contraction we forecasted previously). Stagnation or even further contraction is likely in 2014 as a consequence of the continued drop in domestic demand. The corporate and household sectors will carry on deleveraging, and restructuring of the banking sector will have to speed up. The continuation of recession will exert further upward pressure on the unemployment rate, not only in 2013 but probably in 2014 as well. Consequently, growth of household consumption will remain subdued owing to the expected decline in disposable income.

Table MK

Macedonia: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012 1st quarter	2013 1st quarter	2013 Forecast	2014 Forecast	2015 Forecast
Population, th pers., mid-year	2050.7	2055.0	2058.5	2065.0	.	.	2070	2075	2080
Gross domestic product, MKD mn, nom. [2]	410734	434112	459789	460587	102228	104789	480100	505400	534100
annual change in % (real) [2]	-0.9	2.9	2.8	-0.2	-1.0	2.9	1.2	2.2	2.6
GDP/capita (EUR at exchange rate)	3300	3400	3600	3600	.	.	.	.	.
GDP/capita (EUR at PPP)	8500	8700	8900	8900	.	.	.	.	.
Consumption of households, MKD mn, nom. [2)3)]	314376	324096	345262	348473	81395	83085	.	.	.
annual change in % (real) [2)3)]	-4.7	2.1	2.9	-1.2	0.1	-0.1	0.0	0.0	1.0
Gross fixed capital form., MKD mn, nom. [2]	81872	82968	94698	104500	.	.	.	.	.
annual change in % (real) [2]	-4.3	-2.7	3.2	7.0	.	.	2.0	4.0	5.0
Gross industrial production [4]									
annual change in % (real)	-8.7	-4.8	6.9	-2.7	-6.0	5.9	4.0	5.0	5.0
Gross agricultural production (EAA)									
annual change in % (real)	-2.3	8.2	2.0	0.0	.	.	5.0	3.0	3.0
Construction output, hours worked									
annual change in % (real)	-2.1	5.8	14.2	-11.6	-13.1	30.8	5.0	5.0	5.0
Employed persons, LFS, th, average	629.9	637.9	645.1	650.6	643.7	.	654	664	674
annual change in %	3.4	1.3	1.1	0.8	-0.9	.	0.6	1.5	1.5
Unemployed persons, LFS, th, average	298.9	300.4	295.0	292.5	297.4	.	.	.	.
Unemployment rate, LFS, in %, average	32.2	32.0	31.4	31.0	31.6	.	31.0	31.0	30.0
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD [5]	29922	30225	30602	30669	30634	30973	.	.	.
annual change in % (real, net) [5]	25.0	1.4	-2.4	-2.9	-1.5	-2.3	.	.	.
Consumer prices, % p.a.	-0.8	1.6	3.9	3.3	2.5	3.5	3.0	3.0	3.0
Producer prices in industry, % p.a. [6]	-7.2	8.7	12.4	4.6	5.1	2.9	.	.	.
General governm. budget, nat.def., % of GDP [7]									
Revenues	31.3	30.4	29.8	30.0	31.1	28.6	.	.	.
Expenditures	33.9	32.9	32.3	33.8	35.5	39.5	.	.	.
Deficit (-) / surplus (+)	-2.7	-2.4	-2.5	-3.9	-4.4	-10.9	-2.5	-2.0	-1.0
Public debt, nat.def., % of GDP [8]	31.7	34.8	35.0	36.0	.	.	36.0	36.0	36.0
Central bank policy rate, %, p.a., end of period [9]	8.50	4.11	4.00	3.73	4.00	3.42	3.5	3.5	3.5
Current account, EUR mn	-457.1	-143.6	-224.3	-291.4	-130.0	-109.3	-310	-490	-520
Current account, % of GDP	-6.8	-2.0	-3.0	-3.9	-7.8	-6.4	-4.0	-6.0	-6.0
Exports of goods, BOP, EUR mn	1932.6	2530.1	3178.9	3092.6	708.8	717.6	3190	3350	3580
annual change in %	-28.2	30.9	25.6	-2.7	-0.5	1.3	3.0	5.0	7.0
Imports of goods, BOP, EUR mn	3492.2	3977.9	4860.6	4877.0	1118.5	1093.8	4880	5030	5280
annual change in %	-21.6	13.9	22.2	0.3	-4.7	-2.2	0.0	3.0	5.0
Exports of services, BOP, EUR mn	617.6	681.4	805.8	828.9	170.4	172.4	862	914	987
annual change in %	-10.8	10.3	18.3	2.9	-4.2	1.2	4.0	6.0	8.0
Imports of services, BOP, EUR mn	601.1	644.6	707.7	806.3	182.9	166.4	806	830	872
annual change in %	-12.0	7.2	9.8	13.9	15.7	-9.0	0.0	3.0	5.0
FDI inflow, EUR mn	145.0	160.0	336.8	104.8	80.2	53.0	200	300	300
FDI outflow, EUR mn	8.1	1.4	0.0	-6.0	0.6	0.1	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1429.4	1482.7	1801.9	1769.0	1796.4	1957.5	.	.	.
Gross external debt, EUR mn	3780.4	4105.7	4846.6	5163.2	4950.3	.	.	.	.
Gross external debt, % of GDP	56.4	58.2	64.9	69.0	66.1	.	.	.	.
Exchange rate MKD/EUR, average	61.27	61.52	61.53	61.53	61.50	61.59	61.5	61.5	61.5
Purchasing power parity MKD/EUR	23.65	24.15	25.19	25.16	.	.	.	.	.

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

1) Preliminary. - 2) According to ESA'95 (FISIM reallocated to industries, including non-observed economy, real growth rates based on previous year prices). - 3) Including Non-Profit Institutions Serving Households (NPISHs). - 4) Enterprises with 10 and more employees. - 5) Including allowances for food and transport. - 6) Domestic output prices. - 7) Refers to central government budget and extra-budgetary funds. - 8) In 2011 and 2012 wiiw estimates. - 9) Central Bank bills (28-days).

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

Vladimir Gligorov

Macedonia:
Stagnating on

The crisis has been as prolonged as in other countries, but the recession was shallower both in 2009 and last year. In part this has been the case because the country has been in more or less prolonged stagnation for about two decades. This is better indicated by the persistent high unemployment rate than by temporary speed-ups of growth, which have happened in some of the years preceding the eruption of the crisis. Also, the country is not as dependent on foreign financing even though the successive governments have made policies to attract foreign investments the cornerstone of their policy strategies. Finally, private and public debts are not high and reliance on credit is not as pervasive as in other countries.

This has made it possible for the government to rely somewhat more on public spending than is traditional for this country. As it relies on a hard peg to the euro, fiscal policy has traditionally been either balanced year on year or over the medium term. In the current crisis the government has allowed for some deficit financing which is probably responsible for the stability in the labour market and for on average positive real growth throughout the crisis. However, private consumption is not increasing, nor is investment.

The policy framework has been, since the stabilisation in the mid-1990s and the introduction of the strict fixed exchange rate, to rely on net exports for growth. This has delivered rather low growth rates, on average, and has not performed better during the crisis. In particular, it has not contributed significantly to the increase of the tradable sector, which continues to rely on agricultural products and on extraction. In about the past five years, as in some neighbouring countries, industrial production has declined and is below the 2007 level still.

Political, social, and ethnic stability has been preserved, though there have been challenging moments throughout the crisis. The main opposition party has attempted several times to unseat the government in elections and in non-parliamentary actions, but has not been successful. The governing coalition has strengthened the hold on power and on the public opinion. It also sees no reason to significantly change its economic policy.

In the short run, some recovery can be expected due to some pick-up in investments, public and private, and the continuing positive contribution of the net exports. In the medium run growth should speed up a bit on the assumption that both the EU and the local markets will improve. Additional fiscal consolidation is not contemplated, though fiscal stimulus is not to be expected either. The policy-makers will continue to care for internal stability and wait for the tide, when and if it comes, to lift their boat too.

Table ME

Montenegro: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., mid-year [2]	631.5	618.8	620.0	621.0	.	.	622	623	625
Gross domestic product, EUR mn, nom. [3]	2981.0	3103.9	3234.1	3276.3	.	.	3400	3600	3800
annual change in % (real) [3]	-5.7	2.5	3.2	-0.5	.	.	1.3	2.0	3.0
GDP/capita (EUR at exchange rate)	4700	5000	5200	5300	.	.	.	.	.
GDP/capita (EUR at PPP)	9700	10200	10500	10500	.	.	.	.	.
Consumption of households, EUR mn, nom. [3]	2503.7	2550.7	2728.5	2900.0	.	.	.	.	.
annual change in % (real) [3]	-12.9	2.0	4.2	1.0	.	.	1.0	1.0	2.0
Gross fixed capital form., EUR mn, nom. [3]	797.6	655.1	596.5	600.0	.	.	.	.	.
annual change in % (real) [3]	-30.1	-18.5	-10.3	2.1	.	.	3.0	5.0	5.0
Gross industrial production [4]									
annual change in % (real)	-32.2	17.5	-10.3	-7.1	-14.7	6.3	5.0	5.0	5.0
Net agricultural production	.	.	.		.	.	.	.	.
annual change in % (real)	2.6	-1.7	9.5	0.0	.	.	.	.	.
Construction output [5]	.	.			.	.	.	.	.
annual change in % (real) [3]	-19.2	-7.4	15.8	0.0	.	5.7	5.0	5.0	5.0
Employed persons, LFS, th, average [6]	212.9	208.2	195.4	200.0	.	.	210	215	220
annual change in % [6]	-2.7	-2.2	.	2.4	.	.	4.0	2.5	1.0
Unemployed persons, LFS, th, average	50.9	50.9	47.9	49.0	.	.	.	.	.
Unemployment rate, LFS, in %, average	19.3	19.6	19.7	19.7	.	.	20.0	19.0	19.0
Unemployment rate, reg., %, average	14.0	16.5	15.9	15.3	16.3	16.4	16.0	16.0	15.0
Average gross monthly wages, EUR	643	715	722	727	741	730	.	.	.
annual change in % (real, net)	7.6	3.0	-2.0	-3.1	-4.6	-4.9	.	.	.
Consumer prices, % p.a.	3.4	0.5	3.1	4.1	3.6	3.7	3.0	3.0	3.0
Producer prices in industry, % p.a. [7]	-3.9	-0.9	3.2	1.9	-1.0	4.2	.	.	.
General governm.budget, nat.def., % of GDP									
Revenues	45.8	40.9	39.7	39.6	.	.	.	.	.
Expenditures	49.4	43.9	45.2	43.7	.	.	.	.	.
Deficit (-) / surplus (+)	-3.6	-3.0	-1.3	-0.4	.	.	-1.0	-1.0	-1.0
Public debt, nat.def., % of GDP	38.2	40.9	45.9	51.9	.	.	52.0	53.0	53.0
Central bank policy rate, % p.a., end of period [8]	8.85	8.98	9.06	8.83	9.0	8.8	9.0	8.0	8.0
Current account, EUR mn	-830.3	-710.2	-573.4	-587.2	-236.6	-192.2	-510	-540	-570
Current account, % of GDP	-27.9	-22.9	-17.7	-17.9			-15.0	-15.0	-15.0
Exports of goods, BOP, EUR mn	296.3	356.6	476.5	391.9	89.3	90	420	450	490
annual change in %	-34.2	20.4	33.6	-17.8	-22.8	5.2	6.0	8.0	8.0
Imports of goods, BOP, EUR mn	1617.9	1623.8	1782.8	1780.7	388.1	350	1780	1830	1920
annual change in %	-34.6	0.4	9.8	-0.1	12.4	-9.0	0.0	3.0	5.0
Exports of services, BOP, EUR mn	731.5	801.0	906.1	997.6	83.2	.	1100	1270	1460
annual change in %	-5.7	9.5	13.1	10.1	34.4	.	10.0	15.0	15.0
Imports of services, BOP, EUR mn	331.0	336.8	316.8	385.3	74.3	.	390	410	430
annual change in %	-18.3	1.8	-5.9	21.6	12.9	.	0.0	5.0	5.0
FDI inflow, EUR mn	1099.4	574.2	401.4	474.4	85.6	.	400	700	800
FDI outflow, EUR mn	32.9	22.1	12.3	20.8	18.6	.	0	20	20
Gross reserves of NB, excl. gold, EUR mn [9]	172.8	164.6	170.8	190.0	169.6	.	.	.	.
Gross external public debt, EUR mn	699.9	912.4	1063.7	1295.0	.	.	.	.	.
Gross external public debt, % of GDP	23.5	29.4	32.9	39.5	.	.	.	.	.
Purchasing power parity EUR/EUR	0.4877	0.4917	0.4957	0.5027	.	.	.	.	.

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

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

Vladimir Gligorov

Montenegro:
Waiting for investors

Probably the main success throughout the crisis has been the preservation of financial and social stability. In addition, the intermediate years of recovery, before the second dip into recession of last year, were characterised by somewhat stronger recovery than in most countries in the neighbourhood or in the EU in general. Last year's recession was rather shallow, but so will probably be the next couple of years of recovery. Still, given the macroeconomic imbalances, especially on the external account, and the banking crisis early on in the crisis, the outcome so far has been not as bad as one might have expected.

One more important effect of the crisis has been additional strong deindustrialisation. The already low level of industrial output has been reduced by about one third with no indication that this trend is going to be reversed in the future. As the level was already quite low, this further deindustrialisation did not have dramatic consequences, except in the public which is uncertain that reliance only on services is sustainable in the long run. Still, with the main industrial enterprises, the aluminium plant and the steel mill, left all but inoperative, there is hardly any industry now except for food processing and some suppliers of spare parts.

Tourism has so far performed as well as could have been expected in these current economic circumstances. Most of the foreign investments that are still coming in are targeting the coastal area and this has certainly been instrumental to economic stability. In general, the Montenegrin economy depends on this interest of investors not drying out. The current situation is nowhere near what it was before the crisis. In a way, the main policy task is to manage to preserve stability until a new way of investors starts to come.

Though political stability has been maintained, the latest parliamentary and subsequent presidential elections have proved challenging for the ruling party and their leaders. They have run the country since the late 1980s and their time seems to be running out. The opposition has started to put more stress on democratic rather than ethnic issues and that has turned out to be a much more credible opposition stance to take. It is hard to see that the political change will be blocked in the next general elections.

This process of democratisation has been supported by social dissatisfaction which has seen a significant increase in the activity of non-governmental organisations. They have proved to be vocal critics of the government and seem determined to continue with their opposition in cooperation with some of the opposition parties.

Democratisation is needed also to strengthen and sustain the process of EU integration. Montenegro is negotiating for membership and is set to become the 29th Member State. This will be made easier and perhaps even speed up the process if far-reaching changes in the rule of law and democratic accountability are made.

In the short run the economy should get out of recession and in the medium run recovery should speed up, but still at relatively slow speed. It will take a much more pronounced return of foreign investors to get the economy back to growth rates experienced before the crisis.

Vladimir Gligorov

Serbia:
Fiscal and other worries

With the change of government last year, a long-term fiscal adjustment programme was adopted, which was supposed to start with a significant correction of the fiscal deficit from around 7% of GDP in 2012 to 3.6% in 2013. About half a year after the adoption of this year's budget, the expected fiscal deficit was running at between 7% and 8% of GDP for this year. As a consequence, the government is contemplating addition measures to reduce public spending. As on previous similar occasions, various structural reforms are also being announced, which do not differ significantly from those in the past. Whether this time around the implementation will be different is hard to say.

However, the government is split several ways along ideological and interest lines. The Socialists argue against measures of fiscal austerity, especially those that would require wages and pensions to be frozen, a measure recommended by the IMF and the Fiscal Council. In addition, there are disagreements about the privatisation and incorporation of public enterprises. They have amassed significant losses and continue to add to those year after year. Giving up the control over those may, however, not be in the interest of all the parties in the governing coalition. Finally, changes in the labour law with the aim to speed up the shedding of labour is not going to be popular, especially given that the government has decided not to fire anybody until the crisis is over. Having in mind the huge decline of employment in the past few years and the expected additional reductions in this and possibly next year, this may be risking social dissatisfaction on a larger scale than it has been seen so far.

The policy strategy of the new government was to rely on export growth and support for investments. Exports have been much higher at the beginning of the year mainly, though not exclusively, due to the start of car production in the FIAT plant in Kragujevac. There is little doubt that exports will continue to post high growth rates all through the year for the same reason. Next year and beyond, that will depend on the realisation of new investments which, however, are yet to materialise; public investments are in fact set to decline as part of fiscal consolidation.

Monetary policy has not been supportive of this investment strategy. The new central bank leadership attempted to shore up their credibility by measures that stabilised the exchange rate and with attempts to strong talk the inflation rate down. That has led to real appreciation of the exchange rate, which indeed contributed, together with the high interest rate, to some slowdown of the growth of prices. This has made investments less attractive because those could make sense only if the intended production is targeting foreign markets as domestic private consumption continues to decline. Also, the stream of bad news, especially that connected with the intended fiscal consolidation,

Table RS

Serbia: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter		Forecast		
Population, th. pers., mid-year	7320.8	7291.4	7160.0	7130.0	.	.	7100	7070	7040
Gross domestic product, RSD bn, nom. 2)	2720.1	2881.9	3208.6	3386.2	746.8	850.0	3600	3900	4200
annual change in % (real) 2)	-3.5	1.0	1.6	-1.7	-2.7	1.9	1.0	2.0	3.0
GDP/capita (EUR at exchange rate)	4000	3800	4400	4200	.	.	.	.	.
GDP/capita (EUR at PPP)	8400	8500	8800	9000	.	.	.	.	.
Consumption of households, RSD bn, nom. 2)	2143.2	2282.8	2438.2	2552.5	614.8	.	.	.	.
annual change in % (real) 3)	-2.4	-0.6	-0.8	-2.0	-2.3	.	0.0	1.0	2.0
Gross fixed capital form., RSD bn, nom. 2)	510.2	512.3	592.8	604.3	111.8	.	.	.	.
annual change in % (real) 3)	-22.1	-5.5	8.4	-3.4	0.8	.	3.0	4.0	5.0
Gross industrial production 4)									
annual change in % (real)	-12.6	2.5	2.1	-2.9	-6.2	5.1	3.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	1.3	1.0	0.8	-18.0	.	.	10.0	5.0	10.0
Construction output 5)									
annual change in % (real)	-19.7	-7.1	7.7	4.0	.	.	3.0	3.0	5.0
Employed persons, LFS, th, average 6)	2616.4	2396.2	2253.2	2228.3	.	.	2200	2200	2200
annual change in % 6)	-7.3	-8.4	-6.0	-1.1	.	.	-1.0	0.0	1.0
Unemployed persons, LFS, th, average 6)	503.0	568.7	671.1	702.7	.	.	.	.	.
Unemployment rate, LFS, in %, average 6)	16.1	19.2	23.0	24.0	.	.	25.0	25.0	25.0
Unemployment rate, reg., in %, end of period	25.9	26.7	27.6	28.2	28.5	29.0 Feb	30.0	30.0	28.0
Average gross monthly wages, RSD 7)	44147	47450	52733	57430	54153	57425	.	.	.
annual change in % (real, net) 7)	0.2	0.7	0.2	1.8	5.9	-5.3	.	.	.
Consumer prices, % p.a.	8.6	6.8	11.0	7.8	4.8	12.1	6.0	5.0	5.0
Producer prices in industry, % p.a. 8)	5.6	12.7	14.2	5.5	6.3	5.9	.	.	.
General governm.budget, nat.def., % of GDP									
Revenues	42.1	42.5	41.0	41.3	.	.	.	.	.
Expenditures	46.6	47.2	46.0	47.7	.	.	.	.	.
Deficit (-) / surplus (+)	-4.5	-4.7	-5.0	-6.4	.	.	-6.0	-4.0	-3.0
Public debt, nat.def., % of GDP	34.7	44.5	49.0	58.9	.	.	65.0	65.0	65.0
Central bank policy rate, % p.a., end of period 9)	9.50	11.50	9.75	11.25	9.5	11.8	6.0	5.0	5.0
Current account, EUR mn	-2084.4	-2082.2	-2870.0	-3155.1	-1175.6	-615.3	-2700	-2750	-2500
Current account, % of GDP	-7.2	-7.4	-9.1	-10.5	-17.0	-8.1	-9.0	-9.0	-8.0
Exports of goods, BOP, EUR mn	5977.8	7402.4	8439.6	8822.3	1853.7	2264.9	9700	10700	11800
annual change in %	-19.4	23.8	14.0	4.5	-5.2	22.2	10.0	10.0	10.0
Imports of goods, BOP, EUR mn	11096.3	12176.0	13758.0	14272.1	3403.3	3410.2	15000	16100	17700
annual change in %	-30.3	9.7	13.0	3.7	5.5	0.2	5.0	7.0	10.0
Exports of services, BOP, EUR mn	2500.0	2667.1	3032.2	3091.1	667.0	703.3	3300	3500	3700
annual change in %	-8.8	6.7	13.7	1.9	5.6	5.4	7.0	7.0	5.0
Imports of services, BOP, EUR mn	2481.7	2661.9	2869.0	2938.8	638.2	664.2	3100	3400	3700
annual change in %	-15.2	7.3	7.8	2.4	5.7	4.1	5.0	10.0	10.0
FDI inflow, EUR mn	1410.1	1003.1	1948.9	274.1	-343.0	173.1	700	1000	1000
FDI outflow, EUR mn	37.6	143.0	122.0	42.3	18.5	1.9	100	100	100
Gross reserves of NB, excl. gold, EUR mn	10278	9555	11497	10295	10492	11217	.	.	.
Gross external debt, EUR mn	22487	23786	24125	25721	24068	36772	.	.	.
Gross external debt, % of GDP	77.7	84.9	76.7	85.8	77.6	87.3	.	.	.
Exchange rate RSD/EUR, average	93.94	102.90	101.96	112.98	108.11	111.69	120	128	135
Purchasing power parity RSD/EUR	44.27	46.56	50.69	54.46	.	.	.	.	.

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

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

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

does not ensure confidence in the stability of the exchange rate. If depreciation cannot be avoided, that will have inflationary consequences and the overall investment climate will not improve.

Hopes are being centred on the start of negotiations with the EU, which may get a positive push at the end of June. It is realistic to expect that the European Council will give Serbia a positive assessment which should lead to the negotiating process to start sometime early next year. That may contribute to political stability, though social stability is another matter altogether. The wave of outward migration has been supportive of the latter, but further deterioration may prove challenging. The mobilisation is low, but that can change rather quickly in current communication circumstances.

Prospects for this year will depend on the measures that will be taken before the summer recess. If the intended cuts in public spending materialise, that will affect negatively this year's growth, which in any case was not projected to be much faster than 2% and may be lower now. In the medium term, persistent fiscal and current account worries will make growth depend on exports and foreign investments. Those may keep recovering slowly, but a significant speed-up of growth is not very likely.

Table TR

Turkey: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012 1st quarter	2013 1st quarter	2013 Forecast	2014 Forecast	2015 Forecast
Population, th pers., average	72050	73003	73950	74885	.	.	75700	76900	80000
Gross domestic product, TRY bn, nom.	952.6	1098.8	1297.7	1416.8	326.9	357.9	1560	1730	1930
annual change in % (real)	-4.8	9.0	8.8	2.2	3.3	3.0	3.4	4.5	5.0
GDP/capita (EUR at exchange rate)	6100	7500	7500	8200	.	.	8600	9600	10500
GDP/capita (EUR at PPP - wiiw)	10900	12200	13100	13300	.	.	.	.	.
Consumption of households,TRY bn, nom.	680.8	787.8	923.8	992.7	236.3	261.9	.	.	.
annual change in % (real)	-2.3	6.7	7.7	-0.7	-0.4	3.0	3.2	4.5	5.0
annual change in % (real)	-19.0	29.9	18.0	-2.5	0.7	0.2	4.5	8.0	10.0
Gross industrial production									
annual change in % (real)	-9.8	12.8	10.0	2.4	3.8	1.3	4.5	5.5	6.5
Gross agricultural production 2)					.	.	.	.	.
annual change in % (real)	3.6	2.4	5.6	3.3					
Construction industry					.	.	.	.	.
annual change in % (real)	-16.3	18.7	11.4	0.4	1.7	.	5.0	9.0	12.0
Employed persons - LFS, th, avg.	21271	22593	24099	24819	23338	24546	25700	26900	28100
annual change in %	0.4	6.2	6.7	3.0	2.4	5.2	3.5	4.5	4.5
Unemployed persons - LFS, th, average	3053	2696	2324	2202	2406	2541	.	.	.
Unemployment rate - LFS, in %, average	12.6	10.7	8.8	8.2	9.4	9.4	9.2	9.0	8.8
Reg. unemployment rate, in %, average	.	.	.	.			.	.	.
Average gross monthly wages, manuf.ind., TRY	.	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	6.3	8.6	6.5	9.0	10.5	7.4	6.6	6.0	6.0
Producer prices in industry, % p.a. 3)	1.0	6.2	12.3	6.1	9.9	3.9	5.5	5.0	5.5
General governm. budget, EU-def., % of GDP 4)									
Revenues	33.5	36.7	39.5	37.5	.	.	37.0	36.8	37.0
Expenditures	40.4	39.4	41.4	39.8	.	.	39.5	39.4	39.5
Net lending (+) / net borrowing (-)	-6.9	-2.7	-1.9	-2.3	.	.	-2.5	-2.6	-2.5
Public debt, EU-def., % of GDP 4)	46.1	42.4	39.2	36.8	.	.	36.0	35.5	35.2
Central bank policy rate, %, p.a., end of period 5)	9.00	6.50	5.75	5.50	5.75	5.50	5.00	5.50	5.50
Current account, EUR mn	-9551	-34215	-53891	-36400	-12433	-12055	-47000	-55000	-65000
Current account, % of GDP	-2.2	-6.2	-9.7	-5.9	-9.0	-7.9	-7.3	-7.5	-7.7
Exports of goods, BOP, EUR mn	78616	91292	103086	127183	28566	30211	140000	158000	182000
annual change in %	-17.7	16.1	12.9	23.4	17.6	5.8	10.0	12.5	15.0
Imports of goods, BOP, EUR mn	96145	133962	166978	178299	41368	43121	193000	212000	237000
annual change in %	-26.7	39.3	24.6	6.8	5.2	4.2	8.0	10.0	12.0
Exports of services, BOP, EUR mn	24251	27776	29427	34899	4872	6074	39000	44000	49000
annual change in %	1.3	14.5	5.9	18.6	3.4	24.7	12.0	12.0	12.0
Imports of services, BOP, EUR mn	12024	15033	15051	16056	3308	3898	17000	19000	21000
annual change in %	-1.3	25.0	0.1	6.7	-6.8	17.8	6.0	12.0	12.0
FDI inflow, EUR mn	6085	6803	11581	9632	3480	1547	9000	12500	13000
FDI outflow, EUR mn	1110	1108	1710	3152	1744	521	3000	3500	4000
Gross reserves of CB, excl. gold, EUR mn	49088	60411	60538	75749	60010	82507	.	.	.
Gross external debt, EUR mn	186883	218473	235109	255315	236806	.	.	.	.
Gross external debt, % of GDP	42.4	39.7	42.4	41.7	38.7	.	.	.	.
Average exchange rate TRY/EUR	2.1631	1.9965	2.3378	2.3135	2.3551	2.3578	2.40	2.35	2.30
Purchasing power parity EUR/EUR	1.2116	1.2387	1.3409	1.4182	.	.	.	.	.

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

1) Preliminary. - 2) Gross value added of agriculture, forestry and fishing. - 3) Domestic output prices. - 4) According to ESA'95 excessive deficit procedure. - 5) From 2010 one-week repo rate, overnight lending rate before.

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

Michael Landesmann

Turkey:
Policy challenges of a European emerging economy

Turkey is a successful catching-up economy in Europe, with an estimated potential growth path of close to 5% per annum, a relatively robust banking system (in contrast to most of Europe), low levels of public and external debt, and improving indicators on labour markets. By all these accounts, Turkey is managing its policy challenges well. However, in today's international and particularly European climate, there is a high degree of risk of various types of negative spillovers: firstly, from international monetary and financial developments; secondly, from the business cycle dynamic in the European economy (not to speak of a highly volatile neighbourhood in the Middle East).

Some of these challenges affect not only Turkey but also other emerging market economies (EMEs) in Europe and globally. First of all, there is the impact of monetary easing adopted now in all the major advanced economies (US, euro area, UK, Japan): Monetary easing has dramatically increased international liquidity at the global level and relatively successful EMEs worldwide have to deal with strong short-term capital inflows leading to real exchange rate appreciation and thus to external imbalances. Turkey is an important country of destination of such capital inflows in Europe and has for a number of years been dealing with this challenge by means of a variety of monetary policy manoeuvres by the Turkish Central Bank.

The most recent steps in this direction took place on 16 May when the Central Bank of Turkey (CBRT) cut all three of its major policy rates more dramatically than most analysts had expected: the one-week repo rate fell from 5.0% to 4.5%; the overnight lending rate dropped from 7.0% to 6.5%, and the overnight borrowing rate from 4.0% to 3.5%. Alongside the interest rate cuts, the CBRT raised the required foreign exchange reserve requirements on a number of securities and increased the reserve requirements lenders must maintain in order to hold a certain portion of their required reserves in a foreign currency. This is a two-pronged monetary policy aimed at dampening the inflow of foreign capital while still trying to contain domestic credit growth. By lowering interest rates the Bank attempts to discourage foreign portfolio investment inflows and by raising reserve requirements it hopes to contain credit growth.

The latest move follows a succession of interest rate cuts since September 2012 when the upper limit of the overnight interest corridor (the lending rate) still stood at 11.5% (now 6.5%) and the lower bound (the borrowing rate) at 5.0% (now 3.5%). This aggressive policy was designed to counteract the rather dramatic slowdown of the economy in 2012 (GDP growth had fallen to 2.2% in 2012 from 8.8% in 2011). This in turn had been the outcome of an earlier phase of restrictive monetary policy which attempted to stem high and deteriorating current account deficits (-9.7% – in % of GDP – in 2011 which then came down to -5.9% in 2012) and very high private sector credit growth. Monetary policy has thus followed see-saw moves over the past few years, using a range of tools and quite strong doses at times leading to overshooting of targets. The external environment with much global liquidity looking for higher yielding investment opportunities in a limited set of relatively large EMEs does not make the task of monetary authorities in Turkey any easier.

While monetary policy is currently still strongly directed towards stimulating domestic demand, there is also a discussion of a possible shift in the external environment where the recovery of the US economy could lead in due course to a return of higher interest rates resulting in a change of global capital flows. Turkey might not be in a very good position to face such a reversal of capital flows at this stage, as the current account has again deteriorated due to the pick-up of domestic demand (it amounted to -7.9% in the first quarter of 2013) and the maturity structure of its foreign debt has shifted over the years strongly towards short-term borrowing (which requires rolling over): of the USD 208 billion foreign capital which has entered Turkey since end-2009, USD 54 billion has been long-term in nature (FDI, long-term bank and non-bank corporate borrowing) and USD 154 billion has been short-term (portfolio flows, currency and deposits, short-term bank and non-bank corporate borrowing). This compares to an inflow of short-term capital into Turkey over the period 2000 to 2007 of USD 60 billion. Hence if a new scenario materialises with a tendency towards capital outflows from EMEs, the Turkish Central Bank would be forced to move again towards a higher interest rate trajectory. This scenario has gained much more relevance in the light of recent political developments in Turkey of which more below.

In any case, at the moment the policy is directed towards stimulating domestic demand and the cost of this policy is a recurrence of higher current account deficits (driven by both declining export growth and increased imports) which is seen so far as acceptable collateral damage. This was easier to accept over the recent months as commodity price inflation has come down and this is reflected in lower overall inflation rates. It is difficult to evaluate at this stage how the current account situation will develop as it depends very much on the external environment (from the trade balance side on the developments in the main export markets, EU and Middle East, on the prospects for tourism and on the harvest; and from the capital accounts side on the issues raised above with respect to international capital market developments).

The fiscal policy situation reflects the pick-up of domestic demand with revenue growth outstripping expenditure growth: over the Jan-April 2013 period central government's non-interest expenditures amounted to TRY 106.71 billion (these amounted to TRY 89.60 billion in Jan-April 2012) as against revenues of 124.63 billion over that period (106.55 billion in the period Jan-April 2012) which amounted to a primary surplus of TRY 17.92 billion. Given the easing of financing conditions (lower interest rates), interest expenditure amounted to 18.22 billion over the period Jan-April 2013 as against 21.97 billion in the period Jan-April 2012, i.e. a decrease of 17% compared to the same period of the previous year. Turkey is thus further heading towards a declining public debt burden in GDP.

One further news event of 16 May was Moody's raising of Turkey's credit rating to investment grade (Baa3) following a similar move by Fitch in November last year (S&P is still two notches below that).

The implication of this is that investment grade by two of the leading rating agencies broadens significantly the investment base to asset managers who are not allowed to invest into sub-investment grade assets. This can further accentuate the potential for capital inflows and thus for an appreciating currency; the likely impact would therefore be to push the CBRT towards interest rate cuts while further tightening reserve requirements (as there is no evidence for a weakening of domestic private sector credit growth). Again, this scenario has to be set against the impact of the current political turbulence and how financial markets will react to it.

The labour market situation is improving along with the general upswing in the economy: the seasonally adjusted unemployment rate stands now at 9.2% (compared to 9.5% at the end of last year) and the labour force participation rate has reached an all-time high of 51.0% (which is still low by European standards and reflects the low – but rising – female participation rate).

wiiw forecasts GDP growth of 3.5% for 2013 and 4.5% for 2014 which is some decimal points lower than the current Consensus forecasts and reflects our more pessimistic view regarding prospects in the main export markets which show up in current trends of export and industrial production developments. On top of this, it is difficult to evaluate the toll which the current turbulent political developments will have on macroeconomic developments in Turkey. On the one hand, they might alleviate the constraint on monetary policy which had to deal with the pressure of short-run capital inflows; on the other hand, a strong destabilisation through capital outflows is not desirable either and could lead to a reversal of interest rate policy with a dampening effect on domestic private (household and investment) spending; this might occur in any case simply because of the uncertainty generated by the new political situation. A further policy reaction could be the loosening of fiscal policy by the Erdogan government to regain some political capital; such loosening would in any case have been expected in the presidential election year 2014 but the current situation might provide further incentive in this direction and might move some of it forward to 2013.

Table AL

Albania: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	2884.3	2856.7	2829.3	2801.7	.	.	2840	2850	2860
Gross domestic product, ALL bn, nom. 3)	1148.1	1222.5	1282.3	1340.0	.	.	1430	1500	1580
annual change in % (real) 3)	3.3	3.8	3.1	1.5	-0.4	.	3.5	2.5	3.0
GDP/capita (EUR at exchange rate)	3000	3100	3200	3400	.	.	.	.	.
GDP/capita (EUR at PPP)	7200	7400	7600	8000	.	.	.	.	.
Consumption of households, ALL bn, nom. 3)	910.0	970.0	1030.0	1060.0	.	.	.	.	.
annual change in % (real) 3)	3.0	2.5	3.0	1.0	.	.	1.5	2.0	3.0
Gross fixed capital form., ALL bn, nom. 3)	430.0	400.0	420.0	380.0	.	.	.	.	.
annual change in % (real) 3)	5.0	-7.0	4.8	-12.0	.	.	0.0	2.0	2.0
Gross industrial production									
annual change in % (real)	-1.2	19.9	-10.1	16.5	.	.	7.0	5.0	6.0
Gross agricultural production 4)									
annual change in % (real)	4.4	5.9	4.0	5.0	4.9	.	4.0	5.0	4.0
Construction output total									
annual change in % (real)	43.7	-13.3	-1.1	-11.2	.	.	4.0	3.0	2.0
Employed persons, LFS, th 5)	1160.5	1185.0	1200.0	1200.0	.	.	1200	1220	1240
annual change in % 5)	3.3	2.1	1.3	0.0	.	.	0.0	1.7	1.6
Employment reg. total, th pers., end of period	899.3	916.9	932.4	927.5	933.3	.	930	950	970
annual change in %	-7.7	2.0	1.7	-0.5	1.4	.	0.3	2.2	2.1
Unemployed persons, LFS, th 5)	185.0	196.0	200.0	200.0	.	.	200	190	180
Unemployment rate, LFS, in % 5)	13.8	14.2	14.3	14.0	.	.	14.0	13.0	13.0
Unemployment rate, reg., in %, end of period	13.9	13.5	13.3	13.3	13.3	.	13.0	12.0	12.0
Average gross monthly wages, ALL 6)	36075	34767	37060	39284	48800	.	.	.	.
annual change in % (real, gross) 6)	2.9	-7.0	3.1	3.9	6.1	.	8.0	4.0	3.0
Consumer prices, % p.a.	2.3	3.6	3.4	2.0	1.1	2.5	3.0	2.0	2.0
Producer prices in industry, % p.a.	-1.6	0.3	2.6	1.5	2.5	-1.2	0.0	3.0	1.0
General governm.budget, nat.def., % of GDP									
Revenues	26.1	26.6	25.8	24.7	.	.	26.0	26.0	27.0
Expenditures	33.1	29.7	29.4	28.1	.	.	31.0	29.0	28.0
Deficit (-) / surplus (+)	-7.0	-3.1	-3.6	-3.4	.	.	-5.0	-3.0	-1.0
Public debt, nat.def., % of GDP 7)	59.8	58.2	58.0	58.6	.	.	59.9	60.1	58.1
Central bank policy rate, % p.a., end of period 8)	5.25	5.00	4.75	4.00	4.25	3.75	3.75	3.5	3.8
Current account, EUR mn	-1329.8	-1018.5	-1185.4	-1021.3	-290.4	.	-900	-800	-800
Current account, % of GDP	-15.3	-11.5	-13.0	-10.6	.	.	-8.7	-7.3	-6.8
Exports of goods, BOP, EUR mn	750.7	1171.5	1405.5	1525.6	325.8	.	1700	1800	2000
annual change in %	-18.2	56.1	20.0	8.5	-12.1	.	11.4	5.9	11.1
Imports of goods, BOP, EUR mn	3054.4	3254.2	3647.1	3524.8	791.2	.	3450	3500	3700
annual change in %	-8.8	6.5	12.1	-3.4	1.6	.	-2.1	1.4	5.7
Exports of services, BOP, EUR mn	1771.4	1750.7	1747.4	1655.1	293.8	.	1700	1750	1850
annual change in %	5.0	-1.2	-0.2	-5.3	-5.9	.	2.7	2.9	5.7
Imports of services, BOP, EUR mn	1597.5	1518.8	1612.4	1459.9	285.4	.	1450	1500	1550
annual change in %	-1.3	-4.9	6.2	-9.5	-13.3	.	-0.7	3.4	3.3
FDI inflow, EUR mn	716.9	793.3	745.4	744.9	205.5	.	800	700	700
FDI outflow, EUR mn	28.2	4.8	29.9	17.7	2.7	.	30.0	40.0	50.0
Gross reserves of NB excl. gold, EUR mn	1607.8	1842.1	1853.1	1907.6	1825.3	.	.	.	.
Gross external debt, EUR mn	3591.4	4097.0	4795.8	5294.5	4886.6	.	.	.	.
Gross external debt, % of GDP	41.3	46.2	52.5	54.9	50.7	.	.	.	.
Exchange rate ALL/EUR, average	132.06	137.79	140.33	139.04	139.23	139.67	139	137	135
Purchasing power parity ALL/EUR	55.55	57.86	59.69	60.01	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). Data partly estimated by wiiw. - 4) Gross value added. - 5) Survey once a year (June or September-October), wiiw estimate in 2010-2012. - 6) Quarterly data refer to public sector. -7) Until 2010 based on IMF data; wiiw estimate thereafter. - 8) One-week repo rate.

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

Mario Holzner

Albania:
Deleveraging and improved business confidence – unity and conflict of opposites

At the time of going to press of this report, with more than 82% of the ballots counted, Albania’s left-wing opposition seems to have won a landslide victory in the 23 June general elections. International observers monitoring Albania's parliamentary election declared that the vote was an improvement to past fraud-rigged elections and generally free and 'quite fair'. Nevertheless, with a new government in place, a major turn-around in economic policy is not necessarily to be expected.

A recent poll has shown that the Albanian electorate was quite apathetic about the elections. The vast majority has been following the general election campaign with little or no interest. Though less intense than in the past, it was once again a tiresome battle of egos between the leaders of the two major competing coalitions. One is headed by the ruling centre-right Democratic Party of Prime Minister Sali Berisha and the other by the Socialists of former Tirana mayor Edi Rama. Post-communist Albania has a long history of elections that do not necessarily meet all international standards and often end in political disputes. A number of scandals and non-transparent government operations have additionally contributed to discrediting the reputation of the Albanian political class.

The murky privatisation attempt of the state oil firm Albpetrol is a case in point. The Albanian government has invalidated the winning bid from a consortium headed by a local businessman close to the ruling Prime Minister in the tender for Albpetrol in early 2013 after it failed for two months to come up with a down payment. The lack of those privatisation receipts is painfully felt in the treasury. Hope remains that the privatisation process can quickly be restarted after the elections and that revenues can be used to bolster economic growth via fiscal expansion. In 2012 a 13% reduction of public capital expenditures had a negative impact on already weak growth dynamics. Figures for the first four months of 2013 show a 10% increase in overall government expenditures year-on-year, which is somewhat less than expected and which will most likely lose dynamics after the elections.

Given the retained fiscal stimulus, household demand is expected to increase only slightly in 2013. In fact imports of goods continued to drop over the first four months of the year. While new loans to households have started to increase again in February and March 2013 as compared to the same period a year earlier, new loans to businesses were slashed almost by half in the same period. This hints at stagnating investments for 2013. The main reason why we have still revised our GDP growth forecast for the whole of 2013 upwards (from 2.8% to 3.5% since our spring forecast report) is an exceptionally robust export development.

Data for the first four months of 2013 depict a nominal increase of goods exports in lek terms by 16.5% as compared to the same period a year earlier. The euro exchange rate has been stable. The price development for fuels and minerals which make up more than a third of Albanian exports has been rather stable as well. If anything, commodity prices are on the decline. The exports to Albania's main trading partner Italy have been stagnating and Italy's share in overall Albanian exports has dropped below 50%. The large increase in overall exports is especially due to a doubling of exports to Spain. Spain is now the second most important export destination for Albanian goods (15%) and these represent almost entirely mineral products. Goods exports to Italy are much more diversified and contain to a large extent textiles and footwear as well as other manufactures. Hence it is particularly the extracting industry that is currently flourishing while the manufacturing industry is rather stagnating.

If the current trends of rising exports and decreasing imports continue, 2013 will be the first year since 2006 when the current account deficit will fall below 10% of GDP. In 2011 and 2012 remittances from expatriates stabilised at a level of about EUR 670 million – a value we expect to drop slightly since according to anecdotal evidence many Albanian migrants return from crisis-torn Greece. If, apart from remittances, FDI flows are also stabilising at the current levels of EUR 700 million to 800 million, a current account deficit of about 7% to 9% of GDP can be sustained for the years to come.

Non-performing loans are continuing to rise. In the first quarter of 2013 they reached a level of 24% of the total credit portfolio. This is about 4 percentage points higher than a year earlier. The banks started to strongly deleverage in the first quarter of 2013. The issuance of new loans was reduced by more than a third as compared to the same period a year earlier. As a consequence the banks' capital adequacy ratio has further increased to a level of almost 17%, which appears to be quite a solid value. According to the latest lending activity survey of the Bank of Albania for the first quarter of 2013, credit standards have continued to tighten on loans to businesses and consumer credit while only easing a bit on loans for house purchases.

The deleveraging process will act as a drag on economic development in Albania in the years to come. This is also one of the reasons for having corrected downwards our GDP growth forecast for 2014: from 3.3% to a mere 2.5%. Interestingly, the most recent business and consumer confidence survey results for the first quarter of 2013 show a further improvement in the overall economic sentiment indicator. The construction sector, in particular, has recently experienced a substantial improvement in confidence after years of deterioration. The above dialectical developments lead us to expect a GDP trend growth rate of around 3% for 2015 and beyond.

Vladimir Gligorov

Bosnia and Herzegovina: Fear of and hope for Spring

With a dysfunctional political system, Bosnia and Herzegovina has been weathering the crisis more or less as well as the better performing countries in the region. The recessions have not been very deep, while the recoveries were rather slow. Exports have held up as has industrial production, while private and public consumption and investments less so. In any case, given the weak economic and institutional fundamentals, it is meaningful to say that things could have been much worse.

Probably the main problem is that the country is basically ungovernable. However, it has also been risk-proof concerning social and political dissatisfaction because there were hardly any country-wide policy issues and centres of responsibility. So, the country succeeded in achieving political and social stability through disintegration of one kind or another. This state of political irresponsibility was for a while supplemented by the interventions of the High Representative, but this instance has become rather ineffective already before the economic crisis.

Lately there has been some movement to put pressure on the various levels of government to start dealing with common interest such as a state-wide social security number. Thus, growing social dissatisfaction with the bad economic situation coupled with policy and political impotence may offer some chances of social and political mobilisation which could result in long overdue political changes in next year's general elections. This is the rising hope of a B&H Spring arriving.

This somewhat new situation, if it were to develop, may lead to a reaction by the incumbent politicians and parties that is not completely predictable. On the one hand, the fear of change may lead them to try to work something out in order to prevent a complete collapse of the current political power set-up. On the other hand, they may be tempted to intensify the crisis with the aim to mobilise the support of their ethnic groups. An additional incentive to move into just that direction is found by some in the upcoming centenary of the start of World War I. That may be an occasion for reconciliation and of an agreement to start working together or the pretext to refight the war all over again, politically this time around.

Against this political and social background, a worsening economic situation, even if some slow recovery materialises this year and the next, may ignite social and political activism not seen in that country for a long time and a possible destabilisation. A positive contribution to change with stability can be provided by the start of negotiations between the EU and Serbia. That should incentivise the local political leaders and parties to turn more towards the EU for fear of B&H being hopelessly left out.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., mid-year	3843.0	3843.1	3839.7	3843.0	3843.0	.	3842	3842	3842
Gross domestic product, BAM mn, nom. 2)	24202	24773	25666	26000	.	.	26600	27700	29100
annual change in % (real) 2)	-2.8	0.7	1.0	-0.7	.	.	0.8	2.0	3.0
GDP/capita (EUR at exchange rate)	3200	3300	3400	3500	.	.	3500	3700	3900
GDP/capita (EUR at PPP)	6200	6400	6600	6600	.	.	.	.	.
GDP by expend. approach, BAM mn, nom. 2)	26378	26410	27240	.	.	.	.	.	.
annual change in % (real) 2)	-4.2	-0.6	2.0	.	.	.	.	.	.
Consumption of households, BAM mn, nom. 2)	20927	21338	21918	21900	.	.	.	.	.
annual change in % (real) 2)	-4.6	0.1	-0.3	-2.0	.	.	0.4	1.0	2.0
Gross fixed capital form., BAM mn, nom. 2)	5380	4779	5241	5400	.	.	.	.	.
annual change in % (real) 2)	-19.4	-11.8	7.0	0.0	.	.	3.0	5.0	5.0
Gross industrial production									
annual change in % (real) 3)	1.5	3.7	3.2	-4.3	-6.0	6.8	4.0	5.0	6.0
Gross agricultural production									
annual change in % (real)	4.2	-5.3	1.8	.	.	.	.	.	.
Construction output total									
annual change in % (real) 4)	-7.2	-12.4	-5.1	-5.0	.	.	.	.	.
Employed persons, LFS, th, April	859.2	842.8	816.0	813.7	813.7	.	810	812	820
annual change in %	-3.5	-1.9	-3.2	-0.3	-0.3	.	-0.5	0.2	1.0
Employees total, reg., th, average 5)	697.6	695.7	691.0	688.4	648.7	649.4	650	655	660
annual change in % 5)	-1.1	-0.3	-0.7	-0.4	.	0.1	-0.2	0.8	0.8
Unemployed persons, LFS, th, April	272.3	315.1	310.9	316.6	316.6	.	313	312	311
Unemployment rate, LFS, in %, April	24.1	27.2	27.6	28.0	28.0	.	28.0	28.0	27.0
Unemployment rate, reg., in %, end of period	42.4	42.8	43.9	45.9	45.5	46.1	46.0	45.0	45.0
Average gross monthly wages, BAM	1204	1217	1273	1290	1284	1281	1310	1350	1390
annual change in % (real, net)	5.6	-1.1	-1.4	-0.9	-0.5	-1.1	0.0	1.0	1.0
Consumer prices, % p.a.	-0.4	2.1	3.7	2.1	2.3	0.9	1.5	2.0	2.0
Producer prices in industry, % p.a. 6)	-3.2	0.9	3.7	1.5	1.1	0.8 I-II	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	43.0	43.8	44.2	43.5	.	.	43.5	44.0	44.0
Expenditures	47.5	46.3	45.5	46.5	.	.	46.0	46.5	46.0
Deficit (-) / surplus (+)	-4.4	-2.5	-1.3	-3.0	.	.	-2.5	-2.5	-2.0
Public debt, nat.def., % of GDP 7)	36.2	39.6	40.7	43.1	.	.	43.0	44.0	45.0
Central bank policy rate, % p.a., end of period 8)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 9)	-777.7	-719.3	-1141.9	-1252.8	-291.2	.	-1300	-1400	-1500
Current account, % of GDP	-6.3	-5.7	-8.7	-9.4	.	.	-9.6	-9.9	-10.1
Exports of goods, BOP, EUR mn 9)	2920.2	3761.9	4347.2	2574.8	554.9	608.7	2700	2800	3100
annual change in %	-17.1	28.8	15.6	-1.9	-10.1	9.7	5.0	5.0	10.0
Imports of goods, BOP, EUR mn 9)	6330.1	6994.1	7976.0	6892.7	1532.6	1541.8	7000	7200	7600
annual change in %	-24.1	10.5	14.0	0.0	2.6	0.6	1.0	3.0	5.0
Exports of services, BOP, EUR mn 9)	1024.9	974.5	922.3	1456.3	303.2	.	1510	1570	1630
annual change in %	-9.5	-4.9	-5.4	-2.0	-5.9	.	4.0	4.0	4.0
Imports of services, BOP, EUR mn 9)	461.7	407.4	378.6	399.3	65.8	.	410	430	450
annual change in %	-1.3	-11.8	-7.1	-3.6	-4.2	.	3.0	5.0	5.0
FDI inflow, EUR mn 9)	180.5	173.6	313.0	492.6	68.7	72.3	500	500	800
FDI outflow, EUR mn 9)	4.3	31.7	14.2	28.4	15.9	.	0	0	0
Gross reserves of NB excl. gold, EUR mn 10)	3143.8	3267.6	3207.0	3246.4	3046.0	3117.0	3200	3200	3300
Gross external public debt, EUR mn	2676.2	3215.4	3405.7	3658.2	3462.9	3696.5	4000	4000	4100
Gross external debt, % of GDP	21.6	25.4	26.0	27.5	26.0	27.2	29.5	28.3	27.6
Exchange rate BAM/EUR, average	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR 11)	1.0137	1.0071	1.0186	1.0147	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). - 3) From 2011 according to NACE Rev.2. - 4) According to gross value added. - 5) Quarterly data and forecast according to new methodology. - 6) Domestic output prices. From 2013 according to NACE Rev.2. - 7) Based on IMF data. - 8) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 9) Converted from national currency with the average exchange rate. From 2012 BOP 6th edition, 5th edition before. - 10) Including investment in foreign securities. - 11) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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

In the short term, the policy framework will remain restrictive because of the currency board and the pressure, by the IMF among others, for fiscal consolidation. If industrial production continues to improve and exports hold up, that should spur more investment and some speed-up of the recovery of growth. But the needed policy turnaround is hardly possible without some kind of political Spring arriving to this country.

Table XK

Kosovo: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average	1748	1775	1802	1816	.	.	1829	1842	1856
Gross domestic product, EUR mn, nom.	4008	4291	4776	5000	.	.	5300	5800	6300
annual change in % (real)	3.5	3.2	4.5	2.1	.	.	3.0	5.0	4.0
GDP/capita (EUR at exchange rate)	2300	2400	2700	2800	.	.	.	.	.
GDP/capita (EUR at PPP)	5000	5300	5600	6000	.	.	.	.	.
Consumption of households, EUR mn, nom.	3605	3822	4220	4300	.	.	.	.	.
annual change in % (real)	8.9	-0.2	5.9	-0.6	.	.	2.0	4.0	3.0
Gross fixed capital form., EUR mn, nom.	1027	1193	1374	1500	.	.	.	.	.
annual change in % (real)	20.4	8.6	15.5	6.6	.	.	3.0	10.0	9.0
Gross industrial production 2)									
annual change in % (real)	-1.5	-5.6	19.2	-10.0	.	.	4.0	7.0	10.0
Gross agricultural production 2)									
annual change in % (real)	19.3	0.5	26.3	0.0	.	.	3.0	4.0	3.0
Construction output 2)									
annual change in % (real)	32.8	-27.7	11.2	3.0	.	.	3.0	6.0	4.0
Unemployment rate, LFS, in %, average	45.4	45.1	44.8	44.0	.	.	43.0	41.0	39.0
Reg. unemployed persons, th, end of period	339	335	325	264	.	.	.	.	.
Average net monthly wages, EUR	246	286	348	360	.	.	.	.	.
annual change in % (real, net)	22.8	12.5	14.6	0.9	.	.	2.0	10.0	5.0
Consumer prices, % p.a.	-2.4	3.5	7.3	2.5	1.7	2.9	3.0	4.0	4.0
Producer prices in industry, % p.a.	3.8	4.7	5.7	1.0	0.3	.	.	.	.
General governm.budget, nat.def., % of GDP 3)									
Revenues	36.7	33.8	35.3	35.2	.	.	35.0	37.0	38.0
Expenditures	32.6	35.1	35.5	36.3	.	.	36.0	39.0	38.0
Deficit (-) / surplus (+)	4.1	-1.3	-0.2	-1.2	.	.	-1.0	-2.0	0.0
Public debt, nat.def., % of GDP 3)	6.2	6.1	5.3	6.2	.	.	6.9	8.3	7.6
Central bank policy rate, % p.a., end of period 4)	14.1	14.3	13.7	12.7	13.8	12.6	.	.	.
Current account, EUR mn	-374.2	-515.7	-658.4	-380.2	-20.9	.	-600	-900	-800
Current account, % of GDP	-9.3	-12.0	-13.8	-7.6	.	.	-11.3	-15.5	-12.7
Exports of goods, BOP, EUR mn	177.2	305.0	324.9	286.9	61.5	67.3	310	330	350
annual change in %	-18.2	72.1	6.5	-11.7	.	9.5	8.0	6.5	6.1
Imports of goods, BOP, EUR mn	1828.9	2057.1	2383.9	2359.7	434.4	484.6	2450	2800	2600
annual change in %	-2.0	12.5	15.9	-1.0	.	11.6	3.8	14.3	-7.1
Exports of services, BOP, EUR mn	517.6	573.0	618.5	635.1	106.6	.	640	650	660
annual change in %	31.9	10.7	7.9	2.7	.	.	0.8	1.6	1.5
Imports of services, BOP, EUR mn	285.3	386.1	352.8	288.8	59.2	.	300	350	330
annual change in %	18.5	35.3	-8.6	-18.1	.	.	3.9	16.7	-5.7
FDI inflow, EUR mn	291.4	365.8	394.6	232.0	56.7	.	700	400	500
FDI outflow, EUR mn	10.5	34.7	15.7	15.8	1.7	.	20	30	40
Gross reserves of NB excl. gold, EUR mn	576	634	575	840	.	.	.	.	.
Gross external debt, EUR mn	1146	1348	1427	1518	.	.	.	.	.
Gross external debt, % of GDP	28.6	31.4	29.9	30.4	.	.	.	.	.
Purchasing power parity EUR/EUR	0.455	0.457	0.471	0.468	.	.	.	.	.

1) Preliminary. - 2) According to gross value added data. - 3) National definition based on ESA'95. - 4) Average weighted lending interest rate (Kosovo uses the euro as national currency).

Source: National statistics and IMF. Forecasts by wiiw.

Mario Holzner

Kosovo:
Cooperation for integration

Kosovo and Serbia adopted a historical agreement on normalising relations on 19 April 2013. The implementation of the agreement is the condition for Serbia to obtain a start date for the opening of accession talks with the EU, while Kosovo has the prospect of obtaining a Stabilisation and Association Agreement (SAA) with the EU. The draft agreement mainly concerns the future of the Serbian community in northern Kosovo, the formation of an Association of Serbian Municipalities with broad autonomy rights and the stepwise abolition of the Serbian state-run parallel institutions there. The prime ministers of Kosovo and Serbia (Hashim Thaçi and Ivica Dačić) at the end of May agreed in principle on the steps for the implementation of the agreement over the next months. A successful implementation is an important precondition for a peaceful and prosperous development of both countries – but also of the wider region – as it signalises a fundamental willingness to cooperate after years of more or less open conflict.

Certainly, in the medium to long run a peace dividend can be reaped also in economic terms, fostering investments, employment and economic growth. However, Kosovo growth prospects in the short to medium run mostly depend on the development in the main host countries to Kosovo's large diaspora – Germany and Switzerland. While in recent years remittances sent into the country by Kosovo migrant workers from abroad were falling or stagnating at a level below EUR 600 million per year (about 12% of GDP), remittances in 2012 grew by almost 4% and are now close to the all-time peak of 2008. The European Commission forecasts for Germany a somewhat slower GDP growth development for 2013 (0.4%) and a substantial improvement in 2014 (1.8%). The Swiss State Secretariat for Economic Affairs expects a slight increase of growth in 2013 (1.3%) and also stronger growth in 2014 (2.1%) in Switzerland. Certainly downside risks cannot be neglected in both cases.

In terms of export development, 2012 was rather disappointing. It was only due to a very weak domestic demand that imports fell even more. For 2013 exports are expected to rise again. Customs data for goods exports in the first four months of 2013 indicate an increase of more than 20% as compared to the same period a year earlier. This happened against the background of rather stagnant or even falling commodity prices (Kosovo's main exports are base metals) and a stable real effective exchange rate. In the same period, imports of goods increased by less than 3%. While these trade growth rates will most likely adjust to a certain extent, the general trend seems to indicate positive dynamics on the side of external demand.

The development of domestic demand appears to be mixed. Overall, new loans to the economy were stagnant over the first four months of 2013 as compared to the same period one year earlier. However, investment loans to non-financial corporations experienced a significant drop of 14%. At the same time household consumer loans increased by almost 21% and household mortgage loans by more than 11%. It seems that deleveraging is primarily occurring in the firms' sector. This is probably also where most of the non-performing loans (NPLs) are concentrated. NPLs increased by about two percentage points to almost 8% of total loans by the end of January 2013. Nevertheless, the financial system of Kosovo appears to be quite stable. The banking system's average capital adequacy ratio stood at 15% at the end of January 2013, well above the regulatory minimum of 12%.

Our forecast for Kosovo is a robust 3% GDP growth for 2013 and a reinforced growth of 5% in 2014. For 2015 and the medium term, growth prospects are expected to hover around a trend growth rate of about 4%. Expansion in 2014 will not only be due to improved external factors, but also to parliamentary elections that are likely to be held in early 2014. Thus, a fiscal stimulus can be expected to boost both consumption and investment. The budget deficit will not necessarily be overly affected given the inflow of funds in the wake of the privatisation of the Post and Telecom of Kosovo (PTK). At the end of April 2013, 75% of PTK, comprising two business units, Telecom (fixed-line telephony) and Vala (mobile telephony), were sold at a relatively low price of EUR 277 million to ACP Axos Capital, an international consortium from Hamburg.

Olga Pindyuk

Kazakhstan:
Strong growth and structural reforms

Kazakhstan's GDP growth was close to 5% in the first quarter 2013 year on year. The highest growth rates were achieved in retail and wholesale trade (12.8%), information and communication services (11.5%), and public services (8%). In contrast, construction dropped by 4.9%. Agriculture seems to have started rebounding after an 18% drop in 2012. Industry's value added demonstrated only modest real growth of 1.2% year on year.[34]

Real household income increased by 2.9% year on year during the first quarter of 2013, in March growth accelerated to 3.6% compared with March 2012. Another indicator which has a significant impact on final consumption is the dynamics of bank loans to physical persons. Overall, the stock of bank loans to households has been growing much faster than the stock of loans to corporate clients – in April 2013, year-on-year growth rates were 25.6% and 8.6% respectively. The comparison gets even more striking if one looks at the data on newly issued loans: in January-April 2013, newly issued loans to physical persons increased by 56.4% compared to January-April 2012, while for corporate loans this indicator was at 15.7%. Newly issued loans for final consumption purposes have been growing even faster – by 66.1% year on year; this category of loans accounted for 77.7% of total loans to households issued during that period. Banks have been turning to consumer loans as a relatively safe harbour, while loans to companies, in particular in construction and related sectors, are still perceived as too risky given the unresolved consequences of the housing bubble burst in 2008. However, so fast a growth of loans, which significantly outpaces household income dynamics, carries a risk of possible bubble development in this segment of the market.

These trends must inevitably translate into private consumption growth. Retail trade volume dynamics (12.5% real growth in the first quarter of 2013 as compared with the same period in the previous year) also supports this conclusion. By the end of 2013, we expect consumption of households to increase by 6% in real terms year on year. In 2014, the growth rate will be at the same level of 6%, and will slightly go down to 5% in 2015.

Investment into fixed capital has been growing quite fast in January-April 2013 – by 7.9% year on year in real terms. 57% of investment outlays during that period were financed from own funds of companies – this is 2.2 percentage points higher than in the same period of the previous year. The share of loans in the sources of financing increased as well, even more significantly – by 4.7 p.p. In

[34] According to the industrial output data for January-March 2013, mining sectors were the most dynamic with 2.7% increase of output compared to the same period last year. Manufacturing attained a mere 1.6% real growth in output during that period, while electricity and water distribution saw their output decrease by 1.8% and 7% respectively.

Table KZ

Kazakhstan: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average 2)	16093	16322	16557	16791	16705	16941	16980	17100	17200
Gross domestic product, KZT bn, nom.	17008	21816	27572	30219	5977	6601	33500	37600	42400
annual change in % (real)	1.2	7.3	7.5	5.0	5.6	4.6	5.0	6.0	6.5
GDP/capita (EUR at exchange rate)	5100	6800	8200	9400	.	.	10100	11000	12200
GDP/capita (EUR at PPP)	9000	9700	10400	11000	.	.	.	.	.
Consumption of households, KZT bn, nom.	7913	9721	11569	13587	2544	.	15400	17400	19400
annual change in % (real)	0.6	11.8	10.9	11.1	12.1	.	6.0	6.0	5.0
Gross fixed capital form., KZT bn, nom.	4727	5307	5772	6298	864	.	6900	7800	9000
annual change in % (real)	-0.8	3.8	3.9	3.3	3.3	.	5.0	7.0	9.0
Gross industrial production									
annual change in % (real)	2.7	9.6	3.8	0.5	2.7	0.9	4.0	7.0	10.0
Gross agricultural production									
annual change in % (real)	14.6	-11.7	26.8	-17.8	-5.1	0.4	12.0	5.0	5.0
Construction industry									
annual change in % (real)	-3.3	2.4	2.8	2.9	-0.7	-4.9	5.0	8.0	10.0
Employed persons, LFS, th, average 3)	7903.4	8114.2	8301.6	8507.1	8462.5	8546.1	8590	8680	8770
annual change in %	0.6	2.7	2.3	1.0	.	1.0	1.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	554.5	496.5	473.0	474.8	478.5	474.5	.	.	.
Unemployment rate, LFS, in %, average 3)	6.6	5.8	5.4	5.3	5.4	5.3	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period 3)	0.6	0.4	0.4	0.4	0.7	0.6	.	.	.
Average gross monthly wages, KZT 4)	67333	77611	90028	101079	93947	101237	.	.	.
annual change in % (real, gross)	3.2	7.6	7.1	6.9	11.5	0.9	.	.	.
Consumer prices (HICP), % p.a.	7.3	7.1	8.3	5.2	5.1	6.8	7.0	6.5	6.0
Producer prices in industry, % p.a.	-22.0	25.2	27.2	3.5	11.3	2.7	4.0	5.0	6.0
General governm.budget, nat.def., % of GDP									
Revenues	20.6	19.7	19.5	19.3	23.7	22.8	.	.	.
Expenditures	23.5	22.1	21.5	22.3	23.5	21.5	.	.	.
Deficit (-) / surplus (+)	-2.9	-2.4	-2.1	-3.0	0.1	1.3	-2.5	-2.0	-1.5
Public debt, nat.def., % of GDP	12.3	14.4	11.8	12.7	11.3	11.4	14.0	15.0	16.0
Central bank policy rate, % p.a., end of period 5)	7.0	7.0	7.5	5.5	7.0	5.5	.	.	.
Current account, EUR mn 6)	-2950	1049	8822	6003	2474	1247	6900	9400	10800
Current account, % of GDP	-3.6	0.9	6.5	3.8	8.0	3.8	4.0	5.0	5.1
Exports of goods, BOP, EUR mn 6)	31504	46235	62868	71630	16655	15346	75700	82700	91900
annual change in %	-35.6	46.8	36.0	13.9	39.2	-7.9	5.7	9.2	11.1
Imports of goods, BOP, EUR mn 6)	20769	24794	29266	36876	7276	7758	40400	43800	50000
annual change in %	-20.5	19.4	18.0	26.0	35.9	6.6	9.6	8.4	14.2
Exports of services, BOP, EUR mn 6)	3038	3203	3213	3856	826	833	4100	4400	4600
annual change in %	1.0	5.4	0.3	20.0	22.3	0.8	6.3	7.3	4.5
Imports of services, BOP, EUR mn 6)	7200	8536	7856	9894	2015	2217	11000	12100	13100
annual change in %	-4.7	18.6	-8.0	25.9	47.1	10.0	11.2	10.0	8.3
FDI inflow, EUR mn 6)	9497	8698	9987	10909	4397	2829	11100	11700	12200
FDI outflow, EUR mn 6)	2266	5938	3326	1231	476	1458	2100	2200	2200
Gross reserves of NB excl. gold, EUR mn	14352	19044	19477	16674	15310	13243	.	.	.
Gross external debt, EUR mn	78674	89259	96853	103250	97064	.	.	.	.
Gross external debt, % of GDP	95.1	80.1	71.7	65.5	61.6	.	.	.	.
Average exchange rate KZT/EUR	205.68	195.67	204.11	191.67	194.12	199.13	196.1	199.1	202.0
Purchasing power parity KZT/EUR 7)	118.00	137.95	160.26	163.39	.	.	.	.	.

Note: Gross industrial production and producer prices refer to NACE Rev. 2 (including E - Water supply, sewerage, waste management and remediation activities).

1) Preliminary. - 2) According to census March 2009. - 3) From 2012 according to census March 2009. - 4) Excluding small enterprises, engaged in entrepreneurial activity. - 5) Refinancing rate of NB. - 6) Converted from USD with the average exchange rate. - 7) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

contrast, government and foreign funding decreased their significance as financing sources compared to the same period of the previous year.

We expect that there will be continuing investment into transport infrastructure (in particular railways and oil pipelines) and oil fields development – financed both by the state and companies. China has been quite active in securing oil supplies from Kazakhstan, in particular through ownership of stakes in oil fields (now it controls 25% of oil production in the country) and co-financing the development of oil transport infrastructure, and it is going to continue investing into infrastructure projects. Construction is going to gradually recover, in particular due to government programmes of residential construction, and reach positive growth by the year-end. Overall, gross fixed capital formation is expected to increase by 5% in real terms in 2013. In 2014 and 2015 annual growth will speed up to 7% and 9% respectively.

Balance of payment data show that goods exports experienced a 7% drop in the first quarter of 2013 (in dollar terms), partly due to the decline in the global oil prices. We expect that this is just a temporary slump, and growth will resume soon on the back of higher volume of oil exports and reach 6% by the end of 2013 – only marginally higher than in 2012. Real exports will be growing faster compared with the previous year, about 6% versus 4.1% in 2012. The main underlying reason for that would be an increase in oil sector output, especially owing to the launch of the Kashagan field's operation in the second half of the year, which is expected to yield an up to 4% increase in oil production in 2013 (up to 3 million tons of oil are planned to be produced at this field by the year-end). In 2014-2015, Kashagan is expected to increase oil production up to 300 thousand barrels per day, which translates into about 20% growth of the country's total oil production. Consequently, both real and nominal exports will speed up their growth.

As a result of the trends described above, Kazakhstan's real GDP growth will be gradually accelerating – from 5% in 2013 to 6% in 2014 and 6.5% in 2015. This makes Kazakhstan a leader with respect to economic growth in the region we analyse. The relatively small size of the country (in terms of population) and the envisaged increase in oil production owing to the start of operation of the Kashagan field limit the negative impact of slightly declining oil prices on the economy.

While the banking sector still continues to struggle with a high ratio of non-performing loans (27.3% in April 2013) and the government has not succeeded yet in helping the banks to clean their balance sheets, the President announced that the commercial banks would no longer get financing from the National Oil Fund. Also, the state holding Samruk-Kazyna, which owns majority shares in the three most troubled banks[35], was ordered to exit the banking sector by the end of the year.

At the same time, the government plans to drastically change the landscape of the pension funds sector – the state plans to nationalise the existing ten private pension funds and merge their assets into one state pension fund responsible for the compulsory pension pillar. The official justification of

[35] Samruk-Kazyna owns 98% of BTA bank, which was the biggest bank by the amount of assets before 2008, and then had to undergo two restructurings and currently has 87% of non-performing loans in its portfolio. Besides, Samruk-Kazyna owns 80% of Temir, 67% of Aliance, and 18% of KKB.

the reform is the need to increase the sector's efficiency. Possibly, banks' shares in Samruk-Kazyna's ownership will be exchanged for assets of some of the pension funds.

Another part of the pension reform envisages an increase in the retirement age of women from 58 to 63 years – to be on a par with the male retirement age. The law on pension reform (covering both the creation of a single state pension fund and an increase in the retirement age) was adopted by the Parliament on 23 May. However, due to the strong discontent of the citizens, the President did not sign the law and asked the Parliament to introduce some changes – in particular, postpone the retirement age increase to 2018. Given that the average life expectancy in Kazakhstan is 67 years, the reform is criticised for being too coldly efficient. Besides, there are concerns that it will negatively affect employment of young people.

Peter Havlik

Russian Federation:
Growth stumbles – how much and for how long?

Russian economic growth has been slowing down during the past five consecutive quarters. Between the first quarter 2012 and the first quarter 2013 the GDP growth rate sacked from 4.8% to just 1.5%. Industrial production and investment are de facto stagnant while the volume of goods transport is even falling. GDP growth is currently fuelled only by rising household consumption as real disposable incomes (+5.3%), consumer expenditures (+4.4%) and retail trade turnover (+3.9%; all figures for the first quarter 2013, year-on-year) are growing. The collapse of investment growth is particularly worrying; it is not surprising that the search for a 'new growth model' has recently intensified – in particular given declining export revenues and falling current account surpluses with prospects for worse (see below). Falling energy prices and export revenues owing to the expected 'shale gas price shock' cast a dark shadow on the future Russian growth outlook. Together with the lasting crisis in the euro area all these factors make the attempted (yet so far largely absent) diversification, modernisation and restructuring of the Russian economy ever more urgent.

The current and expected rates of GDP growth have been revised downwards – below (in 2013) respectively close to 3% (2014-2015) per year at best. As in the recent past, growth will be driven mainly by consumer spending. The contribution of net exports to GDP growth has been negative already for nearly a decade (with the exception of 2009) because import volumes have been growing faster than those of exports. Though there are still sizeable trade and current account surpluses (the latter is estimated at about 3% of GDP in 2013), given the projected paths of export and import revenues even the Central Bank of Russia is now expecting that the current account will turn into a deficit in a couple of years. The share of investment in GDP is planned to be increased from the current rate of about 22% to 27% by the year 2018 in one of the official economic programmes. With this target in mind, a substantial improvement in the investment climate is required. In order to foster this improvement, new privatisation plans have been announced. Unfortunately (as mentioned repeatedly in our previous assessments), the recent years have not been used for launching economic restructuring and institutional reforms which would bring about the badly needed improvements in the business and investment climate; the expected positive effects of WTO accession in August 2012 are yet to materialise.

Foreign exchange reserves have so far remained constant (about USD 530 billion in May 2013), despite sizeable capital flight: after more than USD 85 billion in 2011 and USD 63 billion in 2012. These outflows are partly linked to genuine outward FDI, partly they are due to the lasting political uncertainties. Sizeable net FDI inflows (more than USD 60 billion) are reported by the CBR for the first quarter 2013; these inflows are probably somehow linked to the Cyprus financial crisis. The consolidation of the banking sector continues, with credits to both households (including housing

Table RU

Russia: Selected Economic Indicators

	2009	2010	2011	2012 [1]	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average [2]	142797	142861	142961	143202	.	.	143000	142500	142000
Gross domestic product, RUB bn, nom. [3]	38807	46309	55800	62599	13802	14900	69200	76600	84000
annual change in % (real) [3]	-7.8	4.5	4.3	3.4	4.8	1.6	2.4	3.1	3.2
GDP/capita (EUR at exchange rate)	6200	8000	9600	10900	.	.	.	.	.
GDP/capita (EUR at PPP)	11700	12500	13300	14000	.	.	.	.	.
Consumption of households, RUB bn, nom. [3]	20986	23618	27165	30543	6825	.	.	.	.
annual change in % (real) [3]	-5.1	5.5	6.4	6.6	9.1	5.0	4.5	5.0	4.5
Gross fixed capital form., RUB bn, nom. [3]	8536	10014	12076	13768	2018	.	.	.	.
annual change in % (real) [3]	-14.5	5.9	10.2	6.0	15.5	-0.2	2.0	5.0	6.0
Gross industrial production [4]									
annual change in % (real)	-9.3	8.2	4.7	2.6	4.0	0.0	3.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	1.4	-11.3	23.0	-4.7	4.0	2.3	.	.	.
Construction output									
annual change in % (real)	-13.2	3.5	5.1	2.5	5.0	0.6	4.0	5.0	5.0
Employed persons, LFS, th, average [2]	69410.5	69933.7	70856.6	71545.4	70076.0	70899.3	71500	71000	71000
annual change in % [2]	-2.2	0.8	1.3	1.0	0.8	1.2	-0.1	-0.7	0.0
Unemployed persons, LFS, th, average [2]	6284.0	5544.0	4922.0	4131.0	4702.7	4355.3	4300	4300	4300
Unemployment rate, LFS, in %, average [2]	8.3	7.3	6.5	5.5	6.3	5.8	6.0	6.0	6.0
Unemployment rate, reg., in %, end of period	2.9	2.1	1.7	1.4	1.8	1.4	.	.	.
Average gross monthly wages, RUB	18637.5	20952.2	23369.2	26690.0	24407.0	27339.0	.	.	.
annual change in % (real, gross)	-3.5	5.2	2.8	7.8	10.3	4.5	.	.	.
Consumer prices, % p.a.	11.8	6.9	8.5	5.1	3.9	7.1	7.0	6.0	5.0
Producer prices in industry, % p.a. [5]	-7.2	12.2	19.0	6.8	7.8	4.3	6.0	5.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	35.0	34.6	37.4	37.0	38	.	.	.	.
Expenditures	41.4	38.0	35.8	26.6	34	.	.	.	.
Deficit (-) / surplus (+)	-6.3	-3.4	1.5	0.4	3.9	1.3	0.0	0.0	.
Public debt, nat.def., % of GDP [6]	8.3	8.4	9.0	9.6	8.1	8.6	7.0	6.0	.
Central bank policy rate, % p.a., end of period [7]	8.75	7.75	8.00	8.25	8.0	8.3	.	.	.
Current account, EUR mn [8]	34893	53588	70976	63245	29878	21103	45000	40000	35000
Current account, % of GDP	4.0	4.7	5.2	4.0	8.6	5.7	2.7	2.2	1.8
Exports of goods, BOP, EUR mn [8]	217796	302039	374872	412840	100402	95078	420000	440000	460000
annual change in %	-32.2	38.7	24.1	10.1	23.0	-5.3	1.7	4.8	4.5
Imports of goods, BOP, EUR mn [8]	137691	187448	232553	260913	55896	57258	280000	300000	330000
annual change in %	-30.8	36.1	24.1	12.2	17.7	2.4	7.3	7.1	10.0
Exports of services, BOP, EUR mn [8]	29859	33912	38797	49087	10097	11573	53000	55000	60000
annual change in %	-14.4	13.6	14.4	26.5	19.0	14.6	8.0	3.8	9.1
Imports of services, BOP, EUR mn [8]	44099	55550	64612	83937	16442	19061	95000	105000	120000
annual change in %	-14.2	26.0	16.3	29.9	30.5	15.9	13.2	10.5	14.3
FDI inflow, EUR mn [8]	26203	32635	37973	40000	9791	.	32000	40000	50000
FDI outflow, EUR mn [8]	31346	39598	48318	39719	8644	.	40000	40000	40000
Gross reserves of CB, excl. gold, EUR mn	290380	335251	350786	367368	348683	372700	.	.	.
Gross external debt, EUR mn	325639	369524	416385	476940	423250	.	.	.	.
Gross external debt, % of GDP	37.0	32.1	30.5	30.4	27.0	.	.	.	.
Exchange rate RUB/EUR, average	44.1	40.3	40.9	39.9	39.7	40.2	41	42	43
Purchasing power parity RUB/EUR [9]	23.1	25.8	29.4	31.2	.	.	.	.	.

1) Preliminary. - 2) According to census October 2010. - 3) According to SNA'93 (FISIM reallocated to industries, real growth rates based on previous year prices etc). - 4) Excluding small enterprises. - 5) Domestic output prices. - 6) wiiw estimate. - 7) Refinancing rate of Central Bank. - 8) Converted from USD with the average exchange rate. From 2012 BOP 6th edition, 5th edition before. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

mortgages) and enterprises growing sharply. The share of non-performing loans on mortgages fell below 4% of the total as of April 2013.

Lacking progress of diversification and modernisation, growing public apathy and widespread corruption, together with the recent slowdown in economic growth and dismal prospects, are all mutually interlinked features of Russia's current development problems. These came to the fore upon Putin's return to the presidency one year ago. More assertive domestic and external policies represent another unpleasant feature of the Medvedev-Putin tandem reshuffle. Mr Medvedev's weakness (and also a general retreat from liberal values which he tried to pursue during his presidency with mixed success) came repeatedly to the open during the first year of Putin's new presidency. Tensions within the ruling tandem reappeared in varying reactions to the harsh sentence for the punk group Pussy Riot, Putin's criticism of the draft 2013 budget, the sacking of Deputy Prime Minister Vladislav Surkov over corruption allegation related to the Skolkovo technology park, and Medvedev's general cabinet performance in April 2013. A strange coalition between the Orthodox Church and the political leadership which is gambling on the support from conservative parts of Russian society raises uneasy feelings among the liberal opposition yet it is popular with the nationalists and populists. On the external front, Russian relations with the United States and the EU further worsened (Syria, Russian ban of USAID and other restrictions on foreign-supported NGOs, etc.).

In the field of economic policy, there have been clear signs that more anti-liberal approaches start to gain the upper hand – at least at the level of ongoing discussions (the eventual implementation may face a similar fate as the previously attempted modernisation efforts) though the ultimate outcome is uncertain.[36] The new economic reform strategy which aims at 'achieving sustainable growth in a period of global instability' has been drafted by an expert team headed by Putin's newly appointed advisors, academicians Sergei Glazyev and Alexander Nekipelov, who both hold more 'interventionist' views regarding economic policies. Their expert group will present specific policy recommendations aiming at significantly boosting economic growth, presumably by recommending a stronger role of the state in the economy, more interventionist industrial policies and the relaxation of monetary policies. The authors of the new Russian pro-growth reform strategy reject the previous 'imported' development models à la Washington Consensus and doubt the usefulness of restrictive monetary and fiscal policies, of trade and price liberalisations and of privatisation. Instead, they call for an increased role of the state and for a significant breakthrough in investment activity with the aim to create a 'technologically advanced manufacturing industry which has a strong export potential and relies on high-technology innovative companies'. As previous ingenious successful modernisation examples they quote the electrification plan GOELRO of the 1920s, the industrialisation and post-war reconstruction drives of the 1930s-1940s, the Soviet nuclear and space programmes of the 1950s-1960s and the exploitation of northern Russian energy resources of the 1970s. As external successful modernisation examples they quote the industrial policies of post-war Japan and present China. The acceleration of GDP growth (to at least 5% per year) should be accompanied by a significant boost in investments (lifting their share in GDP to at least 30-40% in the medium perspec-

[36] The highly publicised defection of one of the leading liberal and well-connected economists Sergei Guriev at the end of May 2013 (he resigned from his position as the rector at the respected New Economic School in Moscow) and his subsequent election into the supervisory board of Sberbank represents the latest peak in the murky political infighting.

tive) in order to accomplish economic restructuring and modernisation. R&D expenditures should increase substantially as well (to at least 4% of GDP). The financing of such a massive investment programme should proceed from existing savings, in particular by using reserves accumulated in foreign exchange and reserve funds. Moreover, monetary policies should be relaxed, liquidity increased and interest rates cut.[37] Other elements of the monetary policy include targeting a 'stable real exchange rate' and the introduction of capital flow controls. In order to stimulate innovation activities various tax incentives and preferential depreciation schemes should be used; external financing is to be gradually cut.

In the current baseline scenario, the wiiw has revised its GDP growth forecast for 2013 downwards (below 3%, in line with most other forecasters) and continues to expect an unspectacular growth rate of GDP during 2014-2015. This scenario assumes no abrupt policy changes or external shocks and is charged with substantial downside risks. In particular, a more severe recession in Europe would have serious consequences, largely via falling export (and fiscal) revenues. In the baseline scenario, export revenues grow slowly due to stagnating volumes of exported oil and gas, while there will be not much else to export since progress in export diversification will be limited. Simultaneously, import volumes are expected to grow at a faster rate as household consumption and investment will gradually pick up, both fuelled by the ongoing real currency appreciation. In the medium and long run, economic reforms and investment (including FDI) may be stimulated by WTO membership induced reform efforts. In summary, we stick to a relatively optimistic scenario of stable yet unspectacular GDP growth of around 3% per year. This implies a continuation of the negative contribution of real net exports to GDP growth and, in nominal terms, gradual reductions of the trade and current account surpluses. Simultaneously, the annual CPI inflation will settle at 5% p.a., the budget will remain balanced and the rate of unemployment stable at some 6%.

[37] The new Chairman of the Russian Central Bank, Elvira Nabiullina, replaced Sergei Ignatiev in June 2013. Ms Nabiullina (a former Minister of Economic Development in Putin's cabinet) may pursue more accommodative monetary policies.

Vasily Astrov

Ukraine:
Ample global liquidity helps maintain fragile status quo

In our previous Forecast Report, we argued that the persistent downward pressure on the hryvnia emanating from high external imbalances and depreciation expectations might ultimately force the National Bank of Ukraine (NBU) to abandon the exchange rate peg to the US dollar and devalue the currency, possibly by up to 10-15%. This scenario has not materialised, at least so far, largely thanks to the ample global liquidity which has facilitated access to external funding even for arguably 'high-risk' borrowers such as Ukraine. The government has had little difficulties in placing Eurobonds whose yields have declined to historic (by Ukraine's standards) lows of around 7% – despite the lack of any progress in negotiations with the IMF over a new loan package. The supply of foreign exchange has been also boosted by the newly implemented administrative measures, notably the 50% surrender requirement on export proceeds and incoming private transfers exceeding UAH 150 thousand,[38] while the demand for forex subsided in line with diminished devaluation expectations. As a result, the NBU has been no longer forced to sell foreign currency to maintain the exchange rate peg. The stability of the exchange rate and the postponement of domestic tariff hikes have also helped to keep inflation at levels close to zero – a remarkable achievement given Ukraine's history of high (and volatile) inflation.

However, the newly gained financial stability has done little to boost the fading GDP growth. In January-March 2013, the economy recorded recession (-1.1%) for the third quarter in a row, although growth turned positive on a quarterly basis (+0.6%). Metals exporters confronted with depressed world prices continue to suffer from the hryvnia strength, while the recent marked slowdown of growth in Russia – Ukraine's key trading partner – has had a dampening impact on machinery exports. In the first five months of 2013, the exports of metals and machinery dropped by 12.5% and 8.3% in nominal (US dollar) terms, respectively. On top of that, the revenues from pipeline transit, which account for some 40% of Ukraine's services exports, declined markedly due to the reduced shipments of Russian gas to Europe. The noticeable improvement in the trade (and current account) balance in January-May 2013 has been solely thanks to a 12% drop in imports, largely on account of the 30% decline in imported energy. The latter has been partly due to the reduced energy consumption in industry (the output of which fell by 5.2%), but also efforts to substitute expensive Russian gas with supplies from elsewhere and with domestically produced coal.[39] In the short run, imports should also be curbed by the newly enacted protectionist measures such as the 'safeguard' duty on im-

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[38] Meanwhile, the surrender requirement has been prolonged until November 2013.

[39] In January-April 2013, Ukraine's natural gas consumption went down by 7%, the volume of gas imports by 20%, and gas transit by 19% year-on-year. In addition, gas which has been increasingly imported from suppliers outside Russia such as Germany (via Poland and Hungary) is reportedly some 10% cheaper than Russian gas.

Table UA

Ukraine: Selected Economic Indicators

	2009	2010	2011	2012 1)	2012	2013	2013	2014	2015
					1st quarter			Forecast	
Population, th pers., average	46053	45871	45706	45593	45611	45533	45470	45360	45250
Gross domestic product, UAH bn, nom. 2)	913.3	1082.6	1302.1	1408.9	293.5	301.6	1420	1520	1640
annual change in % (real) 2)	-14.8	4.1	5.2	0.2	2.2	-1.1	0.5	2.5	3.5
GDP/capita (EUR at exchange rate)	1800	2200	2600	3000	.	.	.	.	.
GDP/capita (EUR at PPP)	5000	5400	5700	5900	.	.	.	.	.
Consumption of households, UAH bn, nom. 2)	581.7	686.1	865.9	986.5	210.5	224.3	.	.	.
annual change in % (real) 2)	-14.9	7.1	15.7	11.7	11.0	4.5	4.0	5.0	6.0
Gross fixed capital form., UAH bn, nom. 2)	167.6	195.9	241.8	265.3	48.1	51.3	.	.	.
annual change in % (real) 2)	-50.5	3.9	7.1	0.9	12.3	4.0	0.0	6.0	6.0
Gross industrial production									
annual change in % (real) 3)	-21.9	11.2	8.0	-0.5	1.8	-5.0	-2.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	-1.8	-1.5	19.9	-4.5	0.5	5.8	.	.	.
Construction output									
annual change in % (real) 3)	-48.2	-5.4	18.6	-8.3	6.2	-13.8	.	.	.
Employed persons, LFS, th, average	20191.5	20266.0	20324.2	20354.3	20040.3	.	20350	20400	20450
annual change in %	-3.7	0.4	0.3	0.1	-0.3	.	0.0	0.2	0.2
Unemployed persons, LFS, th, average	1958.8	1785.6	1732.7	1657.2	1845.0	.	.	.	.
Unemployment rate, LFS, in %, average	8.8	8.1	7.9	7.5	8.4	.	7.8	7.7	7.5
Unemployment rate, reg., in %, end of period 4)	1.9	2.0	1.8	1.8	1.9	2.0	.	.	.
Average gross monthly wages, UAH 5)	1905.9	2239.2	2633.0	3025.0	2814.7	3085.3	.	.	.
annual change in % (real, gross)	-9.0	9.7	8.9	14.2	14.5	10.2	.	.	.
Consumer prices, % p.a.	15.9	9.4	8.0	0.6	2.9	-0.5	0.5	4.5	4.0
Producer prices in industry, % p.a. 6)	6.5	20.9	19.0	3.6	8.5	0.3	3.0	5.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	29.9	29.1	30.6	31.6	33.6	35.4	.	.	.
Expenditures	34.0	35.0	32.4	35.2	33.8	37.3	.	.	.
Deficit (-) / surplus (+) 7)	-4.1	-6.0	-1.8	-3.6	-0.2	-1.9	-3.5	-3.0	-2.5
Public debt, nat.def., % of GDP	34.8	39.9	36.3	36.6	34.3	37.9	37.5	36.0	35.0
Central bank policy rate, % p.a., end of period 8)	10.25	7.75	7.75	7.50	7.5	7.5	.	.	.
Current account, EUR mn 9)	-1242	-2274	-7359	-11485	-1568	-1326	-8000	-9500	-10500
Current account, % of GDP	-1.5	-2.2	-6.3	-8.4	-5.6	-4.6	-5.9	-6.9	-6.7
Exports of goods, BOP, EUR mn 9)	28958	39321	49865	54316	12515	12130	55900	61500	70700
annual change in %	-37.4	35.8	26.8	8.9	9.8	-3.1	3.0	10.0	15.0
Imports of goods, BOP, EUR mn 9)	32046	45641	61540	70260	15469	14451	68900	79200	91100
annual change in %	-44.0	42.4	34.8	14.2	10.2	-6.6	-2.0	15.0	15.0
Exports of services, BOP, EUR mn 9)	9936	12856	13954	15527	3338	3260	15500	17100	18800
annual change in %	-18.8	29.4	8.5	11.3	10.2	-2.3	0.0	10.0	10.0
Imports of services, BOP, EUR mn 9)	8248	9538	9576	11076	2345	2381	11600	12800	14100
annual change in %	-25.3	15.6	0.4	15.7	11.5	1.5	5.0	10.0	10.0
FDI inflow, EUR mn 9)	3453	4893	5177	6094	1568	933	5000	6000	7000
FDI outflow, EUR mn 9)10)	116	555	138	938	298	.	1000	500	300
Gross reserves of NB excl. gold, EUR mn	17825	25096	23593	17186	22283	17864	.	.	.
Gross external debt, EUR mn	72113	88363	97940	102442	95603	.	.	.	.
Gross external debt, % of GDP	85.8	86.0	83.4	74.7	69.7	.	.	.	.
Exchange rate UAH/EUR, average	10.868	10.533	11.092	10.271	10.459	10.554	10.5	11.0	10.5
Purchasing power parity UAH/EUR 11)	3.962	4.407	4.968	5.239	.	.	.	.	.

1) Preliminary. - 2) According to SNA'93 (real growth rates based on previous year prices). -3) Starting from 2011 according to NACE Rev.2. - 4) In % of working age population. - 5) Excluding small enterprises. - 6) Domestic output prices. In first quarter 2013 according to NACE Rev.2. - 7) Without transfers to Naftohaz. - 8) Discount rate of NB. - 9) Converted from USD with the average exchange rate. - 10) In first quarter 2013 FDI net. - 11) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

ported cars[40] and the import quota for coal, as well as further advances in gas supply diversification. These policies should lead to a moderate decline in the current account deficit this year (to an estimated 6% of GDP, down from 8.4% in 2012), even if the exchange rate remains intact.

Although the contraction of GDP in the first quarter 2013 was first of all due to a sharp decline in inventories (by some UAH 23 billion, resulting in overall gross capital formation plunging by 27%), private consumption has been losing steam too: it rose by only 4.5%, after a nearly 12% increase last year. The latter should not come as a surprise given that the labour markets are no longer improving, wage growth is slowing down, and a resumption of household borrowing is not in sight. In addition, household incomes have been increasingly saved and used to repay loans rather than consumed. On the contrary, fixed investments have held up surprisingly well, partly benefiting from the increased affordability of credits whose share as a source of investment has climbed from 13% to 25%. However, the decline in construction output has deepened (-16% in January-April 2013), not least due to the high statistical base in the first months of last year on account of large-scale infrastructure projects ahead of the European football championship.

Depressed steel markets, the continued recession in the euro area, growth slowdown in Russia, and subsiding domestic demand will all dampen Ukraine's economic prospects. Even assuming that the economy will return to growth in the second half of 2013 (due to the low statistical base and very good grain harvest projections), the outcome for the year as a whole is unlikely to be much better than stagnation. The projected growth acceleration next year (to 2-3%) is conditional on improvement in the global environment, particularly regarding steel markets and an improved growth performance in Russia, and risks lie primarily on the downside. To boost domestic lending, on 10 June 2013 the NBU lowered its discount rate from 7.5% to 7%. However, given the weak transmission mechanism of this policy instrument, its impact on the money supply will probably be modest and counterweighted by other factors such as the high risk perceptions. Equally questionable are the government plans to provide state guarantees for 'priority projects' in order to attract up to UAH 50 billion of bank credit at preferential interest rates: the interest rates offered by the government (9-10% p.a. in hryvnia terms) under the scheme remain largely unattractive for banks.

Continued easy access to global capital markets will further limit the authorities' interest in cooperating with the IMF: since the beginning of 2013, Ukraine has repaid USD 2.8 billion to the IMF (out of USD 5.7 billion due to be repaid this year) without any real need for a new loan package. Still, the potentially dangerous – and abrupt – swings in global financial markets' sentiments remain a serious risk factor and could, in the event of materialising, prompt the authorities to turn to the IMF once again. With or without a new IMF programme, the government might still decide to hike gas tariffs for households in order to reduce the deficit of the state-owned energy company Naftohaz. However,

[40] The 6.5-13% 'safeguard' duty on imported cars was imposed as of mid-April 2013 for a period of three years. The coal import quota for 2013 has been set at 10.2 million tons, while coke imports have been banned altogether. These measures may be not compatible with Ukraine's WTO membership, so that the country may either have to adopt compensating measures (easing access to the domestic market for other goods) or else face increased protectionism in export markets – such as in Turkey, which has announced a retaliatory 23% duty on the imports of Ukrainian walnuts.

the potential scope of the hike will be increasingly constrained by the approaching presidential elections in early 2015, and securing cheaper gas imports – coupled with reduced gas consumption – will remain the 'first-best' option for the government.

The prospects of signing the Association Agreement between Ukraine and the EU (including a Deep and Comprehensive Free Trade Area) which was initialled last year remain highly uncertain. Theoretically, it could be signed at the forthcoming Eastern Partnership summit in Vilnius in November 2013. However, for this to happen, Ukraine needs to show progress in implementing 'reforms', which essentially boils down to releasing the currently imprisoned opposition leader and former prime minister Yuliya Tymoshenko. Meanwhile, Ukraine has secured 'observer' status in the Russia-led Eurasian Economic Union (which includes also Belarus and Kazakhstan) which will be launched in 2015 on the basis of the current Customs Union/Common Economic Space. Although Ukraine's move should be primarily interpreted as an instrument of pressure on the EU ahead of the Vilnius summit, in the longer run it could facilitate the country's full-fledged membership in the Eurasian Economic Union, representing a continuation of the traditional Ukrainian 'tug of war' between the EU and Russia.

Appendix

Selected indicators of competitiveness

Table A/1 **GDP per capita at current PPPs (EUR), from 2012 at constant PPPs and population**

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2013	2014 Forecast	2015
Bulgaria	4400	4600	5400	8200	10900	10300	10700	11600	12100	12200	12400	12800
Croatia	7000	6700	9500	12800	15800	14500	14300	15200	15200	15000	15200	15500
Cyprus	10600	12800	16700	20900	24900	23500	23600	23700	23200	21200	20400	20800
Czech Republic	8800	11200	13500	17800	20200	19400	19500	20100	20500	20300	20600	21100
Estonia	5500	5300	8600	13900	17300	14700	15500	17500	18700	19100	19700	20400
Hungary	6800	7500	10300	14200	16000	15300	15900	16500	16500	16500	16700	17100
Latvia	6400	4600	6900	10800	14100	12000	12300	14700	16100	16600	17100	17700
Lithuania	7100	5200	7500	11900	15400	12900	14100	16600	18000	18600	19300	20100
Malta	9500	13100	16500	18100	20200	19800	21100	21500	22100	22400	22800	23300
Poland	4500	6200	9100	11500	14100	14200	15400	16200	17000	17200	17700	18300
Romania	4000	4800	5000	7900	11700	11100	11400	13300	13700	14000	14300	14600
Slovakia	5800	7000	9600	13500	18100	17100	17900	18500	19100	19300	19800	20400
Slovenia	8500	10900	15300	19700	22700	20400	20500	21000	20900	20200	20100	20300
NMS-13	5300	6500	8600	11800	14800	14200	14900	16000	16600	16700	17100	17600
Macedonia	4300	4000	5100	6600	8400	8500	8700	8900	8900	9000	9200	9400
Montenegro	.	.	5600	6900	10700	9700	10200	10500	10500	10600	10800	11100
Serbia	.	.	5000	7100	9000	8400	8500	8800	9000	9100	9300	9600
Turkey	3800	4400	8000	9500	11700	10900	12200	13100	13300	13800	14400	15100
Albania	1400	2000	3500	5200	7000	7200	7400	7600	8000	8300	8500	8800
Bosnia & Herzeg.	.	.	3900	5200	6500	6200	6400	6600	6700	6800	6900	7100
Kosovo	.	.	.	4400	5100	5000	5300	5600	6000	6200	6500	6800
Kazakhstan	3900	3000	4100	7300	9200	9000	9700	10400	11000	11600	12300	13100
Russia	7600	5300	6600	9900	12900	11700	12500	13300	14000	14300	14700	15200
Ukraine	4600	2600	2800	4700	5900	5000	5400	5700	5900	5900	6000	6200
Austria	18600	19700	25100	28200	31100	29400	31100	32400	33300	33500	34100	34800
Germany	18200	18900	22400	26100	29000	27000	29000	30300	31200	31300	31900	32500
Greece	12200	12300	16000	20400	23100	22100	21400	19900	19100	18300	18400	18800
Ireland	12400	15200	25100	32500	32700	30000	31000	32300	32900	33300	34000	34700
Italy	16900	17800	22400	23700	26100	24400	24700	25100	25100	24800	25000	25500
Portugal	10700	11300	15500	17900	19500	18800	19700	19500	19400	19000	19100	19500
Spain	12800	13400	18500	22900	25900	24200	24300	24700	24900	24500	24700	25200
USA	21400	23300	30600	35700	36700	34300	36000	37100	38600	39300	40300	41100
EU-28 average	13600	14600	18900	22400	24900	23400	24300	25100	25600	25600	26000	26500

European Union (28) average = 100

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2013	2014	2015
Bulgaria	32	32	29	37	44	44	44	46	47	48	48	48
Croatia	51	46	50	57	63	62	59	61	59	59	58	58
Cyprus	78	88	88	93	100	100	97	94	91	83	78	78
Czech Republic	65	77	71	79	81	83	80	80	80	79	79	80
Estonia	40	36	46	62	69	63	64	70	73	75	76	77
Hungary	50	51	54	63	64	65	65	66	64	64	64	65
Latvia	47	32	37	48	57	51	51	59	63	65	66	67
Lithuania	52	36	40	53	62	55	58	66	70	73	74	76
Malta	70	90	87	81	81	85	87	86	86	88	88	88
Poland	33	42	48	51	57	61	63	65	66	67	68	69
Romania	29	33	26	35	47	47	47	53	54	55	55	55
Slovakia	43	48	51	60	73	73	74	74	75	75	76	77
Slovenia	63	75	81	88	91	87	84	84	82	79	77	77
NMS-13	39	45	46	53	59	61	61	64	65	65	66	66
Macedonia	32	27	27	29	34	36	36	35	35	35	35	35
Montenegro	.	.	30	31	43	41	42	42	41	41	42	42
Serbia	.	.	26	32	36	36	35	35	35	36	36	36
Turkey	28	30	42	42	47	47	50	52	52	54	55	57
Albania	10	14	19	23	28	31	30	30	31	32	33	33
Bosnia & Herzeg.	.	.	21	23	26	26	26	26	26	27	27	27
Kosovo	.	.	.	20	20	21	22	22	23	24	25	26
Kazakhstan	.	21	22	33	37	38	40	41	43	45	47	49
Russia	56	36	35	44	52	50	51	53	55	56	57	57
Ukraine	34	18	15	21	24	21	22	23	23	23	23	23
Austria	137	135	133	126	125	126	128	129	130	131	131	131
Germany	134	129	119	117	116	115	119	121	122	122	123	123
Greece	90	84	85	91	93	94	88	79	75	71	71	71
Ireland	91	104	133	145	131	128	128	129	129	130	131	131
Italy	124	122	119	106	105	104	102	100	98	97	96	96
Portugal	79	77	82	80	78	80	81	78	76	74	73	74
Spain	94	92	98	102	104	103	100	98	97	96	95	95
USA	157	160	162	159	147	147	148	148	151	154	155	155
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

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

Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Spring Report 2013.

Table A/2

Indicators of macro-competitiveness, 2008-2015

EUR based, annual averages

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Bulgaria								
Producer price index, 2010=100	97.9	92.2	100.0	109.2	114.0	116.8	120.4	123.9
Consumer price index, 2010=100	94.7	97.1	100.0	103.4	105.9	108.5	111.8	115.1
GDP deflator, 2010=100	93.3	97.3	100.0	104.9	107.2	109.9	113.2	116.6
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	97.7	99.1	100.0	100.3	100.1	100.8	102.0	103.0
Real ER (PPI-based), 2010=100	96.9	95.2	100.0	103.4	105.4	106.3	107.8	108.8
PPP, NC/EUR	0.8355	0.8738	0.8746	0.8839	0.8812	0.89	0.90	0.91
Price level, EU27 = 100	43	45	45	45	45	45	46	47
Average monthly gross wages, NC	545	609	648	707	777	800	840	900
Average monthly gross wages, EUR (ER)	279	311	331	362	397	410	430	460
Average monthly gross wages, EUR (PPP)	652	697	741	800	882	900	930	990
GDP nominal, NC mn	69295	68322	70511	75308	77582	80200	84300	89400
Employed persons, LFS, th.,average	3361	3254	3053	2950	2934	2940	2950	2970
GDP per employed person, NC	20619	20999	23097	25532	26442	27300	28600	30100
GDP per empl. person, NC at 2005 ref.pr.	16288	15906	17018	17938	18167	18300	18600	19000
Unit labour costs, NC, 2010=100	87.8	100.6	100.0	103.5	112.3	114.8	118.6	124.4
Unit labour costs, ER adj., 2010=100	87.8	100.6	100.0	103.5	112.3	114.8	118.6	124.4
Unit labour costs, PPP adj., Austria=100	24.5	26.4	26.3	27.1	28.5	28.6	29.0	29.9
Croatia								
Producer price index, 2010=100	96.3	95.9	100.0	107.0	112.8	115.6	118.5	121.5
Consumer price index, 2010=100	96.6	98.9	100.0	102.3	105.8	109.5	112.2	115.0
GDP deflator, 2010=100	96.4	99.2	100.0	102.0	104.1	107.7	110.4	112.6
Exchange rate (ER), NC/EUR	7.223	7.340	7.286	7.434	7.517	7.5	7.5	7.5
ER, nominal, 2010=100	99.1	100.7	100.0	102.0	103.2	102.9	102.9	102.9
Real ER (CPI-based), 2010=100	100.5	100.3	100.0	97.3	96.9	98.8	99.5	100.0
Real ER (PPI-based), 2010=100	96.1	98.3	100.0	99.3	101.1	102.3	103.1	103.6
PPP, NC/EUR	4.900	5.117	5.131	5.066	5.089	5.19	5.23	5.23
Price level, EU27 = 100	68	70	70	68	68	69	70	70
Average gross monthly wages, HRK	7544	7711	7679	7796	7875	7900	7950	8000
Average monthly gross wages, EUR (ER)	1044	1051	1054	1049	1048	1050	1060	1070
Average monthly gross wages, EUR (PPP)	1539	1507	1497	1539	1547	1520	1520	1530
GDP nominal, NC mn	343412	328672	323807	330171	330232	338400	350300	364500
Employed persons, LFS, th., average	1636	1605	1541	1493	1446	1420	1420	1430
GDP per employed person, NC	209974	204742	210101	221220	228408	238300	246700	254900
GDP per empl. person, NC at 2005 ref. pr.	183489	173954	177072	182764	184940	186400	188300	190700
Unit labour costs, NC, 2010=100	94.8	102.2	100.0	98.4	98.2	97.7	97.4	96.7
Unit labour costs, ER adj., 2010=100	95.6	101.5	100.0	96.4	95.2	94.9	94.6	94.0
Unit labour costs, PPP adj., Austria=100	53.3	53.3	52.6	50.5	48.3	47.2	46.2	45.2
Czech Republic								
Producer price index, 2010=100	101.5	99.9	100.0	103.7	106.1	106.7	108.3	109.9
Consumer price index, 2010=100	98.2	98.9	100.0	102.2	105.8	107.8	110.0	112.0
GDP deflator, 2010=100	99.3	101.7	100.0	99.0	100.5	101.0	101.7	103.2
Exchange rate (ER), NC/EUR	24.95	26.44	25.28	24.59	25.15	25.75	25.50	25.25
ER nominal, 2010=100	98.7	104.6	100.0	97.3	99.5	101.8	100.9	99.9
Real ER (CPI-based), 2010=100	102.7	96.5	100.0	101.9	100.6	98.3	99.6	100.4
Real ER (PPI-based), 2010=100	101.8	98.7	100.0	101.0	98.7	95.4	96.2	96.7
PPP, NC/EUR	18.24	18.46	18.49	18.09	17.81	17.6	17.5	17.4
Price level, EU27 = 100	73	70	73	74	71	68	68	69
Average monthly gross wages, NC	22592	23344	23864	24455	25112	25500	26300	27300
Average monthly gross wages, EUR (ER)	906	883	944	995	999	990	1030	1080
Average monthly gross wages, EUR (PPP)	1238	1264	1291	1352	1410	1450	1510	1570
GDP nominal, NC bn	3848	3759	3791	3823	3830	3820	3900	4050
Employed persons, LFS, th., average	5003	4934	4885	4904	4890	4890	4900	4910
GDP per employed person, NC	769298	761806	775993	779649	783310	781200	795900	824800
GDP per empl. person, NC at 2005 ref. pr.	727242	703591	728668	739516	731871	726000	734700	750800
Unit labour costs, NC, 2010=100	94.9	101.3	100.0	101.0	104.8	107.2	109.3	111.0
Unit labour costs, ER adj., 2010=100	96.1	96.9	100.0	103.8	105.3	105.3	108.4	111.2
Unit labour costs, PPP adj., Austria=100	42.6	40.5	41.9	43.2	42.6	41.7	42.1	42.6

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Estonia								
Producer price index, 2010=100	96.0	96.9	100.0	104.2	107.0	110.4	114.8	120.1
Consumer price index, 2010=100	97.1	97.3	100.0	105.1	109.5	113.2	117.8	123.1
GDP deflator, 2010=100	100.7	99.3	100.0	102.9	106.2	109.6	113.9	119.3
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.2	99.4	100.0	101.9	103.5	105.2	107.5	110.2
Real ER (PPI-based), 2010=100	95.0	100.1	100.0	98.7	98.9	100.5	102.8	105.5
PPP, NC/EUR	0.7020	0.6966	0.6906	0.7044	0.7060	0.72	0.73	0.75
Price level, EU27 = 100	70	70	69	70	71	72	73	75
Average monthly gross wages, NC	825	784	792	839	889	950	1020	1110
Average monthly gross wages, EUR (ER)	825	784	792	839	889	950	1020	1110
Average monthly gross wages, EUR (PPP)	1176	1125	1147	1191	1260	1320	1390	1470
GDP nominal, NC mn	16235	13762	14323	15951	16998	17900	19200	20800
Employed persons, LFS, th., average	656.5	595.8	570.9	609.1	624.4	634	642	650
GDP per employed person, NC	24730	23098	25088	26188	27223	28200	29900	32000
GDP per empl. person, NC at 2005 ref. pr.	19318	18299	19729	20019	20162	20200	20600	21100
Unit labour costs, NC, 2010=100	106.4	106.7	100.0	104.4	109.8	117.1	123.3	131.0
Unit labour costs, ER adj., 2010=100	106.4	106.7	100.0	104.4	109.8	117.1	123.3	131.0
Unit labour costs, PPP adj., Austria=100	51.3	48.4	45.5	47.3	48.3	50.4	52.1	54.5
Hungary								
Producer price index, 2010=100	92.1	96.2	100.0	104.1	108.4	113.1	117.5	121.5
Consumer price index, 2010=100	91.8	95.5	100.0	103.9	109.8	112.6	115.8	119.3
GDP deflator, 2010=100	94.3	97.6	100.0	103.1	106.4	111.0	115.3	119.2
Exchange rate (ER), NC/EUR	251.51	280.33	275.48	279.37	289.25	295	290	285
ER, nominal 2010=100	91.3	101.8	100.0	101.4	105.0	107.1	105.3	103.5
Real ER (CPI-based), 2010=100	103.7	95.8	100.0	99.4	98.9	97.6	100.5	103.2
Real ER (PPI-based), 2010=100	99.8	97.6	100.0	97.2	95.5	96.2	100.0	103.1
PPP, NC/EUR	165.55	166.78	167.48	169.65	172.86	177.5	181.4	183.9
Price level, EU27 = 100	66	59	61	61	60	60	63	65
Average monthly gross wages, NC	198741	199837	202525	213094	222990	228600	235200	242300
Average monthly gross wages, EUR (ER)	790	713	735	763	771	770	810	850
Average monthly gross wages, EUR (PPP)	1200	1198	1209	1256	1290	1290	1300	1320
GDP nominal, NC bn	26543	25626	26607	27886	28276	29500	31000	32800
Employed persons, LFS, th., average	3879	3782	3781	3812	3878	3890	3900	3920
GDP per employed person, NC	6842116	6776265	7036745	7315617	7291576	7583500	7948700	8367300
GDP per empl. person, NC at 2005 ref. pr.	5956461	5696713	5774171	5821941	5623408	5605900	5658600	5759200
Unit labour costs, NC, 2010=100	95.1	100.0	100.0	104.4	113.1	116.3	118.5	120.0
Unit labour costs, ER adj., 2010=100	104.2	98.3	100.0	102.9	107.7	108.6	112.6	115.9
Unit labour costs, PPP adj., Austria=100	40.8	36.2	37.0	37.8	38.4	38.0	38.6	39.2
Latvia								
Producer price index, 2010=100	100.7	97.6	100.0	107.7	112.1	113.2	114.5	116.6
Consumer price index, 2010=100	98.0	101.2	100.0	104.2	106.6	107.7	109.3	111.5
GDP deflator, 2010=100	102.5	101.3	100.0	105.9	109.0	110.0	111.4	113.4
Exchange rate (ER), NC/EUR	0.7027	0.7057	0.7087	0.7063	0.6973	0.7087	0.7087	0.7087
ER, nominal, 2010=100	99.2	99.6	100.0	99.7	98.4	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	102.0	103.8	100.0	101.4	102.4	100.0	99.8	99.8
Real ER (PPI-based), 2010=100	100.5	101.3	100.0	102.4	105.4	103.0	102.6	102.4
PPP, NC/EUR	0.5051	0.4812	0.4632	0.4726	0.4726	0.47	0.47	0.47
Price level, EU27 = 100	72	68	65	67	68	66	66	66
Average monthly gross wages, NC	479	461	445	464	481	510	540	580
Average monthly gross wages, EUR (ER)	682	653	628	657	690	720	760	820
Average monthly gross wages, EUR (PPP)	948	958	961	982	1,018	1090	1150	1240
GDP nominal, NC mn	16085	13070	12784	14275	15521	16100	16800	17700
Employed persons, LFS, th., average	1125	983	941	971	886	905	915	925
GDP per employed person, NC	14304	13295	13587	14709	17525	17800	18400	19100
GDP per empl. person, NC at 2005 ref. pr.	9431	8870	9184	9390	10864	10900	11200	11400
Unit labour costs, NC, 2010=100	104.8	107.3	100.0	102.0	91.4	96.6	99.5	105.0
Unit labour costs, ER adj., 2010=100	105.7	107.7	100.0	102.3	92.9	96.6	99.5	105.0
Unit labour costs, PPP adj., Austria=100	52.2	50.1	46.6	47.5	41.8	42.6	43.1	44.7

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Lithuania								
Producer price index, 2010=100	104.8	90.6	100.0	113.9	119.6	122.0	125.1	129.5
Consumer price index, 2010=100	94.9	98.8	100.0	104.1	107.4	109.6	112.3	116.3
GDP deflator, 2010=100	101.6	98.1	100.0	105.5	108.4	110.6	113.4	117.5
Exchange rate (ER), NC/EUR	3.453	3.453	3.453	3.453	3.453	3.45	3.45	3.45
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	99.9	99.9	99.9
Real ER (CPI-based), 2010=100	97.8	100.9	100.0	101.0	101.5	101.8	102.6	104.2
Real ER (PPI-based), 2010=100	103.7	93.6	100.0	107.9	110.6	111.1	112.1	113.9
PPP, NC/EUR	2.171	2.136	2.063	2.120	2.111	2.12	2.14	2.17
Price level, EU27 = 100	63	62	60	61	61	61	62	63
Average monthly gross wages, NC	2152	2056	1988	2046	2137	2250	2400	2600
Average monthly gross wages, EUR (ER)	623	595	576	593	619	650	700	750
Average monthly gross wages, EUR (PPP)	991	962	964	965	1012	1060	1120	1200
GDP nominal, NC mn	111920	92032	95323	106370	113472	119800	127500	137600
Employed persons, LFS, th., average	1520	1416	1344	1371	1279	1295	1315	1330
GDP per employed person, NC	73632	64999	70941	77591	88754	92500	97000	103500
GDP per empl. person, NC at 2005 ref. pr.	58026	53039	56774	58874	65506	66900	68500	70500
Unit labour costs, NC, 2010=100	105.9	110.7	100.0	99.2	93.2	96.0	100.1	105.3
Unit labour costs, ER adj., 2010=100	105.9	110.7	100.0	99.2	93.2	96.1	100.1	105.4
Unit labour costs, PPP adj., Austria=100	38.2	37.6	34.1	33.6	30.6	30.9	31.7	32.8
Poland								
Producer price index, 2010=100	95.2	98.2	100.0	107.3	110.8	110.8	113.0	115.3
Consumer price index, 2010=100	93.7	97.4	100.0	103.9	107.7	109.3	111.5	113.7
GDP deflator, 2010=100	95.0	98.5	100.0	103.2	105.8	107.5	109.7	112.2
Exchange rate (ER), NC/EUR	3.512	4.328	3.995	4.121	4.185	4.25	4.20	4.15
ER, nominal, 2010=100	87.9	108.3	100.0	103.2	104.8	106.4	105.1	103.9
Real ER (CPI-based), 2010=100	109.9	91.8	100.0	97.7	97.2	95.4	96.8	98.0
Real ER (PPI-based), 2010=100	107.2	93.6	100.0	98.5	97.8	94.8	96.3	97.4
PPP, PLN/EUR	2.375	2.477	2.404	2.442	2.438	2.44	2.45	2.46
Price level, EU27 = 100	68	57	60	59	58	57	58	59
Average gross monthly wages, PLN	2942	3102	3224	3404	3540	3620	3720	3850
Average monthly gross wages, EUR (ER)	838	717	807	826	846	850	890	930
Average monthly gross wages, EUR (PPP)	1239	1252	1341	1393	1452	1480	1520	1570
GDP nominal, NC bn	1276	1345	1417	1528	1595	1640	1720	1820
Employed persons, LFS, th., average	15800	15868	15961	16131	15591	15590	15620	15700
GDP per employed person, NC	80729	84731	88756	94735	102322	105200	110100	115900
GDP per empl. person, NC at 2005 ref. pr.	74253	75132	77550	80242	84523	85500	87700	90300
Unit labour costs, NC, 2010=100	95.3	99.3	100.0	102.0	100.7	101.8	102.0	102.6
Unit labour costs, ER adj., 2010=100	108.4	91.7	100.0	98.9	96.2	95.7	97.0	98.7
Unit labour costs, PPP adj., Austria=100	50.4	40.2	43.9	43.2	40.8	39.8	39.6	39.6
Romania								
Producer price index, 2010=100	93.6	95.8	100.0	107.1	112.7	119.5	125.4	131.7
Consumer price index, 2010=100	89.3	94.3	100.0	105.8	109.4	114.0	118.0	122.1
GDP deflator, 2010=100	90.8	94.6	100.0	104.1	109.1	115.6	121.4	127.5
Exchange rate (ER), NC/EUR	3.683	4.240	4.212	4.239	4.459	4.40	4.42	4.45
ER, nominal, 2010=100	87.4	100.7	100.0	100.6	105.9	104.5	104.9	105.6
Real ER (CPI-based), 2010=100	105.3	95.6	100.0	102.0	97.7	101.3	102.7	103.5
Real ER (PPI-based), 2010=100	105.9	98.3	100.0	100.7	98.4	104.1	107.1	109.5
PPP, NC/EUR	2.042	2.105	2.141	2.203	2.256	2.35	2.43	2.50
Price level, EU27 = 100	55	50	51	52	51	53	55	56
Average monthly grross wages, NC	1761	1845	1902	1980	2079	2180	2280	2400
Average monthly gross wages, EUR (ER)	478	435	452	467	466	500	520	540
Average monthly gross wages, EUR (PPP)	862	877	888	899	922	930	940	960
GDP nominal, NC mn	514700	501139	523693	556708	587499	634600	679700	728700
Employed persons, LFS, th., average	9369	9244	9239	9138	9263	9300	9300	9400
GDP per employed person, NC	54936	54215	56680	60924	63426	68200	73100	77500
GDP per empl. person, NC at 2005 ref. pr.	37969	35955	35559	36730	36482	37000	37800	38100
Unit labour costs, NC, 2010=100	86.7	95.9	100.0	100.8	106.5	110.2	112.8	117.8
Unit labour costs, ER adj., 2010=100	99.2	95.3	100.0	100.1	100.6	105.4	107.5	111.5
Unit labour costs, PPP adj., Austria=100	42.8	38.8	40.8	40.6	39.6	40.7	40.7	41.6

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Slovakia								
Producer price index, 2010=100	107.0	99.6	100.0	104.5	106.5	106.7	108.8	111.0
Consumer price index, 2010=100	98.4	99.3	100.0	104.1	108.0	110.1	113.4	116.8
GDP deflator, 2010=100	100.7	99.5	100.0	101.6	103.0	105.1	108.2	111.4
Exchange rate (ER), NC/EUR	1.0377	1.0	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2010=100	103.8	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	97.8	101.4	100.0	101.0	102.1	102.3	103.6	104.6
Real ER (PPI-based), 2010=100	102.0	102.9	100.0	99.0	98.5	97.1	97.5	97.5
PPP NC/ EUR	0.6813	0.6790	0.6790	0.6910	0.6921	0.69	0.70	0.71
Price level, EU27 = 100	66	68	68	69	69	69	70	71
Average monthly gross wages, NC	723	745	769	786	805	820	850	900
Average monthly gross wages, EUR (ER)	697	745	769	786	805	820	850	900
Average monthly gross wages, EUR (PPP)	1061	1096	1132	1137	1163	1180	1210	1270
GDP nominal, NC mn	66842	62794	65870	69108	71463	73600	77600	82300
Employed persons, LFS, th., average	2434	2366	2318	2351	2329	2330	2350	2370
GDP per employed person, NC	27465	26537	28423	29390	30684	31600	33000	34700
GDP per empl. person, NC at 2005 ref. pr.	25652	25086	26727	27205	28007	28300	28700	29300
Unit labour costs, NC, 2010=100	98.0	103.1	100.0	100.4	99.9	100.7	102.9	106.8
Unit labour costs, ER adj., 2010=100	94.4	103.1	100.0	100.4	99.9	100.7	102.9	106.8
Unit labour costs, PPP adj., Austria=100	36.7	37.8	36.8	36.7	35.4	35.0	35.1	35.9
Slovenia								
Producer price index, 2010=100	99.5	98.1	100.0	104.6	105.5	107.6	110.3	113.0
Consumer price index, 2010=100	97.1	98.0	100.0	102.1	105.0	107.6	109.7	111.9
GDP deflator, 2010=100	97.6	101.1	100.0	101.0	101.4	98.0	106.0	108.1
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.1	100.0	100.0	99.0	99.2	99.9	100.2	100.2
Real ER (PPI-based), 2010=100	98.4	101.3	100.0	99.0	97.5	97.9	98.8	99.3
PPP, NC/EUR	0.8114	0.8561	0.8467	0.8387	0.8261	0.79	0.84	0.84
Price level, EU27 = 100	81	86	85	84	83	79	84	84
Average monthly gross wages, NC	1391	1439	1495	1525	1525	1480	1480	1520
Average monthly gross wages, EUR (ER)	1391	1439	1495	1525	1525	1480	1480	1520
Average monthly gross wages, EUR (PPP)	1715	1681	1766	1818	1846	1880	1770	1820
GDP nominal, NC mn	37244	35556	35607	36172	35466	33150	35710	36790
Employed persons, LFS, th., average	996	981	966	936	924	880	860	860
GDP per employed person, NC	37390	36256	36860	38641	38392	37700	41500	42800
GDP per empl. person, NC at 2005 ref. pr.	33742	31596	32472	33697	33367	33900	34500	34900
Unit labour costs, NC, 2010=100	89.6	98.9	100.0	98.3	99.3	94.8	93.2	94.6
Unit labour costs, ER adj., 2010=100	89.6	98.9	100.0	98.3	99.3	94.8	93.2	94.6
Unit labour costs, PPP adj., Austria=100	60.3	62.7	63.6	62.2	60.9	57.0	55.0	55.0
Macedonia								
Producer price index, 2010=100	99.1	92.0	100.0	112.4	117.6	121.1	124.7	128.5
Consumer price index, 2010=100	99.2	98.4	100.0	103.9	107.3	110.6	113.9	117.3
GDP deflator, 2010=100	96.7	97.4	100.0	103.1	103.5	106.6	109.8	113.1
Exchange rate (ER), NC/EUR	61.27	61.27	61.52	61.53	61.53	61.5	61.5	61.5
ER, nominal, 2010=100	99.6	99.6	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	102.7	100.9	100.0	100.7	101.5	102.7	104.0	105.0
Real ER (PPI-based), 2010=100	98.5	95.4	100.0	106.4	108.7	110.3	111.7	112.8
PPP, NC/EUR	23.93	23.65	24.15	25.19	25.16	25.5	25.9	26.1
Price level, EU27 = 100	39	39	39	41	41	41	42	42
Average gross monthly wages, MKD [1)]	26229	29922	30225	30602	30669	31600	32500	33800
Average monthly gross wages, EUR (ER)	428	488	491	497	498	510	530	550
Average monthly gross wages, EUR (PPP)	1096	1265	1252	1215	1219	1240	1260	1290
GDP nominal, NC mn	411728	410734	434112	459789	460587	480100	505400	534100
Employed persons, LFS, th., average	609.0	629.9	637.9	645.1	650.6	654	664	674
GDP per employed person, NC	676056	652061	680581	712757	707992	734100	761100	792400
GDP per empl. person, NC at 2005 ref. pr.	566852	542933	551781	560493	554528	558200	561900	567900
Unit labour costs, NC, 2010=100	84.5	100.6	100.0	99.7	101.0	103.3	105.6	108.7
Unit labour costs, ER adj., 2010=100	84.8	101.0	100.0	99.7	100.9	103.4	105.6	108.7
Unit labour costs, PPP adj., Austria=100	33.2	37.3	37.0	36.7	36.0	36.1	36.3	36.7

1) From 2009 including allowances for food and transport.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Montenegro								
Producer price index, 2010=100	105.0	100.9	100.0	103.2	105.1	106.9	111.0	113.8
Consumer price index, 2010=100	96.2	99.5	100.0	103.1	107.3	110.5	113.9	117.3
GDP deflator, 2010=100	96.1	98.4	100.0	100.9	102.8	104.6	108.6	111.3
Exchange rate (ER), NC/EUR	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real ER (CPI-based), 2010=100	99.2	101.6	100.0	100.0	101.5	102.7	104.0	105.0
Real ER (PPI-based), 2010=100	103.9	104.2	100.0	97.7	97.2	92.7	93.5	93.1
PPP, NC/EUR	0.4596	0.4877	0.4917	0.4957	0.5026	0.50	0.51	0.52
Price level, EU27 = 100	46	49	49	50	50	50	51	52
Average monthly gross wages, NC	609	643	715	722	727	760	790	830
Average monthly gross wages, EUR (PPP)	1325	1318	1454	1457	1447	1510	1540	1610
GDP nominal, NC mn	3085.6	2981.0	3103.9	3234.1	3300	3400	3600	3800
Employed persons, LFS, th., average	218.8	212.9	208.2	195.4	200.0	210	215	220
GDP per employed person, NC	14102	14002	14912	16553	16500	16200	16700	17300
GDP per empl. person, NC at 2005 ref. pr.	10656	10331	10827	11907	11652	11200	11200	11300
Unit labour costs, NC, 2010=100	86.5	94.2	100.0	91.8	94.5	102.8	106.8	111.2
Unit labour costs, PPP adj., Austria=100	48.0	49.3	52.4	47.9	47.8	50.9	52.0	53.3
Serbia								
Producer price index, 2010=100	84.1	88.7	100.0	114.2	120.5	126.8	134.7	140.8
Consumer price index, 2010=100	86.2	93.6	100.0	111.0	119.7	126.8	133.2	139.8
GDP deflator, 2010=100	90.0	95.3	100.0	109.6	117.6	123.8	131.5	137.5
Exchange rate (ER), NC/EUR	81.5	93.9	102.9	102.0	113.0	120	128	135
ER, nominal, 2010=100	79.2	91.3	100.0	99.1	109.8	116.6	124.4	131.2
Real ER (CPI-based), 2010=100	112.3	104.7	100.0	108.7	103.0	101.0	97.8	95.4
Real ER (PPI-based), 2010=100	105.1	100.4	100.0	109.1	101.5	99.0	97.0	94.3
PPP, NC/EUR	40.16	44.27	46.56	50.69	52.86	54.8	57.2	58.7
Price level, EU27 = 100	49	47	45	50	47	46	45	43
Average monthly gross wages, NC	45674	44147	47450	52733	57430	60880	64560	69140
Average monthly gross wages, EUR (ER)	561	470	461	517	508	510	500	510
Average monthly gross wages, EUR (PPP)	1137	997	1019	1040	1086	1110	1130	1180
GDP nominal, NC bn	2661	2720	2882	3209	3386	3600	3900	4200
Employed persons, LFS, th., average	2822	2616	2396	2253	2228	2200	2200	2200
GDP per employed person, NC	943178	1039614	1202670	1424023	1519591	1636400	1772700	1909100
GDP per empl. person, NC at 2005 ref. pr.	675968	703440	775916	838400	833337	852500	869600	895700
Unit labour costs, NC, 2010=100	110.5	102.6	100.0	102.9	112.7	116.8	121.4	126.2
Unit labour costs, ER adj., 2010=100	139.6	112.4	100.0	103.8	102.6	100.1	97.6	96.2
Unit labour costs, PPP adj., Austria=100	52.7	40.0	35.7	36.8	35.3	33.8	32.3	31.4
Albania								
Producer price index, 2010=100	101.4	99.8	100.0	102.6	104.2	104.2	107.3	108.4
Consumer price index, 2010=100	94.4	96.6	100.0	103.4	105.5	108.7	110.8	113.1
GDP deflator, 2010=100	95.5	97.5	100.0	101.7	104.7	108.0	110.5	113.0
Exchange rate (ER), NC/EUR	122.8	132.1	137.8	140.3	139.0	139	137	135
ER, nominal, 2010=100	89.1	95.8	100.0	101.8	100.9	100.9	99.4	98.0
Real ER (CPI-based), 2010=100	109.2	102.9	100.0	98.5	98.8	100.0	101.8	103.3
Real ER (PPI-based), 2010=100	112.6	107.5	100.0	95.4	95.5	94.0	96.7	97.1
PPP, NC/EUR	53.48	55.55	57.86	59.69	60.01	60.9	61.3	61.5
Price level, EU27 = 100	44	42	42	43	43	44	45	46
Average monthly gross wages, NC	34277	36075	34767	37060	39284	41100	42800	45000
Average monthly gross wages, EUR (ER)	279	273	252	264	283	300	310	330
Average monthly gross wages, EUR (PPP)	641	649	601	621	655	670	700	730
GDP nominal, NC bn	1089	1148	1222	1282	1340	1430	1500	1580
Employed persons, LFS, th., Oct	1123	1161	1185	1200	1200	1200	1220	1240
GDP per employed person, NC	969738	989300	1031614	1068546	1116667	1191700	1229500	1274200
GDP per empl. person, NC at 2005 ref. pr.	870868	870864	885014	901064	914592	946600	954400	967100
Unit labour costs, NC, 2010=100	100.2	105.4	100.0	104.7	109.3	110.5	114.2	118.4
Unit labour costs, ER adj., 2010=100	112.4	110.0	100.0	102.8	108.4	109.6	114.8	120.9
Unit labour costs, PPP adj., Austria=100	33.4	30.8	28.1	28.7	29.4	29.1	30.0	31.0

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2007=100	102.4	99.1	100.0	103.7	105.3	106.3	108.4	110.6
Consumer price index, 2010=100	98.3	97.9	100.0	103.7	105.9	107.5	109.6	111.8
GDP deflator, 2010=100	98.4	98.4	100.0	102.6	104.6	106.2	108.4	110.6
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	101.4	100.0	100.0	100.6	100.1	99.8	100.1	100.1
Real ER (PPI-based), 2007=100	101.3	102.4	100.0	98.2	97.3	96.8	97.1	97.1
PPP, NC/EUR	0.9982	1.0137	1.0071	1.0186	1.0147	1.01	1.02	1.02
Price level, EU27 = 100	51	52	51	52	52	52	52	52
Average monthly gross wages, NC	1113	1204	1217	1273	1290	1310	1350	1400
Average monthly gross wages, EUR (ER)	569	615	622	651	660	670	690	720
Average monthly gross wages, EUR (PPP)	1115	1187	1208	1250	1271	1290	1330	1370
GDP nominal, NC mn	24898	24202	24773	25666	26000	26600	27700	29100
Employed persons, LFS, th., April	890.2	859.2	842.8	816.0	813.7	810	812	820
GDP per employed person, NC	27967	28167	29392	31453	31953	32800	34100	35500
GDP per empl. person, NC at 2005 ref. pr.	22831	22987	23603	24625	24525	24800	25300	25800
Unit labour costs, NC, 2010=100	94.6	101.6	100.0	100.3	102.0	102.5	103.5	105.3
Unit labour costs, ER adj., 2010=100	94.6	101.6	100.0	100.3	102.0	102.5	103.5	105.3
Unit labour costs, PPP adj., Austria=100	42.8	43.3	42.8	42.6	42.1	41.4	41.1	41.1
Kazakhstan								
Producer price index, 2010=100	102.4	79.9	100.0	127.2	131.7	136.9	143.8	152.4
Consumer price index, 2010=100	87.0	93.4	100.0	108.3	113.9	121.9	129.8	137.6
GDP deflator, 2010=100	79.9	83.6	100.0	117.8	123.0	129.8	137.5	145.6
Exchange rate (ER), NC/EUR	177.04	205.68	195.67	204.11	191.67	196	199	202
ER, nominal, 2010=100	90.5	105.1	100.0	104.3	98.0	100.2	101.8	103.2
Real ER (CPI-based), 2010=100	99.2	90.7	100.0	100.7	110.0	113.0	116.5	119.3
Real ER (PPI-based), 2010=100	112.0	78.5	100.0	115.5	124.3	124.4	126.6	129.6
PPP, NC/EUR	111.0	118.0	138.0	160.3	163.4	169.8	179.8	190.4
Price level, EU27 = 100	63	57	71	79	85	87	90	94
Average monthly gross wages, NC	60805	67333	77611	90028	101079	114640	129420	144040
Average monthly gross wages, EUR (ER)	343	327	397	441	527	580	650	710
Average monthly gross wages, EUR (PPP)	548	571	563	562	619	680	720	760
GDP nominal, NC bn	16053	17008	21816	27572	30219	33500	37600	42400
Employed persons, LFS, th., average	7857	7903	8114	8302	8507	8590	8680	8770
GDP per employed person, NC	2043084	2151941	2688560	3321274	3552156	3899900	4331800	4834700
GDP per empl. person, NC at 2005 ref. pr.	1203230	1210451	1264491	1326017	1358429	1412600	1481800	1561900
Unit labour costs, NC, 2010=100	82.3	90.6	100.0	110.6	121.2	132.2	142.3	150.3
Unit labour costs, ER adj., 2010=100	91.0	86.2	100.0	106.0	123.8	131.9	139.8	145.5
Unit labour costs, PPP adj., Austria=100	39.3	35.1	40.8	43.1	48.7	50.9	53.0	54.3
Russia								
Producer price index, 2010=100	96.0	89.2	100.0	119.0	127.1	134.7	141.4	148.5
Consumer price index, 2010=100	83.7	93.5	100.0	108.5	114.0	122.0	129.3	135.8
GDP deflator, 2010=100	85.9	87.6	100.0	115.5	125.3	135.3	145.2	154.3
Exchange rate (ER), NC/EUR	36.41	44.13	40.27	40.87	39.94	41	42	43
ER, nominal, 2010=100	90.4	109.6	100.0	101.5	99.2	101.8	104.3	106.8
Real ER (CPI-based), 2010=100	95.4	87.2	100.0	103.7	108.7	111.3	113.2	113.9
Real ER (PPI-based), 2010=100	105.1	84.0	100.0	111.0	118.5	120.4	121.5	122.1
PPP, NC/EUR	22.35	23.14	25.83	29.44	31.18	33.1	35.0	36.5
Price level, EU27 = 100	61	52	64	72	78	81	83	85
Average monthly gross wages, NC	17290	18638	20952	23369	26690	29840	33210	36440
Average monthly gross wages, EUR (ER)	475	422	520	572	668	730	790	850
Average monthly gross wages, EUR (PPP)	774	805	811	794	856	900	950	1000
GDP nominal, NC bn	41277	38807	46309	55800	62599	69200	76600	84000
Employed persons, LFS, th., average	71003	69411	69934	70857	71545	71500	71000	71000
GDP per employed person, NC	581339	559097	662178	787500	874956	967800	1078900	1183100
GDP per empl. person, NC at 2005 ref. pr.	376008	354553	367736	378506	387761	397300	412500	425700
Unit labour costs, NC, 2010=100	80.7	92.3	100.0	108.4	120.8	131.8	141.3	150.2
Unit labour costs, ER adj., 2010=100	89.3	84.2	100.0	106.8	121.8	129.5	135.5	140.7
Unit labour costs, PPP adj., Austria=100	38.5	34.2	40.7	43.2	47.8	49.8	51.2	52.4

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Ukraine								
Producer price index, 2010=100	77.7	82.7	100.0	119.0	123.3	127.0	133.4	140.0
Consumer price index, 2010=100	78.9	91.4	100.0	108.0	108.6	109.2	114.1	118.6
GDP deflator, 2010=100	77.8	87.9	100.0	114.3	123.4	123.8	129.3	134.8
Exchange rate (ER), NC/EUR	7.708	10.868	10.533	11.092	10.271	10.5	11.0	10.5
ER, nominal, 2010=100	73.2	103.2	100.0	105.3	97.5	99.7	104.4	99.7
Real ER (CPI-based), 2010=100	111.1	90.4	100.0	99.5	105.3	101.7	99.7	106.5
Real ER (PPI-based), 2010=100	105.0	82.8	100.0	107.0	117.0	116.0	114.4	123.4
PPP, NC/EUR	3.4533	3.9617	4.4071	4.9678	5.2391	5.17	5.31	5.43
Price level, EU27 = 100	45	36	42	45	51	49	48	52
Average monthly gross wages, NC	1806	1906	2239	2633	3025	3160	3470	3830
Average monthly gross wages, EUR (ER)	234	175	213	237	295	300	320	360
Average monthly gross wages, EUR (PPP)	523	481	508	530	577	610	650	710
GDP nominal, NC mn	948	913	1083	1302	1409	1420	1520	1640
Employed persons, LFS, th., average	20972	20192	20266	20324	20354	20350	20400	20450
GDP per employed person, NC	45205	45234	53418	64065	69218	69800	74500	80200
GDP per empl. person, NC at 2005 ref. pr.	24956	22098	22932	24062	24073	24200	24700	25500
Unit labour costs, NC, 2010=100	74.1	88.3	100.0	112.1	128.7	133.7	143.9	153.8
Unit labour costs, ER adj., 2010=100	101.3	85.6	100.0	106.4	132.0	134.1	137.8	154.3
Unit labour costs, PPP adj., Austria=100	37.7	30.0	35.2	37.2	44.8	44.6	45.0	49.6
Austria								
Producer price index, 2010=100	102.8	95.2	100.0	108.3	110.9	113.1	115.1	117.1
Consumer price index, 2010=100	97.6	98.1	100.0	103.3	105.8	108.1	110.3	112.8
GDP deflator, 2010=100	96.9	98.4	100.0	102.2	104.8	106.9	108.6	110.5
Real ER (CPI-based), 2010=100	100.7	100.2	100.0	100.2	100.0	100.4	100.7	101.0
Real ER (PPI-based), 2010=100	101.8	98.4	100.0	102.6	102.6	103.0	103.1	102.9
PPP, NC/EUR	1.0904	1.1214	1.0970	1.1018	1.1003	1.115	1.118	1.116
Price level, EU27 = 100	109	112	110	110	110	111	112	112
Average monthly gross wages, EUR	3087	3162	3200	3270	3370	3450	3540	3640
Average monthly gross wages, EUR (PPP)	2831	2819	2917	2968	3063	3094	3165	3262
GDP nominal, NC mn	282744	276151	286400	300700	310800	320200	331700	344300
Employed persons - LFS, th., average	4090	4078	4100	4140	4180	4210	4250	4290
GDP per employed person, NC	69131	67722	69900	72600	74400	76100	78000	80300
GDP per empl. person, NC at 2005 pr.	65403	63115	64070	65112	65092	65300	65800	66600
Unit labour costs, NC, 2010=100	94.5	100.3	100.0	100.6	103.7	105.8	107.7	109.4
Unit labour costs, PPP adjusted	0.60	0.64	0.63	0.64	0.66	0.67	0.68	0.69

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

The indicator of unit labour costs is defined as average gross wages per employee relative to labour productivitiy (real GDP per employed person, LFS) . For level comparisons, labour productivity is converted with the PPP rate 2005 (PPP adjusted).

PPP rates have been taken from Eurostat based on the benchmark results 2005. For Albania, Bosnia and Herzegovina, Montenegro and Serbia available data 2005-2011 have been extrapolated by wiiw with GDP deflators. Kazakhstan, Russia and Ukraine are estimated by wiiw using the OECD PPP benchmark results 2005 and extrapolation with GDP price deflators.

Real exchange rates: Increasing values mean real appreciation.

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

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

Table A/3

Indicators of macro-competitiveness, 2008-2015

annual changes in %

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Bulgaria									
GDP deflator	8.4	4.3	2.8	4.9	2.3	2.5	3.1	3.0	8.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	8.0	1.5	0.9	0.3	-0.2	0.7	1.3	1.0	5.4
Real ER (PPI-based)	4.5	-1.8	5.0	3.4	1.9	0.9	1.4	0.9	5.2
Average gross wages, NC	26.5	11.8	6.4	9.1	9.9	3.0	5.0	7.1	16.8
Average gross wages, real (PPI based)	14.3	18.8	-1.9	-0.1	5.2	0.5	1.9	4.1	6.6
Average gross wages, real (CPI based)	13.0	9.1	3.3	5.6	7.3	0.4	1.9	4.0	8.0
Average gross wages, EUR (ER)	26.5	11.8	6.4	9.1	9.9	3.2	4.9	7.0	16.8
Employed persons (LFS)	3.3	-3.2	-6.2	-3.4	-0.5	0.2	0.3	0.7	3.6
GDP per empl. person, NC at 2005 ref. pr.	2.8	-2.3	7.0	5.4	1.3	0.7	1.6	2.2	2.7
Unit labour costs, NC at 2005 ref. prices	23.1	14.5	-0.6	3.5	8.5	2.2	3.3	4.9	13.7
Unit labour costs, ER (EUR) adjusted	23.1	14.5	-0.6	3.5	8.5	2.2	3.3	4.9	13.7
Croatia									
GDP deflator	5.7	2.9	0.8	2.0	2.0	3.5	2.5	2.0	4.3
Exchange rate (ER), EUR/NC	1.6	-1.6	0.7	-2.0	-1.1	0.2	0.0	0.0	0.9
Real ER (CPI-based)	3.9	-0.2	-0.3	-2.7	-0.3	1.9	0.8	0.5	2.2
Real ER (PPI-based)	3.8	2.3	1.7	-0.7	1.8	1.1	0.9	0.5	1.0
Average gross wages, NC	7.1	2.2	-0.4	1.5	1.0	0.3	0.6	0.6	6.0
Average gross wages, real (PPI based)	-1.1	2.7	-4.5	-5.1	-4.2	-2.1	-1.8	-1.8	1.6
Average gross wages, real (CPI based)	0.9	-0.2	-1.5	-0.8	-2.3	-3.1	-1.8	-1.8	2.0
Average gross wages, EUR (ER)	8.7	0.6	0.3	-0.5	-0.1	0.2	1.0	0.9	6.9
Employed persons (LFS)	1.3	-1.8	-4.0	-3.2	-3.1	-1.8	0.0	0.7	1.1
GDP per empl. person, NC at 2005 ref. pr.	0.8	-5.2	1.8	3.2	1.2	0.8	1.0	1.3	2.9
Unit labour costs, NC at 2005 ref. prices	6.2	7.8	-2.2	-1.6	-0.2	-0.5	-0.4	-0.6	3.0
Unit labour costs, ER (EUR) adjusted	7.9	6.1	-1.5	-3.6	-1.3	-0.2	-0.4	-0.6	3.9
Czech Republic									
GDP deflator	1.9	2.4	-1.6	-1.0	1.5	0.5	0.7	1.4	1.3
Exchange rate (ER), EUR/NC	11.3	-5.6	4.6	2.8	-2.2	-2.3	1.0	1.0	6.3
Real ER (CPI-based)	14.1	-6.0	3.6	1.9	-1.3	-2.2	1.3	0.8	7.0
Real ER (PPI-based)	5.6	-3.0	1.3	1.0	-2.3	-3.4	0.8	0.5	3.0
Average gross wages, NC	7.8	3.3	2.2	2.5	2.7	1.5	3.1	3.8	6.6
Average gross wages, real (PPI based)	7.3	4.9	2.1	-1.2	0.3	1.0	1.6	2.3	5.7
Average gross wages, real (CPI based)	1.4	2.7	1.1	0.3	-0.8	-0.3	1.1	2.0	3.3
Average gross wages, EUR (ER)	20.0	-2.5	6.9	5.4	0.4	-0.9	4.0	4.9	13.4
Employed persons (LFS)	1.6	-1.4	-1.0	0.4	-0.3	0.0	0.2	0.2	1.5
GDP per empl. person, NC at 2005 ref. pr.	1.5	-3.3	3.6	1.5	-1.0	-0.8	1.2	2.2	4.0
Unit labour costs, NC at 2005 ref. prices	6.2	6.8	-1.3	1.0	3.8	2.4	1.9	1.6	2.5
Unit labour costs, ER (EUR) adjusted	18.2	0.8	3.2	3.8	1.5	0.0	2.9	2.6	9.0
Estonia									
GDP deflator	5.4	-1.4	0.7	2.9	3.2	3.2	3.9	4.7	8.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	6.7	-0.8	0.6	1.9	1.6	1.6	2.3	2.5	3.7
Real ER (PPI-based)	2.2	5.4	-0.1	-1.3	0.2	1.6	2.3	2.6	1.3
Average gross wages, NC	13.9	-5.0	1.1	5.9	6.0	6.8	7.4	8.8	15.4
Average gross wages, real (PPI based)	5.3	-5.9	-2.0	1.6	3.3	3.5	3.3	4.0	9.4
Average gross wages, real (CPI based)	3.0	-5.2	-1.6	0.8	1.7	3.3	3.2	4.1	8.4
Average gross wages, EUR (ER)	13.9	-5.0	1.1	5.9	6.0	6.8	7.4	8.8	15.4
Employed persons (LFS)	0.2	-9.2	-4.2	6.7	2.5	1.5	1.3	1.2	2.5
GDP per empl. person, NC at 2005 ref. pr.	-4.4	-5.3	7.8	1.5	0.7	0.2	2.0	2.4	2.9
Unit labour costs, NC at 2005 ref. prices	19.1	0.3	-6.2	4.4	5.3	6.6	5.3	6.2	12.2
Unit labour costs, ER (EUR) adjusted	19.1	0.3	-6.2	4.4	5.3	6.6	5.3	6.2	12.2
Hungary									
GDP deflator	5.3	3.6	2.5	3.1	3.2	4.3	3.8	3.4	4.2
Exchange rate (ER), EUR/NC	-0.1	-10.3	1.8	-1.4	-3.4	-1.9	1.7	1.8	0.0
Real ER (CPI-based)	2.2	-7.6	4.4	-0.6	-0.5	-1.3	2.9	2.8	2.7
Real ER (PPI-based)	-0.4	-2.2	2.4	-2.8	-1.8	0.7	3.9	3.2	0.3
Average gross wages, NC	7.4	0.6	1.3	5.2	4.6	2.5	2.9	3.0	8.1
Average gross wages, real (PPI based)	1.7	-3.7	-2.5	1.0	0.5	-1.7	-0.9	-0.4	3.5
Average gross wages, real (CPI based)	1.3	-3.3	-3.2	1.2	-1.0	0.0	0.0	0.0	2.6
Average gross wages, EUR (ER)	7.3	-9.8	3.1	3.8	1.1	-0.1	5.2	4.9	8.1
Employed persons (LFS)	-1.2	-2.5	0.0	0.8	1.7	0.3	0.3	0.5	-0.1
GDP per empl. person, NC at 2005 ref. pr.	2.1	-4.4	1.4	0.8	-3.4	-0.3	0.9	1.8	2.3
Unit labour costs, NC at 2005 ref. prices	5.2	5.1	0.0	4.4	8.3	2.8	1.9	1.2	5.6
Unit labour costs, ER (EUR) adjusted	5.1	-5.7	1.7	2.9	4.6	0.8	3.7	3.0	5.7

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Latvia									
GDP deflator	12.9	-1.2	-1.3	5.9	3.0	0.9	1.2	1.8	13.7
Exchange rate (ER), EUR/NC	-0.4	-0.4	-0.4	0.3	1.3	-1.6	0.0	0.0	-1.4
Real ER (CPI-based)	10.7	1.8	-3.7	1.4	1.0	-2.4	-0.2	0.0	5.4
Real ER (PPI-based)	6.4	0.8	-1.3	2.4	3.0	-2.3	-0.4	-0.2	6.0
Average gross wages, NC	20.5	-3.8	-3.5	4.3	3.7	6.0	5.9	7.4	22.8
Average gross wages, real (PPI based)	6.5	-0.7	-5.7	-3.2	-0.4	5.1	4.6	5.5	9.7
Average gross wages, real (CPI based)	4.5	-6.8	-2.3	0.0	1.3	5.0	4.3	5.3	12.0
Average gross wages, EUR (ER)	20.0	-4.2	-3.9	4.6	5.0	4.4	5.6	7.9	21.1
Employed persons (LFS)	0.6	-12.6	-4.3	3.1	-8.7	2.2	1.1	1.1	2.5
GDP per empl. person, NC at 2005 ref. pr.	-3.8	-5.9	3.5	2.2	15.7	0.3	2.8	1.8	4.1
Unit labour costs, NC at 2005 ref. prices	25.2	2.3	-6.8	2.0	-10.4	5.7	3.0	5.5	17.9
Unit labour costs, ER (EUR) adjusted	24.8	1.9	-7.2	2.3	-9.2	4.0	3.0	5.5	16.3
Lithuania									
GDP deflator	9.6	-3.4	2.0	5.5	2.8	2.0	2.5	3.6	7.8
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Real ER (CPI-based)	7.1	3.1	-0.9	1.0	0.6	0.3	0.8	1.6	3.1
Real ER (PPI-based)	11.6	-9.7	6.8	7.9	2.5	0.5	0.9	1.5	6.5
Average gross wages, NC	19.4	-4.4	-3.3	2.9	4.5	5.3	6.7	8.3	17.0
Average gross wages, real (PPI based)	1.0	10.5	-12.4	-9.7	-0.5	3.2	4.0	4.6	5.4
Average gross wages, real (CPI based)	7.5	-8.3	-4.4	-1.2	1.2	3.2	4.1	4.6	10.6
Average gross wages, EUR (ER)	19.4	-4.4	-3.3	2.9	4.5	5.0	7.7	7.1	17.0
Employed persons (LFS)	-0.9	-6.8	-5.1	2.0	-6.7	1.3	1.5	1.1	1.4
GDP per empl. person, NC at 2005 ref. pr.	3.9	-8.6	7.0	3.7	11.3	2.1	2.4	2.9	5.5
Unit labour costs, NC at 2005 ref. prices	14.9	4.5	-9.7	-0.8	-6.1	3.1	4.2	5.3	10.8
Unit labour costs, ER (EUR) adjusted	14.9	4.5	-9.7	-0.8	-6.1	3.2	4.2	5.3	10.8
Poland									
GDP deflator	3.1	3.7	1.5	3.2	2.5	1.6	2.1	2.2	2.8
Exchange rate (ER), EUR/NC	7.7	-18.8	8.3	-3.1	-1.5	-1.5	1.2	1.2	6.6
Real ER (CPI-based)	8.3	-16.5	8.9	-2.3	-0.5	-1.8	1.5	1.2	6.5
Real ER (PPI-based)	3.7	-12.6	6.8	-1.5	-0.7	-3.1	1.6	1.2	3.7
Average gross wages, NC	10.1	5.4	3.9	5.6	4.0	2.3	2.8	3.5	6.7
Average gross wages, real (PPI based)	7.9	2.2	2.1	-1.6	0.7	2.3	0.7	1.5	5.2
Average gross wages, real (CPI based)	5.6	1.4	1.2	1.6	0.3	0.7	0.7	1.5	4.0
Average gross wages, EUR (ER)	18.6	-14.4	12.6	2.3	2.4	0.5	4.7	4.5	13.6
Employed persons (LFS)	3.7	0.4	0.6	1.1	-3.3	0.0	0.2	0.5	3.5
GDP per empl. person, NC at 2005 ref. pr.	1.4	1.2	3.2	3.5	5.3	1.2	2.6	3.0	1.9
Unit labour costs, NC at 2005 ref. prices	8.5	4.2	0.7	2.0	-1.3	1.1	0.2	0.5	4.6
Unit labour costs, ER (EUR) adjusted	16.9	-15.4	9.1	-1.1	-2.8	-0.5	1.4	1.7	11.5
Romania									
GDP deflator	15.3	4.2	5.7	4.1	4.8	6.0	5.0	5.0	12.9
Exchange rate (ER), EUR/NC	-9.4	-13.1	0.7	-0.6	-4.9	1.3	-0.5	-0.7	2.4
Real ER (CPI-based)	-5.8	-9.2	4.6	2.0	-4.2	3.7	1.3	0.8	6.9
Real ER (PPI-based)	-3.6	-7.1	1.7	0.7	-2.3	5.8	2.9	2.3	8.5
Average gross wages, NC	26.1	4.8	3.1	4.1	5.0	4.9	4.6	5.3	21.1
Average gross wages, real (PPI based)	11.9	2.3	-1.2	-2.8	-0.2	-1.1	-0.4	0.2	9.8
Average gross wages, real (CPI based)	16.9	-0.8	-2.8	-1.6	1.6	0.6	1.1	1.7	13.1
Average gross wages, EUR (ER)	14.2	-9.0	3.8	3.4	-0.2	7.2	4.0	3.8	24.0
Employed persons (LFS)	0.2	-1.3	0.0	-1.1	1.4	0.4	0.0	1.1	0.6
GDP per empl. person, NC at 2005 ref. pr.	7.2	-5.3	-1.1	3.3	-0.7	1.4	2.2	0.8	5.8
Unit labour costs, NC at 2005 ref. prices	17.7	10.6	4.2	0.8	5.7	3.4	2.4	4.4	14.5
Unit labour costs, ER (EUR) adjusted	6.6	-3.9	4.9	0.1	0.5	4.8	1.9	3.7	17.2
Slovakia									
GDP deflator	2.9	-1.2	0.5	1.6	1.4	2.0	3.0	3.0	2.3
Exchange rate (ER), EUR/NC	8.0	3.8	0.0	0.0	0.0	0.0	0.0	0.0	6.4
Real ER (CPI-based)	8.3	3.7	-1.4	1.0	1.1	0.2	1.3	1.0	7.0
Real ER (PPI-based)	4.2	0.9	-2.8	-1.0	-0.5	-1.4	0.4	0.0	3.8
Average gross wages, NC	8.1	3.0	3.3	2.2	2.4	1.9	3.7	5.9	8.3
Average gross wages, real (PPI based)	5.9	10.6	2.9	-2.2	0.5	1.7	1.6	3.8	6.6
Average gross wages, real (CPI based)	4.0	2.0	2.6	-1.8	-1.3	-0.1	0.6	2.8	4.9
Average gross wages, EUR (ER)	16.8	6.9	3.3	2.2	2.4	1.9	3.7	5.9	15.2
Employed persons (LFS)	3.2	-2.8	-2.1	1.5	-1.0	0.0	0.9	0.9	2.9
GDP per empl. person, NC at 2005 ref. pr.	2.5	-2.2	6.5	1.8	2.9	1.0	1.4	2.1	4.8
Unit labour costs, NC at 2005 ref. prices	5.5	5.3	-3.0	0.4	-0.5	0.8	2.2	3.7	3.4
Unit labour costs, ER (EUR) adjusted	14.0	9.3	-3.0	0.4	-0.5	0.8	2.2	3.7	10.0

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Slovenia									
GDP deflator	4.1	3.6	-1.1	1.0	0.3	-3.3	8.2	2.0	3.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	1.8	-0.1	0.0	-1.0	0.2	0.7	0.3	0.0	0.9
Real ER (PPI-based)	-1.9	2.9	-1.3	-1.0	-1.5	0.4	0.9	0.5	-1.0
Average gross wages, NC	8.3	3.4	3.9	2.0	0.0	-3.0	0.0	2.7	5.7
Average gross wages, real (PPI based)	4.3	4.9	1.9	-2.5	-0.8	-4.9	-2.4	0.2	2.5
Average gross wages, real (CPI based)	2.6	2.5	1.8	-0.1	-2.7	-5.3	-2.0	0.7	2.0
Average gross wages, EUR (ER)	8.3	3.4	3.9	2.0	0.0	-3.0	0.0	2.7	5.6
Employed persons (LFS)	1.1	-1.5	-1.5	-3.1	-1.3	-4.7	-2.3	0.0	1.4
GDP per empl. person, NC at 2005 ref. pr.	2.3	-6.4	2.8	3.8	-1.0	1.6	1.8	1.2	3.6
Unit labour costs, NC at 2005 ref. prices	5.9	10.4	1.1	-1.7	1.0	-4.5	-1.7	1.5	2.0
Unit labour costs, ER (EUR) adjusted	5.9	10.4	1.1	-1.7	1.0	-4.5	-1.7	1.5	1.9
Macedonia									
GDP deflator	7.5	0.7	2.7	3.1	0.4	3.0	3.0	3.0	5.5
Exchange rate (ER), EUR/NC	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	4.3	-1.8	-0.9	0.7	0.7	1.2	1.3	1.0	0.9
Real ER (PPI-based)	3.8	-3.1	4.8	6.4	2.1	1.5	1.3	1.0	1.4
Average gross wages, NC [1)]	8.7	9.0	1.0	1.2	0.2	3.0	2.8	4.0	6.0
Average gross wages, real (PPI based)	-1.3	17.5	-7.1	-9.9	-4.2	0.0	-0.2	1.0	0.4
Average gross wages, real (CPI based)	0.3	9.9	-0.6	-2.5	-3.0	0.0	-0.1	1.0	2.4
Average gross wages, EUR (ER)	8.5	9.0	0.6	1.2	0.2	2.3	3.9	3.8	6.0
Employed persons (LFS)	3.2	3.4	1.3	1.1	0.8	0.5	1.5	1.5	3.9
GDP per empl. person, NC at 2005 ref. pr.	1.7	-4.2	1.6	1.6	-1.1	0.7	0.7	1.1	1.2
Unit labour costs, NC at 2005 ref. prices	6.9	13.8	-0.6	-0.3	1.3	2.4	2.2	2.9	4.8
Unit labour costs, ER (EUR) adjusted	6.7	13.8	-1.0	-0.3	1.3	2.4	2.2	2.9	4.8
Montenegro									
GDP deflator	7.7	2.4	1.6	0.9	1.9	1.7	3.8	2.5	8.4
Real ER (CPI-based)	3.6	2.4	-1.6	0.0	1.5	1.2	1.3	1.0	1.6
Real ER (PPI-based)	7.7	0.3	-4.1	-2.3	-0.5	-4.6	0.8	-0.5	2.7
Average gross wages, NC	22.5	5.6	11.2	1.0	0.7	4.5	3.9	5.1	19.1
Average gross wages, real (PPI based)	7.5	9.9	12.2	-2.1	-1.2	2.8	0.1	2.5	11.3
Average gross wages, real (CPI based)	14.1	2.1	10.6	-2.1	-3.3	1.5	0.9	2.0	14.3
Employed persons (LFS)	0.6	-2.7	-2.2	-6.1	2.4	5.0	2.4	2.3	4.0
GDP per empl. person, NC	14.4	-0.7	6.5	11.0	-0.3	-1.8	3.1	3.6	12.2
GDP per empl. person, NC at 2005 ref. pr.	6.2	-3.0	4.8	10.0	-2.1	-3.9	0.0	0.9	3.5
Unit labour costs, NC at 2005 ref. prices	15.3	8.9	6.1	-8.2	2.9	8.8	3.9	4.1	15.1
Unit labour costs, ER (EUR) adjusted	15.3	8.9	6.1	-8.2	2.9	8.8	3.9	4.1	15.1
Serbia									
GDP deflator	12.6	5.9	4.9	9.6	7.4	5.3	6.2	4.6	12.7
Exchange rate (ER), EUR/NC	-1.8	-13.3	-8.7	0.9	-9.8	-5.9	-6.3	-5.2	-2.9
Real ER (CPI-based)	7.5	-6.7	-4.5	8.7	-5.2	-2.0	-3.2	-2.4	6.1
Real ER (PPI-based)	4.2	-4.4	-0.4	9.1	-7.0	-2.4	-2.0	-2.8	3.9
Average gross wages, NC	17.9	-3.3	7.5	11.1	8.9	6.0	6.0	7.1	22.1
Average gross wages, real (PPI based)	4.9	-8.4	-4.6	-2.7	3.2	0.7	-0.2	2.4	9.6
Average gross wages, real (CPI based)	3.9	-11.0	0.6	0.1	1.0	0.0	1.0	2.0	9.0
Average gross wages, EUR (ER)	15.7	-16.2	-1.9	12.2	-1.7	0.3	-2.0	2.0	18.6
Employed persons (LFS)	6.3	-7.3	-8.4	-6.0	-1.1	-1.3	0.0	0.0	-0.9
GDP per empl. person, NC at 2005 ref. pr.	-2.3	4.1	10.3	8.1	-0.6	2.3	2.0	3.0	5.5
Unit labour costs, NC at 2005 ref. prices	20.6	-7.1	-2.6	2.9	9.6	3.6	4.0	4.0	15.7
Unit labour costs, ER (EUR) adjusted	18.4	-19.4	-11.0	3.8	-1.1	-2.4	-2.5	-1.4	12.4
Albania									
GDP deflator	4.7	2.0	2.6	1.7	3.0	3.1	2.3	2.3	3.4
Exchange rate (ER), EUR/NC	0.7	-7.0	-4.2	-1.8	0.9	0.0	1.5	1.5	1.0
Real ER (CPI-based)	0.3	-5.8	-2.8	-1.5	0.3	1.2	1.8	1.5	1.1
Real ER (PPI-based)	1.3	-4.5	-7.0	-4.6	0.0	-1.5	2.8	0.5	0.7
Average gross wages, NC	25.3	5.2	-3.6	6.6	6.0	4.6	4.1	5.1	15.8
Average gross wages, real (PPI based)	17.7	7.0	-3.9	3.9	4.4	4.6	1.1	4.1	11.5
Average gross wages, real (CPI based)	21.3	2.9	-7.0	3.1	3.9	1.6	2.1	3.1	12.7
Average gross wages, EUR (ER)	26.2	-2.1	-7.6	4.7	7.0	6.2	3.3	6.5	17.0
Employed persons (LFS)	-6.2	3.3	2.1	1.3	0.0	0.0	1.7	1.6	-1.0
GDP per empl. person, NC at 2005 ref. pr.	14.7	0.0	1.6	1.8	1.5	3.5	0.8	1.3	7.2
Unit labour costs, NC at 2005 ref. prices	9.3	5.2	-5.2	4.7	4.4	1.1	3.3	3.8	8.0
Unit labour costs, ER (EUR) adjusted	10.0	-2.1	-9.1	2.8	5.4	1.1	4.8	5.3	9.1

1) In 2009 wiiw estimate (including allowances for food and transport).

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Bosnia and Herzegovina									
GDP deflator	7.3	0.0	1.6	2.6	2.0	1.5	2.1	2.0	6.1
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.7	-1.4	0.0	0.6	-0.5	-0.3	0.3	0.0	1.9
Real ER (PPI-based)	2.5	1.0	-2.3	-1.8	-0.9	-0.6	0.4	0.0	.
Average gross wages, NC	16.7	8.1	1.1	4.6	1.3	1.6	3.1	3.7	10.4
Average gross wages, real (PPI based)	7.4	11.7	0.2	0.9	-0.2	0.5	1.0	1.7	.
Average gross wages, real (CPI based)	8.5	8.6	-1.0	0.9	-0.8	0.0	1.0	1.7	5.7
Average gross wages, EUR (ER)	16.7	8.1	1.1	4.6	1.3	1.6	3.1	3.7	10.4
Employed persons (LFS)	4.8	-3.5	-1.9	-3.2	-0.3	-0.5	0.2	1.0	2.8
GDP per empl. person, NC at 2005 ref. pr.	0.8	0.7	2.7	4.3	-0.4	1.1	2.0	2.0	2.4
Unit labour costs, NC at 2005 ref. prices	15.8	7.4	-1.6	0.3	1.8	0.4	1.0	1.7	7.9
Unit labour costs, ER (EUR) adjusted	15.8	7.4	-1.6	0.3	1.8	0.4	1.0	1.7	7.9
Kazakhstan									
GDP deflator	21.0	4.7	19.6	17.8	4.4	5.6	5.9	5.9	18.9
Exchange rate (ER), EUR/NC	-5.2	-13.9	5.1	-4.1	6.5	-2.3	-1.5	-1.4	-1.1
Real ER (CPI-based)	5.5	16.2	-4.9	4.3	9.2	2.7	3.1	2.4	1.2
Real ER (PPI-based)	6.9	-8.6	10.3	0.7	7.6	0.1	1.8	2.4	6.9
Average gross wages, NC	15.9	10.7	15.3	16.0	12.3	13.4	12.9	11.3	21.0
Average gross wages, real (PPI based)	-15.3	42.0	-7.9	-8.8	8.5	9.1	7.5	5.0	-1.2
Average gross wages, real (CPI based)	-1.0	3.2	7.6	7.1	6.7	6.0	6.0	5.0	9.1
Average gross wages, EUR (ER)	9.8	-4.7	21.2	11.2	19.6	10.0	12.1	9.2	19.6
Employed persons (LFS)	3.0	0.6	2.7	2.3	2.5	1.0	1.0	1.0	2.3
GDP per empl. person, NC	21.3	5.3	24.9	23.5	7.0	9.8	11.1	11.6	25.7
GDP per empl. person, NC at 2005 ref. pr.	0.3	0.6	4.5	4.9	2.4	4.0	4.9	5.4	5.7
Unit labour costs, NC at 2005 ref. prices	15.5	10.1	10.3	10.6	9.6	9.1	7.6	5.6	14.5
Unit labour costs, ER (EUR) adjusted	9.5	-5.3	16.0	6.0	16.7	6.6	6.0	4.1	13.2
Russia									
GDP deflator	18.0	2.0	14.2	15.5	8.5	8.0	7.4	6.3	16.5
Exchange rate (ER), EUR/NC	-3.8	-17.5	9.6	-1.5	2.3	-2.6	-2.4	-2.3	-0.4
Real ER (CPI-based)	5.8	-8.7	14.7	3.7	4.8	2.4	1.7	0.5	8.1
Real ER (PPI-based)	10.2	-20.1	19.0	11.0	6.7	1.7	0.9	0.5	12.0
Average gross wages, NC	27.2	7.8	12.4	11.5	14.2	11.8	11.3	9.7	26.6
Average gross wages, real (PPI based)	4.8	16.1	0.2	-6.3	6.9	5.5	6.0	4.5	8.1
Average gross wages, real (CPI based)	11.5	-3.6	5.2	2.8	8.7	4.5	5.0	4.5	13.7
Average gross wages, EUR (ER)	22.3	-11.1	23.2	9.9	16.9	9.2	8.2	7.6	26.0
Employed persons (LFS)	0.3	-2.2	0.8	1.3	1.0	-0.1	-0.7	0.0	1.3
GDP per empl. person, NC at 2005 ref. pr.	4.9	-5.7	3.7	2.9	2.4	2.5	3.8	3.2	5.7
Unit labour costs, NC at 2005 ref. prices	21.3	14.3	8.4	8.4	11.5	9.1	7.2	6.3	19.8
Unit labour costs, ER (EUR) adjusted	16.6	-5.7	18.8	6.8	14.1	6.3	4.6	3.9	19.3
Ukraine									
GDP deflator	28.6	13.0	13.8	14.3	8.0	0.3	4.4	4.2	22.5
Exchange rate (ER), EUR/NC	-10.3	-29.1	3.2	-5.0	8.0	-2.2	-4.5	4.8	-3.8
Real ER (CPI-based)	8.4	-18.6	10.6	-0.5	5.9	-3.4	-1.9	6.8	7.9
Real ER (PPI-based)	14.8	-21.2	20.8	7.0	9.3	-0.8	-1.4	7.8	10.8
Average gross wages, NC	33.7	5.5	17.5	17.6	14.9	4.5	9.8	10.4	32.3
Average gross wages, real (PPI based)	-1.3	-0.9	-2.8	-1.2	10.9	1.4	4.6	5.1	10.3
Average gross wages, real (CPI based)	6.8	-9.0	7.4	8.9	14.2	3.9	5.1	6.1	15.0
Average gross wages, EUR (ER)	20.0	-25.2	21.2	11.7	24.1	1.9	6.7	12.5	27.3
Employed persons (LFS)	0.3	-3.7	0.4	0.3	0.1	0.0	0.2	0.2	0.8
GDP per empl. person, NC at 2005 ref. pr.	2.0	-11.4	3.8	4.9	0.0	0.5	2.1	3.2	4.2
Unit labour costs, NC at 2005 ref. prices	31.1	19.2	13.2	12.1	14.8	3.9	7.6	6.9	27.0
Unit labour costs, ER (EUR) adjusted	17.7	-15.5	16.8	6.4	24.0	1.6	2.7	12.0	22.2
Austria									
GDP deflator	1.7	1.5	1.7	2.2	2.5	2.0	1.6	1.8	1.9
Real ER (CPI-based)	-0.5	-0.5	-0.2	0.2	-0.2	0.4	0.3	0.3	-0.3
Real ER (PPI-based)	0.5	-3.3	1.6	2.6	0.0	0.4	0.1	-0.2	-0.3
Average gross wages, NC	3.4	2.4	1.2	2.2	3.1	2.4	2.6	2.8	3.2
Average gross wages, real (PPI based)	-2.8	10.6	-3.6	-5.6	0.6	0.4	0.8	1.0	-0.6
Average gross wages, real (CPI based)	0.2	1.9	-0.7	-1.1	0.6	0.2	0.6	0.5	0.9
Employed persons (LFS)	1.5	-0.3	0.5	1.0	1.0	0.7	1.0	0.9	2.2
GDP per empl. person, NC at 2005 ref. pr.	-0.1	-3.5	1.5	1.6	0.0	0.3	0.8	1.2	0.6
Unit labour costs, NC at 2005 ref. prices	3.5	6.1	-0.3	0.6	3.1	2.0	1.8	1.6	2.7
Unit labour costs, ER (EUR) adjusted	3.5	6.1	-0.3	0.6	3.1	2.0	1.8	1.6	2.7

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

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