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Back from the Peak, Growth in Transition Countries Returns to Standard Rate of Catching-up

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Summary

Even in the short time that has elapsed since wiiw completed its previous assessment of the transition countries[1]*, new facts have emerged. First, according to the latest data, in 2004 GDP growth was higher than had been reported three months ago. The revised data lend substance to our earlier positive evaluation of the transition countries' recent performance. Second, incoming reports on the first months of 2005 point to a definite slowdown in growth – at least in most new EU member states (NMS). The average GDP growth rate for eight NMS in the first quarter of 2005 dropped by 2.5 percentage points (to 3.3%). The extent of the current slowdown is compounded by a marked deterioration of growth in Poland. Nonetheless, a slowdown has also been observed in other NMS. Only in the Czech Republic (and Estonia) has there been any (marginal) growth acceleration. The slowdown appears to be associated with: (a) greatly reduced rates of growth in gross fixed investment; (b) massive declines in the rates of growth of industrial production; (c) quite an abrupt deterioration in industrial labour productivity; and (d) real currency appreciation and a strong rise in unit labour costs in industry. Despite this (and despite growth being weaker than expected in the euro-zone), NMS foreign trade continues to perform excellently. Foreign trade has been even more instrumental in generating GDP growth in the first quarter of 2005 than in the past. It should be pointed out that NMS trade with the 'old' EU has grown at a relatively slower pace. Entry into the EU has turned out to be particularly conducive to expanding NMS trade with the more dynamic regions of the world, viz. CIS, USA and the NMS themselves.*

The first quarter results for 2005 confirm our previous assessment of the medium-term prospects in the NMS. Growth will generally decelerate below 4% on average in 2005; it will most probably not accelerate too much in 2006. Given the relatively poor economic performance in the euro-zone (particularly the stagnation-inducing policies pursued by Germany), there is little that the otherwise constrained fiscal or monetary policies in the NMS can do to change this situation. Much more will depend on the corporate sector's willingness to invest. Poland's experience indicates that high and rising profits (in tandem with lower taxation) do not of themselves guarantee a high propensity to invest. Growth in 2005 is also slowing down in Southeast Europe – particularly among the region's largest economies: Turkey, Romania, Croatia and Serbia. Fiscal consolidation and increasing trade deficits will thus hamper growth which over the biennium 2005-2006 will nonetheless range between 4 and 6% in this region. Only in Croatia will growth be weaker. The prospects for further EU enlargements have taken a turn for the worse in the wake of the recent EU 'constitutional' and budget crises. That notwithstanding, the accession of Bulgaria and Romania is beyond dispute – even if they should join a year later than initially planned.

Despite high world market commodity prices, the robust growth in Russia may be a thing of the past. Already in 2004 investment growth was disappointing, reflecting high uncertainty. Lagging reforms and huge structural imbalances blur the prospects for sustainable long-term growth. The stimulation of domestic demand through a fiscal relaxation will protract disinflation and induce real appreciation. This will be conducive to higher imports, a lower trade surplus and eventually to slower GDP growth. Following Ukraine's recent explosive growth, things are settling down somewhat, despite some fiscal relaxation. Currency appreciation has had an effect on trade surpluses, while the investment climate has been poisoned by rumours of re-nationalization and the lacklustre performance of the new government.

Despite some slowdown in investment growth, China continues to register extremely rapid GDP growth. Private consumption is picking up and net exports are rising faster than expected.

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1 See 'Accelerated GDP Growth, Improved Prospects for European Integration', *wiiw Research Reports* (special issue on economic prospects for Central, East and Southeast Europe), No. 314, March 2005.

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

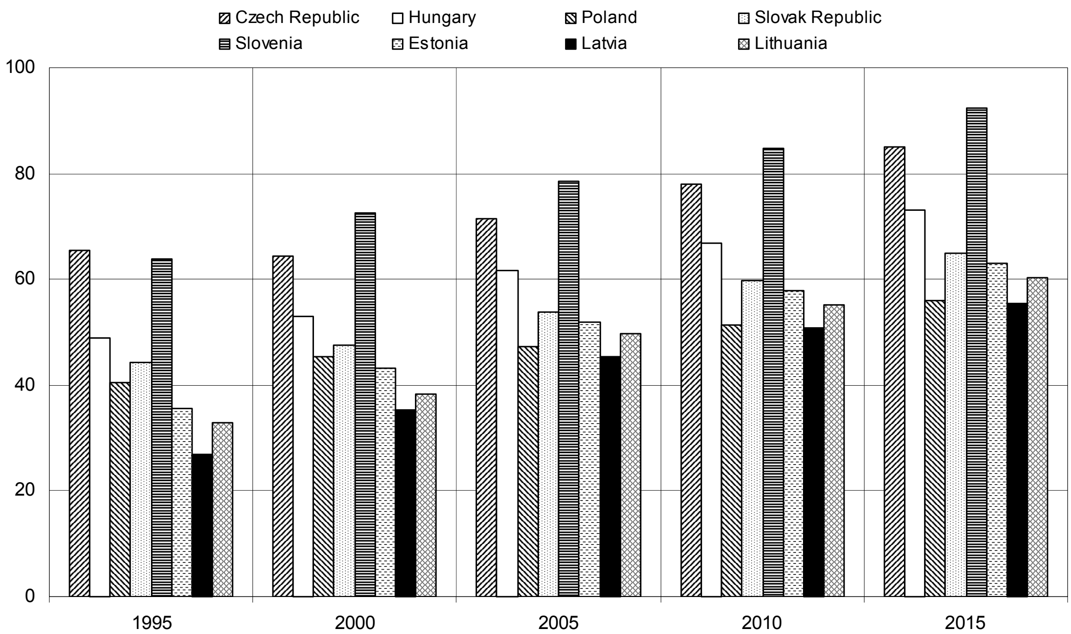
JEL classification: O52, O57, P24, P27, P33, P52

Figure I

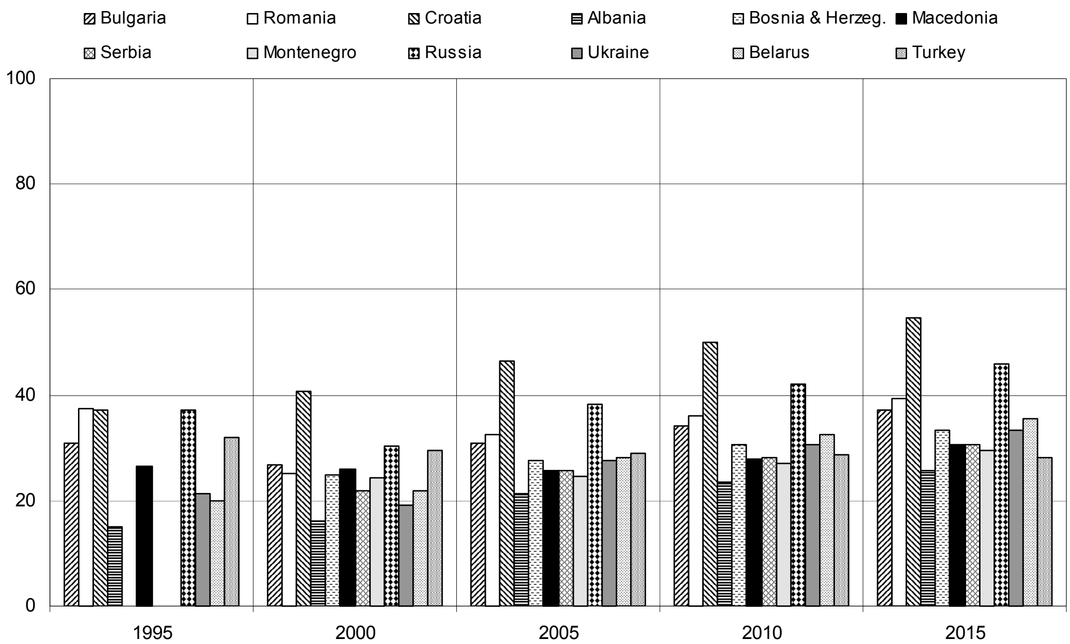
Real per capita GDP in selected transition countries

European Union (25) average = 100

New EU Member States



East and Southeast European Countries



Projection assuming a 2 percentage points growth differential to the EU-15 after 2005.

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2003-2004 and outlook 2005-2006

	GDP real change in % against previous year				Consumer prices change in % against previous year				Unemployment, based on LFS[1] rate in %, annual average				Current account in % of GDP			
	2003	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
			forecast				**forecast**				**forecast**				**forecast**	
Czech Republic	3.2	4.4	4.3	4.3	0.1	2.8	1.8	2.2	7.8	8.3	8.7	9	-6.3	-5.2	-2.1	-2.1
Hungary	2.9	4.2	3.4	3.7	4.7	6.8	3.6	3.3	5.9	6.1	6.6	6.5	-8.8	-8.8	-8.1	-7.7
Poland	3.8	5.4	3	4	0.8	3.5	3	3	19.6	19.0	19	19	-2.2	-1.5	-1.3	-1.7
Slovak Republic	4.5	5.5	5.5	6	8.5	7.5	3	2.5	17.4	18.1	17	16	-0.8	-3.5	-4.7	-4.0
Slovenia	2.5	4.6	3.4	3.4	5.6	3.6	2.7	2.5	6.7	6.3	6.5	6	-0.4	-0.9	-0.6	-0.6
NMS-5 [2)3)]	*3.5*	*5.0*	*3.5*	*4.1*	.	.	.	.	*15.1*	*14.9*	*15.1*	*15.0*	*-4.0*	*-3.8*	*-3.0*	*-3.0*
Estonia	5.1	6.2	6	6.2	1.3	3.0	2.8	2.5	10.0	9.7	9.5	9	-13.2	-12.6	-12.1	-11.2
Latvia	7.5	8.5	7.2	6.9	2.9	6.2	5.5	4.5	10.6	10.4	9.8	9.5	-8.2	-12.3	-10.5	-10.0
Lithuania	9.7	6.7	6.4	5.9	-1.2	1.2	1.5	1	12.4	11.4	11	10	-6.9	-7.2	-7.8	-7.5
NMS-8 [2)3)]	*3.9*	*5.1*	*3.8*	*4.3*	.	.	.	.	*14.7*	*14.4*	*14.6*	*14.4*	*-4.4*	*-4.3*	*-3.5*	*-3.5*
EU-15 [3)]	*0.9*	*2.2*	*1.9*	*2.2*	*1.9*	*2.0*	*1.8*	*1.6*	*7.9*	*8.0*	*8.0*	*7.8*	*0.35*	*0.43*	.	.
EU-25 [2)3)]	*1.1*	*2.5*	*2.1*	*2.4*	*2.0*	*2.1*	*1.9*	*1.7*	*8.9*	*9.0*	*9.0*	*8.7*	*0.14*	*0.21*	.	.
Bulgaria	4.5	5.6	5.5	5.3	2.3	6.2	4	4	13.7	12.0	10.3	9.5	-9.2	-7.4	-7.5	-6.4
Croatia	4.3	3.8	3	3	1.8	2.1	3	2.5	14.3	13.8	13.5	13	-6.9	-4.5	-4.4	-4.5
Romania	5.2	8.3	5.5	5.5	15.3	11.9	9	7	7.0	8.0	7	7	-6.0	-7.5	-8.3	-7.4
Turkey	5.8	8.0	6	6	25.3	10.6	8	6	10.5	10.3	10.8	11	-3.3	-5.1	-5	-5
Albania [4)]	6.0	5.9	6.5	6.5	2.3	2.9	2.5	2.5	15.0	14.4	14	14	-6.7	-4.4	-5	-4
Bosnia and Herzegovina [4)5)]	3.0	5.0	5	6	0.6	0.4	0.5	0.5	42.0	42.8	42	42	-24.5	-23.3	-21.4	-18.8
Macedonia	2.8	2.9	4	4	1.2	-0.4	2	2	36.7	37.2	35	35	-3.3	-7.7	-6.6	-6.3
Serbia	2.4	8.6	4	5	9.9	11.4	15	10	14.6	18.5	20	20	-9.2	-13.1	-14	-13
Montenegro [5)]	2.5	3.0	5	5	7.8	3.3	3	3	22.9	22.3	23	23	-7.4	-9.7	-5	-5
Russia	7.3	7.2	5.3	5.0	13.6	11.0	12	10	8.6	8.0	8.5	9	8.2	10.3	10.0	7.5
Ukraine	9.6	12.1	5.5	6	5.2	9.0	12	10	9.1	8.6	8.0	8	5.8	10.5	5.2	3.1
China	9.1	9.5	8.5	8.5	1.2	3.9	3.0	3.0	.	.	.	.	3.3	4.2	3.0	2.8

Notes: NMS: The New EU Member States. - 1) LFS - Labour Force Survey. - 2) wiiw estimate. - 3) Current account data include flows within the region. - 4) Unemployment rate by registration, end of period. - 5) Consumer price inflation measured by retail prices.

Source: wiiw (June 2005); Eurostat; forecasts for EU-15: European Commission (Spring 2005).

Part A: The new EU member states

*Leon Podkaminer**

Booming foreign trade, yet weaker GDP growth

Worsening external conditions

The period of accelerated growth in the EU-15 in 2004 was not only rather unimpressive, but also quite short-lived. The GDP growth rate in the 'old' EU-15 dropped from 2.2% in 2004 to a meagre 1.4% in the first quarter of 2005. Growth in the euro-zone was even lower (0.9%) in the first quarter of 2005: primarily on account of stagnation in Germany – the closest and by far the most important economic partner for all the new member states in Central Europe (NMS-5). Throughout 2005 growth in 'old' Europe is unlikely to be much faster than in the first quarter. As before, developments in Germany are the decisive factor. Domestic demand in Germany continues to be weak: in the first quarter of 2005, private consumption fell by 0.8% and gross fixed capital formation dropped by a massive 4.1%. Falling domestic demand has been offset by strong growth in net exports, a reflection of Germany's high and growing external competitiveness. Ongoing reforms of the labour market as well as of the public pension and health systems in Germany will enhance the external competitiveness – to the detriment of ailing domestic consumption (and at the expense of growth in Germany's trading partners). This is likely to depress growth in the major EU countries – and thus directly (and indirectly) in the NMS as well. Growth is also slowing down in most other transition countries (Russia, Ukraine, some Balkan countries), all of which are fairly important trading partners of the NMS-5. All in all, worsening external conditions will have a negative effect on growth in the NMS-5.

GDP growth slowdown in the first quarter of 2005

With a few exceptions, GDP growth in the NMS slowed down markedly in the first quarter of 2005. The most pronounced drop in growth (compared to the first quarter of 2004) occurred in Poland and Hungary. The decline in Poland's growth rate is further reflected in the pronounced decline in the average growth rate for the NMS overall. Only in the Czech Republic and Estonia did growth accelerate slightly in the first quarter (see Table 1).

Gross fixed capital formation (termed investment for short) expanded at a generally lower rate than the year previous. It only accelerated in Slovakia where investment had stagnated in the period 2002-2003. Contrary to expectations, investment growth was very weak in Poland where falling interest rates and an accumulation of huge profits in the corporate sector failed to support the expansion of production capacities. In Slovenia investment even declined (see Table 2).

* K. Laski, P. Havlik, M. Landesmann (all wiiw) as well as the authors of the country reports provided valuable comments on the draft of this overview.

Table 1

Gross domestic product

real change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	3.9	2.6	1.5	3.2	4.4	4.1	4.4	4.3	4.3	114.9	112.2
Hungary	5.2	3.8	3.5	2.9	4.2	4.5	2.9	3.4	3.7	124.5	115.3
Poland	4.0	1.0	1.4	3.8	5.4	7.0	2.1	3.0	4.0	160.5	112.0
Slovak Republic	2.0	3.8	4.6	4.5	5.5	5.4	5.1	5.5	6	123.9	119.7
Slovenia	3.9	2.7	3.3	2.5	4.6	4.1	2.6	3	3	136.2	113.8
NMS-5 [2)]	*4.0*	*2.1*	*2.1*	*3.5*	*5.0*	*5.7*	*3.0*	*3.5*	*4.1*	*137.9*	*113.3*
Estonia	7.8	6.4	7.2	5.1	6.2	6.8	7.0	6	6.2	115.9	127.4
Latvia	6.9	8.0	6.4	7.5	8.5	8.7	7.4	7.2	6.9	86.4	134.1
Lithuania	3.9	6.4	6.8	9.7	6.7	7.1	5.6	6.4	5.9	94.6	132.9
NMS-8 [2)]	*4.1*	*2.4*	*2.5*	*3.9*	*5.1*	*5.9*	*3.3*	*3.8*	*4.3*	*132.2*	*114.7*

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

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2005) for Baltic States.

Table 2

Gross fixed capital formation

real change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	4.9	5.4	3.4	4.7	7.6	7.9	5.5	8	7	141.5	122.8
Hungary	7.7	5.9	9.3	2.5	7.9	18.4	6.8	7	12	184.6	128.0
Poland	2.7	-8.8	-5.8	-0.2	5.3	3.7	1.0	3	4	210.8	90.3
Slovak Republic	-7.2	13.9	-0.6	-1.5	2.5	0.9	5.8	7	10	93.3	114.4
Slovenia	0.6	4.1	3.1	6.3	6.8	8.0	-0.5	6.5	6	234.2	121.8
Estonia	14.3	13.0	17.2	5.4	6.9	-8.5	.	6	5.5	.	149.2
Latvia	10.2	11.4	13.0	10.9	19.3	16.5	.	9	8	96.7	166.6
Lithuania	-9.0	13.5	11.1	14.0	12.3	17.4	8.2	15	12	.	161.4

Note: 1) Preliminary.

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

The contribution of rising investment expenditure to total expenditure (effective demand) – and hence to actual GDP growth recorded – does not depend solely on the magnitude of the rate of investment growth. Allowance also has to be made for the 'base', i.e. the share of investment in GDP. This also applies to other components of the GDP, viz. consumption, exports and imports. In particular, determining whether foreign trade in goods and non-factor services (with changing real *volumes* of both exports and imports) has contributed positively to a rise in GDP may easily lead to mistaken conclusions, if abstraction is based on the shares of exports and imports in the GDP. It must also be remembered that even if the trade balance measured at *current* prices – e.g. in current euros – greatly improves, the actual contribution of foreign trade to *real* GDP growth may still be negative.

In order to assess properly the actual significance of changes in individual components of GDP growth, the *contributions* of those components have to be calculated. Table 3 shows those contributions to recent GDP growth rates in the NMS. (It should be recalled that the data for the first quarter of 2005 are preliminary. As such, they are likely to be revised somewhat at a later date).

As can be seen, individual items of expenditure have recently played different roles in generating growth in aggregate demand (and GDP) across individual NMS. In the first quarter of 2005, total consumption (private and public combined) contributed quite significantly to overall GDP growth in all NMS, except the Czech Republic. Whereas in the first quarter of 2004 foreign trade contributed negatively to GDP growth in both Slovenia and the Czech Republic, it contributed to growth everywhere else (except Slovenia) in the first full year of EU membership.

A comparison of foreign trade contributions to the GDP growth in 2004 and 2003 (and the earlier years) may indeed – with some obvious qualifications – offer some indication of 'the effects of EU accession'. In the Czech Republic and Hungary, the contributions in question were negative prior to accession (This also applied to both countries in the period 2002-2003 and to the Czech Republic in 2001 as well). In Slovenia the contribution of trade was also negative in 2003. By way of contrast, in 2004 the contribution of trade was positive in both Hungary and the Czech Republic (and close to zero in Slovenia). The impression that 'accession mattered' is further reinforced when one compares the contributions of Czech and Slovene trade in the first quarters of 2004 and 2005, respectively. (In Slovenia, the contribution shifted from -0.7 to +1.3 percentage points, while in the Czech Republic it switched from -1.2 to 4 percentage points), That notwithstanding, the conclusions to be drawn from this analysis of trade and its contribution to GDP growth in the Czech Republic, Hungary and Slovenia do not seem to fit the data for Poland and Slovakia. In the case of Poland (where trade made a positive contribution both before and after accession), this may signify weak domestic demand prior to accession (2001-2003) – as well as in the first quarter of 2005. In the case of Slovakia, the unusual weak domestic demand in 2003 and the current (equally unusual) strong domestic demand may be responsible for creating the impression that 'accession has contributed negatively to growth'. Quite certainly, that impression defies justification. Arguably, if consumption in Slovakia had not increased close to 5% in the first quarter of 2005, the contribution of foreign trade to GDP growth would most probably have been positive. (A marked rise in disposable incomes and private consumption has had a positive impact on the growth in imports of consumer goods in Slovakia). It may also be observed that in all NMS (except Slovakia once again), the contribution of gross fixed investment to GDP growth has declined. EU accession brought about a temporary rise in GDP growth yet failed to generate an immediate boom in investment.

Table 3

Contributions (percentage points) to the GDP growth rates

	2001	2002	2003	2004	1 Q 2004	1Q 2005
Czech Republic						
GDP growth rate (%)	**2.6**	**1.5**	**3.2**	**4.4**	**4.1**	**4.4**
Consumption	2.2	2.5	3.3	0.6	1.4	-0.2
Gross fixed investm.	1.6	1.1	1.5	2.5	2.4	1.8
Trade Balance	-2.2	-2.7	-1.3	0.4	-1.2	4.0
Other items*	1.0	0.6	-0.3	0.9	1.5	-1.2
Hungary						
GDP growth rate (%)	**3.8**	**3.5**	**2.9**	**4.2**	**4.5**	**2.9**
Consumption	4.3	6.6	5.6	1.4	1.2	1.6
Gross fixed investm.	1.4	2.2	0.6	2.0	2.9	1.2
Trade Balance	1.8	-2.1	-3.0	1.9	3.6	1.1
Other items*	-3.7	-3.2	-0.3	-1.1	-3.2	-1.0
Poland						
GDP growth rate (%)	**1.0**	**1.4**	**3.8**	**5.4**	**7.0**	**2.1**
Consumption	1.4	2.2	2.1	2.8	3.6	1.7
Gross fixed investm.	-2.2	-1.2	0.0	1.0	0.5	0.1
Trade Balance	2.7	0.6	1.1	0.3	0.7	0.9
Other items*	-0.9	-0.2	0.6	1.3	2.2	-0.6
Slovak Republic						
GDP growth rate (%)	**3.8**	**4.6**	**4.5**	**5.5**	**5.4**	**5.1**
Consumption	3.5	3.8	0.4	2.0	1.2	3.3
Gross fixed investm.	3.6	-0.3	-0.3	0.6	0.2	1.3
Trade Balance	-3.7	0.0	6.4	0.9	3.5	-0.3
Other items*	0.4	1.1	-2.0	2.0	0.5	0.8
Slovenia						
GDP growth rate (%)	**2.7**	**3.3**	**2.5**	**4.6**	**4.1**	**2.6**
Consumption	2.1	0.5	2.0	2.3	2.1	2.0
Gross fixed investm.	1.0	0.8	1.6	1.8	2.0	-0.1
Trade Balance	1.7	1.0	-2.2	-0.2	-0.7	1.3
Other items*	-2.1	1.0	1.1	0.7	0.7	-0.6
Estonia						
GDP growth rate (%)	**6.4**	**7.2**	**5.1**	**6.2**	**6.8**	**7.0**
Consumption	3.8	6.9	4.3	4.5	4.0	
Gross fixed investm.	3.3	4.7	1.6	2.1	-2.5	
Trade Balance	-2.1	-2.6	-4.9	0.3	5.6	
Other items*	1.3	-1.8	4.1	-0.7	-0.2	
Latvia						
GDP growth rate (%)	**8.0**	**6.4**	**7.5**	**8.5**	**8.7**	**7.4**
Consumption	5.2	5.0	5.8	*6.2*		
Gross fixed investm.	2.8	3.3	2.9	*4.4*		
Trade Balance	-4.0	-0.2	-4.7	*-4.8*		
Other items*	4.0	-1.7	3.4	*2.7*		
Lithuania						
GDP growth rate (%)	**6.4**	**6.8**	**9.7**	**6.7**	**7.1**	**5.6**
Consumption	2.4	4.2	8.6	7.2	10.1	4.0
Gross fixed investm.	2.5	2.2	2.9	2.7		
Trade Balance	0.5	-0.3	-2.4	-6.0	-9.4	-2.4
Other items*	0.9	0.6	0.6	2.8		

*Other items include change in stocks and statistical discrepancies

Note: The contributions for Latvia in 2004 refer to the first three quarters of 2004.

Source: wiiw estimates based on national statistics.

Industry: (almost fully) losing steam

The rapid expansion of industrial output over the past few years was facilitated by appreciable inflows of foreign direct investments, the current restructuring process and subsequent consolidation associated with downsizing the workforce culminating in a marked rise in labour productivity. However, at present (the first quarter of 2005), growth in industrial production would seem to have come to a general standstill, with a decline in Slovenia (see Table 4, Figure 1).

Table 4

Gross industrial production

real change in % against preceding year

	2000	2001	2002	2003	2004 1)	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	5.4	6.5	4.8	5.8	9.9	9.0	4.0	6	6	109.5	129.8
Hungary	18.1	3.6	2.8	6.4	8.3	10.4	1.7	5	7	185.8	122.8
Poland 2)	6.7	0.6	1.1	8.3	11.6	18.9	0.8	7	7	210.3	123.0
Slovak Republic	8.4	7.6	6.7	5.3	4.2	6.5	0.3	4	7	117.3	126.0
Slovenia	6.2	2.9	2.4	1.4	4.8	4.2	-2.6	1	2	100.4	112.0
NMS-5 3)	*8.3*	*3.2*	*2.8*	*6.8*	*9.7*	*13.6*	*1.5*	*5.9*	*6.5*	*163.4*	*124.2*
Estonia	14.6	8.9	8.2	11.0	7.5	7.5	7.8	7.5	7	91.8	140.6
Latvia	4.7	9.2	8.4	6.5	6.0	9.2	0.1	6	5.5	62.8	133.6
Lithuania	2.2	16.0	3.1	16.1	10.8	9.0	4.0	10	9.5	56.4	153.8
NMS-8 3)	*8.1*	*3.7*	*3.0*	*7.2*	*9.7*	*13.2*	*1.7*	*6.1*	*6.6*	*151.3*	*125.6*

Notes: 1) Preliminary. - 2) Sales; quarterly-enterprises with more than 9 employees. - 3) wiiw estimate.

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

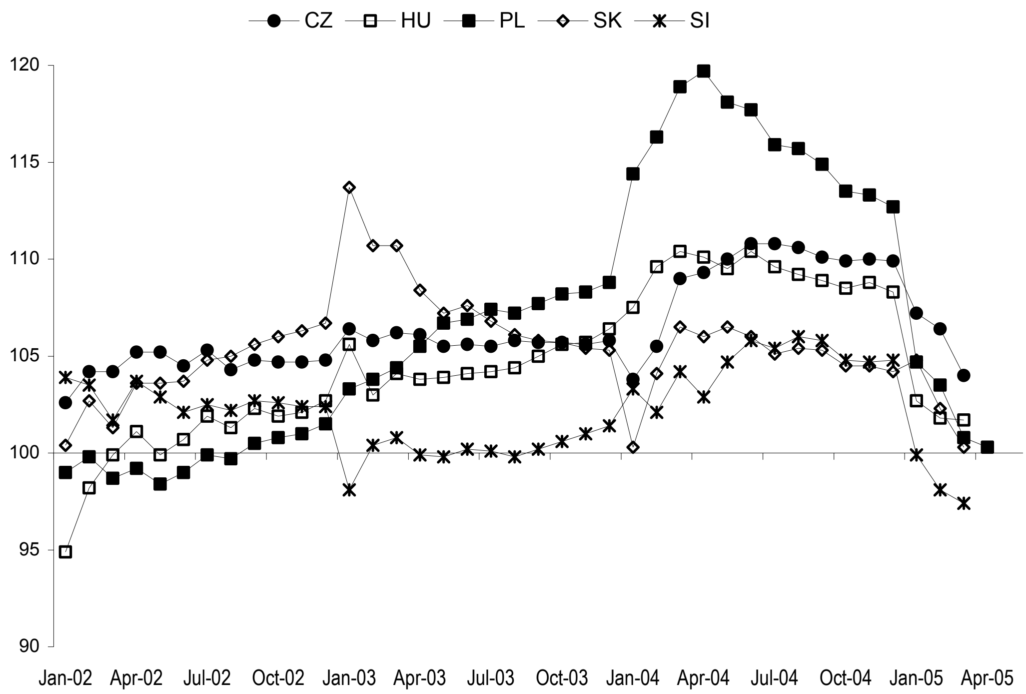
This deceleration in industrial expansion may be seen as a reflection of the overall slowdown in GDP growth. Furthermore, the aggregate figures for the industrial sector as a whole may well be masking structural changes that would seem to be on the rise at present. The contraction of mining and labour-intensive 'light manufacturing' (textiles, apparel, leather products) seems to have shifted into higher gear – possibly as a spin-off of the accession process, the adoption of the EU external tariff system (with generally lower rates), expiry of the Multi-Fibre Agreement and increased Chinese competition. This is best illustrated by various developments in individual countries. For example, in Poland gross output in mining fell by about 4% in the first quarter of 2005, while output in apparel manufacture dropped by over 10%. In Slovenia, where gross industrial output fell 2.6% in the first quarter of 2005, gross value-added in manufacturing rose 1.1% in real terms; however, gross value-added in mining fell over 8%. Similar figures are reported for Hungary.

Another factor possibly underlying this marked slowdown in overall industrial output may have something to do with a new phase of industrial restructuring. Quantitative industrial growth, i.e. measured increases in gross output, is perhaps becoming less relevant as an indicator. Real industrial progress is reflected more and more in the increase in the volume of value-added generated, not in terms of ‘socialistic’ gross turnover. A slowdown in the growth of gross industrial output is quite a natural development since many of the 'old' industries in the NMS are, by international standards, still far too energy- and resource-intensive. Without a shadow of doubt, restructuring and the shift from extensive to intensive industrial growth will accelerate – also as an outcome of the ever-increasing cross-county industrial integration promoted by multinational corporations.

Figure 1

NMS-5: Gross industrial production, 2002-2005

annual growth, cumulated



Source: wiiw Monthly Database incorporating national statistics.

Certainly, the analysis of data on the dynamics of gross industrial output will continue to yield important insights, especially where trends in terms of labour productivity and unit labour costs are concerned. Analyses of the external competitiveness of industrial production customarily require information on gross output as well (in relation to employment, prices, wages and exchange rates).

The recent slowdown in production growth is also reflected in the slowdown of growth in labour productivity (see Table 5, Figure 2).

With labour productivity rising much less than in the past, wages improving fairly strongly (at least in Hungary, the Czech Republic and Slovakia) and domestic currencies appreciating in nominal terms (in all NMS except Slovenia), unit labour costs in industry have been on the rise throughout the region (see Figure 3). In actual fact, the most rapid increases in the unit labour costs are to be observed in the Baltic states (not shown separately in Figure 3 see also Appendix Tables A/2-A/3).

Table 5

Labour productivity in industry

change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004 1st quarter	2005 1st quarter	Index 1990=100 2004	Index 2000=100 2004
Czech Republic [2)]	9.5	5.5	5.8	9.5	10.4	10.3	5.2	177.6	134.9
Hungary [3)]	17.7	4.8	4.6	10.2	11.2	13.6	4.1	314.0	134.3
Poland [4)]	13.6	4.6	6.6	9.4	13.2	19.8	-0.1	325.6	138.1
Slovak Republic	11.9	6.5	6.5	4.7	3.8	7.4	-2.6	153.3	123.3
Slovenia	8.4	3.5	5.6	3.6	6.2	5.7	-1	196.3	120.2
Estonia	17.6	15.3	10.3	.	.	.	.	.	.
Latvia	.	6.9	7.7	6.4	4.7	.	.	.	128.2
Lithuania	5.5	19.3	5.9	5.9	9.0	.	.	.	145.8

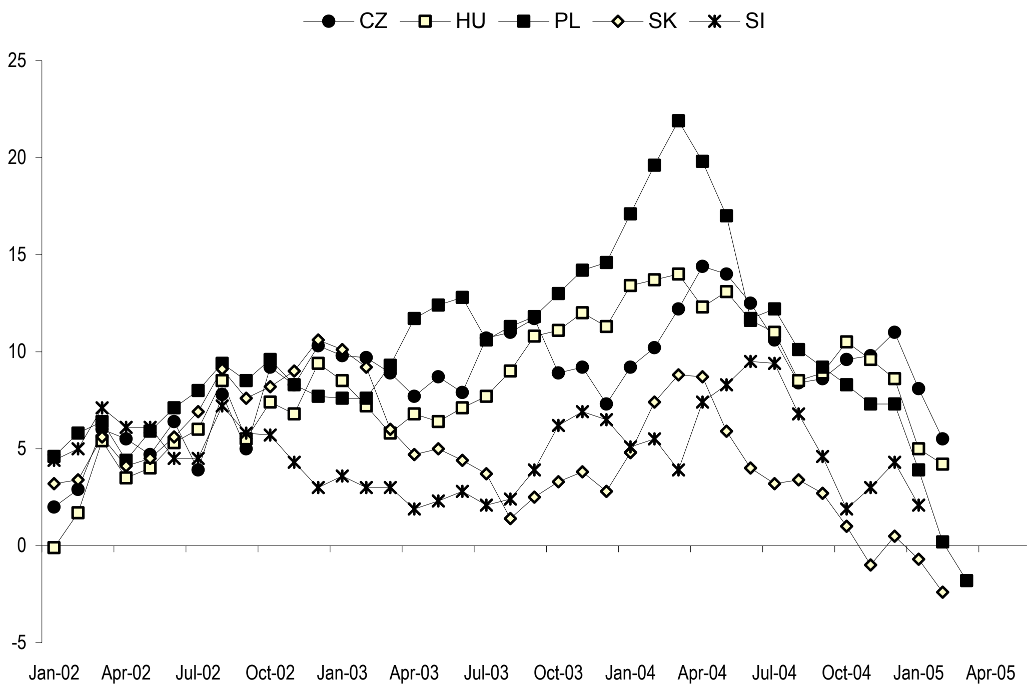
Notes: 1) Preliminary. - 2) Enterprises with 20 and more employees. From 2001 calculated with sales. - 3) Enterprises with more than 5 employees. - 4) From 2004 enterprises with more than 9 employees.

Source: wiiw Database incorporating national statistics.

Figure 2

NMS-5: Labour productivity in industry, 2002-2005

3-month moving average, year-on-year, in %

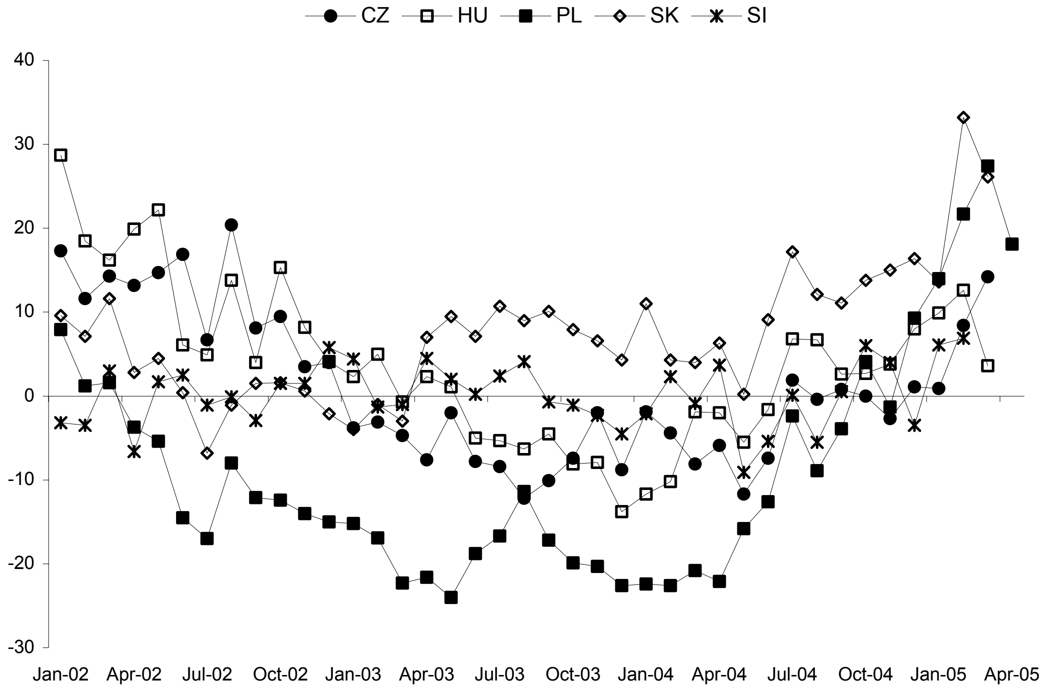


Source: wiiw Monthly Database incorporating national statistics.

Figure 3

NMS-5: Unit labour costs, 2002-2005

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



Source: wiiw Monthly Database incorporating national statistics.

To date, rising unit labour cost have not had a negative impact on foreign trade performance (except in Slovakia, discussed below). Qualitative improvements, reflected in rising prices for products exported by the NMS, are certainly offsetting – at least partially – growing unit labour costs. This is reflected also in terms of trade improvements and thus also in faster growth in gross national income (visible especially in the Czech Republic) – see Vintrovà, R., Working Paper CES VŠEM, No. 1/2005. Furthermore, the fact that unit labour costs are rising is irrelevant (e.g. to foreign investors locating their activities in the NMS) insofar as actual wages (and associated labour costs) are still very low by West European standards (see Appendix, Selected indicators of competitiveness, and also *wiiw Statistical Report*, January 2005[2]).

Of course, unit labour costs continue to be relevant as far as the bulk of traditional labour-intensive activities of the NMS-5 are concerned. For those activities, an unchecked rise in unit labour costs may soon prove troublesome (as is already happening in the textile and apparel industries) – especially when they stem from undue appreciation of domestic currencies. Therefore, as long as the national economic structures of some NMS remain dominated by solid traditional activities, any undue appreciation of domestic currencies will continue to pose a highly serious macroeconomic threat as well.

2 P. Havlik, 'Unit Labour Costs in the New EU Member States', *wiiw Statistical Report*, No. 1, January 2005.

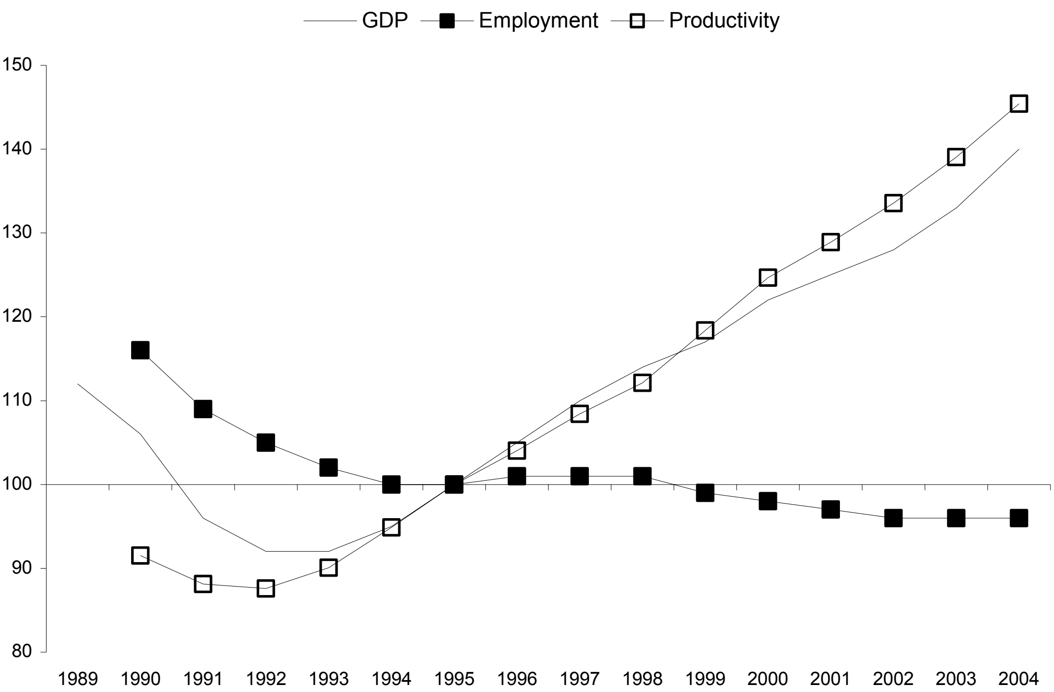
Labour market situation virtually unchanged

In the past – ever since the mid-1990s – comparatively rapid GDP growth in the NMS has been associated with falling or at best stagnant employment – and the resultant growth in labour productivity (GDP per employed person). This is shown in Figure 4. The 'jobless growth' pattern suggests that sustained GDP growth at a rate much higher than was to be recently observed in the majority of NMS (at least 4-5% p.a.) is needed to ensure the gradual absorption of redundant labour. In actual fact, the slowdown in growth in the first quarter of 2005 has been associated with a rise in employment in all NMS-5 (except Hungary).

Figure 4

GDP, employment and productivity in NMS-8

1995 = 100



Source: wiiw Database incorporating national statistics; wiiw estimates (weighted averages for NMS-8).

The above notwithstanding, unemployment rates have not changed much in Slovenia, Hungary and the Czech Republic. It is worth adding that the unemployment rates in those three countries do not vary that much from the average rates observed in the 'old' EU. Although still very high, unemployment in Slovakia has apparently started to drop (primarily thanks to robust GDP growth – but possibly on account of the recent labour market reforms as well). The same trend – albeit to a much lesser degree – may even be detected in Poland (see Table 6). Of course, it is a rather risky business generalizing on the basis of numbers reported for just one quarter. (All too soon it may transpire that these numbers have to be revised). None the less, the 'jobless growth pattern' is perhaps not an inevitability after all – and unemployment could be gradually reined in, even if the GDP growth rate falls short of the high levels often observed elsewhere. Nevertheless, the unemployment rate will stay above 14% on average in NMS (Table 6).

Table 6

Unemployment, LFS definition, annual averages

	in 1000 persons					rate in %						
	2000	**2001**	**2002**	**2003**	**2004** [1]	**2002**	**2003**	**2004** [1]	**2004**	**2005**	**2005**	**2006**
									1st quarter		**forecast**	
Czech Republic [2]	455	421	374	399	426	7.3	7.8	8.3	8.7	8.4	8.7	9
Hungary	264	234	239	245	253	5.8	5.9	6.1	6.1	7.1	6.6	6.5
Poland	2785	3170	3431	3329	3230	19.9	19.6	19.0	20.7	18.9	19	19
Slovak Republic	485	508	487	459	481	18.5	17.4	18.1	19.3	17.5	17	16
Slovenia	68	63	62	65	64	6.4	6.7	6.3	6.8	6.9	6.5	6
NMS-5 [3]	*4056*	*4396*	*4593*	*4496*	*4454*	*15.3*	*15.1*	*14.9*	*16.0*	*14.9*	*15.1*	*15.0*
Estonia	90	83	67	66	64	10.3	10.0	9.7	10.1	.	9.5	9
Latvia	159	145	135	119	119	12.0	10.6	10.4	11.5	9.9	9.8	9.5
Lithuania	274	284	224	204	184	13.8	12.4	11.4	13.0	.	11	10
NMS-8 [3]	*4579*	*4908*	*5019*	*4885*	*4820*	*15.0*	*14.7*	*14.4*	*15.6*	.	*14.6*	*14.4*

Notes: 1) Preliminary. - 2) From 2002 weighted according to census 2001. - 3) wiiw estimate.

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

Continuing expansion of foreign trade

2004 was an exceptionally successful year in terms of NMS external trade. Accession to the EU and the related changes in the trade regime have apparently provided an additional stimulus for both exports and imports. After a rather unimpressive performance in 2003 (which was also associated with sluggish demand in the euro-zone), NMS-8 exports leapt by 21% in 2004 (in current EUR terms), significantly swifter than imports (+17.4%): the region's trade integration into both the European and global economy thus forged ahead.

In general, the positive trends apparent in 2004 have continued on into 2005, despite trade expansion in Hungary and Slovenia being slower than in the other NMS. In all NMS (except Slovakia) the (high) growth of export revenues has outstripped the (high) growth of import payments. In effect, trade deficits have been contracting; for the first time in history, the Czech Republic even achieved a trade surplus (see Table 7).

Table 8 documents NMS trade with the enlarged EU-25. In general, the message is the same throughout: a rapid rise in both exports and imports in 2004, extending into 2005. It is somewhat surprising, however, that the growth in NMS foreign trade with the EU-25 has been less dynamic than NMS foreign trade overall. Paradoxically, accession turned out to be better for trade with the 'outer' world than for trade with the EU. In 2004, the shares of the EU-25 in NMS trade generally declined. This may reflect the fact that the EU has been growing at a slower pace than the 'outer world'. It is also interesting to note that Slovakia, Hungary, the Czech Republic and Poland even had trade surpluses with the EU-25. Poland only achieved this kind of surplus in 2004. Hungary's recent trade performance vis-à-vis the 'old' EU has been less successful.

Table 7

Foreign trade of the new EU member states, EUR million

based on customs statistics

		2000	2001	2002	2003	2004 [1]	2005 I-III	2003	2004 [1]	I-III 05 / I-III 04
								change in %		
Czech Republic	Exports	31483	37251	40726	43051	53714	14313	5.7	24.8	24.9
	Imports	34876	40675	43025	45243	54414	13825	5.2	20.3	21.0
	Balance	-3393	-3424	-2298	-2192	-700	488	.	.	.
Hungary [2]	Exports	30545	34082	36523	38041	44079	11176	4.2	15.9	9.8
	Imports	34856	37654	39939	42189	47933	11747	5.6	13.6	7.8
	Balance	-4312	-3572	-3417	-4149	-3854	-570	.	.	.
Poland	Exports	34383	40375	43400	47511	60015	16384	9.5	26.3	24.2
	Imports	53122	56223	58307	60288	71606	17931	3.4	18.8	15.4
	Balance	-18739	-15848	-14907	-12777	-11592	-1546	.	.	.
Slovakia [3]	Exports	12880	14115	15270	19359	22352	5580	26.8	15.5	12.6
	Imports	13860	16488	17517	19924	23525	5844	13.7	18.1	17.8
	Balance	-980	-2372	-2247	-565	-1172	-264	.	.	.
Slovenia	Exports	9505	10349	10966	11288	12539	3279	2.9	11.1	10.5
	Imports	10996	11345	11578	12242	13701	3455	5.7	11.9	9.0
	Balance	-1491	-997	-612	-954	-1162	-176	.	.	.
NMS-5	*Exports*	*118795*	*136172*	*146885*	*159250*	*192699*	*50734*	*8.4*	*21.0*	*18.7*
	Imports	*147709*	*162385*	*170367*	*179886*	*211179*	*52802*	*5.6*	*17.4*	*14.8*
	Balance	*-28915*	*-26213*	*-23481*	*-20636*	*-18480*	*-2068*	.	.	.
Estonia	Exports	3445	3698	3642	4003	4747	1363	9.9	18.6	26.5
	Imports	4615	4798	5079	5715	6738	1750	12.5	17.9	20.2
	Balance	-1171	-1101	-1437	-1713	-1991	-387	.	.	.
Latvia	Exports	2020	2233	2418	2560	3175	888	5.8	24.0	30.6
	Imports	3453	3913	4287	4635	5615	1417	8.1	21.1	20.3
	Balance	-1433	-1680	-1868	-2076	-2440	-529	.	.	.
Lithuania	Exports	3837	4775	5524	6158	7451	1954	11.5	21.0	22.2
	Imports	5644	6762	7941	8526	9875	2410	7.4	15.8	14.1
	Balance	-1807	-1987	-2416	-2368	-2424	-456	.	.	.
NMS-8	*Exports*	*128096*	*146877*	*158470*	*171970*	*208073*	*54939*	*8.5*	*21.0*	*19.2*
	Imports	*161422*	*177858*	*187673*	*198762*	*233407*	*58379*	*5.9*	*17.4*	*15.1*
	Balance	*-33326*	*-30980*	*-29203*	*-26792*	*-25334*	*-3440*	.	.	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) Quarterly data refer to trade excluding value of goods for repair.

Source: wiiw Database incorporating national statistics.

Table 8

Foreign trade of the new EU member states with EU-25, EUR million

based on customs statistics [4)]

		2001	2002	2003	2004 [1)]	2005 I-III	2003	2004 [1)]	I-III 05 / I-III 04	2003	2004 [1)]
							change in %			share of EU-25 in % of total	
Czech	Exports	31804	34477	37153	46155	12286	7.8	24.2	23.0	86.3	85.9
Republic	Imports	29858	31069	32303	39077	9693	4.0	21.0	20.1	71.4	71.8
	Balance	1946	3409	4850	7078	2593	.	.	.	.	.
Hungary [2)]	Exports	27586	29885	30877	34937	8723	3.3	13.1	4.0	81.2	79.3
	Imports	24368	25444	26613	34209	8154	4.6	6.5	-0.4	63.1	71.4
	Balance	3217	4441	4263	728	569	.	.		.	.
Poland	Exports	32415	34822	38383	47451	12852	10.2	23.6	16.7	80.8	79.1
	Imports	38958	40591	41694	48639	11901	2.7	16.7	10.4	69.2	67.9
	Balance	-6543	-5769	-3312	-1188	951	.	.	.	.	.
Slovakia [3)]	Exports	12593	13449	16375	19039	4929	21.8	16.3	18.9	84.6	85.2
	Imports	11902	12815	14834	17317	4087	15.8	16.7	12.1	74.5	73.6
	Balance	690	634	1541	1722	842	.	.	.	.	.
Slovenia [2)]	Exports	7858	7402	7551	8270	2308	2.0	9.5	11.8	66.9	66.0
	Imports	9449	8840	9258	11325	2765	4.7	11.4	4.9	75.6	82.7
	Balance	-1591	-1438	-1706	-3055	-456	.	.	.	.	.
NMS-5	*Exports*	*112254*	*120035*	*130339*	*155851*	*41098*	*8.6*	*19.6*	*15.5*	*81.8*	*80.9*
	Imports	*114535*	*118759*	*124702*	*150566*	*36600*	*5.0*	*14.8*	*9.8*	*69.3*	*71.3*
	Balance	*-2281*	*1277*	*5637*	*5285*	*4498*	.	.	.	.	.
Estonia [2)]	Exports	3006	2974	3298	3797	1066	10.9	15.1	18.1	82.4	80.0
	Imports	3177	3485	3699	5238	1304	6.1	19.3	18.9	64.7	77.7
	Balance	-170	-511	-401	-1441	-238	.	.	.	.	.
Latvia [2)]	Exports	1754	1879	2030	2475	693	8.0	21.9	26.9	79.3	77.9
	Imports	2965	3310	3494	4278	1008	5.5	21.2	16.9	75.4	76.2
	Balance	-1210	-1431	-1464	-1804	-315	.	.	.	.	.
Lithuania [4)]	Exports	3498	3822	3849	4951	1385	0.7	28.6	43.8	62.5	66.4
	Imports	4306	5258	5561	6222	1423	.	11.9	7.7	65.2	63.0
	Balance	-808	-1435	-1712	-1271	-38	.	.	.	.	.
NMS-8	*Exports*	*120513*	*128711*	*139516*	*167075*	*44243*	*8.4*	*19.8*	*16.4*	*81.1*	*80.3*
	Imports	*124982*	*130812*	*137456*	*166305*	*40335*	.	*15.0*	*10.2*	*69.2*	*71.3*
	Balance	*-4470*	*-2101*	*2060*	*770*	*3907*	.	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) Quarterly data refer to trade excluding value of goods for repair. - 4) From 2003 dispatches and arrivals according to Intrastat methodology.

Source: wiiw Database incorporating national statistics.

Accession proved conducive to an explosive expansion of trade among the NMS (see Table 9). Poland, the Czech Republic and the Baltic states are clear winners in terms of trade expansion, as they report the highest growth rates. The first two countries even managed to increase on a massive scale their (otherwise high) surpluses in trade with other NMS. This rapid rise in intra-NMS trade may be seen as yet another outcome of accession (despite the fact that trade had already been partly liberalized at an earlier stage within the framework of the regional CEFTA co-operation agreements).

Table 9

Intra-NMS-8 foreign trade (trade among the new EU member states), EUR million

based on customs statistics [4)]

		2001	**2002**	**2003**	**2004** [1)]	**2005 I-III**	**2003**	**2004** [1)]	**I-III 05 / I-III 04**	**2003**	**2004** [1)]
							change in %			**share of NMS-8 in % of EU-25**	
Czech Republic	Exports	6121	6620	7086	9558	2443	7.1	34.9	32.5	19.1	20.7
	Imports	4719	5166	5498	7096	1772	6.4	29.1	28.9	17.0	18.2
	Balance	1403	1454	1588	2462	671	.	.	.	.	.
Hungary [2)]	Exports	2270	2444	2869	3773	1128	17.4	31.5	46.2	9.3	10.8
	Imports	2607	2977	3407	4382	1095	14.4	20.2	17.2	12.8	12.8
	Balance	-337	-533	-538	-609	33	.	.	.	.	.
Poland	Exports	4473	5002	5711	8051	.	14.2	41.0	.	14.9	17.0
	Imports	4446	4619	4832	6439	.	4.6	33.2	.	11.6	13.2
	Balance	27	382	879	1612	.	.	.	.	.	.
Slovakia	Exports	4143	4202	4635	5689	.	10.3	22.7	.	28.3	29.9
	Imports	3695	4001	4599	5537	.	14.9	20.4	.	31.0	32.0
	Balance	448	201	36	152	.	.	.	.	.	.
Slovenia [2)]	Exports	1427	893	956	1039	.	7.1	8.6	.	12.7	12.6
	Imports	1775	969	1023	1246	.	5.6	16.5	.	11.1	11.0
	Balance	-347	-76	-67	-207	.	.	.	.	.	.
NMS-5	*Exports*	*18435*	*19161*	*21258*	*28109*	.	*10.9*	*32.2*	.	*16.3*	*18.0*
	Imports	*17242*	*17733*	*19359*	*24699*	.	*9.2*	*26.1*	.	*15.5*	*16.4*
	Balance	*1193*	*1428*	*1899*	*3411*	.	.	.	.	.	.
Estonia [2)]	Exports	438	498	562	843	232	12.8	50.0	36.1	17.0	22.2
	Imports	465	545	646	1085	276	18.6	35.4	30.8	17.5	20.7
	Balance	-27	-46	-84	-242	-44	.	.	.	.	.
Latvia [2)]	Exports	387	419	447	730	248	6.6	63.5	86.5	22.0	29.5
	Imports	908	1040	1132	1629	416	8.8	30.3	43.2	32.4	38.1
	Balance	-521	-622	-685	-899	-168	.	.	.	.	.
Lithuania [3)]	Exports	1106	1082	1197	1579	411	10.6	32.0	47.9	31.1	31.9
	Imports	1065	1325	1453	1799	419	.	23.9	23.6	26.1	28.9
	Balance	41	-243	-256	-220	-8	.	.	.	.	.
NMS-8	*Exports*	*20366*	*21160*	*23462*	*31262*	.	*10.9*	*33.2*	.	*16.8*	*18.7*
	Imports	*19680*	*20643*	*22589*	*29212*	.	.	*26.5*	.	*16.4*	*17.6*
	Balance	*686*	*517*	*874*	*2050*	.	.	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2003 dispatches and arrivals according to Intrastat methodology.

Source: wiiw Database incorporating national statistics.

Fiscal deficits lower than feared in 2004

While somewhat higher than expected, GDP growth in 2004 resulted in the fiscal deficits/GDP ratios being lower than generally feared (see Table 10). In actual fact, the deficit/GDP ratios improved in all NMS except Poland. (However, even in Poland things took a turn for the better: the deficit/GDP ratio for 2004 was originally expected to be about 5.5%). In the Czech Republic, the enormous fiscal improvement in 2004 was not the outcome of fiscal restraint. (A one-time adjustment in 2003 to account for public debt yielded an abnormally high deficit ratio in that year). Given the tax reform in Slovakia (with a 19% flat personal income tax and corporate tax having been introduced at the beginning of 2004), a reduction in the budget deficit/GDP ratio would have been an achievement, had it yielded higher tax revenue (in relation to the current GDP). In actual fact, however, revenue under the new tax regime was less than before (35.1% as compared to 35.4% in 2003). This lower fiscal deficit/GDP ratio was due to lower levels of public expenditure (38.5% of GDP vs. 39.2% in 2003).

Table 10

General government budget balance in % of GDP [1)]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [2)]	2005 forecast	2006 forecast
Czech Republic	-13.4	-3.1	-2.3	-5.0	-3.6	-3.7	-5.9	-6.7	-11.6	-3.0	-4.2	-3.5
Hungary	.	.	.	.	.	-2.3	-3.7	-8.5	-6.2	-4.5	-4.1	-3.9
Poland	-2.2	-3.6	-4.0	-2.1	-1.3	-1.6	-3.9	-3.6	-4.5	-4.7	-4.4	-3.7
Slovak Republic	-0.9	-7.4	-6.2	-3.7	-7.0	-12.3	-6.0	-5.7	-3.7	-3.2	-3.7	-4.0
Slovenia	.	.	.	.	.	-3.5	-2.7	-2.3	-2.0	-1.9	-2.2	-2.1
Estonia	0.4	-1.7	1.7	-0.3	-3.7	-0.6	0.3	1.3	3.1	1.8	0.9	0.5
Latvia	-2.0	-0.5	1.5	-0.6	-5.4	-2.7	-2.1	-2.7	-1.5	-0.8	-1.6	-1.5
Lithuania	-1.9	-3.6	-1.1	-3.0	-5.5	-2.5	-2.0	-1.5	-1.9	-2.5	-2.3	-1.9

Notes: 1) EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure. – 2) Preliminary.

Source: AMECO Database; wiiw forecasts, for Baltic States forecasts by European Commission (Spring 2005).

The deceleration in GDP growth expected in 2005 will not be conducive to a strong reduction in the deficit/GDP ratios. Once again, these ratios are likely to deteriorate (at least in 2005) in a number of countries. The ongoing tax reforms (reducing progression rates in personal taxes and lowering corporate income taxes) will not be particularly conducive to reducing budgetary gaps. Moreover, given the attempts to offset the reduced tax revenue by cutbacks on spending, the fiscal policies – even if generating high deficits – will dampen overall growth.

On the other hand, the general drop in interest rates expected in 2005 will alleviate the fiscal cost of servicing the public debt. Public debt accounts for a significant portion of overall public expenditure in some NMS (especially in Hungary and Poland).

Inflation, monetary policy and exchange rates

In 2004 the yearly inflation rates in many NMS were higher than in 2003 (see Tables 11a and 11b). In part, this was the result of fiscally motivated hikes in regulated prices and/or changes in indirect (VAT) taxes and excises (e.g. on tobacco) prior to EU accession, as required by EU regulations. Higher international prices for energy and other raw materials also boosted inflation. Finally, the post-accession liberalization of trade in agro-food products has led to an increase, at least in some countries (e.g. in Poland), in the relatively low domestic prices of certain food items (e.g. sugar, as well as some dairy and meat products).

Table 11a

Consumer price inflation

change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004	2005	2005	2006
						1st quarter		forecast	
Czech Republic	3.9	4.7	1.8	0.1	2.8	2.3	1.7	1.8	2.2
Hungary	9.8	9.2	5.3	4.7	6.8	6.8	3.6	3.6	3.3
Poland	10.1	5.5	1.9	0.8	3.5	1.6	3.6	3	3
Slovak Republic	12.0	7.1	3.3	8.5	7.5	8.3	2.8	2.7	2.5
Slovenia	8.9	8.4	7.5	5.6	3.6	3.7	2.6	2.7	2.5
Estonia	4.0	5.8	3.6	1.3	3.0	0.4	4.6	2.8	2.5
Latvia	2.6	2.5	1.9	2.9	6.2	4.3	6.7	5.5	4.5
Lithuania	1.0	1.3	0.3	-1.2	1.2	-1.2	3.2	1.5	1

Note: 1) Preliminary.

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

Table 11b

Producer prices in industry

change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004	2005	2005	2006
						1st quarter		forecast	
Czech Republic	4.9	2.8	-0.5	-0.3	5.7	1.8	6.9	4	2.5
Hungary	11.6	5.2	-1.8	2.4	3.5	4.3	4.0	4	.
Poland	7.8	1.6	1.0	2.6	7.0	4.4	3.3	3	3
Slovak Republic	10.8	6.5	2.1	8.3	3.4	2.9	2.5	3	2
Slovenia	7.6	8.9	5.1	2.5	4.3	3.2	4.3	3	.
Estonia	4.9	4.4	0.4	0.2	2.9	0.8	3.3	2.5	2
Latvia	0.6	1.7	1.0	3.2	8.6	5.3	10.4	6	5
Lithuania	16.0	-3.0	-2.8	-0.5	5.0	-1.9	9.1	3	2

Note: 1) Preliminary.

Source: wiiw Database incorporating national statistics.

Inflation in 2004 lost momentum shortly after accession. In the second half of the year, inflation was in free fall – and signs of recurrent deflation were to be detected. Falling inflation in the second half of 2004 and low (and stable) inflation in the first quarter of 2005 was accompanied by an easing of monetary policy in Hungary, Slovenia, Poland and Slovakia. This notwithstanding, monetary policy in Hungary and Poland has remained comparatively restrictive, as evidenced by fairly high interest rates (see Figure 5).

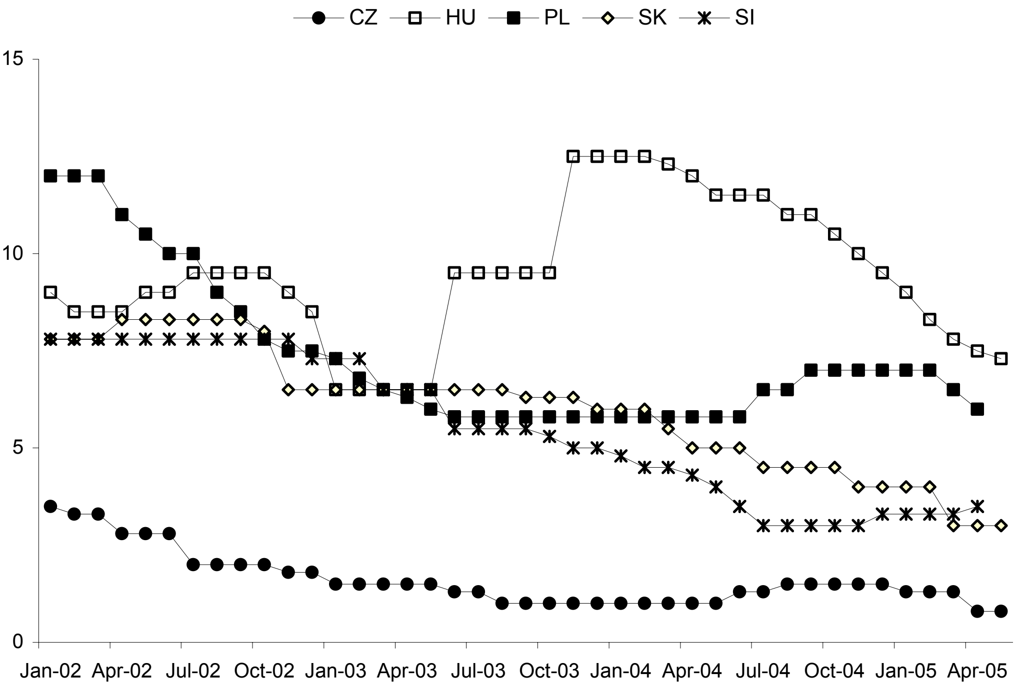
NMS exchange rates with respect to the euro have been fairly stable over the past few years. However, throughout much of 2004 all NMS-5 currencies (excepting Slovenia) firmed up in nominal terms against the euro (see Figure 6a). This trend has persisted throughout the first months of 2005. Generally, this strengthening of national currencies might be explained by a relative 'oversupply' of foreign exchange on domestic markets.

The 'oversupply' of foreign exchange, which has been a material force behind the increasing strength of the NMS currencies, has taken the form of inflows of portfolio investment and/or foreign loans. Relatively high (by international standards) interest rates (and yields on governmental debt) in Hungary and Poland are associated with both countries' relatively good economic standing. A combination of factors such as this is normally conducive to high inflows of portfolio capital. This, in turn can lead to further nominal appreciation. Despite much lower official interest rates being set by the central banks, the currencies of Slovakia and the Czech Republic have also appreciated. This may well reflect widespread expectations of further nominal appreciation.

Figure 5

NMS-5: Minimum interest rates

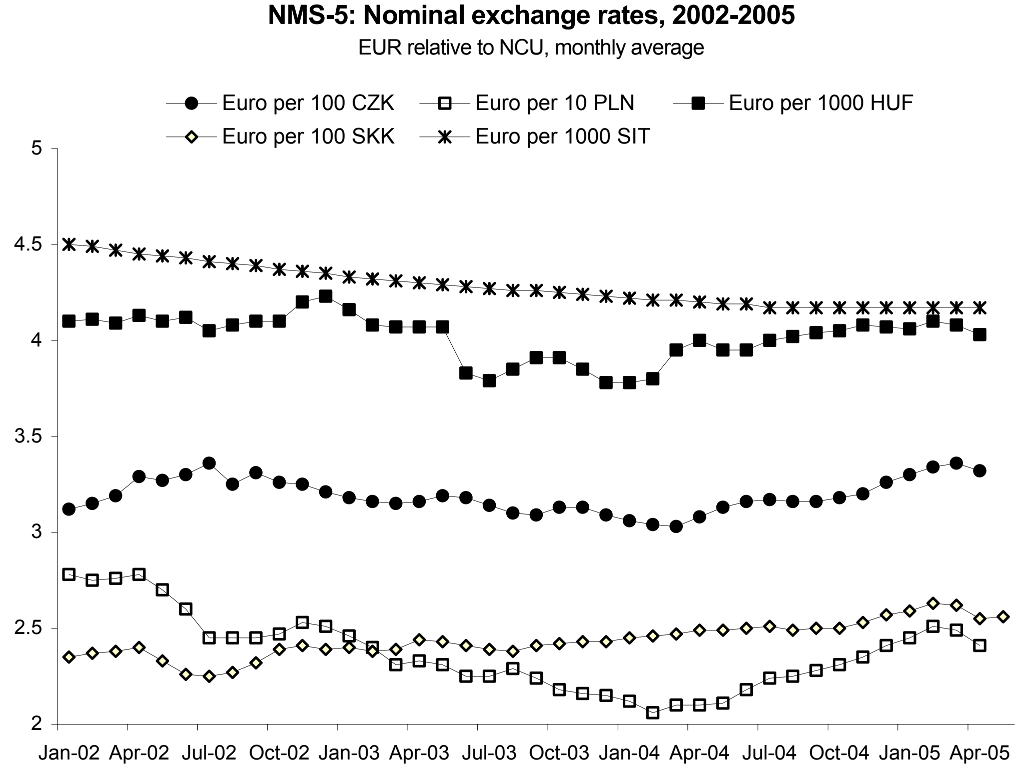
nominal NB leading rate in % p.a.



Source: wiiw Monthly Database incorporating national statistics.

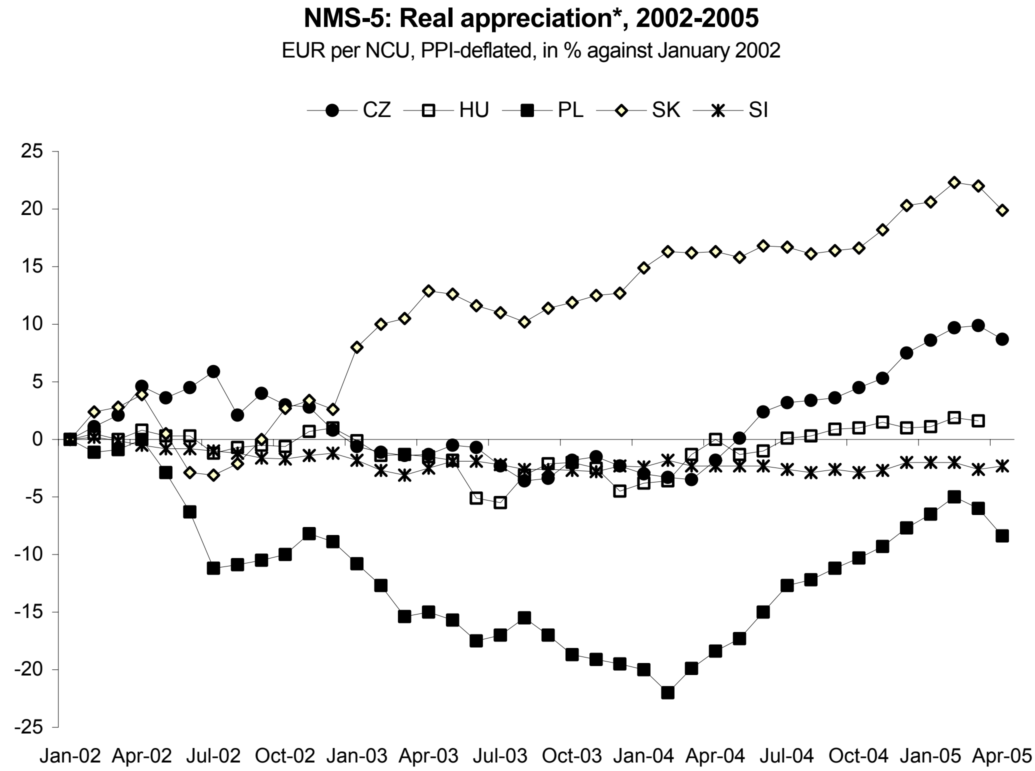
Experience teaches us that self-sustaining nominal appreciation may even persist for years (as happened in Poland in the early 2000s, and more recently again in the Czech Republic, Hungary and Slovakia). This is one of the reasons why so many economists in the NMS are in favour of adopting the euro. A certain degree of currency appreciation is plausible for the NMS in the medium and long term (given the price levels that are still low and the currency undervaluation that this implies). An 'orderly' appreciation, especially when backed up by 'strong' fundamentals, such as productivity growth and not too large a current account deficit, is a fairly normal phenomenon. However, avoiding excessive appreciation (and the subsequent loss of international competitiveness) remains one of the key challenges to exchange rate policy prior to joining the EMU.

Figure 6a



Source: wiiw Monthly Database incorporating national statistics.

Figure 6b



* Increasing line indicates real appreciation

Source: wiiw Monthly Database incorporating national statistics.

Table 12

Foreign financial position

EUR billion, end of period

	Gross external debt			Reserves of National Bank (excluding gold) [1]			Current account EUR billion				Current account in % of GDP			
	2002	2003	2004	2002	2003	2004	2003	2004	2005 forecast	2006 forecast	2003	2004	2005 forecast	2006 forecast
Czech Republic	25.7	27.6	33.3	22.6	21.3	20.9	-5.0	-4.5	-2.0	-2.2	-6.3	-5.2	-2.1	-2.1
Hungary	38.6	46.0	54.9	9.9	10.1	11.7	-6.4	-7.1	-7.0	-7.1	-8.8	-8.8	-8.1	-7.7
Poland	81.0	84.0	92.9	27.4	26.0	25.9	-4.1	-3.0	-3.0	-4.0	-2.2	-1.5	-1.3	-1.7
Slovak Republic	12.7	14.7	17.4	8.8	9.7	11.0	-0.2	-1.2	-1.8	-1.7	-0.8	-3.5	-4.7	-4.0
Slovenia	11.5	13.3	15.4	6.7	6.8	6.5	-0.1	-0.2	-0.2	-0.2	-0.4	-0.9	-0.6	-0.6
Estonia	4.5	5.7	7.5	1.0	1.1	1.3	-1.1	-1.1	-1.2	-1.2	-13.2	-12.6	-12.1	-11.2
Latvia	6.9	7.5	9.8	1.2	1.1	1.4	-0.8	-1.4	-1.2	-1.3	-8.2	-12.3	-10.5	-10.0
Lithuania	5.9	6.7	7.7	2.3	2.7	2.6	-1.1	-1.3	-1.5	-1.6	-6.9	-7.2	-7.8	-7.5

Note: 1) Forex reserves, SDR and reserve position with the IMF. Including gold for the Czech Republic, Slovakia. Figures for Hungary and Baltic States correspond to total reserves of the country.

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

Table 13

FDI inflow to NMS, EUR million

	1998	1999	2000	2001	2002	2003	2004	2005 forecast
Czech Republic	3317	5933	5404	6296	9012	1863	3596	3900
Hungary	2988	3106	2998	4391	3185	1909	3365	3200
Poland	5676	6824	10334	6372	4371	3660	4892	4500
Slovakia	629	402	2089	1768	4397	636	904	1800
Slovenia	194	99	149	412	1750	299	422	300
New Member States-5	*12805*	*16364*	*20974*	*19240*	*22716*	*8366*	*13178*	*13700*
Estonia	511	284	425	603	307	797	742	800
Latvia	317	325	447	147	269	267	522	600
Lithuania	824	457	412	499	772	160	623	600
New Member States-8	*14457*	*17430*	*22258*	*20488*	*24063*	*9590*	*15065*	*15700*

Remarks: Czech Republic: equity capital + reinvested earnings from 1998 + loans from 1998.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1991.
Slovak Republic: equity capital + reinvested earnings from 1995 + loans from 1995.
Slovenia: equity capital + reinvested earnings from 1994 + loans from 2001.
Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings from 1996 + loans from 1996.
Lithuania: equity capital + reinvested earnings from 1995 + loans from 1997.

Source: Respective National banks according to balance of payments statistics.

The risks and potential costs associated with sudden outflows of portfolio investment with ensuing devaluation do not yet loom large in most NMS. In Hungary, where persistent current account deficits are very large (and unlikely to be fully offset by the FDI inflows: see Table 13) and where foreign debt is high, the potential risks seem larger than elsewhere in the region (see Tables 12 and 13). None the less, even in countries that have managed to reduce their current account deficits, the persistent nominal appreciation can hardly be good for foreign trade – and hence for sustainable growth. Arguably, the relatively low speed of (real) appreciation in 2004 (in Hungary) and the relatively low level of real exchange rates (in Poland and the Czech Republic) were conducive to the respectable trade performance in 2004 (e.g. lower trade deficits). No doubt, the impressive gains in both labour productivity and unit labour costs recorded in recent years constitute a buffer which will absorb the effects of real appreciation, at least for the time being. Nevertheless, the pace of real appreciation in Slovakia, Poland and Hungary may offer reason for concern (see Figure 6b). Unlike the Czech Republic, these countries have yet to demonstrate their ability to generate trade surpluses.

The first quarter of 2005 has not changed much as far as the prospects of the NMS being admitted into the Economic and Monetary Union (EMU) are concerned. The three Baltic countries and Slovenia are currently party to the Exchange Rate Mechanism (ERM-2), with a view to adopting the euro in late 2006 or early 2007 (if things go right). So far their membership in ERM-2 has not incurred any instability; this may be put down to certain features particular to those countries (viz. low levels of public debt or relative smallness of their economies and exchange rate markets). At present, the larger NMS with high budget deficits do not seem to be excessively obsessed with the prospects of early entry into the ERM-2 mechanism (because they still have to consolidate their public finances as well).

Outlook: some deceleration of growth in 2005, acceleration in future still uncertain

For various (in part country-specific) reasons, growth in gross fixed investment will be quite anaemic in most NMS in 2005. Industrial production will also expand at a much slower pace than in recent years. Generally, no positive impulses are to be expected from fiscal policy, while the positive impact of more relaxed monetary policies (which are likely as inflation is low and on the retreat everywhere) will be of secondary importance. Recurrent weakness of the EU economy is likely to be associated with some deceleration in overall growth in the NMS. Foreign trade, which contributed positively to GDP growth in the major NMS during 2004 and in the first quarter of 2005, will continue to boost growth. However, its contribution to growth may well lessen – especially if the NMS currencies continue to appreciate rapidly in real terms. A certain slowdown in the pace of industrial labour rising productivity and unit labour costs that was to be observed recently may also play a negative role as far as foreign trade (and overall growth) is (are) concerned. In the ultimate analysis, the NMS will continue to grow some 2 percentage points faster than the 'old' EU in both 2005 and 2006.

The longer-term evolution of the external environment is notoriously difficult to predict. In any event, experience shows that forecasts of even modest growth in the EU (particularly in Germany and, more broadly, in the euro-zone) tend to be unduly optimistic. More realistically, growth in the euro-zone is unlikely to speed up in 2006. If anything, it may be even weaker than in 2005. As the likely new (conservative/liberal) German government sets about trying to dismantle much of the remaining elements of the German economic model (*soziale Marktwirtschaft*), domestic demand in Germany will have no reason to recover in the short or even medium term. Moreover, the rise in German net exports will dampen growth among its economic partners. Under such conditions (amplified by high world market oil prices), notwithstanding its being twice as fast as in the euro-zone, growth in the NMS will most probably not be much higher than in 2005.

The highlights of the country-specific forecasts are presented below. More detailed analyses of individual NMS in Central Europe follow this overview.

The Czech Republic

Very low inflation and interest rates have failed to check a certain degree of nominal appreciation. This has been associated with major expansion of foreign trade. Rising net exports are the main force behind the GDP growth a more than 4% per year.

Hungary

As growth decelerated in early 2005, the trade deficit decreased and inflation bottomed out. Fundamental fiscal reforms will not be launched before the general election in spring 2006. In the meantime government-initiated investment programmes will call for higher spending. Despite this, growth in 2005 and 2006 will be lower than in 2004.

Poland

Weak growth in domestic demand, with fixed investments rising only 1%, resulted in very low GDP growth in the first quarter of 2005. High profits in the corporate sector and falling interest rates have not had the expected impact on capital formation. Despite relatively pronounced real appreciation, foreign trade has performed quite well so far, bolstering overall growth. Unless the propensity to invest improves, growth will be unimpressive in the near future, regardless who wins the autumn election.

Slovenia

After the unexpectedly strong GDP growth in 2004, Slovenia started out in 2005 at a slower pace. Growth was driven by rising consumption and foreign trade while fixed investment contracted. GDP growth exceed reach 3% in both 2005 and 2006. Disinflation will continue, with CPI already below 3% this year. Public finances are under control and the country will adopt euro in late 2006.

Slovakia

Falling inflation and rebounding wages will contribute to a steady consumption-led GDP growth. This will be matched by capital inflows, appreciating currency and somewhat declining unemployment. With high levels of export-oriented foreign direct investment, the current account deficits should not cause any major problems.

Table II **Central and East European new EU member states (NMS-8): an overview of economic fundamentals, 2004**

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovak Republic	Slovenia	*NMS-8* [1)]	*EU-15*	*EU-25* [2)]
GDP in EUR at exchange rates, EUR bn	86.20	8.89	80.81	10.97	17.93	195.27	33.10	25.92	*459.08*	*9793.85*	*10269.67*
GDP in EUR at PPP, EUR bn	159.71	15.11	137.67	22.35	36.75	399.91	62.68	34.78	*868.97*	*9383.48*	*10269.67*
GDP in EUR at PPP, EU-25=100	1.6	0.1	1.3	0.2	0.4	3.9	0.6	0.3	*8.5*	*91.4*	*100.0*
GDP in EUR at PPP, per capita	15650	11200	13620	9660	10700	10470	11650	17420	*11908*	*24369*	*22371*
GDP in EUR at PPP per capita, EU-25=100	70	50	61	43	48	47	52	78	*53*	*109*	*100*
GDP at constant prices, 1990=100	114.9	115.9	124.5	86.4	94.6	141.9 [3)]	123.9	136.2	*132.2*	*131.6*	*132.0*
GDP at constant prices, 2000=100	112.2	127.4	115.3	134.1	132.9	112.0	119.7	113.8	*114.7*	*106.1*	*106.8*
Industrial production real, 1990=100	109.5	91.8	185.8	62.8	56.4	159.4 [3)]	117.3	100.4	*151.3*	*120.2*	*122.6*
Industrial production real, 2000=100	129.8	140.6	122.8	133.6	153.8	123.0	126.0	112.0	*125.6*	*101.2*	*103.3*
Population - thousands, average	10206.9	1349.3	10096.0	2312.8	3435.7	38183.0	5382.2	1997.0	*72962.9*	*385059.0*	*458983.0*
Employed persons - LFS, thousands, average	4706.6	595.5	3900.4	1018.0	1436.3	13794.8	2170.4	943.0	*28565.0*	*170469* [4)]	*198661* [4)]
Unemployment rate - LFS, in %	8.3	9.7	6.1	10.4	11.4	19.0	18.1	6.3	*14.4*	*8.0* [4)]	*9.0* [4)]
Public sector expenditures, EU-def., in % of GDP	45.7	39.1	52.0	35.8	34.2	48.7	38.5	47.7	*46.8*	*48.0*	*47.8*
Public sector revenues, EU-def., in % of GDP	42.7	40.9	47.5	35.2	31.8	43.8	35.1	45.8	*43.0*	*45.4*	*45.3*
Price level, EU-25=100 (PPP/exch. rate)	54	59	59	49	49	49	53	75	*53*	*104*	*100*
Compensation per employee,[5)] monthly, in EUR	813	631	938	427	511	645	594	1515	*723*	*2930*	*2628*
Compensation per employee, monthly, EU-25=100	30.9	24.0	35.7	16.2	19.4	24.5	22.6	57.6	*27.5*	*111.5*	*100.0*
Exports of goods in % of GDP	62.3	53.9	55.1	30.7	41.6	33.6	67.5	49.1	*46.7* [6)]	*27.9* [6)]	*28.7* [6)]
Imports of goods in % of GDP	63.1	71.7	58.0	50.9	-52.0	35.9	71.1	52.4	*50.1* [6)]	*27.0* [6)]	*28.1* [6)]
Exports of services in % of GDP	9.0	25.7	10.1	13.1	11.2	5.5	9.1	10.8	*8.3* [6)]	*8.1* [6)]	*8.1* [6)]
Imports of services in % of GDP	8.6	15.4	10.1	8.6	-7.0	5.1	8.4	8.2	*7.4* [6)]	*7.5* [6)]	*7.6* [6)]
Current account in % of GDP	-5.2	-12.6	-8.8	-12.3	-7.2	-1.5	-3.5	-0.9	*-4.3* [6)]	*0.4* [6)]	*0.2* [6)]
FDI stock per capita in EUR	4052	5187	4381	1430	1369	1310	2043	2757	*2291*	.	.

Notes: NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. EU-15: EU up to 30 April 2004. EU-25: EU as of 1 May 2004. PPP: Purchasing power parity. - 1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) LFS adjusted time series (Eurostat). - 5) Gross wages plus indirect labour costs, whole economy, national account concept. - 6) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Sándor Richter

The future of the EU budget and the new members

The failure of the June European Council to arrive at an agreement on the next financial perspective for the years 2007-2013 is a serious blow to the case of European integration – particularly against the background of the victory of the opponents to the Constitution in the referenda in France and the Netherlands. Nevertheless, the negative symbolic meaning of that failure is bigger than the practical damage it has caused. A similar delay in finding a consensus on the multi-annual EU budget occurred in the case of the current financial perspective (2000-2006), which was adopted as late as May 1999. Thus, two six-month periods are left to seek a compromise, under the British Presidency in the second half of 2005 and the Austrian Presidency in the first half of 2006.

At the summit on 16/17 June, the new EU member states (NMS) were apparently participants of secondary importance. All attention focused on the major net-payer member states in their struggle to get away with the smallest possible loss in terms of their net financial position in 2007-2013. The NMS came to the limelight only in the very last round of the bargaining with their desperate declaration to renounce part of the transfers envisaged for them.[3] Otherwise the new member states have in fact been in the background of the struggle about the next multi-annual EU budget. What has become obvious is that the enlargement has made the inconsistent construction of the EU budget untenable.[4] This is the core of the problem, although the net-payer member states' attitude towards the EU budget must also be seen in the context of the sluggish growth performance in the euro-zone and, due to the requirements of the Stability and Growth Pact, in that of excessive fiscal deficits in some of these countries, first of all in Germany.

In one respect, the new member states may wait for things to come more or less calmly: none of the member states in the frontline of the discussions questioned the justification and the magnitude of expenditures for structural policy, earmarked for supporting the catching-up process in less developed member states. There was also a consensus that these expenditures should be focused on the most needy new members – implying that, with the exception of Slovenia and Cyprus, and perhaps the Czech Republic, none of the new members will have to reckon with substantial cuts of funds earmarked for them in the original proposal of the European Commission.

Nevertheless, the new members cannot be indifferent to the discussion on issues of the future budget. The UK rebate, i.e. the reimbursement of 66% of the UK's net contributions to the EU (in other words: two thirds of the UK's deficit vis-à-vis the EU budget are reimbursed), has been financed annually by all member states, since 2004 including the new member states as well. The wider public was not aware of that fact until the recent fierce discussions on the topic, and it would be difficult to sell the idea of maintaining the present way of financing the UK rebate (even if the latter were reduced) to the now better informed domestic audience in the less wealthy new member states.

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3 The proposal was put forward by the Czech Republic, Hungary, Latvia, Lithuania, Poland and Slovakia.

4 See more on this in S. Richter, 'Scenarios for the Financial Redistribution across Member States in the European Union in 2007-2013', *wiiw Research Reports*, No. 317, April 2005.

Concerning the future of agricultural expenditures, the interests of the new members are diverging. This year, according to a wiiw estimation, direct payments to farmers in the NMS[5] will make up, on average, 0.25% of their GDP. This average of course conceals the differences by country. In the 'more agricultural' NMS Lithuania, Hungary and Poland, direct payments may amount to 0.37, 0.31 and 0.28% of GDP, respectively, while in 'less agricultural' Slovenia only 0.05%. Slovakia, Estonia, Latvia and the Czech Republic are between the two extremes, with 0.23, 0.2, 0.18 and 0.18%, respectively.[6] Certainly the relative importance of EU agricultural subsidies has an important influence on the respective new member state's position on the future of agricultural expenditures from the EU budget. Slovenia has already earlier declared that it could approve a smaller, '1%' EU budget as proposed by the six net payers, if the necessary cuts are not confined to cohesion and competitiveness expenditures, that is, if the issue of agricultural subsidies is re-opened for discussion.[7] Among the new members, only Hungary and Poland are most likely to take a position closer to that of France, the main beneficiary of the prevailing CAP system.

The Commission's original proposal recommended some important changes in the structure of expenditures as compared to the current financial perspective. From the Heading 'Internal policies' and from other minor positions of the current financial perspective, a new expenditure category (sub-heading) was created, 'Competitiveness for growth and employment' (for short 'Competitiveness'), under Heading 1 Sustainable growth. This would have been the host for programmes fostering the Lisbon Agenda. About half of this fund would have financed research and development, the rest trans-European transport, energy and telecommunications networks, education and training, internal market and social policy, etc. This spending category was proposed to be increased gradually from 7.3% of total expenditures in 2006 (the last year of the current financial perspective) to 16.3% by 2013, more than doubling its relative weight in total expenditures. The programmes receiving EU budgetary contributions under the sub-heading 'Competitiveness' would have been subject to free competition, with 'excellence' as the main or sole criterion for selection. Implicitly that would have meant that no 'country envelopes' for the allocation would have been created, leaving a wide space for different drawing rates for individual member states in this expenditure category. With 'excellence' as the criterion for selection and R&D the focus of the expenditure category, the presumption seems justified that the main beneficiaries would have been the highly developed (and therefore net-payer) member states.

It is remarkable that exactly this expenditure sub-heading fell victim to the desperate attempts of the Luxembourg Presidency to come as close as possible to the 1% ceiling for expenditures required by the major net payer countries. The Luxembourg proposal for a 1.06% expenditure ceiling corresponds to a 15% drop in total expenditures (in absolute terms more than EUR 150 billion), but cuts in competitiveness would have been much bigger, nearly 40%. This outcome is self-evident, considering that cohesion expenditures were to remain as high as possible under the changed conditions and direct payments and market intervention within agricultural expenditures were exempted from cuts as agreed at the October 2002 European Council. However, this could have proved to be scoring an own goal. Through losing potential transfers from the competitiveness

[5] Except for Cyprus and Malta.

[6] Z. Lukas and J. Pöschl, 'Bedrohung für Österreichs Landwirtschaft? Szenarien zur Entwicklung der MOE-Landwirtschaft im europäischen und internationalen Verbund', study commissioned by the Austrian Ministry of Agriculture, The Vienna Institute for International Economic Studies (wiiw), 2003, p. 99.

[7] For more on Sloveniaa's position see Richter (2005), op. cit., p. 94.

chapter, the highly developed member states' net financial position would have improved to a smaller extent (if at all) as hoped for, despite the smaller overall budget.

Table 14

Rate of reduction by Headings of the 2007-2013 EU financial perspective as proposed by the Luxembourg Presidency compared to the European Commission's original proposal

1a Competitiveness	39 %
1b Cohesion	9 %
2 Preservation and management of natural resources	6 %
3 Citizenship, freedom, security & justice	43 %
4 External policies: The EU as a global partner	43 %
5 Administration	11 %
TOTAL	15 %

Source: Own calculation based on *Figyelö* (Budapest), 9-15 June 2005, referring to the European Commission as source of information.

With the failure of the June summit the search for consensus will have to be continued. The time horizon for that is approximately one year. By the end of June 2006 a solution for the budget must be found in order to avoid serious delay in launching the programmes of the next financial perspective. It is an open question whether the solution will be a reconciliation of the British and the French positions, with an interlinked compromise for the UK rebate and agricultural spending, or whether more innovative and courageous solutions will be put forward. It is worth noting that the earlier proposal of the Commission for a general correction mechanism, which would have remedied excessive net financial positions in the case of any member state whose deficit surpassed a pre-fixed threshold (e.g. 0.35% of the member state's GDP), has not even been mentioned as a way out of the stalemate at the summit. That or a similar proposal may be recommended again, with the obvious advantage that it would depart from the present case-to-case intervention (UK rebate, rebate on financing the UK rebate for Austria, Germany, the Netherlands and Sweden) and implement a systemic approach to the problem of excessive financial positions. It will be more difficult to find a solution to the problem of direct payments in agriculture, at least for the next financial perspective. A detailed phasing-out programme and/or partial re-nationalization starting from 2014 may be the most appropriate approach in this question. While there are serious vested interests here – not only in the case of France, but also as concerns Spain and some of the new member states – it will be difficult to argue for maintaining these expenditures after 2013 to the detriment of programmes that foster the catching-up process of less developed member states or implement the Lisbon Agenda.

The time that has passed since 1 May 2004 is too short to obtain reliable evidence on the new members' record of absorption. Probably not earlier than the end of 2005 will an initial assessment be available. With the failure of the June summit the discussion on the 2007-2013 financial perspective will carry on, possibly even up to June 2006. This means that the first evaluation of the new members' absorption capacity may still play an important role in the discussions on the future budget. Information on the experiences with absorption may prove to be a double-edged weapon from the new member states' point of view. If the experience is overwhelmingly positive or at least acceptable in most of these countries, no additional element will enter the discussion. However, should it transpire that all or most of the new members have encountered serious difficulties in drawing available resources from the EU budget and are thus far behind their own projections for absorption, the discussion on the new financial perspective might take a decisive turn for the worse, from the new member states' point of view. Those calling for a smaller budget and/or less spending on cohesion would receive important arguments for the discussion.

Country reports

Josef Pöschl

Czech Republic joins the trade-surplus country club

Joining the EU on 1 May 2004 did not upset the Czech economy. Real GDP growth, year-on-year, rose to 4.4% in the first quarter of 2005, thanks mostly to greater gross fixed investment and favourable foreign trade results.

EU accession stimulated trade expansion. As CZK figures at current prices indicate, both export and import growth rates experienced an upswing during the accession period. Year-on-year, export growth rose from 13% in the first quarter of 2004 up to 33% in the second quarter, while export growth leapt from 11% to 31% over the same period. Later on, this growth gradually decelerated; by the first quarter of 2005, it had dropped back to pre-accession levels. Exports, however, have grown faster than imports throughout; in the first quarter of 2005, the Czech Republic achieved an overall trade surplus amounting to EUR 500 million. April 2005 likewise ended with a trade surplus and the same held true for the period May 2004 to April 2005 as a whole. This improvement occurred despite accelerated GDP growth (which generally tends to boost import growth) and regardless of the 9% appreciation of the Czech koruna from Q1 2004 to Q1 2005 (3.04 against 3.33 EUR per 100 CZK). Machinery and transport equipment have generated these high and ever-increasing surpluses. This trend is likely to strengthen with the new Toyota-Peugeot-Citroen plant in Kolín having started production earlier this year. It will be bringing out three versions of a small passenger car. Were it not for the acquisition of military equipment from abroad adding to import growth, the results would have been even better. In the longer term, the Czech Republic stands good chances of firming up its position as a trade-surplus country.

Contrary to trade in goods, the trade surplus in services is shrinking. In March 2005, the country recorded a major deficit for the first time. The balance of incomes, which has always been negative, has also taken a turn for the worse. Nevertheless, in February and April 2005, the current account yielded a slightly positive result. The Czech government sold its shares in Czech Telecom to Spain's Telefónica for almost EUR 3 billion; hence, the inflow of foreign direct investment in 2005 will be quite significant.

Overall the ever-improving trade balance, coupled with its positive impact on the current account and the high inflow of foreign direct investment, tends to build up pressure in favour of currency appreciation. In keeping with its managed floating regime, the Czech National Bank (CNB) has endeavoured to keep appreciation at a modest level so as to prevent any stress in terms of the Czech enterprises' competitiveness. The CNB adheres to interest rates that rank among the lowest in Europe; it also cooperates closely with the government in order to avoid accretion of appreciation pressure due to the marked inflow of FDI.

The characteristic feature of the country's economic climate is low inflation. In terms of both inflation and interest rates, the Czech Republic has already met the Maastricht criteria. The same also applies to government debt, which was close to 39% of GDP in 2004; however, it does not apply to the government deficit. The latter fell to 3% in 2004, but a figure of 4.7% has been projected for 2005. Only after the parliamentary elections scheduled for June 2006 will a more restrictive budgetary policy come into effect. The early introduction of the euro is not on the Czech political agenda; the Czech authorities recently mentioned 2010 as the target year.

In 2004 a number of large financial and non-financial corporations registered excellent results. Czech agriculture would also appear to have benefited from EU accession; it accrued profits of the order of EUR 300 million in sharp contrast to the losses it suffered throughout most of the transition and post-transition period. This has come about as a result of larger support payments (up from EUR 700 million in 2003 to 930 million in 2004) and higher farm-gate prices.

Data for the first months of the current year suggest that the initial accession party is coming to a close. Not only has foreign trade expansion quietened down, but industrial output growth has also slowed up to year-on-year 4.4% in the first quarter of 2005. High growth in manufacture of machinery and transport equipment stands in contrast to a decline in leather, non-metallic mineral products and wood processing. Whereas the production of intermediate goods rose, that of capital goods stagnated and consumer durables declined.

A long-lasting coalition crisis culminated in the prime minister being replaced; that, however, did but little harm to the economy. As for the parliamentary elections due in mid-2006, one factor in the government’s favour will the best macroeconomic data for a decade; this, however, is no guarantee that it will regain popularity. At the beginning of June, the Deputy Prime Minister, Martin Jahn, presented a strategy for promoting long-term growth promotion. This forward-looking stance could heighten the government’s popularity; at the same time, however, it might also disappoint voters left of centre. The same holds true for the discussion on pension reform, which has gained momentum over the past few months. For the time being, the mandatory pay-as-you-go system, which is complemented by a voluntary fully funded second pillar, is not in bad shape. However, a very low birth rate and increasing life expectancy make for an ageing population; this fuels the popular misconception that a fund-based system could lessen the burden on the working-age population in the future. However important they may be, reform discussions such as these that give rise to fears about cutbacks in social security can have a negative impact on private consumption growth – and thus on overall GDP growth as well. As the experience of other countries in Central and Eastern Europe has shown, transforming the pension system will be a costly undertaking for the government in budgetary terms.

In 2005 – and probably in 2006 as well – economic growth should not differ much from 2004; it should remain within the range of 4-5%. Inflation will drop back to around 2% and the CNB will keep interest rates low: something that should help to limit the currency appreciating against the euro. The government deficit was exceptionally low in 2004; it will probably increase in 2005. The current account deficit will lessen on account of continued strong export performance.

Table CZ

Czech Republic: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year [2]	10272.5	10224.2	10200.8	10201.7	10206.9	10205.3	.	.	.
Gross domestic product, CZK bn, nom. [3]	2150.1	2315.3	2414.7	2555.8	2750.3	644.7	682.1	2920	3110
annual change in % (real) [3]	3.9	2.6	1.5	3.2	4.4	4.1	4.4	4.3	4.3
GDP/capita (EUR at exchange rate)	5878	6644	7683	7867	8446	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	12760	13470	14260	14660	15650	.	.	.	.
Gross industrial production									
annual change in % (real)	5.4	6.5	4.8	5.8	9.9	9.0	4.0	6	6
Construction industry									
annual change in % (real)	5.3	9.6	2.5	8.9	9.7	16.1	-3.1	.	.
Consumption of households, CZK bn, nom. [3]	1108.8	1179.4	1220.6	1300.5	1362.5	317.8	325.8	.	.
annual change in % (real) [3]	2.9	2.8	2.7	4.6	2.0	2.8	1.3	3.0	3.3
Gross fixed capital form., CZK bn, nom. [3]	594.9	638.6	643.3	685.6	749.9	169.3	179.9	.	.
annual change in % (real) [3]	4.9	5.4	3.4	4.7	7.6	7.9	5.5	6	5
LFS - employed persons, th, avg. [4]	4731.6	4750.2	4764.9	4733.2	4706.7	4675.9	4704.4	.	.
annual change in %	-0.7	0.4	0.3	-0.7	-0.6	-1.4	0.6	.	.
LFS - employed pers. in industry, th, avg. [4]	1429.4	1470.6	1463.1	1424.7	1409.0	1398.8	1400.9	.	.
annual change in %	-2.7	2.9	-0.1	-2.6	-1.1	-1.9	0.2	.	.
LFS - unemployed, th pers., average	454.5	421.0	374.1	399.1	425.9	443.8	429.3	.	.
LFS - unemployment rate in %, average [4]	8.8	8.1	7.3	7.8	8.3	8.7	8.4	8.7	9
Reg. unemployment rate in %, end of period	8.8	8.9	9.8	10.3	9.5	10.7	9.4	9.8	10
Average gross monthly wages, CZK [5]	13614	14793	15866	16920	18035	16708	17678	.	.
annual change in % (real, gross)	2.4	3.8	5.4	6.5	3.7	6.3	4.1	.	.
Consumer prices, % p.a.	3.9	4.7	1.8	0.1	2.8	2.3	1.7	1.8	2.2
Producer prices in industry, % p.a.	4.9	2.8	-0.5	-0.3	5.7	1.8	6.9	4	2.5
General governm. budget, EU-def., % GDP [6]									
Revenues	38.5	39.1	40.2	41.6	42.7	.	.	.	.
Expenditures	42.1	45.0	46.8	53.2	45.7	.	.	.	.
Deficit (-) / surplus (+)	-3.7	-5.9	-6.7	-11.6	-3.0	.	.	-4.2	-3.5
Public debt, EU-def., in % of GDP [6]	18.2	27.2	30.7	38.3	37.4	.	.	38.0	40.0
Discount rate, % p.a., end of period	5.0	3.8	1.8	1.0	1.5	1.0	1.3	.	.
Current account, EUR mn	-2945	-3652	-4426	-5044	-4490	-418	485	-2000	-2200
Current account in % of GDP	-4.9	-5.4	-5.6	-6.3	-5.2	-2.1	2.1	-2.1	-2.1
Gross reserves of NB incl. gold, EUR mn	14159	16400	22614	21340	20884	22076	21246	.	.
Gross external debt, EUR mn	23285	25368	25738	27624	33258	26543	34286	.	.
FDI inflow, EUR mn	5404	6296	9012	1863	3596	890	982	.	.
FDI outflow, EUR mn	47	185	219	183	440	36	29	.	.
Exports of goods, BOP, EUR mn	31483	37251	40711	43051	53714	11461	14624	64000	74000
annual growth rate in %	27.8	18.3	9.3	5.7	24.8	8.8	27.6	19	16
Imports of goods, BOP, EUR mn	34876	40675	43026	45243	54414	11423	13979	63000	71700
annual growth rate in %	32.0	16.6	5.8	5.2	20.3	7.0	22.4	16	14
Exports of services, BOP, EUR mn	7436	7913	7501	6882	7787	1608	1909	8600	10200
annual growth rate in %	12.5	6.4	-5.2	-8.3	13.2	601	18.7	10	19
Imports of services, BOP, EUR mn	5904	6211	6792	6466	7396	1553	1853	8400	10000
annual growth rate in %	7.6	5.2	9.4	-4.8	14.4	9.6	19.3	14	19
Average exchange rate CZK/USD	38.59	38.04	32.74	28.23	25.70	26.28	22.90	.	.
Average exchange rate CZK/EUR (ECU)	35.61	34.08	30.81	31.84	31.90	32.85	30.02	30.0	29
Purchasing power parity CZK/USD	14.36	14.60	14.27	14.40	14.54	.	.	.	.
Purchasing power parity CZK/EUR	16.40	16.81	16.60	17.09	17.22	.	.	.	.

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

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

Sándor Richter

Hungary: switching to lower gear

Economic growth in Hungary decelerated in the first quarter of the year, from 4.5% in the respective period of 2004 to 2.9%, reflecting the trend in the European Union. The trade deficit has become smaller, and inflation has bottomed out after the hike related to the country's entry into the EU. Although the persisting budget deficit threatens to cause a delay in Hungary's accession to the euro-zone, the demand generated by government-initiated programmes and spending has been lending a boost to investments and thus prevented an even stronger deceleration of GDP growth.

Gross value added rose by 1.5% in the primary and secondary sectors combined; in services the expansion amounted to 3.6%. The former was substantially less, the latter somewhat more than the respective rate of expansion in the first quarter of 2004. The slowdown was particularly strong in industry. The growth rate of gross output fell from 10.4% in the first four months of 2004 to 3.6% in the respective period of 2005. Construction performed better; being the main beneficiary of state-initiated highway constructions, it recorded an expansion of more than 10% in the first quarter.

Investment increased by close to 7% in the first quarter, with construction investment expanding by over 12% due to the highway projects, while machinery investment was up by 2.7% only. An important development is the revival of investment in agriculture following the record (20%) gross output expansion in the sector last year.

Household consumption, rising by 2.2% in the first quarter, lagged 0.7 percentage points behind the GDP's expansion. This may be surprising in the wake of the 9.7% real wage growth in the first quarter. The reason is the postponement, to January 2005, of the paying and accounting of the 13th month salary of 2004 for public servants, which has resulted in a distortion of real wage data in both years. Real wages in March, cleared of those distorting effects, were 4.4% higher than in the respective month of 2004. Household consumption expanded at a slower pace, to some extent attributable to households' increasing savings/income ratio.

In the first quarter of the year employment in the business sector increased by 0.6%, while in the public sector it decreased by 1.4%. In sum the number of employed persons declined marginally while unemployment rose by one percentage point to 7.1%. Several factors account for that increase: the impact of the shift from a conscription army to a professional one, the higher pension entry age according to the reformed pension system, and the increasing number of university graduates with skills not in demand on the labour market.

According to foreign trade statistics, in the first four months of the year the expansion of exports was twice as large as that of imports (12% and 6%, respectively). The gap between export and import growth rates was particularly wide in April, reflecting the high basis in the case of imports due to last hasty import purchases in 2004 immediately prior to Hungary's accession to the EU on 1 May. The balance of payments data of the first quarter of 2005 show that the deficit in trade of goods halved as compared to the respective period of the previous year. However, due to a deterioration of the balance in services trade and income and in current transfers, the current account deficit was 14% higher than in the first quarter of 2004. Though Hungary's external financing requirement (combined current and capital account deficit) deteriorated only marginally as against the first quarter of 2004, non-debt creating financing covered only 16% of it, a coverage substantially less than a year earlier.

Table HU

Hungary: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period	10200.3	10174.9	10142.4	10116.7	10096.0	10110	10093	10065	10040
Gross domestic product, HUF bn, nom.	13150.8	14849.8	16740.4	18408.8	20338.2	4686	4865.1	21800	23300
annual change in % (real)	5.2	3.8	3.5	2.9	4.2	4.5	2.9	3.4	3.7
GDP/capita (EUR at exchange rate)	4953	5679	6782	7169	7996	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	10510	11500	12350	12770	13620	.	.	.	.
Gross industrial production									
annual change in % (real)	18.1	3.6	2.8	6.4	8.3	10.4	1.7	5	7
Construction industry									
annual change in % (real)	7.9	7.7	17.5	2.2	6.8	15.5	11.7	.	.
Consumption of households, HUF bn, nom.	6689.2	7671.3	8756.3	9855.8	10925.5	2573.3	2716.5	.	.
annual change in % (real)	4.4	5.8	10.4	7.8	3.1	2.0	2.0	2.8	3.2
Gross fixed capital form., HUF bn, nom.	3179.8	3493.0	3916.9	4141.3	4598.9	731.4	792.8	.	.
annual change in % (real)	7.7	5.9	9.3	2.5	7.9	18.4	6.8	7	12
LFS - employed persons, th, avg.	3856.2	3868.3	3870.6	3921.9	3900.4	3891.5	3870.6	.	.
annual change in % [2]	1.2	0.3	0.1	1.3	-0.5	0.8	-0.5	.	.
Reg. employees in industry, th pers., avg. [2]	844.8	833.9	817.9	801.8	785.2	789.2	771.9	.	.
annual change in %	1.3	-1.3	-1.9	-2.0	-2.1	-2.2	-2.2	.	.
LFS - unemployed, th pers., average	263.7	234.1	238.8	244.5	252.9	252.2	297.4	.	.
LFS - unemployment rate in %, average	6.4	5.7	5.8	5.9	6.1	6.1	7.1	6.6	6.5
Reg. unemployment rate in %, end of period	8.6	8.0	8.0	8.3	9.2	9.1	10.0	8.5	8.5
Average gross monthly wages, HUF [2)3)]	87645	103553	122482	137193	145675	140719	160028	.	.
annual change in % (real, net)	1.5	6.4	13.6	9.2	-1.1	1.1	9.7	.	.
Consumer prices, % p.a.	9.8	9.2	5.3	4.7	6.8	6.8	3.6	3.6	3.3
Producer prices in industry, % p.a.	11.6	5.2	-1.8	2.4	3.5	4.3	4.0	4	.
General governm.budget, EU-def., % GDP [4]	-2.3	-3.7	-8.5	-6.2	-4.5	.	.	.	.
Revenues	45.3	45.0	44.1	44.5	47.5	.	.	.	.
Expenditures	47.6	48.7	52.6	50.7	52.0	.	.	.	.
Deficit (-) / surplus (+) [5]	-2.3	-3.7	-8.5	-6.2	-4.5	.	.	-4.1	-3.9
Public debt, EU-def., in % of GDP [4)5)]	55.4	52.2	55.5	56.9	57.6	.	.	.	.
Refinancing rate, % p.a., end of period	11.0	9.8	8.5	12.5	9.5	12.3	7.8	7.0	6.5
Current account, EUR mn	-4352.4	-3576.5	-4929.2	-6363.9	-7123.2	-1307.9	-1496.6	-7000	-7100
Current account in % of GDP	-8.6	-6.2	-7.2	-8.8	-8.8	-7.3	-7.5	-8.1	-7.7
Reserves total, excl. gold, EUR mn	12038.4	12163.7	9887.4	10108.3	11670.9	10156.5	13222.7	.	.
Gross external debt, EUR mn	32571.5	37387.0	38559.3	46035.6	54927.5	47929.1	58426.3	.	.
FDI inflow, EUR mn	2998.4	4390.7	3185.1	1909.0	3364.6	661.4	1091.1	.	.
FDI outflow, EUR mn	664.4	398.5	295.7	1465.6	424.2	252.2	376.7	.	.
Exports of goods, BOP, EUR mn	31277.5	34697.1	36820.7	38376.9	44515.8	10277.2	11425.4	49000	55400
annual growth rate in %	30.0	10.9	6.1	4.2	16.0	14.3	11.2	10	13
Imports of goods, BOP, EUR mn	34457.1	37192.8	39024.1	41274.5	46906.6	10679.4	11614.0	50700	56300
annual growth rate in %	32.0	7.9	4.9	5.8	13.6	11.3	8.8	8	11
Exports of services, BOP, EUR mn	6429.2	7864.7	7820.0	7665.6	8132.1	1874.2	2035.4	.	.
annual growth rate in %	30.9	22.3	-0.6	-2.0	6.1	16.7	8.6	.	.
Imports of services, BOP, EUR mn	5194.8	6203.3	7233.1	8043.1	8141.7	1851.9	2057.8	.	.
annual growth rate in %	26.9	19.4	16.6	11.2	1.2	-1.0	11.1	.	.
Average exchange rate HUF/USD	282.27	286.54	258.00	224.44	202.63	208.09	186.98	.	.
Average exchange rate HUF/EUR (ECU)	260.04	256.68	242.97	253.51	251.68	260.31	245.10	252	253
Purchasing power parity HUF/USD	107.34	110.10	114.72	120.50	125.22	.	.	.	.
Purchasing power parity HUF/EUR	122.57	126.74	133.44	142.34	147.73	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with more than 5 employees. - 3) The high growth in the first quarter 2005 results from the one month extra salary paid out in January instead of December. - 4) According to ESA'95, excessive deficit procedure. - 5) After corrections related to the pension reform.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

The budget deficit has remained the most critical issue. Due to various accounting manoeuvres of the government it is very difficult to get a clear picture about developments in this field. Last year's 13th month wages for public servants were paid in January 2005, disbursements of the value added tax rebate due in 2004 were partly brought forward to this year. Further tricks related to the off-budgetary financing of the highway construction projects will make the picture even more blurred. Although the development so far makes it likely that the fiscal deficit will come close to the envisaged year-end level already in early summer, the Ministry of Finance reckons with an improvement in the second half of the year and has not been ready as yet to revise its 3.6% (relative to GDP) deficit target. However, without intervention the deficit will most probably surpass 4% of the GDP by the end of the year. With regard to the approaching elections (spring 2006) it is not likely that radical expenditure cuts will be risked in the near future. Considering the discouraging record of election-related deficit spending cycles in Hungary, even the resistance to the temptation to buying votes with costly 'election sweeteners' will have to be appreciated. As a prologue to the election campaign, prime minister Gyurcsány announced a new government project labelled '100 steps'. The project initiates a series of small reform measures in health care, education, family allowance, labour market regulation, etc. Though these measures represent primarily a re-design of existing programmes within their pre-set financial framework, their overall impact on the fiscal balances is not yet clear.

Inflation (CPI) has been decreasing spectacularly (from 6.8% in January-May 2004 to 3.6% in the respective period of this year) as one-time effects related to EU accession are bottoming out. The monetary authorities continued with the cautious, stepwise reduction of the prime rate, which dropped to 7% by the end of June (from 11.5% a year earlier), leaving the real interest rate still remarkably high. Until mid-April the forint/euro rate was fairly close to the stronger edge of the intervention band, ranging between 241-248; since then it has turned somewhat weaker (248-255).

In 2005 economic growth will be less dynamic (about 3.3 to 3.5%) than it was last year, and for 2006 only a marginal acceleration can be expected. Inflation will remain low, the current account deficit to GDP ratio will improve moderately in both 2005 and 2006. In the coming several months the Hungarian political elite will be preoccupied with the preparations for the next elections. Although a longer-term consolidation of the budget – a precondition for accession to the euro-zone – requires fundamental reforms in sub-systems of the general government finances, these will not be launched before the inauguration of the new government. The latter, no matter of which political bent, will have to start its legislative period with unpopular measures or postpone the euro introduction beyond 2010.

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After the editorial deadline for this report, the government announced a five-year tax package as a first milestone in a far-reaching reform of the public sector. The package is meant to positively affect economic growth through expected supply-side effects in the corporate sector and higher demand generated in the household sector. The highlights of the programme are: reducing the highest VAT rate to 20% (from currently 25%) from January 2006, gradual elimination of the municipal tax on sales, lowering the personal income tax rate, reducing the social security contributions, lowering the corporate tax rate that benefits primarily small and medium-size companies and, finally, the introduction of a luxury tax on real estates with a value of over EUR 400,000 (annually 0.5% of the value). These steps and the increase and differentiation of the minimum wage by education will have a negative primary net effect on the revenues of the budget, equalling about 0.8% of the GDP in

2006 and in 2007 as well. The government claims that the envisaged – but in detail still unknown – cuts in the budget expenditures to the same magnitude will ensure that the convergence targets concerning the budget will be observed. As a side effect of the lowering of the upper VAT rate, CPI inflation may be substantially lower than envisaged by the monetary authorities (possibly below 2%).

Leon Podkaminer

Poland: a weak start into 2005

After two years (2001-2002) of stagnation Poland's GDP growth gradually accelerated in 2003, peaking at a 7% rate in the first quarter of 2004. The 2003 acceleration was propelled by fast rising consumption, net exports, and also inventories. Throughout 2004 consumption and net exports (but not the growing inventories) were losing importance as engines of GDP growth, which was slowing down. Fortunately, there was also a gradual recovery of gross fixed investment: its growth culminated with a rate of 7.4% in the fourth quarter of 2004. Although the overall GDP growth in the final quarter of 2004 fell to 4%, it was quite legitimate to expect fixed investment to maintain its momentum – and thus to support respectable GDP growth in 2005.

The actual (as reported by the Central Statistical Office) GDP growth rate in the first quarter of 2005 was an unimpressive 2.1%. Domestic demand rose only 1.2%, with consumption up by a modest 1.8%. Gross fixed investment increased by a surprisingly low 1% and – under the impact of inventories falling (after a two-years period of expansion) – the volume of gross capital formation declined rather massively, by 3.1%. The volume of both exports and imports of goods and non-factor services (in national accounts' terms) fell in the first quarter of 2005. However, as imports contracted more strongly than exports, the contribution of foreign trade to the overall GDP growth rate turned out to be positive and significant, amounting to 0.9 percentage points.

To some observers of the Polish economy the official statistical indicators for the first quarter of 2005 must be wrong. Gross fixed investment is quite generally believed to have been underestimated on account of inadequate coverage (or underreporting of actual investment outlays in small firms and in the household sector). Also, there are some doubts about the correctness of the price deflator for gross fixed investment. Some reservations on the accuracy of the official statistical reporting for the first quarter of 2005 may be justified. The output of both the construction and capital goods' manufacturing sectors rose quite strongly which may indeed indicate higher than reported growth of gross fixed investment. On the other hand the fact that imports have declined (in real terms) in the first quarter of 2005 would seem consistent with stagnant investments. Besides, the overall (low) GDP growth is wholly consistent with other facts: low growth in the overall gross value added (by 2.2%, of which in industry by 0.9%) and very low growth of industrial sales (0.7%).

The official GDP figures for the first quarter of 2005 would not have provoked openly expressed reservations about the quality of statistical reporting, had not the expectations concerning investments been so radically disappointed. (It is rather odd that no such reservations were voiced on other occasions – especially when growth reported turned out to be higher than expected.) The investment expectations, reflecting conventional wisdom about factors conducive to fast investment growth, were (and still are) quite high. Conventional wisdom has it that strong profits, rising productivity and falling unit labour costs should all translate into fast expansion of business investments – especially if interest rates are reasonably low and falling. Since the Polish corporate sector continues to register very high profits, with an impressive record on gains in labour productivity and unit labour costs, the lack of a 'proper' response from business investment is a kind of paradox. In absence of generally accepted explanations of that paradox there is a temptation to put down the weak growth of investments to phenomena such as an insufficiently flexible labour market, high indirect labour costs, excessive red tape, 'hostile' corporate taxation – or in general delayed 'structural reforms'. These explanations do not seem convincing though. In the mid-1990s a very high and sustained expansion of business investment was observed, arguably under much less flexible labour market conditions, even more red tape, much higher tax rates etc. An alternative explanation – referring to weak expected sales prospects and relatively high spare production capacities as factors responsible for weak investments – still remains to be taken more seriously.

No special mystery lies behind the observed developments in private consumption. The weak growth in consumption is consistent with the very weak (0.7%) growth in the real purchasing power of the total wage bill (and a close to 3% fall in the real purchasing power of pensions and other social transfers combined). Also, the fall in inventories was only to be expected, following their massive increases in recent years.

Despite definite interest rate reductions, Poland continues to be an attractive destination for foreign portfolio investment (targeting primarily government bonds). EU membership has enhanced that attractiveness by reducing the risks normally associated with 'less mature' emerging markets. High capital inflows have strengthened the Polish zloty (PLN). The level, but also the instability, of the zloty/euro exchange rate has become the main cause for concern for the entire corporate sector.[8] Domestic firms face intensified foreign competition, also on the home market. The share of unprofitable exports has already been on the rise. In such circumstances the incentives to increase exports will be gradually weakening. Of course, the impressive improvements in labour productivity and unit labour costs recorded in recent years will be offsetting the effects of the strength of the domestic currency, at least for some time.

The weak macroeconomic performance is likely to encourage a further relaxation of the monetary policy. Certainly, lower interest rates administered by the National Bank of Poland will not be harmful to a sustained recovery in fixed investment. However, the role of lower interest rates in inducing stronger investment acceleration must not be overemphasized. The corporate sector already 'sits' on huge amounts of idle money stocks bearing relatively modest interest and, on the whole, does not need any sizeable external financing. Lower interest rates may be needed primarily to moderate the inflows of portfolio investment – and thus to alleviate the appreciation pressure. In any case, even a relatively resolute relaxation of the monetary policy could do very little to affect the yields on government bonds very soon. The Polish currency may remain quite strong for quite some time.

In practical terms also the fiscal policy is unlikely to affect the course of the current events to any appreciable extent. The caretaker government of Mr. Belka, awaiting its inevitable (and almost certainly humiliating) defeat in the Fall elections, lacks the authority to devise, let alone implement, any meaningful policy. Its only mission is to persevere, without having any definite economic or political purpose.

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8 This is documented in the report on the business climate in the second quarter of 2005. (See the web page of the National Bank of Poland, www.nbp.pl/publikacje/koniunktura).

Table PL

Poland: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period [2]	38644	38633	38219	38191	38175	38181	38162	.	.
Gross domestic product, PLN mn, nom.	723886	760595	781112	816081	885338	204124	218505	939300	1006200
annual change in % (real)	4.0	1.0	1.4	3.8	5.4	7.0	2.1	3	4
GDP/capita (EUR at exchange rate)	4670	5366	5299	4858	5114	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9010	9250	9620	9800	10470	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	6.7	0.6	1.1	8.3	11.6	19.0 [4]	0.7 [4]	7	7
Construction output total									
annual change in % (real)	1.0	-6.4	-0.3	0.9	.	-5.0 [4]	7.6 [4]	.	.
Consumption of households, PLN mn, nom.	455405	486504	510817	530063	564067	139066	146315	.	.
annual change in % (real)	2.8	2.1	3.3	3.1	3.4	4.1	1.7	2.5	.
Gross fixed capital form., PLN mn, nom.	170430	157209	148338	150433	161686	25719	27313	.	.
annual change in % (real)	2.7	-8.8	-5.8	-0.2	5.3	3.7	1.0	3	4
LFS - employed persons, th, avg. [3]	14526.0	14207.0	13782.0	13616.8	13794.8	13465.0	13767.0	.	.
annual change in %	-1.6	-2.2	-3.0	0.6	1.3	-0.9	2.2	.	.
Reg. employees in industry, th pers., avg.	2955.0	2820.6	2670.5	2639.1	2414.0 [4]	2426.0 [4]	2411 [4]	.	.
annual change in %	-5.8	-4.5	-5.3	-1.2	-0.4 [4]	-0.6 [4]	1.2 [4]	.	.
LFS - unemployed, th pers., average [3]	2785.0	3170.0	3431.0	3328.5	3230.3	3509.0	3199.0		
LFS - unemployment rate in %, average [3]	16.1	18.2	19.9	19.6	19.0	20.7	18.9	19	19
Reg. unemployment rate in %, end of period [3]	15.1	17.5	18.0	20.0	19.1	20.5	19.3	18	.
Average gross monthly wages, PLN	1893.7	2045.1	2097.8	2185.0	2289.6	2332.2 [4]	2415.5 [4]	.	.
annual change in % (real, gross)	1.0	2.5	0.7	3.4	1.5	3.0 [4]	0.3 [4]	.	.
Consumer prices, % p.a.	10.1	5.5	1.9	0.8	3.5	1.6	3.6	3	3
Producer prices in industry, % p.a.	7.8	1.6	1.0	2.6	7.0	4.4	3.3	3	3
General governm.budget, EU-def., % GDP [5]									
Revenues	42.5	43.8	43.9	44.3	43.8	.	.	44.2	44.2
Expenditures	45.2	47.7	47.5	48.7	48.7	.	.	48.6	48.0
Deficit (-) / surplus (+)	-1.6	-3.9	-3.6	-4.5	-4.7	.	.	-4.4	-3.7
Public debt, EU-def., % of GDP [5]	36.8	36.7	41.2	45.4	43.6	.	.	46.8	47.6
Discount rate of NB % p.a., end of period	21.5	14.0	7.5	5.8	7.0	5.8	6.5	.	.
Current account, EUR mn	-10788	-6006	-5399	-4108	-2959	-648	118	-3000	-4000
Current account in % of GDP	-6.0	-2.9	-2.7	-2.2	-1.5	-1.5	0.2	-1.3	-1.7
Gross reserves of NB excl. gold, EUR mn	28555	29031	27367	26000	25904	28856	28407	.	.
Gross external debt, EUR mn	74671	81461	81046	84003	92881	87960	95892	.	.
FDI inflow, EUR mn	10334	6372	4371	3660	4892	1340	895	.	.
FDI outflow, EUR mn	18	-97	228	173	637	7	9	.	.
Exports of goods, BOP, EUR mn	39022	46537	49338	53836	65641	14451	17469	71500	77200
annual growth rate in %	38.3	19.3	6.0	9.1	21.9	19.4	20.9	9	8
Imports of goods, BOP, EUR mn	52349	55094	57039	58913	70151	15364	17787	76400	84000
annual growth rate in %	23.6	5.2	3.5	3.3	19.1	12.8	15.8	9	10
Exports of services, BOP, EUR mn	11320	10914	10545	9850	10734	2121	2589	11100	11400
annual growth rate in %	44.2	-3.6	-3.4	-6.6	9.0	8.1	22.1	3	3
Imports of services, BOP, EUR mn	9773	10021	9690	9408	10043	2167	2355	10100	10200
annual growth rate in %	49.1	2.5	-3.3	-2.9	6.7	-2.1	8.7	1	1
Average exchange rate PLN/USD	4.35	4.09	4.08	3.89	3.65	3.82	3.07	.	.
Average exchange rate PLN/EUR (ECU)	4.01	3.67	3.86	4.40	4.53	4.78	4.03	4.2	4.2
Purchasing power parity PLN/USD	1.82	1.85	1.83	1.81	1.82	.	.	.	.
Purchasing power parity PLN/EUR	2.08	2.13	2.12	2.18	2.21	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census May 2002. - 3) From 2003 according to census May 2002. - 4) Enterprises with more than 9 employees. - 5) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

All in all, unless the corporate sector finds it expedient to expand investments on a fairly massive scale, the current weakness may well extend to the rest of 2005 and perhaps even beyond.

Zdenek Lukas

Slovakia: domestic demand boosts growth

Despite mediocre growth in the EU, the Slovak economy has been growing robustly over the past four years. However, in the second half of 2004 the former main driving force of economic expansion, exports, lost momentum and the high growth of imports of investment goods exceeded the export expansion. In addition, growing private consumption has supported imports of consumer goods. In 2005, just as in the year before, Slovakia has remained to be among the NMS with the fastest growing economies. Driven by domestic demand, GDP grew by 5.1% in the first quarter of 2005. Private consumption expanded by 5.5% and gross fixed capital formation by 5.8%, accompanied however by rising inventories. Foreign trade contributed negatively to overall GDP growth, as a result of real appreciation by some 7% in euro terms and rising unit labour costs.

Private consumption has been predominantly driven by wage rises due to pre-election populism; wage increases in foreign investment enterprises have encouraged overall wage and personal income growth as well. All in all, in the first months of 2005 wages expanded faster than labour productivity in all important sectors except construction. Falling interest rates have also supported private consumption. As a result, the increased purchasing power due to expanding wages coupled with higher borrowing may overheat the economy.

Gross industrial output nearly stagnated (0.3%) in the first quarter of 2005, while industrial employment, according to Labour Force Survey (LFS) data, rose by 2.4%: industrial labour productivity dropped by 2%. Along with the nominal wage growth by 12.2% this resulted in rising unit labour costs.[9] The stagnation in total industrial production is first of all related to the 11% output decline registered by VW Bratislava in the first quarter of 2005, as against massive growth in the same period a year earlier. Otherwise, foreign investment industrial companies, mostly operating in metallurgy, machinery & equipment and electrical & optical equipment, reported an output expansion by around 7% in the first quarter of 2005. Labour productivity in these FDI-dominated and export-oriented sectors rose and the increase in unit labour costs here was less pronounced than in other sectors.

The relatively robust expansion of the economy has been reflected in rising employment. Following stagnation in 2004, employment (LFS) rose by 2.3% in the first quarter of 2005. At the same time, the unemployment rate (LFS) dropped by 1.8 percentage points to 17.5% and new foreign greenfield investment has already created more new jobs. Moreover, a number of revisions in labour regulations in the past, targeted at more flexibility in the labour market, may have yielded positive results.

[9] Among other factors, rising industrial employment has been associated with new green-field investments, which will start production later on. Consequently, this is leading to a temporary fall in labour productivity in industry.

Table SK

Slovak Republic: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year	5400.7	5379.8	5378.6	5378.8	5382.2	.	.	.	.
Gross domestic product, SKK bn, nom.	934.1	1009.8	1098.7	1201.2	1325.5	308.7	332.5	1450	1580
annual change in % (real)	2.0	3.8	4.6	4.5	5.5	5.4	5.1	5.5	6
GDP/capita (EUR at exchange rate)	4061	4334	4784	5382	6149	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9460	10050	10880	11180	12040	.	.	.	.
Gross industrial production									
annual change in % (real)	8.4	7.6	6.7	5.3	4.2	6.5	0.3	4	7
Construction industry									
annual change in % (real)	-0.4	0.8	4.1	6.0	5.7	2.5	12.5	.	.
Consumption of households, SKK bn, nom.	519.6	577.5	624.5	667.5	738.7	176.3	191.4	.	.
annual change in % (real)	-0.9	4.9	5.5	-0.8	3.5	3.0	5.5	5	6
Gross fixed capital form., SKK bn, nom.	242.3	291.0	303.5	308.4	327.2	68.2	74.4	.	.
annual change in % (real)	-7.2	13.9	-0.6	-1.5	2.5	0.9	5.8	7	10
LFS - employed persons, th, avg.	2101.7	2123.7	2127.0	2164.6	2170.4	2128.8	2177.4	.	.
annual change in %	-1.4	1.0	0.2	1.8	0.3	-0.1	2.3	.	.
LFS - employed pers. in industry, th, avg.	615.3	628.8	640.9	634.1	641.3	626.8	642.0	.	.
annual change in %	-2.4	2.2	1.9	-1.1	1.1	-1.6	2.4	.	.
LFS - unemployed, th pers., average	485.2	508.0	486.9	459.2	480.7	511.5	461.9	.	.
LFS - unemployment rate in %, average	18.6	19.2	18.5	17.4	18.1	19.3	17.5	17	16
Reg. unemployment rate in %, end of period	17.9	18.6	17.5	15.6	13.1	16.0	12.7	11	10
Average gross monthly wages, SKK	11430	12365	13511	14365	15825	14541	16022	.	.
annual change in % (real, gross)	-4.5	0.8	5.8	-2.0	2.5	2.7	7.2	.	.
Consumer prices, % p.a.	12.0	7.1	3.3	8.5	7.5	8.3	2.8	3	2.5
Producer prices in industry, % p.a.	10.8	6.5	2.1	8.3	3.4	2.9	2.5	3	2
General governm.budget, EU-def., % GDP [2]									
Revenues	47.6	45.5	45.2	35.4	35.1	.	.	.	.
Expenditures	59.8	51.5	50.8	39.2	38.5	.	.	.	.
Deficit (-) / surplus (+)	-12.3	-6.0	-5.7	-3.7	-3.2	.	.	-3.7	-4.0
Public debt in % of GDP [2]	49.9	48.7	43.3	42.6	43.6	.	.	44.2	44.9
Discount rate, % p.a., end of period	8.8	8.8	6.5	6.0	4.0	5.5	3.0	.	.
Current account, EUR mn	-761	-1950	-2043	-244	-1166	99	-138	-1800	-1700
Current account in % of GDP	-3.5	-8.4	-7.9	-0.8	-3.5	1.3	-1.6	-4.7	-4.0
Gross reserves of NB incl. gold, EUR mn [3]	4391	4748	8824	9717	10954	10019	13928	.	.
Gross external debt, EUR mn [4]	11637	12516	12655	14654	17404	14321	21724	.	.
FDI inflow, EUR mn	2089	1768	4397	506	891	276 [I-II]	34 [I-II]	.	.
FDI outflow, EUR mn	23	39	5	20	-122	-1 [I-II]	12 [I-II]	.	.
Exports of goods, BOP, EUR mn [5]	12879	14115	15270	19359	22354	4954	5580	25100	29400
annual growth rate in %	34.1	9.6	8.2	26.8	15.5	.	12.6	12	17
Imports of goods, BOP, EUR mn [5]	13860	16488	17517	19924	23526	4959	5844	27500	31700
annual growth rate in %	30.4	19.0	6.2	13.7	18.1	.	17.8	17	15
Exports of services, BOP, EUR mn	2436	2779	2958	2912	3001	458 [I-II]	525 [I-II]	.	.
annual growth rate in %	25.8	14.1	6.4	-1.5	3.0	.	14.7	.	.
Imports of services, BOP, EUR mn	1961	2244	2474	2703	2771	437 [I-II]	476 [I-II]	.	.
annual growth rate in %	13.2	14.5	10.3	9.2	2.5	.	9.1	.	.
Average exchange rate SKK/USD	46.20	48.35	45.34	36.77	32.26	32.43	29.16	.	.
Average exchange rate SKK/EUR (ECU)	42.59	43.31	42.70	41.49	40.05	40.58	38.28	38.0	37.0
Purchasing power parity SKK/USD	16.06	16.29	16.21	17.02	17.21	.	.	.	.
Purchasing power parity SKK/EUR	18.35	18.75	18.85	20.05	21.15	.	.	.	.

Notes: 1) Preliminary. - 2) According to ESA'95, excessive deficit procedure. - 3) From January 2002 new valuation of gold. - 4) Up to 2002 wiiw calculated from USD, from 2003 original data in EUR. - 5) Quarterly data refer to trade excluding value of goods for repair.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

The general government budget deficit dropped by 0.4 percentage points to 3.3% of GDP in 2004. It seems that the good budget performance is related to the flat (19%) tax rate introduced at the beginning of 2004, which reduced tax evasion and improved tax collection. However, the budget deficit did not include the amount of SKK 24.7 billion, about 1.9% of GDP, that had to be paid to the Czech bank Československá Obchodní Banka AS as a result of a court decision. At the beginning of 2005, the reform of the pension system also introduced a privately managed second pillar based on personal accounts. As a result, the publicly managed first pillar will be driven into deficit. Despite these liabilities, the Slovak government has confirmed its target to reduce the budget deficit to 3% of GDP soon and to adopt the euro by 2009.

After a fall to EUR 0.6 billion in 2003, FDI inflows recovered to EUR 0.9 billion in 2004. As a result of EU membership, the low corporate tax rate, the rising number of industrial parks and the improved business climate, foreign investors are increasingly looking towards Slovakia.[10] The greatest number of investors has targeted the car and electro-technical industries as well as services. The largest projects are expected in the coming years thanks to two new car factories (PSA Peugeot-Citroen and KIA Hyundai), both located in Western Slovakia. If the two projects are fully realized as agreed in the deals with the Slovak government, they would bring in investments of some EUR 1.5 billion, create 10,000 new jobs and produce over 500,000 cars by 2007. As foreign investors are focusing on the country's more developed western regions, the eastern parts of the country with high unemployment are falling behind. So far, only the German automobile gear box manufacturer Getrag Ford has announced to invest a larger sum (EUR 300 million by 2006) in the poorer regions in the East. On 5 May 2005 the Korean tyre maker Hankook Tyre announced to build a new tyre facility in Levice (over 100 kilometres east of the capital Bratislava) with planned investments totalling EUR 510 million and creating some 1600 new jobs. For this year we expect a recovery of the FDI inflow thanks to the above large-scale projects and on account of the privatization of 66% stake in the power utility Slovenské elektrárne, which is finally taking shape. The latter should be acquired by the Italian company Enel for over EUR 800 million, probably in the second half of 2005. As a result, the total FDI inflow may reach some EUR 2 billion in 2005.

Backed by rising private demand and the strong investment expansion, GDP growth will remain high and reach about 5.5% in 2005. In 2006 GDP growth may even accelerate, additionally fostered by pre-election demand stimulation and by gradually rising industrial output, particularly related to FDI in car manufacturing. The inflation rate may go down further, if the gap between the increase in labour productivity and the growth in real incomes were diminishing. The current account deficit, at 3.5% of GDP in 2004, will rise this year, due to increasing repatriation of profits by FDI companies. In addition, the still strong Slovak koruna and recovering domestic demand will boost imports and temporarily hold back exports.

[10] Some investors (e.g. Hankook Tyre from Korea) are asking for incentives, which may not be compatible with EU regulations.

Hermine Vidovic

Slovenia: GDP growth cooling down

After an unexpectedly high 4.6% increase in 2004, Slovenia's GDP growth lost momentum during the first quarter of 2005, amounting to a modest 2.6%. The slowdown was primarily due to a fall in investments, particularly those in transport equipment and construction. The latter stagnated, on an aggregate level, in the first quarter, with building construction increasing by 7.5% and civil engineering down by 8%. At the same time both household and government consumption rose by 2.7%. The revival of the external sector starting in the final quarter of 2004 continued, contributing some 1.3% to overall GDP growth in the first quarter of 2005.

Industrial output declined by 1.1% during the first four months of the year, of which manufacturing accounted for 0.7%. As in the past few years, output fell significantly in labour-intensive industries such as textiles and leather as well as in the food and beverages industries. The latter has come under severe pressure after the country's accession to the EU. The most outstanding result, an output increase of nearly 17%, was reported for the manufacturing of transport equipment (cars by Revoz); this translated into high export growth, particularly to France. As a result of the production decline that was not matched by equivalent employment cuts, labour productivity growth turned negative during the first quarter of 2005.

Based on labour force survey (LFS) results, employment grew by 1.3% in the first quarter of the year, almost double the rate obtained from registration data. The latter point to continued job creation in the services sector, particularly business activities, financial intermediation and education. By contrast, employment declines were registered in industry and agriculture, the latter reporting a 7% drop; exceptions were electricity as well as gas and water supply. According to the Slovenian Employment Service, enterprises expect these trends to continue. LFS unemployment was at the same level, 6.9%, as in the first quarter of 2004, while the registration rate was 1 percentage point lower than in the corresponding period a year earlier.

Since the entry of the Slovenian tolar into the ERM II by the end of June 2004, the exchange rate has remained close to the central band. The disinflation process has continued, with consumer price inflation averaging 2.6% during the first five months of the year or 2.2% May on May. Real wage growth, up 3.8% during the first quarter of the year, exceeded productivity growth at least for that period, thus going beyond the limits set in the Convergence Programme 2004-2007 (according to which wage growth should lag behind labour productivity growth by at least one percentage point).

Given the poor performance of industry, foreign trade developed surprisingly well. Expressed in euro terms, both exports and imports rose by 11% and 6.5% respectively during the first four months of 2005. As a result the foreign trade deficit was nearly EUR 150 million lower than in the same 2004 period. Exports to the EU-25 reported above-average growth of close to 14% in the period January-April (with exports to France nearly doubling), while deliveries to non-member states rose by 5% only. On the import side the development was quite the opposite: imports from non-member countries were twice as high as the average rate. The improved trade balance translated into a slight current account surplus in the first four months of the year (versus a EUR 40 million deficit in the same period of 2004). As in the past two years, Slovenia witnessed higher outward than inward FDI flows during the first four months of 2005, resulting in a net outflow of about EUR 170 million. Most of

Table SI

Slovenia: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year	1990.3	1992.0	1995.7	1996.8	1997.0	.	.	.	.
Gross domestic product, SIT bn, nom.	4252.3	4761.8	5314.5	5747.2	6191.2	1449.4	1516.0	6600	7000
annual change in % (real)	3.9	2.7	3.3	2.5	4.6	4.1	2.6	3.4	3.4
GDP/capita (EUR at exchange rate)	10421	11006	11771	12316	12979	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	14410	15230	15870	16340	17420	.	.	.	.
Gross industrial production									
annual change in % (real)	6.2	2.9	2.4	1.4	4.8	4.2	-2.6	1	2
Construction output, in effect. working time									
annual change in % (real) [2]	-1.2	-2.1	-3.4	-1.7	2.5	9.0	-3.6	.	.
Consumption of households, SIT bn, nom.	2373.6	2621.8	2830.4	3053.9	3261.3	738.7	772.8	.	.
annual change in % (real)	0.3	2.3	0.2	2.8	3.5	4.0	2.7	3.5	3
Gross fixed capital form., SIT bn, nom.	1066.8	1164.4	1239.2	1373.3	1529.1	352.4	366.6	.	.
annual change in % (real)	0.6	4.1	3.1	6.3	6.8	8.0	-0.5	2	3
LFS - employed persons, th, avg.	901	916	910	897	943 [3]	922	934	.	.
annual change in %	1.7	1.7	-0.7	-1.4	5.2 [3]	4.2	1.3	.	.
Reg. employees in industry, th pers., avg. [4]	241.6	243.5	246.1	242.2	239.7	239.7	240.9 [I-II]	.	.
annual change in %	-0.5	0.8	1.1	-1.6	-1.0	-1.5	.	.	.
LFS - unemployed, th pers., average	68.0	63.0	62.0	64.8	64.0	68	69	.	.
LFS - unemployment rate in %, average	7.0	6.4	6.4	6.7	6.3	6.8	6.9	6.5	6
Reg. unemployment rate in %, end of period	12.0	11.8	11.3	11.0	10.1	11.1	10.2	10	9.5
Average gross monthly wages, SIT	191669	214561	235436	253200	284281	258118	270994	.	.
annual change in % (real, net)	1.4	3.1	2.1	1.8	2.1	1.8	3.1	.	.
Consumer prices, % p.a.	8.9	8.4	7.5	5.6	3.6	3.7	2.6	2.7	2.5
Producer prices in industry, % p.a.	7.6	8.9	5.1	2.5	4.3	3.2	4.3	3	.
General governm.budget, EU-def., % GDP [5]									
Revenues	44.7	45.1	45.7	46.2	45.8	.	.	.	.
Expenditures	48.2	47.8	48.1	48.2	47.7	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.5	-2.7	-2.3	-2.0	-1.9	.	.	-2.2	-2.1
Public debt in % of GDP [4]	27.4	28.1	29.5	29.4	29.4	.	.	30.2	30.4
Discount rate % p.a., end of period [6]	10.0	7.8	7.3	5.0	3.3	4.5	3.3	.	.
Current account, EUR mn	-583.0	38.0	335.4	-91.2	-238.3	34.4	12.9	-170	-170
Current account in % of GDP	-2.8	0.2	1.4	-0.4	-0.9	0.6	0.2	-0.6	-0.6
Gross reserves of NB excl. gold, EUR mn	3435.8	4907.5	6701.5	6798.2	6464.0	6791.4	6515.2	.	.
Gross external debt, EUR mn	9490	10403	11455	13305	15397	13812	16313	.	.
FDI inflow, EUR mn	149.1	412.4	1750.4	298.8	421.6	24.8	-99.7	.	.
FDI outflow, EUR mn	71.7	161.2	168.1	413.7	400.7	134.9	126.0	.	.
Exports of goods, BOP, EUR mn	9574.2	10454.3	11081.6	11414.0	12736.1	2991.0	3310.8	13700	14400
annual growth rate in %	18.2	9.2	6.0	3.0	11.6	8.3	10.7	8	5
Imports of goods, BOP, EUR mn	10801.2	11138.7	11351.0	11959.8	13576.0	3088.7	3383.0	14500	15400
annual growth rate in %	16.6	3.1	1.9	5.4	13.5	5.9	9.5	7	6
Exports of services, BOP, EUR mn	2051.5	2177.6	2440.0	2468.6	2792.8	552.6	593.6	.	.
annual growth rate in %	16.3	6.1	12.0	1.2	13.1	7.8	7.4	.	.
Imports of services, BOP, EUR mn	1562.3	1642.1	1823.5	1930.3	2120.9	413.0	441.7	.	.
annual growth rate in %	8.9	5.1	11.0	5.9	9.9	12.3	6.9	.	.
Average exchange rate SIT/USD	222.68	242.75	240.24	207.11	192.38	189.84	182.73	.	.
Average exchange rate SIT/EUR (ECU)	205.03	217.19	226.22	233.70	238.86	237.39	239.75	239.5	240
Purchasing power parity SIT/USD	130.38	137.35	147.93	152.75	154.36	.	.	.	.
Purchasing power parity SIT/EUR	148.28	156.95	167.82	176.15	178.01	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 construction put in place; units with at least 20 employees. - 3) Registration data show a growth of 0.6% only. - 4) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 5) According to ESA'95, excessive deficit procedure. - 6) From 2001 main refinancing rate.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

outward FDI was directed towards the successor states of the former Yugoslavia, particularly Serbia and Montenegro as well as Bosnia and Herzegovina. After several failed attempts, the privatization of Slovenia's second largest bank Nova Kreditna Banka Maribor (NKBM) is taking shape. The current model envisages a fresh capital injection by the EBRD and privatization thereafter. A quarter of the shares will be offered on the stock exchange, primarily – but not exclusively – for domestic investors. The exact date of the listing has not yet been decided. The state, however, is to retain control over the bank.

Slovenia's foreign debt has been growing steadily over the past several years and reached EUR 16.5 billion (of which 20% of short-term debt) by the end of April. This represents 63.8% of the 2004 GDP. Most of the debt (close to 45%) is owed by enterprises (other sectors), followed by banks (34%) and the government (about 15%); foreign direct investment accounts for the remainder. Servicing the debt seems to be manageable.

In May the Slovenian government adopted a supplementary state budget for 2005, setting the deficit to GDP ratio at 1.4%, down from the 1.7% anticipated in the original document that was passed in December 2003. Final data for 2004 indicate a 1.9% general government deficit, somewhat lower than originally expected.

Recently the Strategic Council for Economic Development presented the results of a feasibility study on the introduction of a flat tax. Accordingly a 20% rate would be optimal. The Council recommends the new regulation to be introduced after the adoption of the euro, planned for the beginning of 2007, 'in order to avoid major economic shocks that could derail the adoption process'.

As for 2005, GDP growth will be less encouraging than anticipated at the beginning of the year and will amount to 3.4%, backed both by domestic and foreign demand. The situation on the labour market may improve, if at all, only slightly. Inflation may continue its downward trend and could fall to below 3% already in 2005. The budget is well under control and the current account will not cause any problems in the near future.

Table III

Southeast Europe: an overview of economic fundamentals, 2004

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Macedonia	Montenegro	Romania	Serbia	Turkey	*NMS-8* [1]	*EU-15*	*EU-25* [2]
GDP in EUR at exchange rates, EUR bn	6.55	6.64	19.43	27.63	4.31	1.54	58.91	17.78	243.04	*459.08*	*9793.85*	*10269.67*
GDP in EUR at PPP, EUR bn	14.60	16.71	51.99	45.68	11.46	3.34	153.25	42.01	486.07	*868.97*	*9383.48*	*10269.67*
GDP in EUR at PPP, EU-25=100	0.1	0.2	0.5	0.4	0.1	0.03	1.5	0.4	4.7	*8.5*	*91.4*	*100.0*
GDP in EUR at PPP, per capita	4560	6010	6680	10290	5650	5340	7070	5600	6750	*11908*	*24369*	*22371*
GDP in EUR at PPP per capita, EU-25=100	20	27	30	46	25	23	32	25	30	*53*	*109*	*100*
GDP at constant prices, 1990=100	143.9	407.7 [3]	97.7	101.9	92.9	.	106.5	.	162.1	*132.2*	*131.6*	*132.0*
GDP at constant prices, 2000=100	126.5	119.2	120.6	118.9	101.9	107.2	126.6	122.2	114.1	*114.7*	*106.1*	*106.8*
Industrial production real, 1990=100	43.8	.	77.4	77.4	49.7	.	75.2	.	181.1	*151.3*	*120.2*	*122.6*
Industrial production real, 2000=100	115.4	130.6	146.0	120.6	94.0	116.2	122.7	105.9	119.7	*125.6*	*101.2*	*103.3*
Population - thousands, average	3200	3832.0	7781.2	4440.0	2030.0	625	21673.3	7500	72003	*72962.9*	*385059.0*	*458983.0*
Employed persons - LFS, thousands, average	924.5 [4]	635.7 [5]	2922.5	1562.5	523.0 [4]	143.5	9157.8	2930.8 [6]	21791	*28565.0*	*170469* [7]	*198661* [7]
Unemployment rate - LFS, in %	14.4	42	12.0	13.8	37.2	22.3	8.0	15	10.3	*14.4*	*8.0* [7]	*9.0* [7]
Public sector expenditures, nat. def., in % of GDP	26.7	42.4 [8]	40.0	49.5 [8]	34.7	.	30.7	27.3	32.6	*46.8*	*48.0*	*47.8*
Public sector revenues, nat. def., in % of GDP	22.1	43.2 [8]	41.7	44.9 [8]	33.4	.	29.6	25.5	25.6	*43.0*	*45.4*	*45.3*
Price level, EU-25=100 (PPP/exch. rate)	45	40	37	60	38	46	38	42	50	*53*	*104*	*100*
Average gross monthly wages, EUR at exchange rate	191 [9]	382	153	798	339	303	204	193 [10]	582 [11]	*723* [12]	*2930* [12]	*2628* [12]
Average gross monthly wages, EUR at PPP	426 [9]	962	409	1320	900	658	530	457 [10]	1163 [11]	*27.5* [12]	*111.5* [12]	*100.0* [12]
Exports of goods in % of GDP	7.4	25.3	41.1	23.9	31.2	24.9	32.1	17.5	22.2	*46.7* [13]	*27.9* [13]	*28.7* [13]
Imports of goods in % of GDP	27.0	80.7	55.1	48.2	52.1	52.9	41.2	49.1	30.1	*50.1* [13]	*27.0* [13]	*28.1* [13]
Exports of services in % of GDP	12.3	10.0	17.3	28.3	7.6	15.7	4.9	6.7	8.0	*8.3* [13]	*8.1* [13]	*8.1* [13]
Imports of services in % of GDP	13.0	5.5	13.6	10.5	8.4	6.6	5.3	4.9	3.7	*7.4* [13]	*7.5* [13]	*7.6* [13]
Current account in % of GDP	-4.4	-23.3	-7.4	-4.5	-7.7	-9.3	-7.5	-13.1	-5.1	*-4.3* [13]	*0.4* [13]	*0.2* [13]
FDI stock per capita in EUR	416	401	773	2150	581	.	608	476	.	*2291*	.	.

Notes: NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. EU-15: EU up to 30 April 2004. EU-25: EU as of 1 May 2004. PPP: Purchasing power parity - wiiw estimates for Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia.

1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1995=100. - 4) Employment total by registration, end of year. - 5) Employees by registration, end of year. - 6) October. - 7) LFS-adjusted time series (Eurostat). - 8) Year 2003; Croatia: IMF definition. - 9) Public sector. - 10) Average net monthly wages, including various allowances. - 11) Gross monthly wages in manufacturing industry - 12) Gross wages plus indirect labour costs, whole economy, national account concept. - 13) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part B: Southeast European countries

Gábor Hunya[*]

Southeast Europe: catching-up continues, but accession prospects uncertain

Introduction

Economic growth in Southeast Europe decelerated modestly in the first months of 2005, but the process of catching up has continued. However, the deterioration of the already high current account deficit is a major concern. Monetary policy is insufficient to deal with the problem and the exchange rate regimes are set mainly to combat inflation. Fiscal tightening is the usual policy response even if the budget deficit is low.

The timetable of further EU enlargement is now more uncertain than it was a few months ago. The likelihood has increased that Bulgaria's and Romania's accession, planned for 2007, will be delayed by one year and that negotiations with Croatia and Turkey will not start this year. But so far there has been no new policy decision on the part of the EU, while the accession and candidate countries are increasing efforts to meet requirements thus keeping to the agreed schedule.

The region under discussion in this chapter includes the two EU accession countries Bulgaria and Romania, the two candidate countries Croatia and Turkey, and the other countries of the Western Balkans (Albania, Bosnia and Herzegovina, Macedonia, and Serbia and Montenegro), all aspiring for EU membership. We shall refer to nine countries, treating Serbia and Montenegro separately because in economic terms they are already two countries: they form neither a customs nor a currency union and have separate fiscal policies; in addition, their statistics are separated. Also for statistical reasons, our analysis excludes Kosovo. Turkey is for the first time integrated into the Southeast European region with which it shares the aspiration for EU membership. Statistical information on the Southeast European countries (SEECs) is generally less reliable than for the NMS, with the partial exception of Bulgaria, Croatia, Romania and Turkey.

Catching-up continues

The SEECs are definitely less developed than the new EU members in terms of GDP per capita in PPP (purchasing power parity; see Overview Table III). According to the most recent data, in 2004 Romania was at 32% of the EU-25 average, Bulgaria at 30%, while the figure for Croatia, 46%, was similar to that of the largest new member state, Poland. Over the past four years, these SEECs have reduced their distance to the EU-25 average: Bulgaria by three percentage points, Romania by seven and Croatia by five percentage points (Appendix Table A/1). Turkey is just behind Bulgaria with 29% of the EU average but it has hardly surpassed the pre-crisis year 2000 level. The rest of the Western Balkan countries, at 25-27% of the EU-25 average, have an even worse record, with Albania at the bottom with only 20%. However, among these latter countries, Albania has been the one to catch up most rapidly while Macedonia has been falling back.

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[*] V. Gligorov, P. Havlik, M. Landesmann (all wiiw) as well as the authors of the country reports provided valuable comments on the draft of this overview.

Incomplete statistics for the first quarter of 2005 suggest that solid economic growth at a rate of about 5% is now present throughout the region; the only exception is Croatia with less than 3% growth (Table 1 and Figure 1).

Table 1

Gross domestic product

real change in % against preceding year

	2000	2001	2002	2003	2004 [1]	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Albania	7.3	7.6	4.7	6.0	5.9	.	.	6.5	6.5	143.9	126.5
Bosnia & Herzegovina	5.5	4.5	5.5	3.0	5.0	.	.	5	6	.	119.2
Bulgaria	5.4	4.1	4.9	4.5	5.6	4.5	6.0	5.5	5.3	97.7	120.6
Croatia	2.9	4.4	5.2	4.3	3.8	4.2	1.8	3	3	101.9	118.9
Macedonia	4.5	-4.5	0.9	2.8	2.9	2.4	.	4	4	92.9	101.9
Romania	2.1	5.7	5.1	5.2	8.3	6.2	5.9	5.5	5.5	106.5	126.6
Serbia	5.2	5.1	4.5	2.4	8.6	7.1	5.2	4	5	.	122.2
Montenegro	.	-0.2	1.7	2.5	3.0	.	1.9	5	5	.	107.2
Turkey	7.4	-7.5	7.9	5.8	8.0	11.8	.	6	6	162.1	114.1

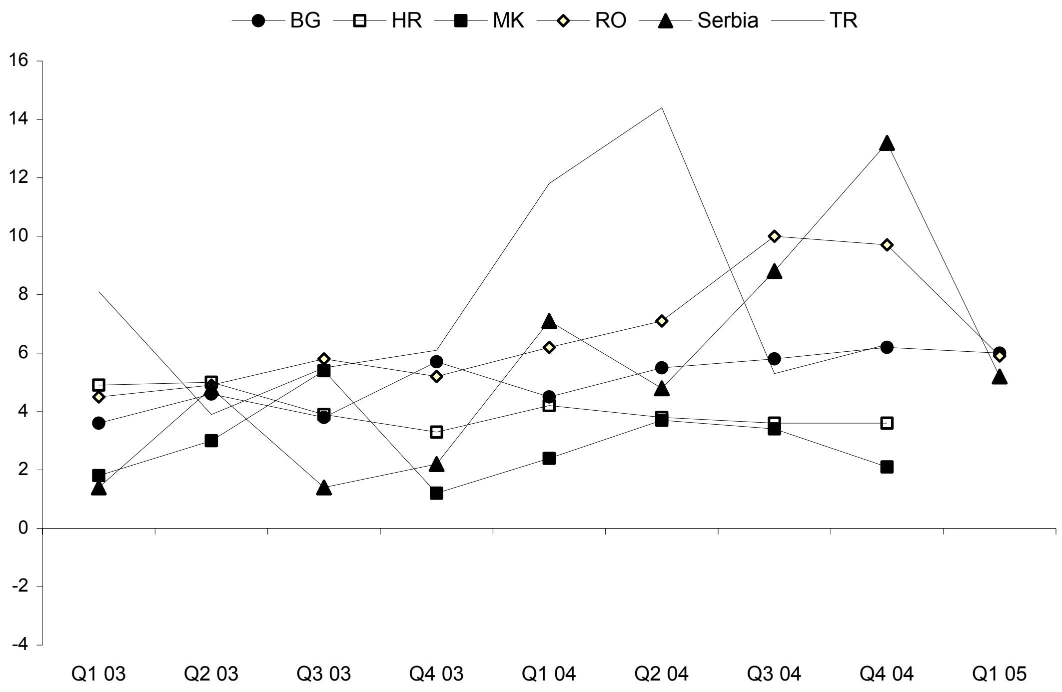
Note: 1) Preliminary.

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

Figure 1

Quarterly GDP, 2003-2005

real change in % against preceding year



Source: wiiw Monthly Database incorporating national statistics.

Croatia grows even more slowly than the NMS, caused by structural weaknesses particularly in the manufacturing sector. Romania, experienced extraordinarily rapid growth in 2004 (8.3%) spurred by private demand and a bumper harvest which cannot be repeated. Quarterly GDP growth rates are falling in Romania while accelerating in Bulgaria. The expected 5.5% economic growth in 2005, identical in both countries, is the result of rapid structural change and improved export competitiveness. In the course of preparing for EU membership, they stepped up reforms and improved the conditions for doing business. Economic growth in Serbia and Turkey, similarly to Romania, will turn out to be lower than in the previous year. Montenegro and Macedonia, which were lagging behind in the past, will probably benefit from accelerated growth in 2005.

Some of the countries in the region are still below their pre-transformation level of GDP. Only Albania, Romania and Croatia have surpassed that level; Bulgaria and Macedonia are close to it. Serbia and Montenegro, and also Bosnia and Herzegovina, which suffered serious setbacks in the 1990s, still have a long way to go, especially since their growth performance has not been higher than that of the other countries in the region. Institutional reforms and structural changes are still under way and large amounts of investments would be needed to modernize infrastructure. Without such reforms, foreign and domestic private investments cannot grow rapidly.

Table 2

Gross fixed capital formation

real change in % against preceding year

	2000	2001	2002	2003	2004 1)	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Bulgaria	15.4	23.3	8.5	13.9	12.0	22.1	9.2	8	10	144.3	170.7
Croatia	-3.8	7.1	12.0	16.8	4.4	8.9	0.3	4	4	.	146.3
Macedonia	-1.5	-8.6	17.6	1.1	.	.	.	.	.	.	.
Romania	5.5	10.2	8.2	9.1	10.1	7.3	5.2	7	8	154.6	143.2
Serbia 2)	13.3	-4.1	-0.8	.	.	.	.	.	.	.	.
Turkey	16.9	-31.5	-1.1	10.0	35.0	57.6	.	25	15	154.4	100.5

Notes: 1) Preliminary. - 2) Gross fixed investment.

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

Gross fixed capital formation grew most rapidly in Bulgaria, Romania and Turkey, at double-digit rates in 2004, promising rapid economic growth and structural change in the future (Table 2). Yet, in the first quarter of 2005 it fell short in all these countries compared to the precious year and a deceleration of investment activities is forecasted for 2005. In the two accession countries foreign direct investment reached record amounts in 2004, supporting privatization and economic growth (Table 10). More modest inflows are forecast for 2005.[11] Turkey is different as fixed capital formation has, despite recent fast growth, just reached the pre-crisis level of the year 2000. Continuing rapid expansion of investments is predicted. But Turkey is still less open to FDI, which may delay the inflow of new technology and know-how. Besides these countries, only Croatia publishes national

[11] For details see *wiiw Database on Foreign Direct Investment in Central, East and Southeast Europe*, May 2005.

accounts conforming to international standards and they show that the construction boom has significantly decelerated and fixed capital formation slowed down in 2004.

Private demand provided the main impetus to economic growth in both EU accession countries in 2004 and also in the first quarter of 2005. This is true first of all for Romania where domestic demand, primarily that of households, grew by 12% (Bulgaria: 5%). As outlined in the section on wages below, wage expansion has been particularly fast in Romania, while Bulgaria showed more restraint last year but less in the current election year. Government final consumption represented a modest positive contribution to growth in Bulgaria and Romania in 2004. As the trade deficit widened, net exports have most probably contributed negatively to growth in both countries.

Domestic demand and export expansion fuelled the increase in industrial output in Romania and Bulgaria both in 2004 and in the first quarter of 2005 (Table 3). Also in Macedonia manufacturing has recovered this year, after a severe decline in 2004. Stagnation of industry in Croatia and its decline in Serbia are signs of structural change but also of problematic industrial competitiveness in both countries. Privatization to insiders has not proved advantageous as capital investments are inadequate and access to foreign markets is limited. Foreign takeovers are rare and investors are generally not keen to enter into joint ventures in Croatia. Serbia relies more on privatization by sale, and the present decline in industrial output may be due to restructuring which may be followed by an upswing. In Turkey, private economic activity traditionally concentrated in the primary and tertiary sectors, while industrialization was mostly publicly organized and remained inward-looking. Now, the secondary sector is growing rapidly, backed by partnerships between private domestic and foreign capital. In all countries of the region, with the exception of Bulgaria, services grow more dynamically than industry and a construction boom is also widely present.

Table 3

Gross industrial production

real change in % against preceding year

	2000	2001	2002	2003	2004 [1)]	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast	Index 1990=100	Index 2000=100 2004
Albania [2)]	0.5	7.1	1.8	2.7	3.1	.	.	4	5	43.8	115.4
Bosnia and Herzegovina	7.9	4.9	5.7	5.1	12.1	.	.	7	10	.	130.6
Bulgaria [3)]	8.3	1.5	6.5	14.1	18.3	14.8	11.1	10	8	77.4	146.0
Croatia	1.7	6.0	5.4	4.1	3.7	5.6	0.3	2	3	77.4	120.6
Macedonia	3.0	-3.1	-5.3	4.7	-2.2	.	4.8	3	5	49.7	94.0
Romania	7.1	8.3	4.3	3.1	5.3	5.9	5.3	5	5	75.2	122.7
Serbia	11.4	0.1	1.8	-3.0	7.1	9.5	-3.4	3	5	.	105.9
Montenegro	4.3	-1.0	1.1	2.1	13.8	-1.7	3.9	5	5	.	116.2
Turkey	6.0	-7.5	9.4	7.8	9.8	10.4	6.2	6	8	181.1	119.7

Notes: 1) Preliminary. - 2) According to gross value added. - 3) For quarterly data enterprises with more than 10 employees.
Source: wiiw Database incorporating national statistics, forecast: wiiw.

Based on the above trends one can conclude that in 2005 Southeast Europe is expected to grow somewhat less dynamically than in 2004. A deceleration of growth characterizes first of all the largest economies of the region: Turkey, Romania, Croatia and Serbia. Only two smaller countries, Macedonia and Montenegro, which were lagging behind, are likely to grow faster. There are indications that in most countries both investments and private consumption will grow more slowly than in the previous year. Public consumption will decline further and net exports may become even more negative. Growth deceleration will not stop the catching-up process, however, as all countries but Croatia will grow at a rate between 4% and 6% in 2005 and most probably also in 2006.

Inflation coming down, wages low but increasing

Inflation rates have been low or declined in seven countries of the region, increasing only in Croatia and Serbia (Table 4). Fixed exchange rates and wide-spread euroization mean that most prices of tradables follow the European trend and hardly increase. Bosnia-Herzegovina and Macedonia have enjoyed price stability for some time; in Albania inflation is low and decreasing. In Croatia, inflation is low as well but in 2005 it will probably rise compared to the previous year. Romania and Turkey exhibit the highest rate of consumer price increase, but inflation is coming down below 10% this year. In Romania, where wages have expanded very rapidly, one cannot observe an acceleration of inflation despite the growth of government-administered energy prices. But prices not covered by the consumer price index, such as those of new dwellings, have skyrocketed in the past few years. The acceleration of inflation in Serbia which started anew last year continued in the first quarter of 2005. This may be associated with the rapid expansion of wages and the generated demand as well as with currency depreciation.

Table 4

Consumer price inflation

change in % against preceding year

	2000	2001	2002	2003	2004 1)	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast
Albania	0.1	3.1	5.2	2.3	2.9	3.9	2.2	2.5	2.5
Bosnia & Herzegovina 2)	4.8	3.1	0.4	0.6	0.4	0.4	.	0.5	0.5
Bulgaria	10.3	7.4	5.8	2.3	6.2	6.4	3.8	4	4
Croatia 3)	6.2	4.9	1.7	1.8	2.1	1.8	3.3	3	2.5
Macedonia	5.8	5.5	1.8	1.2	-0.4	1.6	-0.4	2	2
Romania	45.7	34.5	22.5	15.3	11.9	13.6	8.8	9	7
Serbia	79.6	93.3	16.6	9.9	11.4	8.6	16.0	15	10
Montenegro 2)	22.9	22.8	17.6	7.8	3.3	6	3.6	3	3
Turkey	54.9	54.4	45.0	25.3	10.6	9.5	8.6	8	6

Notes: 1) Preliminary. - 2) Retail prices. - 3) Up to 2001 retail prices.

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

Real wages have increased quite rapidly in many countries of the region in recent years (Table 5). In Albania, Romania and Serbia they increased at or close to double-digit rates and this trend even accelerated in the first quarter of 2005. Wage expansions are far more rapid than the GDP increase and may cause inflation or a deterioration of the trade balance.

Relatively low euro wages are the advantage of Bulgaria when it comes to attracting labour-intensive manufacturing. Romania has lost some of its attractiveness after the recent wage rises and appreciation of the local currency (Appendix Table A/3). Albania and Serbia also have low wages, but other factors of doing business are not favourable. In countries whose currencies are fixed and where wages increase rapidly production is consequently more costly than in the rest of region, wages are significantly higher in euro terms compared to the rest of the region. In Bosnia and Herzegovina, in Croatia and in Montenegro. These countries will probably not attract labour-intensive export-oriented manufacturing FDI and will have to find an alternative growth path if the current trend of high wagecosts persists.

Table 5

Real net wages

change in % against preceding year

	1998	1999	2000	2001	2002	2003	2004	2004 1st quarter	2005 1st quarter
Albania 1)	-0.2	9.9	17.7	11.6	8.1	6.0	11.2	.	.
Bosnia & Herzegovina 1)	.	9.7	4.0	14.8	-0.6	7.3	.	.	.
Bulgaria 1)	20.7	6.9	1.3	-0.5	1.5	3.7	-1.9	0.0	5.5
Croatia	6.0	10.1	3.4	1.6	3.1	3.8	3.7	4.3	1.7
Macedonia	3.8	3.6	-0.3	-1.9	5.0	3.6	4.4	2.1	2.9
Romania	3.4	-3.8	4.6	4.9	2.1	10.7	9.5	9.0	13.1
Serbia	.	.	5.5	16.5	29.9	14.0	11.1	5.0	16.5
Montenegro	.	.	.	.	.	9.3	9.6	.	5.7
Turkey 2)	.	.	-3.9	-23	-10.9	11.9	1.0	3.4	.

Notes: 1) Real gross wages. - 2) Real gross wages in manufacturing industry.

Source: wiiw Database incorporating national statistics.

Unemployment high and hardly changing

Low participation and high unemployment rates are lasting characteristics of the Western Balkans (Table 6).[12] The situation is worst in Bosnia and Herzegovina, where about 40% of the workforce is registered as jobless, but the real unemployment rate – had there been a labour force survey – might be about half of that. In Macedonia the strict stabilization policy has depressed output and employment. The unemployment rate peaked at 37% in 2004 and is expected to decline slowly as a result of resumed economic growth in 2005. The situation is still much better in Serbia but the restructuring of the economy triggers an increase in unemployment also in this country. Serbia is now heading towards a 20% rate of unemployment, the level recorded by Bulgaria five years ago. The latter country embarked on a more rapid economic growth path after privatizing and restructuring most of the economy, thus the unemployment rate is now coming down towards 10%. But the participation rate is 56% in Serbia while below 50% in Bulgaria – a perhaps only temporary advantage of Serbia.

[12] We do not have exact knowledge either about the size of illegal employment and or about the importance of underemployment in the public or socially owned sector – therefore it is unclear whether official unemployment statistics under- or overestimate the problem. All data are according to the labour force survey except for Albania and Bosnia and Herzegovina.

The lowest unemployment rate together with a relatively high participation rate can be found in Romania. Fast economic growth has increased employment, mainly in construction and trade. Unemployment stagnates at about 8% despite major layoffs in the course of the restructuring of former state-owned enterprises. A lasting problem is the severe underemployment in rural areas. In Turkey, the overall employment situation is worse than in Romania the although rate of unemployment is not much higher. The participation rate is very low and unemployment increases slowly for demographic reasons, despite fast economic growth.

Table 6

Labour market, LFS definition, annual average rate in %

	Participation rate			Unemployment rate						
	2002	2003	2004 1)	2002	2003	2004 1)	2004 1st quarter	2005 1st quarter	2005 forecast	2006 forecast
Albania 2)	.	.	.	15.8	15.0	14.4	14.9	.	14	14
Bosnia & Herzegovina 2)	.	.	.	40.9	42.0	42.8	.	.	42	42
Bulgaria	49.4	49.2	49.7	17.8	13.7	12.0	13.3	11.3	10.3	9.5
Croatia	50.9	50.2	50.5	14.8	14.3	13.8	.	.	13.5	13
Macedonia	52.6	54.5	52.2	31.9	36.7	37.2	37.2	.	35	35
Romania 3)	56.0	54.8	54.8	8.4	7.0	8.0	8.8	.	7	7
Serbia	56.1	55.7	56	13.3	14.6	18.5	.	.	20	20
Montenegro	.	.	.	21.6	22.9	22.3	.	.	23	23
Turkey	49.6	48.3	48.7	10.3	10.5	10.3	12.4	11.7	10.8	11

Notes: 1) Preliminary. - 2) Unemployment by registration, end of period. - 3) From 2002 new methodology in accordance to EU definitions.

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

On the whole, unemployment is stubborn in the whole region but prospects are not altogether bad. The examples of Bulgaria and Romania, to some extent also of Albania, show that employment can increase in the presence of very high rates of economic growth. For the rest of the region, however, we do not expect such employment-creating development in the near future.

Foreign trade and current account deficits expand

A high and growing foreign trade deficit is a major characteristic of Southeast European countries. Although exports have expanded quite rapidly in some of the countries, imports have grown even faster. The exports to GDP ratio, an indicator of openness, is low, except for Bulgaria; the lowest in Albania, 8% in 2004 (Overview Table III). Ratios around or below 25% for Serbia, Croatia, Montenegro and Bosnia-Herzegovina indicate that the export sector is very weak and the manufacturing sector is slow to recover. As to the import side, openness is pathologically high in the case of Bosnia-Herzegovina, 81%, and above 50% in Bulgaria, Macedonia and Montenegro. High import dependence together with a low ability to export add up to a large foreign trade deficit.

The deficit of goods trade in the balance of payments is the lowest in Turkey (8% of GDP in 2004), Romania (9%) and Bulgaria (14%) (Table 7). The trend has been increasing in all three countries over the past few years. The accession countries boast high rates of export expansion and deepening integration with the EU. But their economic growth is import-intensive, partly due to investment goods and raw materials that come from abroad, partly due to the growing demand for consumer goods. Romania's imports in particular have been boosted by soaring demand of private consumers driven by rising wages. In addition, a large part of manufacturing exports is wage-processing with low value added. First quarter 2005 data confirm the trend of rising foreign trade deficits in Bulgaria and Romania calculated in nominal euro (Table 8). In these countries both export and import growth accelerated compared to the previous year. Turkey seems to switch to a healthier trend with imports growing less than exports in the first quarter, but the two growth rates may become more similar later in the year, and in absolute terms the trade deficit will continue to widen.

Table 7

Components of the current account

in % of GDP

	Balance on goods			Balance on services			Balance on incomes			Balance on transfers		
	2002	**2003**	**2004**	**2002**	**2003**	**2004**	**2002**	**2003**	**2004**	**2002**	**2003**	**2004**
Albania	-23.9	-21.9	-19.6	-0.1	-1.4	-0.6	2.6	2.8	2.2	12.9	13.7	13.6
Bosnia & Herzegovina	-59.2	-58.4	-55.4	3.3	3.7	4.5	9.1	7.5	5.4	24.6	22.7	22.2
Bulgaria	-10.2	-12.5	-14.0	2.9	3.0	3.7	-1.7	-3.2	-1.8	3.4	3.5	4.6
Croatia	-24.6	-27.3	-24.3	13.6	19.8	17.7	-2.4	-4.2	-2.2	4.8	4.9	4.3
Macedonia	-21.3	-18.4	-20.9	-0.6	-0.1	-0.8	-0.8	-0.7	-0.7	13.2	15.9	14.7
Romania	-5.7	-7.8	-9.0	0.0	0.1	-0.4	-1.0	-2.4	-2.3	3.3	4.0	4.2
Serbia	-24.7	-24.2	-31.7	1.9	1.5	1.8	-0.7	-1.1	-1.0	10.0	12.1	15.3
Montenegro	-32.7	-25.1	-28.1	7.6	7.8	9.1	5.8	6.9	6.8	6.7	3.2	2.9
Turkey	-4.0	-5.8	-7.9	4.3	4.4	4.2	-2.5	-2.3	-1.8	1.3	0.4	0.4

Source: wiiw Database incorporating national statistics.

Five other countries of the region have a trade deficit between 20% and around 30% of GDP (Table 7). The lower end is represented by Albania, where exports rise impressively albeit from a very low level. Serbia has the highest deficit and largest increase in 2004, but this will be corrected in 2005 as the growth rate of exports is likely to exceed that of imports (Table 8). The same is true for Montenegro. In Croatia the foreign trade deficit came down somewhat in 2004 but it is on the rise again in 2005.

In all countries, the current account deficit is fortunately much smaller than the trade deficit of goods (Tables 7 and 9). Some countries register very positive balances of services. Croatia has the most significant earnings from tourism and these are also rising in Montenegro. As a result, services trade showed an 18% surplus (of GDP) in Croatia and 9% in the case of Montenegro in 2004. While it seems that the Croatian tourism revenues have levelled off, there is more room for an increase in the latter country. Turkey has a large tourism industry, but net services revenues amount to only 4.2% of GDP, similar to Bosnia and Herzegovina or Bulgaria.

Another major foreign revenue source for several countries are transfers, i.e. remittances of people working abroad. In 2004 transfers amounted to 22% of GDP in Bosnia and Herzegovina, 15% in Macedonia and Serbia and 14% in Albania. They are on the increase in Serbia while

Table 8

Foreign trade

cumulated data within respective period, based of customs statistics

Exports total (fob)

		I Q 2003	I-II Q 2003	I-III Q 2003	I-IV Q 2003	I Q 2004	I-II Q 2004	I-III Q 2004	I-IV Q 2004	I Q 2005
Albania	EUR mn	101	204	303	**401**	109	238	360	**486**	121
	change in %	16.5	23.8	19.7	**14.7**	7.8	16.8	18.9	**21.3**	11.1
Bosnia & Herzegovina	EUR mn	260	602	955	**1303**	357	760	1197	**1677**	.
	change in %	9.0	15.5	14.7	**11.5**	37.3	26.2	25.4	**28.7**	.
Bulgaria	EUR mn	1635	3252	5004	**6668**	1719	3618	5807	**7994**	2078
	change in %	20.5	15.0	10.9	**10.0**	5.1	11.3	16.0	**19.9**	20.8
Croatia	EUR mn	1364	2696	4002	**5468**	1452	3042	4727	**6451**	1491
	change in %	15.5	6.8	4.2	**5.4**	6.5	12.8	18.1	**18.0**	2.7
Macedonia	EUR mn	274	588	890	**1206**	293	598	960	**1343**	364
	change in %	-1.6	4.0	1.5	**2.4**	6.9	1.7	7.9	**11.4**	24.4
Romania	EUR mn	3778	7501	11574	**15614**	4337	9033	13995	**18935**	5091
	change in %	14.4	8.2	7.6	**6.4**	14.8	20.4	20.9	**21.3**	17.4
Serbia	EUR mn	576	1173	1812	**2397**	544	1228	2033	**2943**	753
	change in %	22.3	18.4	14.1	**11.0**	-5.5	4.7	12.2	**22.8**	38.4

Imports total (cif)

		I Q 2003	I-II Q 2003	I-III Q 2003	I-IV Q 2003	I Q 2004	I-II Q 2004	I-III Q 2004	I-IV Q 2004	I Q 2005
Albania	EUR mn	384	802	1218	**1648**	380	827	1302	**1851**	417
	change in %	4.6	5.1	5.2	**3.6**	-1.0	3.0	6.9	**12.3**	9.7
Bosnia & Herzegovina	EUR mn	1045	2332	3654	**4974**	1051	2421	3855	**5354**	.
	change in %	3.5	8.2	8.7	**6.0**	0.6	3.8	5.5	**7.6**	.
Bulgaria	EUR mn	2084	4541	6933	**9611**	2412	5330	8204	**11617**	2959
	change in %	17.1	17.1	16.5	**14.3**	15.8	17.4	18.3	**20.9**	22.7
Croatia	EUR mn	2752	5982	9176	**12546**	2919	6483	9855	**13338**	3076
	change in %	12.5	9.9	10.2	**10.8**	6.1	8.4	7.4	**6.3**	5.4
Macedonia	EUR mn	496	1009	1499	**2037**	493	1087	1665	**2332**	530
	change in %	-2.1	0.0	-0.6	**-3.3**	-0.6	7.8	11.1	**14.5**	7.4
Romania	EUR mn	4541	9814	15129	**21201**	5482	11992	18644	**26281**	6642
	change in %	9.3	10.5	10.6	**12.3**	20.7	22.2	23.2	**24.0**	21.2
Serbia	EUR mn	1531	3117	4692	**6484**	1893	3996	6099	**8852**	1667
	change in %	14.0	14.1	10.9	**11.0**	23.6	28.2	30.0	**36.5**	-12.0

Trade balance

		I Q 2003	I-II Q 2003	I-III Q 2003	I-IV Q 2003	I Q 2004	I-II Q 2004	I-III Q 2004	I-IV Q 2004	I Q 2005
Albania	EUR mn	-283	-598	-915	**-1247**	-271	-588	-942	**-1365**	-296
Bosnia & Herzegovina	EUR mn	-784	-1731	-2699	**-3671**	-694	-1661	-2658	**-3677**	.
Bulgaria	EUR mn	-448	-1289	-1929	**-2942**	-693	-1712	-2398	**-3624**	-881
Croatia	EUR mn	-1388	-3286	-5174	**-7079**	-1466	-3441	-5128	**-6887**	-1585
Macedonia	EUR mn	-222	-420	-609	**-830**	-200	-489	-705	**-989**	-165
Romania	EUR mn	-763	-2313	-3555	**-5588**	-1146	-2959	-4649	**-7346**	-1552
Serbia	EUR mn	-956	-1944	-2880	**-4086**	-1349	-2768	-4066	**-5909**	-914

Note: Albania, Bosnia and Herzegovina: Data refer to balance of payments statistics.

Source: wiiw Monthly Database incorporating national statistics; IMF for Albania.

stagnating or falling in the other countries. Emigration and foreign employment of Bulgarian and Romanian citizens are of smaller scale and more recent than in the former Yugoslav countries; transfers of earnings from abroad are constantly growing and amount to 4-5% of GDP. Turkish data on transfers, 0.4% of GDP, are very modest if compared to the large size of the diaspora in Europe. But there is a huge amount of unclassified capital inflow in the balance of payments booked as errors and omissions, in part hiding remittances.

Taking all the components together, we arrive at a current account deficit to GDP ratio of 23% in Bosnia and Herzegovina, which is sustainable only due to foreign aid and multilateral loans (Table 9). The deficit levels of 13% in Serbia, 10% in Montenegro, around 7% in three other countries, and 5% in the rest of the region have to be judged in relation to the level of the external debt situation. Running a high deficit should be a lesser problem for Romania and Macedonia, which have low and declining debt to GDP ratios (around 30%). But it is certainly a major problem for Croatia and Macedonia, where debts piled up to 82% and 80% of GDP respectively. Even the net debt (gross debt minus National Bank reserves) of Croatia is high, 60% of GDP, which calls for policy adjustment. High debt is due primarily to increased private borrowing from abroad and the chosen stable exchange rate regime discussed below.

Table 9

Foreign financial position

end of period, in % of GDP, EUR based

	Gross external debt [1]			Reserves of National Bank (excluding gold) [2]			Current account			
	2002	2003	2004	2002	2003	2004	2003	2004	2005 forecast	2006 forecast
Albania	22.0	20.6	.	15.9	15.0	15.4	-6.7	-4.4	-5	-4
Bosnia & Herzegovina	36.8	32.7	30.7	21.2	22.6	26.6	-24.5	-23.3	-21.4	-18.8
Bulgaria	65.1	60.2	63.0	13.1	14.4	17.0	-9.2	-7.4	-7.5	-6.4
Croatia	62.2	77.6	82.1	23.3	25.7	23.3	-6.9	-4.5	-4.4	-4.5
Macedonia	37.7	34.5	33.4	17.3	17.5	15.4	-3.3	-7.7	-6.6	-6.3
Romania	30.9	31.3	30.7	12.1	12.6	18.4	-6.0	-7.5	-8.3	-7.4
Serbia	71.2	64.7	57.9	13.7	16.3	16.8	-9.2	-13.1	-14	-13
Montenegro	.	65.7	80.4	.	.	.	-7.4	-9.7	-5	-5
Turkey	70.9	60.5	53.5	13.9	13.4	11.4	-3.3	-5.1	-5	-5

Notes: 1) General government foreign debt for Bosnia and Herzegovina; Macedonia and Romania medium- and long-term debt. - 2) Albania: total foreign assets including gold.

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

Turkey has successfully emerged, in the past four years, from the default. Foreign debt to GDP is declining, the current account deficit is moderate, but reserves could be higher. The prospects for the country are quite good and another default is unlikely. The other country of the region which went through a currency crisis a few years before Turkey is Bulgaria, which has an improving net debt position under the currency board regime since 1997. Staying with the currency board until the country joins the EMS seems to be a feasible policy.

FDI could be a non-debt creating way of financing the current account deficit. This was achieved in Albania, Bulgaria and Romania in 2004 (Table 10). But inflows fluctuate year-by-year according to the availability of major privatization deals, and a high level of deficit financing is possible only as long as there are state assets to be sold. Export oriented greenfield investments are confined to Bulgaria and Romania.

Table 10

FDI inflow to SEE, EUR million

	2000	2001	2002	2003	2004	2005 forecast	2004 in % CA	2005 in % CA
Albania	155	232	151	158	275	400	95.8	111.1
Bosnia and Herzegovina	159	133	282	338	400	400	25.9	26.7
Bulgaria	1103	903	980	1851	2114	1800	146.1	112.5
Croatia	1142	1503	1195	1788	921	1000	73.7	76.9
Macedonia	189	493	83	84	122	100	36.5	33.3
Romania	1147	1294	1212	1946	4098	3500	93.1	58.3
Serbia	55	186	502	1197	775	800	33.1	32.0
Montenegro	.	11	89	39	50	50	35.0	35.0
Turkey	1855	3684	621	367	2199	2000	17.6	14

Note: CA means current account deficit.

Remarks: Albania: equity capital.
Bosnia and Herzegovina: equity capital.
Bulgaria: equity capital + reinvested earnings + loans.
Croatia: equity capital + reinvested earnings + loans.
Macedonia: equity capital.
Romania: equity capital + reinvested earnings from 2003 + loans.
Serbia: FDI net (inflow minus outflow).
Montenegro: FDI net (inflow minus outflow).

Source: Respective National banks according to balance of payments statistics.

Managing the exchange rate and capital inflows

Five SEECs have currencies with fixed exchange rates to the euro: Bulgaria and Bosnia-Herzegovina run a currency board, Macedonia and Croatia (unofficially) maintain a peg, Montenegro (and Kosovo) use the euro as a legal tender. Four countries have more flexible exchange rate regimes: Serbia has an unannounced crawling peg system, similarly to Romania until recently, which means that the central bank allows a depreciation somewhat below the rise in the consumer price index and guides the floating exchange rate towards an unannounced target. This target is given up in the case of an unexpected shock. Romania is now about to switch to a freer float. Inflation targeting is the current direction of monetary policy in Romania, Turkey and Albania and is associated with floating exchange rate regimes.

With a fixed or pegged exchange rate countries can achieve monetary stability, but still their inflation is usually higher than in the euro-zone and the real appreciation may erode their competitiveness. More flexible exchange rate systems usually go hand in hand with higher inflation. These regimes allow for a depreciation of the local currency that may help maintain international price competitiveness. But capital inflows may also appreciate a currency and thus work against the current account balance. This has been the case in Romania since October 2004 and to a lesser extent in Albania as well. Also the Croatian and the Bulgarian currencies appreciated in real terms in 2004 and in the first quarter of 2005. But only Croatia has problems with exporting while the Bulgarian currency still seems undervalued. Serbia is similar to Romania of the late 1990s with inflation and depreciation supporting each other. While most of the Southeast European countries have relied on the currency peg to control inflation, Romania also gradually improved fundamentals which brought down inflation. It is to be seen what steps the Serbian authorities will take if the current trend of widening current account deficit and accelerating inflation continues.

Table 11

Exchange rate development, 2003-2005

11a

Nominal exchange rates per EUR, growth rate year-on-year 1)

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004	I Q 2005
Bulgaria	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Croatia	-2.7	-0.7	-0.1	0.2	1.6	2.3	2.0	2.5	-1.3
Macedonia	0.2	0.1	0.0	0.1	0.6	0.5	0.4	0.4	0.2
Romania	25.7	22.1	15.1	18.8	13.9	8.7	9.6	0.4	-8.6

Note: 1) Quarterly data refer to averages of monthly rates.

Source: wiiw Monthly Database incorporating national statistics.

11b

Real rates per EUR, PPI-based – growth rate year-on-year 1)

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004	I Q 2005
Bulgaria	-5.6	-2.4	-3.4	-3.7	-1.5	-4.8	-4.5	-3.2	-2.6
Croatia	0.1	1.0	0.9	2.4	0.6	-2.5	-3.7	-3.0	-2.8
Macedonia	0.6	2.2	2.7	2.9	2.9	1.9	1.0	1.2	1.3
Romania	4.8	2.4	-1.6	0.0	-3.3	-7.2	-7.0	-12.2	-16.7

Note: 1) Minus means real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

11c

Real rates per EUR, CPI-based – growth rate year-on-year 1)

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004	I Q 2005
Bulgaria	2.0	1.2	-0.7	-2.3	-4.2	-4.0	-4.0	-2.1	-1.4
Croatia	2.5	3.1	2.2	2.9	0.5	-1.3	-1.0	-0.8	-2.0
Macedonia	1.0	0.6	-0.6	0.0	-0.2	1.9	2.0	1.9	1.9
Romania	10.5	8.7	2.3	5.6	2.2	-0.8	0.4	-6.3	-13.9

Note: 1) Minus means real appreciation.

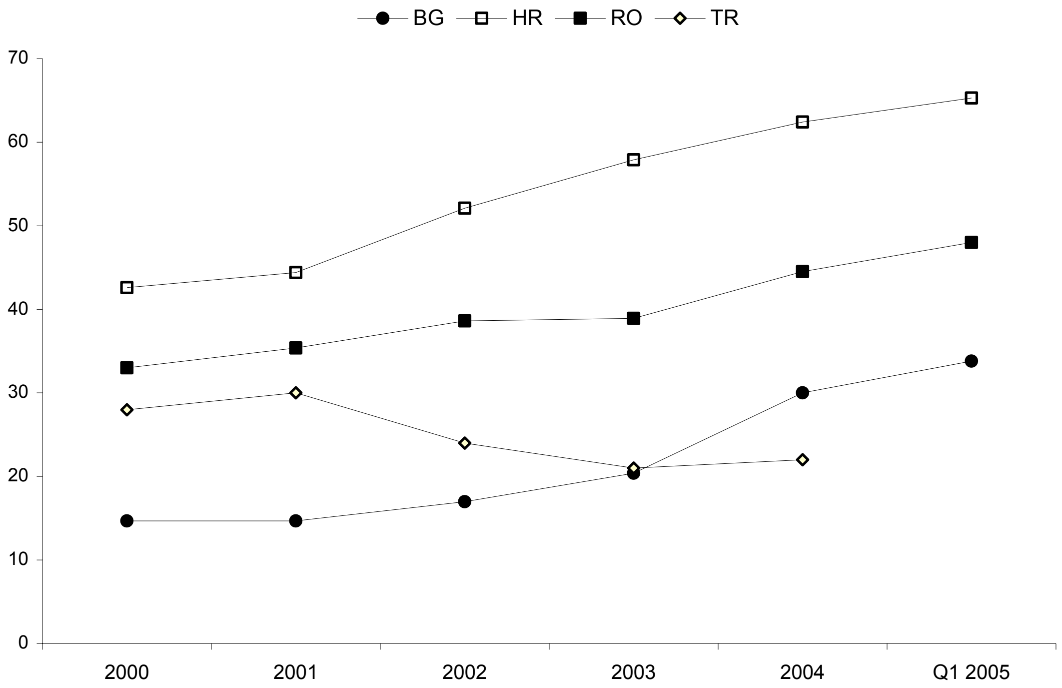
Source: wiiw Monthly Database incorporating national statistics.

Investment risk has declined in the accession countries and in Croatia. Appreciating currencies together with high domestic interest rates attract investments and help accumulate private sector debts (Tables 9 and 11). Looking at the composition of foreign debt, one can observe the increasing share of private debt in total foreign debt in all three countries (Figure 2). Foreign banks, which are the main owners of local commercial banks, are particularly active in borrowing abroad cheaply and investing in the host country, thus earning on the interest rate differential. They extend credits to households rather than to companies, or buy government securities. Lending to households and mortgage loans have been attractive businesses in recent years.

Figure 2

Share of private foreign debt in total foreign debt, 2000-2005

in per cent



Source: National Banks of the respective countries.

Central banks are concerned about the excessive capital inflows and the fast increase of lending to the population. Capital inflows increase the current account deficit or, if not sterilized, they may increase inflation. But with currency boards or pegged exchange rates in place, central banks have very few monetary policy instruments at hand. Bulgaria and Croatia try to influence the commercial banks' credit activity by raising reserve requirements. Romania was concerned about the domestic credit expansion early last year and increased the lead interest rate. Later on the authorities became more concerned about capital inflows and worked on lowering the interest rate. The absence or limited availability of monetary policy instruments together with a fixed or appreciating exchange rate puts the burden of adjustment on fiscal policy.

Fiscal policy tight

Fiscal consolidation has been a primary target throughout the region with the aim to cure the high current account deficits, while only two countries have also high budget deficits. Albania and Croatia run general government deficits of more than 4.5% of GDP, the rest of the countries have deficits of less than 2%, Bulgaria is running a surplus (Table 12). Budgetary austerity is the IMF-led government programme irrespective of the size of the budget balance. In the long run this policy has been very helpful to introduce fiscal discipline and improve transparency but in individual cases it proved to be overambitious or even counterproductive.

Table 12

General government budget balance, in % of GDP [1)]

	2000	2001	2002	2003	2004 [2)]	2005 forecast	2006
Albania	-7.5	-6.9	-6.0	-4.6	-4.6	-6	-5
Bosnia and Herzegovina	-7.0	-3.3	-0.2	0.8	.	.	.
Bulgaria	-0.6	-0.6	-0.7	0.0	1.7	1	-0.5
Croatia	-6.5	-6.8	-4.8	-6.3	-4.9	-4	.
Macedonia [3)]	2.3	-6.3	-5.6	-1.6	-1.3	.	.
Romania	-4.0	-3.2	-2.5	-2.3	-1.1	-1.0	-1.0
Sebia	-0.9	-1.4	-4.5	-4.2	-1.7	.	.
Montenegro [4)]	6.0	3.1	2.7	3.0	2.1	.	.
Turkey	-11.9	-16.2	-12.6	-8.6	-7.0	.	.

Notes: 1) National definition, for Croatia IMF definition. - 2) Preliminary. - 3) From 2001 excluding privatization revenues. – 4) Central government deficit.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Under the currency board regime in Bulgaria there is hardly any other tool in the hands of the authorities to curtail the current account deficit and the inflationary pressure than working on government-generated demand. The fiscal surplus over the past few years has helped the country to reduce its public debt from the level of default to a level earning constantly improving sovereign credit ratings. Fast structural reforms helped the country to embark on a sustainable economic growth path which effected increased budgetary revenues. But expenditure tightening has curtailed public services, depressed wages and pensions and contributed to the low standard of living. The wage increases introduced at the beginning of this year despite the objections of the IMF have actually not reduced the surplus of the budget. Also Romania was in dispute with the IMF over the compensation of lost revenues due to the introduction of a 16% flat tax at the beginning of 2005. However, revenues from other sources grew fast enough to keep the deficit within the modest limit of 1% of GDP.

In Croatia the public deficit is a more pressing problem. It has been high for several years and has contributed to the soaring external indebtedness. The government planned to bring down the deficit from close to 5% of GDP in 2004 to 3.7% in 2005. This seems quite impossible if only due to the deceleration of economic growth, and in midyear the government has probably softened the target. Transparency of the budget is another acute problem and methodological improvement is necessary before a more exact judgement can be made. This is certainly true also for many other countries in the region.

Macedonia has been an example of successful fiscal consolidation, bringing down the deficit from over 6% of GDP in 2001 to 1% in 2004. Arriving at a healthy budget has had a depressing effect on economic growth. Now that a resumption of growth is the main aim, the government seems to lack ideas how to stimulate growth without falling back on the fiscal side. Serbia is a more recent example of a similar budgetary consolidation policy. It has brought down the general government deficit from 4.2% of GDP in 2003 to 1.7% in 2004. The IMF programme stipulates a surplus for 2005. Fiscal austerity is a vehicle to speed up structural reforms in the still too large public sector and to press for privatization. Subsidies and inefficient employment are to be reduced. The short-term effects of this programme have already shown up in an increasing rate of unemployment while exports recovered and economic growth accelerated.

Turkey is on an even stricter programme of the IMF which has supported its recovery from the 2001 crisis. The budget deficit has been brought down from 16% of GDP to 8% in 2004 while it has a primary surplus of 6% of GDP. The difference are the interest payments on the huge public debt the country is servicing. Similar to the transition economies, privatization revenues should help bring down government debt.

EU enlargement now more uncertain

Accession to the European Union in 2007 is the main goal of all political forces in Bulgaria and Romania. Also other governments in the region target EU accession in the more remote future. This aspiration contributes to enforcing structural reforms and may increase political stability as well. But the European sentiment towards further EU enlargements has cooled down recently. The outcome of the referenda on the EU Constitution in France and the Netherlands interrupted the process of deepening the integration and also questioned the usefulness of further enlargements. An ebb of the integration process may start a re-thinking of the future of European integration and solutions to pending issues may be further delayed. The dates and conditions of further enlargements could come under renewed consideration and political goodwill may no longer tolerate the lack of preparedness.

Having signed the accession treaty on 25 April 2004, Bulgaria and Romania can feel quite safe over their future in the EU. Unilateral withdrawal of the EU from this commitment is unlikely. Still there are at least two major hurdles over which the accession of the two countries on 1 January 2007 may stumble. One is the annual assessment by the Commission; the other is the ratification of the accession treaties in the parliaments of the member states.

The European Commission is expected to provide the next screening of Bulgaria and Romania in November 2005 and will detail the most sensitive aspects of the current situation. This report is expected to determine whether Bulgaria and Romania should join in 2007 or 2008. Meanwhile early warning letters have arrived in the two capitals reminding the governments of areas where further efforts are necessary. There are several chapters including competition where the governments may get bad marks.[13] If inadequate preparedness should be stated, the safeguard clause by which accession would be postponed to 2008 will probably take effect. The likelihood of this has increased. Following the negative referenda on the European Constitution, the Commission will be more strict when judging the conditions in the accession countries.

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[13] The accession treaty refers to a list of policy areas (11 for Romania and 7 for Bulgaria) in which the two countries must make significant progress before accession. In Romania, the main issues are corruption, border controls, the enforcement of state aid controls and the implementation of environmental laws. In Bulgaria, the concerns center upon judicial reforms, agriculture, environment (including the closure of the Kozloduy nuclear power plant), intellectual property rights and the free movement of services.

Accession delayed by one year would not do much economic harm to Bulgaria and Romania. It could in fact be used for further preparation and increasing competitiveness. While they would not be eligible for increased funds from the EU budget, their ability to draw on these funds later on may increase. The loss in transfers would amount to EUR 1.16 billion for Romania, but only under the unlikely condition that the country would be able to exploit all these funds. There will certainly be disappointment in both Bulgaria and Romania if they do not prepare for the delay in due time. The negative political sentiment towards enlargement in some incumbent countries may also postpone the ratification of the two accession treaties. This may not only delay accession by one year but postpone enlargement for good. What seemed to be very unlikely just a few months ago has become a real possibility in the new political circumstances.

The renewed discussion on enlargement deals a blow to all other countries in the region as well. Turkey in particular, which was promised the start of the lengthy accession negotiations as of October 2005, may have to suffer a delay. Croatia is another official candidate country. Its prospects are better as it may start the negotiation process provided its cooperation with the Hague Tribunal is found satisfactory.

For countries in the Western Balkans that have made sufficient progress in terms of political and economic reform and administrative capacity, the next step is a formal contractual relationship with the EU. This takes the form of a tailor-made Stabilization and Association Agreement (SAA). To keep the process of preparation for enlargement going is essential for longer-term political stability and continued reform efforts in the region. Macedonia has already signed an SAA with the EU and may obtain candidate status soon. The Serbian government, in order to get an SAA, has first of all to improve cooperation with the Hague Tribunal. Further, it has to adopt a national strategy of accession to the EU. The unresolved status of Kosovo and the uncertain future of the union with Montenegro are additional constitutional problems that have to be solved. In Bosnia and Herzegovina local authorities do not appear enthusiastic to meet the EU conditions necessary for concluding an SAA. The Serb-dominated part of the country (RS) has recently rejected one of the conditions, the creation of a country-wide police force. While the lack of fulfilling political conditions seems to be the major delaying factor to sign SAAs, only a deepening cooperation with the EU and the prospect of membership can stimulate governments to solve the pending problems, guarantee stability and create conditions for sustainable economic development.

Economic outlook and major risks

In 2005 Southeast Europe is expected to grow somewhat less dynamically than in 2004. In most countries both investments and private consumption are likely to grow less than in the previous year. Public consumption will decline further and net exports may become even more negative than last year. Growth deceleration will not stop the catching-up process as all countries but Croatia will grow at a rate between 4% and 6% in 2005 and probably also in 2006.

Inflation is low or coming down while most currencies are strengthening in real terms. The employment situation improves only in the fast growing accession countries while high unemployment is stubborn throughout the Western Balkans. The main economic policy challenge are the widening current account deficits and, in some countries, also the expansion of foreign debt. Fiscal consolidation is the main policy tool applied to curtail the foreign deficits which may depress economic growth.

The negative political sentiment towards further enlargement expressed by several policy makers in EU member countries has not de facto changed the policy of the EU. All countries in Southeast Europe are hopeful that the timetables agreed earlier will be followed. If the accession of Bulgaria and Romania were to be delayed by one year, as foreseen in the safeguard clause of their accession treaty, this would not have much negative economic effect.

Albania

Economic dynamics is strong. The parliamentary elections in July 2005 need to be fair and democratic for a continuation of the favourable economic development and European integration.

Bosnia and Herzegovina

During the next few years transfers and multilateral loans will continue to fuel consumption and, to some degree, also gross fixed investment; thus economic growth can be maintained coupled with high current account deficits. The international community including the EU is pressing for a strengthening of the central government disliked by Croat and Serb political circles.

Bulgaria

The economic rebound, underpinned by an export-led surge in manufacturing, reflects a virtuous cycle of strong growth and accelerating reforms in the run-up to full EU membership.

Croatia

Combating both high foreign debt and fiscal deficits will remain the main challenge. Following the slowdown of economic growth, employment will stagnate or even decline.

Macedonia

The country intends to build on the achieved stability, speed up structural reforms and bring the economy unto a higher and sustainable growth path. The exchange rate will remain firmly fixed to the euro and fiscal policy will be tight. That will not bring more acceleration of growth in the short run.

Romania

Economic growth has slowed down but is still robust. Inflation and the exchange rate remain the main uncertainties in view of the widening current account deficit.

Serbia

The squeeze of consumption will have the expected effect on a decrease of the trade deficit, but will also contribute to lower GDP growth. Inflation will remain relatively high, currency depreciation will continue.

Montenegro

Fiscal consolidation completed, inflation is slowing down and GDP growth is accelerating. The public sector is the main remaining threat to macroeconomic stability.

Turkey

The economic policy melange of IMF conditionality and EU observance has a positive impact. The government gradually reduces the debt burden, and has taken important steps towards a consolidation of the banking sector. Nominal stabilization is on the way, both in terms of inflation and exchange rate, without impeding high GDP growth. It would be detrimental to economic growth, should the Turkish lira experience significant nominal appreciation, especially against the euro.

Country reports

Anton Mihailov

Bulgaria: a lasting upswing

The economic upswing in Bulgaria continued in the first quarter of 2005 with a healthy GDP growth of 6% over the same period of 2004. Economic activity remained buoyant across the board and even gained further momentum in sectors such as manufacturing, construction and market services. Both the robust domestic demand (in particular private consumption) and the strong export performance provided solid support to domestic economic activity; nevertheless the foreign trade deficit increased.

The export-led surge in the manufacturing industry continued in the first quarter, although there was a certain deceleration in the rates of industrial output growth as compared to the exceptionally fast rates seen in 2004. In current euro terms, merchandise exports grew by almost 21% year on year in the first quarter, but this was also below the 31% rate of change in the last quarter of 2004. Despite the modest slowdown, this growth pattern is expected to continue in the short run as new export-oriented production capacity is coming on stream.

Judging from labour force surveys, there was further improvement in the labour market both in terms of growing employment and a decreasing rate of unemployment. The temporary discontinuation of some public works programmes in January (they were re-initiated later) led to a one-off hike in the number of registered unemployed in the first quarter. However, this one-off effect will probably be phased out in the course of the year.

Consumer demand remained buoyant, with real retail sales increasing by nearly 13% year on year in the first quarter. Consumer spending was underpinned by a renewed surge in household credit: in April 2005 the stock of outstanding bank claims on households was 81% higher than a year earlier. This also remained a major point of contention between the authorities and the IMF, as the latter is concerned that the credit boom is fuelling the current account deficit. In 2004 the authorities undertook a series of measures seeking to check the growth of credit (including tightening of the banks' mandatory reserve requirements); however, these measures did not bring about the expected effect. In March 2005 the central bank introduced strict ceilings on the credit activity of commercial banks and further tightened the banks' capital adequacy regulations. There are some first signs that after these new measures the growth of commercial credit may be slowing down.

In January the government went ahead with the planned 25% increase in minimum wages despite strong objections from the IMF. Disputes continued for several months and in the end, during the March review of the two-year precautionary agreement, the IMF grudgingly accepted the unilateral decision of the Bulgarian government. In return, the government agreed with the IMF's insistence to further tighten its fiscal stance and aim for a consolidated general budget surplus of BGN 415 million (1% of GDP) in 2005 (the budget bill adopted in late 2004 envisaged a deficit 0.5%). Obviously, this is a commitment that will have to be fully implemented by the next government that will take office after the June parliamentary elections. However, in view of the excellent fiscal outturn in the early months of 2005, this goal seems to be within easy reach: by end-April public finances were already in a healthy surplus of BGN 673 million, largely thanks to more efficient tax collection. As to the repercussions of the minimum wage hike, so far it has been relatively limited: the average salaries of the employed on labour contracts in the first quarter of 2005 increased by 8.8% year on year, compared to an average rate of growth of 6.4% in 2004 as a whole. So far there has been no discernible pro-inflationary impact either.

While the ongoing bargaining with the IMF continued to lay its fingerprint on the day-to-day policy agenda, the most visible, positive development in the international arena was the signing in April, together with Romania, of the Accession Treaty to the European Union, in accordance with which the two countries are set to become full EU members in January 2007. This is an unequivocal acknowledgement of Bulgaria's progress in market reforms and an undoubted success for the governments that implemented these reforms.

The continuing economic rebound in Bulgaria seems to reflect a virtuous cycle of strong growth and accelerating reforms in the run-up to full EU membership. A similar process could be observed in the Central European and the Baltic countries prior to their accession to the EU, but also now in Romania and, partly, in Croatia and Turkey. As evidenced by the experience of these countries (now including Bulgaria), the realistic prospect of EU accession, especially when it is accompanied by a definite timetable, can generate a powerful impetus to economic growth through its anchoring effect on the expectations of both investors and consumers. At the same time, it strengthens the government's incentives to push ahead with its commitments for market reforms, amplifying the positive effect on expectations. The resulting investment boom, in particular the surge in inward FDI, gives a solid boost to economic growth.

At present, however, there are a number of uncertainties, both internal and external, as to the sustainability of this benign scenario in Bulgaria, and in fact risks related to the actual timetable for the country's accession to the EU. On the external side, one should point out the new situation in the EU after the two negative popular votes (in France and the Netherlands) on the EU constitutional treaty. It is not yet clear what specific impact these two negative votes may have on the prospects and timing of Bulgaria's accession to the EU, but definitely they have increased the downside risks. In principle, since both Bulgaria and Romania are considered to be an inherent part of the ongoing round of EU enlargement (together with the ten countries that acceded in 2004), in the framework of established rules, there should be no formal impediments to the completion of this round as envisaged. However, the change in sentiment within the EU may have negative implications for the speed of this process and the EU might be more stringent in scrutinizing the progress made by the two countries in their commitments to implement the required reforms. Moreover, the two Accession Treaties contain a safeguard clause that allows the EU Council, upon a recommendation from the EC, to postpone accession by one year in the case of serious delays in the implementation of the *acquis* in some important areas.

On the domestic side, the greatest risks are related to the possible outcomes of the June parliamentary elections and the capacity of the new government to finalize the pre-accession reform agenda. The main risk related to the political cycle would be an eventual inability of the new parliament to designate a government backed by strong parliamentary support. The absence of such support may be an important impediment for the completion of the remaining pre-accession reform agenda, which includes some rather politically sensitive areas. Thus, considerable delays seem to have been incurred in the envisaged overhaul of the judiciary system, which requires the adoption of a broad package of related legislation (within the domain of justice and home affairs).

Table BG

Bulgaria: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1)]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period [2)]	8149.5	7891.1	7845.8	7801.3	7761.0	.	.	.	.
Gross domestic product, BGN mn, nom.	26752.8	29709.2	32335.1	34546.6	38008.4	8003.7	8690.1	41500	45500
annual change in % (real)	5.4	4.1	4.9	4.5	5.6	4.5	6.0	5.5	5.3
GDP/capita (EUR at exchange rate)	1674	1920	2101	2258	2497	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5310	5820	6070	6340	6680	.	.	.	.
Gross industrial production									
annual change in % (real) [3)]	8.3	1.5	6.5	14.1	18.3	14.8	11.1	10	8
Construction output total									
annual change in % (real)	8.0	15.0	2.7	5.6	12.9	.	.	.	.
Actual final consump.of househ., BGN mn, nom.	20687.8	23009.1	24822.9	26846.0	29136.4	6529.4	7276.2	.	.
annual change in % (real)	4.9	4.6	3.4	7.1	4.9	4.8	7.3	.	.
Gross fixed capital form., BGN mn, nom.	4206.0	5415.2	5908.5	6694.4	7957.3	1505.9	1762.6	.	.
annual change in % (real)	15.4	23.3	8.5	13.9	12.0	22.1	9.2	8	10
LFS - employed persons, th, avg.	2794.7	2698.8	2739.6	2834.8	2922.5	2783.8	2838.4	.	.
annual change in %	-2.8	-3.4	1.5	3.5	3.1	2.9	2.0	.	.
Reg. employees in industry, th pers., avg.	662.0	658.4	666.8	689.5	680.0	687.4	675.8	.	.
annual change in %	-8.4	-0.5	1.3	3.4	-1.4	1.0	-1.7	.	.
LFS - unemployed, th pers., average	566.8	663.9	592.4	448.7	399.7	428.8	362.3	350	330
LFS - unemployment rate in %, average	16.9	19.7	17.8	13.7	12.0	13.3	11.3	10.3	9.5
Reg. unemployment rate in %, end of period	17.9	17.3	16.3	13.5	12.2	13.7	12.7	11	10
Average gross monthly wages, BGN	224.5	240.0	257.6	273.3	299.0	281.0	308.0	.	.
annual change in % (real, gross)	1.3	-0.5	1.5	3.7	-1.9	0.0	5.5	.	.
Consumer prices, % p.a.	10.3	7.4	5.8	2.3	6.2	6.4	3.8	4	4
Producer prices in industry, % p.a.	17.5	3.8	1.2	4.9	5.9	1.8	6.2	.	.
General governm.budget, nat.def., % GDP									
Revenues	41.4	39.8	38.7	40.7	41.7	45.1	47.9	.	.
Expenditures	42.0	40.4	39.4	40.7	40.0	42.3	42.4	.	.
Deficit (-) / surplus (+), % GDP	-0.6	-0.6	-0.7	0.0	1.7	2.8	5.5	1	-0.5
Public debt in % of GDP [4)]	73.6	66.2	53.2	46.2	38.8	44.8	32.5 Feb	33	28
Base rate of NB % p.a., end of period	4.7	4.7	3.4	2.9	2.4	2.6	1.9	.	.
Current account, EUR mn	-761.4	-1101.7	-925.5	-1630.2	-1447.1	-499.4	-704.4	-1600	-1500
Current account in % of GDP	-5.6	-7.3	-5.6	-9.2	-7.4	-12.2	-15.9	-7.5	-6.4
Gross reserves of NB excl. gold, EUR mn	3390.6	3734.0	4247.1	4981.0	6443.0	5038.1	6325.1	.	.
Gross external debt, EUR mn	11882.7	11934.9	10768.9	10638.7	12245.9	11452.1	12854.8	.	.
FDI inflow, EUR mn	1103.3	903.4	980.0	1850.5	2114.2	362.6	289.1	1600	1400
FDI outflow, EUR mn	3.5	10.8	28.9	23.3	-174.8	-8.3	-15.6	.	.
Exports of goods, BOP, EUR mn	5253.1	5714.2	6062.9	6668.2	7993.9	1719.2	2077.6	9300	10400
annual growth rate in %	40.7	8.8	6.1	10.0	19.9	5.1	20.8	16	12
Imports of goods, BOP, EUR mn	6533.0	7492.6	7754.7	8867.8	10711.8	2227.6	2729.2	12000	13200
annual growth rate in %	37.8	14.7	3.5	14.4	20.8	15.7	22.5	12	10
Exports of services, BOP, EUR mn	2366.2	2384.8	2478.9	2790.9	3361.8	494.1	537.9	3750	4150
annual growth rate in %	40.3	0.8	3.9	12.6	20.5	20.6	8.9	12	11
Imports of services, BOP, EUR mn	1818.6	1930.3	1992.9	2267.7	2638.3	522.4	613.6	2900	3200
annual growth rate in %	31.7	6.1	3.2	13.8	16.3	11.8	17.5	10	10
Average exchange rate BGN/USD	2.124	2.185	2.077	1.733	1.575	1.564	1.492	.	.
Average exchange rate BGN/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD	0.543	0.564	0.597	0.599	0.612	.	.	.	.
Purchasing power parity BGN/EUR	0.617	0.645	0.677	0.696	0.731	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 according to census March 2001. - 3) Different methodology for quarterly data. - 4) According to ESA'95, excessive deficit procedure.

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

These were supposed to be passed by the outgoing parliament but were put on hold due to the absence of a wider consensus (both political and among the judiciary itself) on the nature of the reforms, as well as due to internal infighting within the governing coalition. The new parliament will thus be faced with the formidable task to accelerate these reforms, which may be even more difficult in the absence of a strong governing parliamentary core. Similarly, there have been serious delays in the implementation of commitments related to agricultural reforms, largely due to a populist pre-election shift in the outgoing government's policy stance. Pushing these ahead will again require strong political backing. The latest reminder from the EC contains also remarks on reforms in the domains of company law, environment and some services.

Despite some political rhetoric, in particular regarding the future of nuclear power in Bulgaria, the risks of a possible deviation of a new government from the commitments made by previous ones seem to be minimal. According to the Accession Treaty (and following a series of previous protocols), Units 3 and 4 of the Kozloduy nuclear power plant are due to be closed in 2006, after closing Units 1 and 2 in 2003. This has been a hot potato in Bulgarian politics during the past decade, with all parties blaming each other for insufficiently protecting the national interest in the negotiations with the EU. During the pre-election campaign some political forces even called for re-opening the energy chapter in order to push for a delay in the deadline for closure. However, the negative results of the referenda in France and the Netherlands seem to have had a sobering effect on the political establishment and even the most vocal Kozloduy proponents have recently kept silence on this issue. Moreover, Bulgaria managed to negotiate a relatively generous direct financial assistance from the EU, amounting to EUR 210 million, for the closure of the four reactors.

Overall, it seems that the emergence of a strong government after the June election would be the key for the successful implementation of the pre-accession reform agenda. The stakes of EU accession are very high, including the crucial detail as to which political party will claim the credit for leading the country into the EU. In this sense, if the newly elected government, regardless of its political leaning, is confident in its strength, it may eventually give up on its own ideological bias for the more pragmatic goal of timely implementation of the *acquis*. Understandably, the opposite scenario entails much greater risks.

In any case, the expected change in government after the elections is unlikely to affect the short-term outlook for the Bulgarian economy, which remains generally positive. The curbing of bank lending may result in some moderation in the pace of aggregate output growth in the second half of the year but nevertheless GDP is expected to increase by more than 5% in 2005 as a whole, and the macroeconomic fundamentals are set to remain stable. Strong growth should support further improvements in the labour market. While the current account deficit is likely to remain high, its financing should not pose major problems, as the surge in FDI continues.

Gábor Hunya

Romania: signs of a slowdown

After a record GDP growth of 8.3% in 2004, economic growth has slowed down in Romania in 2005. In the first quarter of the year the economy still grew by an impressive 5.9%, marginally less than the 6.2% recorded in the same period of the previous year. Private consumption expanded rapidly but government consumption contracted and net exports declined further. Investments increased close to the rate recorded a year earlier. A less abundant harvest will result in lower agricultural output while manufacturing industry grows at a rate of 5%. Construction and retail trade are the most dynamic sectors of the economy.

With the tax cuts introduced at the beginning of 2005 – a flat tax rate (16%) for corporate and personal incomes – there had been widespread fears that the budget deficit would widen. Although a deficit in the range of 1.5% of GDP would not have been detrimental, the government felt obliged to discuss with the IMF some countervailing measures. But revenues in the first four months of the year showed a substantial increase: The rise in revenues from indirect taxes and social security contributions was much stronger than the decline in revenues from taxes on profits and personal income. The government has therefore postponed the introduction of a capital gains tax to next year, and the 10% tax on interests – originally envisaged for April, then for June – is still not in place. The budget rectification that would accommodate all the expected results of the changes introduced since the beginning of the year has not been passed yet, and as of mid-June the country has no valid budget for the current year. After the talks with the IMF in mid-June a budgetary deficit of 0.7% of GDP was agreed for the current year. A similar deficit is now envisaged for 2006 when the rate of VAT should increase to 22% while social security contributions should diminish.

The tax cuts and public-sector wage increases are reflected in the growth of net wages and retail sales. Real net wages increased by 13% in the first quarter while retail trade turnover boomed by 19%, cars and fuel sales by 23%; only the increase of services was modest. Savings of the population grew by 30% in real terms compared to the first quarter of the previous year, probably as a reaction to the threat of the new tax on interest on new deposits. Employment profited from the economic boom: the number of wage-earners increased and the unemployment rate fell to 6%, the lowest rate in ten years.

Increased demand has not generated inflation as measured by the official consumer basket. In May 2005 consumer prices were 10% higher than a year earlier, but it was mainly government-administered prices that accounted for that rise. Further increases will come in July and October when gas and communal heating prices will be increased. At the same time, currency appreciation has been a factor working towards price stability. The National Bank envisages 7% inflation in December 2005, year-on-year: in view of the latest developments this target may be exceeded by about one percentage point.

The nominal appreciation of the Romanian leu (ROL) has continued in 2005. At the end of April, the local currency was 8.7% stronger in relation to the euro than at the end of December 2004. Improved credit ratings and high interest rates have attracted foreign portfolio investors, increasing the demand for the local currency. The liberalization of sight deposits for foreigners in April has prompted a further albeit modest inflow of foreign currency. To forestall inflows, the National Bank reduced the policy interest rate by 2 percentage points, to 12.5%. The National Bank has also lowered the interest rate on its lending and deposit facilities and the rates on compulsory reserves. The reference interest rate of central bank operations came down from 18% in December 2004 to 8% in June 2005, which demonstrates high liquidity of the banking system. Still the interest applied by commercial banks to non-government non-bank clients fell from 25% in December 2004 to only 22% in April 2005 while deposit rates dropped from 14% to 8%. Following the liberalization of the

Table RO

Romania: Selected Economic Indicators

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year	22435.2	22408.4	21794.8	21733.6	21673.3	.	.	.	.
Gross domestic product, ROL bn, nom.	803773	1167687	1514751	1903354	2387914	408957	497251	2746000	3100000
annual change in % (real)	2.1	5.7	5.1	5.2	8.3	6.2	5.9	5.5	5.5
GDP/capita (EUR at exchange rate)	1795	2002	2224	2332	2718	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4990	5440	6040	6330	7070	.	.	.	.
Gross industrial production									
annual change in % (real)	7.1	8.3	4.3	3.1	5.3	5.9	5.3	5	5
Construction output total									
annual change in % (real)	2.8	9.0	10.0	9.8	9.2	8.8	3.1	.	.
Actual final consump.of househ., ROL bn, nom.	634590	917186	1169404	1483481	1896937	344886	428598	.	.
annual change in % (real)	0.2	6.8	4.8	7.2	10.8	9.5	12.5	.	.
Gross fixed capital formation, ROL bn, nom.	151947	241154	322836	422535	532549	67778	79407	.	.
annual change in % (real)	5.5	10.2	8.2	9.1	10.1	7.3	5.2	7	8
LFS - employed persons, th, avg. 2)	10763.8	10696.9	9234.3	9222.5	9157.8	8816.9	.	.	.
annual change in %	-0.1	-0.6	.	-0.1	-0.7	0.1	.	.	.
Reg. employees in industry, th pers., avg.	1873.0	1901.0	1891.0	1848.0	1818.0	.	.	.	.
annual change in %	-5.9	1.5	-0.5	-2.3	-1.6	-2.4	-0.2	.	.
LFS - unemployed, th pers., average 2)	821.2	750.0	845.3	691.8	799.5	850.2	.	.	.
LFS - unemployment rate in %, average 2)	7.1	6.6	8.4	7.0	8.0	8.8	.	7	7
Reg. unemployment rate in %, end of period	10.5	8.8	8.4	7.4	6.2	7.8	6.0	.	.
Average gross monthly wages, ROL	2876645	4282622	5452097	6741152	8261492	7852024	9155605	.	.
annual change in % (real, net)	4.6	4.9	2.1	10.7	9.5	9.0	13.1	.	.
Consumer prices, % p.a.	45.7	34.5	22.5	15.3	11.9	13.6	8.8	9	7
Producer prices in industry, % p.a.	53.4	38.1	23.0	19.5	18.6	17.9	13.3	.	.
General governm.budget, nat.def., % GDP									
Revenues	31.2	30.1	29.5	29.8	29.6	.	.	.	.
Expenditures	35.2	33.3	32.1	32.1	30.7	.	.	.	.
Deficit (-) / surplus (+)	-4.0	-3.2	-2.5	-2.3	-1.1	.	.	-1.0	-1.0
Public debt, EU-def., % of GDP 3)	23.9	23.2	23.3	21.3	18.5	.	.	.	.
Discount rate, % p.a., end of period 4)	35.0	35.0	20.4	20.4	18.0	21.3	10.8	.	.
Current account, EUR mn	-1494	-2488	-1623	-3060	-4402	-484	-899	-6000	-6000
Current account in % of GDP	-3.7	-5.5	-3.3	-6.0	-7.5	-4.8	-6.7	-8.3	-7.4
Gross reserves of NB excl. gold, EUR mn	2654.8	4445.3	5876.8	6373.6	10838.5	6725.1	12561.5	.	.
Gross external debt, EUR mn 5)	11162.6	13575.0	14969.4	15853.8	18099.5	15993.0	20455.4	.	.
FDI inflow, EUR mn	1147	1294	1212	1946	4098	498	365	.	.
FDI outflow, EUR mn	-14	-18	18	36	56	7	-8	.	.
Exports of goods, BOP, EUR mn	11273	12722	14675	15614	18935	4336	5091	22000	24200
annual growth rate in %	41.3	12.9	15.4	6.4	21.3	14.8	17.4	16	10
Imports of goods, BOP, EUR mn	13140	16045	17427	19569	24258	5061	6131	29100	32000
annual growth rate in %	43.4	22.1	8.6	12.3	24.0	20.8	21.1	20	10
Exports of services, BOP, EUR mn	1910	2273	2468	2671	2903	617	777	3100	3300
annual growth rate in %	48.4	19.0	8.6	8.2	8.7	4.6	25.9	7	6
Imports of services, BOP, EUR mn	2170	2402	2463	2609	3116	612	909	3400	3600
annual growth rate in %	31.0	10.7	2.5	5.9	19.4	5.0	48.5	9	6
Average exchange rate ROL/USD	21692.7	29060.9	33055.5	33200.1	32636.6	32430.0	28296.9	.	.
Average exchange rate ROL/EUR (ECU)	19955.8	26026.9	31255.3	37555.9	40532.1	40573.7	37093.6	38000	38000
Purchasing power parity ROL/USD	6316.4	8383.3	10141.4	11992.4	13511.4	.	.	.	.
Purchasing power parity ROL/EUR	7183.6	9579.8	11504.9	13830.0	15581.9	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 break in methodology and according to census March 2002. - 3) According to ESA 95, excessive deficit procedure. - 4) From February 2002 reference rate of NB. - 5) Medium- and long-term.

Source: wiiw Database incorporating national statistics; Eurostat; EU Economic Forecasts, Spring 2005; wiiw forecasts.

capital account, the National Bank again intervened on the foreign exchange market to curtail appreciation – successfully. Interventions and privatization-related capital inflows resulted in a jump of National Bank reserves to the amount of EUR 13.2 billion (gold excluded) by the end of May, 80% more than a year before and equal to 5.6 months of imports. The cost of keeping such high reserves tends to be higher than the advantage of stability it may provide.

Exports expanded by 18% in current euro terms in the first four months of 2005. The highest increases were registered for metallurgical and mineral products, reflecting to a large extent the price development of these commodities on international markets. Machinery and transport equipment exports increased by 32% and their share reached 23.5% of total exports. Exports of textile and clothing products increased by just 2% and their share declined to less than 20%. This upgrading of the export structure is a favourable response to the declining competitiveness in labour-intensive low-tech industries. Imports rose by some 23% in the first four months of 2005, faster than exports. Also in imports, the highest growth rates in current euro terms were achieved by mineral and metallurgical products as well as vehicles. The foreign trade deficit of goods and services nearly doubled in the first quarter of 2005 as compared to the same period a year earlier and also the current account deficit increased from 4.8% of GDP to 6.7%; the year-end result may be as much as 8.3%. In this respect, the government's policy target was missed by a wide margin, and the authorities seem to lack the tools to forestall a further current account deterioration.

In 2005 and 2006 the Romanian economy will grow less rapidly (5.5%) than in the previous year, partly due to lower agricultural production, partly to less vigorous foreign demand. In the second half of 2005, wage expansion will slow down and the nominal appreciation of the leu will probably come to an end. The correction of the expansionist policy will proceed moderately but inflation will remain somewhat above the target.

The European Commission is expected to provide the next screening of Romania in November 2005. There are several chapters, including competition, where the Romanian government may get a bad mark. If this is the case, the safeguard clause by which accession would be postponed to 2008 will probably come into effect. Following the negative referenda on the European Constitution, the Commission will be more strict when judging the conditions in the country. A postponement of accession by one year will not do much harm to Romania and could be used for further institutional preparation and increasing competitiveness.

Hermine Vidovic

Croatia: foreign debt impeding economic growth

The deceleration of economic activity already apparent in late 2004 continued during the first months of 2005. Construction activity slowed down steadily from July last year and external imbalances increased further. However, retail trade turnover and industrial output, performing disappointingly in the first quarter of the year, showed signs of recovery from April and May respectively. Consumer price inflation accelerated at the beginning of the year but slowed to 2.8% in May year on year.

Final data on 2004 obtained from the labour force survey indicate a 1.7% employment increase as compared to a year earlier and a decline of the unemployment rate to 13.8%. Labour market results available from registration data are traditionally more unfavourable: according to these data, employment stagnated in the first quarter of 2005 and registered unemployment was at 18.7% in April. Croatia's employment rate, at 54.5% in 2004, is very low by EU standards and ranks at the lower end of the scale if compared with the new EU member states or the other candidate countries; only Poland and the two candidate countries Turkey and Bulgaria report even lower rates.

On the external side, data from the customs statistics indicate a weak export performance for the first four months of 2005 (up by 6% in euro terms) coupled with an overall import growth of 9%. This resulted in a EUR 2.3 billion trade deficit, EUR 300 million more than in the same period a year earlier. As in the past few years, shipbuilding accounted for the biggest share of manufacturing exports (close to 40%), but reported a significant drop (by 37%) against the first four months of 2004. Current account data for 2005 are not yet available; considering the increased foreign merchandise trade deficit and a reported 4% drop in overnight stays, the current account deficit may have reached EUR 1.5 billion in the first quarter of 2005.

Combating rising foreign debt has been one of the main challenges for the Croatian authorities over recent years. In contrast to the agreement with the IMF signed in August 2004, under which Croatia committed itself to keeping the debt to GDP ratio at 77% (measured in euro terms), the ratio jumped to some 82% in December 2004. After a slight decline in the first two months of 2005, foreign debt rose again and reached EUR 23.5 billion or 84% of the 2004 GDP in April. The bulk of the rise was borne by the banking sector, accounting for 35% of total foreign debt. The most recent report of the World Bank on Global Development Finance has downgraded Croatia to a 'severely indebted middle income country' from a 'moderately indebted middle income country' in the past couple of years.[14]

In response to these developments, in order to reduce the incentives for external borrowing, the National Bank of Croatia *inter alia* raised the marginal reserve requirement rate from 30% to 40% and reduced the remuneration rate for the kuna portion of the reserve requirement allocated with the central bank from 1.25% to 0.75%. The Ministry of Finance, which had apparently not been informed about these steps, demurred that the new measures would trigger a reduction of the banks' liquidity and an increase in interest rates.

During the recent months the Croatian currency has appreciated steadily against the euro, reaching a three-year high at 7.3 HRK per euro in May, and prompting the National Bank to intervene on the foreign exchange market several times. Only recently the governor of the central bank, Mr. Rohatinski, blamed foreign-owned banks (that is, almost the entire sector) for exerting pressure on the foreign exchange market through the euro import from their mother banks and underlined that the costs of sustaining the current exchange rate system are becoming higher and higher.

According to final data, the general government closed with a 4.9% deficit to GDP in 2004, higher than agreed with the IMF. For 2005 the deficit is projected at 3.7%, but taking into account lower GDP growth than anticipated and the delayed restructuring of public expenditures this target seems to be out of reach. Data obtained for the first quarter of 2005 point to a HRK 6.1 billion deficit, almost

[14] According to the World Bank, a country is severely indebted if either its debt to GDP ratio is above 80% or its debt to exports of goods and services is above 220% – in both cases Croatia meets the criteria.

Table HR

Croatia: Selected Economic Indicators

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year 2)	4437	4437	4443	4442	4440	.	.	.	.
Gross domestic product, HRK mn, nom.	152519	165640	179390	193067	207082	47056	49574	219700	231900
annual change in % (real)	2.9	4.4	5.2	4.3	3.8	4.2	1.8	3	3
GDP/capita (EUR at exchange rate)	4502	4998	5451	5747	6222	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	8080	8600	9260	9680	10290	.	.	.	.
Gross industrial production 3)									
annual change in % (real)	1.7	6.0	5.4	4.1	3.7	5.6	0.3	2	3
Construction industry, hours worked 3)									
annual change in % (real)	-9.1	3.6	12.8	22.8	2.0	11.5	-6.6	.	.
Consumption of households, HRK mn, nom.	89637	98054	107427	113396	120312	28919	30605	.	.
annual change in % (real)	4.2	4.5	7.6	4.1	3.9	3.9	2.4	2	2.5
Gross fixed capital form., HRK mn, nom.	33281	36984	44114	53168	57141	13301	13617	.	.
annual change in % (real)	-3.8	7.1	12.0	16.8	4.4	8.9	0.3	4	4
LFS - employed persons, th, avg.	1553	1469	1528	1537	1563	.	.	.	.
annual change in %	4.1	-5.4	4.0	0.6	1.7	.	.	.	.
Reg. employees in industry, th pers., avg.	291.9	287.2	281.0	282.6	281.7	280.4	275.2	.	.
annual change in %	-2.5	-1.6	-2.2	0.6	-0.3	0.0	-1.9	.	.
LFS - unemployed, th pers., average	298.0	277.0	266.0	256.0	249.5	.	.	.	.
LFS - unemployment rate in %, average	16.1	15.9	14.8	14.3	13.8	.	.	13.5	13
Reg. unemployment rate in %, end of period	22.3	23.1	21.3	19.1	18.7	19.1	19.2	18.5	18
Average gross monthly wages, HRK	4869	5061	5366	5623	5985	5832	6087	.	.
annual change in % (real, net)	3.4	1.6	3.1	3.8	3.7	4.3	1.7	.	.
Consumer prices, % p.a. 4)	6.2	4.9	1.7	1.8	2.1	1.8	3.3	3	2.5
Producer prices in industry, % p.a.	9.7	3.6	-0.4	1.9	3.5	0.2	4.8	2	.
General governm.budget, IMF-def., % GDP									
Revenues	46.2	44.7	45.2	44.9	.	.	.	.	.
Expenditures	52.7	51.5	50.0	49.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.5	-6.8	-4.8	-6.3	-4.9	.	.	-4	.
Public debt in % of GDP	48.9	50.3	50.4	51.7	53.2	.	.	55	56
Discount rate % p.a., end of period	5.9	5.9	4.5	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn	-489.9	-817.7	-2097.2	-1756.9	-1249.5	-1183.0	.	-1300	-1400
Current account in % of GDP	-2.5	-3.7	-8.7	-6.9	-4.5	-19.1	.	-4.4	-4.5
Gross reserves of NB excl. gold, EUR mn	3783.2	5333.6	5651.3	6554.1	6436.2	6178.5	6700.4	.	.
Gross external debt, EUR mn	11865.2	12827.6	15054.8	19810.6	22675.4	20604.2	22906.8	.	.
FDI inflow, EUR mn	1142.1	1502.5	1195.1	1788.4	921.4	265.9	.	.	.
FDI outflow, EUR mn	1.5	175.6	597.8	93.0	254.5	40.7	.	.	.
Exports of goods, BOP, EUR mn	4969.3	5318.8	5293.1	5571.7	6601.9	1483.4	.	6930	7350
annual growth rate in %	20.2	7.0	-0.5	5.3	18.5	7.2	.	5	6
Imports of goods, BOP, EUR mn	8468.6	9922.6	11253.5	12545.9	13326.7	2919.8	.	14390	15110
annual growth rate in %	17.0	17.2	13.4	11.5	6.2	6.9	.	8	5
Exports of services, BOP, EUR mn	4442.0	5481.3	5832.3	7679.7	7818.1	857.3	.	.	.
annual growth rate in %	26.6	23.4	6.4	31.7	1.8	9.0	.	.	.
Imports of services, BOP, EUR mn	1971.5	2178.5	2547.5	2632.8	2914.5	635.8	.	.	.
annual growth rate in %	0.3	10.5	16.9	3.3	10.7	19.9	.	.	.
Average exchange rate HRK/USD	8.28	8.34	7.86	6.70	6.04	6.09	5.72	.	.
Average exchange rate HRK/EUR (ECU)	7.63	7.47	7.41	7.56	7.50	7.61	7.51	7.4	7.5
Purchasing power parity HRK/USD	3.74	3.80	3.85	3.89	3.94	.	.	.	.
Purchasing power parity HRK/EUR	4.25	4.34	4.36	4.49	4.53	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 20 employees. - 4) Up to 2001 retail prices.

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

double the value recorded in the same period a year earlier. In general, information on fiscal developments is non-transparent due to several methodological changes in the data compilation, thus making an assessment of the actual situation almost impossible. Croatia's public debt has been on a steady increase in both absolute and relative terms over the past couple of years. These tendencies continued during the first months of 2005 and may jeopardize Croatia's intentions to meet the Maastricht criteria by 2007.

In March the EU delayed the start of membership negotiations with Croatia as the country failed to cooperate fully with the war criminal tribunal ICTY in delivering war-crime fugitive general A. Gotovina to The Hague. This position was confirmed by a statement of EU officials in mid-June; the next talks on the issue are scheduled for the middle of July at the earliest. A postponement of the negotiations to the beginning of next year would seriously jeopardize Croatia's target date (2009) for full membership.

The results obtained for the first months of 2005 suggest a further deceleration of economic growth. Accordingly wiiw will revise its GDP forecast down to below 3%, from 3.5% earlier. Growth will be primarily supported by domestic demand, although (public) investment growth is expected to further slow down as compared to the robust growth over the last couple of years, particularly in construction investment. Thus, the private sector will have to be the main engine of growth. In view of the weakening of overall economic activity employment will stagnate or even slightly decline this year and in 2006. Similarly unemployment will remain at high levels. In 2005 the current account may close with a similar or slightly higher deficit than last year, given the increasing trade deficit and a reduction of overnight stays during the first months of the year. The high and growing foreign indebtedness coupled with persistently high fiscal deficits remain the main challenges in the years to come.

Vladimir Gligorov

Macedonia: slow turnaround

After a relatively bad year, recent figures on the Macedonian economy indicate a slow improvement. Last year's figures have also been revised and they now show a smaller drop in industrial production and close to 3% GDP growth. It is hard to say how these figures are connected to reality, but there is indirect evidence that a certain turnaround has started in the second half of last year. Imports have increased significantly fuelled by the growing availability of credits. This has put the central bank on the alert and it has continued to implement a rather tight monetary policy that has already had some effect on the expansion of credit and consumption. Likewise, fiscal policy has been cautious and that has also contributed to a rather slow acceleration of growth. Exports and investments, the main sources of growth in the tight macroeconomic environment, have not shown a stellar performance at the beginning of this year. Overall, the Macedonian government continues to be preoccupied with stability and has yet to come up with a policy that is more conducive to growth.

In mid-year 2004 the government reached an agreement with the IMF on a new three-year programme. It intends to build on the achieved stability to speed up structural reforms and bring the economy on a higher and sustainable growth path. This strategy has not worked all that well so far,

Table MK

Macedonia: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year [2]	2026.4	2034.9	2020.2	2026.8	2030.0	.	.	.	.
Gross domestic product, MKD mn, nom.	236389	233841	243970	251486	264599	.	.	280700	297800
annual change in % (real)	4.5	-4.5	0.9	2.8	2.9	2.4	.	4	4
GDP/capita (EUR at exchange rate)	1921	1887	1981	2025	2125	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5170	5000	5210	5370	5650	.	.	.	.
Gross industrial production									
annual change in % (real) [3]	3.0	-3.1	-5.3	4.7	-2.2	.	4.8	3	5
Construction output, value added									
annual change in % (real)	-1.1	-14.4	0.6	4.1	.	.	.	.	.
Consumption of households, MKD mn, nom.	175965	163788	188179	191873	.	.	.	.	.
annual change in % (real)	11.2	-11.6	12.4	-1.5	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	38332	34716	40448	42110	.	.	.	.	.
annual change in % (real)	-1.5	-8.6	17.6	1.1	.	.	.	.	.
LFS - employed persons, th. avg.	549.8	599.3	561.3	545.1	523.0	519.6	.	.	.
annual change in %	0.8	9.0	-6.3	-2.9	-4.1	.	.	.	.
Reg. employees in industry, th pers., avg. [4]	114.4	122.5	110.9	106.7	101.5	103.3	98.3	.	.
annual change in % [3]	-4.5	-4.8	-9.5	-3.8	-4.9	-4.8	-4.9	.	.
LFS - unemployed, th pers., average	261.7	263.2	263.5	315.9	309.3	307.1	.	.	.
LFS - unemployment rate in %, average	32.3	30.5	31.9	36.7	37.2	37.2	.	35	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average net monthly wages, MKD	10193	10552	11279	11824	12293	12041	12392	.	.
annual change in % (real, net)	-0.3	-1.9	5.0	3.6	4.0	2.1	2.9	.	.
Consumer prices, % p.a.	5.8	5.5	1.8	1.2	-0.4	1.6	-0.4	2	2
Producer prices in industry, % p.a.	10.7	2.0	-0.9	-0.3	0.9	-1.5	1.9	2	3
Central governm. budget, nat.def., % GDP									
Revenues	26.7	22.6	23.8	21.4	21.3	.	.	.	.
Expenditures	24.4	28.0	26.8	22.4	22.1	.	.	.	.
Deficit (-) / surplus (+), % GDP	2.3	-5.5	-3.0	-1.0	-0.8	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	7.9	10.7	10.7	6.5	6.5	6.5	6.5	.	.
Current account, EUR mn [5] [6]	-78.5	-272.1	-379.9	-135.0	-334.0	-85.2	-16.0	-300	-300
Current account in % of GDP	-2.0	-7.1	-9.5	-3.3	-7.7	.	.	-6.6	-6.3
Gross reserves of NB, excl. gold, EUR mn	461.5	845.5	692.8	718.4	665.2	.	.	.	.
Gross external debt, EUR mn [7]	1606.8	1621.4	1507.9	1417.0	1439.0	1449.5	1486.6	.	.
FDI inflow, EUR mn [6]	189.4	493.2	82.6	83.8	121.9	33.7	.	.	.
FDI outflow, EUR mn [6]	-0.7	1.0	0.1	0.3	0.9	0.1	.	.	.
Exports of goods, BOP, EUR mn [6]	1433	1291	1181	1205	1347	292	357	1400	1500
annual growth rate in %	28.3	-9.9	-8.5	2.0	11.8	7.3	22.0	4	7
Imports of goods, BOP, EUR mn [6]	2182	1879	2035	1959	2249	472	499	2400	2450
annual growth rate in %	37.9	-13.9	8.3	-3.7	14.8	-0.7	5.7	7	2
Exports of services, BOP, EUR mn [6]	344	273	269	289	328	62	.	.	.
annual growth rate in %	34.2	-20.5	-1.6	7.5	13.6	10.3	.	.	.
Imports of services, BOP, EUR mn [6]	291	295	292	291	363	87	.	.	.
annual growth rate in %	34.2	1.3	-0.8	-0.3	24.7	36.3	.	.	.
Average exchange rate MKD/USD	65.89	68.04	64.74	54.30	49.41	49.05	46.80	.	.
Average exchange rate MKD/EUR (ECU)	60.73	60.91	60.98	61.26	61.34	61.29	61.40	62	62
Purchasing power parity MKD/USD, wiiw	19.40	19.63	20.00	19.73	19.77	.	.	.	.
Purchasing power parity MKD/EUR, wiiw	22.55	22.97	23.18	23.11	23.09	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census November 2002. - 3) Excluding small enterprises, from 2004 new methodology. - 4) From 2001 according to NACE. - 5) Including grants. - 6) Converted from USD to EUR at the official cross exchange rate. - 7) Medium- and long-term.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

so it remains to be seen what the outcome will be this time. Both the government and the IMF have shied away from a more ambitious change in the macroeconomic set-up that Macedonia has followed for a decade now. The exchange rate will remain firmly fixed to the euro and fiscal policy will be tight. That will not bring faster acceleration of growth in the short run because exports will continue to increase rather slowly and public spending will not be relied on to boost demand.

Structural reforms are to be speeded up. The exceptionally high unemployment, at above 35%, will continue to be the main problem. The reform of the labour market with the aim to increase flexibility, cannot be expected to bring about fast increases in employment. The reform of public administration will also put some additional pressure on the labour market. Finally, the restructuring of the privatized enterprises will push productivity but not employment in the short run.

The product market is not very innovative and competition could be increased. For instance, the structure of exports has not been changing in about the past ten years. Also, Macedonia is not very competitive in the region, where still about one third of its trade is conducted. Wages are higher than in all the neighbouring countries except Greece.

Investment opportunities are limited because of the problem with competitiveness and because of the small size of the market. As a location, Macedonia has some disadvantages because it is landlocked and the access to regional markets is in some cases difficult.

Macedonia’s main hopes are with progress in the process of EU integration. The avis, responding to Macedonia’s application for membership, should be published by the Commission in early autumn of this year. The expectation is that it will be at least conditionally positive, i.e., that it will contain added requirements for the country to meet in order for negotiations to start. That would certainly bring the needed positive boost to the country, which is still facing a number of internal problems and is particularly vulnerable to external, i.e., regional shocks. A positive avis would stabilize the internal political situation and decrease the risk for investors at a time when significant decisions will have to be made in the neighbourhood, particularly those concerning the constitutional issues in Kosovo. Similar positive effects will be the eventual start of negotiations between the EU and Serbia and Montenegro on their Stabilization and Association Agreement. In general, continuing active presence of the EU in the Balkan region is essential for Macedonia as the country depends on the region to a greater extent than most other countries. In that context, the planned accession to the EU of Bulgaria would be quite beneficial for Macedonia.

Given favourable regional developments, GDP should continue to expand in the next couple of years with inflation remaining low. This is premised on an economic policy slowly moving towards a more relaxed stance as the credibility of the banking sector is improving and the need for some public investments is recognized. The government and the central bank will be pushed in that direction by the growing social pressure and the nearing of the parliamentary elections that are due in about two years’ time.

Vladimir Gligorov

Serbia and Montenegro

Serbia: problems with the budget

In the first half of 2005, Serbia's record has been mixed. Growth is negative, at least of industry, while there are no indications how agriculture and services are performing. Inflation is higher than anticipated and will probably continue to run faster than planned. On the positive side, exports are higher by about 50% than a year before, while imports are lower by about 8% in the first four months. The target is for exports to grow by 25% and for imports to rise by less than 10% for the year as a whole. At the moment, that seems achievable. The aim is to decrease the trade and current account deficits, which have been designated as the main threats to macroeconomic stability by the IMF as well as by the government.

In order to get consumption under control, monetary policy has become even more restrictive than it was in the previous year. Reserve requirements are being raised from time to time and preference is given to loans in dinar rather than in euro or other foreign currencies. It is not yet clear whether this is having the desired effect of curtailing the growth of private spending.

More importantly, there is increased pressure from the IMF to reduce overall public spending significantly. The plan is for a budget surplus this year. This is to be achieved through a reduction of subsidies and of public expenditures on wages and salaries. Also, an added effort should be made to increase the collection of public revenues, particularly after the introduction of VAT at the beginning of 2005. In the first five months, the central budget was in surplus; data on the general government budget are not available.

The IMF has also demanded that the reform of the public sector is speeded up. A number of actions are planned but those will mostly signal intentions rather than bringing real action. There are huge problems with the restructuring of the energy sector and of utilities in general. Also, difficult decisions will have to be made with regard to the car plant Zastava in central Serbia, which has been a chronic problem and the major beneficiary of subsidies. There is no doubt that employment in the public sector will go down significantly, which will also contribute to lower consumption.

Overall employment has not been decreasing, though there have been announcements of some significant shedding of labour in the public sector later this year. Data on unemployment are not very reliable and the difference between registered unemployment and unemployment according to the LFS continues to be quite high. The situation on the labour market is also difficult to assess: flexibility seems to be rather high, with employees moving out of the public employment tending to find jobs in the private sector rather quickly; wages continue to rise faster than productivity, which indicates that there are still significant structural problems in the labour market.

In the second half of the year the government intends to initiate the necessary legislation for a pension reform. The intention is for pensions to be cut, working years to be prolonged and private pension schemes to be introduced. The final outcome is hard to predict in details, but there is no

Table Serbia

Serbia: Selected Economic Indicators *)

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year 2)	7661.4	7736.3	7515.1	7532.6	7550	.	.	.	.
Gross domestic product, CSD mn, nom.	355168	708423	919231	1095402	1305700	.	.	1560000	1800000
annual change in % (real)	5.2	5.1	4.5	2.4	8.6	7.1	5.2	4	5
GDP/capita (EUR at exchange rate) 3)	882	1541	2012	2228	2370	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4230	4500	4940	5140	5600	.	.	.	.
Gross industrial production 4)									
annual change in % (real)	11.4	0.1	1.8	-3	7.1	9.5	-3.4	3	5
Gross agricultural production									
annual change in % (real)	-12.8	18.6	-3.4	-7.2	19.8	.	.	.	.
Construction, hours of work actually done									
annual change in %	.	-13.8	-7.4	10.9	5.2	.	-18.8	.	.
Gross fixed investment, CSD mn, nom.	50047	66765	122922	.	.	.	.	.	.
annual change in % (real)	13.3	-4.1	-0.8	.	.	.	.	.	.
LFS - employed persons, th, Oct. 5)	3093.7	3105.6	3000.2	2918.6	2930.8	.	.	.	.
annual change in %	.	0.4	-3.4	-2.7	0.4	.	.	.	.
Reg. employees in industry, th pers., avg.	.	705.0	648.1	605.3	562.0	569.0	535.0	.	.
annual change in %	.	.	-8.1	-6.6	-7.1	-8.2	-6.0	.	.
LFS - unemployed, th pers., average 5)	425.6	432.7	459.6	500.3	665.4	.	.	.	.
LFS - unemployment rate in %, average 5)	12.1	12.2	13.3	14.6	18.5	.	.	20	20
Reg. unemployment rate in %,end of period 6)	.	.	30.5	31.9	32.4	31.4	33.1	34	34
Average net monthly wages, CSD 7)	2389	5375	9208	11500	14108	12567	15140	.	.
annual change in % (real, net)	5.5	16.5	29.9	14.0	11.1	5.0	16.5	.	.
Consumer prices, % p.a.	79.6	93.3	16.6	9.9	11.4	8.6	16.0	15	10
Producer prices in industry, % p.a.	102.6	87.7	8.8	4.6	9.1	5.7	13.5	15	10
Central governm. budget, nat.def., % GDP									
Revenues	.	.	.	.	25.5	.	.	.	.
Expenditures	.	.	.	.	27.3	.	.	.	.
Deficit (-) / surplus (+), % GDP	-0.9	-1.4	-4.5	-4.2	-1.7	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	26.3	16.4	9.5	9.0	8.5	8.5	8.5	.	.
Current account, EUR mn 8)	-352	-398	-1514	-1546	-2349	-596	-264	-2500	-2500
Current account in % of GDP	-5.2	-3.3	-10.0	-9.2	-13.1	.	.	-14	-13
Gross reserves of NB, excl. gold, EUR mn	.	1138.6	2076.8	2728.2	3008.0	2613.0	3211.0	.	.
Gross external debt, EUR mn	11659	12609	10768	10858	10355	11111	10934 Apr	.	.
FDI net, EUR mn 7)	55	186	502	1197	777	170	263	.	.
Exports of goods, BOP, EUR mn 8)	1699	1935	2191	2513	3133	587	807	3600	3960
annual growth rate in %	.	13.9	13.2	14.7	24.7	13.0	37.6	15	10
Imports of goods, BOP, EUR mn 8)	3632	4791	5928	6578	8799	1887	1475	9700	10700
annual growth rate in %	.	31.9	23.7	11.0	33.8	40.5	-21.8	10	10
Exports of services, BOP, EUR mn 8)	495	832	886	886	1196	281	251	.	.
annual growth rate in %	.	68.1	6.5	0.0	35.0	51.1	-10.6	.	.
Imports of services, BOP, EUR mn 8)	320	363	604	632	870	170	274	.	.
annual growth rate in %	.	13.4	66.4	4.6	37.7	47.9	60.8	.	.
Average exchange rate CSD/USD	16.69	66.84	64.19	57.44	58.69	56.31	69.40	.	.
Average exchange rate CSD/EUR (ECU)	15.30	59.44	60.79	65.26	73.00	61.68	80.82	85	90
Purchasing power parity CSD/USD, wiiw	9.67	17.87	21.92	24.64	26.88	.	.	.	.
Purchasing power parity CSD/EUR, wiiw	10.95	20.33	24.76	28.30	30.88	.	.	.	.

*) Note: Excluding Kosovo and Metohia.

1) Preliminary. - 2) From 2002 according to census data. In 2004 wiiw estimate. - 3) In 2000 wiiw estimate with black market rate. - 4) From 2004 new methodology harmonized with EU standards. - 5) From 2004 fully adjusted to ILO definition. - 6) In % of unemployed plus employment (excluding individual farmers). - 7) From 2002 including various allowances. - 8) Converted from USD to EUR at the official cross exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

doubt that the pension bill will go down. The amount will depend on political and social considerations, which may weigh heavily on the government because of the possibility of early elections being held some time at the beginning of next year.

Privatization should also be speeded up, in particular in the banking sector and in the oil and telecommunications sectors. A number of smaller banks are to be sold, but much more important will be the privatization of the oil company. The process should start this year, but it is unclear when it will be finished. The battle between the interested companies will be fierce and in all probability the competition will be rather less than fair. The experience from recent privatizations suggests that one or the other type of corruption plays a role in the sale of state assets.

Similarly, there is the continuing saga of the privatization of the mobile phone company Mobtel. Lately, the private part of the company was bought by a group of Austrian investors, though the share they actually bought is unclear. The division of shares between the previous private owner and the Serbian government is yet to be decided by an international court of arbitration.

Overall economic prospects for this year are not very good. GDP will probably grow by around 3%, though the risk is on the downside because of the uncertainty connected with the performance of agriculture, which may not be as good as expected. The squeeze of consumption will most likely have the expected effect on the decrease of the trade deficit, but will also contribute to a lower growth rate. Inflation will remain relatively high, while the success of intended reforms is quite uncertain. Much of those are undertaken in order to complete the current three-year programme with the IMF, now prolonged until the end of this year, because the remaining write-off of the inherited foreign debt, in an amount of close to USD 1 billion, is conditional on that. The continuation of the reforms after that is increasingly uncertain.

Montenegro: slow improvement

The similarity with Serbia is that Montenegro is making the same effort at fiscal consolidation. It also aims to bring down the trade and current account deficits. In other respects, Montenegro is different. Inflation is slowing down, perhaps not as fast as planned because of the rising oil prices, and growth is accelerating, though still rather slowly. Also, privatization is in a different stage as it started much earlier than in Serbia and was based on vouchers rather than on sales. Finally, foreign investors are showing increased interest, especially for the tourist sector.

The latter also gives a different significance to the trade deficit. Investments in tourism should bring higher revenues and will contribute to the sustainability of the trade deficit. Tourism has a great potential and its growth will mainly depend on an upgrading of infrastructure. Significant growth cannot be expected this year, but the prospects are much better over the medium run.

The labour market does not indicate any major changes. Employment and unemployment rates have not changed very much in the recent past. Wages do not seem to be growing faster than productivity, though the data could be improved. There are indications that inequality is growing as are regional differences. These social developments may have important consequences.

Table Montenegro

Montenegro: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1)]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year [2)]	608.9	612.9	615.9	620.1	625.0	.	.	.	.
Gross domestic product, EUR mn, nom. [3)]	1022.2	1244.8	1301.5	1433.0	1535.0	322	340	1660	1800
annual change in % (real)	.	-0.2	1.7	2.3	3.7	.	1.9	5	5
GDP/capita (EUR at exchange rate)	1679	2031	2113	2311	2456	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4800	4840	5030	5140	5340	.	.	.	.
Gross industrial production [4)]	.	.	.	.	.	.	.	.	.
annual change in % (real)	4.3	-1.0	1.1	2.1	13.8	-1.7	3.9	5	5
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	-5.0	6.9	5.9	.	.	.	.	.	.
Construction, hours of work actually done	.	.	.	.	.	.	.	.	.
annual change in %	.	.	.	.	.	.	.	.	.
Gross fixed investment, EUR mn, nom. [5)]	.	226	183	166	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Employment total, average reg [6)]	140.8	141.1	140.8	142.7	143.5	142.5 I-II	142.1 I-II	.	.
annual change in %	-3.3	0.2	-0.2	1.4	0.6	.	-0.2	.	.
Reg. employees in industry, th pers., avg. [7)]	.	36.7	35.8	34.1	36.6	.	.	.	.
annual change in %	.	.	-2.3	-5.0	7.6	.	.	.	.
LFS - unemployed, th pers., average	.	.	.	.	.	.	.	.	.
LFS - unemployment rate in %, average [8)]	20.1	19.5	21.6	22.9	22.3	.	.	23	23
Reg. unemployment rate in %,end of period [9)]	.	.	.	32.9	29.3	33.3 Feb	29.3 Feb	.	.
Average gross monthly wages, EUR	.	.	251	271	303	284	297	.	.
annual change in % (real, net)	.	.	.	9.3	9.6	.	5.7	.	.
Retail prices, % p.a.	22.9	22.8	17.6	7.8	3.3	6	3.6	3	3
Producer prices in industry, % p.a.	.	.	14.6	4.5	5.7	7.3	3.1	3	3
Central governm. budget, nat.def., % GDP	.	.	.	.	.	.	.	.	.
Revenues	.	.	.	.	.	.	.	.	.
Expenditures	.	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP [10)]	6.0	3.1	2.7	3.0	2.1	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [11)]	.	-195.4	-163.5	-102.0	-143.0	-74.6	-34.5	-80	-90
Current account in % of GDP	.	-15.7	-12.6	-7.1	-9.3	-23.2	-10.1	-5	-5
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external debt, EUR mn	.	.	.	408	502	.	.	.	.
FDI net, EUR mn	.	10.6	89.2	38.7	50.0	9.3	161.2	.	.
Exports of goods, BOP, EUR mn [11)]	.	235	323	271	382	102	95	400	450
annual growth rate in %	.	.	37.2	-16.2	41.0	32.9	-6.5	5	13
Imports of goods, BOP, EUR mn [11)]	.	723	748	630	813	205	163	900	950
annual growth rate in %	.	.	3.5	-15.8	29.0	32.6	-20.6	11	6
Exports of services, BOP, EUR mn [11)]	.	150	172	191	241	17	21	.	.
annual growth rate in %	.	.	14.4	11.4	26.0	40.0	26.7	.	.
Imports of services, BOP, EUR mn [11)]	.	53	73	80	101	21	23	.	.
annual growth rate in %	.	.	35.9	9.8	27.1	44.8	5.2	.	.
Average exchange rate EUR/USD	0.92	0.90	0.94	1.13	1.24	1.07	1.31	.	.
Purchasing power parity EUR/USD, wiiw [12)]	0.31	0.37	0.37	0.39	0.40	.	.	.	.
Purchasing power parity EUR/EUR, wiiw [12)]	0.35	0.42	0.42	0.45	0.46	.	.	.	.

Notes: 1) Preliminary. - 2) From 2003 according to census 2003. Year 2004 wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) 2003 excluding private sector. - 6) Employees plus own account workers, excluding individual farmers. - 7) In 2004 new methodology. - 8) Estimate of the Institute for Strategic Studies and Prognoses (ISSP). - 9) In % of unemployed plus employment (excluding individual farmers). Quarterly data refer to new methodology (employees include private sector as well). - 10) Data given by ISSP. - 11) In 2001 converted from USD to EUR at the official cross exchange rate. - 12) Estimate based on a 45% price level (EU-25=100) in 2003 and extrapolation with GDP deflator.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The improved macroeconomic and business situation in Montenegro is the reason that the country is having less of a problem with the IMF than Serbia. The main vulnerability is the public sector, which is still rather unreformed. There are also worries about the soundness of the banking sector, in part because it is financing the state. Thus, the public sector is the main remaining threat to macroeconomic stability. Short-term expectations are for an acceleration of growth and a further deceleration of inflation.

Political risks

This and the next years may prove crucial for Serbia and Montenegro because of the political decisions that will have to be taken, some of which are rather risky. The future of Kosovo will be discussed and there are indications that the positions of international mediating bodies may be opposed by Serbia. In spring of 2006, most likely in April, Montenegro will hold a referendum on independence. Whatever the outcome, the risks of destabilization will increase. Finally, the issue of cooperation with the Hague tribunal will have to be resolved by the end of 2005. Each of these decisions and even more all of them in conjunction have the potential to raise the political risks and also bring the existing governments down. If all of them are taken and stability is preserved, political risks will be reduced significantly. Chances for a good outcome are better than fifty per cent at the moment.

Josef Pöschl

Bosnia and Herzegovina: transfers and loans bolster economic advancement

Bosnia and Herzegovina (BiH) continues to import much and export little. In 2004, exports made up less than one third of imports: EUR 1.7 billion as against EUR 5.4 billion. Admittedly, throughout 2003 exports grew at a much faster rate than imports: 29% as against 8%; however, in absolute terms the increase in both was almost identical. The reliability of these figures is limited: they differ considerably from the trade figures published by the main trading partners; the monitoring of cross-border transport is still incomplete; and improper invoicing is probably widespread. Possibly, the trade deficit is smaller than suggested by the balance of payments figures.

According to the balance of payments for 2004, several factors contributed to covering the trade deficit of EUR 3.7 billion and increasing the country's currency reserves by EUR 0.3 billion. Trade in services recorded a surplus, with exports close to EUR 0.7 billion and imports close to EUR 0.4 billion. The balance of incomes recorded a surplus of roughly the same magnitude, whereas net current transfers were more substantial: EUR 1.5 billion. Capital transfers amounted to EUR 0.4 billion and foreign direct investment accounted for another EUR 0.4 billion, while other investment, mainly in the form of new loans, amounted to EUR 0.6 billion with errors and omissions of over EUR 0.4 billion. Should these balance of payments figures correspond (roughly) to reality, the reason for imports consistently outstripping exports by a factor of three lies in the massive inflow of transfers and new loans. Such inflows are likely to become scarcer during the next few years, so it is highly important to establish an appropriate infrastructure for more production of domestic value-added.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year	3781	3798	3828	3832	3832	.	.	.	.
Gross domestic product, BAM mn, nom.	10050	10960	11650	12303	12980	.	.	13700	14600
annual change in % (real)	5.5	4.5	5.5	3.0	5.0	.	.	5	6
GDP/capita (EUR at exchange rate)	1359	1475	1556	1642	1732	.	.	.	.
GDP including NOE, BAM mn, nom. [2]	14160	15410	16170	16954	17886	.	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	4910	5200	5490	5610	6010	.	.	.	.
Gross industrial production									
annual change in % (real) [3]	7.9	4.9	5.7	5.1	12.1	15.7	4.0	7	10
Employees total, th pers., end of period	640.6	625.6	637.7	634.0	635.7 [4]	.	.	.	.
annual change in %	1.5	-2.3	1.9	-0.6	0.3 [4]	.	.	.	.
Reg. unemployed, th pers., end of period	421.2	422.2	441.9	459.6	476.2 [4]	.	.	.	.
Reg. unemployment rate in %, end of period	39.7	40.3	40.9	42.0	42.8 [4]	.	.	42	42
Average gross monthly wages, BAM	541	652	661	716	747	733	.	.	.
annual change in % (real, net) [4]	4.0	14.8	-0.6	7.3	.	.	.	.	.
Retail prices, % p.a.	4.8	3.1	0.4	0.6	0.4	0.4	.	0.5	0.5
General governm.budget, nat.def., % GDP									
Revenues	53.8	49.7	44.1	43.2	.	.	.	.	.
Expenditures	60.7	53.1	44.2	42.4	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-7.0	-3.3	-0.2	0.8	.	.	.	.	.
Public debt in % of GDP	58.8	48.2	42.2	34.0	.	.	.	.	.
Current account, EUR mn [5]	-502.5	-903.0	-1318.8	-1539.5	-1544.8	-228.6	.	-1500	-1400
Current account in % of GDP	-9.8	-16.1	-22.1	-24.5	-23.3	.	.	-21.4	-18.8
Gross reserves of CB excl. gold, EUR mn	522.2	1378.7	1260.0	1421.7	1767.8	1541.8	1756.3	.	.
Gross external debt, EUR mn [6]	2073.6	2260.6	2193.8	2054.2	2036.4	.	.	.	.
FDI net inflow, EUR mn	158.6	132.8	281.8	337.6	400.4	47.1	.	.	.
Exports of goods, BOP, EUR mn [5]	1226.3	1268.1	1168.5	1303.0	1676.9	357.3	.	2000	2400
annual growth rate in %	57.1	3.4	-7.9	11.5	28.7	37.3	.	19	20
Imports of goods, BOP, EUR mn [5]	4226.7	4576.4	4692.2	4974.1	5354.4	1051.0	.	5600	5900
annual growth rate in %	9.1	8.3	2.5	6.0	7.6	0.6	.	5	5
Exports of services, BOP, EUR mn [5]	472.4	539.4	536.8	601.4	666.5	125.6	.	.	.
annual growth rate in %	11.1	14.2	-0.5	12.0	10.8	12.5	.	.	.
Imports of services, BOP, EUR mn [5]	307.5	318.5	339.5	366.5	367.7	61.5	.	.	.
annual growth rate in %	12.8	3.6	6.6	7.9	0.3	3.7	.	.	.
Average exchange rate BAM/USD	2.119	2.186	2.077	1.734	1.575	1.565	1.491	.	.
Average exchange rate BAM/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96
Purchasing power parity BAM/USD, wiiw [7]	0.673	0.686	0.681	0.686	0.676	.	.	.	.
Purchasing power parity BAM/EUR, wiiw [7]	0.762	0.780	0.769	0.788	0.777	.	.	.	.

Notes: BAM: ISO-Code for the convertible mark in Bosnia and Herzegovina.

1) Preliminary. - 2) GDP figures including the Non-Observed Economy (NOE) are based on IMF estimates. - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) wiiw calculation. - 5) Converted from the national currency to EUR at the official exchange rate. - 6) General government foreign debt. - 7) Rough estimates based on World Bank and wiiw; price level presumably higher.

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

BiH was a net exporter in three commodity groups. Whereas trade in wood and wood products registered a large surplus in 2004, it shrank appreciably over the period January-May 2005 compared to the same period in the previous year. BiH is also a net exporter of arms and ammunition: thanks to a surge in exports expansion, the surplus took on substantial proportions in the period January-May 2005. In that same period the third surplus was registered in respect of miscellaneous products; however, this commodity group only accounts for an insignificant share in overall trade. Several commodity groups notorious for their deficits experienced major slumps: not surprisingly, the groups in question were fuels, textiles and apparel. In the case of two other commodity groups, animals and animal products and transport equipment, the reasons for the higher trade deficits are less obvious. Deficits in respect of vegetable products and prepared foodstuffs, chemical products as well as machinery and mechanical appliances were significantly reduced.

In countries with a weak industrial structure, low wages tend to boost the international competitiveness of those producing tradables and attract newcomers. As mentioned in the wiiw report of March 2005[15], gross monthly wages in BiH are as high as those in Slovakia; hence, far in excess of wages in Bulgaria and Romania. This has since become an issue in BiH. Central bank spokesmen are now insistent that the fixed peg, 1,965 BAM per euro, is not under threat, pointing out that the central bank has accumulated a large stock of currency reserves. Under the circumstances this standpoint seems quite justified, despite the tendency of the present peg regime to keep the number of internationally competitive BiH companies at a low level. Aluminium and steel manufacture might prove the exception.

BiH will continue to enjoy macroeconomic stability in terms of prices and the exchange rate. The GDP will continue to grow by around 5% annually; in 2006 it might even touch 6%, should Mital Steel expand steel production in Zenica to the level projected and thus stimulate business activities over a broader range. In any event, the situation on the labour market is unlikely to change substantially in the short and medium term; this means that official labour will remain scarce and unofficial labour plentiful. It thus remains an open question to which degree, at a figure of 40%, the level of unemployment is over- or underestimated.

The pace of institutional changes is slow. If changes are to materialize at all, massive pressure from international bodies and foreign powers is still required. In the meantime, however, the authorities have postponed until 1 January 2006 the new value-added tax scheme that was to be introduced across the country. A draft for a new income tax scheme has also been tabled. This is of fundamental importance to the Federation of BiH. Hitherto, each canton has had its own tax regime; however, it may take years for the reform to come through.

The government of Republika Srpska vetoed a policy reform which would have deprived the interior ministry of its power, despite the EU having made the initiation of talks on a Stabilization and Association Agreement (SAA) contingent upon that particular reform being introduced. For the time being Bosnia and Herzegovina thus remains in legal limbo with the European Union. As for the countries in the West Balkans in general, the EU has entered into a debate on drawing up regulations pertaining to an Instrument for Pre-Accession Assistance. The draft lists BiH as a potential candidate country. Up until the time when BiH gains candidate status, the proposal does

[15] *wiiw Research Reports*, No 314, March 2005, p. 89.

not envisage increasing the volume of assistance that the country currently receives under the umbrella of the CARDS programme. It is not clear when a SAA will be signed; however, it is patently obvious that the shift from SAA to candidate status will take a number of years.[16]

Mario Holzner

Albania: key elections

Albania's economic growth remains high. Starting from very low levels, the country has been catching up at an average annual growth rate of 6% in recent years.[17] This is also expected to continue in the years to come. Fair and democratic elections in July 2005 are seen as a keystone to sustainable development in the future.

The Albanian Socialist Party (SP) has been running the country for the past eight years. The parliamentary elections on 3 July 2005 will decide whether the SP will rule for another legislative period. The main opposition party is the Democratic Party (DP). A recent opinion poll funded by USAID sees the DP leading in front of the SP with 42% against 32% of the decided voters. Next come the SP split-off Socialist Movement for Integration (SMI) with 11% and the Movement for National Development (MND), headed by crown prince Leka Zog, with 4%. Whatever the outcome of the elections, it is unlikely that a potential change in government will lead to a substantial change in the main strands of economic policy. Rather, it can be expected that Albania will continue with the economic reforms necessary in the course of the EU accession process, carry on with a fairly sound fiscal policy and proceed with a stable monetary policy targeting a 2-4% inflation range.

The concern of the international community is in fact that the elections will not be conducted according to international standards – as has happened in the past. Thus, the EU is waiting to see how the elections will be conducted before it sets a time frame for the signing of the Stabilization and Association Agreement (SAA) with Albania. The conclusion of the SAA is of utmost importance for the Albanian EU accession process. It is a precondition for the start of EU-accession negotiations and thereby paving the way for various EU support programmes. However, NGOs have already expressed fear of election manipulations by the two big parties, the SP and the DP. Using strategic voting schemes in the proportional system could hurt especially the SMI and the MND while 'gifting' votes to the DP's and SP's smaller allied parties.

Political unrest following unfair elections and a delay of the SAA could potentially harm Albania's favourable economic development. This development has been facilitated by the latest upward trend in FDI in the wake of the privatization of strategic enterprises. In 2005 Turkish CETEL offered EUR 120 million to purchase 76% of the Albanian fixed line telephone company Albtelecom. Moreover, also greenfield FDI starts to trickle in. An important sector of the Albanian economy with a strong growth prospect is tourism. The French Club Méditerranée constructs a EUR 40 million holiday village on the southern part of the Albanian coast opposite the Greek island of Corfu.

[16] Breaking out of the Balkan Ghetto: Why IPA should be changed, 1 June 2005, http://www.esiweb.org/pdf/esi_document_id_66.pdf.

[17] Yet, a note of caution is required here. Albania's national accounts statistics are still in their fledgling stages. The GDP figures are constantly being revised. This relates both to the level of nominal GDP as well as to the rate of real GDP growth. Similarly, other statistics have to be treated with caution.

Table AL

Albania: Selected Economic Indicators

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period 2)	3418.1	3112.4	3145.4	3190	.	.	.	.	.
Gross domestic product, ALL mn, nom.	530906	610426	677684	744974	835448	.	.	920000	1010000
annual change in % (real)	7.3	7.6	4.7	6.0	5.9	.	.	6.5	6.5
GDP/capita (EUR at exchange rate)	1174	1539	1636	1710	2046	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3180	3860	4080	4270	4560	.	.	.	.
Gross industrial production									
annual change in % (real) 3)	0.5	7.1	1.8	2.7	3.1	.	.	4	5
Gross agricultural production									
annual change in % (real) 3)	4.5	2.2	2.1	3.0	3.8	.	.	3.5	3.5
Construction output total									
annual change in % (real) 3)	37.2	49.3	8.7	11.3	10.6	.	.	11	10
Consumption of households, ALL mn, nom.	350038	359016	363864	.	.	.	.	.	.
Consumption of households, in % of GDP	65.9	58.8	53.7	.	.	.	.	.	.
Gross fixed capital form., ALL mn, nom.	112958	151327	145920	.	.	.	.	.	.
Gross fixed capital form., in % of GDP	21.3	24.8	21.5	.	.	.	.	.	.
Employment total, th pers., end of period	1068.2	920.6	920.1	926.2	924.5	919.0	.	.	.
annual change in %	0.3	.	0.0	0.7	-0.2	-0.8	.	.	.
Reg. unemployed, th pers., end of period	215.0	181.0	172.0	164.0	155.5	161.0	.	.	.
Reg. unemployment rate in %, end of period	16.8	16.4	15.8	15.0	14.4	14.9	.	14	14
Average gross monthly wages, ALL 4)	14963	17218	19659	21325	24399	23077	.	.	.
annual change in % (real, gross) 4)	17.7	11.6	8.1	6.0	11.2	.		.	.
Consumer prices, % p.a.	0.1	3.1	5.2	2.3	2.9	3.9	2.2	2.5	2.5
Producer prices in manufacturing ind., % p.a.	6.5	-7.2	5.1	1.8	.	.	.	.	.
Consolidated budget, nat.def., % GDP									
Revenues	24.6	23.9	22.8	22.4	22.1	.	.	.	.
Expenditures	32.1	30.5	28.4	27.0	26.7	.	.	.	.
Deficit (-) / surplus (+), % GDP	-7.5	-6.9	-6.0	-4.6	-4.6	.	.	-6	-5
Public debt in % of GDP	41.0	39.4	38.5	37.7	.	.	.	.	.
Interest rate of NB % p.a., end of period 5)	6.9	6.9	8.0	5.5	4.5	5.2	4.0	.	.
Current account, EUR mn 6)	-175.6	-243.5	-433.1	-360.7	-287.5	-36.0	.	-360	-320
Current account in % of GDP	-4.4	-5.1	-8.5	-6.7	-4.4			-5	-4
Gross reserves of BoA incl. gold, EUR mn 7)	691.5	863.5	813.0	812.7	1005.2	839.1	1045.6	.	.
Gross external debt, EUR mn	1262.0	1356.0	1124.0	1117.0	.	.	.	.	.
FDI net inflow, EUR mn 6)	156.1	231.2	151.4	157.8	275.4	28.8	.	.	.
Exports of goods, BOP, EUR mn 6)	277.5	340.2	350.5	397.9	484.8	108.7	.	550	600
annual growth rate in %	7.3	22.6	3.0	13.5	21.8	7.1	.	13.4	9.1
Imports of goods, BOP, EUR mn 6)	1166.8	1486.5	1574.5	1578.3	1768.6	363.7	.	1950	2020
annual growth rate in %	32.6	27.4	5.9	0.2	12.1	-0.9	.	10.3	3.6
Exports of services, BOP, EUR mn 6)	485.6	595.3	618.4	638.1	808.6	175.8	.	850	950
annual growth rate in %	94.1	22.6	3.9	3.2	26.7	46.3	.	5.1	11.8
Imports of services, BOP, EUR mn 6)	467.2	494.8	623.7	709.8	849.7	166.2	.	900	950
annual growth rate in %	202.2	5.9	26.1	13.8	19.7	42.8	.	5.9	5.6
Average exchange rate ALL/USD	143.7	143.5	140.2	121.9	102.8	105.9	96.7	.	.
Average exchange rate ALL/EUR (ECU)	132.6	128.5	132.4	137.5	127.6	132.5	126.7	126	125
Purchasing power parity ALL/USD, wiiw	43.2	45.0	47.1	48.0	49.8	.	.	.	.
Purchasing power parity ALL/EUR, wiiw	48.9	51.3	53.2	55.1	57.2	.	.	.	.

Notes: ALL: ISO-Code for the Albanian lek.

1) Preliminary. - 2) Until 2000: population estimates; 2001: census data; thereafter: projection. - 3) According to gross value added. - 4) Public sector only. - 5) 3-month deposit rate. - 6) Converted from USD to EUR at the official cross exchange rate. - 7) Refer to total foreign assets of Bank of Albania.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Besides increasing FDI, remittances from abroad are traditionally a strong stimulus for Albanian GDP growth. However, whether real GDP growth in 2005 will remain above or below the 6% target rate will also depend on the level of fiscal expansion. The government emphasizes that the budget is so far in line with the projections and the IMF even expects a surplus on current operations, for the first time since the beginning of transition. Nevertheless, given that 2005 is an election year, we may still expect a certain increase in government expenditures. Thus, wiiw's forecast for 2005 real GDP growth is 6.5%. In 2006 a slight recovery of Albania's main trading partners (in particular the euro-zone countries) may support Albanian exports of goods and services and keep GDP growth at 6.5%.

Overall, economic dynamics in Albania appear to be strong. Fair and democratic parliamentary elections could be the keystone for a continuation of favourable economic development and European integration.

Josef Pöschl

Turkey: an economic hot spot

Turkey is consolidating its entry into the one-digit inflation mode. In the first months of 2005, year-on-year inflation stood at somewhat above 8%. Had it not been for the rising oil and transport prices, the rise in the consumer price index would have been even less: around 7%. In common with many other countries, it is to be observed that relatively high, yet declining inflation does not of necessity hamper vigorous GDP growth. This year the Turkish economy will in all likelihood record a lower growth rate than in 2004; however, growth will still be significantly higher than 5%. Last year, a marked rise in the demand for durable consumer goods boosted consumption, a major contributory factor being the introduction of a new regulation encouraging households to replace their old cars with new. That type of consumption boom is now past; moreover, the demand for fixed capital investment slowed down. Overall industrial output increased by 6.2% in the first quarter of 2005; manufacturing output by 5.6%. Within the latter sector, the output of leather, textiles and clothing diminished, whereas the output of mineral products, optical instruments, wood processing, electrical and transport equipment experienced a marked increase. Growth has had a minimal impact on employment levels; increased growth derives mainly from a higher rate of labour productivity. New entrepreneurs are now rapidly entering the market; in the first five months of 2005, over 40.000 new businesses opened up and some 12,000 closed down.[18]

Foreign trade expansion remained robust. According to balance of payments statistics, in the first four months of 2005 exports rose by 15.5% in euro terms, imports by 16.8%. The growth in exports was mostly attributable to increased exports of machinery, appliances and transport equipment. The greater competition from China notwithstanding, even textile exports rose significantly. As for imports, the demand for transport equipment dropped. Export revenues covered about three quarters of import expenditures. In the first four months of 2005, the deficit in the current account amounted to EUR 6.8 billion compared to 5.7 billion the year previous. The current account gap was not bridged by the inflow of foreign direct investment (some EUR 500 million), but by inflows of

[18] Union of Turkish Chambers and Commodities Exchanges (TOBB).

Table TR

Republic of Turkey: Selected Economic Indicators

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., mid-year 2)	67469	68618	69757	70885	72003	.	.	72003	73109
Gross domestic product, YTL mn, nom.	124583	178412	277574	359763	430512	81166	.	492900	553800
annual change in % (real)	7.4	-7.5	7.9	5.8	8.0	11.8		6	6
GDP/capita (EUR at exchange rate)	3210	2372	2776	3004	3375	.	.	.	.
GDP/capita (EUR at PPP)	6260	5570	5950	6250	6750	.	.	.	.
Gross industrial production									
annual change in % (real)	6.0	-7.5	9.4	7.8	9.8	10.4	6.2	6	8
Gross agricultural production									
annual change in % (real)	3.9	-6.5	6.9	-2.5	2.0	2.7	.	.	.
Construction industry									
annual change in % (real)	0.2	-10.6	-6.1	-9.0	4.6	12.7	.	.	.
Consumption of households,YTL mn, nom.	89098	128513	184420	239586	284631	59746	.	.	.
annual change in % (real)	6.2	-9	2.1	6.6	8.3	12.4	.	7	7
Gross fixed capital form., YTL mn, nom.	27848	32409	46043	55618	76722	13507	.	.	.
annual change in % (real)	16.9	-31.5	-1.1	10.0	35.0	57.6	.	25	15
LFS - employed persons, th, avg.	20557	20492	21463	21147	21791	19902	20838	.	.
LFS - employed pers. in agricult. th, avg.	7176	8105	7623	7390	7414	6412	.	.	.
LFS - employed pers. in industry th, avg.	3731	3767	3913	3821	3955	3844	.	.	.
LFS - employed pers. in services th, avg.	9650	9647	8969	9127	9316	8924	.	.	.
LFS - unemployed, th pers. average 3)	1449	1905	2473	2493	2498	.	2750	.	.
LFS - unemployment rate in %, average	6.5	8.4	10.3	10.5	10.3	12.4	11.7	10.8	11
Reg. unemployment rate in %, average	3.3	3.2	1.9	2.5	.	.	.	.	.
Average nom. wages (YTL/Hour)	1.48	1.95	2.68	3.30	.	.	.	.	.
annual change in % (real)	0.8	-14.6	-5.4	-1.9	2.5	0.4	.	.	.
Consumer prices, % p.a.	54.9	54.4	45.0	25.3	10.6	9.5	8.6	8	6
Wholesale prices in manufacturing, % p.a.	56.1	66.7	48.3	23.8	11.1	8.6	10.9	.	.
Government budget, % GDP									
Central government revenues	26.7	29.0	27.5	27.9	25.6	29.6	.	.	.
Central government expenditures	37.4	45.1	41.6	38.9	32.6	38.3	.	.	.
General governm. deficit (-) / surplus (+) 4)	-11.9	-16.2	-12.6	-8.6	-7.0	-8.7	.	.	.
Public debt in % of GDP	53.8	100.4	88.8	83.3	.	.	.	.	.
Discount rate % p.a., end of period	60.0	60.0	55.0	43.0	.	.	.	.	.
Current account, EUR mn	-10670	3798	-1603	-7120	-12506	-4293	-4893	-14000	-17000
Current account in % of GDP	-4.9	2.3	-0.8	-3.3	-5.1	-8.8	.	-5	-5
Gross reserves of CB, excl. gold, EUR mn	24095	21050	26902	28430	27657	.	.	.	.
Gross external debt, EUR mn	129107	127620	137229	128901	130143	.	.	.	.
FDI inflow, EUR mn	1855	3684	621	367	2199	556	546	.	.
FDI outflow, EUR mn	788	25	5	7	691	152	96	.	.
Exports of goods, BOP, EUR mn	33385	38484	42203	45365	53909	11478	13626	62000	71300
annual change in %	22.8	15.3	9.7	7.5	18.8	10.9	18.7	15	15
Imports of goods, BOP, EUR mn	55673	42495	49557	57777	73159	15517	18429	84100	96000
annual change in %	54.5	-23.7	16.6	16.6	26.6	23.4	18.8	15	14
Exports of services, BOP, EUR mn	22130	17961	15570	16855	19334	2578	3078	.	.
annual growth rate in %	39.7	-18.8	-13.3	8.3	14.7	14	19.4	.	.
Imports of services, BOP, EUR mn	9776	7731	7271	7548	9056	1826	2162	.	.
annual growth rate in %	11.4	-20.9	-6.0	3.8	20.0	12.2	18.4	.	.
Average exchange rate YTL/USD	0.6252	1.2284	1.5095	1.4967	1.4253	1.3309	1.3249	.	.
Average exchange rate YTL/EUR (ECU)	0.5753	1.0963	1.4332	1.6894	1.7714	1.6670	1.7371	.	.
Purchasing power parity YTL/USD	0.2744	0.4301	0.6183	0.7451	0.7126	.	.	.	.
Purchasing power parity YTL/EUR	0.2950	0.4668	0.6689	0.8116	0.8857	.	.	.	.

Notes: 1) Preliminary. - 2) 2004 to 2006 SIS projections. - 3) Civilian Labour Force: unemployed. - 4) Based on the Public Sector Borrowing Requirement (PSBR) methodology including local public administraion, social security and enterprises under public administration.

Source: Central Bank of Turkey; State Institute of Statistics (SIS); State Planning Organization; Undersecretary of Treasury.

portfolio investment (EUR 2.2 billion) and other investment (EUR 4.5 billion). The latter inflows were also the main factor contributing to the EUR 1.9 billion rise in the country's currency reserves as indicated by the balance of payments for the period January-April 2005.

The latest edition of the central bank's quarterly monetary policy report stresses that over the period March 2004 to February 2005, Turkey attracted some EUR 15 billion in short-term financial investments or more exactly EUR 11 billion allowing for cash inflow registered as net error and omissions. Some EUR 8 billion of the total inflow comprised investments by foreigners, whereas the other EUR 7 billion were withdrawals from accounts held abroad by Turkish citizens. Most of this inflow, EUR 9 billion, entered Turkey during the period December 2004 to February 2005 reflecting the market's response to the news that broke December about the EU accession negotiations being scheduled to start on 3 October 2005.

A number of factors heighten the attractiveness of Turkey in terms of capital inflows: greater confidence in the country's positive macroeconomic prospects stemming, for example, from the government's strict budgetary discipline and a less vulnerable banking system; larger foreign currency reserves; and high nominal interest rates in tandem with expectations of continued exchange rate stability or even some nominal appreciation. Interest rates, such as the central bank's overnight rates or those in the secondary GDI market, range between 15 and 20%. By whatever reason, in the aftermath of the French EU referendum, the Turkish lira came under appreciation pressure, compelling the central bank to intervene repeatedly in order to 'halt excessive volatility'.

It is the inflow of short-term financial investment which covers the greater part of the current account deficit. Some analysts regard such 'hot money' inflow as a source of rising vulnerability, whereas others consider it as indicative of improving financial markets. From this latter point of view risks will remain within limits as long as fiscal and monetary policies avoid major mistakes. A completion of the banking sector reform reinforcing prudent banking rules could add to the economy's predominantly positive prospects. Throughout 2005 and 2006, slower inflation and high GDP growth are likely to continue. In spite of some deceleration, the latter most likely will remain above 5% annually. The exceptional boost in private consumption ground to a halt in the course of 2004, whereas the regular consumption growth is restrained by real wages close to stagnation and a lack of perceptible growth in employment. In all probability, GDP growth will remain predominantly based on increases in productivity. The unemployment rate will remain at its current level: around 10%. Foreign trade will continue to expand as the economy opens up still further. Commodity trade and current account deficits will remain high, as the adverse impact of liberalizing the textile markets may not be fully offset by the increase in exports of machinery, instruments and transport equipment.

The government will maintain its policy of budgetary restraint. Apart from that it will be preoccupied with all kind of political problems as it endeavours to come up to the expectations voiced by both the IMF and the EU. Although the deregulation of major companies such as Tüpraş (oil refinery), Erdemir (steel production) and the state-owned tobacco company run by Tekel is on the government's agenda, it will not be such a simple task.

In order to ensure that EU accession negotiations do start as planned on 3 October 2005, Turkey still has to sign a document pertaining to the adjustment of the customs union it has entered into with the EU: it will have to be extended in scope so as to include the new EU member states. This adjustment protocol, which will have to be completed in the course of the summer, will constitute, implicitly at least, some kind of recognition of the Greek Cypriot government. Although Turkey has declared its willingness to sign the protocol, the exact wording might still pose a problem. The EU Commission is supposed to issue an outline for the negotiations, on the basis of which the talks on Turkey's membership will be conducted. By the time negotiations begin, the Council of Europe will have had to accord the document official recognition.

To sum up, throughout 2005 and 2006, slower inflation and high GDP growth are likely to continue. Economic growth will be slower than in 2004; most likely, however, it will remain above 5% annually. Commodity trade and current account deficits will remain high. The manner in which these deficits are being funded offers some cause for concern. Despite the positive aspect of the exchange rate having stabilized, nominal appreciation in the wake of large capital inflows would give rise to an economically unsound situation. The emergent risk factor is the outcome of relatively high interest rates and improved economic fundamentals.

Part C: Russia and Ukraine; China

Country reports

Peter Havlik

Russian Federation: lower GDP growth despite surging trade surplus

During the past five years – in Putin's era – the Russian economy expanded at an average annual rate of nearly 7%. The main drivers of growth have been booming private consumption and large export surpluses, the latter resulting mainly from surging oil export revenues. The government budget has been in a sizeable surplus, foreign exchange reserves increased fivefold and external debt has been reduced. In addition, the Stabilization Fund (established in 2004 and fed from a portion of windfall oil export revenues) reached RUR 860 billion (EUR 23.5 billion) by April 2005. The accumulated funds enabled Russia to repay part of its external debt (to the IMF and recently also to Paris Club creditors) ahead of schedule. At the same time, the pace of structural reforms has recently slowed down substantially and the investment climate has deteriorated. The Russian variety of Dutch disease symptoms is becoming increasingly apparent as more than half of all export revenues stem from energy carriers (another 30% of exports represent metals). With a roughly constant nominal exchange rate over the period (28 RUR per USD) and persisting, albeit somewhat declining, double-digit annual inflation the rouble has strengthened by nearly 50% in real terms against the US dollar since 2000 (the real appreciation against the euro was much less pronounced). The year 2004, when the GDP increased by about 7%, might well have been the last one of robust economic growth – high world market commodity prices notwithstanding.

Indeed, GDP growth decelerated already in the closing months of last year and even more markedly in the first quarter of 2005 (Table RU). The slowdown was recorded in industry, transport and construction whereas output growth of some services (especially retail trade and telecommunications) accelerated. Agricultural production was flat. On the demand side, investment growth was somewhat disappointing, reflecting the growing uncertainty on the part of economic agents regarding the future outlook – despite robust household consumption as mirrored in growing retail sales. Exceptionally high world market prices of the main Russian export commodities (particularly of energy carriers and metals) represented once again the key growth stimulus during the first quarter of 2005. Due to the combined effects of high foreign exchange inflows, expanding money supply, robust economic growth, and price hikes in energy and services, disinflation came to a halt. Consumer price inflation accelerated to nearly 13% on an annual average in the first quarter of 2005. Still more disturbing is the fact that producer price inflation has been even higher, exceeding 23% in the first quarter of 2005, mainly as a result of surging domestic prices of energy and metals. Given the further envisaged adjustments of administered prices, e.g. of electricity and gas, it is obvious that permanently rising producer prices will eventually translate into higher consumer price inflation as well. Rapid disinflation is therefore highly unlikely: consumer prices will increase by about 12% in 2005 and not much less in 2006.

Goods exports were up by more than 34% in EUR terms during the first quarter of 2005 (+41% in USD terms) compared to a year earlier, largely thanks to a jump in energy revenues. Imports of

Table RU

Russia: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1)]	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period [2)]	144819	143954	144964	144168	143400	143527	143300	143000	142500
Gross domestic product, RUB bn, nom.	7305.6	8943.6	10830.5	13243.2	16751.5	3485.5	4364.9	20300	24000
annual change in % (real)	10.0	5.1	4.7	7.3	7.2	7.6	5.2	5.3	5.0
GDP/capita (EUR at exchange rate)	1928	2365	2539	2641	3253	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6030	6480	7010	7530	8300	.	.	.	.
Gross industrial production									
annual change in % (real)	11.9	4.9	3.7	7.0	6.1	7.6	3.9	4.5	4.5
Construction output total									
annual change in % (real)	17.0	9.9	2.7	14.4	10.1	13.8	5.3	.	.
Consumption of households, RUB bn, nom.	3295.2	4318.1	5408.4	6559.9	8010.7	1780.1	.	.	.
annual change in % (real)	7.3	9.5	8.5	7.5	11.3	9.7	.	8	7
Gross fixed capital form., RUB bn, nom.	1232.0	1689.3	1938.8	2407.6	3002.1	465.5	509.8	.	.
annual change in % (real)	18.1	10.2	2.8	12.8	10.8	13.1	7.6	7.5	7
LFS - employed persons, th, avg.	64255	64400	66071	65800	67383	66067	66200	.	.
annual change in %	2.8	0.2	2.6	-0.4	2.4	2.4	0.2	.	.
Reg. employment in industry, th pers., avg.	14543	14692	14534	14345	14130	.	.	.	.
annual change in %	1.7	1.0	-1.1	-1.3	-1.5	.	.	.	.
LFS - unemployed, th pers., average	7515	6416	5712	6231	5988	6672	6011	.	.
LFS - unemployment rate in %, average	10.5	9.1	8.0	8.6	8.0	9.2	8.3	8.5	9
Reg. unemployment rate in %, end of period	1.4	1.6	2.1	2.3	2.6	2.3	2.8	.	.
Average gross monthly wages, RUB	2223.4	3240.4	4360.3	5498.5	6828.0	6167.0	7634.7	.	.
annual change in % (real, gross)	20.9	19.9	16.2	11.0	10.8	15.0	7.4	.	.
Consumer prices, % p.a.	20.8	21.6	16.0	13.6	11.0	10.8	12.9	12	10
Producer prices in industry, % p.a.	46.6	19.1	11.8	15.6	24.0	18.6	23.3	20	15
General governm.budget, nat.def., % GDP									
Revenues	28.7	30.0	32.5	31.3	32.4	30.0	39.3	.	.
Expenditures	26.8	27.1	31.6	29.9	27.9	25.5	24.3	.	.
Deficit (-) / surplus (+), % GDP	1.9	3.0	0.9	1.3	4.5	4.5	15.0	.	.
Public debt, nat.def., in % of GDP [3)]	57.1	44.1	37.0	31.7	23.5	.	.	.	.
Refinancing rate of NB % p.a., end of period	25	25	21	16	13	14	13	.	.
Current account, EUR mn [4)]	50619	37885	30789	31330	48347	10213	17097	58000	50000
Current account in % of GDP	18.0	11.1	8.4	8.2	10.3	9.6	14.3	10.0	7.5
Gross reserves of NB, excl. gold, EUR mn	26139	37026	42290	58531	88663	65187	103142	.	.
Gross external debt, EUR mn	172903	169530	147067	148536	155148	155521	.	.	.
FDI inflow, EUR mn [4)]	2933	3069	3660	7041	9388	3929	.	.	.
FDI outflow, EUR mn [4)]	3433	2828	3736	8606	7722	3388	.	.	.
Exports of goods, BOP, EUR mn [4)]	113510	113744	113468	120265	147555	29815	40092	174000	169000
annual growth rate in %	60.1	0.2	-0.2	6.0	22.7	3.0	34.5	18	-3
Imports of goods, BOP, EUR mn [4)]	48483	60022	64470	67304	77462	15697	18688	90000	103500
annual growth rate in %	30.7	23.8	7.4	4.4	15.1	5.4	19.1	16	15
Exports of services, BOP, EUR mn [4)]	10337	12773	14393	14359	16320	3116	3358	17600	19100
annual growth rate in %	21.5	23.6	12.7	-0.2	13.7	9.5	7.8	8	8.5
Imports of services, BOP, EUR mn [4)]	17540	22967	24848	23997	27106	5114	5572	29800	32800
annual growth rate in %	40.0	30.9	8.2	-3.4	13.0	7.2	9.0	10	10
Average exchange rate RUB/USD	28.13	29.17	31.35	30.69	28.81	28.63	27.88	28	29
Average exchange rate RUB/EUR (ECU)	26.03	26.13	29.65	34.69	35.81	35.83	36.52	35	36
Purchasing power parity RUB/USD, wiiw	7.16	8.15	9.27	10.39	12.02	.	.	13.5	15
Purchasing power parity RUB/EUR, wiiw	8.32	9.53	10.74	12.17	14.04	.	.	16.2	17

Notes: 1) Preliminary. - 2) Resident population; from 2002 according to census October 2002. - 3) In 2000 wiiw estimate. - 4) Converted from USD to EUR at the official cross exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

goods increased by nearly 20% (+25% in USD terms), with machinery and transport equipment (in particular passenger cars) imports rising faster than average. The export surplus reached a new record in early 2005: more than USD 28 billion in the first quarter, as compared to 18 billion a year earlier, and the current account surplus (USD 22.4 billion) amounted to nearly 14% of GDP. Despite the prevailing expectation of lasting high world market commodity prices (and moderately growing Russian production and exports), the growth in export revenues will most likely fall due to the bottoming out of energy prices (and export capacity constraints) while imports, fuelled by robust domestic demand and the ongoing real appreciation of the rouble, will continue to rise. Although the trade and current account surpluses will remain large, the contribution of net exports to GDP growth will gradually diminish.

Apart from net exports, the main growth pillar during the last couple of years has been private consumption. The share of investments in GDP is still rather low (about 18% of GDP) and their growth has slowed down – despite rising profits. Indeed, the situation of most Russian companies, in particular those engaged in export activities, is quite comfortable (except Yukos, which is facing liquidation after its main asset Yuganskneftegas was sold to a subsidiary of Gazprom), and they can easily finance investments from own resources (or credits, as was the case in Gazprom's recent acquisition of Yukos assets).

The deterioration of the investment climate in Russia, in part related to the protracted Yukos trial and the announcement of new tax claims on other companies, is reflected in lower overall investment growth: 7.6% in the first quarter of 2005, as compared to 13.5% in the same period of the previous year. Curiously, there has been an increase in registered FDI, by about 30%, in particular in raw materials production and the processing and trade sectors of the economy (so far not confirmed by balance of payments data). The total stock of foreign investments in Russia is estimated to amount to about USD 85 billion (less than 15% of GDP), of which around half (USD 38 billion) represent FDI. Compared to most other transition economies, the FDI penetration of Russia is extremely low and outflows of capital are high. Contrary to other transition countries, and to China, foreign investors are not particularly welcome in Russia and, as recently announced by the government, the access of foreign investors to the most attractive ('strategic') sectors will remain restricted to minority participation.

Despite predominantly positive economic indicators, the prospects for sustainable long-term growth are blurred considering the lagging reform progress, insufficient transparency of legal regulations and, last but not least, the structural imbalances in the economy which is excessively dependent on the fluctuating world market commodity prices. In line with most observers and even the official government forecasts, wiiw expects Russia's GDP growth to slow down in both 2005 and 2006 (the Russian government is more optimistic with its recently revised forecast for GDP growth to less than 6% in both 2005 and 2006). Yet there is a broad consensus – both in- and outside Russia – that even the current rate of economic growth is unsustainable unless the pace of structural, institutional, legal and banking sector reforms (and especially their implementation) speeds up substantially. After the lacklustre implementation of public sector administration and tax reforms, the latest example was the botched attempt at social benefits reform.

The favourable price developments on world commodities markets and the related huge 'twin surpluses' make an acceleration of liberal reforms in Russia unlikely – notwithstanding public declarations, such as in President Putin's latest annual address. On the contrary, a tendency towards increasing state intervention in the economy (particularly in strategic sectors such as energy and metals) and exerting more influence on decision-making at the regional level, is becoming more apparent. Increasing bureaucratic hurdles and less efficiency may be the outcome. The recently announced relaxation of fiscal policies, aimed at the stimulation of domestic demand, will certainly make disinflation more difficult; it will also increase the pressure on real appreciation. This may lead to even higher imports, lower trade surplus and eventually to lower GDP growth as well.

Vasily Astrov

Ukraine: deteriorating investment climate

The record-high economic growth registered in Ukraine in 2004 (12.1%, according to revised figures) slowed down to a mere 4.7% in the first five months of 2005. Measured in value added, the manufacturing industry (+6.6%) remained one of the principal growth engines, although it has suffered a considerable deceleration as well. In particular, the two leading industrial branches – machine-building and metals – recorded a dramatic slowdown of output growth: from 36.3% to 11.2%, and from 19.1% to -0.3%, respectively. These developments largely reflect a marked weakening of investment activity, albeit from very high levels. In the first quarter of 2005, investments in fixed capital were up only 4.5% year-on-year – compared to 28% in 2004 as a whole and 52% in its first quarter.[19]

The reluctance to invest is hardly surprising given the policies of the new authorities, which launched a major revision of privatization deals concluded by the previous regime of president Kuchma. To make things worse, the government added to investors' worries by a series of contradicting statements regarding both the scope and the particulars of the upcoming re-privatization scheme. In particular, it took the government several months to draft a list of enterprises subject to re-privatization and representing most notably the assets of domestic financial-industrial groups, but also some foreign investment companies, including Russian, Austrian, German and from the US. However, the list has never been officially published (although it was referred to by several high-ranking officials including President Yushchenko), and Prime Minister Tymoshenko denied its very existence. In turn, the State Property Fund has compiled an alternative list of 194 mostly medium-sized enterprises subject to re-privatization, which allegedly does not overlap with the former list. In the meantime, several privatization deals have been annulled in court, including the country's biggest steel producer *Kryvorizhstal'*, but the legal dispute over the enterprise is far from being over, and its ownership status remains unclear. Apart from the re-privatization campaign, the investment climate in the country has suffered from the unilateral abolition of tax and customs benefits granted to the so-called 'special economic zones' (SEZs) and 'territories of priority development' (TPDs).[20]

[19] The latter high figure, though, is partly explained by the one-time completion of nuclear power blocks in Rivne and Khmelnitsk in early 2004. No wonder it is these two regions in Western Ukraine where fixed investments in January-March 2005 plunged the most: by 65% and 49% year-on-year, respectively.

[20] The move was aimed at closing the 'loopholes' for smuggling, but it has also hurt investment projects implemented there. Facing the business pressure, more recently the government has revitalized the idea of SEZs and elaborated a draft law on the uniform principles of their functioning (hitherto, each SEZ was regulated by a separate law). As of January 2005, Ukraine reportedly had 11 SEZs and 72 TPDs on its territory, involving 212 and 556 investment projects, respectively.

Table UA

Ukraine: Selected Economic Indicators

	2000	2001	2002	2003	2004 1)	2004	2005	2005	2006
						1st quarter		forecast	
Population, th pers., end of period 2)	48923.2	48457.1	48003.5	47622.4	47280.8	47516.7	47166	47000	46800
Gross domestic product, UAH mn, nom.	170070	204190	225810	267344	344822	64746	79356	407500	475200
annual change in % (real)	5.9	9.2	5.2	9.6	12.1	12.7	5.4	5.5	6
GDP/capita (EUR at exchange rate)	688	872	931	928	1099	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3770	4230	4610	5120	5920	.	.	.	.
Gross industrial production									
annual change in % (real)	13.2	14.3	7.0	15.8	12.5	18.8	7.1	7	7
Construction output total									
annual change in % (real)	0.4	3.5	-5.8	26.5	17.2	29.9	-5.9	.	.
Consumption of households, UAH mn, nom.	92406	112260	124560	146301	185533	.	.	.	.
annual change in % (real)	2.5	9.6	9.5	12.4	15.1	.	.	.	.
Gross fixed investment, UAH mn, nom.	23629	32573	37178	51011	75714	10236	12638	.	.
annual change in % (real)	14.4	20.8	8.9	31.3	28.0	52.1	4.5	10	10
LFS - employed persons, th, avg. 3)	20175.0	19971.5	20091.2	20163.3	20295.7	19974.6	.	.	.
annual change in % 4)	1.9	-1.0	0.6	0.4	0.7	.	.	.	.
Reg. employees in industry, th pers., avg. 5)	3445.0	3811.0	3578.1	3416.0	3408.3	.	3427.9	.	.
annual change in %	-12.4	-6.2	-6.1	-4.5	-0.2	.	.	.	.
LFS - unemployed, th pers., average 3)	2655.8	2455.0	2140.7	2008.0	1906.7	2055.2	.	.	.
LFS - unemployment rate in %, average 3)	11.6	10.9	9.6	9.1	8.6	9.3	.	8.0	8
Reg. unemployment rate in %, end of period	4.2	3.7	3.8	3.6	3.5	3.9	3.6	3.4	3.4
Average gross monthly wages, UAH 5)	230.1	311.1	376.4	462.3	589.6	517.5	676.4	.	.
annual change in % (real, gross)	1.1	20.7	20.0	16.7	17.0	18.3	15.0	.	.
Consumer prices, % p.a.	28.2	12.0	0.8	5.2	9.0	7.4	13.5	12	10
Producer prices in industry, % p.a.	20.9	8.6	3.1	7.8	20.4	14.1	22.3	19	15
General governm.budget, nat.def., % GDP									
Revenues	28.9	26.9	27.4	28.1	26.3	28.2	32.1	.	.
Expenditures	28.3	27.2	26.7	28.3	29.4	26.2	28.2	.	.
Deficit (-) / surplus (+), % GDP	0.6	-0.3	0.7	-0.2	-3.4	1.9	3.7	.	.
Public debt in % of GDP	45.3	36.5	33.5	29.0	24.7	.	.	.	.
Refinancing rate of NB % p.a., end of period	27.0	12.5	7.0	7.0	9.0	7.0	9.0	.	.
Current account, EUR mn 6)	1602	1565	3360	2559	5476	1308	.	3500	2500
Current account in % of GDP	4.7	3.7	7.5	5.8	10.5	13.5	.	5.2	3.1
Gross reserves of NB excl. gold, EUR mn 7)	1453	3353	4088	5386	6838	6328	9066	.	.
Gross external debt, EUR mn 8)	12759	13785	12247	19055	22487	20213	.	.	.
FDI inflow, EUR mn 6)	644	884	734	1261	1380	267	.	.	.
FDI outflow, EUR mn 6)	1	26	-5	12	3	1	.	.	.
Exports of goods, BOP, EUR mn 6)	17008	19074	19770	21013	26906	5855	.	29500	32500
annual growth rate in %	37.2	12.1	3.6	6.3	28.0	23.5	.	10	10
Imports of goods, BOP, EUR mn 6)	16165	18853	19018	21251	23895	5108	.	29000	33000
annual growth rate in %	32.8	16.6	0.9	11.7	12.4	20.3	.	21	14
Exports of services, BOP, EUR mn 6)	4111	4459	4958	4615	5060	1173	.	5000	5000
annual growth rate in %	13.0	8.5	11.2	-6.9	9.6	4.7	.	-1	0
Imports of services, BOP, EUR mn 6)	3433	3995	3743	3237	4149	907	.	4000	4000
annual growth rate in %	59.3	16.4	-6.3	-13.5	28.2	-5.8	.	-4	0
Average exchange rate UAH/USD	5.440	5.372	5.327	5.333	5.319	5.330	5.299	5.1	4.9
Average exchange rate UAH/EUR (ECU)	5.029	4.814	5.030	6.024	6.609	6.662	6.956	6.1	5.9
Purchasing power parity UAH/USD, wiiw	0.849	0.912	0.944	1.003	1.131	.	.	.	.
Purchasing power parity UAH/EUR, wiiw	0.917	0.991	1.017	1.092	1.228	.	.	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census December 2001. - 3) From 2000 revised data according to census 2001. - 4) In 2000 unrevised data. - 5) Excluding small enterprises. - 6) Converted from USD to EUR at the official cross exchange rate. - 7) Useable. - 8) Up to 2002 long-term debt only.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

In contrast to the 'heavy industry', consumption-oriented sectors continue performing well. The food processing industry recorded a healthy 14.8% output growth in January-May 2005, and retail trade turnover was up 18.8% year-on-year. The booming consumption is backed by a strong rise in households' disposable money incomes. The latter jumped by 24.8% in real terms in the first four months of 2005 (year-on-year), reflecting first of all a strong pick-up in government transfers, while the increase in real wages (+15.3%) was more moderate. Increased social spending is partly a legacy of the previous government, which doubled the minimum pension in September 2004, but it is also due to the 2005 budget amendments enacted by the new government in March. In line with those, the minimum pension was raised by another 17% (to UAH 332, or some USD 65 per month), retroactively, from 1 January. The *average* pension increased even more, by nearly 22% – in accordance with the strategy of pension differentiation. Public wages were raised by 57% on average (in nominal terms), and the government has reportedly paid back its wage arrears by early June. The generous fiscal policy will probably continue in the run-up to the parliamentary elections of March 2006, especially taking into account the enhanced powers the new parliament will have after the constitutional reform takes effect.

The rising budget expenditure commitments are to be backed by increased revenues resulting from higher excise taxes on tobacco and fuels, the imposition of VAT on energy imports, a harder stance on smuggling, and the already mentioned abolition of preferences to SEZs. These measures – along with better tax compliance – have already helped boost the consolidated government revenues, which were up by 29% in real terms in the first four months. The 2005 budget is based on the official projections of 8.2% economic growth and 9.7% year-end consumer price inflation. While the growth projection seems now overly optimistic (we expect 6% GDP growth at best), inflation will be almost certainly double-digit. In the first five months, consumer prices rose already by 5.7% against December 2004.

Given the expansionary fiscal policy, the inflation problem is being tackled by monetary and exchange rate instruments. Facing a strong appreciation pressure stemming from the current account surplus and the recent surge in speculative capital inflows, the National Bank in April abandoned the *de facto* nominal peg to the US dollar (at around UAH 5.3 per USD) pursued since 2002 and revalued the hryvnia to UAH 5.05 per USD. The measure was intended to ease the inflationary pressure by depressing the cost of imports (especially energy), on the one hand, and reducing the current account surplus and the resulting inflow of foreign exchange, on the other. In another move, the National Bank scrapped, as of April, the 50% surrender requirement for export earnings which had been in place since the 1998 crisis.

Despite these measures, the upward pressure on the hryvnia has hardly weakened due to the fact that households have started converting their dollar savings into hryvnia in response to the recent revaluation. Also, while Ukraine may still be a risky place for direct (strategic) investors, the country's attractiveness for portfolio (speculative) investors has increased. This applies particularly to the government domestic bonds, the yields on which have fallen sharply from around 11% p.a. last year to just 6.74% for the March 2005 issue as a result of an upswing in demand. In May, Standard and Poor's revised Ukraine's long-term sovereign rating upwards (to BB- in foreign, and BB in domestic currency), and a new influx of speculative capital betting on further hryvnia appreciation cannot be ruled out. However, the National Bank will probably stick to the new exchange rate of UAH 5.05 per USD at least until the end of this year, fearing that any further appreciation would further harm the already weakening economic growth. The current strengthening of the US dollar in the world markets may be another argument for the National Bank to resist further appreciation.

While a decline of inflation as a result of the recent revaluation is rather unlikely, it can be argued that without revaluation, inflation would have turned even higher. On the other hand, imports will be growing at an accelerated pace, leading to a likely squeeze of the trade and current account surplus this year (the latter reached a record level of 10.5% of GDP in 2004). According to the customs statistics, in the first four months of 2005 imports were already growing ahead of exports: by 22.9% vs. 12.4% in dollar terms year-on-year, respectively, and the trade surplus in goods has nearly halved.

Political developments since the 'orange revolution' of late 2004 have been controversial. In particular, the new authorities have embarked upon repressions against their political opponents and the affiliated business structures, usually – and similarly to Russia – under the pretext of criminal charges on economic grounds. Meanwhile, integration into the EU and NATO has been re-instated into Ukraine's foreign policy doctrine. The majority of Ukrainians are in favour of joining the EU, although the latter is very unlikely to acknowledge the country's membership prospects, at least in the short and medium term. Ironically, even the prospects of obtaining a 'market economy status' from the EU have been complicated by the recent government policies.[21] The country's membership in NATO appears more realistic, although most Ukrainians actually oppose it.

Waltraut Urban

China: rapid growth, but some signs of cooling down

During the first quarter of 2005, the Chinese economy continued to grow fast, at a rate of 9.4% – nearly the same as in the previous quarter and in 2004 on average, but somewhat slower than in the same period of last year (9.8%). However, the rate of growth is still well above the government's target rate of 8% for this year.

Investment in fixed assets, the major driving force of last year's growth, and output in some overheated sectors of the economy have cooled down significantly, but private consumption has picked up and (net) foreign trade expanded faster than expected. For the rest of the year, the main trends will continue, although exports may lose momentum. We thus expect the Chinese economy to grow by about 8.5% in the whole year 2005 and to keep its pace in 2006.

Growth of fixed asset investment reached 22.8% (in nominal terms) in the first quarter of this year; this was much less than in the same period of last year (43%) and remained also below the average growth rate in 2004 (25.8%). That deceleration was a consequence of various government measures (such as credit restraints and limitation of operating licences) aimed at cooling down investment growth, which in certain sectors (e.g. real estate development, steel industry) was considered unsustainably high, but was also due to emerging over-capacities (e.g. in car

[21] In particular, in response to the rising domestic prices of oil products – partly resulting from the introduction of VAT on imported oil and higher excise taxes – the government imposed, in April 2005, caps on the wholesale prices of fuels and a 13% retail margin cap. This has led to widespread fuel shortages, forcing the government to give up administrative price-setting and lower the excise taxes and import duties on oil products instead.

production). Thus, the structure of investment has changed, too. The growth of investment slowed down, for instance, in various branches of the metal and the vehicle industries, but accelerated in so-called 'bottleneck' industries supported by the government, such as agriculture (70%), oil refining (46%), coal (80%), electricity, gas & water (44%) and railways (300%). Investment in the steel sector fell by 1.4% year-on-year, compared to an increase of 106% in the first quarter of 2004; investment in ferrous metal smelting and in non-metal mining decreased by 9% and 7.7% respectively in the first two months of this year. But investment in real estate development remained high (27%), despite government measures to restrain growth. (Credit restrictions have been tightened further and a tax on profits from house sales, if owners sell the house within two years of purchase, has been introduced.) Overall, investment growth is significantly above the official target of 16% and the danger of a rebound of investment activity and unbalanced growth is not banned yet. Thus the restrictive measures of the government will remain in place. Still, we expect investment to continue to grow at a similar pace as in the first quarter for the rest of the year.

Data on aggregate private consumption are not available for the time being, but retail sales of consumer goods (in real terms), which may be used as a proxy for private consumption, expanded by 12.1% year-on-year in the first quarter, at a similar rate as during the last few months of 2004 and significantly faster than in the first quarter of 2004. The relatively strong growth of private consumption was supported by a robust increase in personal incomes: in real terms, per capita urban incomes rose by 8.6% and per capita rural incomes increased by 11.9% year-on-year in the first quarter of 2005. With overall economic growth remaining high and continuous support of the agricultural sector, growth of personal incomes and thus of private consumption can be expected to remain high for the months to come.

Consumer price inflation reached a peak in mid-2004 and decelerated thereafter. In the first quarter of this year it stood at the same level as in the same period of last year (2.8%). The rise in producer prices has likewise decelerated, but increases are still high (5.6%) because of price hikes for many raw materials, fuels and electricity. Thus a surge in consumer prices with some delay cannot be excluded. However, retail fuel prices and prices for electricity are regulated. For the year as a whole, we expect the CPI to increase by 3%. Property prices are not included in the CPI and continued rising rapidly: real estate prices rose by 10% as compared to 7% in the last quarter of 2004; land leasing costs were up 8% on average but skyrocketed in some cities, such as in Dalian (50%), reflecting government efforts to rein in real estate development through restricting land supplies. But demand is staying high: in a recent survey, over a fifth of households in urban areas are planning to purchase a new apartment within the next few months.

Chinese exports reached USD 155.9 billion in the first quarter of 2005 while imports came up to USD 139.3 billion, resulting in a massive trade surplus of USD 16.6 billion, which is in marked contrast to the trade deficit of USD 8.4 billion in the first quarter of 2004. While exports rose at a similar pace as last year, import growth decelerated sharply to 12.2% as compared to 42.3% in the first quarter of 2004. Exports increased strongly in all main sectors such as electronic products, machinery, textiles, clothing and shoes. A very strong acceleration of exports could be observed in steel and steel products (220%), with world market prices higher than domestic prices. However, for the reason of saving energy and to avoid supply bottlenecks on the domestic market, the Chinese government intends to curb exports of these product categories to a certain extent: thus, it reduced export tax rebates in April and introduced a ban on iron and steel processing trade in May. By the latter measure, processors in China will be prohibited from making goods for overseas clients with imported iron ore, pig iron, steel, steel scraps, etc. provided by these customers (for similar reasons, rare earth and phosphorite processing trade will be banned as well).

Textiles & clothing exporters have benefited from the global removal of T&C quotas among the World Trade Organization (WTO) members as of 1 January 2005. While overall Chinese textiles and clothing exports increased only 16% during the first three months of the year, exports to the USA and the European Union rose much faster and in certain product groups, export growth reached 2-digit and even 3-digit rates (e.g. T-shirts, cotton trousers, underwear). As a consequence, the US and the EU resorted to the special safeguard measures provided for in China's Accession Treaty to the WTO, to restrict imports from China of these particular product groups. However, in June, an agreement between the EU and China was reached in this matter, restricting the export growth of 10 T&C categories (e.g. pullovers, cotton fabrics, T-shirts, flax yarn) to a range between 8% and 12.5% for the years 2005 to 2007. No such agreement has so far been reached between the USA and China. Instead, the US has unilaterally imposed new quotas on certain Chinese-made garments including cotton trousers, cotton & knitwear shirts and synthetic fibres underwear, to restrict import growth to 7.5% per year.

Likewise, with regard to shoes, all quotas on Chinese trade were eliminated by the end of 2004, in accordance with China's WTO Treaty. In response to the resulting surge in shoe exports to the European Union, the EU Commission announced an anti-dumping investigation only days after negotiating an end to the trade dispute with China over textiles. These cases and other examples in the past illustrate that trade conflicts may become a decisive factor in the future development of Chinese exports.

The low import growth in the first quarter mainly reflects the cooling down of investment and increased domestic production capacities in certain sectors. Machinery imports rose only by 5% year-on-year; imports of oil, steel, steel products, copper and cars showed even negative growth rates. In certain cases, the introduction of licensing regimes, e.g. for iron ore, curbed imports. Moreover, extended refining capacities allowed for a substitution of less expensive raw oil for higher-priced oil derivatives, depressing imports in value terms. However, imports for export processing continued to rise by nearly 20%, pointing to a further expansion of exports in the near future, although probably at a lower rate than in the first quarter. A slowing down of Chinese exports is also supported by forecasts, e.g. of the International Monetary Fund, of slower growth of the world economy in 2005 (4.3%) than in 2004 (5.1%) and in particular of world trade (7.4% in 2005 vs. 9.9% in 2004).

Foreign direct investment (FDI) reached an impressive USD 13.4 billion in the first quarter, but was only slightly higher than in the same period a year earlier. In April and May, the inflow of foreign direct investment even fell year-on-year. This is probably linked to the cooling-down of the economy, mounting risks with regard to possible trade conflicts, uncertainties about the future exchange rate policy and the pending tax reform, which is expected to raise corporate tax rates for foreign enterprises which have so far been privileged as compared to domestic enterprises. A certain saturation of manufacturing investment and greater imponderabilities when it comes to investments in other sectors of the economy may play a certain role as well. In any case, contracted investment, a kind of forward indicator for actual investment, slowed down in the first quarter as well. For the year as a whole, we thus expect FDI inflows to be lower than last year, probably reaching USD 55 billion.

Table CN

China: Selected Economic Indicators

	2000	2001	2002	2003	2004 [1)]	2004	2005 [1)]	2005	2006
						1st quarter		forecast	
Population, mn pers., end of period [2)]	1265.8	1277.3	1286.0	1292.0	1299.9	.	.	.	.
Gross domestic product, CNY bn, nom.	8940.4	9593.3	10239.8	11669.4	13651.5	2710.6	3140.0	15330	.
annual change in % (real)	8.0	7.3	8.0	9.1	9.5	9.8	9.5	8.5	8.5
GDP/capita (USD at exchange rate)	853.0	907.1	960.5	1091.1	1268.3	.	.	.	.
GDP/capita (USD at PPP - wiiw)	4082.6	4444.3	4818.3	5344.4	6105.8	.	.	.	.
Industrial value added									
annual change in % (real)	9.9	8.9	9.9	12.5	11.1	11.6	11.0	11	.
Construction output, CNY bn [3)]	1249.7	1536.1	1852.7	2308.3	.	.	.	.	.
annual change in % (nominal)	12.1	22.9	20.6	.	.	.	.	.	.
Retail trade turnover, CNY bn	3415.3	3759.5	4191.1	4572.5	5395.0	1283.1	1414.0	.	.
annual change in % (real)	11.1	10.9	10.6	9.2	10.5	9.3	12.0	.	.
Total investment in fixed assets, CNY bn	3291.8	3689.8	4283.9	5427.6	7007.3	879.9	1080.5	.	.
annual change in % (nominal)	10.3	12.1	16.1	26.7	25.8	43.0	22.8	.	.
Employment total, mn pers., end of period	720.9	730.3	737.4	744.3	.	.	.	.	.
annual change in %	1.0	1.3	1.0	0.9	.	.	.	.	.
Staff and workers, mn pers., end of period [4)]	112.6	107.9	105.6	104.6 [5)]	104.5 [5)]	103.5	.	.	.
annual change in %	-4.3	-4.2	-2.2	-0.9	-0.1	-0.5	.	.	.
Unemployment rate (urban) in %,end of per. [6)]	3.1	3.6	4.0	4.5	4.2	4.3	.	4.4	.
Average gross annual wages, CNY [7)]	9371	10870	12466	14052	14453	14318	.	.	.
annual change in % (real) [8)]	11.1	15.2	15.5	11.5	10.4	.	.	.	.
Retail prices, % p.a.	-1.5	-0.8	-1.8	-0.1	2.8	1.4	1.8	.	.
Consumer prices, % p.a.	0.4	0.7	-0.8	1.2	3.9	2.8	2.8	3.0	3.0
General government budget, nat.def., % GDP									
Revenues	15.0	17.1	18.5	18.6	19.3	.	.	.	.
Expenditures	17.8	19.6	21.5	21.1	20.8	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.8	-2.6	-3.1	-2.5	-1.5	.	.	.	.
Refinancing rate of NB % p.a., end of per. [9)]	3.2	3.2	2.7	2.7	2.9	2.7	2.9	.	.
Current account, USD bn	20.5	17.4	35.4	45.9	70.0	.	.	54	.
Current account in % of GDP	1.9	1.5	2.9	3.3	4.2	.	.	3.0	2.8
Gross reserves of NB excl. gold, USD bn	165.6	212.2	286.4	403.3	609.9	439.8	659.1	.	.
Gross external debt, USD bn	145.7	170.1	171.7	194.0	228.6	200.2	233.4	.	.
FDI inflow, USD bn	40.7	46.9	52.8	53.3	60.6	12.2	13.4	60	.
FDI outflow, USD bn	0.9	6.9	2.9	2.8	3.6	.	.	.	.
Exports of goods total, USD bn [10)]	249.2	266.2	325.6	438.4	593.4	115.7	155.9	.	.
annual change in %	27.8	6.8	22.3	34.6	35.4	34.1	35.0	.	.
Imports of goods total, USD bn [10)]	225.1	243.6	295.3	412.8	561.3	124.1	139.3	.	.
annual change in %	35.8	8.2	21.2	39.9	36.0	42.3	12.0	.	.
Trade balance of goods, USD bn [10)]	24.1	22.5	30.3	25.5	32.0	-8.4	16.6	30	.
Average exchange rate CNY/USD	8.28	8.28	8.28	8.28	8.28	8.28	8.28	8.28	.
Average exchange rate CNY/EUR	7.65	7.35	7.75	9.37	11.28	10.34	.	.	.
Purchasing power parity CNY/USD, wiiw [11)]	1.73	1.69	1.69	1.69	1.72	.	.	.	.
Purchasing power parity CNY/EUR, wiiw	1.86	1.83	1.83	1.84	1.98	.	.	.	.

Note: CNY: ISO-Code for the Chinese yuan.

1) Preliminary. - 2) From 2000 according to census November 2000. - 3) Construction enterprises with independent accounting systems. - 4) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives and foreign invested enterprises. - 5) End of September. - 6) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 7) Average gross annual wages of staff and workers, defined as: total wages of staff and workers per average number of staff and workers; "staff on duty". - 8) Staff and workers cost of living index is used as deflator for calculating real wage. - 9) Overnight rate. - 10) According to customs statistics. - 11) Purchasing power parity, ICP-method; see Ren Ruoen, The Vienna Institute Monthly Report 1996/2.

Sources: China Statistical Yearbook; International Financial Statistics; China Monthly Statistics; China Daily; Asian Development Bank (ADB, ARIC Indicators); World Investment Report 2003 (UNCTAD);

Due to the high trade surplus and supported by the considerable net inflow of FDI, China's foreign reserves increased to USD 659.1 billion, 50% up from the same period last year, and worth more than a year's imports.

On the fiscal front, the government will follow a 'prudent' fiscal policy, including a further reduction of the (central) government's deficit and a reduction of the amount of special government bonds, issued to support infrastructure investment, from last year's yuan 110 billion to yuan 80 billion. Monetary policy will remain tight, with the growth target for money supply and credit expansion set at 14% and 15% respectively.

Regarding the supply side of the economy, the industrial sector remained the fastest growing sector in China, expanding at a rate of 11.1%, followed by the services sector with 7.7% and the agricultural sector and other primary industries with 4.6%. This growth pattern is very similar to that over the year 2004.

Industrial output on average expanded at a slightly lower pace than in the same period last year, but the development differed greatly in the various industries: Basically, the production of raw materials and investment-driven industries expanded very fast. Prominent examples are the extraction of coal, iron ore and oil. In manufacturing, important examples are steel and steel products (20%), aluminium (22%), and electrical power generation equipment (30%). The production of electronic equipment (19%) and of textiles & clothing was fuelled by exports. However, production of the car industry, which was among the fast growing industries in the first quarter of last year, declined by 2.8%, due to a supply glut. For the rest of the year, we may expect the ongoing trade conflicts and re-introduction of quantitative trade restrictions to affect the textiles, clothing and shoe industry negatively.

The massive trade surplus and the corresponding explosion of the bilateral trade deficit of the EU and the USA with China, have revived the debate on a revaluation of the Chinese currency. But the stance of the Chinese government has remained the same: stepwise liberalization of the capital account and a reform of the banking sector as preconditions for a more flexible exchange rate. In both regards, certain steps have been taken: In April, the government approved a USD 15 billion capital injection to the state-owned Industrial and Commercial Bank of China (ICBC), following the capital injections at the end of 2003 to the Bank of China (BOC) and the China Construction Bank (CCB). (Out of the four large state-owned banks, the Agricultural Bank of China will thus be the last one to receive a capital injection from the government.) But, it has turned out to be difficult to find strategic foreign investors for these banks as the shares that can be acquired are restricted to 19.9%, and taking into account the recent disclosures of fraud and corruption at several big Chinese banks. However, in June, the Bank of America bought a 9% stake (worth USD 3 billion) in the China Construction Bank, thus becoming the biggest foreign investor in the Chinese banking sector so far.

To further liberalize capital outflows, the monetary authorities began to allow portfolio investments, e.g. for Chinese insurance companies, abroad. Also, increasing amounts of money may be transferred abroad for direct investments, as part of the government's 'going out' policy. Chinese outward FDI is still small, reaching USD 3.6 billion as compared to FDI inflows of USD 60.6 billion in 2004, but it is on the rise. However, the increase in 2004 was mainly due to the acquisition of the IBM notebook section by Lenovo, worth USD 1.8 billion. A large proportion of Chinese acquisitions are in the field of mining but they recently also include medium-sized enterprises in advanced industrial countries, to get access to technology and established brand names. From a geographic perspective, the focus is on Latin America and Asia. Europe's share (mainly Germany and Russia) was less than 10%.

In sum, we expect the Chinese economy to grow slightly more slowly in 2005 than it did the year before, with investment growth lagging significantly behind last year's pace and private consumption remaining strong for the rest of the year. Net foreign trade will lose momentum and foreign direct investment will probably reach the same amount as in 2004. Industrial production will slow down in certain sectors, but remain strong in others. Inflation is expected to stay below last year's level, despite a possible acceleration during the rest of the year. Unemployment will remain high and may even increase if labour-intensive industries were to suffer to a greater extent from trade conflicts and trade restrictions.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2005 at constant PPPs

	1991	1995	1999	2000	2001	2002	2003	2004	2005	2006	2007	2010	2015
									projection assuming 4% p.a. GDP growth and zero population growth p.a.				
Czech Republic	9191	10003	12139	12761	13474	14258	14661	15647	16320	17022	17703	19913	24228
Hungary	7310	7452	9707	10507	11501	12349	12768	13623	14086	14607	15192	17088	20791
Poland	4480	6187	8432	9014	9251	9622	9801	10474	10788	11219	11668	13125	15969
Slovak Republic	6966	6756	8717	9428	10010	10836	11139	11645	12286	13023	13544	15235	18535
Slovenia	9421	9730	13649	14409	15230	15868	16339	17416	17938	18476	19215	21615	26298
Estonia	6394	5437	7616	8568	9138	9848	10337	11201	11873	12609	13113	14751	17947
Latvia	8618	4087	6325	6981	7626	8216	8721	9663	10359	11073	11516	12954	15761
Lithuania	7459	5017	6961	7581	8305	8939	9744	10697	11381	12053	12535	14100	17155
Cyprus	10891	13037	15688	16973	18191	17615	17490	18114	18821	19611	20395	22942	27913
Malta	8754	11134	14340	15321	14998	15436	15575	16031	16304	16613	17278	19435	23646
Bulgaria	5138	4731	4881	5305	5821	6073	6341	6681	7049	7422	7719	8683	10564
Romania	5252	5718	4745	4987	5440	6041	6332	7071	7460	7870	8185	9207	11202
Croatia	5943	5660	7425	8081	8602	9255	9682	10289	10598	10916	11352	12770	15536
Albania	1456	2313	2792	3184	3857	4075	4267	4562	4845	5150	5356	6025	7331
Bosnia & Herzeg.	.	.	4629	4912	5199	5493	5612	6010	6311	6689	6957	7826	9521
Macedonia	4327	4042	4824	5173	5003	5211	5369	5645	5871	6106	6350	7143	8690
Serbia	.	.	.	4333	4556	4993	5139	5615	5840	6132	6377	7173	8727
Montenegro	.	.	.	4796	4836	5032	5135	5339	5606	5886	6122	6886	8378
Russia	8112	5683	5462	6033	6484	7008	7527	8298	8738	9175	9542	10733	13059
Ukraine	5775	3272	3419	3771	4232	4608	5122	5919	6303	6681	6949	7816	9510
									projection assuming 2% p.a. GDP growth and zero population growth p.a.				
Germany	17574	18592	21293	22397	22853	23366	23406	24346	24833	25330	25836	27418	30271
Greece	10781	10948	13263	14263	15010	16355	17279	18261	18626	18999	19379	20565	22705
Spain	12470	13281	16972	18471	19341	20422	21194	21951	22390	22838	23295	24721	27293
Austria	18450	19602	23445	25160	25318	25778	25951	27104	27646	28199	28763	30523	33700
Portugal	10488	11096	14264	15214	15721	16179	15900	16217	16542	16873	17210	18263	20164
Turkey	4476	4570	5470	5969	5328	5605	5898	6458	6588	6719	6854	7273	8030
USA	21193	23281	28931	30563	31059	32073	32782	34617	35309	36015	36736	38984	43042
EU(15) average	15864	16932	20411	21796	22579	23263	23433	24369	24856	25353	25861	27443	30300
EU(25) average	14230	15260	18556	19827	20569	21252	21454	22371	22854	23364	23885	25519	28494

European Union (25) average = 100

	1991	1995	1999	2000	2001	2002	2003	2004	2005	2006	2007	2010	2015
Czech Republic	65	66	65	64	66	67	68	70	71	73	74	78	85
Hungary	51	49	52	53	56	58	60	61	62	63	64	67	73
Poland	31	41	45	45	45	45	46	47	47	48	49	51	56
Slovak Republic	49	44	47	48	49	51	52	52	54	56	57	60	65
Slovenia	66	64	74	73	74	75	76	78	78	79	80	85	92
Estonia	45	36	41	43	44	46	48	50	52	54	55	58	63
Latvia	61	27	34	35	37	39	41	43	45	47	48	51	55
Lithuania	52	33	38	38	40	42	45	48	50	52	52	55	60
Cyprus	77	85	85	86	88	83	82	81	82	84	85	90	98
Malta	62	73	77	77	73	73	73	72	71	71	72	76	83
Bulgaria	36	31	26	27	28	29	30	30	31	32	32	34	37
Romania	37	37	26	25	26	28	30	32	33	34	34	36	39
Croatia	42	37	40	41	42	44	45	46	46	47	48	50	55
Albania	10	15	15	16	19	19	20	20	21	22	22	24	26
Bosnia & Herzeg.	.	.	25	25	25	26	26	27	28	29	29	31	33
Macedonia	30	26	26	26	24	25	25	25	26	26	27	28	30
Serbia	.	.	.	22	22	23	24	25	26	26	27	28	31
Montenegro	.	.	.	24	24	24	24	24	25	25	26	27	29
Russia	57	37	29	30	32	33	35	37	38	39	40	42	46
Ukraine	41	21	18	19	21	22	24	26	28	29	29	31	33
Germany	124	122	115	113	111	110	109	109	109	108	108	107	106
Greece	76	72	71	72	73	77	81	82	81	81	81	81	80
Spain	88	87	91	93	94	96	99	98	98	98	98	97	96
Austria	130	128	126	127	123	121	121	121	121	121	120	120	118
Portugal	74	73	77	77	76	76	74	72	72	72	72	72	71
Turkey	31	30	29	30	26	26	27	29	29	29	29	29	28
USA	149	153	156	154	151	151	153	155	154	154	154	153	151
EU(15) average	111	111	110	110	110	109	109	109	109	109	108	108	106
EU(25) average	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1997-2004

EUR based, annual averages

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Czech Republic								
Producer price index, 2000=100	90.0	94.4	95.3	100.0	102.8	102.3	102.0	107.8
Consumer price index, 2000=100	85.1	94.3	96.2	100.0	104.7	106.6	106.7	109.7
GDP deflator, 2000=100	86.3	95.9	98.6	100.0	104.9	107.8	110.6	114.0
Exchange rate (ER), CZK/EUR	35.80	36.16	36.88	35.61	34.08	30.81	31.84	31.90
ER nominal, 2000=100	100.5	101.6	103.6	100.0	95.7	86.5	89.4	89.6
Real ER (CPI-based), 2000=100	113.0	104.5	105.6	100.0	93.4	84.7	89.2	88.8
Real ER (PPI-based), 2000=100	107.9	103.1	103.7	100.0	94.7	85.9	90.4	88.1
PPP, CZK/EUR	14.80	16.14	16.35	16.40	16.81	16.60	17.09	17.22
Price level, EU(25)=100	41	45	44	46	49	54	54	54
Average monthly gross wages, CZK	10802	11801	12797	13614	14793	15866	16920	18035
Average monthly gross wages, EUR (ER)	302	326	347	382	434	515	531	565
Average monthly gross wages, EUR (PPP)	730	731	783	830	880	956	990	1047
GDP nominal, bn CZK	1785.1	1962.5	2041.4	2150.1	2315.3	2414.7	2555.8	2750.3
Employed persons - LFS, th., average	4936.5	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2	4706.6
GDP per employed person, CZK	361619	403330	428487	454404	487402	506762	539975	584340
GDP per empl. person, CZK at 1999 pr.	413380	414638	428487	448143	458220	463438	481285	505657
Unit labour costs, 2000=100	86.0	93.7	98.3	100.0	106.3	112.7	115.7	117.4
Unit labour costs, ER adj., 2000=100	85.6	92.3	94.9	100.0	111.0	130.2	129.4	131.0
Unit labour costs, PPP adj., Austria=100	27.14	29.53	29.86	31.52	34.47	39.65	38.39	38.58
Hungary								
Producer price index, 2000=100	76.6	85.3	89.6	100.0	105.2	103.3	105.8	109.5
Consumer price index, 2000=100	72.4	82.8	91.1	100.0	109.2	115.0	120.4	128.6
GDP deflator, 2000=100	74.6	84.0	91.1	100.0	108.6	118.3	126.3	133.9
Exchange rate (ER), HUF/EUR	210.93	240.98	252.80	260.04	256.68	242.97	253.51	251.68
ER, nominal 2000=100	81.1	92.7	97.2	100.0	98.7	93.4	97.5	96.8
Real ER (CPI-based), 2000=100	107.2	108.5	104.8	100.0	92.4	84.8	86.2	81.8
Real ER (PPI-based), 2000=100	102.2	104.1	103.6	100.0	95.5	91.8	95.0	93.7
PPP, HUF/EUR	97.72	108.03	114.66	122.57	126.74	133.44	142.34	147.73
Price level, EU(25)=100	46	45	45	47	49	55	56	59
Average monthly gross wages, HUF	57270	67764	77187	87645	103553	122482	137193	145675
Average monthly gross wages, EUR (ER)	272	281	305	337	403	504	541	579
Average monthly gross wages, EUR (PPP)	586	627	673	715	817	918	964	986
GDP nominal, bn HUF	8540.7	10087.4	11393.5	13150.8	14849.8	16740.4	18408.8	20338.2
Employed persons - LFS, th., average [1)]	3610.3	3674.7	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4
GDP per employed person, HUF	2365640	2745104	2990969	3410291	3838846	4325018	4693851	5214384
GDP per empl. person, HUF at 1999 pr.	2888463	2976353	2990969	3107678	3222322	3332933	3386140	3548728
Unit labour costs, 2000=100	70.3	80.7	91.5	100.0	113.9	130.3	143.7	145.6
Unit labour costs, ER adj., 2000=100	86.7	87.1	94.1	100.0	115.4	139.5	147.4	150.4
Unit labour costs, PPP adj., Austria=100	24.50	24.85	26.39	28.10	31.94	37.84	38.96	39.46
Poland								
Producer price index, 2000=100	81.8	87.8	92.8	100.0	101.6	102.6	105.3	112.7
Consumer price index, 2000=100	75.7	84.6	90.8	100.0	105.5	107.5	108.4	112.2
GDP deflator, 2000=100	79.0	88.1	93.7	100.0	104.0	105.4	106.0	109.2
Exchange rate (ER), PLN/EUR	3.706	3.923	4.227	4.011	3.669	3.856	4.398	4.534
ER, nominal, 2000=100	92.4	97.8	105.4	100.0	91.5	96.1	109.6	113.0
Real ER (CPI-based), 2000=100	116.8	112.0	113.9	100.0	88.6	93.3	107.7	109.5
Real ER (PPI-based), 2000=100	109.0	106.7	108.5	100.0	91.6	95.1	107.3	106.3
PPP, PLZ/EUR	1.757	1.923	2.002	2.078	2.128	2.123	2.180	2.214
Price level, EU(25)=100	47	49	47	52	58	55	50	49
Average monthly gross wages, PLN [2)]	1066	1233	1697	1894	2045	2098	2185	2290
Average monthly gross wages, EUR (ER)	288	314	401	472	557	544	497	505
Average monthly gross wages, EUR (PPP)	607	641	848	911	961	988	1002	1034
GDP nominal, bn PLN	504.1	589.4	652.5	723.9	760.6	781.1	816.1	885.3
Employed persons - LFS, th., average [3)]	15177	15354	14757	14526	14207	13782	13617	13795
GDP per employed person, PLN	33217	38385	44217	49834	53537	56676	59932	64179
GDP per empl. person, PLN at 1999 pr.	39409	40826	44217	46718	48244	50426	52980	55120
Unit labour costs, 2000=100	66.7	74.5	94.7	100.0	104.6	102.6	101.7	102.5
Unit labour costs, ER adj., 2000=100	72.2	76.2	89.8	100.0	114.3	106.8	92.8	90.7
Unit labour costs, PPP adj., Austria=100	33.22	35.35	40.98	45.72	51.48	47.14	39.92	38.70

Notes: 1) From 1999 according to census 2002. - 2) From 1999 broader wage coverage. - 3) From 2003 according to census 2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Slovak Republic								
Producer price index, 2000=100	83.8	86.5	90.2	100.0	106.5	108.7	117.8	121.8
Consumer price index, 2000=100	75.7	80.7	89.3	100.0	107.1	110.6	120.0	129.0
GDP deflator, 2000=100	82.3	86.5	92.2	100.0	104.2	108.4	113.5	118.6
Exchange rate (ER), SKK/EUR	38.01	39.60	44.12	42.59	43.31	42.70	41.49	40.05
ER, nominal, 2000=100	89.2	93.0	103.6	100.0	101.7	100.3	97.4	94.0
Real ER (CPI-based), 2000=100	112.9	111.7	113.9	100.0	97.0	94.6	86.4	79.2
Real ER (PPI-based), 2000=100	102.8	102.9	109.6	100.0	97.1	93.6	85.2	81.8
PPP, SKK/EUR	16.68	17.23	17.95	18.35	18.75	18.85	20.05	21.15
Price level, EU(25)=100	44	43	41	43	43	44	48	53
Average monthly gross wages, SKK	9226	10003	10728	11430	12365	13511	14365	15825
Average monthly gross wages, EUR (ER)	243	253	243	268	286	316	346	395
Average monthly gross wages, EUR (PPP)	553	581	598	623	659	717	717	748
GDP nominal, bn SKK	712.7	781.4	844.1	934.1	1009.8	1098.7	1201.2	1325.5
Employed persons - LFS, th., average	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6	2170.4
GDP per employed person, SKK	323079	355425	395905	444440	475509	516529	554927	610710
GDP per empl. person, SKK at 1999 pr.	361950	378496	395905	409615	420561	439297	450768	474502
Unit labour costs, 2000=100	91.3	94.7	97.1	100.0	105.4	110.2	114.2	119.5
Unit labour costs, ER adj., 2000=100	102.4	101.9	93.7	100.0	103.6	109.9	117.2	127.1
Unit labour costs, PPP adj., Austria=100	27.37	27.48	24.85	26.57	27.11	28.21	29.31	31.54
Slovenia								
Producer price index, 2000=100	85.9	91.0	92.9	100.0	108.9	114.5	117.3	122.4
Consumer price index, 2000=100	80.2	86.5	91.8	100.0	108.4	116.5	123.1	127.5
GDP deflator, 2000=100	83.1	89.4	94.7	100.0	109.1	117.8	124.2	128.0
Exchange rate (ER), SIT/EUR	180.40	186.27	193.63	205.03	217.19	226.22	233.70	238.86
ER, nominal, 2000=100	88.0	90.8	94.4	100.0	105.9	110.3	114.0	116.5
Real ER (CPI-based), 2000=100	105.0	101.8	100.9	100.0	99.9	98.8	98.6	99.3
Real ER (PPI-based), 2000=100	98.9	95.6	97.0	100.0	99.0	97.9	100.1	100.9
PPP, SIT/EUR	130.60	137.89	142.98	148.28	156.95	167.82	176.15	178.01
Price level, EU(25)=100	72	74	74	72	72	74	75	75
Average monthly gross wages, SIT	144251	158069	173245	191669	214561	235436	253200	284281
Average monthly gross wages, EUR (ER)	800	849	895	935	988	1041	1083	1190
Average monthly gross wages, EUR (PPP)	1105	1146	1212	1293	1367	1403	1437	1597
GDP nominal, bn SIT	3110.1	3464.9	3874.7	4252.3	4761.8	5314.5	5747.2	6191.2
Employed persons - LFS, th., average	906	901	886	901	916	910	897	943
GDP per employed person, SIT	3432754	3845604	4373273	4719550	5198488	5840103	6407099	6565388
GDP per empl. person, SIT at 1999 pr.	3912046	4074017	4373273	4467591	4512219	4693028	4881328	4855648
Unit labour costs, 2000=100	85.9	90.4	92.3	100.0	110.8	116.9	120.9	136.5
Unit labour costs, ER adj., 2000=100	97.7	99.5	97.8	100.0	104.6	106.0	106.1	117.1
Unit labour costs, PPP adj., Austria=100	66.45	68.33	65.95	67.60	69.66	69.19	67.47	73.95
Estonia								
Producer price index, 2000=100	92.6	96.5	95.3	100.0	104.4	104.8	105.0	108.1
Consumer price index, 2000=100	86.0	93.1	96.2	100.0	105.8	109.6	111.0	114.4
GDP deflator, 2000=100	83.5	91.0	94.9	100.0	105.8	110.5	113.1	117.8
Exchange rate (ER), EEK/EUR	15.670	15.783	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	100.1	100.9	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	111.4	105.1	102.1	100.0	96.6	95.2	95.9	95.0
Real ER (PPI-based), 2000=100	104.4	100.1	100.2	100.0	97.4	96.9	98.1	98.0
PPP, EEK/EUR	7.136	7.640	7.793	7.901	8.370	8.735	8.992	9.207
Price level, EU(25)=100	46	48	50	50	53	56	57	59
Average monthly gross wages, EEK	3573	4125	4440	4907	5510	6144	6723	7287
Average monthly gross wages, EUR (ER)	228	261	284	314	352	393	430	466
Average monthly gross wages, EUR (PPP)	501	540	570	621	658	703	748	791
GDP nominal, bn EEK	68.3	78.3	81.6	92.7	104.3	116.9	125.8	139.1
Employed persons - LFS, th., average	617.2	606.5	579.3	572.5	577.7	585.5	594.3	595.5
GDP per employed person, EEK	110706	129169	140928	161951	180609	199605	211732	233669
GDP per empl. person, EEK at 1999 pr.	125825	134713	140928	153732	162089	171516	177669	188228
Unit labour costs, 2000=100	89.0	95.9	98.7	100.0	106.5	112.2	118.5	121.3
Unit labour costs, ER adj., 2000=100	88.8	95.1	98.7	100.0	106.5	112.2	118.5	121.3
Unit labour costs, PPP adj., Austria=100	32.11	34.69	35.38	35.92	37.68	38.93	40.07	40.68

(Table A/2 ctd.)

(Table A/2 ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Latvia								
Producer price index, 2000=100	101.6	103.5	99.4	100.0	101.7	102.7	106.0	115.1
Consumer price index, 2000=100	90.9	95.2	97.5	100.0	102.5	104.4	107.5	114.1
GDP deflator, 2000=100	87.9	92.0	96.4	100.0	102.1	105.6	109.2	117.1
Exchange rate (ER), LVL/EUR	0.6574	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449	0.6711
ER, nominal, 2000=100	117.4	118.1	111.4	100.0	100.5	104.0	115.2	119.8
Real ER (CPI-based), 2000=100	123.6	120.3	112.1	100.0	100.2	103.9	114.0	114.1
Real ER (PPI-based), 2000=100	111.5	109.3	107.0	100.0	100.5	102.8	112.0	110.3
PPP, LVL/EUR	0.2654	0.2724	0.2794	0.2829	0.2878	0.2962	0.3118	0.3293
Price level, EU(25)=100	40	41	45	51	51	51	48	49
Average monthly gross wages, LVL	120	133	141	150	159	173	192	211
Average monthly gross wages, EUR (ER)	183	202	226	267	283	297	298	314
Average monthly gross wages, EUR (PPP)	452	489	505	529	553	584	617	641
GDP nominal, bn LVL	3.563	3.903	4.224	4.686	5.168	5.691	6.322	7.359
Employed persons - LFS, th., average	990.2	986.1	968.5	941.1	962.1	989.0	1006.9	1018.0
GDP per employed person, LVL	3598	3958	4362	4979	5372	5754	6279	7229
GDP per empl. person, LVL at 1999 pr.	3944	4147	4362	4798	5069	5249	5540	5947
Unit labour costs, 2000=100	97.7	103.1	103.7	100.0	100.6	105.8	111.5	113.9
Unit labour costs, ER adj., 2000=100	83.2	87.3	93.1	100.0	100.2	101.6	96.8	95.0
Unit labour costs, PPP adj., Austria=100	29.41	31.15	32.65	35.14	34.66	34.49	32.01	31.18
Lithuania								
Producer price index, 2000=100	88.7	84.8	86.2	100.0	97.0	94.3	93.8	98.5
Consumer price index, 2000=100	93.5	98.2	99.0	100.0	101.3	101.6	100.4	101.6
GDP deflator, 2000=100	94.8	99.6	99.0	100.0	99.9	99.9	99.1	102.3
Exchange rate (ER), LTL/EUR	4.5272	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528	3.4528
ER, nominal, 2000=100	122.4	121.4	115.5	100.0	96.9	93.6	93.3	93.3
Real ER (CPI-based), 2000=100	125.4	119.9	114.4	100.0	97.8	96.1	99.0	99.8
Real ER (PPI-based), 2000=100	133.2	137.2	127.9	100.0	101.6	100.7	102.5	100.4
PPP, LTL/EUR	1.7623	1.8169	1.7675	1.7161	1.6733	1.6653	1.6691	1.6843
Price level, EU(25)=100	39	40	41	46	47	48	48	49
Average monthly gross wages, LTL	778	930	987	971	982	1014	1073	1158
Average monthly gross wages, EUR (ER)	172	207	231	262	274	293	311	335
Average monthly gross wages, EUR (PPP)	442	512	559	566	587	609	643	687
GDP nominal, bn LTL	39.4	44.4	43.4	45.5	48.4	51.6	56.2	61.9
Employed persons - LFS, th., average	1570.7	1489.4	1456.5	1397.8	1351.8	1405.9	1438.0	1436.3
GDP per employed person, LTL	25070	29795	29770	32570	35788	36733	39067	43095
GDP per empl. person, LTL at 1999 pr.	26176	29614	29770	32235	35458	36399	39036	41697
Unit labour costs, 2000=100	98.7	104.3	110.1	100.0	92.0	92.5	91.2	92.2
Unit labour costs, ER adj., 2000=100	80.6	85.8	95.4	100.0	94.9	98.9	97.7	98.8
Unit labour costs, PPP adj., Austria=100	26.39	28.34	30.94	32.52	30.40	31.05	29.91	29.99
Bulgaria								
Producer price index, 2000=100	69.7	82.8	85.1	100.0	103.8	105.0	110.1	116.6
Consumer price index, 2000=100	74.5	88.4	90.7	100.0	107.4	113.6	116.2	123.4
GDP deflator, 2000=100	73.1	90.4	93.7	100.0	106.7	110.7	113.1	117.9
Exchange rate (ER), BGN/EUR	1.8958	1.9723	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	96.9	100.8	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	124.6	110.6	108.3	100.0	95.2	91.9	91.6	88.1
Real ER (PPI-based), 2000=100	134.2	116.7	112.2	100.0	98.0	96.7	93.6	90.8
PPP, BGN/EUR	0.4815	0.5850	0.5937	0.6173	0.6450	0.6767	0.6964	0.7311
Price level, EU(25)=100	25	30	30	32	33	35	36	37
Average monthly gross wages, BGN	128	183	201	225	240	258	273	299
Average monthly gross wages, EUR (ER)	67	93	103	115	123	132	140	153
Average monthly gross wages, EUR (PPP)	266	313	339	364	372	381	392	409
GDP nominal, bn BGN	17.4	22.4	23.8	26.8	29.7	32.3	34.5	38.0
Employed persons - LFS, th.,average	3060.3	3034.8	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5
GDP per employed person, BGN	5696	7388	8274	9573	11008	11803	12187	13005
GDP per empl. person, BGN at 1999 pr.	7307	7661	8274	8972	9669	9992	10095	10339
Unit labour costs, 2000=100	70.0	95.6	97.1	100.0	99.2	103.0	108.2	115.6
Unit labour costs, ER adj., 2000=100	72.2	94.8	97.1	100.0	99.2	103.0	108.2	115.6
Unit labour costs, PPP adj., Austria=100	12.46	16.52	16.62	17.16	16.77	17.08	17.47	18.52

(Table A/2 ctd.)

(Table A/2 ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Romania								
Producer price index, 2000=100	33.9	45.1	65.2	100.0	138.1	169.9	203.0	241.8
Consumer price index, 2000=100	29.6	47.1	68.6	100.0	134.5	164.8	190.0	212.6
GDP deflator, 2000=100	30.4	46.9	69.3	100.0	137.4	169.6	202.6	234.7
Exchange rate (ER), ROL/EUR	8090.9	9989.3	16295.6	19955.8	26026.9	31255.3	37555.9	40532.1
ER, nominal, 2000=100	40.5	50.1	81.7	100.0	130.4	156.6	188.2	203.1
Real ER (CPI-based), 2000=100	131.1	103.1	116.7	100.0	99.1	99.2	105.4	103.8
Real ER (PPI-based), 2000=100	115.5	106.3	119.6	100.0	96.1	93.6	95.5	89.0
PPP, ROL/EUR	1875.2	3542.9	5121.5	7183.6	9579.8	11504.9	13830.0	15581.9
Price level, EU(25)=100	23	35	31	36	37	37	37	38
Average monthly grross wages, ROL	846450	1357132	1957731	2876645	4282622	5452097	6741152	8261492
Average monthly gross wages, EUR (ER)	105	136	120	144	165	174	179	204
Average monthly gross wages, EUR (PPP)	451	383	382	400	447	474	487	530
GDP nominal, bn ROL	252926	371194	545730	803773	1167687	1514751	1903354	2387914
Employed persons - LFS, th., average [4)]	11050.0	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5	9157.8
GDP per employed person, th. ROL	22889.2	34227.5	50645.0	74673.7	109161.3	164035.3	206381.6	260752.0
GDP per empl. person, th. ROL at 1999 pr.	52139.0	50578.0	50645.0	51768.2	55061.1	67034.9	70611.3	77013.2
Unit labour costs, 2000=100	29.2	48.3	69.6	100.0	140.0	146.4	171.8	193.0
Unit labour costs, ER adj., 2000=100	72.1	96.5	85.2	100.0	107.3	93.5	91.3	95.0
Unit labour costs, PPP adj., Austria=100	23.36	31.56	27.39	32.22	34.06	29.08	27.68	28.60
Croatia								
Producer price index, 2000=100	89.9	88.8	91.2	100.0	103.6	103.2	105.1	108.8
Consumer price index, 2000=100	85.5	90.4	94.2	100.0	104.9	106.7	108.6	110.9
GDP deflator, 2000=100	84.9	92.0	95.5	100.0	104.0	107.1	110.5	114.2
Exchange rate (ER), HRK/EUR	6.9597	7.1366	7.5796	7.6350	7.4690	7.4068	7.5634	7.4956
ER, nominal, 2000=100	91.2	93.5	99.3	100.0	97.8	97.0	99.1	98.2
Real ER (CPI-based), 2000=100	102.1	100.3	103.5	100.0	95.3	94.9	97.1	96.2
Real ER (PPI-based), 2000=100	97.8	100.8	104.0	100.0	96.1	95.5	97.1	95.6
PPP, HRK/EUR	3.8704	4.1019	4.1870	4.2539	4.3400	4.3626	4.4892	4.5330
Price level, EU(25)=100	56	57	55	56	58	59	59	60
Average monthly gross wages, HRK	3668	4131	4551	4869	5061	5366	5623	5985
Average monthly gross wages, EUR (ER)	527	579	600	638	678	724	743	798
Average monthly gross wages, EUR (PPP)	948	1007	1087	1145	1166	1230	1253	1320
GDP nominal, bn HRK	123.8	137.6	141.6	152.5	165.6	179.4	193.1	207.1
Employed persons - LFS, th., average	1593.0	1544.0	1492.0	1553.0	1469.0	1528.0	1536.5	1562.5
GDP per employed person, HRK	77722	89122	94892	98209	112757	117402	125654	132532
GDP per empl. person, HRK at 1999 pr.	87493	92529	94892	93813	103548	104720	108615	110866
Unit labour costs, 2000=100	80.8	86.0	92.4	100.0	94.2	98.7	99.7	104.0
Unit labour costs, ER adj., 2000=100	88.6	92.0	93.1	100.0	96.3	101.8	100.7	105.9
Unit labour costs, PPP adj., Austria=100	57.34	60.09	59.73	64.31	60.97	63.21	60.94	63.63
Macedonia								
Producer price index, 2000=100	86.9	90.4	90.3	100.0	102.0	101.1	100.8	101.7
Consumer price index, 2000=100	95.3	95.2	94.5	100.0	105.5	107.4	108.7	108.2
GDP deflator, 1990=100	45183.5	45800.5	47072.7	50948.2	52787.9	54581.7	54757.9	55964.3
Exchange rate (ER), MKD/EUR	56.20	61.07	60.62	60.73	60.91	60.98	61.26	61.34
ER, nominal, 2000=100	92.5	100.6	99.8	100.0	100.3	100.4	100.9	101.0
Real ER (CPI-based), 2000=100	93.0	102.4	103.6	100.0	97.2	97.6	98.8	101.4
Real ER (PPI-based), 2000=100	102.7	106.5	105.5	100.0	100.0	100.9	103.2	105.2
PPP, MKD/EUR	21.41	21.34	21.48	22.55	22.97	23.18	23.11	23.09
Price level, EU(25)=100	38	35	35	37	38	38	38	38
Average monthly net wages, MKD	9063	9394	9664	10193	10552	11279	11824	12293
Average monthly net wages, EUR (ER)	161	154	159	168	173	185	193	200
Average monthly net wages, EUR (PPP)	423	440	450	452	459	487	512	532
GDP nominal, bn MKD	186.0	195.0	209.0	236.4	233.8	244.0	251.5	264.6
Employed persons - LFS, th., average	512.3	539.8	545.2	549.8	599.3	561.3	545.1	523.0
GDP per employed person, MKD	363103	361231	383348	429919	390185	434620	461351	505931
GDP per empl. person, MKD at 1999 pr.	378285	371265	383348	397216	347941	374828	396601	425548
Unit labour costs, 2000=100	93.4	98.6	98.2	100.0	118.2	117.3	116.2	112.6
Unit labour costs, ER adj., 2000=100	100.9	98.1	98.4	100.0	117.8	116.8	115.2	111.4
Unit labour costs, PPP adj., Austria=100	20.82	20.42	20.14	20.51	23.80	23.13	22.23	21.35

Note: 4) Methodological break in 2001/2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Russia								
Producer price index, 2000=100	40.1	42.9	68.2	100.0	119.1	133.0	153.8	190.7
Consumer price index, 2000=100	34.9	44.6	82.8	100.0	121.6	141.1	160.2	177.9
GDP deflator, 2000=100	35.5	42.1	72.6	100.0	116.5	134.7	153.5	181.2
Exchange rate (ER), RUB/EUR	6.541	11.063	26.239	26.029	26.130	29.647	34.686	35.814
ER, nominal, 2000=100	25.1	42.5	100.8	100.0	100.4	113.9	133.3	137.6
Real ER (CPI-based), 2000=100	68.9	92.5	119.5	100.0	84.4	84.3	88.5	84.1
Real ER (PPI-based), 2000=100	60.5	94.8	141.1	100.0	85.8	86.9	89.3	76.4
PPP, RUB/EUR	3.066	3.574	6.035	8.320	9.529	10.740	12.170	14.040
Price level, EU(25)=100	47	32	23	32	36	36	35	39
Average monthly gross wages, RUB	950.2	1051.5	1522.6	2223.4	3240.4	4360.3	5498.5	6828.0
Average monthly gross wages, EUR (ER)	145	95	58	85	124	147	159	191
Average monthly gross wages, EUR (PPP)	310	294	252	267	340	406	452	486
GDP nominal, bn RUB	2342.5	2629.6	4823.2	7305.6	8943.6	10830.5	13243.2	16751.5
Employed persons - LFS, th., average	60021	58437	62475	64255	64400	66071	65800	67383
GDP per employed person, RUB	39028	44999	77203	113698	138876	163922	201264	248600
GDP per empl. person, RUB at 1999 pr.	79753	77573	77203	82570	86584	88360	95201	99652
Unit labour costs, 2000=100	44.2	50.3	73.2	100.0	139.0	183.3	214.5	254.5
Unit labour costs, ER adj., 2000=100	176.1	118.4	72.7	100.0	138.4	160.9	161.0	184.9
Unit labour costs, PPP adj., Austria=100	24.99	16.96	10.23	14.11	19.24	21.92	21.37	24.36
Ukraine								
Producer price index, 2000=100	55.7	63.1	82.7	100.0	108.6	112.0	120.7	145.3
Consumer price index, 2000=100	57.5	63.6	78.0	100.0	112.0	112.9	118.8	129.5
GDP deflator, 2000=100	57.0	63.8	81.2	100.0	109.9	115.6	124.9	143.7
Exchange rate (ER), UAH/EUR	2.113	2.768	4.393	5.029	4.814	5.030	6.024	6.609
ER, nominal, 2000=100	42.0	55.0	87.4	100.0	95.7	100.0	119.8	131.4
Real ER (CPI-based), 2000=100	70.0	83.9	109.9	100.0	87.3	92.4	107.4	110.3
Real ER (PPI-based), 2000=100	72.8	83.5	100.8	100.0	89.7	90.7	102.3	95.8
PPP, UAH/EUR	0.5600	0.6160	0.7680	0.9170	0.9913	1.0167	1.0917	1.2278
Price level, EU(25)=100	27	22	17	18	21	20	18	19
Average monthly gross wages, UAH	143.0	153.0	177.5	230.1	311.1	376.4	462.3	589.6
Average monthly gross wages, EUR (ER)	68	55	40	46	65	75	77	89
Average monthly gross wages, EUR (PPP)	255	248	231	251	314	370	423	480
GDP nominal, bn UAH	93.4	102.6	130.4	170.1	204.2	225.8	267.3	344.8
Employed persons - LFS, th., average	23755.5	22998.4	20048.2	20175.0	19971.5	20091.2	20163.3	20295.7
GDP per employed person, UAH	3930	4461	6506	8430	10224	11239	13259	16990
GDP per empl. person, UAH at 1999 pr.	5604	5681	6506	6848	7554	7899	8627	9607
Unit labour costs, 2000=100	75.9	80.1	81.2	100.0	122.5	141.8	159.4	182.6
Unit labour costs, ER adj., 2000=100	180.7	145.6	92.9	100.0	128.0	141.7	133.1	138.9
Unit labour costs, PPP adj., Austria=100	21.09	17.14	10.75	11.60	14.62	15.87	14.53	15.05
Austria								
Producer price index, 2000=100	97.4	96.9	96.2	100.0	101.5	101.1	102.7	107.7
Consumer price index, 2000=100	96.2	97.1	97.7	100.0	102.7	104.5	106.0	108.2
GDP deflator, 2000=100	97.4	97.9	98.6	100.0	102.1	103.4	105.4	107.4
Exchange rate (ER), ATS-EUR/EUR	1.0017	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.0881	1.0892	1.0646	1.0397	1.0543	1.0560	1.0692	1.0585
Price level, EU(25)=100	109	108	106	104	105	106	107	106
Average monthly gross wages, EUR-ATS	2180	2245	2296	2355	2389	2438	2499	2545
Average monthly gross wages, EUR (ER)	2177	2225	2296	2355	2389	2438	2499	2545
Average monthly gross wages, EUR (PPP)	2004	2061	2157	2265	2266	2308	2337	2404
GDP nominal, bn EUR-ATS	182.5	190.6	197.1	206.7	212.5	218.3	224.0	232.7
Employment total - reg., th., average	3506.1	3532.6	3576.0	3597.0	3628.3	3675.3	3704.4	3738.6
GDP per employed person, EUR-ATS	52050	53963	55107	57457	58570	59405	60459	62242
GDP per empl. person, EUR-ATS at 1999 pr.	52685	54339	55107	56659	56592	56631	56561	57164
Unit labour costs, 2000=100	99.6	99.4	100.2	100.0	101.5	103.5	106.3	107.1
Unit labour costs, ER adj., 2000=100	99.4	98.5	100.2	100.0	101.5	103.5	106.3	107.1
Unit labour costs, PPP adjusted	0.53	0.52	0.53	0.53	0.54	0.55	0.56	0.57

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

ATS-EUR: ATS divided by fixed parity before 1999 (1€ = 13.7603 ATS).

For new EU member states and candidate countries PPPs are taken from Eurostat. For the rest of the countries PPPs have been estimated by wiiw using the OECD benchmark PPPs for 2002 and extrapolated with GDP price deflators.

Sources: National statistics; WIFO; Eurostat; Purchasing power parities and real expenditures, 2002 benchmark year, OECD 2005; wiiw estimates.

Table A/3

Indicators of macro-competitiveness, 1997-2004

annual changes in %

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Czech Republic									
GDP deflator	8.3	11.2	2.8	1.4	4.9	2.8	2.6	3.0	5.0
Exchange rate (ER), CZK/EUR	5.3	1.0	2.0	-3.4	-4.3	-9.6	3.3	0.2	-0.8
Real ER (CPI-based)	-1.3	-7.6	1.1	-5.3	-6.6	-9.3	5.3	-0.5	-3.5
Real ER (PPI-based)	1.2	-4.4	0.7	-3.6	-5.3	-9.3	5.2	-2.5	-2.6
Average gross wages, CZK	9.9	9.2	8.4	6.4	8.7	7.3	6.6	6.6	9.0
Average gross wages, real (PPI based)	4.8	4.1	7.4	1.4	5.7	7.8	7.0	0.8	5.7
Average gross wages, real (CPI based)	1.3	-1.3	6.2	2.4	3.8	5.4	6.5	3.7	4.0
Average gross wages, EUR (ER)	4.4	8.2	6.3	10.2	13.5	18.6	3.2	6.4	9.9
Employed persons (LFS)	-0.7	-1.4	-2.1	-0.7	0.4	0.3	-0.7	-0.6	-0.6
GDP per empl. person, CZK at 1999 pr.	0.0	0.3	3.3	4.6	2.2	1.1	3.9	5.1	3.4
Unit labour costs, CZK at 1999 prices	10.0	8.9	4.9	1.7	6.3	6.0	2.7	1.5	5.4
Unit labour costs, ER (EUR) adjusted	4.5	7.8	2.9	5.4	11.0	17.3	-0.6	1.3	6.3
Hungary									
GDP deflator	18.4	12.6	8.4	9.7	8.6	8.9	6.8	6.0	11.1
Exchange rate (ER), HUF/EUR	10.3	14.2	4.9	2.9	-1.3	-5.3	4.3	-0.7	5.0
Real ER (CPI-based)	-5.1	1.2	-3.5	-4.5	-7.6	-8.2	1.6	-5.1	-3.8
Real ER (PPI-based)	-7.6	1.9	-0.5	-3.5	-4.5	-3.8	3.4	-1.4	-2.2
Average gross wages, HUF	22.3	18.3	13.9	13.5	18.2	18.3	12.0	6.2	15.8
Average gross wages, real (PPI based)	1.6	6.3	8.4	1.7	12.3	20.4	9.4	2.6	6.7
Average gross wages, real (CPI based)	3.3	3.5	3.5	3.4	8.2	12.3	7.0	-0.6	4.2
Average gross wages, EUR (ER)	10.8	3.6	8.6	10.4	19.7	25.0	7.4	7.0	10.3
Employed persons (LFS) [1]	0.1	1.8	0.6	1.2	0.3	0.1	1.3	-0.5	0.5
GDP per empl. person, HUF at 1999 pr.	4.5	3.0	3.6	3.9	3.7	3.4	1.6	4.8	3.5
Unit labour costs, HUF at 1999 prices	17.1	14.8	10.0	9.3	13.9	14.4	10.3	1.3	11.9
Unit labour costs, ER (EUR) adjusted	6.1	0.5	4.8	6.2	15.4	20.8	5.7	2.1	6.6
Poland									
GDP deflator	13.9	11.5	6.4	6.7	4.0	1.3	0.6	2.9	7.2
Exchange rate (ER), PLN/EUR	9.7	5.9	7.7	-5.1	-8.5	5.1	14.1	3.1	4.2
Real ER (CPI-based)	-2.9	-4.1	1.6	-12.2	-11.4	5.3	15.4	1.7	-1.9
Real ER (PPI-based)	-1.4	-2.1	1.6	-7.8	-8.4	3.9	12.8	-0.9	-0.8
Average gross wages, PLN [2]	21.9	15.7	10.6	11.6	8.0	2.6	4.2	4.8	11.5
Average gross wages, real (PPI based)	8.6	7.8	30.3	3.5	6.3	1.6	1.5	-2.1	7.4
Average gross wages, real (CPI based)	6.1	3.5	28.3	1.3	2.4	0.7	3.3	1.2	5.5
Average gross wages, EUR (ER)	11.1	9.2	27.8	17.6	18.1	-2.4	-8.7	1.6	9.6
Employed persons (LFS) [3]	1.4	1.2	-3.9	-1.6	-2.2	-3.0	0.6	1.3	-0.6
GDP per empl. person, PLN at 1999 pr.	5.3	3.6	8.3	5.7	3.3	4.5	3.2	4.0	4.7
Unit labour costs, PLN at 1999 prices	15.7	11.7	2.1	5.6	4.6	-1.9	1.0	0.7	6.5
Unit labour costs, ER (EUR) adjusted	5.5	5.5	-5.2	11.3	14.3	-6.6	-11.5	-2.3	2.2
Slovak Republic									
GDP deflator	6.7	5.2	6.5	8.5	4.2	4.0	4.7	4.5	5.4
Exchange rate (ER), SKK/EUR	-1.0	4.2	11.4	-3.5	1.7	-1.4	-2.8	-3.5	0.5
Real ER (CPI-based)	-5.1	-1.1	2.0	-12.2	-3.0	-2.6	-8.7	-8.3	-4.8
Real ER (PPI-based)	-4.5	0.1	6.5	-8.8	-2.9	-3.6	-8.9	-4.0	-3.4
Average gross wages, SKK	13.1	8.4	7.2	6.5	8.2	9.3	6.3	10.2	9.2
Average gross wages, real (PPI based)	8.3	5.0	2.8	-3.8	1.6	7.0	-1.8	6.5	3.7
Average gross wages, real (CPI based)	6.6	1.6	-3.0	-4.9	1.0	5.8	-2.0	2.5	1.6
Average gross wages, EUR (ER)	14.3	4.1	-3.7	10.4	6.4	10.8	9.4	14.1	8.7
Employed persons (LFS)	-0.9	-0.3	-3.0	-1.4	1.0	0.2	1.8	0.3	0.1
GDP per empl. person, SKK at 1999 pr.	5.5	4.6	4.6	3.5	2.7	4.5	2.6	5.3	4.0
Unit labour costs, SKK at 1999 prices	7.2	3.7	2.5	3.0	5.4	4.6	3.6	4.7	5.0
Unit labour costs, ER (EUR) adjusted	8.3	-0.5	-8.0	6.7	3.6	6.1	6.6	8.4	4.5
Slovenia									
GDP deflator	8.8	7.6	5.9	5.6	9.1	8.0	5.5	3.0	7.1
Exchange rate (ER), SIT/EUR	6.4	3.3	4.0	5.9	5.9	4.2	3.3	2.2	5.1
Real ER (CPI-based)	-0.2	-3.1	-0.8	-0.9	-0.1	-1.1	-0.2	0.7	-0.3
Real ER (PPI-based)	1.2	-3.3	1.5	3.1	-1.0	-1.1	2.3	0.8	0.8
Average gross wages, SIT	11.7	9.6	9.6	10.6	11.9	9.7	7.5	12.3	10.9
Average gross wages, real (PPI based)	5.3	3.4	7.3	2.8	2.8	4.4	4.9	7.6	5.2
Average gross wages, real (CPI based)	3.1	1.6	3.3	1.6	3.3	2.1	1.8	8.4	3.3
Average gross wages, EUR (ER)	5.0	6.1	5.4	4.5	5.7	5.3	4.1	9.9	5.6
Employed persons (LFS)	3.2	-0.6	-1.7	1.7	1.7	-0.7	-1.4	5.1	0.7
GDP per empl. person, SIT at 1999 pr.	1.5	4.1	7.3	2.2	1.0	4.0	4.0	-0.5	3.8
Unit labour costs, SIT at 1999 prices	10.0	5.2	2.1	8.3	10.8	5.5	3.4	12.9	6.8
Unit labour costs, ER (EUR) adjusted	3.4	1.9	-1.8	2.3	4.6	1.3	0.1	10.4	1.7

Note: 1) From 1999 according to census 2002. - 2) From 1999 broader wage coverage. - 3) From 2003 according to census 2002.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Estonia									
GDP deflator	10.5	9.0	4.3	5.3	5.8	4.4	2.4	4.2	7.6
Exchange rate (ER), EEK/EUR	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.6
Real ER (CPI-based)	-4.9	-5.7	-2.9	-2.0	-3.4	-1.4	0.7	-0.9	-4.1
Real ER (PPI-based)	-3.6	-4.1	0.0	-0.2	-2.6	-0.6	1.3	-0.1	-2.4
Average gross wages, EEK	19.7	15.4	7.6	10.5	12.3	11.5	9.4	8.4	13.3
Average gross wages, real (PPI based)	10.0	10.8	8.9	5.4	7.6	11.1	9.2	5.3	8.6
Average gross wages, real (CPI based)	7.6	6.7	4.2	6.3	6.1	7.6	8.0	5.2	6.0
Average gross wages, EUR (ER)	15.1	14.6	8.6	10.5	12.3	11.5	9.4	8.4	12.6
Employed persons (LFS)	-0.3	-1.7	-4.5	-1.2	0.9	1.4	1.5	0.2	-0.7
GDP per empl. person, EEK at 1999 pr.	10.9	7.1	4.6	9.1	5.4	5.8	3.6	5.9	6.6
Unit labour costs, EEK at 1999 prices	7.9	7.8	2.9	1.3	6.5	5.4	5.6	2.3	6.3
Unit labour costs, ER (EUR) adjusted	3.8	7.1	3.8	1.3	6.5	5.4	5.6	2.3	5.6
Latvia									
GDP deflator	7.0	4.6	4.8	3.8	2.1	3.4	3.4	7.3	5.6
Exchange rate (ER), LVL/EUR	-4.7	0.6	-5.7	-10.2	0.5	3.5	10.7	4.1	-0.2
Real ER (CPI-based)	-10.6	-2.7	-6.8	-10.8	0.2	3.7	9.7	0.0	-3.5
Real ER (PPI-based)	-7.7	-2.0	-2.1	-6.5	0.5	2.3	8.9	-1.5	-2.2
Average gross wages, LVL	21.6	11.1	5.8	6.1	6.3	8.8	11.3	9.6	10.0
Average gross wages, real (PPI based)	16.8	9.0	10.2	5.4	4.6	7.7	7.8	1.0	6.5
Average gross wages, real (CPI based)	12.2	6.1	3.3	3.4	3.7	6.8	8.1	3.2	4.4
Average gross wages, EUR (ER)	27.6	10.4	12.2	18.1	5.8	5.1	0.5	5.4	10.2
Employed persons (LFS)	4.4	-0.4	-1.8	-2.8	2.2	2.8	1.8	1.1	0.6
GDP per empl. person, LVL at 1999 pr.	3.7	5.2	5.2	10.0	5.7	3.6	5.5	7.3	7.0
Unit labour costs, LVL at 1999 prices	17.2	5.6	0.6	-3.6	0.6	5.1	5.4	2.1	2.8
Unit labour costs, ER (EUR) adjusted	23.0	5.0	6.7	7.4	0.2	1.5	-4.8	-1.8	3.0
Lithuania									
GDP deflator	14.0	5.1	-0.6	1.0	-0.1	0.0	-0.8	3.3	4.5
Exchange rate (ER), LTL/EUR	-9.7	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	0.0	-4.4
Real ER (CPI-based)	-15.6	-4.4	-4.5	-12.6	-2.2	-1.7	3.0	0.9	-6.7
Real ER (PPI-based)	-14.1	3.0	-6.8	-21.8	1.6	-0.9	1.8	-2.1	-6.6
Average gross wages, LTL	25.9	19.5	6.2	-1.7	1.2	3.2	5.8	7.9	10.3
Average gross wages, real (PPI based)	18.7	25.0	4.4	-15.2	4.3	6.2	6.3	2.8	6.4
Average gross wages, real (CPI based)	15.6	13.7	5.4	-2.7	-0.1	2.9	7.1	6.7	5.6
Average gross wages, EUR (ER)	39.3	20.4	11.7	13.5	4.4	6.9	6.0	7.9	15.3
Employed persons (LFS)	-3.1	-5.2	-2.2	-4.0	-3.3	4.0	2.3	-0.1	-1.4
GDP per empl. person, LTL at 1999 pr.	10.4	13.1	0.5	8.3	10.0	2.7	7.2	6.8	7.5
Unit labour costs, LTL at 1999 prices	14.0	5.6	5.6	-9.2	-8.0	0.5	-1.4	1.1	2.6
Unit labour costs, ER (EUR) adjusted	26.2	6.4	11.1	4.8	-5.1	4.2	-1.1	1.1	7.3
Bulgaria									
GDP deflator	948.6	23.7	3.7	6.7	6.7	3.8	2.2	4.2	49.5
Exchange rate (ER), BGN/EUR	760.2	4.0	-0.8	0.0	0.0	0.0	0.0	0.0	41.4
Real ER (CPI-based)	-24.5	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-3.8	-5.1
Real ER (PPI-based)	-19.0	-13.0	-3.8	-10.9	-2.0	-1.4	-3.2	-2.9	-5.4
Average gross wages, BGN	865.6	43.3	9.7	11.7	6.9	7.3	6.1	9.4	50.4
Average gross wages, real (PPI based)	-9.9	20.7	6.7	-5.0	3.0	6.1	1.1	3.3	-0.5
Average gross wages, real (CPI based)	-16.6	20.7	6.9	1.2	-0.4	1.4	3.7	3.1	-0.9
Average gross wages, EUR (ER)	12.3	37.7	10.6	11.7	6.9	7.3	6.1	9.4	6.4
Employed persons (LFS)	-0.2	-0.8	-5.3	-2.8	-3.4	1.5	3.5	3.1	-0.2
GDP per empl. person, BGN at 1999 pr.	-5.4	4.8	8.0	8.4	7.8	3.3	1.0	2.4	1.9
Unit labour costs, BGN at 1999 prices	920.9	36.6	1.6	3.0	-0.8	3.9	5.0	6.8	47.7
Unit labour costs, ER (EUR) adjusted	18.7	31.3	2.4	3.0	-0.8	3.9	5.0	6.8	4.5
Romania									
GDP deflator	147.3	54.2	47.8	44.2	37.4	23.4	19.4	15.8	44.6
Exchange rate (ER), ROL/EUR	109.5	23.5	63.1	22.5	30.4	20.1	20.2	7.9	35.5
Real ER (CPI-based)	-16.4	-21.4	13.2	-14.3	-0.9	0.1	6.3	-1.5	-3.6
Real ER (PPI-based)	-16.4	-8.0	12.5	-16.4	-3.9	-2.6	2.1	-6.8	-4.9
Average gross wages, ROL	98.4	60.3	44.3	46.9	48.9	27.3	23.6	22.6	45.6
Average gross wages, real (PPI based)	-21.5	20.4	-0.2	-4.2	7.8	3.5	3.5	2.9	0.9
Average gross wages, real (CPI based)	-22.1	0.8	-1.1	0.9	10.7	3.9	7.2	9.5	1.6
Average gross wages, EUR (ER)	-5.3	29.9	-11.6	20.0	14.1	6.0	2.9	13.6	7.4
Employed persons (LFS) 4)	1.0	-1.9	-0.6	-0.1	-0.6	.	-0.1	-0.7	-0.6
GDP per empl. person, ROL at 1999 pr. 4)	-7.1	-3.0	0.1	2.2	6.4	.	5.3	9.1	2.2
Unit labour costs, ROL at 1999 prices 4)	113.5	65.3	44.1	43.7	40.0	.	17.4	12.4	44.8
Unit labour costs, ER (EUR) adjusted 4)	1.9	33.9	-11.7	17.4	7.3	.	-2.3	4.1	5.2

Note: 4) In 2002 no comparable growth rates available due to methodological break in employment. Average 1996-2004 is calculated without 2002.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Croatia									
GDP deflator	7.4	8.4	3.8	4.7	4.0	3.0	3.2	3.3	4.6
Exchange rate (ER), HRK/EUR	2.3	2.5	6.2	0.7	-2.2	-0.8	2.1	-0.9	1.2
Real ER (CPI-based)	0.4	-1.7	3.1	-3.3	-4.7	-0.4	2.3	-0.9	-0.7
Real ER (PPI-based)	0.8	3.0	3.2	-3.8	-3.9	-0.6	1.7	-1.5	-0.2
Average gross wages, HRK	13.1	12.6	10.2	7.0	3.9	6.0	4.8	6.4	8.4
Average gross wages, real (PPI based)	10.6	14.0	7.4	-2.5	0.3	6.5	2.8	2.8	5.7
Average gross wages, real (CPI based)	9.2	6.5	5.7	0.7	-0.9	4.3	2.9	4.3	4.5
Average gross wages, EUR (ER)	10.6	9.8	3.7	6.2	6.3	6.9	2.6	7.4	7.2
Employed persons (LFS)	3.4	-3.1	-3.4	4.1	-5.4	4.0	0.6	1.7	-0.5
GDP per empl. person, HRK at 1999 pr.	3.2	5.8	2.6	-1.1	10.4	1.1	3.7	2.1	4.4
Unit labour costs, HRK at 1999 prices	9.5	6.5	7.4	8.2	-5.8	4.8	1.0	4.3	3.8
Unit labour costs, ER (EUR) adjusted	7.1	3.9	1.1	7.4	-3.7	5.7	-1.1	5.2	2.6
Macedonia									
GDP deflator	3.4	1.4	2.8	8.2	3.6	3.4	0.3	2.2	3.1
Exchange rate (ER), MKD/EUR	12.2	8.7	-0.7	0.2	0.3	0.1	0.5	0.1	2.5
Real ER (CPI-based)	11.2	10.2	1.2	-3.5	-2.8	0.4	1.3	2.6	2.4
Real ER (PPI-based)	8.6	3.7	-0.9	-5.2	0.0	0.8	2.3	2.0	1.5
Average net wages, MKD	2.8	3.7	2.9	5.5	3.5	6.9	4.8	4.0	4.1
Average net wages, real (PPI based)	-1.4	-0.3	3.0	-4.7	1.5	7.9	5.1	3.0	1.8
Average net wages, real (CPI based)	0.2	3.8	3.6	-0.3	-1.9	5.0	3.6	4.4	2.1
Average net wages, EUR (ER)	-8.4	-4.6	3.6	5.3	3.2	6.8	4.3	3.8	1.5
Employed persons (LFS)	-4.7	5.4	1.0	0.8	9.0	-6.3	-2.9	-4.1	-0.3
GDP per empl. person, MKD at 1999 pr.	7.0	-1.9	3.3	3.6	-12.4	7.7	5.8	7.3	2.3
Unit labour costs, MKD at 1999 prices	-3.9	5.6	-0.4	1.8	18.2	-0.8	-0.9	-3.1	1.9
Unit labour costs, ER (EUR) adjusted	-14.4	-2.8	0.4	1.6	17.8	-0.9	-1.4	-3.2	-0.7
Russia									
GDP deflator	15.1	18.5	72.4	37.7	16.5	15.7	14.0	18.0	26.9
Exchange rate (ER), RUB/EUR	-1.4	69.1	137.2	-0.8	0.4	13.5	17.0	3.3	22.2
Real ER (CPI-based)	-12.6	34.3	29.3	-16.3	-15.6	-0.1	5.0	-5.0	-2.0
Real ER (PPI-based)	-13.5	56.7	48.8	-29.1	-14.2	1.3	2.7	-14.4	-2.2
Average gross wages, RUB	20.2	10.7	44.8	46.0	45.7	34.6	26.1	24.2	34.6
Average gross wages, real (PPI based)	4.6	3.3	-8.9	-0.4	22.4	20.4	9.1	0.1	6.4
Average gross wages, real (CPI based)	4.7	-13.3	-22.0	20.9	19.9	16.0	11.0	11.9	5.9
Average gross wages, EUR (ER)	21.9	-34.6	-38.9	47.2	45.2	18.6	7.8	20.3	10.1
Employed persons (LFS)	-4.6	-2.6	6.9	2.8	0.2	2.6	-0.4	2.4	0.5
GDP per empl. person, RUB at 1999 pr.	6.3	-2.7	-0.5	7.0	4.9	2.1	7.7	4.7	3.0
Unit labour costs, RUB at 1999 prices	13.1	13.8	45.5	36.5	39.0	31.9	17.0	18.6	30.6
Unit labour costs, ER (EUR) adjusted	14.7	-32.7	-38.7	37.6	38.4	16.2	0.0	14.9	6.9
Ukraine									
GDP deflator	18.1	12.0	27.4	23.1	9.9	5.1	8.0	15.1	19.4
Exchange rate (ER), UAH/EUR	-9.0	31.0	58.7	14.5	-4.3	4.5	19.8	9.7	14.7
Real ER (CPI-based)	-20.1	20.0	30.9	-9.0	-12.7	5.8	16.1	2.7	-1.6
Real ER (PPI-based)	-14.8	14.8	20.7	-0.8	-10.3	1.2	12.8	-6.3	-1.3
Average gross wages, UAH	13.5	7.0	16.0	29.6	35.2	21.0	22.8	27.6	26.1
Average gross wages, real (PPI based)	5.4	-5.5	-11.5	7.2	24.5	17.4	13.9	5.9	7.3
Average gross wages, real (CPI based)	-2.1	-3.3	-5.4	1.1	20.7	20.0	16.7	17.0	6.2
Average gross wages, EUR (ER)	24.7	-18.3	-26.9	13.3	41.2	15.8	2.5	16.3	10.0
Employed persons (LFS)	-1.5	-3.2	-12.8	0.6	-1.0	0.6	0.4	0.7	-1.9
GDP per empl. person, UAH at 1999 pr.	-1.6	1.4	14.5	5.2	10.3	4.6	9.2	11.4	4.8
Unit labour costs, UAH at 1999 prices	15.3	5.5	1.3	23.2	22.5	15.7	12.5	14.5	20.4
Unit labour costs, ER (EUR) adjusted	26.7	-19.4	-36.2	7.6	28.0	10.7	-6.1	4.4	5.0
Austria									
GDP deflator	0.9	0.5	0.7	1.4	2.1	1.4	1.9	1.9	1.3
Exchange rate (ER), ATS-EUR/EUR	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.6
Average gross wages, ATS-EUR	1.1	3.0	2.3	2.6	1.4	2.1	2.5	1.8	1.9
Average gross wages, real (PPI based)	0.7	3.5	3.1	-1.4	-0.1	2.5	0.9	-2.9	0.8
Average gross wages, real (CPI based)	-0.2	2.0	1.7	0.2	-1.3	0.2	1.1	-0.3	0.3
Average gross wages, EUR (ER)	-2.8	2.2	3.2	2.6	1.4	2.1	2.5	1.8	1.3
Employment total	0.3	0.8	1.2	0.6	0.9	1.3	0.8	0.9	0.6
GDP per empl. person, ATS-EUR at 1999 pr.	1.3	3.1	1.4	2.8	-0.1	0.1	-0.1	1.1	1.4
Unit labour costs, ATS-EUR at 1999 prices	-0.2	-0.2	0.9	-0.2	1.5	2.0	2.6	0.8	0.5
Unit labour costs, ER (EUR) adjusted	-4.0	-0.9	1.8	-0.2	1.5	2.0	2.6	0.8	-0.1

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

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