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Broader-based Growth Resilient to Global Uncertainties

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Summary

Under favourable external conditions, the economies of the new EU member states (NMS) fared pretty well in 2005. Their performance in the first quarter of 2006 has continued to improve. Gross fixed investment has accelerated sharply. Industrial growth is proving buoyant. The labour market situation has improved: employment and real wages have risen. At the same time labour productivity has registered strong gains leading to a decline in unit labour costs. This is one of the reasons for the highly successful expansion of foreign trade, the second being the ongoing qualitative and structural upgrading of exports (and production). The contribution of foreign trade to overall growth continues to be positive and significant in the NMS in Central Europe. The contributions of both consumption (supported by rising wages) and expanding investment, however, are also rising, thus making for more balanced overall growth in the NMS.

In 2006 growth in gross fixed investment will accelerate further and remain quite strong in 2007. Industrial production will continue to expand rapidly, also on account of a stronger growth in domestic demand. With the exception of Hungary, fiscal policy will not interfere substantially with real growth. Under the impact of faster growth in the EU-15, NMS exports will perform well. Trade expansion is likely to be supported by some slowdown of nominal appreciation and the continuing gains in unit labour costs. Generally, external trade will continue to be an important source of overall growth in the Czech Republic, Poland, Hungary and Slovenia.

The deceleration of growth expected for 2007 in the EU-15 is likely to restrict the growth of NMS exports – and GDP overall. However, the scale of the slowdown is likely to be small, especially in view of further gains expected in terms of unit labour costs, ongoing structural changes and quality improvements in both production and exports.

The generally positive outlook for 2006 and 2007 assumes an absence of major turbulence on the exchange rate markets. This assumption is not risk-free, however, especially where Hungary is concerned. It is to be hoped that the recently announced fiscal consolidation programme proves credible and pre-empts excessive adjustments. A different type of risk faces Poland. Disinflation seems to have gone too far. Should this turn into outright deflation, Poland may plunge into destructive recession.

The labour market situation is improving across most NMS and accession countries as accelerated GDP growth has at last started to generate more substantial job creation. Migration to the UK and Ireland was also significant, both in magnitude and in its effects on the sending countries, in the cases of Poland, Slovakia, Lithuania and Latvia. The effects on the UK and Ireland of migration from these countries have so far been modest but broadly positive. We expect similar outcomes for the next enlargement that will bring in Romania and Bulgaria.

Growth, driven primarily by domestic demand, is expected to continue to be strong throughout Southeast Europe. The external balances should deteriorate due to strong demand for imports, which is sustained by exchange rates that are appreciating in real terms. Macroeconomic stability will be maintained, though inflation is picking up. In Serbia that is still a serious concern, while in Romania it may threaten the credibility of the central bank. Inflation is a major concern in Turkey, as is macroeconomic stability more fundamentally. Fiscal policy continues to be prudent, though perhaps more relaxed in some countries. Monetary policy, however, continues to present a puzzle, because the central banks have not found effective means to manage the high inflows of foreign money. Thus, the region remains under-monetized and starved for credit, while central banks continue to accumulate foreign currency reserves.

At the beginning of 2007, a regional free-trade area should come into existence. It will apply to the countries in the Western Balkans only, if Bulgaria and Romania join the EU at that time. The added boost that is expected to come from the creation of the multilateral free-trade area should be also the consequence of the growing regional investments.

This year, three new states have come or will come into being in Southeast Europe: Montenegro, Serbia and Kosovo. The really serious political shock may come with the independence of Kosovo. That will have consequences for political developments in Serbia and primarily for the results of the early parliamentary elections.

At the end of 2006 it should be decided whether Bulgaria and Romania will join the EU on 1 January 2007, as is widely expected; whether the EU will start negotiations with Macedonia, which at the moment seem unlikely; whether the other Western Balkan countries will sign Stabilization and Association Agreements with the EU; and what is the EU's strategy for further enlargements. The momentum has been lost when it comes to the Balkans, but the accession of Bulgaria and Romania and later on of Croatia may still make it possible for the rest of the Balkans to join the EU by 2015.

Russian growth is slowing down as the real sector weakens. Domestic demand is robust, the contribution of foreign trade to GDP growth is negative. In nominal terms exports are booming thanks to the high prices of energy and metals. Paris Club debt repayments are ahead of schedule. Real growth will be about 6% in both 2006 and 2007; disinflation will be gradual. The restructuring and institutional reforms, however, are running late. WTO accession may be postponed yet again; it is unclear what course future EU-Russia relations will take after expiry of the Partnership and Cooperation Agreement.

In Ukraine the slowdown in economic growth has been reversed in 2006; domestic demand (particularly investments) has picked up. Exports, however, are performing badly, and the current account is expected to switch to a deficit. The hike in gas prices in early 2006 did not have any sizeable impact on the economy, not least because it has yet to be fully passed on to the final consumers. However, given the planned tariff hikes, inflation is expected to remain in double digits. Under the renewed 'orange' coalition, a liberal and reform-oriented economic policy course may be problematic; besides, this coalition is likely to be highly unstable.

The Chinese economy kept fast growth in the first quarter of 2006. The expansion was mainly driven by a surge of investment and supported by a record foreign trade surplus. Private consumption developed at a stable pace, inflation remained low. Government measures to dampen growth and to prevent an overheating of the economy may become more effective in the near future. Nevertheless, we expect GDP growth close to 10% in both 2006 and 2007.

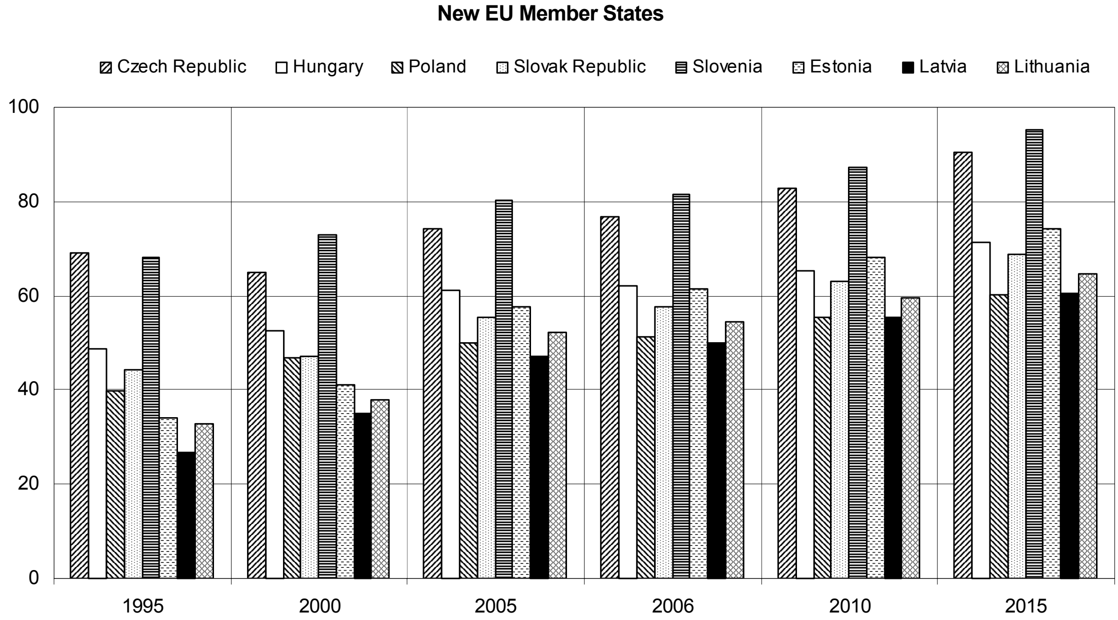
Keywords: *Central and East European new EU member states, Southeast Europe, Balkans, former Soviet Union, China, Turkey, GDP, industry, productivity, labour market, foreign trade, exchange rates, inflation, fiscal deficits, EU integration*

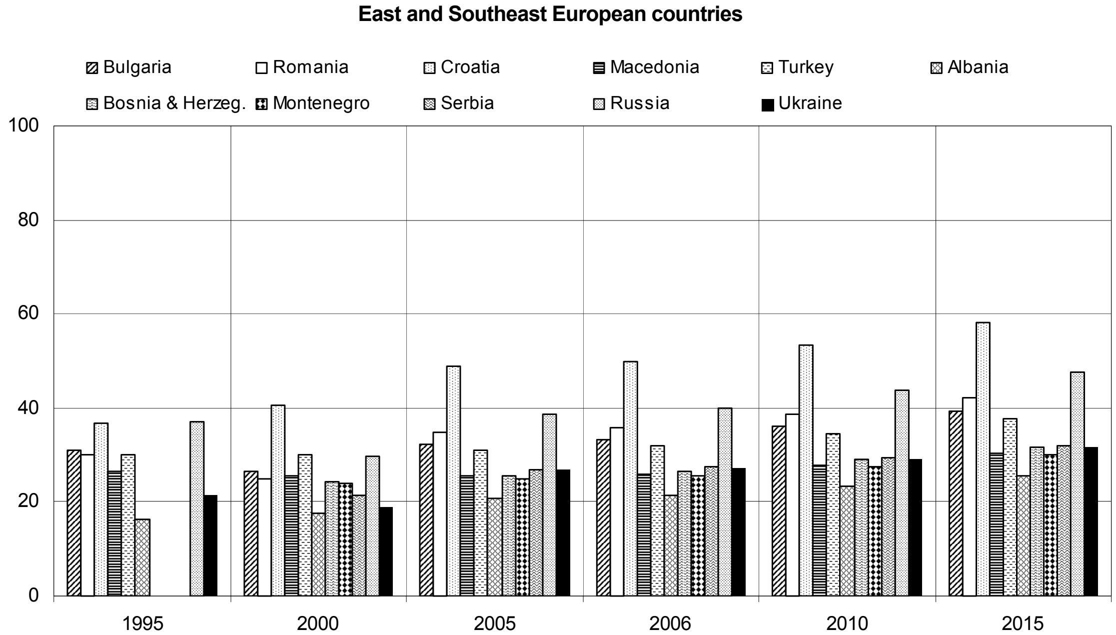
JEL classification: *O52, O57, P24, P27, P33, P52*

Figure I

Real per capita GDP in transition countries

European Union (25) average = 100





Projection assuming a 2 percentage points growth differential to the EU-15 after 2006.

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2004-2005 and outlook 2006-2007

	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			
	2004	2005	2006	2007	2004	2005	2006	2007	2004	2005	2006	2007	2004	2005	2006	2007
			forecast				forecast				forecast				forecast	
Czech Republic	4.2	6.1	5.5	5	2.8	1.9	2.8	2.5	8.3	8.0	7.5	7.5	-6.0	-2.1	-1.8	-1.7
Hungary	5.2	4.1	4.0	2.3	6.8	3.6	3.5	6	6.1	7.2	7.9	8.5	-8.6	-7.4	-7.4	-6.0
Poland	5.3	3.4	5	4.5	3.5	2.1	2	2	19.0	17.8	17.5	17	-4.2	-1.4	-1.5	-1.4
Slovak Republic	5.4	6.1	6.5	6.5	7.5	2.7	4	3.5	18.1	16.2	14.5	14	-3.6	-8.6	-5.7	-5.0
Slovenia	4.2	3.9	4	4	3.6	2.5	2.6	2.4	6.3	6.6	6.5	6	-2.1	-1.1	-1.2	-1.0
NMS-5 [2)3)]	*5.0*	*4.3*	*5.0*	*4.4*	.	.	.	.	*14.9*	*14.1*	*13.9*	*13.7*	*-5.2*	*-3.2*	*-2.9*	*-2.5*
Estonia	7.8	9.8	8.9	7.9	3.0	4.1	3.5	3	9.6	7.9	7	6.5	-12.7	-10.5	-9.8	-9.0
Latvia	8.5	10.2	8.5	7.6	6.2	6.7	6	4.5	10.4	8.7	8	7.5	-12.9	-12.5	-13.1	-12.6
Lithuania	7.0	7.5	6.5	6.2	1.2	2.7	3	2.8	11.4	8.3	7	6.5	-7.7	-7.0	-7.3	-7.4
NMS-8 [2)3)]	*5.2*	*4.7*	*5.2*	*4.6*	.	.	.	.	*14.4*	*13.5*	*13.1*	*12.9*	*-5.6*	*-3.7*	*-3.4*	*-3.1*
EU-15 [3)]	*2.3*	*1.5*	*2.2*	*2.0*	*2.0*	*2.1*	*2.2*	*1.9*	*8.1*	*7.9*	*7.8*	*7.6*	*0.50*	*-0.33*	.	.
EU-25 [2)3)]	*2.5*	*1.7*	*2.5*	*2.3*	*2.1*	*2.2*	*2.1*	*2.2*	*9.1*	*8.7*	*8.5*	*8.2*	*0.21*	*-0.51*	.	.
Bulgaria	5.7	5.5	5.5	5	6.1	5.0	8	5	12.0	10.1	9	8	-5.8	-11.8	-14.1	-13.2
Romania	8.4	4.1	5.0	4.8	11.9	9.0	8.5	8.0	8.0	7.2	7	7	-8.4	-8.7	-9.5	-9.5
Croatia	3.8	4.3	4	4	2.1	3.3	3.5	3	13.8	12.7	12.5	12	-5.1	-6.3	-6.5	-6.2
Macedonia	4.1	3.6	3.5	4	-0.4	0.5	3	3	37.2	37.3	37	37	-7.7	-1.4	-3.1	-2.9
Turkey	8.9	7.4	5.5	5.5	8.6	8.2	9.0	6.0	10.3	10.3	11.5	11.0	-5.2	-6.4	-7.0	-6.5
Albania [4)]	6.7	5.3	5.2	5.8	3.0	2.4	2.5	2	14.4	14.2	14	14	-4.7	-6.7	-6.8	-6.5
Bosnia and Herzegovina [4)]	6.0	5.5	6	6	0.7	2.9	6	4	43.9	45.4	46	46	-20.9	-22.5	-20.1	-18.2
Montenegro	3.7	4.1	5	5	2.4	2.3	3	3	27.7	28.0	28	28	-7.8	-8.6	-9.1	-7.9
Serbia	9.3	6.3	4	4	11.4	16.2	15	15	18.5	20.8	22	23	-12.6	-8.8	-10	-10
Russia	7.2	6.4	5.8	5.9	11.0	12.5	10	9	8.2	7.6	7.5	7	9.9	11.0	10.8	6.8
Ukraine	12.1	2.6	3.5	4.5	9.0	13.5	11	9	8.6	7.0	6.8	6.6	10.6	3.1	-1.9	-2.7
China	9.5	9.9	9.7	9.5	3.9	1.8	2.0	1.8	.	.	.	.	3.6	7.2	7.3	5.0

Note: NMS: The New EU Member States

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

Source: wiiw (July 2006); Eurostat; forecasts for EU-15 and the Baltic states: European Commission (Spring 2006).

Table II **Central and East European new EU member states (NMS-8): an overview of economic fundamentals, 2005**

	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	99.99	10.54	87.90	12.67	20.59	243.67	38.15	27.37	*540.87*	*10263.59*	*10822.38*
GDP in EUR at PPP, EUR bn	177.61	18.12	143.84	25.36	41.63	446.27	69.53	37.46	*959.81*	*9842.87*	*10822.38*
GDP in EUR at PPP, EU-25=100	1.6	0.2	1.3	0.2	0.4	4.1	0.6	0.3	*8.9*	*90.9*	*100.0*
GDP in EUR at PPP, per capita	17360	13460	14260	11020	12190	11690	12910	18720	*13160*	*25277*	*23353*
GDP in EUR at PPP per capita, EU-25=100	74	58	61	47	52	50	55	80	*56*	*108*	*100*
GDP at constant prices, 1990=100	122.7	131.3	132.4	102.1	102.7	148.6 [3)]	129.5	142.0	*140.8*	*137.0*	*137.6*
GDP at constant prices, 2000=100	119.6	144.2	122.6	147.5	144.3	115.9	125.2	118.0	*120.4*	*108.2*	*109.2*
Industrial production real, 1990=100	109.0	102.9	197.4	66.4	60.5	167.0 [3)]	121.5	103.8	*157.7*	*121.6*	*124.7*
Industrial production real, 2000=100	134.1	157.5	130.5	141.1	165.1	128.8	130.5	115.8	*131.5*	*102.3*	*104.9*
Population - thousands, average	10232	1346	10077	2300	3414	38165	5387	2001	*72922*	*389407*	*462017*
Employed persons - LFS, thousands, average	4764	607	3902	1036	1474	14116	2216	949	*29064*	*173446*	*202006*
Unemployment rate - LFS, in %	8.0	7.9	7.2	8.7	8.3	17.8	16.2	6.6	*13.6*	*7.9*	*8.7*
Public sector expenditures, EU-def., in % of GDP	41.1	35.9	50.7	36.2	33.7	43.3	37.7	47.3	*43.6*	*47.6*	*47.4*
Public sector revenues, EU-def., in % of GDP	43.7	37.5	44.5	36.4	33.1	40.8	34.7	45.5	*40.8*	*45.3*	*45.1*
Price level, EU-25=100 (PPP/exch. rate)	56	58	61	50	49	55	55	73	*56*	*104*	*100*
Compensation per employee [4)], monthly, in EUR	906	753	1046	460	596	728	647	1592	*807*	*3144*	*2803*
Compensation per employee, monthly, EU-25=100	32.3	26.8	37.3	16.4	21.3	26.0	23.1	56.8	*28.8*	*112.2*	*100.0*
Exports of goods in % of GDP	63.0	59.9	56.7	33.7	46.2	31.6	67.5	53.0	*46.3* [5)]	*27.7* [5)]	*28.6* [5)]
Imports of goods in % of GDP	61.6	73.8	58.5	52.6	57.3	32.5	72.6	56.8	*48.4* [5)]	*27.6* [5)]	*28.7* [5)]
Exports of services in % of GDP	8.7	24.1	11.3	13.7	12.2	5.3	9.3	11.8	*8.3* [5)]	*8.4* [5)]	*8.5* [5)]
Imports of services in % of GDP	8.0	16.5	10.8	9.9	8.0	4.7	8.6	8.5	*7.2* [5)]	*7.8* [5)]	*7.8* [5)]
Current account in % of GDP	-2.1	-10.5	-7.4	-12.5	-7.0	-1.4	-8.6	-1.1	*-3.7* [5)]	*-0.3* [5)]	*-0.5* [5)]
FDI stock per capita in EUR	4932	7717	5134	1759	1600	1835	2414	3002	*2895*	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. 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) Gross wages plus indirect labour costs, whole economy, national account concept. - 5) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Table III

Southeast Europe: an overview of economic fundamentals, 2005

	Bulgaria	Romania	Croatia	Macedonia	Turkey	Albania	Bosnia and Herzegovina	Montenegro	Serbia	*NMS-8* [1)]	*EU-15*	*EU-25* [2)]
GDP in EUR at exchange rates, EUR bn	21.45	79.26	30.95	4.63	291.12	6.72	7.54	1.64	19.47	*540.87*	*10263.59*	*10822.38*
GDP in EUR at PPP, EUR bn	58.25	176.07	50.83	12.21	519.45	15.28	17.58	3.65	46.96	*959.81*	*9842.87*	*10822.38*
GDP in EUR at PPP, EU-25=100	0.5	1.6	0.5	0.1	4.8	0.1	0.2	0.03	0.4	*8.9*	*90.9*	*100.0*
GDP in EUR at PPP, per capita	7530	8140	11450	6000	7210	4860	5990	5790	6300	*13160*	*25277*	*23353*
GDP in EUR at PPP per capita, EU-25=100	32	35	49	26	31	21	26	25	27	*56*	*108*	*100*
GDP at constant prices, 1990=100	103.1	111.0	107.7	97.3	175.6	147.3	434.2 [3)]	.	.	*140.8*	*137.0*	*137.6*
GDP at constant prices, 2000=100	127.3	131.9	125.7	106.8	123.6	132.7	127.0	112.1	130.8	*120.4*	*108.2*	*109.2*
Industrial production real, 1990=100	80.7	76.7	81.4	53.2	192.6	44.6	.	.	.	*157.7*	*121.6*	*124.7*
Industrial production real, 2000=100	152.3	125.2	126.7	100.7	125.6	117.6	144.4	114.2	106.7	*131.5*	*102.3*	*104.9*
Population - thousands, average	7740	21624	4439	2035	72065	3143	3845	630	7450	*72922*	*389407*	*462017*
Employed persons - LFS, thousands, average	2980	9160	1573	545	22046	932 [4)]	631 [5)]	185	2900	*29064*	*173446*	*202006*
Unemployment rate - LFS, in %	10.1	7.2	12.7	37.3	10.3	14.2 [4)]	45.4 [5)]	28.0	20.8	*13.6*	*7.9*	*8.7*
Public sector expenditures, nat. def., in % of GDP	39.7	29.9	.	32.5	30.7 [6)]	27.8	38.6 [7)]	26.4 [7)]	46.5 [7)]	*43.6* [6)]	*47.6* [6)]	*47.4* [6)]
Public sector revenues, nat. def., in % of GDP	42.9	29.1	.	32.7	31.8 [6)]	24.5	41.5 [7)]	24.3 [7)]	45.0 [7)]	*40.8* [6)]	*45.3* [6)]	*45.1* [6)]
Price level, EU-25=100 (PPP/exch. rate)	37	45	61	38	56	44	43	45	41	*56*	*104*	*100*
Average gross monthly wages, EUR at exchange rate	163	264	844	348	649 [8)]	216 [9)]	405	326	307 [10)]	*807* [8)]	*3144* [8)]	*2803* [8)]
Average gross monthly wages, EUR at PPP	444	587	1387	917	1157 [8)]	490 [9)]	945	725	740 [10)]	*28.8* [8)]	*112.2* [8)]	*100.0* [8)]
Exports of goods in % of GDP	44.1	28.1	23.4	35.4	21.2	7.9	27.6	26.5	19.3	*46.3* [11)]	*27.7* [11)]	*28.6* [11)]
Imports of goods in % of GDP	64.5	37.9	47.6	53.7	30.3	29.8	80.7	57.3	42.4	*48.4* [11)]	*27.6* [11)]	*28.7* [11)]
Exports of services in % of GDP	16.1	5.0	26.0	8.2	7.1	13.8	10.8	19.2	6.7	*8.3* [11)]	*8.4* [11)]	*8.5* [11)]
Imports of services in % of GDP	13.0	5.5	8.8	8.8	3.3	16.4	4.9	7.5	6.6	*7.2* [11)]	*7.8* [11)]	*7.8* [11)]
Current account in % of GDP	-11.8	-8.7	-6.3	-1.4	-6.4	-6.7	-22.5	-8.6	-8.8	*-3.7* [11)]	*-0.3* [11)]	*-0.5* [11)]
FDI stock per capita in EUR	1105	930	2970	735	400	488	598	895	641	*2895*	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. 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 and unemployment by registration, end of year. - 5) Employees and unemployment (by registration), end of year. - 6) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 7) Year 2004. - 8) Gross wages plus indirect labour costs, whole economy, national account concept. - 9) Public sector. - 10) Including various allowances. - 11) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Global adjustment and emerging markets

Vladimir Gligorov *

Introduction

The long-awaited global rebalancing seems to have begun this spring. Inflation has started to rear its ugly head, according to the Federal Reserve Board (FED); growth may have started to moderate in the USA as a consequence of ever-rising interest rates, while emerging markets have been confronted by an outflow of financial resources. Thus far, the transition economies in Central and Southeast Europe have not been affected too much. Hungary may be an exception, as is Turkey among the European Union candidate countries. More problems may arise in the future.

External balances and prices

It has been generally agreed for some time that the main risk to global stability emanates from the high US current account and fiscal deficits and the implications that they bear for the sustainability of the dollar exchange rate. People have come to expect a certain measure of rebalancing as being essential. Clearly, if there is a choice, gradual adjustment is the preferable route to take. The risk to date has been that a major devaluation of the dollar would lead to a speed-up of inflation in the USA, which would require a firm response from the FED in the way of a sharp increase in interest rates. The ensuing recession could well slow down growth across the globe.

This scenario can always be played out; however, adjustment to date has been helped by stubbornly low inflation due in part to the benefits of globalization. Increased imports from emerging economies and outsourcing have kept wages down in the USA despite high growth rates and low registered rates of unemployment. Increased migration has also contributed to favourable developments on the labour market. Thus, increased global trade – in goods, services and labour – has kept inflation in check, while persistent investments in the US debt instruments and assets have kept the dollar and interest rates at acceptable levels. Finally, the ever-rising prices of oil and raw materials in general have not made inflation any swifter until recently, because those prices have been adjusting to growing demand that stems from high growth rates in developing economies and the USA, as well as from improving prospects in Japan and the EU.

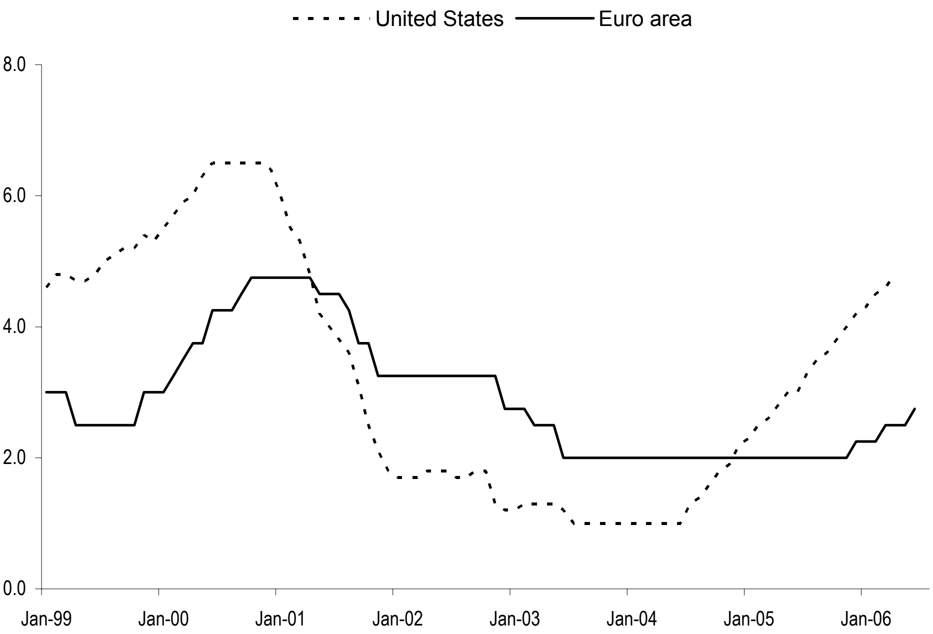
These three fundamentals – high growth rates, low inflation and high commodity prices – allowed the central banks, and primarily the FED, to move gradually from an accommodative or highly accommodative monetary policy stance to a more restrictive approach. In the aftermath of 11 September 2001, the FED began progressively slashing its interest rates until they reached a record low of 1%. For the past two years, it has started raising its interest rates once again and they now stand at 5.25%; it is expected that its short-term interest rate will continue to go up in the course of 2006. The European Central Bank (ECB) has been much less active so far (see Figure 1). The FED traditionally cares about growth as well, whereas the new ECB is concerned almost exclusively with inflation. The ECB also has a credibility problem because ever since it came into existence, it has failed to reach its inflation target. On the other hand, the reluctance of the ECB to raise interest rates aggressively is proving helpful in the current upturn, although it could well have been otherwise in the previous downturn.

* P. Havlik, M. Landesmann, L. Podkaminer and S. Richter (all wiiw) provided valuable comments on this introduction.

Figure 1

Transatlantic asymmetry: Policy rates since 1999

percentage points: monthly data



Note: For the euro area the policy rate refers to the rate on the main refinancing operation until 28 June 2000 and to the minimum bid rate thereafter. For the US the federal funds rate is shown.

Source: ECB and IMF.

In any event, all these interest rate and exchange rate movements have had a stabilizing effect on the global economy; they have even given rise to quite significant improvements in emerging market economies over the past few years. In addition, economies in transition have enjoyed a period of comparatively high growth. These favourable circumstances may now have come to an end. Due to a gradual change in the monetary policy stance, growth is expected to slow down in the US in order to (a) contain a further widening of the country's current account deficit; and also (b) because of an attempt to reduce the high fiscal deficit. Monetary policy must thus remain restrictive in order to prevent the exchange rate from depreciating too much and so lead to increased inflationary pressures. Growth in other parts of the world is still expected to stay strong, though the prospects for the euro area are more muted.

The advantages of increased flexibility

Over the past few years, the relatively low inherited prices of assets in emerging markets, as a result of the series of crises that occurred in the final decade of the past century and the early years of the current century, have attracted significant inflows of credit and investment, despite significant current account surpluses in major emerging economies, that in turn have brought about a marked decline in interest rates. That has supported higher growth rates: once more a good development for public and private balance sheets. However, as of this spring and especially May this year, money has started to flow out, thus creating problems in a number of countries, not all of which are emerging economies.

The most vulnerable countries have been those with high current account deficits. That leads to the question whether exchange rate and interest rate adjustments can be combined in such a way as to stabilize the markets and support the restructuring required in the various balances of payments.

The reaction of most countries hit by the outflow of funds has been to raise interest rates and intervene in foreign exchange markets. The aim has been to 'soften' the depreciation of their currencies and contain the surge in inflation. That the monetary authorities have been able to react in this manner was made possible by the generally high levels of foreign currency reserves that had been accumulated in previous years. Moreover, in a number of emerging markets, the relatively flexible exchange rate regimes proved quite helpful.

One way of differentiating between the roles that an exchange rate regime may play is to compare, for instance, Turkey with Hungary. In both cases, the countries' currencies have depreciated and their central banks have been forced to raise interest rates, though very modestly in Hungary to date. In Turkey, the main concern has been surging inflation rather than anything else. In Hungary, however, current account sustainability is the main issue. The difference stems from the fact that Turkey has gone through a process of fiscal consolidation, whereas Hungary should do that now. In the latter case, a major devaluation would make fiscal adjustment more costly so that the preferred policy is to keep the exchange rate stable, while increasing taxes and cutting back expenditures. In Turkey, the public and presumably private balance sheets are in a better shape and exchange rate adjustment may be what is needed in order to slow down import growth and support that of exports.

Compared to both Hungary and Turkey, countries in the eurozone and those firmly linked to the euro seem to be benefiting from the fixed exchange rate. Although a number of member states, new member states and those that are firmly tied to the euro have significant current account and even fiscal deficits, this has yet to translate into instability. Given that exchange rates are fixed and the interest rates are determined by the ECB, which still does not feel that it needs to adopt a more aggressive monetary policy, adjustment can only come via the growth rate.

Stocks and bonds in transition

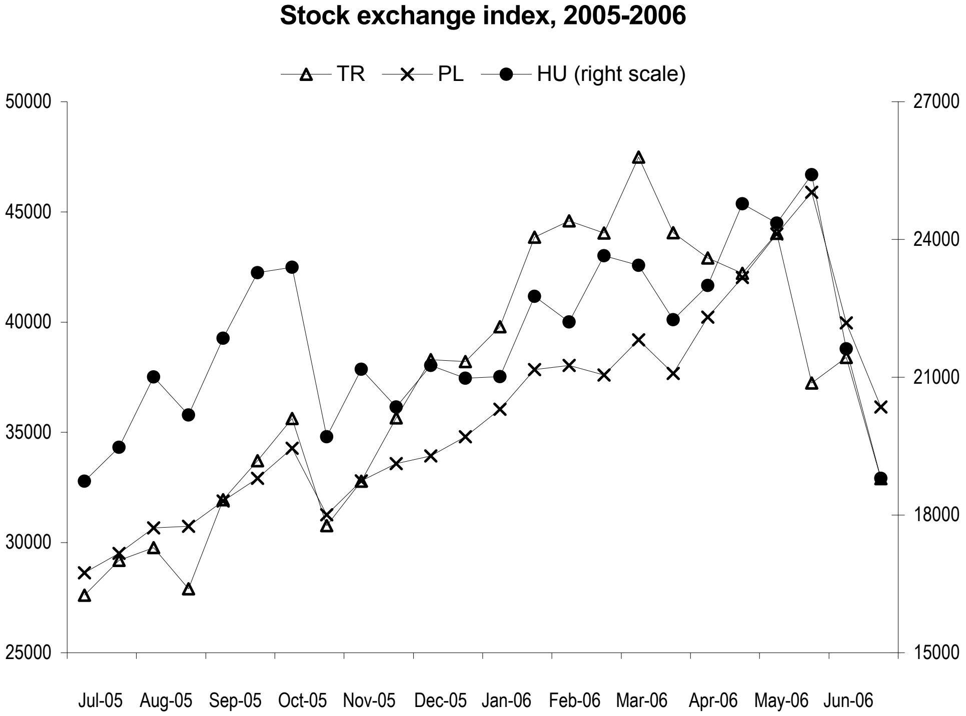
Current financial turmoil has been primarily a stock market phenomenon. A typical emerging stock market has a record of steep price increases over the past couple of years, with a sharp contraction in the past few months. On average, the markets have shed about a quarter of their previous gains. The development of the Warsaw stock exchange is rather typical for most emerging markets.

A somewhat different picture emerges if developments in the Turkish and Hungarian markets are viewed more closely. The Turkish market shows a pattern similar to the markets in Poland, but volatility is apparently higher. On the other hand, the Hungarian stock market is clearly more volatile. Both markets have undergone major corrections to the extent that most of the gains of the past year or so have been largely reversed (see Figure 2).

Unlike Hungary and Turkey, but also unlike emerging markets in general, where corrections have been introduced and increased volatility may be expected in the future, sheltered markets are to be found in a number of transition countries. Thus, markets in countries such as Slovenia and Croatia, as well as Romania, show little tendency to decline; in fact, they continue to post healthy gains.

These are markets with both low capitalization and little foreign participation. They thus continue to push equity prices up.

Figure 2



Source: www.bloomberg.com.

In comparison to stocks, bonds have remained relatively stable. That is mostly attributable to the improved fiscal and banks' balance sheets, as well as the large accumulation of foreign exchange reserves in most emerging markets, irrespective of whether they are characterized by current account deficits or surpluses.

Conclusion

The process of rebalancing is still at the incipient stage. Risks of global instability are expected to increase in the second part of the current year, should growth slow down sharply in the USA. If in addition, inflationary pressures build up and interest rates climb even higher in the US, global growth may suffer and the emerging markets and transition economies may experience a more pronounced shortage of financial resources. However, the increased flexibility of exchange rates and financial markets together with improved fiscal and private balance sheets should make it possible to provide for a soft version of global rebalancing this time around.

Part A: The new EU member states

*Leon Podkaminer**

Faster and broader-based GDP growth

A temporary improvement in external conditions in 2006

After a temporary acceleration in 2004, growth in the EU-15 in 2005 reverted to its standard, unfortunately weak pace. However, growth in the eurozone (and the EU-15) has recently accelerated once more. Quite naturally this has led to a further improvement in the new member states' trade performance. The fact that growth has remained high outside the EU further bolsters exports and overall growth in the NMS. However, the favourable external conditions are unlikely to prevail for long. Growth in major non-EU countries is expected to slow down in 2007. Demand for exports from the NMS will slacken. At the same time competition from fast-growing Asian countries (primarily China) will become fiercer. Above all, however, the current modest acceleration in the eurozone is likely to falter again. Much of the present growth in the eurozone is driven by the 'precautionary' consumption boom in Germany. This has been activated by expectations of significant price increases following the introduction of higher VAT rates (from 1 January 2007). The German boom is likely to burst next year. This will depress growth throughout the eurozone, a compounding factor being even stronger competitive pressure emanating from the German export sector. An additional burden on growth in the eurozone (as well as in the remaining EU-15) will be imposed by the activities of the ECB and other central banks that have started to ratchet up their interest rates.

Some deterioration of growth in the major export markets of the NMS would normally translate into a worsening of their export performance, thus depressing their overall growth. However, it may well transpire that the losses suffered by the NMS will be fairly limited. Their exports are likely to prove resilient not only on account of the underlying domestic developments (structural change and unit labour cost trends). Higher interest rates in the EU and elsewhere are likely to restrict nominal appreciation of the NMS currencies. It is quite possible that these currencies will depreciate somewhat in real terms. This would be an additional external factor that would help the NMS to withstand any deterioration in the business climate of their major trading partners in 2007.

Marked GDP growth acceleration in the first quarter of 2006

Without exception, the pace of GDP growth in the NMS increased markedly in the first quarter of 2006. Among the NMS in Central Europe (i.e. excluding the Baltic states) the most pronounced growth rate increase (as against the first quarter of 2005) occurred in Poland. The rise in Poland's growth rate is further reflected in the pronounced rise in the average growth rate for the NMS overall. An exceptionally high growth rate was also recorded in the Czech Republic (and, as is now customary, in the Baltic states, see Table 1).

Gross fixed capital formation (termed investment for short) accelerated everywhere – despite the protracted and harsh winter. This acceleration is a natural development given the overall growth that

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

has been sustained for several years, good demand prospects, high profits in the corporate sector and, last but not least, the drop in interest rates (see Table 2).

Table 1

Gross domestic product

real change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007	Index 1990=100 2005	Index 2000=100 2005
							1st quarter		forecast			
Czech Republic	3.6	2.5	1.9	3.6	4.2	6.1	5.4	7.4	5.5	5	122.7	119.6
Hungary	5.2	4.3	3.8	3.4	5.2	4.1	3.2	4.6	4.0	2.3	132.4	122.6
Poland	4.2	1.1	1.4	3.8	5.3	3.4	2.2	5.2	5	4.5	168.0	115.9
Slovak Republic	2.0	3.2	4.1	4.2	5.4	6.1	5.4	6.3	6.5	6.5	129.5	125.2
Slovenia	4.1	2.7	3.5	2.7	4.2	3.9	2.8	5.1	4	4	142.0	118.0
NMS-5 2)	*4.1*	*2.1*	*2.2*	*3.7*	*5.0*	*4.3*	*3.3*	*5.6*	*5.0*	*4.4*	*145.6*	*118.5*
Estonia	7.9	6.5	7.2	6.7	7.8	9.8	7.2	11.6	8.9	7.9	131.3	144.2
Latvia	6.9	8.0	6.5	7.2	8.5	10.2	7.3	13.1	8.5	7.6	102.1	147.5
Lithuania	3.9	6.4	6.8	10.5	7.0	7.5	4.4	8.8	6.5	6.2	102.7	144.3
NMS-8 2)	*4.2*	*2.5*	*2.5*	*4.1*	*5.2*	*4.7*	*3.5*	*6.1*	*5.2*	*4.6*	*140.8*	*120.4*

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

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

Table 2

Gross fixed capital formation

real change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007	Index 1990=100 2005	Index 2000=100 2005
							1st quarter		forecast			
Czech Republic	5.1	6.6	5.1	0.4	4.7	3.6	2.3	7.1	7	5	141.4	122.1
Hungary	7.7	6.0	10.2	2.9	8.0	6.6	6.8	9.7	9	5	199.4	138.3
Poland	2.7	-9.7	-6.3	-0.1	6.3	6.5	1.4	7.4	7	6	222.8	95.7
Slovak Republic	-7.2	12.9	0.3	-2.3	5.0	13.8	4.7	16.1	17	18	107.9	132.2
Slovenia	1.8	0.4	0.9	7.1	5.9	3.7	0.6	8.9	7	7	223.1	119.0
Estonia	14.3	13.0	17.2	8.5	6.0	13.9	10.3	.	9.5	8	.	173.5
Latvia	10.2	11.4	13.0	10.9	17.3	18.6	15.9	.	14	9.2	112.8	194.2
Lithuania	-9.0	13.5	11.1	14.0	12.3	11.1	8.8	8.2	9.7	8.7	.	179.3

Note: 1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

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': the share of investment in GDP. This also applies to other components of the GDP: 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. It should also be recalled that even if the trade balance measured at *current* prices –

e.g. in current euros – improves greatly, the actual contribution of foreign trade to *real* GDP growth may still be negative.

Box 1

Calculation of contributions to the GPP growth rate: an example

In 1Q2005 consumption accounted for 74.1% of the Slovak GDP; gross fixed investment for 23%; exports for 86%; imports for 86.5% (at constant prices of 2000). The real GDP growth rate (1Q2006 over 1Q2005) was 6.3%. Consumption, investment, exports and imports rose by 6.6%, 16%, 18% and 20.8% respectively. The contribution of consumption to the 6.3% GDP growth rate was 4.9 percentage points (4.9 = 0.066 x 74.1%); of investment 3.7 p.p. (3.7 = 0.16 x 23%); of exports 15.5 p.p. (15.5 = 0.18 x 86%); of imports (minus) 18 p.p. (18 = 0.208 x 86.5%). The trade balance contributed -2.5 p.p. (= 15.5 p.p. – 18 p.p.). The sum of the contributions of consumption, investment and the trade balance is 6 p.p. Other items (change in stocks and statistical discrepancy) contributed another 0.3 p.p.

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 2006 are preliminary. As such, they are likely to undergo some revision at a later date.)

As can be seen, individual items of expenditure have recently played differing roles in generating growth in aggregate demand (and GDP) across individual NMS. In the first quarter of 2006, total consumption (private and public combined) contributed quite significantly to overall GDP growth in all NMS. In Poland and Slovakia consumption was the key factor in promoting growth. The contribution of consumption in the Czech Republic, Hungary and Slovenia, however, remained moderate.

In the first quarter of 2006, all NMS entered a phase of intensified investment activity. The contributions of gross fixed investment to overall growth increased perceptibly across all countries (but markedly so in Slovakia).

Foreign trade continued to contribute positively to GDP growth in all NMS in Central Europe except Slovakia, where the contribution of the trade balance has been negative since 2004. Currently, that negative contribution is rather high. Poland and Slovenia have recorded positive contributions of a moderate magnitude. The exceptionally high contribution of trade to growth recorded in the Czech Republic in 2005 has since been replaced by a much more moderate rate. That notwithstanding, it is still quite large (similar to Hungary).

The major negative contributions of the trade balance to GDP growth (as is to be observed in Slovakia) are a generally unwelcome development. In a direct form, those contributions mean a reduction in GDP growth. In an indirect form, negative contributions often augur a rise in the country's foreign debt (which may be unwelcome, even if rising debt reflects an expansion of domestic fixed investment). On the other hand, this does not mean that large positive contributions on the part of the trade balance (as in the Czech Republic in 2005) are always a welcome development. In particular, when combined with very small contributions on the part of domestic demand (consumption and gross capital formation combined), the large contributions emanating from the trade balance are not necessarily all that beneficial to the nation as a whole. Such a situation (obtaining in the Czech Republic in 2005) is indicative of an export-led growth achieved at

Table 3

Contributions (percentage points) to the GDP growth rates

	2000	2001	2002	2003	2004	2005	2005 I Q	2006 I Q
Czech Republic								
GDP growth rate (%)	**3.6**	**2.5**	**1.9**	**3.6**	**4.2**	**6.1**	**5.4**	**7.4**
Consumption	0.8	1.9	2.6	4.7	0.6	1.3	0.6	1.4
Gross fixed investment	1.4	1.8	1.5	0.1	1.3	1.0	0.6	1.8
Trade balance	0.0	-1.1	-2.2	-0.9	1.3	4.0	4.3	1.9
Other items*	1.4	-0.1	0.0	-0.3	1.0	-0.2	-0.1	2.3
Hungary								
GDP growth rate (%)	**5.2**	**4.3**	**3.8**	**3.4**	**5.2**	**4.1**	**3.2**	**4.6**
Consumption	3.1	3.9	7.0	6.1	2.6	0.9	0.4	1.6
Gross fixed investment	1.9	1.4	2.4	0.7	2.0	1.7	1.2	1.8
Trade balance	0.6	1.9	-2.2	-2.9	0.9	3.3	2.2	3.2
Other items*	-0.4	-2.9	-3.4	-0.5	-0.3	-1.8	-0.6	-2.0
Poland								
GDP growth rate (%)	**4.2**	**1.1**	**1.4**	**3.8**	**5.3**	**3.4**	**2.2**	**5.2**
Consumption	2.2	1.8	2.4	2.1	3.3	2.2	1.7	4.1
Gross fixed investment	0.7	-2.3	-1.3	0.0	1.2	1.2	0.2	0.9
Trade balance	1.0	2.6	0.5	1.1	-0.8	1.1	1.1	0.7
Other items*	0.3	-1.0	-0.2	0.6	1.6	-1.1	-0.8	-0.5
Slovenia								
GDP growth rate (%)	**4.1**	**2.7**	**3.5**	**2.7**	**4.2**	**3.9**	**2.8**	**5.1**
Consumption	0.9	2.0	1.4	2.2	2.3	2.4	2.0	2.4
Gross fixed investment	0.5	0.1	0.2	1.7	1.4	0.9	0.1	2.0
Trade balance	2.7	1.7	1.0	-2.1	-0.5	2.3	1.2	1.2
Other items*	0.0	-1.1	0.9	0.9	1.0	-1.7	-0.5	-0.5
Slovak Republic								
GDP growth rate (%)	**2.0**	**3.2**	**4.1**	**4.2**	**5.4**	**6.1**	**5.4**	**6.3**
Consumption	-0.1	4.0	4.0	0.9	2.7	4.0	4.4	4.9
Gross fixed investment	-2.0	3.3	0.1	-0.6	1.3	3.5	1.1	3.7
Trade balance	1.9	-5.0	-0.3	5.5	-0.9	-2.0	-1.4	-2.5
Other items*	2.2	0.9	0.3	-1.6	2.3	0.6	1.3	0.2
Estonia								
GDP growth rate (%)	**7.9**	**6.5**	**7.2**	**6.7**	**7.8**	**9.8**	**7.2**	**11.6**
Consumption	5.4	4.2	7.5	5.8	4.1	6.4	5.0	.
Gross fixed investment	3.9	3.7	5.2	2.8	2.0	4.6	3.0	.
Trade balance	-2.1	-2.5	-3.2	-5.7	-1.4	0.5	-1.7	.
Other items*	0.7	1.1	-2.3	3.8	3.1	-1.7	0.9	.
Latvia								
GDP growth rate (%)	**6.9**	**8.0**	**6.5**	**7.2**	**8.5**	**10.2**	**7.6**	**13.1**
Consumption	3.3	5.0	4.9	5.4	6.2	7.2	5.0	.
Gross fixed investment	2.5	2.9	3.4	3.5	7	6.2	4.9	.
Trade balance	3.9	-4.2	-0.1	-4.9	-5.5	1.1	-0.2	.
Other items*	-2.8	4.3	-1.7	3.2	0.8	-4.3	-2.1	.
Lithuania								
GDP growth rate (%)	**3.9**	**6.4**	**6.8**	**10.5**	**7.0**	**7.5**	**4.4**	**8.8**
Consumption	5.3	2.7	4.5	9.3	8.0	8.4	4.2	.
Gross fixed investment	-2.7	3.5	3.1	4.0	3.7	3.5	2.2	.
Trade balance	1.7	-1.4	-2.4	-4.5	-10.6	-6.0	-5.3	.
Other items*	-0.4	1.6	1.6	1.7	5.9	1.6	3.3	.
Eurozone								
GDP growth rate (%)	**3.9**	**1.9**	**0.9**	**0.8**	**2.1**	**1.3**	**0.5**	**2.6**
Consumption	2.2	1.5	1.0	1.0	1.1	1.0	0.6	1.5
Gross fixed investment	1.0	0.1	-0.3	0.2	0.5	0.5	0.0	1.0
Trade balance	0.6	0.7	0.5	-0.6	0.1	-0.2	-0.3	0.1
Other items*	0.1	-0.4	-0.3	0.2	0.4	0.0	0.2	0.0

*) Other items include change in stocks and statistical discrepancies.

Source: wiiw estimates incorporating national sources, Eurostat for Baltic states and eurozone.

the cost of suppressing domestic consumption and/or investment. Occasionally, this export-led growth may serve a good purpose (for example, when the country's foreign debt is dangerously high). Otherwise, more balanced growth would seem preferable – with the bulk of growth coming from the expansion of domestic demand.[1] A policy which bases overall growth exclusively on the performance of the 'export engine' (i.e. through the domestic policies favouring suppression of wages and labour costs, as well as the suppression of domestic demand via restrictive fiscal policies) is unlikely to be successful in the long term. This is evidenced by Germany which, in terms of unit labour costs and (net) exports, has been far outperforming other EU-15 countries. Since 1999 foreign trade has contributed on average 0.8 percentage points to German GDP growth – and domestic demand a mere 0.4 percentage points. In total, German GDP rose at a miserable 1.2% per annum over that period.

Industry: regaining strength once more

After temporary stagnation in the second half of 2004 and the first half of 2005, strong growth of gross industrial output has resumed in all NMS in Central Europe (see Table 4 and Figure 1).

Table 4

Gross industrial production

real change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005 1st quarter	2006 1st quarter	2006 forecast	2007 forecast	Index 1990=100 2005	Index 2000=100 2005
Czech Republic	1.5	6.7	1.9	5.5	9.6	6.7	3.9	15.4	10	8	109.0	134.1
Hungary	18.1	3.6	2.8	6.4	7.4	7.3	1.9	12.9	9	8	197.4	130.5
Poland 2)	6.7	0.6	1.1	8.3	12.6	3.8	0.7	12.4	7	7	220.3	128.8
Slovak Republic	8.4	7.6	6.7	5.3	4.2	3.6	0.3	9.7	9	9	121.5	130.5
Slovenia	6.2	2.9	2.4	1.4	4.8	3.4	-0.2	8.2	5.5	5	103.8	115.8
NMS-5 3)	*7.4*	*3.2*	*2.1*	*6.7*	*10.0*	*5.0*	*1.6*	*12.7*	*8.1*	*7.5*	*169.8*	*129.8*
Estonia	14.6	8.9	8.2	10.9	10.5	9.1	7.1	8.2	9	9	102.9	157.5
Latvia	4.7	9.2	8.4	6.5	6.0	5.6	0.1	9.4	6	5.5	66.4	141.1
Lithuania	2.2	16.0	3.1	16.1	10.8	7.3	3.9	15.4	7	7	60.5	165.1
NMS-8 3)	*7.2*	*3.8*	*2.3*	*7.1*	*9.9*	*5.2*	*1.8*	*9.3*	*8.1*	*7.4*	*157.7*	*131.5*

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

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

The acceleration in industrial expansion is, of course, a reflection of the strength of overall GDP growth. In addition, however, industry appears to be a major driving force behind overall growth. Gross value-added (GVA) in industry (or in manufacturing) appears to be rising much more rapidly than gross industrial output – but also faster than GDP itself (and thus faster than GVA in the remaining sectors, including services). For example, in the Czech Republic GVA in manufacturing rose by a phenomenal 18.5% in real terms (against a meagre 1.3% one year previous). Similar (though less extreme) data are reported for other countries. For Slovenia, the respective GVA

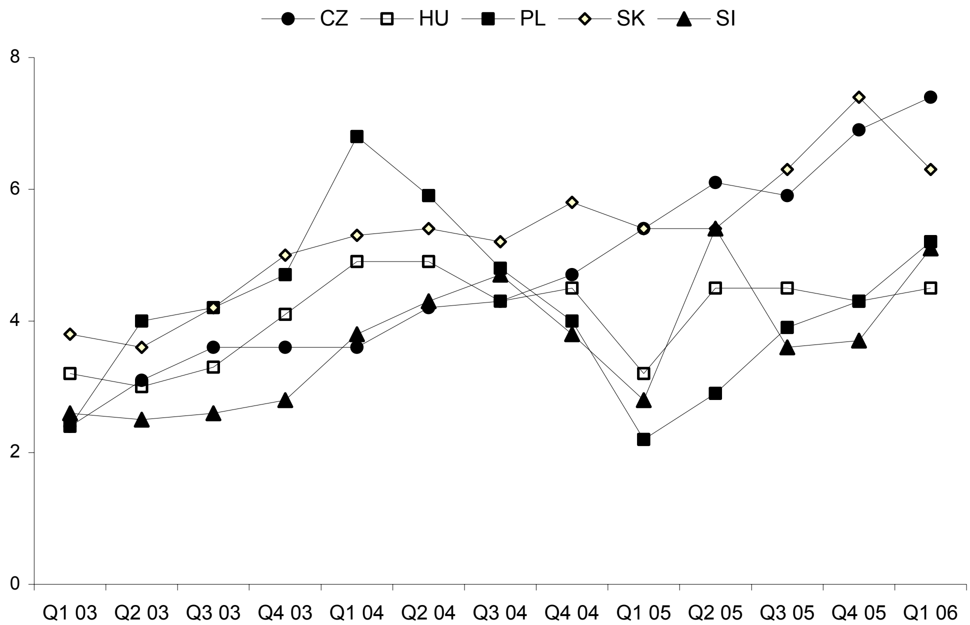
1 This type of growth is observed in Ireland, where the domestic demand contributed 4.4 percentage points to the average GDP growth of 6.3% (1999-2005), with the trade balance adding another 1.9 percentage points.

growth rates were 8.6% and 0% in the first quarters of 2006 and 2005. In Hungary the industrial GVA rose 11.5% and 1.4% , while in Poland it increased by 8.2% and 0.9% respectively.

Figure 1

Quarterly GDP, 2003-2006

real change in % against preceding year



Source: wiiw Monthly Database incorporating national statistics.

Manufacturing in the NMS has been stalwartly refusing to fade into insignificance (as had been expected in the early 1990s). On the contrary, a trend towards re-industrialization is to be discerned. For all its importance, the service sector currently appears less dynamic. The renaissance of manufacturing is certainly related to its having undergone a fundamental restructuring over the past decade and its being firmly supported by high FDI inflows. Under intensified competition (also on external markets) and owing to the growing involvement of foreign direct investors, industry in the NMS is shifting towards more sophisticated ('higher-tech') activities and withdrawing from the low-value-added branches where it can hardly beat the low-price Chinese competition. The structural transformation – of industry (and, in particular, the manufacturing sector) – is well reflected in the outstanding trade performance, with rising price/quality premia in NMS industrial exports (see below).

Another factor possibly underlying the high dynamics of gross value-added in industry (or in manufacturing) seems to be related to the overall improvements in efficiency, even in the traditional branches. Disciplined by the market and no longer (over)protected by governments that have to watch their overall spending, firms in the NMS are now using material production inputs more economically than in the past.[2]

[2] See E. Christie, 'Energy intensity and industry composition: a comparison between selected new and old EU member states', *wiiw Monthly Report*, No.1, 2006, and E. Christie, 'Electricity efficiency in the new EU member states and the accession countries: convergence to Western European levels', *wiiw Monthly Report*, No. 6, 2006.

The acceleration of industrial production growth happens to be combined with remarkable improvements in labour productivity (see Table 5, Figure 2).[3] This has occurred despite industry having started to increase its workforce everywhere (except Hungary).

Rising industrial employment reflects rising demand – especially for skilled labour. Despite high unemployment rates in both Poland and Slovakia, industrial enterprises in both countries have started to signal labour shortages. At the moment, the problem is making itself felt in selected branches/occupations in the countries' most dynamic regions (West Slovakia and Southwest Poland). There is also a growing demand for labour in the Czech Republic, with a growing number of foreigners (primarily Slovaks, Poles and Ukrainians) filling the vacant positions. The rising demand for labour may have supported the perceptibly faster growth in wage rates. In real terms, the average industrial wage in Poland, the Czech Republic and Slovenia rose by 3-4% in the first quarter of 2006; this is faster than a year ago. In Slovakia, where real industrial wages had already leapt upwards the year previous, growth now appears more moderate. Interestingly enough, in Hungary real wages continue to rise at a spectacular speed. This may reflect the particularly low level of unemployment in Hungary – and the correspondingly strong bargaining position that the workers can assume (which was further bolstered by the large wage increases granted to employees in the public sector). The fact that Hungarian industry continues to reduce its workforce could thus be interpreted as a manifestation of ongoing distributive conflict over the division of value-added between labour and capital.

Table 5

Labour productivity in industry

change in % against preceding year

	2000	2001	2002	2003	2004	2005 [1]	2005 1st quarter	2006 1st quarter	Index 1990=100 2005	Index 2000=100 2005
Czech Republic [2]	9.5	5.8	5.8	9.5	10.5	8.2	5.0	13.5	192.8	146.5
Hungary [3]	17.7	4.8	4.6	10.2	10.8	10.7	4.3	16.1	346.3	148.2
Poland [4]	13.6	4.6	6.6	9.7	11.7	2.9	-0.1	10.5	331.5	140.6
Slovak Republic	11.9	6.5	6.5	4.7	3.8	0.6	-2.9	10.7	154.2	124.0
Slovenia	8.4	3.5	5.6	3.6	6.2	5.2	1.0	10	206.5	126.4
Estonia	17.6	15.3	10.3	11.8	10.2	9.1	.	.	.	171.0
Latvia	.	6.9	7.7	6.4	6.9	5.0	.	.	.	137.6
Lithuania	5.5	19.3	5.9	5.9	9.0	7.5	.	.	.	156.7

Notes: 1) Preliminary. - 2) Enterprises with 20 and more employees. From 2001 calculated with sales. - 3) Enterprises with more than 5 employees. - 4) From 2005 enterprises with more than 9 employees.

Source: wiiw Database incorporating national statistics.

Rising wages have not eroded the cost advantages accruing to the NMS. Even with production valued at domestic prices, the industrial unit labour costs keep falling. In Slovenia and Slovakia this is a relatively new trend. (In the Czech Republic, Poland and Hungary industrial unit labour costs have been falling since at least 2002.) In the first quarter of 2006, unit labour costs adjusted for changes in nominal exchange rates against the euro dropped, after a lengthy period of a relatively

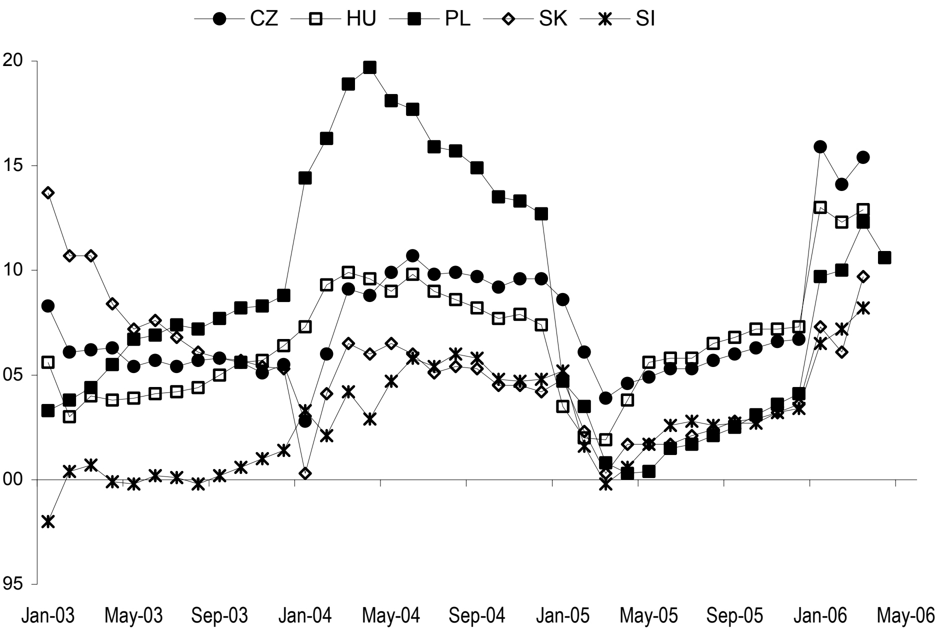
3 Labour productivity growth and growth of industrial output appear to be positively correlated.

pronounced 'deterioration' (i.e. rise). The pronounced increases in the exchange rate-adjusted industrial unit labour costs in 2005 (as well as in other instances in earlier years) reflected irregular movements in nominal exchange rates (see below). Only in Slovenia and Hungary did the present drop in exchange rate-adjusted ULCs appear to be a continuation of earlier trends – in parallel with a weakening of the exchange rates over the long term.

Figure 2

Gross industrial production, 2003-2006

cumulated, year-on-year, growth in %



Source: wiiw Monthly Database incorporating national statistics.

It is common knowledge by now that rising unit labour costs (including those that are exchange rate-adjusted) do not necessarily have a negative impact on foreign trade performance. Qualitative improvements, reflected in rising prices for products exported by the NMS, are certainly offsetting – at least partially – rising unit labour costs. This is also reflected in the longer-run improvements in the terms of trade (especially in the Czech Republic at present).[4] Furthermore, the fact that unit labour costs are rising may be irrelevant (e.g. to foreign investors locating their activities in the NMS) as actual wages (and associated labour costs) are still very low by West European standards (see Appendix, Selected indicators of competitiveness, below).

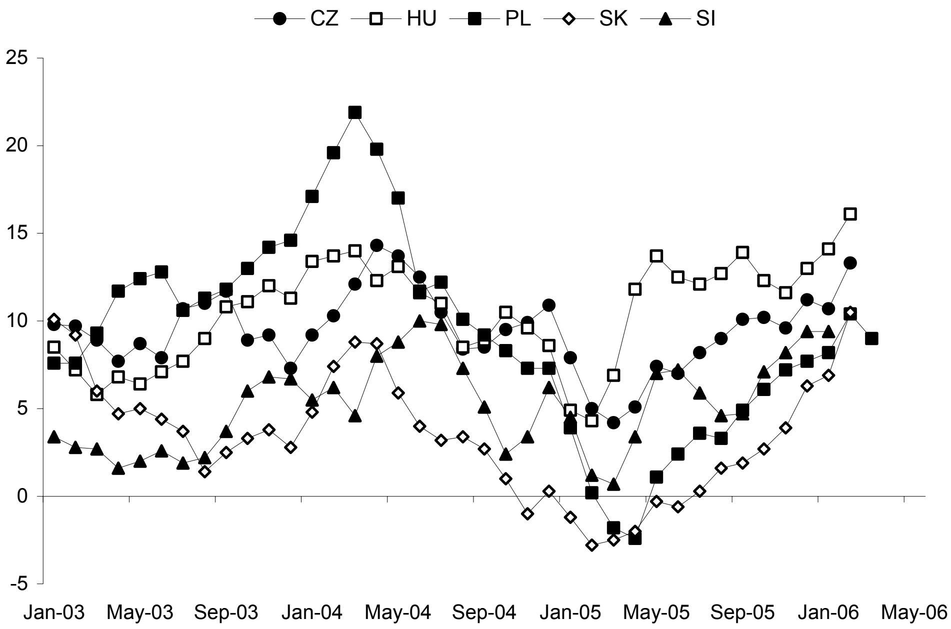
Of course, it must be repeated that unit labour costs are still relevant as far as most traditional labour-intensive activities in the NMS are concerned. For those activities, an unchecked rise in unit labour costs usually proves troublesome (as has already been the case in the textile and apparel industries) – especially when they stem from undue appreciation of domestic currencies. As long as the national economic structures of certain NMS remain dominated by solid traditional activities, undue appreciation of domestic currencies will continue to pose a highly serious macroeconomic threat as well.

[4] See R. Vintrova, 'Alternative indicators of economic growth and real convergence in the transition countries', *wiiw Monthly Report*, No. 2, 2006.

Figure 3

Labour productivity in industry, 2003-2006

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

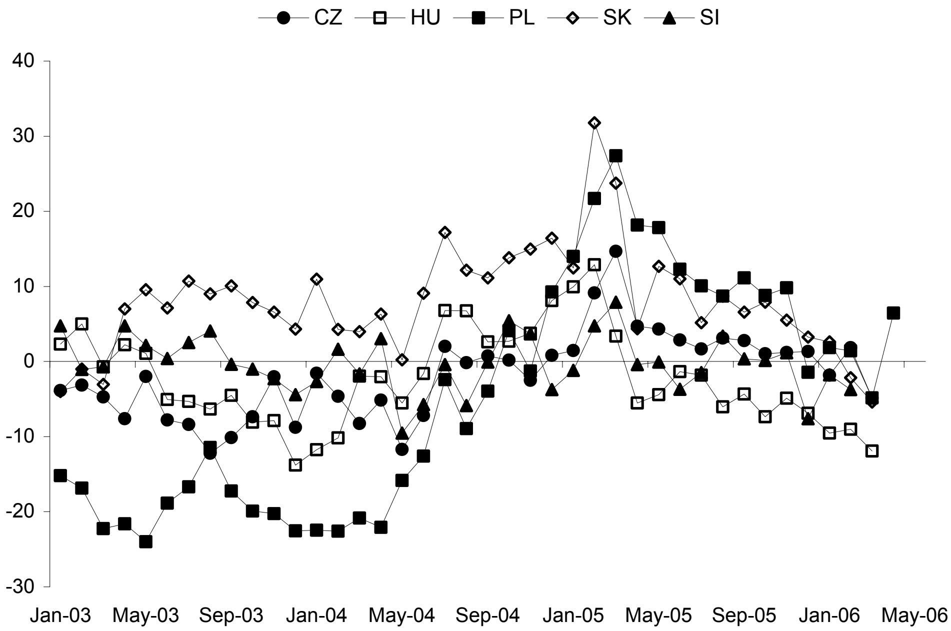


Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Unit labour costs in industry, 2003-2006

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



Source: wiiw Monthly Database incorporating national statistics.

Faster expansion of foreign trade in goods

2004 was an exceptionally successful year in terms of NMS external trade. In 2005 growth in total merchandise exports and imports (expressed in current euros) was less impressive, even though it was in double digits. In the first quarter of 2006 export and import growth accelerated once again, markedly so in Hungary, Slovakia and Slovenia (see Table 6). The far higher prices of energy imports, however, are taking their toll: the differentials between export and import growth rates have narrowed. This has led to larger trade deficits in all countries (except the Czech Republic where despite everything, the trade surplus increased still further).

Table 6

Foreign trade of the new EU member states, EUR million

(based on customs statistics)

		2001	2002	2003	2004	2005 [1]	2006 I-III	2004	2005	I-III 06 / I-III 05
								change in %		
Czech Republic	Exports	37251	40726	43051	53995	62961	17498	25.4	16.6	20.0
	Imports	40675	43025	45243	54824	61606	16544	21.2	12.4	20.7
	Balance	-3424	-2298	-2192	-829	1355	954	.	.	.
Hungary [2]	Exports	34082	36523	38041	44630	49761	13277	17.3	11.5	18.6
	Imports	37654	39939	42189	48550	52599	13919	15.1	8.3	18.9
	Balance	-3572	-3417	-4149	-3920	-2838	-642	.	.	.
Poland	Exports	40375	43400	47511	60014	71715	19864	26.3	19.5	21.4
	Imports	56223	58307	60288	71812	81013	21950	19.1	12.8	20.1
	Balance	-15848	-14907	-12777	-11798	-9298	-2086	.	.	.
Slovakia [3]	Exports	14115	15270	19318	22424	25746	7125	16.1	15.7	27.4
	Imports	16488	17517	19923	23683	27716	7759	18.9	17.9	30.7
	Balance	-2372	-2247	-606	-1259	-1969	-634	.	.	.
Slovenia	Exports	10349	10966	11288	12786	14314	3946	13.3	12.0	18.9
	Imports	11345	11578	12242	14146	15728	4226	15.6	11.2	18.1
	Balance	-997	-612	-954	-1360	-1414	-280	.	.	.
NMS-5	*Exports*	*136172*	*146885*	*159209*	*193849*	*224497*	*61710*	*21.8*	*15.9*	20.9
	Imports	*162385*	*170367*	*179885*	*213015*	*238661*	*64398*	*18.4*	*12.1*	21.0
	Balance	*-26213*	*-23481*	*-20677*	*-19166*	*-14164*	-2688	.	.	.
Estonia	Exports	3698	3642	4003	4769	6193	1721	19.1	29.9	26.9
	Imports	4799	5080	5716	6703	8164	2285	17.3	21.8	31.5
	Balance	-1101	-1437	-1713	-1934	-1970	-565	.	.	.
Latvia	Exports	2233	2418	2560	3204	4110	1018	25.2	28.3	13.8
	Imports	3913	4287	4635	5670	6925	1809	22.3	22.1	27.1
	Balance	-1680	-1868	-2076	-2467	-2815	-791	.	.	.
Lithuania	Exports	4775	5524	6158	7478	9502	2608	21.4	27.1	32.0
	Imports	6762	7941	8526	9958	12446	3382	16.8	25.0	38.5
	Balance	-1987	-2416	-2368	-2480	-2945	-774	.	.	.
NMS-8	*Exports*	*146877*	*158470*	*171929*	*209299*	*244302*	*67056*	*21.7*	16.8	21.3
	Imports	*177858*	*187674*	*198762*	*235346*	*266196*	*71874*	*18.4*	13.2	22.2
	Balance	*-30981*	*-29203*	*-26833*	*-26047*	*-21894*	*-4818*	.	.	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) From 2005 data refer to trade excluding value of goods for repair.

Source: wiiw Database incorporating national statistics.

Table 7

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

(based on customs statistics).

		2002	2003	2004	2005 [1)]	2006	2004	2005 [1)]	I-III 06	2004	2005 [1)]
						I-III			I-III 05	share of EU-25	
							change in %			in % of total	
						279					
Czech Republic	Exports	34477	37153	46409	53000	14735	24.9	14.2	19.9	85.9	84.2
	Imports	31069	32303	39375	43662	11683	21.9	10.9	20.5	71.8	70.9
	Balance	3409	4850	7034	9338	3052	.	.	.	.	.
Hungary [2)]	Exports	29885	30877	35472	37960	10084	14.9	6.8	15.3	79.5	76.3
	Imports	25444	26613	34814	35688	9389	8.4	1.7	15.8	71.7	67.8
	Balance	4441	4263	658	2272	695	.	.	.	.	.
Poland	Exports	34822	38392	47548	55389	15575	23.9	16.5	21.2	79.2	77.2
	Imports	40428	41699	49020	53114	13810	17.6	8.4	16.0	68.3	65.6
	Balance	-5606	-3307	-1472	2276	1764	.	.	.	.	.
Slovakia [3)]	Exports	13449	16339	19112	21988	6224	17.0	16.1	26.3	85.2	85.4
	Imports	12815	14812	17463	19714	5123	17.9	14.0	25.4	73.7	71.1
	Balance	634	1527	1649	2274	1101	.	.	.	.	.
Slovenia [2)]	Exports	7402	7551	8507	9688	2787	12.7	13.9	20.8	66.5	67.7
	Imports	8840	9258	11649	12722	3315	14.6	9.2	19.9	82.3	80.9
	Balance	-1438	-1706	-3143	-3034	-528	.	.	.	.	.
NMS-5	*Exports*	*120035*	*130312*	*157047*	*178025*	49405	*20.5*	*13.5*	20.2	*81.0*	*79.3*
	Imports	*118596*	*124686*	*152320*	*164898*	43321	*16.2*	*8.4*	18.5	*71.5*	*69.1*
	Balance	*1439*	*5627*	*4727*	*13126*	6084	.	.	.	.	.
Estonia [2)]	Exports	2974	3298	3819	4814	1185	15.8	26.0	11.2	80.1	77.7
	Imports	3485	3699	5203	6201	1591	18.5	19.2	22.0	77.6	76.0
	Balance	-511	-401	-1384	-1388	-406	.	.	.	.	.
Latvia [2)]	Exports	1879	2030	2475	3138	758	21.9	26.8	9.4	77.2	76.4
	Imports	3310	3494	4278	5205	1324	21.2	21.7	31.3	75.5	75.2
	Balance	-1431	-1464	-1804	-2067	-565	.	.	.	.	.
Lithuania [4)]	Exports	3822	3849	5000	6221	1698	29.9	24.4	20.3	66.9	65.5
	Imports	5258	5561	6259	7359	1959	12.6	17.6	34.7	62.9	59.1
	Balance	-1435	-1712	-1260	-1138	-261	.	.	.	.	.
NMS-8	*Exports*	*128711*	*139489*	*168340*	*192197*	*53047*	*20.7*	*14.3*	19.8	*80.4*	*78.7*
	Imports	*130649*	*137439*	*168061*	*183664*	*48195*	*16.2*	*9.4*	19.5	*71.4*	*69.0*
	Balance	*-1938*	*2050*	*280*	*8533*	*4852*	.	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2005 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.

NMS trade with the EU-25 also bounced back in the first quarter of 2006 (see Table 7). Primarily this should reflect stronger overall growth in the EU-15; however, the growth rate displayed by NMS trade with the EU-25 is far larger than the expansion of EU total trade or GDP. The Czech Republic, Hungary, Poland and Slovakia, all have high and rising surpluses in trade with the enlarged EU. The combined trade surplus of those four NMS rose from EUR 4.9 billion in the first quarter of 2005 to EUR 6.6 billion in the first quarter of 2006. Slovenia, however, has suffered a (rising) deficit in trade with the enlarged EU, reflecting the fact that the EU market is generally less important to that country (which still maintains, and further develops, quite close trading links with other successor states to former Yugoslavia).

Table 8

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

(based on customs statistics)

		2002	2003	2004	2005 [1]	2006 I-III	2004	2005 [1]	I-III 06 / I-III 05	2004	2005
							change in %			share of NMS-8 in % of EU-25	
Czech Republic	Exports	6620	7086	9535	11375	2905	34.6	19.3	26.3	20.5	21.5
	Imports	5166	5498	7144	8162	2325	29.9	14.3	40.5	18.1	18.7
	Balance	1454	1588	2391	3212	580	.	.	.	.	.
Hungary [2]	Exports	2444	2869	3874	5442	1588	35.1	40.5	37.3	10.9	14.3
	Imports	2977	3407	4476	5319	1365	22.8	18.8	22.1	12.9	14.9
	Balance	-533	-538	-602	123	224	.	.	.	.	.
Poland	Exports	5002	5721	7081	.	3212	23.8	.	36.8	14.9	.
	Imports	4457	4837	6167	.	2340	27.5	.	26.7	12.6	.
	Balance	545	884	915	.	872	.	.	.	.	.
Slovakia [3]	Exports	4202	4605	5735	7118	.	24.5	25.1	.	30.0	32.4
	Imports	4001	4581	5774	6903	.	26.0	20.5	.	33.1	35.0
	Balance	201	24	-39	216	.	.	.	.	.	.
Slovenia [2]	Exports	893	956	1068	1233	.	11.7	15.4	.	12.6	12.7
	Imports	969	1023	1275	1438	.	19.2	12.8	.	10.9	11.3
	Balance	-76	-67	-207	-205	.	.	.	.	.	.
NMS-5	*Exports*	*19161*	*21237*	*27294*	.	.	*28.5*	.	.	*17.4*	.
	Imports	*17570*	*19346*	*24836*	.	.	*26.4*	.	.	*16.3*	.
	Balance	*1591*	*1891*	*2458*	.	.	.	.	.	.	.
Estonia [2]	Exports	498	562	850	1072	279	51.4	26.1	26.8	22.3	22.3
	Imports	545	646	1081	1358	388	34.8	25.7	40.6	20.8	21.9
	Balance	-46	-84	-230	-286	-109	.	.	.	.	.
Latvia [2]	Exports	419	447	730	1202	293	63.5	64.6	17.1	29.5	38.3
	Imports	1040	1132	1629	2186	549	30.3	34.2	35.1	38.1	42.0
	Balance	-622	-685	-899	-984	-256	.	.	.	.	.
Lithuania [4]	Exports	1082	1197	1596	2182	606	33.4	36.7	43.0	31.9	35.1
	Imports	1325	1453	1823	2253	637	25.5	23.6	47.8	29.1	30.6
	Balance	-243	-256	-227	-71	-31	.	.	.	.	.
NMS-8	*Exports*	*21160*	*23442*	*30471*	.	.	*30.0*	.	.	*18.1*	.
	Imports	*20480*	*22576*	*29369*	.	.	*26.9*	.	.	*17.5*	.
	Balance [5]	*680*	*866*	*1102*	.	.	.	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2005 data refer to trade excluding value of goods for repair. - 4) From 2003 dispatches and arrivals according to Intrastat methodology. – 5) Positive balance is due to valuation effects (exports:fob, imports:cif).

Source: wiiw Database incorporating national statistics.

The (incomplete) data on mutual trade among the NMS indicate that this part of trade is expanding at record rates (see Table 8). The recent integration of the NMS in EU trade is a natural development given the countries' geographical proximity, their strong growth performance and their current rapid structural transformation. Last but not least, it is a by-product of EU accession, which has eliminated completely the trade barriers erected at the beginning of the 1990s. High foreign direct investment in individual NMS has also brought about a rapid rise in mutual trade. Large multinationals (e.g. in the automotive industry) have affiliates (e.g. producers of components) located beyond NMS borders. Internal transactions between those firms happen to constitute significant components of international and intra-NMS trade.

NMS gain export market shares and improve export quality*

NMS foreign trade has thus maintained its exceptional dynamism. In the first quarter of 2006, both NMS exports and imports of goods increased by more than 20% in nominal EUR terms, surpassing the previous year's growth. With an increase of close on 30%, trade expansion was particularly strong in Slovakia, Estonia and Lithuania. As in the recent past, trade with the EU increased at a somewhat lower rate than overall NMS exports and imports – reflecting slower market growth in the 'old' EU. Still, close to 80% of NMS exports and 70% of imports are traded within the EU: a very high degree of trade integration.

NMS are also opening up more to (or heightening their dependence on) trade in goods – though to different degrees. In general, smaller countries are more open to trade. Over the period 1995-2005, in the NMS the share of exports in GDP increased on average by 17 percentage points to more than 45%. Over the past decade, openness to trade increased most in Hungary, Slovakia and the Czech Republic, which (together with Estonia) are highly dependent on the export of goods.

The NMS continue to gain market shares in both EU and world trade.[5] The NMS share in total (both extra- and intra-) EU-25 imports increased by 60% over the period 1999-2005 (from 3.7% in 1999 to 5.9% in 2005). Even more impressive were the longer-term gains in the market shares that the NMS secured in the EU-15; they rose from 2.6% in 1995 to 4.5% in 2004: an increase of 73% over that period. Successful export performance and the related industrial restructuring are to be seen not only at the aggregate level, but they are also particularly evident in medium-high-tech industries. Figure 5 shows the changes in market shares and relative export prices in NMS exports to the EU-15 (as well as those of Bulgaria, Romania and Croatia), by groups of industries.[6]

As can be seen, the Czech Republic, Poland, Slovakia and Hungary have been gaining strongly in terms of their EU market shares – especially in medium-high-tech industries (which include chemicals, machinery and equipment, electrical machinery and apparatus, motor vehicles, other transport equipment). At the same time they have also been gaining in terms of prices received for their exports, hence in terms of improved product quality as well. Those four countries can thus be seen to be competing successfully with higher quality – not merely with lower prices. As for high-tech exports, the four countries have been less successful in terms of higher prices/quality. Nonetheless the Czech Republic and Hungary have also increased their market shares in those products (which include such items as office machinery and equipment, computers, radio, television and communications equipment, medical, precision and optical instruments). As for traditional low-tech

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* This section was written by Peter Havlik.

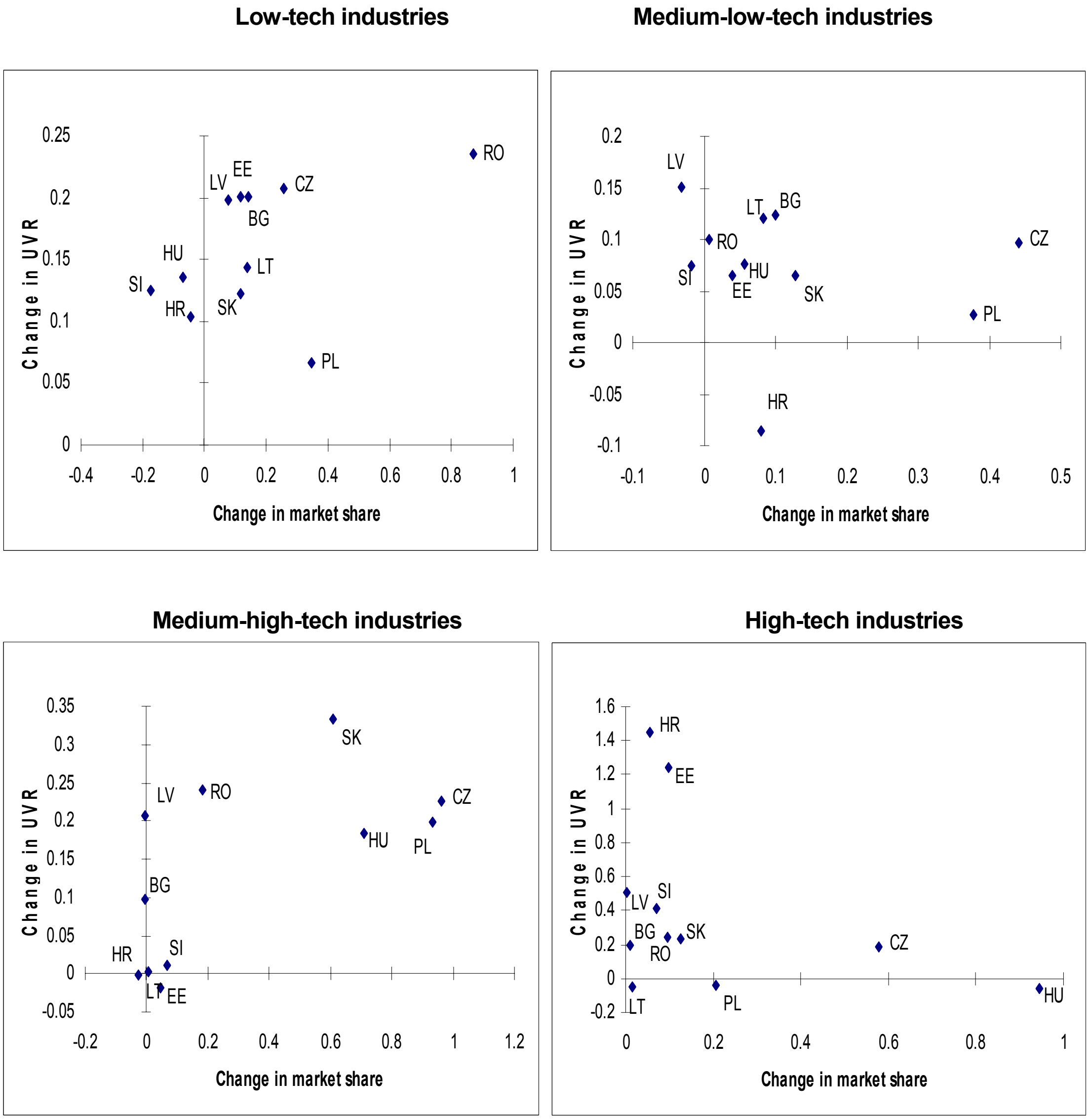
[5] Total intra-EU-25 trade exports increased by 13% in the first four months of 2006, the overall extra-EU-25 exports by 14%, as exports to China, Russia and Turkey grew by close on 30%.

[6] Relative export prices compared to other competitors – unit value ratios (UVR). Changes in UVR represent the gains in export prices in the specific manufacturing product group (relative to prices of all EU imports in that group) – for details see M. Landesmann and J. Wörz, 'CEECs' Competitiveness in the Global Context', *wiiw Research Reports*, No. 327, May 2006.

products, most countries have achieved significant gains – in terms of both prices and market shares. The latter gains were particularly high in Romania. A similar situation obtains in medium-low-tech products; both the Czech Republic and Poland seem to have secured large gains on both counts.

Figure 5

Changes in quality/price competitiveness and market shares in EU-15 markets, 1995/98 to 2002/04



Source: wiiw calculations. UVR (Unit Value Ratio) refers to the relative export price (see Landesmann and Wörz, 2006).

Another indicator bearing witness to improving NMS trade competitiveness is the evolution of their trade balances. Overall NMS trade deficits have gradually dropped (despite rising energy prices which add slightly to NMS import growth),[7] and the surpluses in trade with the EU have even been growing. After Hungary, the Czech Republic and Slovakia, even Poland recorded a trade surplus with the EU for the first time ever in 2005. Data for the first months of 2006 suggest that these positive developments will continue, at least in the short term (Table 7).

There is every reason to expect generally favourable trade developments also over the medium to long term:

- *FDI inflows support industrial restructuring*. FDI inflows to NMS reached a new record in 2005 (about EUR 26 billion). The flows are expected to continue (albeit at a slightly lower level), not least since international companies in the region are earning more. A large segment of FDI stocks (about 40%) went into manufacturing and contributed to structural and quality upgrading in industry.[8]
- *Maintaining costs competitiveness*. Despite a clear trend towards rising costs (including labour costs), the countries in Central and Eastern Europe remain cost-competitive. Although ULCs have shown an upward trend in all NMS (slowest of all in Slovenia) over the past decade, estimated ULC levels (taking into account estimated productivity differentials) are still less than half those in Austria (except Slovenia where ULCs amount to approximately 70% of those in Austria. (See Appendix: Selected Indicators of Competitiveness).
- *Productivity outstrips labour cost increases*. The evolution of ULCs is the outcome of a number of factors, including exchange rate movements. Wage increases and currency appreciation, both of which contribute to a rise in ULCs, have usually been partly offset by productivity improvements, even at the macro (GDP) level.[9] Since productivity improvements in NMS industries have been even more impressive than macro-productivity (whereas industrial wages usually develop in line with aggregate wages), we can assume that the ULCs in industry are still highly competitive.

Lower fiscal deficits reported

It has been reported[10] that the share of general government budget deficits in the GDP is declining in all NMS, except Hungary.

Hungary's problems with public finances have a very long history (dating back to the old days of 'planned economy'). More recently, in the early 1990s, the fiscal deficits, combined with an inflexible exchange rate policy, plunged Hungary into a crisis that called for rather harsh counter-measures in

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7 In 2004, about 5.5% of NMS imports consisted of energy carriers (including refined products).

8 See *wiiw Database on Foreign Direct Investment in Central, East and Southeast Europe: Increasing Significance of Repatriated and Reinvested Earnings*, by G. Hunya (concept and analysis) and M. Schwarzhappel (database), May 2006.

9 Detailed data are to be found in Appendix Table A/3. For more details on the methodology see P. Havlik, 'Unit Labour Costs in the New EU Member States', *wiiw Statistical Reports*, No. 1, January 2006.

10 The official fiscal statistics turn out to be highly 'volatile'. Generally, the authorities keep 'revising' the data – even for the past. For example, a couple of months ago the official fiscal deficit/GDP ratio in the Czech Republic for 2003 was 11.3%. This figure has since been 'rectified' and now stands at 6.7%. Similarly, major changes obscure the truth about the actual fiscal position in the remaining NMS (in the Baltic countries as well). As a rule more recent estimates suggest lower deficits or higher surpluses. While there may be valid substantive reasons for the continual revisions, one may also suspect there being purely 'decorative' motives. Of course, this would have to be viewed in the context of the EU Commission's obsession with fiscal deficits in the member states.

1995 (the 'Bokros Package'). Memories of that painful lesson have since faded away. As of 2001, large fiscal deficits have been reported in Hungary (see Table 9). For the most part, these were due to the dominance of populist politicking over economic policy (with generous spending shooting upwards far ahead of taxation). In addition, the three-pillar pension system introduced in the late 1990s is incurring sizeable losses for public finances. The high deficits of recent years have been adding to public debt, which currently comes close to 60% of GDP (the highest of all NMS). The impact of the debt increases and deficits is compounded by the interest rates which are still relatively high in Hungary (matching the relatively high inflation rate). All in all, Hungary's financial situation has become increasingly fragile. In view of the country's exceptionally high (by the NMS standards) foreign debt (68% of the GDP at end-2005), a further rise in the fiscal deficit and public debt can only bear grave consequences for the exchange rate, capital outflows and interest rates. It is therefore not surprising that the recently re-elected Hungarian government has announced a package of measures designed to raise tax revenues and cut spending. Interestingly enough, the tax measures run counter to the recent fashion favouring lower progression in personal taxes and lower corporate income tax rates. This does not mean that the measures announced will spare the low-income social groups. They too will be hit – by the increase in the VAT rates.[11]

The official projection for fiscal deficit/GDP ratio in Hungary for the current year stands at 8% and for next year at 5%. An energetic and credible realization of the consolidation programme may convince the public (including Hungary's foreign creditors and holders of the Hungarian treasury bonds) that improvements are just around the corner. This would reduce – though not entirely eliminate – the risks of an exchange rate crisis.

Table 9

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

	1995	2000	2001	2002	2003	2004	2005 [2)]	2006 forecast	2007 forecast
Czech Republic	-13.4	-3.7	-5.9	-6.8	-6.6	-2.9	-2.6	-3.2	-3.4
Hungary	.	-3.0	-3.5	-8.4	-6.4	-5.4	-6.2	-8	-5
Poland	-4.4	-1.5	-3.7	-3.2	-4.7	-3.9	-2.5	-3.0	-3.0
Slovak Republic	-0.9	-12.2	-6.5	-7.7	-3.7	-3.0	-2.9	-2.7	-2.1
Slovenia	.	-3.9	-4.3	-2.7	-2.8	-2.3	-1.8	-1.9	-1.6
Estonia	0.4	-0.4	0.3	1	2.4	1.5	1.6	1.4	0.8
Latvia	-2.0	-2.8	-2.1	-2.3	-1.2	-0.9	0.2	-1.0	-1.0
Lithuania	-1.9	-3.6	-2.0	-1.4	-1.2	-1.5	-0.5	-0.6	-0.9

Notes: 1) EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure. - 2) Preliminary.
Source: EUROSTAT; forecasts by European Commission, Hungary by wiiw.

In the remaining NMS, the fiscal deficits reported for 2005 are comparatively low (less than 3% of GDP). However, fiscal deficits are expected to deteriorate, albeit insignificantly, in Poland and the Czech Republic, while things may improve in Slovakia which has set as its target accession to the eurozone before 2010. Overall, public debt levels in all other NMS (except Hungary) are low or very low (as in the Baltic countries and Slovenia). All in all, these countries are most unlikely to fall victims

[11] See the Hungarian country report for an evaluation of the fiscal consolidation measures.

to turbulence unleashed by a misperception of fiscal deficits and public debt as being out of control. Of course, experience has shown that turbulence (for example, on the foreign exchange market) can strike fiscally (and otherwise) sound economies a swingeing blow. Insofar as they are unprovoked or undeserved, crises of this kind are essentially unpredictable. We have no valid reason to believe that they will occur in the NMS (although regrettably Hungary may well be hit).

Lower inflation, exchange rates likely to stop strengthening

In 2005 inflation dropped substantially in the NMS in Central Europe and increased somewhat in the three Baltic states. These trends have also continued on into the first quarter of 2006 (see Tables 10a and 10b). Inflationary acceleration in the Baltic countries is taking place amidst continuing 'explosive' growth (mostly part fuelled by the rapid expansion of consumer credit). The rise in fiscal surpluses (in Estonia and Lithuania) or the drop in deficits (in Latvia) have proved insufficient: much harsher fiscal suppression would be needed to check inflation (thereby – most probably – also putting an end to strong real growth itself). Apparently, the authorities in the Baltic countries are not prepared to sacrifice strong growth on the altar of price stability. As a result of this attitude, the attempts of Estonia and Lithuania to join the euroclub at the beginning of 2007 have been foiled. (The two countries failed, by a tiny margin, to meet the Maastricht inflation criterion)[12]. It is worth noting that under the currency board arrangements, applied in the Baltic states, the monetary authority has no effective control over interest rates; hence, they cannot avail themselves of customary monetary policy, such as the manipulation of short-term interest rates. This is a lesson which in due time will have a bearing on the EU-accession of other candidate countries which have pursued a currency board (or fixed peg) regime (e.g. Bulgaria or – in due time – Montenegro).

In the first quarter of 2006 inflation, which in 2005 had been comparatively low in both the Czech Republic and Poland, firmed up slightly in the first country and dropped further in the second. In neither country have markedly higher energy/fuel prices unleashed any perceptible inflationary pressures. (In Hungary, where household energy prices have been heavily subsidized, the shock will only come this summer; the huge price hikes have already been announced). Only in Slovakia is inflation accelerating perceptibly. This is understandable given the fact that Slovakia (like the Baltic states) has experienced a protracted and pronounced expansion of domestic demand. Interestingly enough, the Slovak National Bank does not seem to have panicked. It raised its interest rates very reluctantly. In real terms they had been negative for over a year. The National Bank of Poland (NBP) has adopted an utterly different approach. It has kept interest rates high (comparable to those in Slovakia, see Figure 6) despite the fact that inflation, currently running at less that 1%, is much lower than in Slovakia (currently in excess of 4%). There are good grounds to expect inflation to persist in Slovakia (all the more so as producer prices in Slovak industry are also rising at extraordinary speed). Persistent inflation in Slovakia would certainly constitute an unwelcome development – if only because it would bear out expectations of eventual restrictions on monetary policy. That tightening, however, must come at some juncture if the Slovak authorities are serious about their intentions of entering the eurozone before 2010. However, expectations of rising interest rates are likely to give rise to a further strengthening of the Slovak currency – despite the current low interest rates.

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12 There are good reasons for viewing the refusal to admit the two countries as being politically rather than economically motivated. Despite sustained high growth, the two countries are still among the poorest in the enlarged EU. This seems to be an obstacle to being accepted into the eurozone, which has proven to be a club of the reasonably rich. The acceptance of Slovenia is not surprising, as it is more affluent than two current members of the eurozone: Greece and Portugal.

Poland faces a different challenge. Given that consumer price inflation is very low and producer prices in Polish manufacturing have followed a (mildly) deflationary path for about two years, the country runs the risk of instigating full-blown deflation. The non-financial business sector in Poland may have been instinctively anticipating that risk. (It has been accumulating huge liquid assets – for example, in the form of bank deposits). Despite large and rising profits, the sector is reluctant to expand fixed assets. Of course, the NBP bears the responsibility for this development as it has repeatedly failed to meet its own inflation target of 2.5%. It is uncertain, however, whether the NBP will heed the danger of deflation and act accordingly. If it does and interest rates are lowered, the Polish currency could avoid appreciation. Under those circumstances, the losses 'suffered' by the zloty in recent months would not be reversed: something that would please Poland's export sector.

Table 10a

Consumer price inflation

change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
							1st quarter		forecast	
Czech Republic	3.9	4.7	1.8	0.1	2.8	1.9	1.7	2.8	2.8	2.5
Hungary	9.8	9.2	5.3	4.7	6.8	3.6	3.6	2.5	3.5	6
Poland	10.1	5.5	1.9	0.8	3.5	2.1	3.6	0.8	2	2
Slovak Republic	12.0	7.1	3.3	8.5	7.5	2.7	2.8	4.3	4	3.5
Slovenia	8.9	8.4	7.5	5.6	3.6	2.5	2.6	2.2	2.6	2.4
Estonia	4.0	5.8	3.6	1.3	3.0	4.1	4.6	4.4	3.5	3
Latvia	2.6	2.5	1.9	2.9	6.2	6.7	6.7	7.0	6	4.5
Lithuania	1.0	1.3	0.3	-1.2	1.2	2.7	3.2	3.4	3	2.8

Note: 1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

Table 10b

Producer prices in industry

change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
							1st quarter		forecast	
Czech Republic	4.9	2.8	-0.5	-0.4	5.7	3.0	6.9	0.3	3	2
Hungary	11.6	5.2	-1.8	2.4	3.5	4.3	4.0	4.7	5.7	7
Poland	7.8	1.6	1.0	2.6	7.0	0.7	3.3	0.6	1	1.5
Slovak Republic	10.8	6.5	2.1	8.3	3.4	4.7	2.5	9.5	8	6
Slovenia	7.6	8.9	5.1	2.5	4.3	2.7	4.3	1.6	2.5	2.4
Estonia	4.9	4.4	0.4	0.2	2.9	2.1	3.3	3.1	.	.
Latvia	0.6	1.7	1.0	3.2	8.6	7.8	10.5	7.5	.	.
Lithuania	16.0	-3.0	-2.8	-0.5	6.0	11.5	9.1	13.0	.	.

Note: 1) Preliminary.

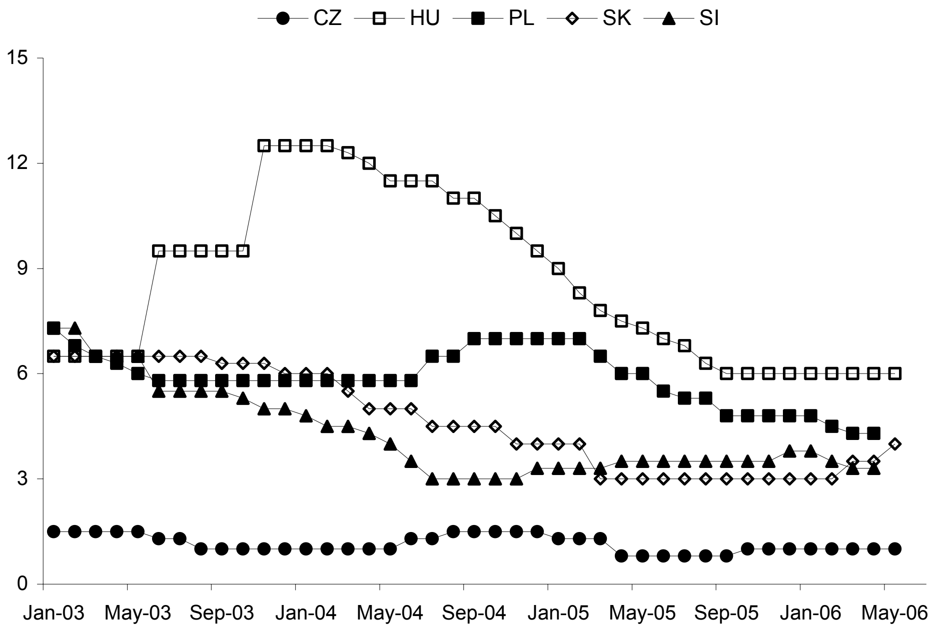
Source: wiiw Database incorporating national statistics, forecast: wiiw.

Inflation in the Czech Republic and Hungary should remain under control in both 2006 and 2007. Despite some increase in current inflation, it is still lower than the Czech National Bank's (CNB) own target. There are no reasons to expect a change in the realistic and pragmatic policy of the CNB. In Hungary some inflationary acceleration in 2007 will ensue in the wake of the increases in VAT rates and certain administrative prices (which are an essential part of the fiscal consolidation package). However, a tax-induced acceleration of inflation of this kind tends to be temporary. By reducing domestic demand, tax-induced inflation is likely in the final analysis to prove deflationary. It is to be hoped that the Hungarian National Bank will not overreact to inflation in 2007. None the less, some increases in Hungarian interest rates appear likely. Providing the fiscal consolidation process gains in credibility, this might even strengthen the Hungarian currency.

Figure 6

Minimum interest rates, 2003-2006

nominal NB leading rate in % p.a.



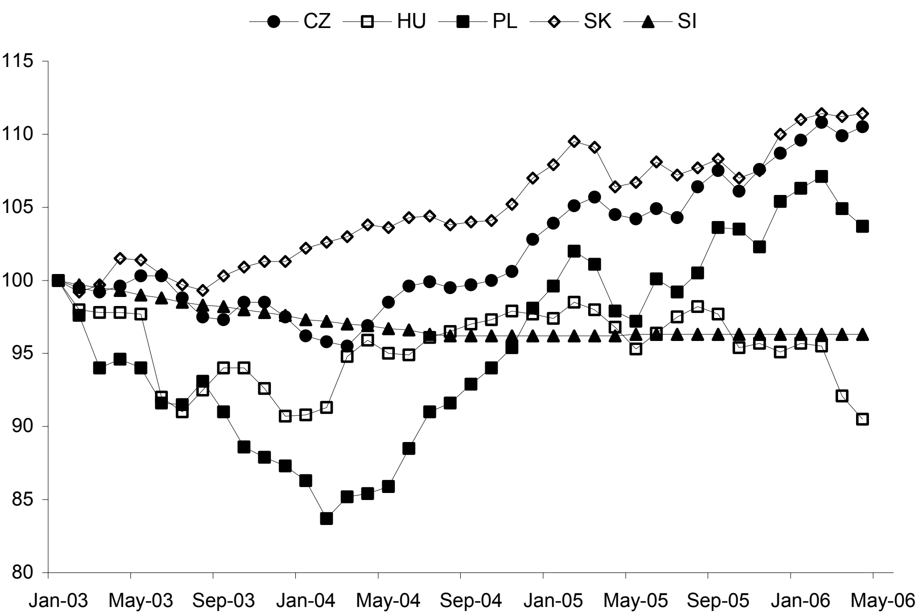
Source: wiiw Monthly Database incorporating national statistics.

In the first quarter of 2006 both the Hungarian and Polish currencies weakened against the euro, while the Slovak and Czech currencies grew no stronger. The weakening of the Hungarian currency, which had been on the cards since the second half of 2004 (see Figure 7a), may be attributed to: (i) persistence of exceedingly high current account deficits; (ii) relatively weak stream of FDI inflows (in relation to the current account deficits); (iii) large – and rapidly growing – foreign debt; (iv) the imminent crisis in public finances (current fiscal deficit and concerns over the sustainability of public debt). Over and above the factors specific to Hungary, international financial investors underwent a general change in mood. Rising interest rates in the US and the eurozone have reduced the attraction of investing in 'emerging markets' – irrespective of the merits of individual countries. The NMS – primarily Poland – were also slightly affected. Although, unlike Hungary, Poland's current account deficits are small (and falling), its foreign debt moderate, its FDI inflows high, and public finances in much better shape than before, the Polish currency has weakened. This can be partly attributed to heightened uncertainty over the course of the conservative-populist government's

Figure 7a

Nominal exchange rates*, 2003-2006

NCU per EUR, monthly average, January 2003 = 100



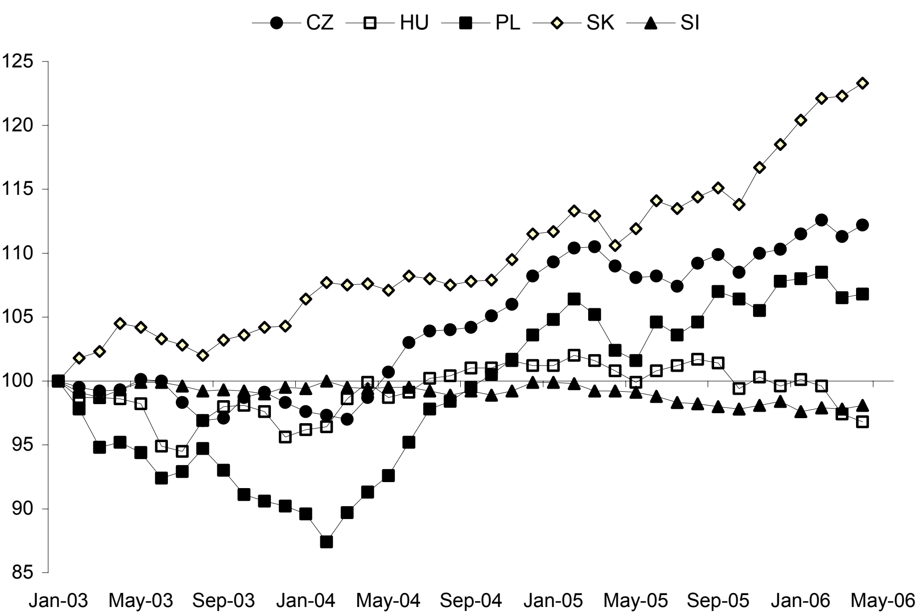
*) Increasing line indicates appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Figure 7b

Real appreciation*, 2003-2006

NCU per EUR, PPI-deflated, in % against January 2003



*) Increasing line indicates appreciation.

Source: wiiw Monthly Database incorporating national statistics.

economic policy. Moreover, the fact that the NBP lowered interest rates (twice) in the first quarter of 2006 (whereas they were increased in the US and the eurozone) may have played an important role. Otherwise, the weakening of the Polish currency must be ascribed to 'contagion'. In the case of the Czech Republic 'contagion', which took the form of exchange rate stabilization, was probably weak because of the reports of the Czech economy's excellent real performance (as well as its low CA deficits and high FDI inflows). The stability of the Slovak exchange rate may have something to do with the country's generally good image (as a paragon of 'business-friendliness'). Of course, the smallness of the Slovak financial market makes it an improbable venue for many of the international speculators. On much the same principle, 'contagion' did not have any observable impact on Slovenia or the Baltic countries.

In 2006 the risks (and ensuing potential costs) associated with sudden capital outflows and/or major devaluation do not seem to loom large in most NMS. Furthermore, in 2007, with rising transfers from the EU budget, those risks are likely to diminish still further. As already discussed, these risks may be higher in Hungary, where the persistent current account deficits are very large (and unlikely to be offset fully by the FDI inflows (see Tables 11 and 12) and/or EU transfers. Otherwise, no symptoms of an impending crisis are to be observed. On the contrary, a gradual weakening of the nominal exchange rates would seem beneficial, especially in Slovakia and Poland – but, of course, in Hungary as well. Unlike the Czech Republic, those three countries are still running trade deficits – under those circumstances, weaker real exchange rates could well be an advantage.

The accession of Slovakia to the Exchange Rate Mechanism 2 restricts its scope for manoeuvre. The monetary policy must be such that it guards against exchange rate fluctuations. This may prove difficult to combine with meeting the Maastricht inflation criterion. Last, but not least, with an inflexible exchange rate, Slovakia may be unable to stop its trade and current account deficits ballooning. Unlike the Baltic countries, this may turn out to be a brake on real GDP growth.

Table 11

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			
	2003	2004	2005	2003	2004	2005	2004	2005	2006 forecast	2007 forecast	2004	2005	2006 forecast	2007 forecast
Czech Republic	27.6	33.2	38.8	21.3	20.9	25.1	-5.2	-2.1	-2.0	-2.0	-6.0	-2.1	-1.8	-1.7
Hungary	46.0	55.1	66.3	10.1	11.7	15.7	-7.0	-6.5	-6.4	-5.6	-8.6	-7.4	-7.4	-6.0
Poland	84.8	94.3	109.8	26.0	25.9	34.5	-8.5	-3.5	-3.8	-3.8	-4.2	-1.4	-1.5	-1.4
Slovak Republic	14.7	17.4	22.7	9.7	11.0	13.1	-1.2	-3.3	-2.5	-2.5	-3.6	-8.6	-5.7	-5.0
Slovenia	13.3	15.3	19.6	6.8	6.5	6.8	-0.5	-0.3	-0.4	-0.3	-2.1	-1.1	-1.2	-1.0
Estonia	5.6	7.3	9.5	1.1	1.3	1.6	-1.1	-1.1	-1.2	-1.2	-12.7	-10.5	-9.8	-9.0
Latvia	7.5	9.8	12.8	1.1	1.4	1.9	-1.4	-1.6	-1.9	-2.1	-12.9	-12.5	-13.1	-12.6
Lithuania	6.7	7.7	10.5	2.7	2.6	3.1	-1.4	-1.4	-1.7	-1.9	-7.7	-7.0	-7.3	-7.4

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

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

Table 12

FDI inflow to NMS, EUR million

	2000	2001	2002	2003	2004	2005 [1)]	2005 [1)] in % CA	2005 [1)] stock
Czech Republic	5404	6296	9012	1863	4007	8837	427	50404
Hungary	2998	4391	3185	1888	3754	5215	80	51737
Poland	10334	6372	4371	4067	10279	6132	175	70000 [2)]
Slovakia	2089	1768	4397	593	1016	1694	52	13000 [2)]
Slovenia	149	412	1700	300	662	427	142	6000 [2)]
New Member States-5	*20974*	*19239*	*22665*	*8710*	*19718*	*22304*	*142*	*191141*
Estonia	425	603	307	822	838	2232	202	10371
Latvia	447	147	269	260	563	503	32	4035
Lithuania	412	499	772	160	623	807	56	5446
New Member States-8	*22258*	*20488*	*24013*	*9952*	*21742*	*25846*	*130*	*210994*

1) Preliminary. - 2) wiiw estimate.

Note: CA means current account deficit.

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.

Outlook: high growth in 2006, some slowdown in 2007

Growth in gross fixed investment will accelerate in 2006; it will also remain quite strong in 2007. Industrial production will continue to expand rapidly, also on account of stronger growth of domestic demand. With the exception of Hungary, fiscal policy will not interfere substantially with real growth. Under the impact of faster growth in the EU-15, NMS exports will perform well in 2006 and – given the ongoing gains in competitiveness – in the period thereafter. Trade expansion has been bolstered by a slowdown in nominal appreciation and the continuing gains in unit labour costs. Generally, external trade will continue to be an important source of overall growth in the Czech Republic, Poland, Hungary and Slovenia. Its role, however, will still diminish, yielding to the more pronounced impact of rising investment and consumption and thus making for more balanced overall growth.

The deceleration of growth in the EU-15 expected in 2007 is likely to restrict growth in terms of both NMS exports and overall GDP. However, the scale of slowdown is likely to be small, especially in view of further gains in unit labour costs and ongoing structural changes and quality improvements in production and exports. The generally positive outlook for 2006 and 2007 is predicated on the absence of any major turbulence on the exchange rate markets. This assumption is not without its risks, at least as far as Hungary is concerned. It is to be hoped that the Hungarian fiscal consolidation programme proves credible and pre-empts excessive adjustments. Poland faces a risk of a different type. Disinflation in Poland seems to have gone too far. Should this develop into outright deflation, Poland may plunge into destructive recession.

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

Growth is likely to remain strong – but arguably less buoyant than the previous year. The revival of fixed investment and private consumption (the latter supported by rising wages and employment) will be combined with a stronger rise in imports. Exports, however, are likely to remain strong as well, even if the CZK continues its slow nominal appreciation. All in all, growth will be more balanced. The next government, the political complexion of which is hard to predict at present, is rather unlikely to launch into any radical experiments (such as the flat tax system) which could jeopardize the country's economic and social stability.

Hungary

The re-elected government announced a package of measures designed to consolidate public finances and so reduce the budget deficit to 8% of the GDP in 2006 and 5% in 2007. The changes will come mostly on the revenue side of the budget, as there have been no signs of far-reaching reforms on the expenditure side. The measures will set the Hungarian economy on a lower growth path. In 2007 less than 3% GDP growth rate, stagnating consumption and higher inflation will be the price the country has to pay for the populist economic policy it has pursued since 2000.

Poland

Conditions are conducive to a further strengthening of fixed investment. This will be essential to growth in 2007 and beyond, primarily because the current levels of capacity utilization are already high. In 2006 foreign trade will continue to contribute positively to GDP growth. Private consumption is expected to firm up under the impact of rising wages and employment. However, this overall optimistic scenario assumes that Poland does not slip into outright deflation: a development that could bear highly negative consequences for growth and employment.

Slovenia

Economic growth is expected to remain relatively strong. Rising investment and (moderate) private consumption will be the driving forces behind a 4% GDP growth in both 2006 and 2007. Foreign trade is likely to contribute positively to growth again. The current account deficit may widen somewhat but remain within limits. Keeping inflation low will be jeopardized by rising oil prices. Further reform steps, in particular the introduction of the flat tax, will be under active consideration in the coming months. Slovenia will be the first among the NMS to adopt the euro on 1 January 2007.

Slovakia

Changes in the political landscape will not radically alter the liberal course of the country’s economic policy. Driven by rising investment and exports, GDP and employment will grow steadily. After some stability during the run-up to the elections, the Slovak currency is likely to experience some appreciation pressures. Coupled with a rise in profit repatriation, this will keep the current account deficit relatively high.

Edward Christie, Anna Iara, Hermine Vidovic

Labour markets and migration in the New Member States and Accession Countries

Labour market situation improving

Up to the beginning of the new millennium strong GDP growth in the NMS and the two accession countries Bulgaria and Romania has been coupled with falling or limited employment growth and a resultant rise in labour productivity (GDP per employed person), known as 'jobless growth'. Thereafter job creation gradually gathered momentum in most countries, the main exceptions being Hungary, Romania and to some extent the Czech Republic where employment either fell or stagnated despite remarkable GDP growth. In early 2006 employment continued increasing or resumed growth in all countries with noticeable rises in the Baltic States, Bulgaria and the Slovak Republic. These developments are reflected in rising employment and activity rates all over the region, the only exceptions being Lithuania and Romania where the activity rates fell in the past two years. In 2005 employment rates ranged from as low as 53% in Poland to 66% in Slovenia. Thus, achieving the Lisbon goal of a 70% employment rate in 2010 seems to be out of reach for the majority of NMS, but also for a number of old EU member states (EU-15 average: 65%).

Though most of the new job creation has been concentrated in the services sector since the mid-nineties, in some NMS the employment shares in industry remained at relatively high levels. After drastic cuts at the outset of transition manufacturing employment started increasing in the past couple of years. However the extent of this recovery differed from country to country. Quite clearly in the cases of Estonia and of the Slovak Republic, and most likely as well in the case of the Czech Republic, these developments are a consequence of the strong FDI inflows of the last years. In early 2006 almost all NMS reported rising industrial employment, except Hungary and Slovenia which suffered particularly from job losses in the textile industry. In the two accession countries high industrial output growth has translated into increasing employment only in Bulgaria, while the Romanian industry – performing less dynamically – still suffers from sizeable employment cuts. The new jobs in industry that are being generated are mainly in the higher-skill segments of the manufacturing sector (see section on industry and foreign trade). Labour shortages for high-skill labour are also reported in construction, retail, transport services and medical care (both doctors and nurses) in almost all NMS and Bulgaria. Recent evidence[13] for the Czech Republic also indicates shortages in the IT, financial services and automotive industries.

Strong GDP growth helped to gradually reduce unemployment in the majority of the NMS and the two accession countries. At around 13.5% the unemployment rate for the NMS has decreased by about one percentage point in the course of 2005 with signs of a further decline in 2006 (see Table 13). Available figures show that the number of jobless fell quickly in the Baltic states, particularly in Lithuania where the unemployment rate dropped by 3 percentage points in 2005. Rising emigration was an important factor in the latter contributing to the reduction of unemployment, but has also caused a decline in the countries' labour force – despite an increase of the working-age population (for further details see below). Large outward migration seems to have had also an impact on the improvement of the labour market situation in Poland, while at the same time creating

[13] In fact as discussed in Vavreckova et al. (2006) a project was launched already in 2003 to try to attract skilled workers but the programme was not very successful due to an excessive focus on the nationality of the applicants.

labour shortages in some regions and/or occupations. Unemployment continued to decline in Bulgaria and the Slovak Republic (by about 2 percentage points in each case), the latter was, together with Poland, one of the NMS hardest hit by unemployment in the past couple of years and for which emigration also played a role. Unemployment has not changed much in Slovenia, Romania and in the Czech Republic, while it continued to grow in Hungary. One of the main reasons behind the rise in Hungarian joblessness is the abolition of compulsory military service along with a reduction in the size of the armed forces up to the end of 2004/beginning of 2005; this has led to thousands of redundancies also among suppliers to the army. In addition, the increase of the retirement age might have contributed to rising unemployment as well. It is worth noting that in five out of ten countries unemployment rates do not deviate much from the average observed in the old EU countries, and in some cases are even below that level.

Table 13

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %							
	2000	**2001**	**2002**	**2003**	**2004**	**2005** [1]	**2002**	**2003**	**2004**	**2005** [1]	**2005 1st quarter**	**2006 1st quarter**	**2006 forecast**	**2007 forecast**
Czech Republic [2]	455	421	374	399	426	410	7.3	7.8	8.3	8.0	8.4	8.0	7.5	7.5
Hungary	264	234	239	245	253	304	5.8	5.9	6.1	7.2	7.1	7.7	7.9	8.5
Poland	2785	3170	3431	3329	3230	3045	19.9	19.6	19.0	17.8	18.9	16.0	17.5	17
Slovak Republic	485	508	487	459	481	428	18.5	17.4	18.1	16.2	17.5	14.9	14.5	14
Slovenia	68	63	62	65	64	67	6.4	6.7	6.3	6.6	6.9	6.9	6.5	6
NMS-5 [3]	*4056*	*4396*	*4593*	*4496*	*4454*	*4254*	*15.3*	*15.1*	*14.9*	*14.1*	*14.9*	*13.0*	*13.9*	*13.7*
Estonia	90	83	67	66	64	52	10.3	10.0	9.6	7.9	9.5	6.4	7	6.5
Latvia	159	145	135	119	119	99	12.0	10.6	10.4	8.7	9.9	7.8	8	7.5
Lithuania	274	284	224	204	184	133	13.8	12.4	11.4	8.3	10.2	.	7	6.5
NMS-8 [3]	*4579*	*4908*	*5019*	*4885*	*4820*	*4538*	*15.0*	*14.7*	*14.4*	*13.5*	*14.4*	.	*13.1*	*12.9*
Bulgaria	567	664	592	449	400	334	17.8	13.7	12.0	10.1	11.3	9.7	9	8
Romania [4]	821	750	845	692	800	705	8.4	7.0	8.0	7.2	8.5	.	7	7

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

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

Despite these general improvements some structural features of unemployment remained unchanged or even deteriorated. Regional disparities in the NMS are large and have widened over time. Long-term unemployment has become a serious problem in all NMS. It has reached much higher levels than in the old EU and continues rising in the majority of countries; the situation is most severe in the Slovak Republic where it amounted to 72% of total unemployed in 2005. Despite improvements in the past couple of years youth unemployment is particularly high in the Slovak Republic and in Poland at around 33%.

Migration from the NMS: experiences from the May 2004 enlargement

Only three old EU member states – the United Kingdom, Sweden and Ireland – chose not to impose any significant labour market restrictions to citizens of the eight CEE new member states (NMS-8) in the first two-year period after May 2004. This period has now passed and it is possible to draw some lessons and observations from this episode of differentiated labour market liberalization.

The total flow of labour migrants from the NMS-8 to the three old member states mentioned above (EU-3) since May 2004 has been relatively large. In the case of the UK, around 375,000 NMS-8 nationals have registered with the government's Worker Registration Scheme (WRS), a compulsory registration system set up specifically for NMS-8 nationals, between 1 May 2004 and 31 March 2006. This is, however, a gross inflow as there is no requirement to de-register and some migration is of course temporary.[14] Looking at stocks, the UK's Labour Force Survey (LFS) statistics[15] imply that the stock of UK residents born in the NMS-8 has risen by 167,000 from 177,000 in February 2004 to 344,000 in August 2005. We assume for simplicity that this rise in stock was for the period from enlargement until the end of August 2005. Over the same period, the WRS accepted around 242,000 applicants. If we assume a constant ratio between the gross inflow of migrant workers and the number of medium-to-long-term immigrants equal to 167,000 / 242,000 = 69%, we can construct an estimate of net migration using the more up-to-date WRS data. We thus assume net migration to have been 375,000 x 0.69 = 258,750. Using the same method and the change in the stock of working-age NMS-8 born residents, we estimate the number of working-age migrants: 375,000 x (154,000 / 242,000) = 238,636.

For Ireland, estimates based on CSO (2006) and Doyle et al. (2006) show that around 62,400 NMS-8 nationals who arrived after accession were in employment on 31 March 2006. Assuming the employment rate to be the same in the total group as in the group of newcomers, we estimate that the total migration flow was 74,049, excluding persons under 15 years of age. Finally, for Sweden the figures are much lower, 7803 up to the end of 2005 according to the net migration data published by Statistics Sweden.

Rounding off, we conclude that at least 341,000 NMS-8 nationals have settled in the EU-3 between 1 May 2004 and 31 March 2006 and that at least 307,000 have joined the EU-3 labour force.[16] This represents an increase in the EU-3 labour force of roughly 0.9%. In terms of an increase over a two-year period this is quite substantial. On the other hand in terms of total stocks this is still rather modest. The UK for example has roughly ten times more residents from outside the enlarged EU than from the NMS-8.

The total migration flow given above is lower than what had been generally anticipated. For example, the projections published in the highly regarded study of Alvarez-Plata et al. (2003) suggest that in the first two years after accession around 510,000 NMS-8 nationals would migrate to the EU-15. Up-to-date statistics on NMS-8 migration to the other EU-15 countries are difficult to come by though for Austria we find according to LFS data summarized in European Commission

[14] Two other caveats are that the self-employed do not need to register with the WRS and that there is evidence of an amnesty effect for NMS-8 nationals who had been working illegally in the UK prior to enlargement.

[15] Our thanks go to Nicola Gilpin and Matthew Henty of the UK's Department for Work and Pensions (DWP) for providing us with an extract of the LFS database along with advice and comments relevant to the UK case. Note that the latest available data we obtained referred to the period ending in February 2006, but that LFS data exclude individuals who have been in the UK for less than six months, hence the equivalent cut-off date of August 2005.

[16] This comes on top of an unknown but – various sources suggest – substantial rolling stock of short-term and seasonal workers. Some of the larger estimates quoted in the media might include this without clearly saying so.

(2006) that there was an increase of around 28,400 in the working-age population with NMS-8 citizenship.

In terms of expected migration by country of destination the flows are much larger than had been anticipated for the UK and Ireland. With hindsight the main reason for this discrepancy is that there was a strong diversion effect away from traditional destinations such as Germany and Austria, where much larger NMS-8 communities existed prior to enlargement and where large flows were expected. The expectation of large inflows had led both countries to put up the most stringent restrictions of all EU-15 countries, while the UK, Ireland and Sweden, perhaps not entirely innocently, left their labour markets open. Overall GDP growth, specific labour shortages (e.g. in agriculture, in catering) as well as growing (and open) segments of the public sector in the case of the UK, coupled with a certain culture of informality and low trade union interference, then provided strong pull factors to both the UK and Ireland. Other contributing factors one should mention are the wide availability of cheap air travel and the special role played by the English language, which almost all young NMS-8 citizens now learn at school. Sweden on the other hand has a more regulated and rigid labour market and poses a higher language barrier; it was thus a less attractive destination.

The pattern in terms of countries of origin of the migrants is extremely differentiated. Using only WRS data, we find that Poland is by very far the largest sending country with 61% of the total flow, followed by Lithuania (10%), Slovakia (10%) and Latvia (6%). In terms of migration propensity (defined here as migration flow divided by working-age population)[17], Poland is in fact not much higher than the NMS-8 (weighted) average (0.78% vs. 0.67%). However, Lithuania and Latvia very clearly lead the pack with respectively 1.82% and 1.38%, followed by Slovakia with 0.93%. At the other end of the spectrum, the Hungarians (0.15%) and especially the Slovenians (0.02%) have shown little interest in the EU-3 labour markets. This pattern makes sense in view of the highly differentiated unemployment rates and real wage levels found across the region. The migration patterns observed come therefore as a very strong confirmation of the variables usually thought to matter, although the degree of country heterogeneity is even stronger than one might have expected.

What are the effects so far of these migration flows on the receiving countries? The evidence gathered by Portes and French (2005) and by Gilpin et al. (2006) indicates a modest though essentially positive impact on the UK economy in the shape of increases in output and employment. The more sensitive question is whether there have been some redistribution or displacement effects that have been detrimental to native workers. Gilpin et al. (2006) find no discernible evidence that NMS-8 migrants have caused either the unemployment rate of native UK workers to go up or wages to stagnate or fall at the national level. Portes and French (2005) had found a stagnation of wages in agriculture, but more recent data gives a less clear picture.

Outlook for migration from Romania and Bulgaria

What is the magnitude and composition of labour migration that can be expected after the next EU enlargement? The projections of Alvarez-Plata et al. (2003) imply a flow of around 151,000 from

[17] This is estimated by taking the WRS data, re-scaling it down to our estimate of net migration using a ratio of 341,000 / 375,000, and then dividing the estimated country-specific migration flow by each sending country's working-age population (defined as all those aged 15 to 64), as measured on 1 January 2004.

Bulgaria and Romania (AC-2) into the EU-15 over the first two years after their accession. However, we are of the view that this estimate, quite contrary to the one implied for migration from the NMS-8, is a little on the low side, bearing in mind the migration propensities that have now been observed for the NMS-8 countries. If Romania and Bulgaria have the same migration propensity as Poland had we should expect a potential outflow of around 160,000 over the first two years. Assuming the same migration propensity as Latvia the outflow would be around 280,000. This latter estimate is one we feel more comfortable with, not so much because of unemployment rates (which are in fact lower in the AC-2) but because Latvian wage levels are relatively close to Romanian wage levels whereas Polish wages are substantially higher, and ultimately we feel that the difference in wage levels is the main driver for young migrant workers. For both scenarios the share of Romanian migrants in the total is 74%, equal to Romania's share in terms of working-age population. An estimate for a five-year time horizon for the specific case of Romanian emigration to Austria can be found in Hunya and Iara (2006).

Still, two countervailing forces should be considered. First of all there is evidence of rather substantial numbers of Bulgarian and Romanian citizens already working in the EU-15, in some cases illegally. Part of the potential supply of migrant workers has therefore already been sent out, while perhaps a smaller share of pre-enlargement migration had happened in the case of the NMS-8. Secondly, as was shown by the contrast between NMS-8 flows to Sweden on the one hand and to the UK and Ireland on the other hand, migrant worker flows crucially depend on the intensity of the pull factor from potential receiving countries. This is made up of two main components: the extent to which each receiving country has put up restrictions or quotas for migrant workers and each country's general economic and labour market conditions. As was conclusively demonstrated with the 2004 enlargement there can be very strong diversion effects if countries with favourable conditions open up more or less completely while others remain quite restrictive. Thus the pattern of migration flows will again depend on the pattern of labour market access restrictions. Furthermore, factors such as cultural and linguistic proximity, climatic tolerance and the existence of migrant networks in the prospective receiving country should also help shape migration patterns. A new feature to look at, moreover, is the possibility of migration from the AC-2 to the NMS-8. For example, Hungary's GDP per capita in PPS is 75% higher than that of Romania. This combines with geographical and linguistic proximity.

So what might the effects, pattern and sequence of labour market liberalization be with the forthcoming enlargement? At present, only Finland has stated that it would fully open its labour market. None of the EU-15 countries, and indeed none of the NMS-8 countries, have completed the decision-making process related to restrictions. As in the run-up to the previous enlargement, we therefore expect a relatively rushed sequence where current EU members will react to one another's decisions in the last months prior to the enlargement. As discussed in Boeri and Brücker (2005) this type of 'race to the top' hinges on the fact that governments assume that diversion effects happen, so that if they see other countries imposing restrictions on migration they will do so as well in order to stem inflows they (and national media and pressure groups) then expect would be higher than initially forecast.

To make sense of this issue it is also useful to bear in mind the current stances with respect to the NMS-8 countries: Finland, Greece, Portugal and Spain have now (as of 1 May 2006) lifted all restrictions towards NMS-8 citizens. Denmark will phase out the restrictions over the next three years, and the Netherlands are considering doing so from January 2007. The other EU-15 members will maintain work permit regimes, though less restrictive ones, except Germany and Austria, which will keep the full restrictions for a further three years.

Taking everything together we expect the restrictive countries to impose restrictions again. However we also believe that an exact repeat of the 2004 enlargement is unlikely: the UK and Ireland do not have endless labour shortages and both governments have expressed interest in applying restrictions this time around, with an eye on their domestic public opinions. On the other hand, some of the countries that liberalized from May 2006 might be considering full liberalization alongside Finland.

The migrant labour to be expected from the AC-2 differs from the NMS-8 migrants in several respects. Survey results on the propensity to migrate (Krieger, 2004) show that the prevalence of the youngest cohort of those aged 15-24 is even more pronounced among those willing to migrate from the AC-2 than from the NMS-8.[18] The wish to emigrate is driven much more by financial considerations in the former than in the latter. Most migrants to be expected are students and persons seeking higher incomes. Besides, the education profile of the typical migrant from the AC-2 is less favourable than of those from the NMS-8. Correspondingly we expect the average wage to be lower and the typical career prospects to be less favourable. This may be compounded in the UK and Ireland by the fact that the AC-2 migrants would face competition from well-established NMS-8 (and other) workers who will by then have developed effective migrant networks.[19]

The expected labour market effects of post-accession labour migration from the AC-2 will again depend on actual labour market restrictions in the various EU countries. In countries with strong labour representation such as Sweden the inflow will probably again be rather small for the reasons discussed earlier. However, in the case of Spain, where there is evidence of quite substantial numbers of both legal and illegal AC-2 workers, we expect both an amnesty effect upon enlargement and a pull factor due to networking and language. The other interesting case to watch is Italy, for the same reasons, although we expect it to open up later for both NMS-8 and AC-2 workers.

Finally, from the perspective of Romania and Bulgaria, fears of a youth and/or brain drain should be tempered by the prospect of larger remittances and, perhaps, of a useful inflow of human capital in the shape of return migrants at a later stage.

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[18] The NMS-8 migrant population to the UK so far is extremely young, with 82% under the age of 35, and there are rather more males than females (57:43). Source: Home Office (2006).

[19] Note that both the UK and Ireland are not part of the Schengen agreement and have so far maintained visa regimes for Romanian and Bulgarian nationals. This may have impeded migrant networks of Romanians and Bulgarians to develop under conditions of illegal worker mobility.

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Country reports

Leon Podkaminer

The Czech Republic: export-led expansion continues

The year 2004 marks a historical change in the recent economic history of the Czech Republic, not only on account of the country becoming an EU member. In 2004 a prolonged period of unimpressive growth performance following the 1996 currency crisis, with an average 1.5% GDP growth per year, seems to have come to an end. Simultaneously, the role of foreign trade in goods and non-factor services changed radically. In contrast to previous years, when foreign trade had been reducing the GDP growth (via the differential performance in real exports and imports), in 2004 foreign trade contributed +1.4 percentage points to the overall 4.7% growth.[20] The role of foreign trade was even more significant in 2005: trade contributed a rather unusually high 4.4 percentage points to the recorded 6.1% GDP growth. Provisional estimates for the first quarter of 2006 suggest that foreign trade continues to contribute positively to the buoyant overall GDP growth (7.4% in 1Q2006) – though its current contribution (about 1.9 p.p.) is much more moderate than in 1Q2005 (4.3 p.p.). The differential between the rates of real growth of exports and imports narrowed to 17% and 15.3% respectively (from 17.5% and 10.4% recorded a year earlier). Correspondingly, the importance of consumption (primarily private, but also public) and of gross fixed investment increased significantly. Moreover, in 1Q2006 there was a massive rise in inventories (accounting for some 36% of the nominal rise in GDP).

The change in the character of growth in 2004 does not seem to be directly related to the accession to the EU. For several years prior to the accession, Czech trade with the EU had already been practically liberalized (the then existing restrictions on trade in food and farm products essentially did not matter for the Czech Republic). The change in macroeconomic performance is related to the successful structural transformation of the economy which has been extended over a longer period. The structural transformation has had several elements. First, high inflows of foreign direct investment: the inward FDI stock as a percentage of GDP has risen from 23% in 1998 to over 51% in 2005. Moreover, over 40% of FDI has gone into manufacturing, predominantly in export-oriented activities. Second, gross fixed investment has been very high, ranging between 28% of the GDP at the beginning of the decade and 25.5% in 2005. Thus, the country's fixed productive assets are generally qualitatively and quantitatively superior to the assets at the disposal of firms in other Central European countries, where investment rates have been much lower.[21]

Industry, which is the backbone of the Czech economy, performed very well in the first quarter of 2006. Its gross value added rose a phenomenal 18.5% in real terms (with the total GVA up about 7.8%). Industrial production grew by 15.4% in real terms. The production of consumer durables rose 38%, of capital goods by 31%. Direct industrial export sales (excluding exports performed by trade intermediaries) rose 16.3%. Sales of foreign-controlled firms expanded by 26.3%.[22] The volume of

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[20] Between 2001 and 2003 the average contribution of foreign trade to GDP growth equalled minus 1.3 percentage points.

[21] The Czech Republic has outperformed Hungary and Poland in manufacturing exports to the EU-15. (See Overview Part A of this Report.)

[22] Direct export sales account for about 49% of all industry's sales. The share of foreign-controlled firms in total sales of industry is close to 59%.

orders placed with industry increased by 22.7%, the volume of export orders by 19%. Both employment in industry and the average nominal industrial wage increased, by 2.4% and 6.1% respectively. But, as labour productivity rose by more than 13%, industrial unit labour costs fell by about 7%.

Preliminary data available for April and May suggest some slowdown in the growth of industrial production, sales, new orders and employment. Most probably this is a seasonal phenomenon. On the other hand, one must see this development in connection with the high rise in inventories reported by the national accounts statistics for the first quarter of 2006. Also, the latest data on foreign trade indicate that, while the trade surplus continues to increase (albeit at moderate speed), the growth rate of imports of goods has caught up with the growth rate of goods' exports (both items at current prices). An acceleration of growth of imports is a fairly natural consequence of rising incomes (the total wage bill in particular) and consumer demand – as well as of the strength of the Czech currency. This foretells a more balanced composition of aggregate demand, with an increasing role for the growth of private consumption as the major factor behind GDP growth. Trade may remain an important factor contributing to growth positively – but stand in a more reasonable proportion to other GDP components.[23]

Some acceleration of inflation observed in April and May can easily be blamed on hikes in prices of energy and administratively-controlled utilities. But prices of other goods have gone up too. Currently inflation appears higher than last year, and this is consistent with strengthening consumer demand. It remains to be seen whether the Czech National Bank perceives the present situation as requiring some action. Formally, the current inflation – running at about 2.8% – is still lower than the CNB's inflation target of 3% (more precisely the 2-4% range). In any case, eventual increases in the policy interest rates (which currently are very low) are highly likely to be insignificant, or harmful to investment or exchange rates.

The parliamentary elections held in June have produced a stalemate. The two largest parties: the Social Democrats (which presided over the country's successful transformation over the past eight years) and the Civic Democrats (who led the country through the most turbulent initial years of the transition to a market economy) voiced – prior to the elections – radically different views on various essential economic policy questions. The Civic Democrats promised fast privatization of utilities (energy, post, railways, etc.), a three-pillar pension reform, a flat-tax with a 15% rate, and a speedy deregulation of housing rents. They did not state any fixed date for the introduction of the euro.[24] The Social Democrats promised not to privatize the utilities, not to change the tax system, and not to deregulate the rents quickly. Moreover, they were in favour of euro adoption by the year 2010.

Whichever party finally forms the government (a formal, or informal, coalition of the two is not unimaginable), it is likely that the pace of change in the tax and pension systems will be low, privatization of utilities token rather than real, and the deregulation of rents protracted. Given the fairly good state of the economy, there is little reason to wage major institutional or social

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23 For example, Ireland's average GDP growth since 1999 (6.3%) has been the effect of rising domestic demand (4.4 p.p. contribution) and foreign trade (1.9 p.p. contribution). This is the opposite of the proportion observed in the Czech Republic in 2005.

24 The party was founded by the present State President, Václav Klaus, an exemplary 'Eurosceptic'.

Table CZ

Czech Republic: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year	10224.2	10200.8	10201.7	10206.9	10231.7	.	.	.	.
Gross domestic product, CZK bn, nom. [2]	2352.2	2464.4	2577.1	2781.1	2978.2	691.2	748.8	3230	3480
annual change in % (real) [2]	2.5	1.9	3.6	4.2	6.1	5.4	7.4	5.5	5
GDP/capita (EUR at exchange rate) [2]	6750	7841	7933	8540	9773	.	.	.	.
GDP/capita (EUR at PPP - wiiw) [2]	13730	14580	14860	16000	17360	.	.	.	.
Gross industrial production									
annual change in % (real) [3]	6.7	1.9	5.5	9.6	6.7	3.9	15.4	10	8
Gross agricultural production									
annual change in % (real)	2.5	-4.4	-7.6	14.9	.	.	.	.	.
Construction industry									
annual change in % (real)	9.6	2.5	8.9	9.7	4.2	-3.1	0.5	.	.
Consumption of households, CZK bn, nom. [2]	1206.9	1248.1	1317.4	1391.1	1449.0	335.1	356.0	.	.
annual change in % (real) [2]	2.3	2.2	6.0	2.5	2.4	1.8	3.4	3.5	4
Gross fixed capital form., CZK bn, nom. [2]	659.3	677.8	687.5	729.3	758.7	172.4	186.3	.	.
annual change in % (real) [2]	6.6	5.1	0.4	4.7	3.6	2.3	7.1	7	5
LFS - employed persons, th, avg. [4]	4750.2	4764.9	4733.2	4706.6	4764.0	4704.4	4785.2	.	.
annual change in %	0.4	0.8	-0.7	-0.6	1.2	0.6	1.7	.	.
LFS - employed pers. in industry, th, avg. [4]	1470.6	1463.1	1424.7	1409.0	1422.0	1400.9	1476.3	.	.
annual change in %	2.9	-0.1	-2.6	-1.1	0.9	0.2	5.4	.	.
LFS - unemployed, th pers., average	421.0	374.1	399.1	425.9	410.0	429.3	414.1	.	.
LFS - unemployment rate in %, average [4]	8.1	7.3	7.8	8.3	8.0	8.4	8.0	7.5	7.5
Reg. unemployment rate in %, end of period	8.9	9.8	10.3	9.5	8.9	9.4	8.8	8.5	8.5
Average gross monthly wages, CZK [5]	14793	15866	16917	18041	19024	17680	18903	.	.
annual change in % (real, gross)	3.8	5.4	6.5	3.7	3.4	4.0	4.0	.	.
Consumer prices, % p.a.	4.7	1.8	0.1	2.8	1.9	1.7	2.8	2.8	2.5
Producer prices in industry, % p.a.	2.8	-0.5	-0.4	5.7	3.0	6.9	0.3	3	2
General governm. budget, EU-def., % GDP [6]									
Revenues	38.7	39.9	40.7	41.4	41.1	.	.	40.8	40.4
Expenditures	44.5	46.7	47.3	44.3	43.7	.	.	44.1	43.9
Deficit (-) / surplus (+)	-5.9	-6.8	-6.6	-2.9	-2.6	.	.	-3.2	-3.4
Public debt, EU-def., in % of GDP [6]	25.3	28.8	30.0	30.6	30.5	.	.	31.5	32.4
Discount rate, % p.a., end of period	3.8	1.8	1.0	1.5	1.0	1.3	1.0	.	.
Current account, EUR mn	-3652	-4426	-5044	-5245	-2071	628	8	-2000	-2000
Current account in % of GDP	-5.3	-5.5	-6.2	-6.0	-2.1	2.7	0.0	-1.8	-1.7
Gross reserves of NB incl. gold, EUR mn	16400	22614	21340	20884	25054	21246	24570	.	.
Gross external debt, EUR mn	25368	25738	27624	33212	38818	34358	.	.	.
FDI inflow, EUR mn	6296	9012	1863	4007	8837	1101	793	.	.
FDI outflow, EUR mn	185	219	183	817	688	34	131	.	.
Exports of goods, BOP, EUR mn	37251	40711	43051	53995	62961	14582	17830	71000	78000
annual growth rate in %	18.3	9.3	5.7	25.4	16.6	27.2	22.3	12.4	10
Imports of goods, BOP, EUR mn	40675	43026	45243	54824	61606	13709	16938	69000	76000
annual growth rate in %	16.6	5.8	5.2	21.2	12.4	20.2	23.6	12.3	10
Exports of services, BOP, EUR mn	7913	7501	6882	7790	8662	1935	1983	9500	.
annual growth rate in %	6.4	-5.2	-8.3	13.2	11.2	20.3	2.5	10	.
Imports of services, BOP, EUR mn	6211	6792	6466	7397	8011	1819	1954	8800	.
annual growth rate in %	5.2	9.4	-4.8	14.4	8.3	17.1	7.4	10	.
Average exchange rate CZK/USD	38.04	32.74	28.23	25.70	23.95	22.90	23.79	.	.
Average exchange rate CZK/EUR (ECU)	34.08	30.81	31.84	31.90	29.78	30.02	28.59	29.4	29.0
Purchasing power parity CZK/USD	14.60	14.27	14.50	14.55	14.20	.	.	.	.
Purchasing power parity CZK/EUR	16.76	16.58	16.99	17.03	16.77	.	.	.	.

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

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Spring 2006).

experiments. True to its traditional style of conducting economic policy, the Czech authorities will be avoiding ‘reform excesses’, which plague some neighbouring countries.

Summing up, GDP growth is likely to remain strong, but perhaps less buoyant than last year. The revival of fixed investment and private consumption (the latter supported by rising wages and employment) will be combined with a stronger rise in imports. But exports are likely to remain strong as well, even if the Czech koruna continues its slow nominal appreciation. All in all, growth may be somewhat slower, but otherwise better balanced. It may also be added that the next government, whose political complexion is hard to predict now, is rather unlikely to start any radical experiments (such as the flat tax system) which could threaten the country's economic and social stability.

Sándor Richter

Hungary: beginning of budget consolidation

On 10 June Ferenc Gyurcsány, the prime minister of the re-elected socialist liberal government, announced a package of measures in order to curb the fiscal deficit and restore the credibility of Hungarian economic policy. The measures are intended to put an end to the irresponsible economic policy that has been pursued since 2000. Over one and a half election cycles (2000-2006), public finances have been misused for political purposes through excessive public spending.

Between 2000 and 2005 the debt of the general government increased by 87%, while the (nominal) GDP grew by 66% only, and the gap may have widened further in the first half of 2006. Close to two thirds of the debt increment are explained by central government deficits; deficits of the social security funds account for one quarter, while the rest is explained by other factors, such as taking over credits from off-budgetary institutions or handing over government securities without being paid for them. This is partly related to investments in the state railway company and highway construction. Although only a small portion of public debt falls on local governments (2.2% of the GDP in 2005), the increase of that debt has been huge (187%) since 2000. The reliability of fiscal planning in the period concerned was extremely weak. The law on the annual budget was amended several times in each year between 2000 and 2005. The responsibility for the fiscal mismanagement is shared by all political parties which participated in both the conservative (Orbán) and the socialist-liberal (Medgyessy and Gyurcsány) governments in office in the past six years.

The prelude to the 10 June announcement of the package of measures had been the prime minister’s confession a few days earlier that the 2006 general government deficit target (4.7% of the GDP) could not be attained. Without immediate measures it would amount to 9.5%, with the help of the correction announced it will make up 8% of the GDP in 2006. This is in sharp contradiction to the repeated declarations of the minister of finance – prior to the elections – about the sustainability of the original deficit.

The government’s package envisages an improvement by HUF 350 billion in the fiscal balance this year and an additional HUF 1000 billion in 2007 and 2008 each. This should help cut the general government deficit from 8% of the GDP in 2006 to about 5% in 2007 and somewhat below 3% by the end of 2008. The announced measures refer to the remaining months of 2006 and to 2007;

Table HU

Hungary: Selected economic indicators

	2001	2002	2003	2004	2005 [1)]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	10174.9	10142.4	10116.7	10097.5	10077.0	10089	10074	10060	10040
Gross domestic product, HUF bn, nom. [2)]	14989.8	16915.3	18650.7	20429.5	21802.6	4968.6	5198.8	23500	25500
annual change in % (real) [2)]	4.3	3.8	3.4	5.2	4.1	3.2	4.6	4.0	2.3
GDP/capita (EUR at exchange rate) [2)]	5732	6853	7263	8031	8714	.	.	.	.
GDP/capita (EUR at PPP - wiiw) [2)]	11640	12510	12890	13630	14260	.	.	.	.
Gross industrial production									
annual change in % (real)	3.6	2.8	6.4	7.4	7.3	1.9	12.9	9	8
Gross agricultural production									
annual change in % (real)	15.8	-4.1	-4.5	22.8	.	.	.	.	.
Construction industry									
annual change in % (real)	7.7	17.5	2.2	6.8	16.6	9.1	7.9	.	.
Consumption of households, HUF bn, nom. [2)]	7816.9	8904.2	10066.3	10814.6	11676.7	2702.5	2842.3	.	.
annual change in % (real) [2)]	6.1	11.0	8.4	3.6	1.7	0.5	2.6	1.9	0.5
Gross fixed capital form., HUF bn, nom. [2)]	3499.7	3941.5	4156.0	4631.2	5057.0	798.3	904.6	.	.
annual change in % (real) [2)]	6.0	10.2	2.9	8.0	6.6	6.8	9.7	9	5
LFS - employed persons, th, avg.	3868.3	3870.6	3921.9	3900.4	3901.5	3870.6	3885.3	.	.
annual change in %	0.3	0.1	1.3	-0.5	0.0	-0.5	0.4	.	.
Reg. employees in industry, th pers., avg. [3)]	833.9	817.9	801.8	785.4	762.7	772.1	751.9	.	.
annual change in %	-1.3	-1.9	-2.0	-2.0	-2.9	-2.2	-2.6	.	.
LFS - unemployed, th pers., average	234.1	238.8	244.5	252.9	303.9	297.4	323.6	.	.
LFS - unemployment rate in %, average	5.7	5.8	5.9	6.1	7.2	7.1	7.7	7.9	8.5
Reg. unemployment rate in %, end of period	8.0	8.0	8.3	9.1	9.4	10.0	9.6	.	.
Average gross monthly wages, HUF [3)]	103553	122482	137193	145521	158315	160014	171723	.	.
annual change in % (real, net)	6.4	13.6	9.2	-0.7	6.2	9.8	5.7	.	.
Consumer prices, % p.a.	9.2	5.3	4.7	6.8	3.6	3.6	2.5	3.5	6
Producer prices in industry, % p.a.	5.2	-1.8	2.4	3.5	4.3	4.0	4.7	5.7	7
General governm.budget, EU-def., % GDP [4)]									
Revenues	44.7	43.7	43.4	44.1	44.5	.	.	.	.
Expenditures	48.2	52.0	49.8	49.5	50.7	.	.	.	.
Deficit (-) / surplus (+) [4)]	-3.5	-8.4	-6.4	-5.4	-6.2	.	.	-8	-5
Public debt, EU-def., in % of GDP [4)5)]	52.2	55.0	56.7	57.1	58.4	.	.	.	.
Refinancing rate, % p.a., end of period	9.8	8.5	12.5	9.5	6.0	7.8	6.0	.	.
Current account, EUR mn	-3576.5	-4929.2	-6381.7	-6975.7	-6524.9	-1461.7	1442.4	-6400	-5600
Current account in % of GDP	-6.1	-7.1	-8.7	-8.6	-7.4	-7.2	7.1	-7.4	-6.0
Reserves total, excl. gold, EUR mn	12163.7	9887.4	10108.3	11670.9	15678.4	13222.7	17781.0	.	.
Gross external debt, EUR mn	37387.0	38559.3	46041.1	55062.4	66259.3	58613.2	72089.5	.	.
FDI inflow, EUR mn	4390.7	3185.1	1887.5	3754.0	5214.7	1042.5	2009.7	4000	4000
FDI outflow, EUR mn	398.5	295.7	1463.4	894.4	1031.0	411.0	320.5	1000	1000
Exports of goods, BOP, EUR mn	34697.1	36820.7	38376.9	45083.0	49805.0	11126.5	13297.9	57300	65900
annual growth rate in %	10.9	6.1	4.2	17.5	10.4	8.3	19.5	15	15
Imports of goods, BOP, EUR mn	37192.8	39024.1	41274.5	47536.2	51414.5	11405.1	13600.3	58600	66500
annual growth rate in %	7.9	4.9	5.8	15.2	8.2	6.7	19.2	14	13.5
Exports of services, BOP, EUR mn	7864.7	7820.0	7673.8	8659.8	9921.1	2180.5	2116.7	11100	12430
annual growth rate in %	22.3	-0.6	-1.9	12.8	14.6	11.7	-2.9	12	12
Imports of services, BOP, EUR mn	6203.3	7233.1	8074.7	8532.5	9473.5	2079.8	2089.8	10230	11000
annual growth rate in %	19.4	16.6	11.6	5.7	11.0	7.8	0.5	8	8
Average exchange rate HUF/USD	286.54	258.00	224.44	202.63	199.66	186.98	211.53	.	.
Average exchange rate HUF/EUR (ECU)	256.68	242.97	253.51	251.68	248.05	245.10	254.40	270	275
Purchasing power parity HUF/USD	110.13	114.72	121.84	126.65	125.82	.	.	.	.
Purchasing power parity HUF/EUR	126.46	133.14	142.85	148.28	151.57	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 revised GDP data (FISIM adjustment). - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure. - 5) After corrections related to the pension reform.

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

those planned for 2008 have not been announced. Half of the deficit reduction in 2006 is intended to be attained through more revenue, the other half via less expenditure, while in 2007 the increase in revenue should make up 60%, expenditure cuts only 40% of the balance improvement.

The proposed corrective measures will affect three groups. First, as part of the political marketing, the government starts saving in its own ranks. The staff of the ministries will be reduced by a quarter, their operational costs will be cut, reserves of the budget will be frozen. The 19 traditional regional administrative units (counties) are planned to be replaced by 7 regions, which also are better compatible with EU financing for regional policy. Local governments' activities will be streamlined.

The second group targeted consists of the business sector and well-to-do strata of the population. All firms and entrepreneurs will pay a 4% solidarity tax levied on pre-tax profit, de facto raising the corporate income tax rate to 20% from the current 16%. Employees with more than about EUR 2000 monthly gross earnings will also have to pay the 4% solidarity tax on that part of their earnings that exceeds EUR 2000, topping the 36% personal income tax rate. The rate of the simplified entrepreneurial tax for small enterprises will be raised to 25% from the current 15%. The abolishment of the health care contribution paid by the employers will be postponed. Cash held at firms will be taxed. Interest income and stock exchange gains will be taxed with a 20% rate except for long-term government securities. Fringe benefits in kind for managers will be taxed with a higher rate than currently. A tax on real estate of higher than 'average' value is planned, without closer specification so far. A special sub-package will address undeclared incomes. Loss-reporting firms avoiding the payment of corporate income tax will have to pay a tax charged on 2% of their net turnover, according to the corporate income tax rate. Assets held illegally abroad may be repatriated at a preferential tax rate. Finally, simultaneously with an amnesty for tax evasion in the case of voluntary reporting up to the end of 2006, a much stricter control over personal incomes was announced, which will be implemented through the comparison of reported incomes with accumulated wealth.

The bulk of the burden, however, will fall on the broader public, the third group targeted. The 15% VAT key will be raised to 20%, leading to price rises primarily of food, public transport, utilities and energy. Subsidies on gas and electricity prices will be radically cut, with partial compensation for the most needy households. Due to changes in the regulation of the sale of pharmaceutical products, prices of the latter will go up as well. Individual and employees' social security contributions will be raised. The excise tax on alcoholic beverages, except for wine, will be raised.

The programme is hardly more than a collection of restrictive measures, except for the changes in the field of regional and local governance. The promised fundamental reforms in health care, education and the amendment of the recently introduced pension reform are not addressed in the announced programme, but later in June elements of the higher education reform were made public and reconciliation on scenarios for the health care reforms began. Nevertheless, the changes in the decision-making structure of the government may be regarded as preparatory steps for far-reaching reforms. First, the number of ministries was reduced from 17 to 12; at the same time the ministerial competencies were curtailed. Public investment strategic concepts, primarily those related to EU financing, will be elaborated by the National Development Council, decisions will be implemented by the Development Cabinet, both institutions newly established in Hungary. The management and financing of several operational activities of the ministries were taken over by the third new institution, the Centre of Government Services. Finally, a fourth new institution, the State Reform

Committee, was called into being as a think tank for the preparation of reforms in the public sector. The changes represent an unprecedented centralization of the executive power in the hands of the prime minister. These steps may be seen as an attempt by prime minister Gyurcsány to minimize the ministries' ability to resist reforms and to increase efficiency in the utilization of resources from the EU, which has been low as a consequence of the permanent struggle among the various ministries for more influence and resources.

The most important question in the short run is whether the measures are sufficient to restore fiscal policy credibility. The reception has been mixed so far with criticism from the market that the government should have put more emphasis on expenditure cuts and less on revenue increases, as the latter decrease competitiveness and the balance improving effects may not prove lasting. No panic sales of the Hungarian currency occurred, but the forint/euro rate weakened, in several stages, to over 284 by the end of June from a range of 260-265 in April and May and 250-255 in the first quarter of this year.

The announced economic policy measures will put the Hungarian economy on a lower growth path. Domestic demand will decline sharply; as a consequence, the GDP growth rate, a healthy 4.6% in the first quarter of this year, will fall below 4% by the last quarter of 2006. The real impact will be felt in 2007. The government reckons with a growth rate of about 2.5% for 2007 and with a return to higher (4%) growth in 2008. The programme foresees that CPI inflation (2.8% in May 2006, year-on-year) will rise to 5% in 2007 (annual average) and that real wages, growing by 5.7% in the first quarter of this year, will stagnate in both 2007 and 2008.

There are significant uncertainties regarding the future (short-term) path of the economy. The extent of the contraction of domestic demand cannot be exactly predicted. The tax burden on enterprises will grow, the cost of labour will rise, the room for 'creative book-keeping' will become narrower. Household consumption may be affected not only due to stagnating real wages but also due to the probably increasing propensity to save. However, a substantial jump in EU transfers from 2007 on will inject additional demand corresponding to 1-1.5 percentage points of the GDP, softening the demand-side shock to some extent. The range for our GDP growth rate forecast for 2007 is wider than in other years and can be put between 1.5% and 3%. Inflation will strongly depend on how the forint/euro rate will develop. By the end of 2006, year-on-year inflation may go up to 4%, and the officially expected 5% inflation in 2007 should be seen as the lower end of a 5-7% range. Should the market find the government programme credible and the international environment develop favourably for emerging markets, the forint/euro exchange rate may range around 275 in the second half of 2006 and in 2007. Limited credibility plus a continuation of the deterioration in the international environment for emerging markets may lead to stronger depreciation of the forint.

The impact on the external equilibrium will result from contradicting forces. As concerns trade, the growth of imports will be slowed down due to hardly expanding consumption and the weaker forint. In January-April 2006 exports increased more dynamically (15.5%) than imports (14.1%), despite the 3% deterioration of the terms of trade. On the one hand, the weaker forint will support, at least in the short run, a further expansion of exports; on the other hand, it is an open question to what extent higher tax burdens and rising labour costs will impede export growth. The income components of the current account may not improve in the short term. Altogether, in 2006 the current account deficit may remain at the level of the previous year. In 2007 it may decrease by close to one billion euro.

The schedule for the introduction of the euro has remained a key issue in restoring credibility. The government is planning to cut the fiscal deficit to the level corresponding to the Maastricht criterion by 2008, but – apart from the feasibility of that target itself – the fulfilment of the inflation criterion by that time is highly questionable. Prime minister Gyurcsány has hinted at a possible postponement of the current 2010 target date by one year to 2011, but the decision is still pending. This question will have to be answered, at the latest, by September 2006, when the revised convergence programme must be presented to the EU. Nevertheless, the credibility of the correction measures would require a clear statement about the government's intentions much earlier than that.

All in all, the new Hungarian government got down to work to break the vicious circle of 'political' economy determined by populism and election cycles in Hungary. However, there is still a long way to go to restored credibility and a properly functioning system of public finances and it is an open question whether the international environment, currently changing to the worse, will allow a 'soft landing' for Hungary.

Leon Podkaminer

Poland: a promising start into 2006

The accession to the EU spurred Poland's growth in 2004. However, much of that growth was due to a very strong accumulation of inventories. The gradual reduction in the abnormally high inventories took another year and resulted in much lower growth rates from the third quarter of 2003 through the third quarter of 2005. Finally, in the fourth quarter of 2005 stronger growth resumed, this time without excessive changes in inventories. In the first quarter of 2006 growth accelerated further, from 4.3% (4Q2005) to 5.2%. At the same time there has been some improvement in the structure of growth: The contribution of foreign trade (goods and services) to the growth rate rose from -1.1 percentage points to +0.7 p.p. (and the contribution of domestic demand was reduced from 5.4 p.p. to 4.5 p.p.).

After more than a year of very weak growth, private consumption increased significantly, by 5.1% (1Q2006). This development appears consistent with rising employment (in the corporate sector alone by close to 2%) and rising wages and other incomes. The total wage bill (of firms and institutions employing over 9 persons) rose over 5% and the total of retirement pays and pensions disbursed by about 2% (both items in real terms). Moreover, the expansion of private consumption was supported by rising credit extended to the household sector. The stock of household credit outstanding rose some 27% (of which housing credit – which accounts for one third of the total – by 46%).

Rising wages have not yet eroded profits. On the contrary, the corporate non-financial sector (firms employing over 50 persons) continues making huge profits. In the 1Q2006 the net (post-tax) profits rose 8.7% vs. the same period of 2005, surpassing PLN 12 billion. The banking sector (commercial and co-operative, combined) performed even better: its net profits rose by 40%, to close to PLN 3 billion.

In the first quarter of 2006 gross fixed investment rose respectably, by 7.4%.[25] But it is not yet quite clear whether the long-awaited sustainable recovery of the investment activity is firmly underway. Imports of machinery and transport equipment have not been accelerating visibly, while the domestic supply of capital goods, which increased strongly in the first quarter of 2006, contracted already in April 2006. Of course, there are good grounds to expect a further strengthening of investment activities. The corporate sector has been making large profits for quite some time and its financial standing is, on the whole, excellent. The sector is highly liquid, with some 70% of firms reportedly having no problem with liquidity.[26] Actually, 32% of firms report excess (or surplus) liquidity. The share of firms meeting their financial obligations on time is high (92%) and rising. Non-financial firms' deposits with the banking system rise much faster than those of households (over the last year by 17.7% vs. 3.1% respectively). Finally, the reluctance of firms to engage in investment more vigorously is hard to square with the fact that the current levels of capacity utilization (currently estimated at 81%) are the highest since 1999.

The attitude of the corporate sector apparently preferring an accumulation of liquid assets to the expansion of fixed capital need not be entirely irrational. Producer prices in manufacturing have been falling for over two years now. (The overall industrial producer price index for 2005 is 0.7% – only on account of strong rises in price indices for coal mining and for the output of the electricity and gas sector. This tendency has continued in 2006.)[27] Given an expectation of continuing deflation, it may make sense to defer major investments. This interpretation of the preference for liquidity seems consistent with information on credits to the corporate sector. Conditions might seem fairly conducive to financing investment with bank loans. Nominal interest rates on credits denominated in zloty are currently not excessive. The average interest on long-term credit is about 6.1%, and on short-term credit about 6.3%. Interest rates on credits denominated in foreign currencies were 3.2% and 3.8% respectively, as of end-March 2006. (But the interest rates on credit denominated in foreign currencies have been set to rise.) Under 'normal' expected inflation of, let us say, about 2%, such conditions would probably have induced strong demand for credit – but not so with a rationally expected continuation of deflation. In effect one observes stagnation of credit to the corporate sector. (Since end-March 2005 the stock of that credit has risen by a mere 4%. Its share in the total stock of credit outstanding has fallen below 47%.)

Consumer price inflation has also been quite low: 0.8%. Similarly as producer price inflation, the CPI is positive primarily on account of stronger rises in the prices of household energy. Without rising energy prices, there would have been a consumer price deflation. The Monetary Policy Council of the National Bank of Poland, ostensibly targeting a 2.5% inflation (with a +/- 1 p.p. tolerance band) has again missed its target by a wide margin. The real interest rates following from its decisions have been too high – with the obvious consequences for both inflation, and investment.

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25 The current volume of gross fixed investment is at the same level registered already five years ago.

26 See the report on the business climate in the second quarter of 2006 (accessible on the web page of the National Bank of Poland, www.nbp.pl/publikacje/koniunktura).

27 The industrial producer price inflation for the first four months of 2006 is 0.9% (vs. the same period of 2005). However, price indices for manufacturing fell 0.6%, while those for mining and electricity-and-gas rose 9.5% and 6.5% respectively.

Table PL

Poland: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	38248	38219	38191	38174	38157	38162	38149	.	.
Gross domestic product, PLN mn, nom. [2]	779205	807860	842120	922157	980884	228670	240259	1050500	1119700
annual change in % (real) [2]	1.1	1.4	3.8	5.3	3.4	2.2	5.2	5	4.5
GDP/capita (EUR at exchange rate) [2]	5553	5480	5013	5327	6385	.	.	.	.
GDP/capita (EUR at PPP - wiiw) [2]	9600	9980	10210	11060	11690	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	0.6	1.1	8.3	12.6	3.8	0.7 [3]	12.4 [3]	7	7
Gross agricultural production									
annual change in % (real)	5.8	-1.9	-0.8	7.5	-2.1	.	.	.	.
Construction output total									
annual change in % (real)	-6.4	-0.3	0.9	-7.0	5.0	7.6 [3]	4.5 [3]	.	.
Consumption of households, PLN mn, nom. [2]	497809	531100	543203	582449	606750	150311	159343	.	.
annual change in % (real) [2]	2.2	3.3	1.9	4.0	2.0	1.4	5.1	3	3
Gross fixed capital form., PLN mn, nom. [2]	161277	151472	153758	165848	178366	27972	29745	.	.
annual change in % (real) [2]	-9.7	-6.3	-0.1	6.3	6.5	1.4	7.4	7	6
LFS - employed persons, th, avg. [4]	14207.0	13782.0	13616.8	13794.8	14115.8	13767.0	14189.0	.	.
annual change in %	-2.2	-3.0	0.6	1.3	2.3	2.2	3.1	.	.
Reg. employees in industry, th pers., avg.	2820.6	2670.5	2639.1	2663.1	2426.0 [3]	2411 [3]	2460 [3]	.	.
annual change in %	-4.5	-5.3	-1.2	0.9	1.1 [3]	1.2 [3]	2.0 [3]	.	.
LFS - unemployed, th pers., average [4]	3170.0	3431.0	3328.5	3230.3	3045.3	3199.0	2708.0		
LFS - unemployment rate in %, average [4]	18.2	19.9	19.6	19.0	17.8	18.9	16.0	17.5	17
Reg. unemployment rate in %, end of period [4]	17.5	18.0	20.0	19.1	17.6	19.3	17.2	.	.
Average gross monthly wages, PLN	2045.1	2097.8	2185.0	2273.4	2380.3	2415.5 [3]	2539.6 [3]	.	.
annual change in % (real, gross)	2.5	0.7	3.4	0.7	2.6	0.3 [3]	4.3 [3]	.	.
Consumer prices, % p.a.	5.5	1.9	0.8	3.5	2.1	3.6	0.8	2	2
Producer prices in industry, % p.a.	1.6	1.0	2.6	7.0	0.7	3.3	0.6	1	1.5
General governm.budget, EU-def., % GDP [5]									
Revenues	40.0	41.0	39.9	38.6	40.8	.	.	41.6	40.7
Expenditures	43.7	44.2	44.6	42.5	43.3	.	.	44.6	43.7
Deficit (-) / surplus (+)	-3.7	-3.2	-4.7	-3.9	-2.5	.	.	-3.0	-3.0
Public debt, EU-def., % of GDP [5]	36.7	39.8	43.9	41.9	42.5	.	.	45.5	46.7
Discount rate of NB % p.a., end of period	14.0	7.5	5.8	7.0	4.8	6.5	4.3	.	.
Current account, EUR mn	-6006	-5399	-4108	-8542	-3503	-1048	-1177	-3800	-3800
Current account in % of GDP	-2.8	-2.6	-2.1	-4.2	-1.4	-1.8	-1.9	-1.5	-1.4
Gross reserves of NB excl. gold, EUR mn	29031	27367	26000	25904	34536	28407	34952	.	.
Gross external debt, EUR mn	81461	81045	84818	94322	109815	97146	.	.	.
FDI inflow, EUR mn	6372	4371	4067	10279	6132	2355	2748	.	.
FDI outflow, EUR mn	-97	228	269	636	1180	93	130	.	.
Exports of goods, BOP, EUR mn	46537	49338	53836	65847	77107	17613	21266	88700	99300
annual growth rate in %	19.3	6.0	9.1	22.3	17.1	23.4	20.7	15	12
Imports of goods, BOP, EUR mn	55094	57039	58913	70399	79289	17875	21536	88800	97700
annual growth rate in %	5.2	3.5	3.3	19.5	12.6	17.7	20.5	12	10
Exports of services, BOP, EUR mn	10914	10545	9850	10812	13017	2612	3409	14600	16400
annual growth rate in %	-3.6	-3.4	-6.6	9.8	20.4	23.0	30.5	12	12
Imports of services, BOP, EUR mn	10021	9690	9408	10036	11465	2302	3090	12400	13400
annual growth rate in %	2.5	-3.3	-2.9	6.7	14.2	8.4	34.2	8	8
Average exchange rate PLN/USD	4.09	4.08	3.89	3.65	3.23	3.07	3.19	.	.
Average exchange rate PLN/EUR (ECU)	3.67	3.86	4.40	4.53	4.03	4.03	3.83	4.1	4.1
Purchasing power parity PLN/USD	1.85	1.83	1.84	1.87	1.93	.	.	.	.
Purchasing power parity PLN/EUR	2.12	2.12	2.16	2.18	2.20	.	.	.	.

Notes: 1) Preliminary. - 2) Revised data (FISIM adjustment, new methodology in government sector, new estimate of shadow economy, etc.). - 3) Enterprises with more than 9 employees. - 4) From 2003 according to census May 2002. - 5) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Spring 2006).

The nominally high interest rates have provoked rather high inflows of portfolio capital (especially in the first half of 2005) and strengthened the zloty. A gradual lowering of the NBP interest rates (June-September 2005) did not prevent the strengthening of the zloty vs. the euro. Until February 2006, the zloty kept strengthening for nine months, on average by 1% per month. Two further cuts in interest rates in January and February 2006, combined with the ongoing monetary tightening in the euro area (and in the US) may have been responsible for the long-overdue weakening of the zloty. The current PLN/EUR exchange rate (4.04 at end-June) is more or less equal to the rate prevailing in early 2005. A further weakening is possible – and unlikely to do much harm to the real economy (in 2003 the average rate was 4.4, in 2004 4.5).

Poland's foreign trade performed quite well in 1-3Q2005 (and less so in 4Q2005). A modest improvement recorded in 1Q2006 may be expected to be further magnified in the future – provided the zloty does not start strengthening again. But such a strengthening seems unlikely as Poland's inflation is too low to provoke hikes in interest rates. Besides, the current fashion for higher interest rates in the US and the euro zone will not be conducive to appreciation of the zloty.

There are other positive developments to report. After several years of depression in wages, these finally seem to be moving ahead. Primarily, this is an effect of rising demand for labour, in particular skilled labour. After years of low investment in machinery and equipment, firms may be trying to make up for insufficient capital with more intensive employment of skilled labour. But such labour is now relatively difficult to find. The very high unemployment since 1999 has forced large-scale migration, even before Poland's accession to the EU. The huge gains in productivity and unit labour costs made during 2002-04 leave much room for some gains in wages. This will undoubtedly strengthen domestic demand and thereby provide some additional motivation for increased investment spending. Certainly, the rise in labour costs (which are offset, as far as external competitiveness is concerned, by the ongoing depreciation) will have some impact on inflation. But, given the current deflationary environment, some moderate inflationary impulses would be only welcome.

The new government, whose political and ideological priorities are largely irrelevant economically, has not yet instituted any legal or institutional changes that could be capable of affecting the economic life either positively or negatively. Of course, the wholesale purge of 'liberals' and other 'post-communists' from the posts (including the important ones) throughout the public sector will impair the latter's functioning. Otherwise, the new regime is still running on the budget worked out by the former, professional, administration. And, as the economy inherited from the liberal post-communists is in a fairly good shape, the new government may manage, to produce a satisfactory budget of its own.

Summing up, the current conditions are conducive to a further strengthening of fixed investment. This will be essential for growth in 2007 and beyond, primarily because the current levels of capacity utilization are already high. In 2006 foreign trade will continue to contribute positively to GDP growth. Private consumption is expected to firm under the impact of rising wages and employment. However, this overall optimistic scenario assumes that Poland does not slip into an outright deflation – which could have grossly negative consequences for growth and employment.

Zdenek Lukas

Slovakia: robust investment-led growth ahead of an export offensive

The coalition government formed by four centre-right parties in 2002 survived until June 2006, despite the loss of the parliamentary majority already in December 2003. On 17 June 2006, three months earlier than scheduled, parliamentary elections were held. This had no impact on the volatility of the exchange rate and the Slovak koruna has remained relatively strong against the euro. As expected, the populist Social-Democratic party Smer led by Robert Fico won the elections, but fell short of a majority. Nevertheless, Mr. Fico was relatively quickly able to form a coalition government on 28 June: Smer has associated with the nationalistic Slovak National Party (SNS) and the Movement for a Democratic Slovakia (HZDS). The seats in the new cabinet and parliamentary posts are to be divided according to the parties' performances in the elections. Smer will get 11 ministries, the SNS will receive 3 seats and the HZDS will get two posts. The two controversial leaders Ján Slota (SNS) and three-time ex-prime minister Vladimír Mečiar (HZDS) will serve neither in the cabinet nor in any official state post. Under this arrangement the government may try to make some change to the liberal economic policy pursued so far. However, backed by the booming economy, most political parties in Slovakia have basically supported the current course of the economy and any potential changes would not be significant. In addition, Mr. Fico has already confirmed a continuation of the current pro-European democratic policy and all obligations related to the OECD and NATO.

Despite the government crisis at the beginning of 2006, Slovakia has remained a fast growing economy. Growth even speeded up in the first quarter of 2006, when GDP rose by 6.3% as compared to 5.4% in the first quarter of 2005. Driven by rising industrial investment led by FDI and by stepped-up infrastructure investment, gross fixed capital formation soared by 16.1%. Rising real wages and credits to private households fuelled private consumption, up 6.6%. The strong domestic demand was partly covered by rising imports. As a result, foreign trade contributed negatively to overall GDP growth, even though exports increased significantly as well, supported by rising labour productivity and by a shift towards high value-added exports. As a result of increasing repatriation of profits of FDI and of the expanding foreign trade deficit, the current account deficit deteriorated, accounting for some 8% of GDP in 2005 and in the first quarter of 2006. In addition, higher prices of imported energy contributed to the deficit.

The increase in household consumption and consumer borrowing as well as higher oil prices have been largely responsible for intensified inflationary pressures. At the same time, fiscal policy has eased. As a result, the inflation rate (CPI) rose by 4.3% in the first quarter of 2006, compared to 2.8% in the same period of the previous year. The rising costs of the pension reform and pre-election 'sweets' have expanded budgetary expenditures. Thus, the general government budget deficit is likely to rise to more than 3% of GDP this year, against 2.9% in 2005.

The strong economic growth for the sixth consecutive year has in the end supported growth in employment as demand for labour has been on the rise. Total employment (according to the Labour Force Survey, LFS) increased by 3.7% in the first quarter of 2006, against 2.3% in the same period a

Table SK

Slovak Republic: Selected economic indicators

	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year	5379.8	5378.8	5379.0	5382.2	5386.7	.	.	.	.
Gross domestic product, SKK bn, nom. 2)	1020.6	1111.5	1212.7	1355.3	1472.1	339.6	368.8	1630	1800
annual change in % (real) 2)	3.2	4.1	4.2	5.4	6.1	5.4	6.3	6.5	6.5
GDP/capita (EUR at exchange rate) 2)	4380	4839	5434	6287	7082	.	.	.	.
GDP/capita (EUR at PPP - wiiw) 2)	10150	10990	11290	12010	12910	.	.	.	.
Gross industrial production									
annual change in % (real)	7.6	6.7	5.3	4.2	3.6	0.3	9.7	9	9
Gross agricultural production									
annual change in % (real)	9.9	1.5	-2.4	1.1	.	.	.	.	.
Construction industry									
annual change in % (real)	0.8	4.1	6.0	5.7	14.7	12.5	14.4	.	.
Consumption of households, SKK bn, nom. 2)	583.7	634.3	676.9	754.4	829.8	197.4	221.5	.	.
annual change in % (real) 2)	5.4	5.2	0.1	3.8	7.2	7.0	6.6	7	4
Gross fixed capital form., SKK bn, nom. 2)	291.0	303.5	302.8	327.1	382.6	75.1	89.1	.	.
annual change in % (real) 2)	12.9	0.3	-2.3	5.0	13.8	4.7	16.1	17	18
LFS - employed persons, th, avg.	2123.7	2127.0	2164.6	2170.4	2216.2	2177.4	2257.5	.	.
annual change in %	1.0	0.2	1.8	0.3	2.1	2.3	3.7	.	.
LFS - employed pers. in industry, th, avg.	628.8	640.9	634.1	641.3	649.1	642.0	653.4	.	.
annual change in %	2.2	1.9	-1.1	1.1	1.2	2.4	1.8	.	.
LFS - unemployed, th pers., average	508.0	486.9	459.2	480.7	427.5	461.9	395.8	.	.
LFS - unemployment rate in %, average	19.2	18.5	17.4	18.1	16.2	17.5	14.9	14.5	14
Reg. unemployment rate in %, end of period	18.6	17.5	15.6	13.1	11.4	12.7	11.4	10	9
Average gross monthly wages, SKK	12365	13511	14365	15825	17274	16022	17223	.	.
annual change in % (real, gross)	1.0	5.8	-2.0	2.5	6.3	7.2	3.1	.	.
Consumer prices, % p.a.	7.1	3.3	8.5	7.5	2.7	2.8	4.3	4	3.5
Producer prices in industry, % p.a.	6.5	2.1	8.3	3.4	4.7	2.5	9.5	8	6
General governm.budget, EU-def., % GDP 3)									
Revenues	36.8	35.7	35.6	35.9	34.7	.	.	33.0	32.5
Expenditures	43.3	43.3	39.4	38.9	37.7	.	.	35.7	34.6
Deficit (-) / surplus (+)	-6.5	-7.7	-3.7	-3.0	-2.9	.	.	-2.7	-2.1
Public debt, EU-def., in % of GDP 3)	49.2	43.3	42.7	41.6	34.5	.	.	34.3	34.7
Discount rate, % p.a., end of period	8.8	6.5	6.0	4.0	3.0	3.0	3.5	.	.
Current account, EUR mn 4)	-1950	-2043	-244	-1214	-3288	-199	-742	-2500	-2500
Current account in % of GDP	-8.3	-7.8	-0.8	-3.6	-8.6	-2.2	-7.5	-5.7	-5.0
Gross reserves of NB incl. gold, EUR mn	4748	8824	9717	10954	13067	13928	13657	.	.
Gross external debt, EUR mn	12516	12655	14654	17421	22705	21724	23114 Jan	.	.
FDI inflow, EUR mn	1768	4397	593	1016	1694	44 I-II	316 I-II	.	.
FDI outflow, EUR mn	39	5	20	-114	126	12 I-II	40 I-II	.	.
Exports of goods, BOP, EUR mn 4)	14115	15270	19359	22247	25742	5590	7125	33000	42000
annual growth rate in %	9.6	8.2	26.8	14.9	15.7	12.8	27.4	28	27
Imports of goods, BOP, EUR mn 4)	16488	17517	19924	23484	27711	5939	7759	35000	43500
annual growth rate in %	19.0	6.2	13.7	17.9	18.0	19.7	30.7	26	24
Exports of services, BOP, EUR mn 4)	2779	2958	2912	3000	3542	525 I-II	580 I-II	.	.
annual growth rate in %	14.1	6.4	-1.5	3.0	18.1	14.7	10.3	.	.
Imports of services, BOP, EUR mn 4)	2244	2474	2703	2785	3285	476 I-II	526 I-II	.	.
annual growth rate in %	14.5	10.3	9.2	3.0	18.0	9.1	10.5	.	.
Average exchange rate SKK/USD	48.35	45.34	36.77	32.26	31.02	29.16	31.17	.	.
Average exchange rate SKK/EUR (ECU)	43.31	42.70	41.49	40.05	38.59	38.28	37.46	37.0	36.0
Purchasing power parity SKK/USD	16.30	16.21	17.03	17.91	17.77	.	.	.	.
Purchasing power parity SKK/EUR	18.70	18.80	19.96	20.97	21.17	.	.	.	.

Notes: 1) Preliminary. - 2) Revised GDP data (FISIM adjustment). - 3) According to ESA'95, excessive deficit procedure. - 4) Calculated from USD.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Spring 2006).

year earlier. The unemployment rate (LFS) fell by 2.6 percentage points, to 14.9% in the first quarter of 2006. However, regional disparities remain large. Whereas in the Bratislava region the jobless rate is at about 2%, southern-central Slovakia has to cope with a rate of around 30%. This situation is reflected in regional income disparities – which are growing, although the purchasing power per capita is rising. The wealthiest region is Bratislava, followed by the Žilina district in the north-west and the urban agglomeration Košice in the east of the country. Purchasing power is lowest in southern-central Slovakia and in districts in the remote east.

Gross industrial output increased by 8.2% in the first four months of 2006. Industrial employment, according to LFS data, rose by just about 2%, whereas industrial labour productivity was up by some 6%. Along with nominal wage growth of only 3.3% this resulted in declining unit labour costs. In particular foreign investment companies, primarily operating in machinery & equipment and electrical & optical equipment branches, reported above-average production growth rates (around 20%). Car manufacturing has temporarily lost momentum as the front-runner in the expanding industrial production, but the automotive sector still accounts for one quarter of total industrial production, and exports and employs more than 60 thousand persons.

Following a big investment in 2005, VW Bratislava plans an annual production of 240,000 cars in Slovakia in 2006, up from 218,000 in 2005. Altogether, VW has so far invested EUR 1.3 billion in Slovakia over the past 15 years. In addition, the new car plant PSA Peugeot Citroen (in the western Slovak town Trnava) – with total investments envisaged at EUR 1 billion – started production in June and is to produce 60,000 cars in 2006; by the end of the decade production is to be gradually stepped up to 450,000 cars annually. In May KIA, the Hyundai associate, started trial production in its first European plant in Žilina (north-western Slovakia). The company is to invest EUR 0.7 billion and to achieve its full production capacity of 300,000 cars per year in 2009. On the whole, all three car factories could produce around one million cars annually by the end of this decade. As a result, they would make Slovakia the world's biggest car producer per capita. With newly starting production or expanding manufacturing, all carmakers located in Slovakia are looking for qualified workers. However, at the same time carmakers situated in Hungary, such as Suzuki in Esztergom and Audi in Györ, are also interested in hiring in Slovakia; thus the labour market in the wider Slovak-Hungarian border region is facing bottlenecks of skilled industrial workers. The low labour mobility within Slovakia (even from regions suffering unemployment to those where labour is in high demand) has exacerbated the scarcity of labour in the country's western and south-western regions. If Slovak workers take a job abroad, they usually head for the Czech Republic, Great Britain and Ireland.

The improved business climate, the liberal employment act, weak trade unions as well as low labour costs have been attracting foreign investors. FDI inflows recovered to EUR 1.7 billion in 2005. At the end of April 2006, after a privatisation process taking five years, the Italian company Enel acquired a 66% stake in the power utility Slovenské elektrárne. Altogether, the Italian company already paid EUR 840 million (SKK 31.3 billion) to a state account and has pledged to invest around EUR 1.9 billion by 2013. This deal and expanding investment in the automotive sector may result in total FDI inflows exceeding EUR 2 billion in 2006.

Supported both by rising private demand and strong investment growth, GDP growth will speed up to 6.5% this year and will remain strong in 2007. The supply side, in particular FDI-led car production (mostly for export), should assure strong GDP growth. Along with rising labour demand the unemployment rate will continue to decline. In the course of its pre-election campaign, the Slovak government confirmed its target of adopting the euro by 2009. As a result of positive macroeconomic indicators, the Slovak koruna will probably return to its appreciation trend in the long run. In the years to come, the current account deficit will face rising income outflow pressure as foreign owners of Slovak companies in the energy and banking sectors will repatriate their growing profits.

Hermine Vidovic

Slovenia: introduction of the euro approved

After a positive assessment of Slovenia in its Convergence Report, on 16 May 2006 the European Commission proposed that the country adopts the euro as of 1 January 2007. Thus, Slovenia will be the first new member – among the ten countries that acceded the European Union in May 2004 – to join the euro-zone. The final decision on the enlargement of the euro area will be made at the Ecofin meeting on 11 July.

Economic developments were favourable in the first quarter of 2006. Backed by strong domestic demand and a moderate contribution of foreign trade, Slovenia's GDP grew by 5.1%. Domestic demand was mainly supported by sustained investment growth, particularly in transport equipment, other machinery equipment and residential building. Along with continued household lending, private consumption grew at a similar rate as a year earlier, by 3%. Consumer prices have been on the rise for three months in a row, with inflation averaging 2.4% in the first five months of 2006 or 3.2% in May year-on-year. The current price rises are seen as a seasonal phenomenon by the Slovenian authorities, however, a continuation of these trends would question the price stability as required by the Maastricht criterion. Since the entry of the Slovenian tolar into the ERM II as of end of June 2004, the exchange rate of the tolar against the euro has remained close to the central band. Generally it is assumed that the exchange rate, which will be fixed at the Ecofin meeting in July, will not deviate much from, or remain at the existing parity of SIT 239.64 per EUR 1.

Industrial output growth fluctuated significantly from month to month; over the period January-April it increased by 5.8%. Growth was mainly impacted by strong foreign demand; the steepest output increases were observed in export-oriented industries such as manufacture of chemicals, machinery and equipment, electrical and optical equipment, and basic metals. On the negative side, the country's textile industry continued its downward trend, with production contracting by another 6%. Industrial productivity rose by 10% in the first quarter of the year. Overall, business expectations remain high both with respect to the improvement of the business climate in general and the growing export demand in particular.

Similar to previous years, the high GDP growth had only a limited impact on employment growth. Based on data obtained from the Labour Force Survey (LFS), employment rose by 1.3%, while national account data indicate a rise of less than 1%. Jobs increased first of all in the small business sector and in construction, whereas the textile industry was hit hardest by employment losses. Unemployment, according to LFS data, remained at 6.9% in the first quarter; based on registration data (traditionally higher than the LFS data) unemployment declined in January-May, to 9.6% – the

Table SI

Slovenia: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year	1992.0	1995.7	1996.8	1997.0	2001.1	1998.1 Mar	.	.	.
Gross domestic product, SIT bn, nom. [2]	4799.6	5355.4	5813.5	6251.2	6557.7	1526.9	1623.2	7000	7470
annual change in % (real) [2]	2.7	3.5	2.7	4.2	3.9	2.8	5.1	4	4
GDP/capita (EUR at exchange rate) [2]	11094	11862	12458	13105	13675	3187	.	.	.
GDP/capita (EUR at PPP - wiiw) [2]	15400	16040	16510	17930	18720	.	.	.	.
Gross industrial production									
annual change in % (real) [3]	2.9	2.4	1.4	4.8	3.4	-0.2	8.2	5.5	5
Gross agricultural production									
annual change in % (real)	-4.3	13.4	-12.7	19.3	.	.	.	.	.
Construction output, in effect. working time									
annual change in % (real) [4]	-2.1	-3.4	-1.7	2.5	3.0	-3.6	1.6	.	.
Consumption of households, SIT bn,nom. [2]	2657.8	2903.4	3167.4	3386.2	3555.8	807.0	848.6	.	.
annual change in % (real) [2]	2.3	1.3	3.5	3.3	3.3	3.0	3.3	3	3
Gross fixed capital form., SIT bn, nom. [2]	1158.7	1211.5	1353.1	1506.0	1625.8	357.3	393.7	.	.
annual change in % (real) [2]	0.4	0.9	7.1	5.9	3.7	0.6	8.9	7	7
LFS - employed persons, th, avg.	916	910	897	943	949	934	946	.	.
annual change in %	1.7	-0.7	-1.4	5.1	0.6	1.3	1.3	.	.
Reg. employees in industry, th pers., avg. [5]	243.5	246.1	242.2	239.7	239.4	240.9	235.1 Jan	.	.
annual change in %	0.8	1.1	-1.6	-1.0	.	.	-2.5 Jan	.	.
LFS - unemployed, th pers., average	63	62	65	64	67	69	70	.	.
LFS - unemployment rate in %, average	6.4	6.4	6.7	6.3	6.6	6.9	6.9	6.5	6
Reg. unemployment rate in %, end of period	11.8	11.3	11.0	10.4	10.2	10.2	10.3	10	9.5
Average gross monthly wages, SIT [6]	214561	235436	253200	267571	277279	267391	281562	.	.
annual change in % (real, net) [6]	3.1	2.1	1.8	2.1	3.5	3.4	3.1	.	.
Consumer prices, % p.a.	8.4	7.5	5.6	3.6	2.5	2.6	2.2	2.6	2.4
Producer prices in industry, % p.a.	8.9	5.1	2.5	4.3	2.7	4.3	1.6	2.5	2.4
General governm.budget, EU-def., % GDP [7]									
Revenues	44.7	45.4	45.2	45.3	45.5	43.6	43.5	45.5	45.3
Expenditures	49.0	48.0	48.1	47.6	47.3	47.9	47.0	47.3	47.0
Deficit (-) / surplus (+), % GDP	-4.3	-2.7	-2.8	-2.3	-1.8	-4.3	-3.5	-1.9	-1.6
Public debt in % of GDP [7]	28.4	29.7	29.1	29.5	29.1	.	.	29.9	29.7
Discount rate % p.a., end of period	7.8	7.3	5.0	3.3	3.8	3.3	3.3	.	.
Current account, EUR mn	38.0	343.8	-81.2	-543.7	-301.1	-125.2	-157.0	-350	-300
Current account in % of GDP	0.2	1.5	-0.3	-2.1	-1.1	-2.0	-2.3	-1.2	-1.0
Gross reserves of NB excl. gold, EUR mn	4907.5	6701.5	6798.2	6464.0	6824.1	6515.2	6840.4	.	.
Gross external debt, EUR mn	10403	11484	13259	15278	19566	16313	20404	.	.
FDI inflow, EUR mn	412.4	1700.2	300.3	662.1	426.6	51.2	17.0	.	.
FDI outflow, EUR mn	161.2	162.1	418.0	441.5	453.3	125.6	99.7	.	.
Exports of goods, BOP, EUR mn	10454.3	11081.6	11417.1	12932.8	14516.6	3350.0	3989.3	16800	18900
annual growth rate in %	9.2	6.0	3.0	13.3	12.2	12.0	19.1	16	13
Imports of goods, BOP, EUR mn	11138.7	11346.6	11959.9	13941.6	15550.7	3534.1	4180.0	17900	19900
annual growth rate in %	3.1	1.9	5.4	16.6	11.5	13.4	18.3	15	11
Exports of services, BOP, EUR mn	2177.6	2440.0	2464.8	2782.2	3223.8	609.7	712.1	.	.
annual growth rate in %	6.1	12.0	1.0	12.9	15.9	10.6	16.8	.	.
Imports of services, BOP, EUR mn	1642.1	1819.9	1924.0	2096.2	2325.5	440.9	514.2	.	.
annual growth rate in %	5.1	10.8	5.7	9.0	10.9	8.1	16.6	.	.
Average exchange rate SIT/USD	242.75	240.24	207.11	192.38	192.70	182.73	199.30	.	.
Average exchange rate SIT/EUR (ECU)	217.19	226.22	233.70	238.86	239.64	239.75	239.58	239.7	239.7
Purchasing power parity SIT/USD	136.39	144.24	150.37	149.15	145.57	.	.	.	.
Purchasing power parity SIT/EUR	156.42	167.32	176.31	174.64	175.05	.	.	.	.

Notes: 1) Preliminary. - 2) Revised data (FISIM adjustment and previous year price introduction). - 3) From July 2005 new methodology. - 4) From 2004 construction put in place; units with at least 20 employees. - 5) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 6) From January 2005 legal persons with 1 or 2 employees in the private sector are included. - 7) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Spring 2006).

lowest rate since 1991. However, that decline may have been the result of people being deleted from the register 'for reasons other than employment' rather than of a movement from unemployment to employment.

On the external side, the export expansion continued: export soared by an unexpected 19% in the first quarter of the year, while imports rose strongly as well, by 18%. Exports and imports of goods developed especially dynamically in trade with non-EU member countries, in particular with Serbia, Croatia and Russia. The increased surplus in services trade could offset the trade deficit, but was not sufficient to compensate for the growing deficits in the transfer and, to a lesser extent, the income balances (rising interest payments). Overall, the current account recorded a similar deficit as in the first quarter of 2005. FDI inflows to and outflows from Slovenia were only moderate in the first months of 2006, but Slovenia remained a net exporter of FDI; as in previous years, the Slovenian outflow of FDI was mainly targeting the successor states of the former Yugoslavia.

The ambitious economic reforms announced by the end of last year seem to have lost momentum after reform minister Jože Damijan resigned from his post after only three months in office. In an attempt to continue the reform project and in order to reach a broad consensus on the envisaged reform measures, a Partnership for Development Agreement was signed by the presidents of six parliamentary parties, except the one from the biggest opposition party (LDS), in mid-April. The Agreement basically relies on the heavily discussed economic and social reform package announced in late 2005, calling for an increase in competitiveness which should be achieved, among other things, through a simplification of the tax system, promoting SMEs, restructuring public expenditures in order to support the development priorities, and speeding up privatization and liberalization in the area of public utilities. The issue of introducing a flat tax, which has been subject to fierce debates in the public, has not yet been decided. A good deal of the envisaged reforms will depend on the assessment of the reform impact, which is currently prepared by the Institute of Economic Research and will be presented by the end of June/beginning of July this year.

As regards the planned privatizations, some progress has been made recently. By mid-May the government gave its approval to the privatization of Nova Kreditna Banka Maribor (NKMB) and adopted a plan for selling the state's share in the country's telecom company. In the case of NKBM, the privatization will be carried out in two stages, with the state keeping 25% plus one share in the end. The privatization plan for Telekom envisages the sale of the state's entire stake (currently over 70%) in the company and its subsidiaries. A different case is that of Nova Ljubljanska Banka, 34%-owned by the Belgian KBC Bank since 2002. After protracted and in the end unsuccessful discussions on raising its stake in Nova Ljubljanska Banka, KBC has recently decided to withdraw from the bank altogether.

The general growth pattern in 2006 and 2007 will not change significantly from that observed in the recent past. Based on results for the first months of the year, GDP growth will be mainly driven by domestic demand (increasing investment in infrastructure projects such as motorways and housing) and will be somewhat higher than originally expected by wiiw, at about 4% in 2006. The current account deficit may exceed the 2005 level, but remain in the range of 1% to 1.5% of the respective GDP this year and the next. Keeping inflation low may be jeopardized by rising oil prices.

Part B: Southeast European countries

*Vladimir Gligorov **

GDP and the number of states on the rise

Introduction

It has always been clear that 2006 was going to be a crucial year for Southeast Europe (SEE) or the Balkans. The overall environment was expected to be more favourable than it ultimately turned out to be, but the agenda could hardly be changed. Key constitutional decisions were to have been taken throughout the region, regional cooperation was to be stepped up and the Balkan enlargement of the EU was to start with the accession of Bulgaria and Romania on 1 January 2007. It was expected that this series of shocks, some positive overall and some negative for particular countries, would be supported by improved economic developments, with accelerated growth and continuing macroeconomic stability. Last but not least, the region was to be assured of the firm commitment of the EU and its readiness to integrate the countries in the region and support the integration process in every way possible.

The economic situation continues to improve, albeit with some problems when it comes to macroeconomic stability; the firm commitment on the part of the EU, however, has failed to materialize. Indeed, at the moment it is the very ambiguity of the EU strategy for the region that has contributed most to the mood of uncertainty. The key effect of this heightened uncertainty is greater instability in the region. For the time being, the economic consequences are comparatively moderate and the region continues to enjoy healthy growth with stability. However, some of the crucial shocks have yet to be absorbed and some unnecessary risks along the way loom large.

External balances deteriorate

The year began with trade balances deteriorating across the region (Table 1). Last year in most of the Western Balkans, exports increased more rapidly than imports. In the Eastern Balkans (Romania and Bulgaria), the trend was different. This year the trends in East and West have converged (except for Bosnia and Herzegovina and perhaps Croatia). For the most part, this is attributable to the uninterrupted rapid growth of credits. As a result, trade deficits that were already traditionally high have continued to deteriorate.

This should not be all that worrisome given the strong export growth still prevailing in most countries. Thus, import growth and the widening trade deficit are signs of continuing strong growth rather than symptoms of deteriorating competitiveness or a shift in external demand away from the region's exports.

The main source of growth continues to be domestic demand. Both consumption and investment are growing strongly. Private investments are being matched by growing public investments, primarily in infrastructure. There are indications that banks are increasing loans to enterprises, while lending to households remains strong.

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* P. Havlik and M. Landesmann (both wiiw) provided valuable comments on this overview.

Table 1

Foreign trade in Southeast Europe

cumulated data within respective period, based on customs statistics

Exports total (fob)

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	109	238	361	**487**	121	264	398	**530**	144
	change in %	5.3	17.1	22.4	**22.0**	11.1	10.8	10.1	**8.8**	19.2
B&H	EUR mn	316	667	1037	**1441**	397	898	1399	**1934**	551
	change in %	22.9	18.5	18.4	**21.4**	25.8	34.6	34.9	**34.2**	38.9
Bulgaria	EUR mn	1718	3615	5798	**7985**	2081	4386	6800	**9454**	2667
	change in %	5.0	11.2	15.9	**19.7**	21.1	21.3	17.3	**18.4**	28.2
Croatia	EUR mn	1452	3042	4726	**6452**	1492	3334	5166	**7092**	1950
	change in %	6.5	12.8	18.1	**18.0**	2.7	9.6	9.3	**9.9**	30.7
Macedonia	EUR mn	293	598	961	**1348**	368	774	1189	**1640**	375
	change in %	6.7	1.4	7.8	**11.5**	25.6	29.4	23.8	**21.7**	2.0
Romania	EUR mn	4337	9033	13995	**18935**	5095	10527	16466	**22255**	6213
	change in %	14.8	20.4	20.9	**21.3**	17.5	16.5	17.7	**17.5**	22.0
Serbia	EUR mn	523	1169	1948	**2867**	744	1651	2591	**3684**	944
	change in %	-9.1	-0.3	7.5	**17.5**	42.3	41.2	33.0	**28.5**	26.8

Imports total (cif)

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	380	827	1302	**1849**	417	950	1494	**2107**	540
	change in %	-3.2	2.2	7.2	**11.8**	9.7	14.9	14.8	**14.0**	29.6
B&H	EUR mn	935	2157	3425	**4758**	1049	2477	3950	**5715**	1045
	change in %	6.3	8.7	9.8	**11.9**	12.1	14.8	15.3	**20.1**	-0.3
Bulgaria	EUR mn	2412	5331	8209	**11620**	2962	6592	10404	**14682**	3933
	change in %	15.8	17.4	18.4	**20.9**	22.8	23.6	26.7	**26.4**	32.8
Croatia	EUR mn	2919	6483	9855	**13342**	3093	7136	10914	**14922**	3936
	change in %	6.1	8.4	7.4	**6.3**	6.0	10.1	10.7	**11.8**	27.3
Macedonia	EUR mn	493	1086	1666	**2358**	535	1240	1870	**2593**	546
	change in %	-0.6	7.6	11.1	**15.6**	8.4	14.1	12.3	**10.0**	2.1
Romania	EUR mn	5482	11992	18644	**26281**	6669	14740	23066	**32569**	8567
	change in %	20.7	22.2	23.2	**24.0**	21.6	22.9	23.7	**23.9**	28.5
Serbia	EUR mn	1801	3846	5826	**8663**	1526	3574	5838	**8354**	2028
	change in %	17.6	23.4	24.2	**31.2**	-15.3	-7.1	0.2	**-3.6**	32.9

Trade balance

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	-271	-588	-940	**-1363**	-296	-686	-1096	**-1578**	-396
B&H	EUR mn	-620	-1490	-2388	**-3317**	-651	-1579	-2551	**-3781**	-494
Bulgaria	EUR mn	-694	-1717	-2411	**-3635**	-881	-2206	-3604	**-5228**	-1266
Croatia	EUR mn	-1466	-3441	-5128	**-6890**	-1601	-3802	-5748	**-7830**	-1986
Macedonia	EUR mn	-201	-488	-705	**-1010**	-167	-466	-681	**-953**	-171
Romania	EUR mn	-1146	-2959	-4649	**-7346**	-1575	-4213	-6600	**-10313**	-2354
Serbia	EUR mn	-1278	-2677	-3878	**-5796**	-781	-1923	-3247	**-4670**	-1084

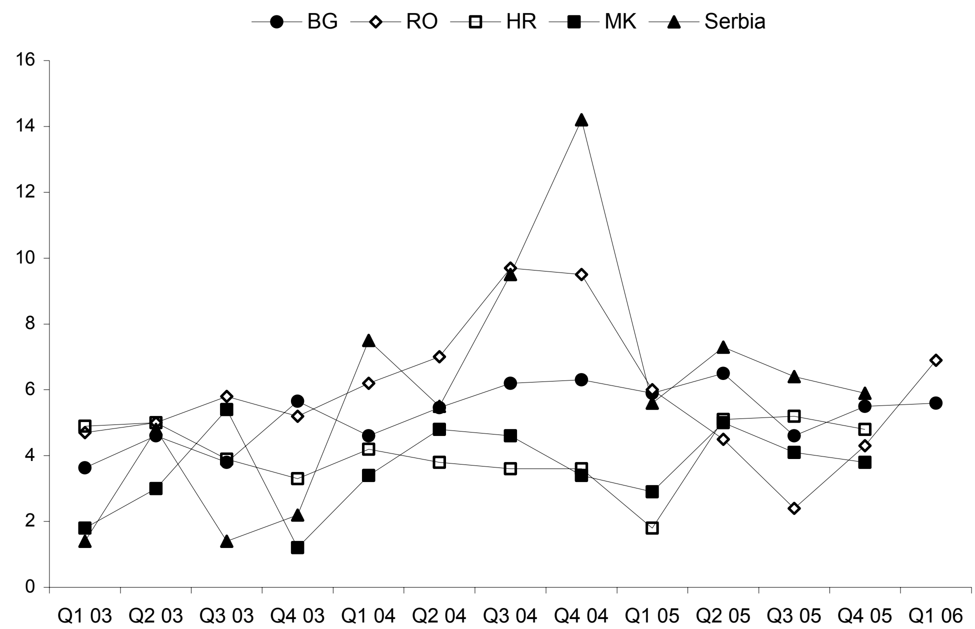
Source: wiiw Monthly Database incorporating national statistics.

The recorded growth rates and growth prospects show some divergence, however. Bulgaria continues to post strong growth rates and the growth prospects of Romania are improving (Figure 1). These two countries should get an additional boost once they join the EU and the assessments of their investment risks improve. In the Western Balkans, Bosnia and Herzegovina continues to record growth rates above 5%. Similarly, in Albania GDP is still rising above 5%; however, the long-term prospects may be closer to the latter figure. In the rest of the Western Balkans, growth is not that impressive and is actually slowing down in a number of cases. Among the better performers are Croatia and Montenegro, with growth rates ranging between 4 and 5%. Serbia, however, seems to be slowing down to around 4%, while Macedonia may still fail to grow even that fast. The worst growth rates are to be found in Kosovo, though the data there leave much to be desired.

Figure 1

Quarterly GDP, 2003-2006

real change in % against preceding year



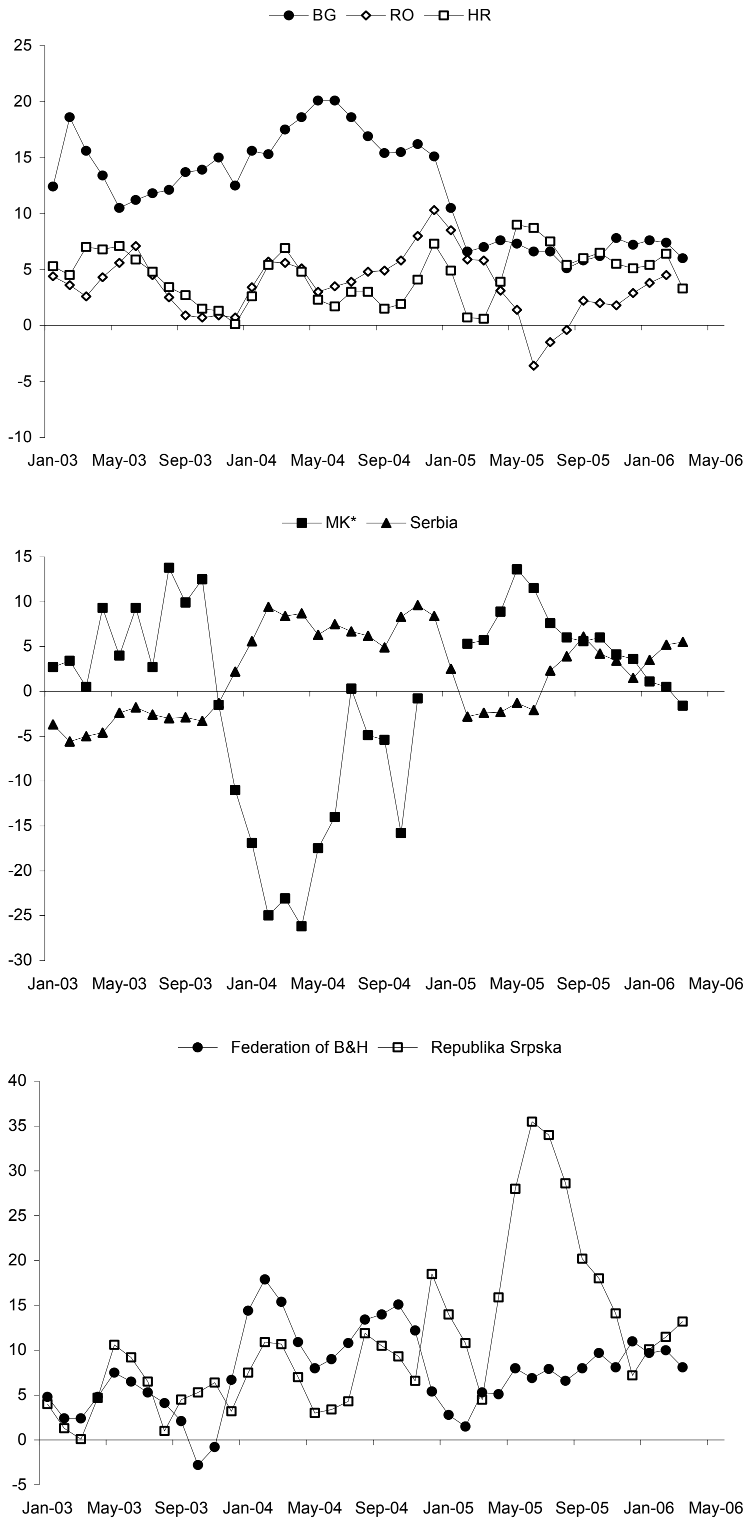
Source: wiiw Monthly Database incorporating national statistics.

In those cases where growth is still comparatively unimpressive, it can at least be partly attributed to the slow recovery of industrial production (Figure 2). In Serbia, industrial production started on a slow note at the beginning of the year and the prospects of things improving in the months remaining are not very convincing. In Macedonia industrial production has also been posting low growth rates. In both countries, sustained reindustrialization does not seem to be taking place. As was to be expected, overall growth also raises industrial production; this, however, is mostly an increase in output of existing firms and industries. There are few signs of a wider range of products or improvements in quality. The same holds true for Montenegro, although growth rates are currently better there. The situation is not much different throughout the Western Balkans.

Figure 2

Gross industrial production in Southeast Europe, 2003-2006

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



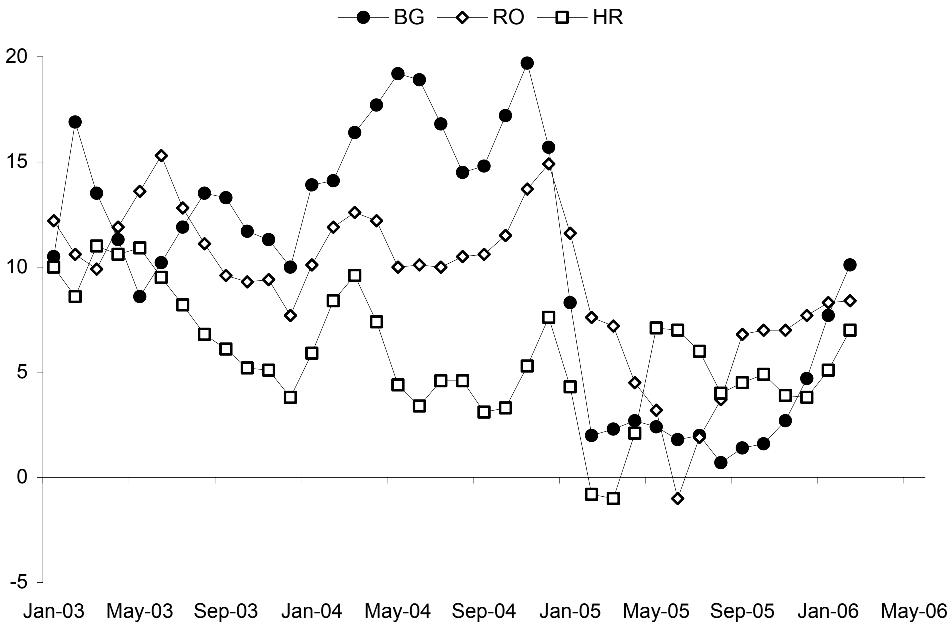
* From 2005 new methodology.

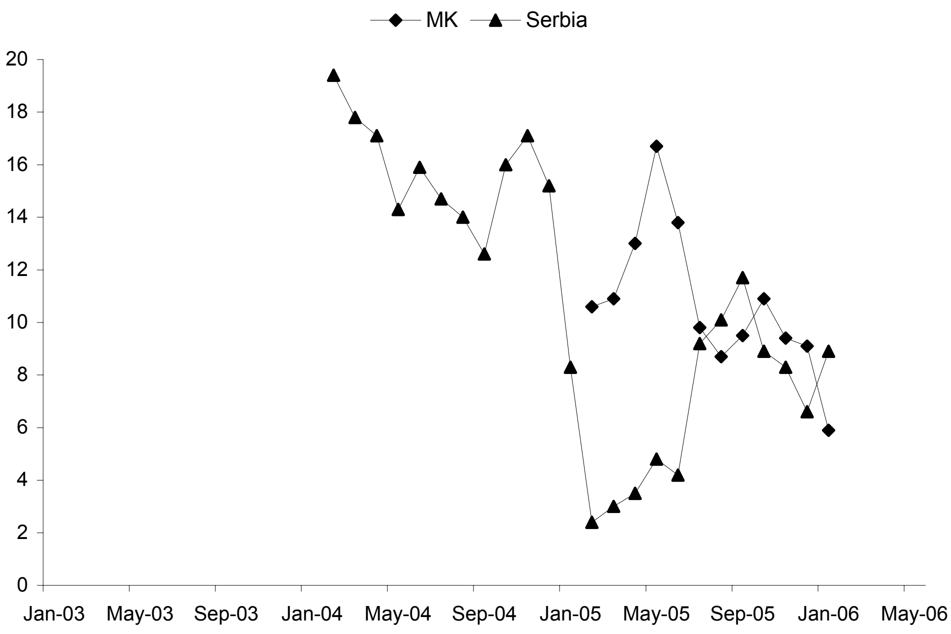
Source: wiiw Monthly Database incorporating national statistics.

Figure 3

Labour productivity in industry, 2003-2006

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





Source: wiiw Monthly Database incorporating national statistics.

Growth of labour productivity is, as a rule, faster than growth of production, which suggests that restructuring is continuing. That is the consequence of privatization and also of the tightening of the budget constraint because it is increasingly more difficult to obtain subsidies or preferential access to financial resources. Overall, however, the process of reindustrialization that has been so characteristic of transition in Central Europe is still not much in evidence in Southeast Europe.

Stability is still manageable

Inflation has been creeping upwards in most countries in the region (Table 2). Apart from Serbia and Romania (and also Turkey), which still have relatively high inflation rates, inflation is accelerating in Bulgaria and is somewhat higher in most other countries. In most cases, however, that is on account of the very low rates inherited from the past. Macedonia is thus emerging from what was to all intents and purposes deflation. Bosnia and Herzegovina is also seeing its inflation rate accelerate somewhat, as is Croatia. Most of these higher inflation rates are being pushed up by increasing oil prices and one-off price adjustments. In Bosnia and Herzegovina the introduction of value-added tax (VAT) at the beginning of the year is having the customary effect, as it is in Montenegro.

In Romania, persistent rates of inflation that are above those targeted by the National Bank may lead to credibility problems for the central bank. In Bulgaria, inflation is harder to keep down because of the currency board in place. The only practical instrument that it can rely on is further fiscal adjustment; it can either (a) run higher fiscal surpluses or (b) perhaps run public debt down; however, in a country that has gone through a period of very low wages for almost a decade, the thought of fiscal austerity rouses little enthusiasm. Some degree of nominal convergence may thus be inevitable. As yet it poses no competitiveness-related problems because of the legacy of low exchange rate levels from the past. Furthermore, high growth rates prevent an increase in debt-to-GDP ratios so the country does not have to face the issue of sustainability at the present juncture.

Table 2

Consumer price inflation

change in % against preceding year

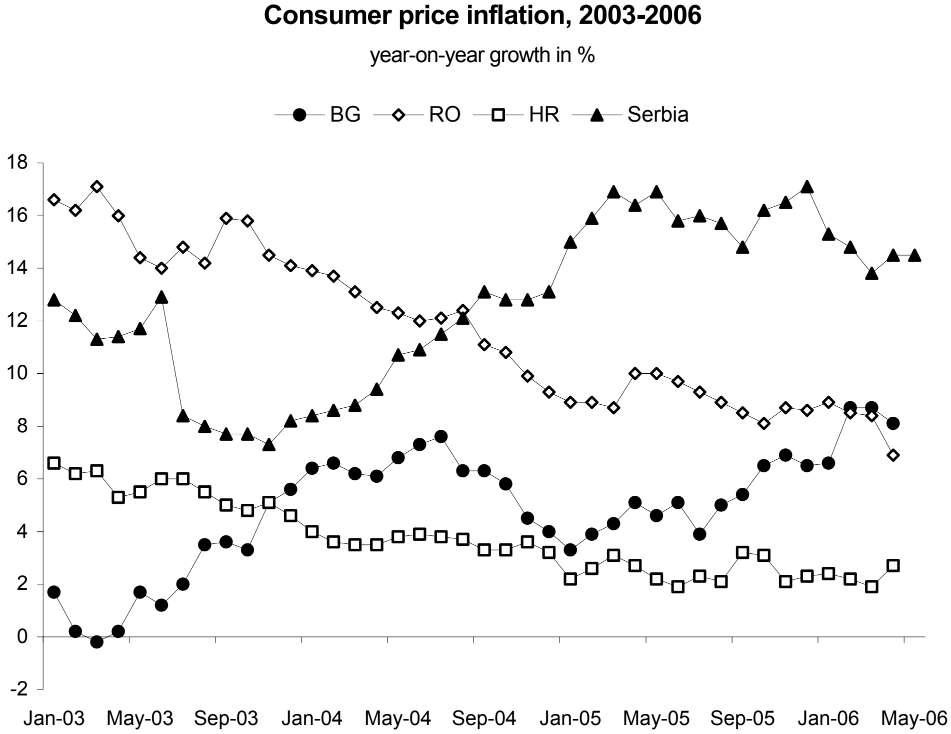
	2000	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
							1st quarter		forecast	
Bulgaria	10.3	7.4	5.8	2.3	6.1	5.0	3.8	8.0	8	5
Romania	45.7	34.5	22.5	15.3	11.9	9.0	8.8	8.6	8.5	8.0
Croatia [2]	6.2	4.9	1.7	1.8	2.1	3.3	3.3	3.5	3.5	3
Macedonia	5.8	5.5	1.8	1.2	-0.4	0.5	-0.4	2.7	3	3
Turkey [3]	54.9	54.4	45.0	25.3	8.6	8.2	8.4	8.1	9.0	6.0
Albania	0.1	3.1	5.2	2.2	3.0	2.4	2.2	1.4	2.5	2
Bosnia & Herzegovina [4]	4.9	3.2	1.3	1.1	0.7	2.9	.	.	6	4
Montenegro	20.2	21.8	16.0	6.7	2.4	2.3	1.2	2.9	3	3
Serbia	79.6	93.3	16.6	9.9	11.4	16.2	16.0	14.8	15	15

Notes: 1) Preliminary. - 2) Up to 2001 retail prices. - 3) From 2004 new methodology. - 4) Costs of living.

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

Serbia and Croatia face somewhat tougher problems with respect to macroeconomic stability, although they are different. Croatia has been following a fiscal stabilization track for the past two or three years. Progress has been steady, although the fiscal deficit has remained somewhat higher than originally planned. However, with growth being somewhat higher than expected and inflation nudging slightly upwards, the fiscal deficit may just exceed 3% this year: a comparatively good figure given Croatia's track record. The other significant imbalance is that of the current account, which was higher than planned last year. If it stays at a similar level this year, that may help to stabilize Croatia's debt-to-GDP ratio, which is currently quite high and constitutes the key constraint on faster growth.

Figure 4



Source: wiiw Monthly Database incorporating national statistics.

It is also to be noted that Croatia has not been shaken by the recent turbulence in the emerging markets. For the most part, this is because the current reversal has mainly affected the stock markets rather than bonds and loans. Croatia's stock market is small and not of great interest to foreign investors. Thus, the main risk is that yields on bonds and interest rates on credits will start rising, in which case refinancing costs will be a problem for both the public and private sectors in Croatia. At present, there are few indications of problems arising in the short term.

The situation in Serbia is quite different. Inflation is essentially a means of rebalancing the public sector – and the fiscal sector in particular. Inflation has not only helped the revenue side of the budget, but it has also led to a cut in real expenditures as reflected in the decline of the latter's share in GDP. However, this cannot be perpetuated at the cost of losing complete control over inflation. On the other hand, a more decisive cut in public expenditures to keep inflationary pressures under control is hardly feasible given the Serbian government's current weak position. As a consequence, expectations seem to be that inflation will settle down at around 15% year-on-year. That figure is based on the assumption that expenditures will not be used to buy support for the government. Otherwise, inflation will accelerate.

In Romania, the central bank is trying to control inflation and meet its concern over the deteriorating current account. In Romania and Serbia there is some debate on the possible impact that high inflows of foreign loans could have on inflation. Most studies seem to indicate that an increase in foreign loans has only a relatively mild impact on inflation. The main impact is on trade and current account balances. Indeed, increased inflows of foreign currency push the exchange rate up and encourage more imports with a stabilizing effect on inflation. In the case of fixed exchange rates, this mechanism cannot work and thus significant stabilization efforts are called for. In addition, it is often necessary to run high primary fiscal surpluses; it may also prove essential to increase costs for banks and debtors alike. If, however, wages cannot be effectively controlled, especially in a high growth setting, inflation may prove a problem. In Romania, the introduction of inflation targeting aims at containing inflationary expectations, while in Serbia the government does not feel that inflation is a problem at all, at least not thus far.

Monetary policy still a puzzle

Credit growth continues throughout the region with the monetary authorities struggling to cap it. So far they have preferred to rely on prudential measures such as mandatory reserve requirements – with little success in most cases. The reason seems to be that households are not very 'elastic' when it comes to interest rates, partly because they are not really indebted. Similarly, businesses seem ready to borrow at high rates because they expect relatively high growth. Furthermore, opportunities to borrow directly from abroad are increasing, thus rendering the prudential measures and capital controls mostly ineffective.

Throughout the region real exchange rates are appreciating (Figure 5). This saps inflationary pressures and could be support for a more relaxed monetary policy, if the monetary authorities were to decide to go in that direction. In Serbia, real exchange appreciation may have become the key instrument to bring the inflation down. That, however, bodes ill for the growing trade deficit. In Romania, real appreciation has been more moderate since the last quarter of last year.

Figure 5

Real appreciation*, 2003-2006

EUR per NCU, CPI-deflated, year-on-year growth in %

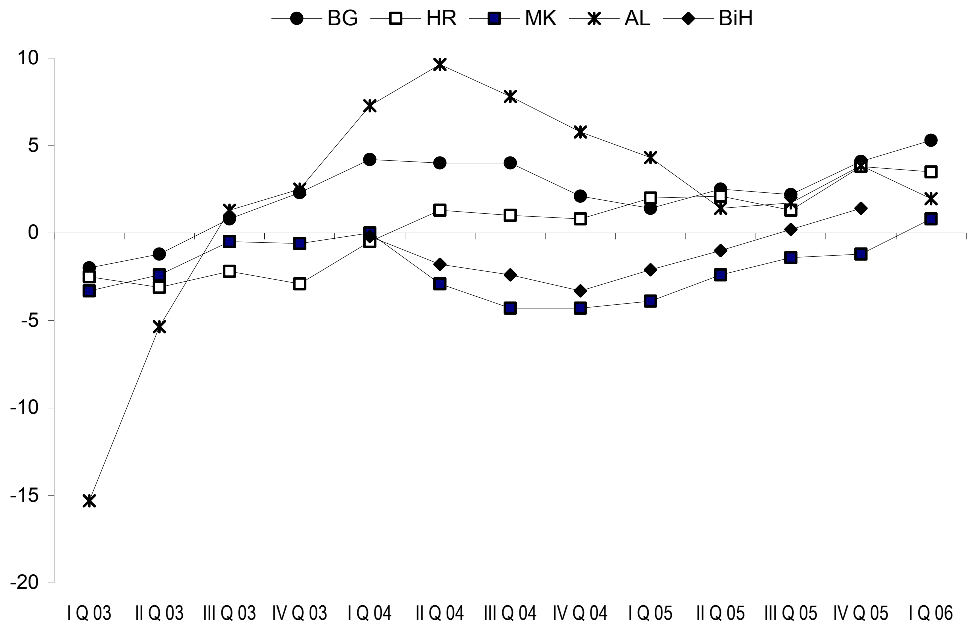
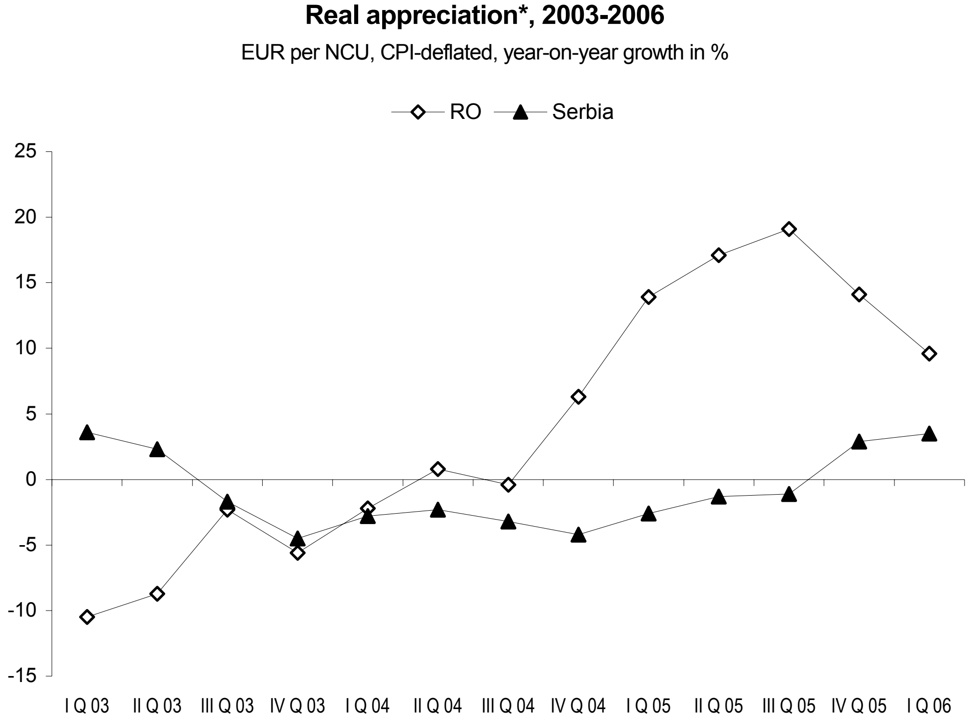


Figure 5 contd.

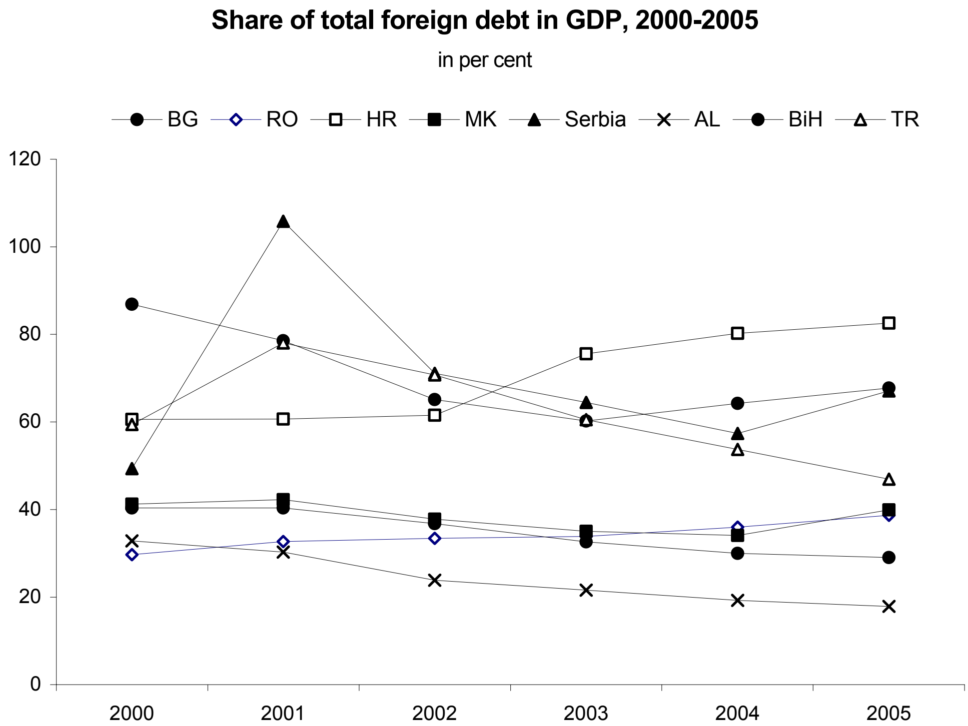
Figure 5 (contd.)



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

Source: wiiw Monthly Database incorporating national statistics.

Figure 6

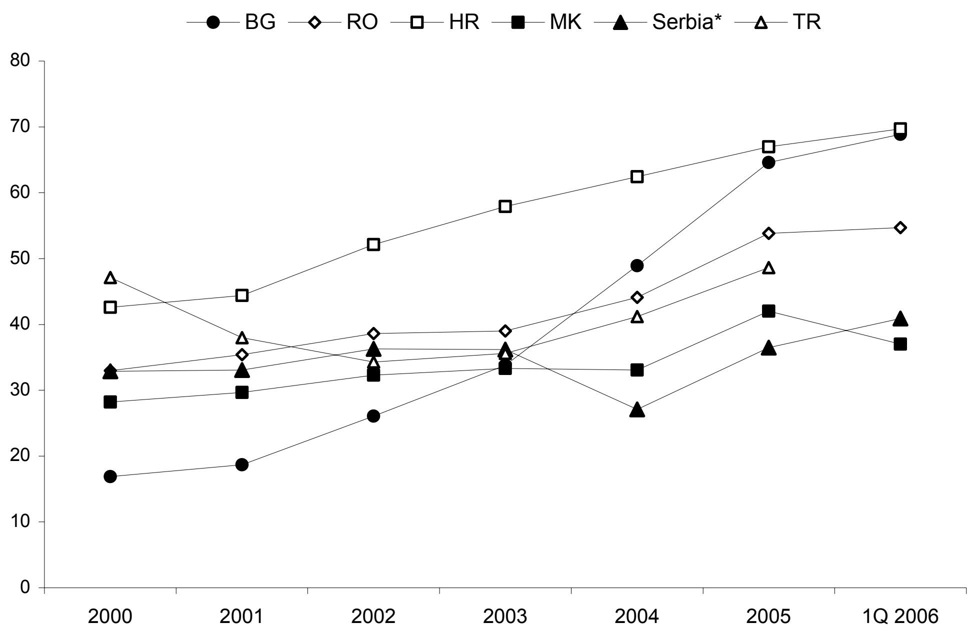


Source: National Banks of the respective countries.

Figure 7

Share of private foreign debt in total foreign debt, 2000-2006

in per cent



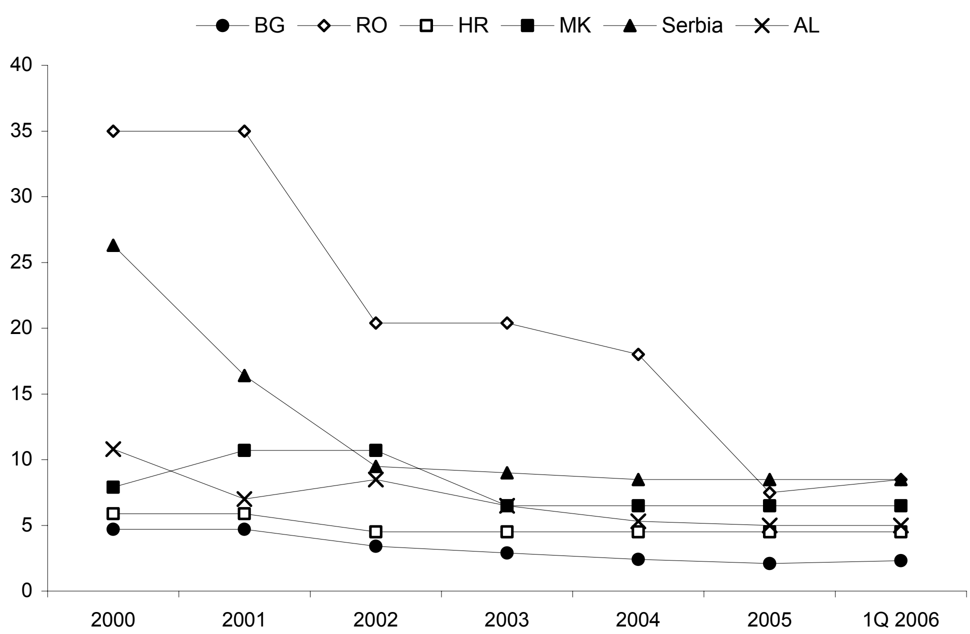
*) 2006 data refer to February 2006.

Source: National Banks of the respective countries.

Figure 8

Minimum interest rates, 2000-2006

nominal NB leading rate in % p.a.



Source: wiiw Monthly Database incorporating national statistics.

Private and overall debt has continued to climb in most countries, though perhaps more slowly than before (Figures 6 and 7). In those cases where central banks have adopted a more relaxed attitude towards the banks' lending activities, interest rates have dropped and credit inflows have abated (Figure 8). Indeed, partly because of the interest rate convergence, foreign capital inflows have undergone reversal in Turkey.

Foreign investments

Inflows of foreign investments have been stronger in some countries, while other countries continue to receive little or even decreasing amounts. Romania, Serbia, Montenegro and Croatia have recorder higher FDI inflows in 2005, while others have seen decreases (Table 3).

Table 3

Net capital flows (EUR million)

	Bulgaria			Romania		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**2511**	**3005**	**2629**	**4491**	**9054**	**10801**
Capital transfer	-0.2	-0.1	-1.0	188	512	584
FDI	1827	2244	1856	1910	5127	5208
Portfolio	-191	-563	-757	529	-416	685
Financial derivatives	.	.	.	.	.	-24
Other capital (loans)	875	1324	1531	1864	3831	4348
Destination of capital inflow	**2447**	**2625**	**2855**	**4080**	**9938**	**12322**
Current account	1630	1131	2531	3060	5099	6891
Increase reserves	817	1493	324	1020	4839	5431
Errors & omissions	**-64**	**-380**	**226**	**-411**	**884**	**1521**
	Croatia			**Macedonia**		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**4232**	**2385**	**3718**	**200**	**344**	**410**
Capital transfer	72.4	23.1	50.9	-6	-4	-2
FDI	1695	709	1185	85	126	78
Portfolio	869	245	-1049	3	12	189
Financial derivatives	.	.	-88	118	210	144
Other capital (loans)	1595	1409	3619	.	.	.
Destination of capital inflow	**3102**	**1501**	**2785**	**177**	**350**	**399**
Current account	1866	1458	1964	132	334	66
Increase reserves	1236	43	822	45	16	334
Errors & omissions	**-1130**	**-884**	**-933**	**-23**	**6**	**-11**
	Albania			**Bosnia & Herzegovina**		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**318**	**415**	**423**	**1333**	**1304**	**1582**
Capital transfer	139	106	99	411	393	360
FDI	158	269	209	338	488	240
Portfolio	-20	5	-2	.	.	.
Other capital (loans)	41	35	116	584	423	982
Financial derivatives	.	.	.	.	.	.
Destination of capital inflow	**449**	**522**	**579**	**1605**	**1783**	**2073**
Current account	361	286	454	1444	1437	1696
Increase reserves	88	236	125	162	346	377
Errors & omissions	**131**	**107**	**156**	**273**	**479**	**491**

(Table 3 contd.)

Table 3 (contd.)

	Montenegro			Serbia		
	2003	2004	2005	2003	2004	2005
Capital inflow transfer	**87**	**36**	**365**	**2219**	**2486**	**3538**
Capital transfer	.	.	.	.	.	.
FDI	39	51	375	1204	777	1196
Portfolio	1	6	5	.	.	.
Other capital (loans)	47	-20	-14	1015	1709	2342
Financial derivatives	.	.	.	.	.	.
Destination of capital inflow	**56**	**97**	**319**	**2178**	**2635**	**3324**
Current account	102	120	141	1362	2274	1687
Increase reserves	-46	-22	178	815	360	1637
Errors & omissions	**-31**	**61**	**-46**	**-42**	**149**	**-214**

Source: wiiw Database incorporating national bank statistics.

Fiscal balances improving

Throughout the region fiscal balances continue to be prudent. Given growing trade deficits, it can be argued that more fiscal consolidation would be desirable; that approach, however, would be difficult to sell in a region with relatively low employment and high unemployment rates. In fact, fiscal authorities are apparently planning to relax their tough fiscal stance in a number of cases. A characteristic example is Macedonia where for a number of years fiscal consolidation was the government's paramount priority. This year, however, it is planning a modest fiscal deficit; it seems that this easing of fiscal policy will continue.

Table 4

General government budget balance, in % of GDP 1)

	2000	2001	2002	2003	2004	2005 2)	2006 forecast	2007 forecast
Bulgaria	-0.6	-0.6	-0.7	0.0	1.7	3.2	3	1
Romania	-4.0	-3.2	-2.6	-2.2	-1.2	-0.8	-1	-3
Croatia	-6.5	-6.8	-4.8	-6.3	-4.9	-4.2	-4	-3.8
Macedonia 3)	2.3	-6.3	-5.0	-1.1	0.0	0.2	.	.
Turkey			-12.9	-11.3	-5.7	-1.2	-1.4	-1.0
Albania	-7.5	-6.9	-6.0	-4.8	-4.9	-3.4	-3	-3
Bosnia and Herzegovina	-7.0	-3.3	-0.2	0.8	1.8	.	.	.
Montenegro 4)	-6.0	-3.1	-2.8	-3.0	-2.1	.	.	.
Serbia	.	-1.6	-3.7	-4.2	-1.5	.	.	.

Notes: 1) National definition; for Turkey EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure; for Croatia IMF definition. - 2) Preliminary. - 3) From 2001 excluding privatization revenues, 2005 data projected. - 4) Central government budget deficit.

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

In a number of other countries, demand for increased transfers and public investments are growing and governments, most of which are not altogether popular with the electorate, seem ready to respond favourably. These pressures can but gain in strength in future; fiscal policies will thus have to be reassessed in the medium term. In the short term, however, fiscal prudence continues to characterize the region.

An interesting comparison between Turkey and Croatia could be made. Croatia has relied mostly on monetary policy to assure macroeconomic stability, with the consequence that its foreign debt has been growing and its fiscal deficit being a permanent concern. Turkey, on the other hand, has implemented a strong programme of fiscal consolidation, with the consequence that its growth has been very strong while interest rates have declined and the exchange rate has appreciated. In the current more risky environment, however, Turkey has had to hike its interest rates rather strongly, while Croatia is trying to support macroeconomic stability with lower fiscal deficits.

Regional trade*

With the highest export share in intra-regional trade (intra-SEE-7), Macedonia (39%), Serbia and Montenegro (35%) and Bosnia and Herzegovina (32%) can be considered the three core countries in the Balkans. Interestingly enough, of all the SEE-7 countries Serbia and Montenegro also registered the highest increase in their export share to the region over the period 2001-2005. This can be seen in Table 5a, which shows the percentage point changes in export shares over the same period.[28] As a matter of fact, all Balkan countries increased their export shares to the region. Except for Macedonia, all SEE countries experienced a substantial drop in their export shares to their main EU trading partner countries, Austria, Germany, Greece and Italy (EU-4), over the respective period. Table 5b presents the nominal changes in USD million. Thus, it might transpire that a drop in shares still represents a nominal increase, albeit below average.

Table 5a

SEE trade: Exports as % of total (2005) – change in shares, 2001-2005

of: / to:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
Albania		0.1	-0.1	0.0	0.0	0.0	0.4	0.0
Bosnia & Herzegovina	0.0		-0.1	**2.3**	-0.3	0.1	**5.0**	0.0
Bulgaria	0.0	0.0		0.3	0.2	0.8	0.4	0.1
Croatia	-0.1	**6.3**	**1.2**		**1.7**	0.8	**2.3**	0.0
Macedonia	-0.3	-0.2	0.0	-0.2		0.4	-0.4	0.0
Romania	0.0	-0.1	**1.0**	0.8	0.0		**-1.8**	0.2
Serbia & Montenegro	**1.2**	**-4.8**	-0.6	**1.2**	**-1.3**	-0.3		0.4
Russia	0.1	-0.1	-0.4	-0.6	0.3	0.0	**1.7**	
EU-4*	**-16.9**	**-5.9**	**-2.4**	**-4.6**	**8.3**	**-4.5**	**-2.7**	**-2.2**
SEE-7	0.8	**1.2**	**1.4**	**4.4**	0.3	**1.8**	**5.9**	0.7
Total change, USD billion	**0.4**	**1.4**	**5.9**	**4.4**	**0.8**	**14.4**	**1.9**	**153.6**

Note: All exports: f.o.b.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

* This section was written by Mario Holzner.

28 Percentage point changes above 1 are shown in bold: bold letters in a frame to show positive changes and white bold letters on a black background to show negative changes.

Table 5b

SEE trade: Exports – change in USD million, 2001-2005

to: / of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
Albania		1.8	19.7	9.8	8.3	11.4	14.9	44.8
Bosnia & Herzegovina	0.1		5.0	**748.3**	9.4	39.2	**442.2**	28.8
Bulgaria	0.2	0.6		32.9	16.0	388.2	31.6	1109
Croatia	0.5	**298.9**	**141.8**		**72.5**	241.9	**129.8**	751.0
Macedonia	1.9	2.8	126.5	32.0		128.8	162.6	-16.4
Romania	0.1	11.0	**254.9**	79.7	0.4		**-1.9**	1878
Serbia & Montenegro	**12.4**	**148.7**	177.3	**246.6**	**206.9**	114.4		1402
Russia	1.2	2.7	89.7	27.0	15.9	91.8	**148.1**	
EU-4*	**208**	**401**	**1807**	**1577**	**426**	**5299**	**627**	**25370**
SEE-7	15	**464**	**725**	**1149**	313	**924**	**779**	5197
Total change, USD billion	**0.4**	**1.4**	**5.9**	**4.4**	**0.8**	**14.4**	**1.9**	**153.6**

Note: All exports: f.o.b.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

The situation is quite similar with regard to import shares (see Table 6a). Once again the largest importers in intra-regional trade are Bosnia and Herzegovina (35%), Macedonia (27%) and Serbia and Montenegro (19%), albeit to a somewhat lesser extent. Those core countries in particular (except Serbia and Montenegro) have even markedly increased their SEE import shares over recent years. Moreover, for all SEE countries (except Bulgaria) the import shares from the EU-4 countries once again dropped sharply.

Russia has also been included in the analysis to show that for most SEE countries the share of Russian imports increased over the period 2001-2005. The increase in oil prices was the important determinant in this context. Only Bulgaria experienced a dramatic drop. However, in 2001 the share of Russian goods in Bulgarian imports stood at 20%. Since then, the country's import structure has become more diversified.

What are the reasons then for the deepening of trade integration in the SEE region? Based on earlier studies that used a gravity model approach, this outcome is partly what was to be expected. After a decade of disintegration due to wars and political instability in the 1990s, trade liberalization and the fundamental factors of geographical proximity and common languages brought about a revival in regional trade. The bilateral free-trade agreements between the countries of Southeast Europe have underpinned the process. Moreover, plans are being mooted for a single free-trade zone based on expanding and modifying the current Central European Free-Trade Agreement (CEFTA). By the end of 2006, the process is expected to culminate in the conclusion of a single regional trade agreement. However, given that a great deal of trade liberalization has already been introduced via the network of bilateral agreements, it is debatable whether the multilateral agreement will yield any additional benefits of substance, especially after Bulgaria and Romania have joined the

EU. The CEFTA framework continues to be more of a political symbol designed to demonstrate a will for regional cooperation in the course of EU integration.

Table 6a

SEE trade: Imports as % of total (2005) – change in shares, 2001-2005

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
from:								
Albania		0.0	0.0	0.0	0.0	0.0	0.1	0.0
Bosnia & Herzegovina	0.1		0.0	**1.1**	0.0	0.0	0.5	0.0
Bulgaria	0.1	-0.1		0.7	**2.7**	0.1	-0.9	-0.2
Croatia	-0.1	**3.9**	0.2		0.4	0.2	0.6	-0.1
Macedonia	-0.3	-0.3	-0.1	0.1		0.0	**-2.4**	0.0
Romania	0.0	0.5	**1.1**	**1.3**	**4.2**		-0.8	-0.1
Serbia & Montenegro	0.6	**3.6**	0.0	0.5	**1.4**	-0.3		0.0
Russia	**1.5**	-0.1	**-10.2**	**1.7**	-0.9	**1.7**	**1.1**	
EU-4*	**-7.5**	-0.9	**2.1**	**-4.8**	-0.1	**-6.8**	**-6.5**	**2.4**
SEE-7	0.4	**7.5**	**1.3**	**3.6**	**8.7**	0.0	**-3.0**	-0.3
Total change, USD billion	**1.3**	**3.1**	**10.1**	**9.6**	**0.9**	**26.4**	**6.2**	**73.4**

Note: All imports: c.i.f., *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

Table 6b

SEE trade: Imports – change in USD million, 2001-2005

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
to:								
Albania		0.1	0.4	0.5	1.8	0.3	13.2	2.0
Bosnia & Herzegovina	2.0		0.4	**328.5**	2.9	11.8	223.0	4.6
Bulgaria	33.9	5.6		150.6	**139.2**	280.2	195.3	93.1
Croatia	10.9	**823.4**	42.8		35.5	82.6	247.4	19.1
Macedonia	9.2	10.4	17.6	79.9		0.3	**207.1**	15.8
Romania	12.9	43.3	**426.3**	**254.3**	**143.0**		126.7	106.0
Serbia & Montenegro	16.5	**452.5**	32.3	129.8	**129.9**	-1.1		161.6
Russia	**48.6**	33.1	**268.8**	**1018**	-14.4	**2070**	**989.1**	
EU-4*	**693**	867	**3654**	**3102**	331	**9107**	**1569**	**18069**
SEE-7	85	**1335**	**520**	**944**	**452**	374	**1013**	402
Total change, USD billion	**1.3**	**3.1**	**10.1**	**9.6**	**0.9**	**26.4**	**6.2**	**73.4**

Note: All imports: c.i.f.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

Political shocks: three new states

In May 2006, Montenegro held a referendum and voted in favour of independence. It is the first of three new countries expected to emerge in the Balkans this year. The other two are Serbia and Kosovo. Indeed, with Montenegro seceding from its union with Serbia, the latter has become an independent state by default. This has caught Serbia unprepared. Although the transfer of power from the state union level to that of Serbia has been smooth and presented few problems at least institutionally, nation- and state-building is another matter. Serbia had become accustomed to functioning along provisional lines; it has yet to adopt a constitution proper and adapt its political and economic strategies to that of a proper nation-state.

The awakening of Serbia will not be complete until the status of Kosovo has been finally determined. That should happen later this year. The expectations, not only in Kosovo, are that it too will become another new state. Thus, by the end of this year or thereabouts, three new states will have come into being in the Balkans. With that, the process of Balkanization should come to an end. It is still not clear what the political consequences of this proliferation of states will be. Regional stability does not seem to be at risk; the outcome has long been expected in all quarters and the emerging political geography is a foregone conclusion. The political and economic consequences, however, are another matter altogether.

A comment on the prospects of Kosovo as a state might be useful. At the moment, Kosovo depends politically on the international community whose members are responsible for the country's security and also pay some of its bills. Unlike all the other Balkan states, Kosovo is totally immersed in the region; it is politically and economically dependent on the region. In sharp contrast, however, it is significantly less integrated with its neighbours today. This quasi-autarchy with the country reliant on aid and transfers is not conducive to Kosovo's economic development as the country is cut off from the local markets which are essential. It is also hard to imagine firms and industries developing without regional strategies and agglomeration. Trade liberalization and economic integration are thus of vital importance to Kosovo.

Everything depends on achieving a state of political normalcy. That is no mean task. It calls for political transformation: not only of Kosovo, a hard enough task in itself, but also of Serbia – and perhaps a number of other countries as well. In Serbia in particular, the political fall-out of Kosovan independence is hard to predict. There is a risk that Serbia will slip into a period of political frustration and it will have a hard time extricating itself.

Economic outlook and prospects of EU integration

Southeast Europe should continue to enjoy high rates of growth. Macroeconomic stability should also be maintained, though inflation is proving to be more of a problem than in the past. Structurally, the old problems remain: high external imbalances and high unemployment in most cases. These relatively good economic prospects should help the region to absorb the last round of political and constitutional changes. Further down the road, much will depend on the prospects of EU integration.

The main recent change has been the weakening of the EU commitment to enlargement in Southeast Europe. It is, of course, hard to break promises, all the more so when they have been made repeatedly to the whole region – as well as during the Austrian presidency this spring. There is growing uncertainty about the meaning of that commitment. The EU has since decided to determine its 'absorption capacity': an unfortunate term lacking any clear meaning. Perhaps the kindest interpretation is that the EU needs to reassess its decision-making structures since current arrangements do not cover the union comprising of more than 27 countries. Assuming that interpretation is correct, the problem is to be seen more as a political rather than a fundamental issue. Nonetheless, in view of this increased uncertainty, it becomes more difficult to predict the course that Balkan enlargement will take.

The chances are that Bulgaria and Romania will be welcomed into the EU on 1 January 2007. Croatia is expecting to join around 2010, once the discussions on the Union's 'absorption capacity' and the new financial framework are over. Everything else is highly uncertain. Most of the countries in the Western Balkans will manage to negotiate stabilization and association agreements with the EU by the end of 2006 or in 2007. It is increasingly uncertain, however, whether Macedonia will start negotiating its membership with the EU at the same time. The expectations are that Turkey will not achieve too swift a progress towards EU membership. Indeed, the debate on the 'absorption capacity' will mostly centre on the prospects of Turkish membership. In any case, 2015 looks increasingly unlikely as the date for Turkey's entry into the EU.

Country reports

Anton Mihailov

Bulgaria: EU accession reforms high on the policy agenda

The drama surrounding the actual date of EU accession dominates entirely Bulgarian policy and politics. The EC monitoring report published in May fell short of pronouncing the Commission's position on the issue, adding a further thrill to the political show. The Bulgarian authorities have mobilized all their resources to show progress in the lagging areas, most notably the reform of the judiciary and the fight against organized crime and corruption, but also in agriculture, financial control (money laundering) and energy. In early June, the government adopted – after consultation with the EC – an Action Plan with urgent measures in these areas that have to be adopted and put in place until September, the earliest date when the EC may announce its recommendation. Some of these measures imply legislative changes and their adoption will require active support from the parliament.

The planned velvet divorce from the IMF – after a decade and a half of difficult relations – has not materialized so far, although the authorities had initially announced that the current precautionary agreement would not be renewed after it expires in September. However, in view of the uncertainty in the EC's position on accession, the authorities have agreed to extend the precautionary agreement for a further six months, until March 2007, which means that both the execution of the 2006 budget and the drafting of the budget for the next year will still be done under close IMF scrutiny.

The consequences of continuing strong IMF presence are already visible in the macroeconomic arena. The authorities have confirmed that they are likely to stick to the 3% budget surplus target for 2006 pushed forward by the IMF (the actual budget for 2006 was adopted in December 2005 with a zero surplus; it was taken for granted that after the expected IMF departure the 3% surplus target would be abandoned altogether). The announced tentative macroeconomic framework for the 2007 budget suggests a continuation of the relatively tight fiscal stance: the government announced that it would aim for a 1% budget surplus next year (the IMF is pressing for a 2% surplus). Admittedly, the precise budgetary framework for 2007 will depend on the date of EU accession.

At the same time the authorities – obviously with IMF consent – announced that they would gradually relax the highly controversial and inefficient administrative credit controls. The declared justification of this relaxation is the decline in the year-on-year rates of credit growth in recent months. What remains questionable is whether the credit controls had any effect at all on the dynamics of credit (as credit continued to grow at a rate of more than 50% throughout 2005 while these controls were fully in place) or whether this dynamics just reflects fundamental determinants of demand, which has now reached a point of relative saturation (as these rates of growth are clearly unsustainable for a longer period).

Notwithstanding the hectic rush towards EU accession, the economy remains in good shape. In the first quarter of 2006, aggregate output continued to grow at a healthy rate, with GDP increasing by

Table BG

Bulgaria: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	7891.1	7845.8	7801.3	7761.0	7718.8	.	.	.	.
Gross domestic product, BGN mn, nom.	29709.2	32335.1	34546.6	38275.3	41948.1	8755.2	9815.4	47000	51800
annual change in % (real)	4.1	4.9	4.5	5.7	5.5	5.9	5.6	5.5	5
GDP/capita (EUR at exchange rate)	1920	2101	2258	2515	2771	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5840	6090	6470	6920	7530	.	.	.	.
Gross industrial production									
annual change in % (real) [2]	1.5	6.5	14.1	13.8	8.4	6.6	7.3	8	8
Construction output total									
annual change in % (real)	14.2	2.7	5.6	35.2	1.0	.	.	.	.
Actual final consump.of househ., BGN mn, nom.	23009.1	24822.9	26846.0	29324.5	33066.7	7286.4	8345.4	.	.
annual change in % (real)	4.6	3.4	7.1	4.9	7.4	7.1	5.4	.	.
Gross fixed capital form., BGN mn, nom.	5415.2	5908.5	6694.4	7969.4	9971.1	1790.0	2345	.	.
annual change in % (real)	23.3	8.5	13.9	13.5	19.0	11.2	21.4	18	15
LFS - employed persons, th, avg.	2698.8	2739.6	2834.8	2922.5	2980.0	2838.4	2940.5	3100	3200
annual change in %	-3.4	1.5	3.5	3.1	2.0	2.0	3.6	4	3
Reg. employees in industry, th pers., avg.	658.4	666.8	689.5	695.8	709.4	718.5	700.6	.	.
annual change in %	-0.5	1.3	3.4	0.9	1.9	4.5	-2.5	.	.
LFS - unemployed, th pers., average	663.9	592.4	448.7	399.7	334.2	362.3	315.2	300	270
LFS - unemployment rate in %, average	19.7	17.8	13.7	12.0	10.1	11.3	9.7	9	8
Reg. unemployment rate in %, end of period	17.3	16.3	13.5	12.2	10.7	12.7	10.8	9.5	8.5
Average gross monthly wages, BGN	240.0	257.6	273.3	292.4	319.5	299.0	329.0	.	.
annual change in % (real, gross)	-0.5	1.5	3.7	0.8	4.1	3.2	1.9	.	.
Consumer prices, % p.a.	7.4	5.8	2.3	6.1	5.0	3.8	8.0	8	5
Producer prices in industry, % p.a.	3.8	1.2	4.9	6.0	6.9	6.2	8.9	7	5
General governm.budget, nat.def., % GDP									
Revenues	39.8	38.7	40.7	41.4	42.9	47.6	44.6	.	.
Expenditures	40.4	39.4	40.7	39.7	39.7	42.1	40.2	.	.
Deficit (-) / surplus (+), % GDP	-0.6	-0.7	0.0	1.7	3.2	5.5	4.4	3	1
Public debt in % of GDP [3]	66.2	53.2	46.2	38.8	31.9	32.5	27.8	25	23
Base rate of NB % p.a., end of period	4.7	3.4	2.9	2.4	2.1	1.9	2.3	.	.
Current account, EUR mn	-1101.6	-925.5	-1630.2	-1131.3	-2530.7	-550.7	-1052.4	-3400	-3500
Current account in % of GDP	-7.3	-5.6	-9.2	-5.8	-11.8	-12.3	-21.0	-14.1	-13.2
Gross reserves of NB excl. gold, EUR mn	3734.0	4247.1	4981.0	6443.0	6815.7	6325.1	6399.6	.	.
Gross external debt, EUR mn	11934.9	10768.9	10640.6	12571.6	14530.3	13120.1	15175.9	.	.
FDI inflow, EUR mn	903.4	980.0	1850.5	2727.5	1789.0	392.0	755.4	2500	2500
FDI outflow, EUR mn	8.7	29.0	23.3	-165.6	256.5	15.2	15.8	.	.
Exports of goods, BOP, EUR mn	5714.2	6062.9	6668.2	7984.9	9454.1	2080.6	2666.7	11300	13000
annual growth rate in %	8.8	6.1	10.0	19.7	18.4	21.1	28.2	20	15
Imports of goods, BOP, EUR mn	7492.6	7754.7	8867.8	10938.4	13823.2	2785.4	3705.2	16500	18500
annual growth rate in %	14.7	3.5	14.4	23.3	26.4	22.5	33.0	19	12
Exports of services, BOP, EUR mn	2384.8	2478.9	2790.9	3261.8	3444.3	508.5	530.3	3800	4200
annual growth rate in %	0.8	3.9	12.6	16.9	5.6	9.0	4.3	10	11
Imports of services, BOP, EUR mn	1930.3	1992.9	2267.7	2569.3	2777.5	586.0	728.7	3300	3600
annual growth rate in %	6.1	3.2	13.8	13.3	8.1	7.2	24.4	19	9
Average exchange rate BGN/USD	2.185	2.077	1.733	1.575	1.574	1.492	1.627	.	.
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	0.561	0.582	0.583	0.607	0.599	.	.	.	.
Purchasing power parity BGN/EUR	0.643	0.675	0.683	0.710	0.720	.	.	.	.

Notes: 1) Preliminary. - 2) Different methodology for quarterly data. - 3) According to ESA'95, excessive deficit procedure.

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

5.6% year-on-year. The booming construction and tourism industries, as well as some manufacturing sectors (textiles, leather, metals, mechanical and electrical engineering) contributed the most to this outcome. Gross fixed capital formation surged in the first quarter, boosted by robust construction demand and healthy FDI inflows, and this was coupled with a rather extensive replenishment of inventories. Compared to 2005, the pace of private consumption lost some steam in the first quarter but still remained buoyant. After a slowdown in the second half of 2005, exports started to gather speed at the beginning of 2006, but this was coupled with an even faster pace of import growth.

The situation in the labour market continued to improve. During the first quarter of 2006 the rate of unemployment (both registered and LFS) was some 2 percentage points lower than a year earlier and in May registered unemployment fell below 10% for the first time ever since reporting began in 1991. In fact, labour shortages are beginning to surface in some segments of the labour market, in particular in some high-skill professional categories but also in sectors such as construction and services (especially tourism). So far there are no indications of a wage cost push related to these tensions but if these emerge, they may add to the current inflationary pressures which are mostly due to rises in controlled prices.

Despite the improvements in export performance, both the merchandise trade and the current account deficit continued to swell in the first quarter of 2006, pushed by the continuing import surge. A new record-high current account deficit figure is expected for the year as a whole.

In March-April 2006, the Bulgarian National Bank undertook revisions in the balance of payments for 2001-2005 after introducing some methodological changes in the statistics. The most important changes – reportedly in accordance with international accounting standards – concern the recording of revenue and expenditure for commercial cargo, revaluation of FOB imports as well as better reporting of remittances from abroad (in the past the BOP statistics included only bank transfers above EUR 2500; now they include all bank transfers from abroad as well as estimates of remittances from informal economic activity abroad). As a result of these methodological changes, there were notable shifts in the positive direction (roughly by some three percentage points of GDP) in the current account balance for the whole period 2001-2005. For example, the final current account deficit in 2005 now amounts to 11.8% of GDP (from 14.7% earlier); the figure for 2004 is now 5.8% (from 8.4% earlier), etc. The amounts of FDI inflows were also revised, resulting in a slight upward shift in some years.

The Bulgarian economy should continue to perform well in the short run. Economic growth is expected to remain strong throughout 2006, with GDP increasing by some 5.5%. The improvements in the labour market should continue with rising employment and falling unemployment rates. Carryover effects from the second half of 2005 and the first months of 2006 (related to energy hikes and rises in other administrative prices) will push up average annual inflation in 2006 significantly above earlier expectations. In contrast, the fiscal stance is likely to be much tighter than envisaged in the 2006 budget. Despite that, the current account deficit can be expected to widen further, reflecting the persistent strength of import demand.

Gábor Hunya

Romania: investment-led recovery

Romania has recovered from last year's growth deceleration. In the first quarter of 2006, GDP expanded by 6.9% over the same period of the previous year. Growth was driven primarily by private consumption (+10.9%), which recovered from the slowdown in the second half of last year despite a more moderate increase in real wages. Another factor of growth was fixed capital formation, up 11.4% over the first quarter of the previous year. Construction sector value added expanded by as much as 20%, mainly due to road construction and real estate development. Government consumption made a positive contribution to GDP as the general government budget was in surplus because expenditures are delayed to the end of the year. Domestic consumption grew to the detriment of the foreign trade balance. Net exports amounted to -9.8% of GDP, implying a one percentage point deterioration of the trade deficit as compared to a year earlier. The Romanian government does not consider the external imbalance to be alarming and accepts the increasing inflationary pressure caused by the overheating in order to keep the dynamism of economic growth.

Besides construction, there was also a rapid expansion of services in the first quarter of 2006 (6.8%). Services contribute already to more than half of the GDP, but we lack more detailed information about the development of value added in this sector. Looking at the turnover of trade and transport, no significant expansion can be observed. Success reports have be issued, on the other hand, concerning the expansion of the telecoms market. Manufacturing production, which contributes only 24% to the GDP, expanded by 4.8% in the first quarter of 2006 – an acceleration as compared to the previous year. The structural change towards machinery and away from light industries continues. It has been partly enforced by Chinese competition and the appreciation of the Romanian leu (RON), which led to declines in the textile and clothing industries, and partly generated by new capacities in the automotive and electrical machinery industries. As manufacturing sector employment continued to decline, labour productivity increased by 7.7%.

Foreign trade results based on customs statistics for the first four months of 2006 reveal an export growth of 17.2% and an imports growth of 24.6%. Exports and imports of machinery and equipment have outpaced all other commodities: together with vehicles they made up close to 30% of exports and 34% of imports. The share of the once leading export commodity group, textiles, clothing and footwear, declined to 22%. Due to high international oil prices, export and import growth of mineral products was fast, effecting some decline in the share of the EU among the trading partners. The current account deficit increased to above 9% of GDP in the first quarter of 2006 and is expected to rise further. However, FDI inflows were even higher than the current account deficit. Further high FDI is expected when the full price of EUR 3.7 billion will be paid according to the privatization contract of the largest commercial bank signed last year with Erste Bank. While privatization revenues are the main part of the extraordinarily high FDI in 2006, also green-field and modernization investments increase in the chemicals and automotive sectors.

It is still uncertain how the one-time privatization revenues will be booked in the budget. They may be used for current expenditures as public debt is only 15% of GDP. But the budgetary plans do not calculate with this possibility yet. The rectification of the government budget in April increased the 2006 deficit target from 0.5% to 0.9% of GDP. Further increases of deficits cannot be ruled out,

Table RO

Romania: Selected economic indicators

	2001	2002	2003	2004	2005 1)	2005 1st quarter	2006 1st quarter	2006 forecast	2007 forecast
Population, th pers., mid-year 2)	22408.4	21794.8	21733.6	21673.3	21623.8	.	.	.	.
Gross domestic product, RON mn, nom.	116768.7	151475.1	197564.8	246371.7	287186.3	50984.7	61034.7	331700	378900
annual change in % (real)	5.7	5.1	5.2	8.4	4.1	6.0	6.9	5.0	4.8
GDP/capita (EUR at exchange rate)	2002	2224	2420	2805	3665	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5460	6060	6520	7290	8140	.	.	.	.
Gross industrial production									
annual change in % (real)	8.3	4.3	3.1	5.3	2.0	5.7	4.5	4	4
Gross agricultural production									
annual change in % (real)	22.7	-3.5	7.5	24.1	.	.	.	.	.
Construction output total									
annual change in % (real)	9.0	10.0	9.8	9.2	8.2	3.2	20.7	.	.
Actual final consump.of househ., RON mn, nom.	91718.6	116940.4	149259.0	189538.4	223331.3	42970.4	52173.4	.	.
annual change in % (real)	6.8	4.8	8.2	12.9	9.1	12.5	10.9	.	.
Gross fixed capital formation, RON mn, nom.	24115.4	32283.6	42293.0	53291.8	66356.8	7903.3	9547.8	.	.
annual change in % (real)	10.2	8.2	8.5	10.8	13.1	5.2	11.4	10	8
LFS - employed persons, th, avg. 2)3)	10696.9	9234.3	9222.5	9157.6	9146.6	8948.1	.	.	.
annual change in %	-0.6	.	-0.1	-0.7	-0.1	1.5	.	.	.
Reg. employees in industry, th pers., avg.	1901.0	1891.0	1848.0	1741.0	1704.0	.	.	.	.
annual change in %	1.5	-0.5	-2.3	-5.8	-2.1	-0.2	-4.0	.	.
LFS - unemployed, th pers., average 2)3)	750.0	845.3	691.8	799.5	704.5	831.6	.	.	.
LFS - unemployment rate in %, average 2)3)	6.6	8.4	7.0	8.0	7.2	8.5	.	7	7
Reg. unemployment rate in %, end of period	8.8	8.4	7.4	6.3	5.9	6.0	6.2	5.8	5.7
Average gross monthly wages, RON	422.0	532.1	663.8	818.3	957.5	915.6	1072.7	.	.
annual change in % (real, net)	5.1	2.4	10.8	10.6	13.5	13.1	5.9	.	.
Consumer prices, % p.a.	34.5	22.5	15.3	11.9	9.0	8.8	8.6	8.5	8.0
Producer prices in industry, % p.a.	38.1	23.0	19.5	19.1	10.5	13.3	10.9	.	.
General governm.budget, nat.def., % GDP									
Revenues	30.1	29.6	28.7	28.7	29.1	.	.	.	.
Expenditures	33.3	32.2	30.9	29.9	29.9	.	.	.	.
Deficit (-) / surplus (+)	-3.2	-2.6	-2.2	-1.2	-0.8	.	.	-1	-3
Public debt, EU-def., % of GDP 4)	23.2	23.8	20.7	18.0	15.2	.	.	.	.
Discount rate, % p.a., end of period 5)	35.0	20.4	20.4	18.0	7.5	10.8	8.5	.	.
Current account, EUR mn	-2488	-1623	-3060	-5099	-6891	-980	-1564	-9000	-10000
Current account in % of GDP	-5.5	-3.3	-5.8	-8.4	-8.7	-7.1	-9.1	-9.5	-9.5
Gross reserves of NB excl. gold, EUR mn	4445.3	5876.8	6373.6	10848.2	16795.6	12561.5	18146.1	.	.
Gross external debt, EUR mn 6)	14685.5	16199.8	17835.3	21894.8	30653.9	.	32360.6	.	.
FDI inflow, EUR mn	1294	1212	1946	5183	5197	754	1720	8000	5000
FDI outflow, EUR mn	-18	18	36	56	-11	8	29	.	.
Exports of goods, BOP, EUR mn	12722	14675	15614	18935	22255	5095	6213	26700	29300
annual growth rate in %	12.9	15.4	6.4	21.3	17.5	17.4	21.9	20	10
Imports of goods, BOP, EUR mn	16045	17427	19569	24258	30061	6156	7907	37600	42100
annual growth rate in %	22.1	8.6	12.3	24.0	23.9	21.1	28.4	25	12
Exports of services, BOP, EUR mn	2273	2468	2671	2903	3931	790	1141	5500	7150
annual growth rate in %	19.0	8.6	8.2	8.7	35.4	25.9	44.4	40	30
Imports of services, BOP, EUR mn	2402	2463	2609	3116	4365	909	1130	5670	7300
annual growth rate in %	10.7	2.5	5.9	19.4	40.1	48.5	24.3	30	29
Average exchange rate RON/USD	2.9061	3.3055	3.3200	3.2637	2.9137	2.8297	2.9624	.	.
Average exchange rate RON/EUR (ECU)	2.6027	3.1255	3.7556	4.0532	3.6234	3.7094	3.5641	3.5	3.6
Purchasing power parity RON/USD	0.8324	0.9893	1.1894	1.3312	1.3563	.	.	.	.
Purchasing power parity RON/EUR	0.9547	1.1475	1.3946	1.5586	1.6311	.	.	.	.

*) On 1st July 2005 the new Romanian leu was introduced (1 RON = 10000 ROL). Data in this table are presented in new leu (RON).

Notes: 1) Preliminary. - 2) From 2002 according to census March 2002. - 3) From 2002 break in methodology. - 4) According to ESA'95, excessive deficit procedure. - 5) From February 2002 reference rate of NB. - 6) From 2004 including short-term deposits and foreign direct investment intercompany lending.

Source: wiiw Database incorporating national statistics; European Commission (Spring 2006); wiiw forecasts.

which means that the government diverts from the stability path encouraged by the IMF. But there are also attempts at increasing revenues. On 1 July 2006, excises will be raised for electricity, petrol, natural gas, cigarettes and alcohol. Energy excises will continue to rise until 2009 to reach the EU level by then, while in the case of alcohol and cigarettes Romania will comply with EU standards by the beginning of 2007. The government envisages to modify the tax code as of 1 January 2007 but to keep the flat tax rate on corporate and private incomes at 16% and to maintain the VAT at the current level of 19%. The 16% rate will be expanded to all types of incomes and profits, and to all activities. This will mean an increase in taxes on dividends and interest earnings and of the tax burden on the so far exempted micro-enterprises. A major uncertainty in terms of budgetary policy is that it is not in conformity with Eurostat rules. According to EU forecasts, the general government deficit will be 2.3% of GDP in 2006, rising to 5.4% in 2007.

The Romanian National Bank's (BNR) policy remains moderately restrictive, by maintaining an 8.5% interest rate and the high (40%) level of the rate of the compulsory minimum reserves on foreign currency deposits. But credit expansion continues disregarding the restrictive measures. Non-governmental credit increased by 41.7% in real terms in April 2006 as compared to April 2005. RON crediting, primarily to households, was the main factor of growth, with a 95.7% annual increase. Foreign currency loans calculated in RON have risen by 22.3% since late April 2005, in accordance with the BNR's policy to shift credits to local currency.

Disinflation is slower than envisaged by the BNR. The inflation target for the end of 2006 is 5% plus/minus 1% – but based on the current and expected developments the BNR expects 6.8% according to its May Inflation Report. Average annual inflation may not come down under 8%, which is the highest rate in Europe. Centrally administered prices continue to rise due to adjustment to EU rules.

The aim of joining the EU is the major political objective which keeps the governing coalition together and guides most of its action. In its May 2006 assessment, the European Commission failed to give a go-ahead to Romania's EU accession. This was confirmed at the EU Summit on 13-14 June by stating that 'it is the common objective of the European Union to welcome Romania and Bulgaria in January 2007, if the countries are ready'. The document states that the Commission will write a new monitoring report on the two countries in early October at the latest. Until then, peer reviews and assessment missions will be taking place to support reform measures in Romania. Some of these measures are in the area of justice and the fight against corruption. In the economic sphere, the ministry of finance will have to review the VAT collection system, and improvement is needed concerning the administrative capacity in taxation. The country will also have to make advance in institution building in order to be able to benefit from EU funds: new personnel is to be employed and trained at the Agriculture Paying Agency and the Paying Agency for Rural Development and Fisheries. If the EU finds deficits in the preparations of Romania (and Bulgaria) in October, accession in 2007 is still possible but with restrictions. In the framework of the monitoring process agreed in the accession treaty, access to EU financing and participation in the single market can be limited even during a pro-forma membership. This solution would save face regarding the accession date and thus the political image of the Romanian government, but delay the application of some of the most important benefits of membership (and thus backfire on the popularity of EU membership in Romania).

The 2007 outlook for the Romanian economy is moderately positive, with expected economic growth close to 5%. We recon with EU membership but with limited access to new funds. Inflation will not come down to the BNR envisaged rate and will hover around 8%. Fiscal adjustments will become necessary to comply with EU standards, which will increase deficits. Romania has no target for the introduction of the euro but will have to oblige to the rules of the Stability and Growth Pact. Fiscal and monetary policies will be moderately restrictive as none of the existing tensions will prompt decisive action.

Hermine Vidovic

Croatia: growth continues but external imbalances remain

The first quarter of 2006 was characterized by high, though abating industrial output growth, moderately growing retail trade turnover and further increasing external imbalances. The jump in construction activities implies a resumption of investment growth after only modest increases in the past two years. Spurred by high oil prices and public utility price hikes, consumer price inflation continued to increase, averaging 3.5% in the first four months of the year and 3.5% in April respectively. On 12 May the EU approved the start of detailed membership talks with Croatia (having formally agreed already in October last year).

Industrial production growth lost momentum from month to month; in the period January-April it was up 3.7%. Within manufacturing, output grew above average in the manufacture of machinery and equipment, other non-metallic mineral products, radio, television and communication equipment as well as in the production of food and beverages. By contrast, the output of the shipbuilding industry – reporting a surge in exports – dropped by 6%. The production of textiles has continued its downward trend: within the past five years the output level in the textile industry fell by about one third; over that period an average 200 jobs were lost per month.

Final data obtained from the Labour Force Survey indicate a 0.7% employment increase in 2005 as compared to a year earlier and a decline of the unemployment rate to 12.7%. Labour market data available from registration point to a further employment rise by 0.7% – particularly in construction, distribution and financial and business services – in the first four months of 2006, while unemployment stood at 17.8 % in April. A special programme launched by the government in March should help to employ the low-educated, long-term unemployed, older workers, young people with no working experience and members of vulnerable groups, such as disabled persons or war veterans.

On the external side, customs statistics data indicate a dynamic performance in the first four months of the year, with exports up 19.6% and imports by 20.4% in euro terms. This resulted in a widening of the trade deficit to EUR 2.8 billion, EUR 480 million more than in the same period a year earlier. After a slump in 2005, shipbuilding (Croatia's main single exporter) reported remarkable export growth during the first four months of the year, as did the manufacture of coke and refined petroleum products. Exports to the EU countries grew above average, with outstanding results in trade with Italy, Croatia's major trading partner. After years of strong expansion, exports to the successor states of former Yugoslavia (excluding Slovenia) rose only modestly, whereas imports from that

Table HR

Croatia: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year	4437	4443	4442	4439	4439	.	.	.	.
Gross domestic product, HRK mn, nom.	165640	181231	198422	212826	229031	50930	.	245300	261500
annual change in % (real)	4.4	5.6	5.3	3.8	4.3	1.8	.	4	4
GDP/capita (EUR at exchange rate)	4998	5507	5906	6397	6972	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	8630	9380	9980	10610	11450	.	.	.	.
Gross industrial production [2]									
annual change in % (real)	6.0	5.4	4.1	3.7	5.1	0.3	6.4	4	4
Gross agricultural production									
annual change in % (real)	8.5	7.7	-15.9	11.9	.	.	.	.	.
Construction industry, hours worked [2]									
annual change in % (real)	3.6	12.8	22.8	2.0	-0.8	-6.6	15.2 [I-II]	.	.
Consumption of households, HRK mn, nom.	98054	108027	115081	122100	130576	30975	.	.	.
annual change in % (real)	4.5	7.7	4.6	3.9	3.4	2.4	.	4	4
Gross fixed capital form., HRK mn, nom.	36984	44105	56662	60866	65391	14186	.	.	.
annual change in % (real)	7.1	13.9	24.7	4.4	4.8	0.3	.	7	6.5
LFS - employed persons, th, avg.	1469	1528	1537	1563	1573	.	.	.	.
annual change in %	-5.4	4.0	0.6	1.7	0.7	.	.	.	.
Reg. employees in industry, th pers., avg.	287.2	281.0	282.6	281.7	278.9	278.3	274.2	.	.
annual change in %	-1.6	-2.2	0.6	-0.3	-1.0	-0.7	-1.5	.	.
LFS - unemployed, th pers., average	277.0	266.0	256.0	249.5	229.0	236.0	.	.	.
LFS - unemployment rate in %, average	15.9	14.8	14.3	13.8	12.7	13.1	.	12.5	12
Reg. unemployment rate in %, end of period	23.1	21.3	18.7	18.5	17.8	19.0	18.1	17.5	17
Average gross monthly wages, HRK	5061	5366	5623	5985	6248	6087	6454	.	.
annual change in % (real, net)	1.6	3.1	3.8	3.7	1.6	1.7	1.5	.	.
Consumer prices, % p.a. [3]	4.9	1.7	1.8	2.1	3.3	3.3	3.5	3.5	3
Producer prices in industry, % p.a.	3.6	-0.4	1.9	3.5	3.0	4.8	3.5	2.7	2.4
General governm.budget, IMF-def., % GDP									
Revenues	44.7	45.2	44.9	.	.	.	.	.	.
Expenditures	51.5	50.0	49.5	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.8	-4.8	-6.3	-4.9	-4.2	.	.	-4	-3.8
Public debt in % of GDP [4]	50.3	50.4	51.7	53.2	54.5	.	.	55	56
Discount rate % p.a., end of period	5.9	4.5	4.5	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn	-817.7	-2097.2	-1866.2	-1458.0	-1963.6	-1542.0	.	-2200	-2200
Current account in % of GDP	-3.7	-8.6	-7.1	-5.1	-6.3	.	.	-6.5	-6.2
Gross reserves of NB excl. gold, EUR mn	5333.6	5651.3	6554.1	6436.2	7438.4	6700.4	8088.5	.	.
Gross external debt, EUR mn	13458.3	15054.8	19810.6	22780.7	25540.8	23145.3	26314.5	.	.
FDI inflow, EUR mn	1502.5	1195.1	1788.4	989.3	1327.8	204.5	.	.	.
FDI outflow, EUR mn	175.7	598.3	93.0	280.3	142.9	29.9	.	.	.
Exports of goods, BOP, EUR mn	5318.8	5293.1	5571.7	6603.1	7244.3	1523.5	.	8300	9200
annual growth rate in %	7.0	-0.5	5.3	18.5	9.7	2.7	.	15	11
Imports of goods, BOP, EUR mn	9922.6	11253.5	12545.9	13330.9	14727.1	3092.7	.	16900	18900
annual growth rate in %	17.2	13.4	11.5	6.3	10.5	5.9	.	15	12
Exports of services, BOP, EUR mn	5481.3	5832.3	7565.9	7636.7	8051.8	652.6	.	.	.
annual growth rate in %	23.4	6.4	29.7	0.9	5.4	5.4	.	.	.
Imports of services, BOP, EUR mn	2178.5	2547.5	2632.8	2921.7	2734.7	648.4	.	.	.
annual growth rate in %	10.5	16.9	3.3	11.0	-6.4	2.0	.	.	.
Average exchange rate HRK/USD	8.34	7.86	6.70	6.04	5.95	5.73	6.11	.	.
Average exchange rate HRK/EUR (ECU)	7.47	7.41	7.56	7.50	7.40	7.51	7.34	7.3	7.4
Purchasing power parity HRK/USD	3.77	3.75	3.82	3.86	3.75	.	.	.	.
Purchasing power parity HRK/EUR	4.33	4.35	4.47	4.52	4.51	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) In 2001 retail prices. - 4) Including guarantees.

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

region performed above average. Considering the increased deficit in merchandise trade and a substantial drop in overnight stays during the first quarter of 2006, the current account deficit has reached almost EUR 2 billion.

Despite several attempts of the Croatian National Bank (CNB) to counteract a further increase in foreign debt, the latter's upward trend has not yet come to a halt. Over the past couple of years, the CNB repeatedly increased the marginal reserve requirement on new bank borrowing from abroad. From January 2006 it was set at 55% and applicable to the rise in banks' foreign liabilities relative to November 2005. This new measure includes corporate borrowing guaranteed by Croatian banks and banks' borrowing from domestic leasing companies. Overall, from December 2005 foreign debt increased by another EUR 1.3 billion and reached EUR 26.3 billion by March 2006. The bulk of the increase was again borne by the banking sector, accounting for almost 38% of total debt, while foreign debt of the government could be somewhat reduced. In a recent study on the foreign debt situation in Croatia, the CNB stated that foreign debt is currently still within the limits of sustainability, but that a continuation of the current tendencies (meaning without effective measures on the fiscal side) may very quickly lead to a debt crisis.

Stabilizing external debt and keeping the public debt below the Maastricht reference value are the key goals stressed in the second Pre-Accession Economic Programme for the period 2005-2008, updated in December last year. These objectives should be reached by further fiscal consolidation through the reduction of subsidies, saving in public administration and on social benefits, a health sector reform and a gradual reduction of taxes. The monetary and exchange rate policies are envisaged to remain unchanged. To support these policies, the Croatian authorities had asked the IMF to extend the Stand-by arrangement (from August 2004) by seven months, until November 2007. Another (draft) document presenting the long-term economic strategy was launched in mid-May, aiming at achieving 'social prosperity through development and employment in a competitive market economy within a European welfare state of the 21st century'. The strategy foresees, among other things, a fast catching-up process up to 2013 which should be facilitated by (very ambitious) annual GDP growth rates of 6%. The strategy stresses again the importance of reducing the external vulnerability and proposes measures for a quick introduction of the euro after EU accession.

Economic prospects for the coming two years are relatively good. Driven primarily by domestic demand, GDP may grow by about 4% in both 2006 and 2007. Private consumption growth will be supported by the credit expansion to the enterprise and household sectors and the repayment of pension arrears starting this year; investments should come primarily from the private sector. Inflation may reach 3.7% on an annual average due to increasing energy prices and a further adjustment of administered prices. Assuming that earnings from tourism will remain at their 2005 level and that the trade deficit will widen again, the current account may close with a higher deficit than last year, at over 6% of the GDP. The big uncertainty, however, remains foreign indebtedness: it may only come to a halt if the Croatian authorities pursue a very strict fiscal consolidation strategy; otherwise the country may face a serious debt crisis.

Mario Holzner

Albania: SAA signed

Besides Croatia and Macedonia, Albania has become the third West Balkan country that has signed a Stabilization and Association Agreement (SAA) with the European Union. This ties Albania closer to the EU and opens a concrete accession perspective for a country that has in recent years progressed a lot in terms of economic development as well as in the sphere of democracy and civil rights. Governments have changed peacefully. The economy has been growing strongly at an average annual rate of 6%, driven by a vibrant construction sector which is fuelled by high remittances from Albania's diaspora. This is notwithstanding a kick-off from very low levels, which is probably one explanation why foreign direct investment has not yet surged in heavily. However, this might change now too.

The SAA foresees free trade between Albania and the EU within the next ten years. In fact the EU has liberalized unilaterally already back in 2000, when it granted Autonomous Trade Concessions to five Western Balkan countries. These concessions allow for tariff-free exports to the EU for almost all product groups. Thus in the years to come Albania is obliged to abolish its remaining trade barriers vis-à-vis the EU. Tariffs on 83% of finished products imported from the EU will be zeroed immediately. Tariffs for the remaining products will be lowered stepwise until 2011. Under the SAA Albania is also committed to align its legislation to the common European standards. Closer cooperation in justice and security issues is envisaged as well.

However, apart from the recent success in EU integration, there are still many stumbling blocks on Albania's path to prosperity. Missing and malfunctioning infrastructure appears to be one of the most crucial. Poor power grids, missing connection to international power networks, mismanagement in the state electricity company KESH, extreme dependence on national hydro-power generation, together with a drought at the end of 2005 caused heavy electricity shortages and dampened 2005 real GDP growth below the mid-term average rate of 6% to some 5.3%. This will also have its effects in 2006, where economic growth is expected at 5.2%. Moreover, first-quarter sales data indicates a drop in construction sector sales. This is allegedly due to a lack of construction permits.

It seems though that it is finally understood that the improvement of the electricity sector is of utmost importance to further dynamic growth of the economy. Various short- and long-term actions have been initiated, on both the demand and supply side. Starting this summer, the energy regulatory entity will increase electricity prices for households by 11%; still, the government has promised to subsidize families in need. At the same time businesses will have to pay 22% lower rates than before. This should help to reduce energy demand without hurting productive economic units. Another important issue will be to reduce technical network losses (i.e. mostly electricity theft). Also, the government plans to privatize the power utility KESH at the beginning of 2007, starting with the sale of the company's distribution arm. On the supply side, a Swiss-based international consortium including US General Electrics plans to build a USD 1.9 billion thermal power plant and re-gasification terminal. This would make the country less dependent on hydro power. The completion of the project is scheduled for 2009. By then the country should not only be able to satisfy domestic demand but also export energy. The deal is expected to be passed by parliament this summer.

Table AL

Albania: Selected economic indicators

	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	3084.1	3102.8	3119.5	3135.0	3150.0	.	.	.	.
Gross domestic product, ALL mn, nom.	590282	631338	714049	775864	835000	.	.	910000	980000
annual change in % (real)	7.1	4.3	5.7	6.7	5.3	.	.	5.2	5.8
GDP/capita (EUR at exchange rate)	1495	1542	1669	1945	2140	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3850	4010	4250	4640	4860	.	.	.	.
Gross agricultural production									
annual change in % (real) 2)	2.2	2.1	3.0	3.1	3	.	.	3.5	3.5
Construction output total									
annual change in % (real) 2)	49.3	8.7	11.3	10.6	9.0	.	.	10	11
Consumption of households, ALL mn, nom.	422651	455952	508108	.	.	.	.	.	.
in % of GDP	71.6	72.2	71.2	.	.	.	.	.	.
Gross fixed capital form., ALL mn, nom.	151156	143914	160210	.	.	.	.	.	.
in % of GDP	25.6	22.8	22.4	.	.	.	.	.	.
Reg. employment total, th pers., end of period 4)	920.6	920.1	926.2	931.0	932.0	931	.	.	.
annual change in %	.	0.0	0.7	0.5	0.1	1.3	.	.	.
Reg. unemployed, th pers., end of period	180.5	172.4	163.0	157.0	155.0	156	.	.	.
Reg. unemployment rate in %, end of period	16.4	15.8	15.0	14.4	14.2	14.3	.	14	14
Average gross monthly wages, ALL 3)	17218	19659	21325	24393	26808	26091	.	.	.
annual change in % (real, gross) 3)	11.6	8.1	6.1	11.2	11.0	.		.	.
Consumer prices, % p.a.	3.1	5.2	2.2	3.0	2.4	2.2	1.4	2.5	2
Producer prices in manufacturing ind., % p.a.	-7.2	5.1	1.8	12.2	.	.	0.7	.	.
General governm.budget, nat.def., % GDP									
Revenues	24.7	24.5	23.4	23.8	24.5	.	.	.	.
Expenditures	31.5	30.5	28.2	28.7	27.8	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.9	-6.0	-4.8	-4.9	-3.4	.	.	-3	-3
Public debt in % of GDP	41.0	41.4	40.3	38.5	38.1	.	.	.	.
Refinancing base rate, % p.a., end of period	7.0	8.5	6.5	5.3	5.0	4.0	5.0	.	.
Current account, EUR mn 4)	-243.5	-433.1	-360.7	-286.2	-453.7	-52.3	.	-500	-520
Current account in % of GDP	-5.3	-9.1	-6.9	-4.7	-6.7			-6.8	-6.5
Gross reserves of BoA incl. gold, EUR mn 5)	863.5	813.0	812.7	1005.2	1201.6	1045.5	1221.5	.	.
Gross external debt, EUR mn	1355.0	1135.0	1118.0	1165.0	1200.0	.	.	.	.
FDI inflow, EUR mn 4)	231.5	151.4	157.8	269.4	209.3	43.3	.	.	.
Exports of goods, BOP, EUR mn 4)	340.2	350.5	397.9	485.6	530.2	121.5	144.4 6)	600	700
annual growth rate in %	22.6	3.0	13.5	22.0	9.2	11.3	19.2 6)	13	17
Imports of goods, BOP, EUR mn 4)	1486.5	1574.5	1578.3	1762.3	2006.9	398.1	540.4 6)	2400	2500
annual growth rate in %	27.4	5.9	0.2	11.7	13.9	9.5	29.6 6)	20	4
Exports of services, BOP, EUR mn 4)	595.3	618.4	638.1	807.5	930.4	196.5	.	1050	1150
annual growth rate in %	22.6	3.9	3.2	26.6	15.2	11.3	.	13	10
Imports of services, BOP, EUR mn 4)	494.8	623.7	709.8	848.0	1099.5	225.9	.	1200	1300
annual growth rate in %	5.9	26.1	13.8	19.5	29.7	35.5	.	9	8
Average exchange rate ALL/USD	143.5	140.2	121.9	102.8	99.9	96.7	102.2	.	.
Average exchange rate ALL/EUR (ECU)	128.5	132.4	137.5	127.7	124.2	126.7	123.0	123	122
Purchasing power parity ALL/USD, wiiw 7)	43.6	43.9	46.1	45.7	45.5	.	.	.	.
Purchasing power parity ALL/EUR, wiiw 7)	49.9	50.9	54.0	53.5	54.7	.	.	.	.

Note: ALL: ISO code for the Albanian lek.

1) Preliminary. - 2) According to gross value added. - 3) Public sector only. - 4) Until 2003 calculated from USD. - 5) Refer to total foreign assets of Bank of Albania. - 6) Based of customs statistics. - 7) wiiw estimates incorporating data of World Penn Tables.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Currently Albania is heavily importing energy products. According to recent customs statistics, first-quarter 2006 imports of the category 'minerals, fuels, electricity' doubled as compared to the first quarter of the previous year. This category now accounts for one sixth of total imports. In euro terms, total imports of goods increased by 30% in the first quarter. Exports were growing too, but only by 20%. Thus, for the whole year 2006 we may again expect a widening trade deficit, though probably less pronounced than what the first-quarter results would suggest – unless domestic hydro power generation is again struck by a drought.

With improvements in the electricity sector and more FDI starting to trickle in, economic growth prospects for 2007 appear favourable. A rebound close to the 6% GDP trend growth rate can be expected. Unlike other countries in the Balkans, Albania is not being threatened by unsustainably high external debt. Debt is well below 20% of GDP. Fiscal and monetary policy being harmonized, the inflation pressure is low. In the first quarter of 2006 consumer prices rose by only 1.4%, which is 0.8 percentage points less than in the first quarter of last year. However, given the expected increase in energy costs, an inflation rate above 2% is likely for the whole of the year 2006. The government was able to improve tax collection and reduce expenditures, which resulted in a budget surplus of lek 10.3 billion in the first quarter of 2006. The main improvements occurred in excise, profit and income tax collection. The general government budget deficit by the end of 2006 can be expected at or below 3% of GDP. This will also be due to a significant wage increase in the public sector planned for the second half of 2006. The Albanian Central Bank continues to pursue a de facto peg of the Albanian lek to the euro. In fact the currency is even appreciating slightly in nominal terms. The increase in the money supply is mainly due to further credit expansion to the economy.

Overall, the economic outlook for Albania is favourable. The persistently high growth rates could even be accelerated: On the one hand, the government could use additional funds from improved tax collection to finance public investment in ailing energy and transport infrastructure; the planned supplementary budget for high-priority capital spending for the second half of 2006 is a move in the right direction. On the other hand, a more flexible exchange rate policy of the Albanian Central Bank could improve the competitiveness of the Albanian export industry.

Zlatko Bosnić

Bosnia and Herzegovina's economic boom

The economy is booming in Bosnia and Herzegovina (BiH): most visibly in the construction sector – public and private, urban and rural, official and grey. In the manufacturing sector, a trend towards specialization in metallurgy is to be discerned, with a ripple effect on mining and quarrying. The generation of electricity continues to contribute significantly to the GDP; the transport sector is also growing. Trade has become a very important and rapidly expanding contributor to the GDP; its share in total GDP is scarcely less than that of manufacturing. This is a trait common to less developed countries. It is also accompanied by a pronounced and ever deeper divide between the recently emerging small class of 'new rich' and the broad masses of 'new poor'.

Trade as a key sector in tandem with weak manufacturing corresponds to the image of a society that imports much and exports little. In 2005 imports of goods amounted to EUR 6 billion; exports to EUR 2 billion. The country can afford this skewed life-style given the massive support, mainly on a private basis, that it enjoys from abroad. The transfers recorded in the balance of payment statistics cover but a fraction of the total inflow. Most people prefer to use informal and invariably less costly conduits to transfer funds. Many of the incoming remittances feed into imports; insofar as this is the case, they have no impact at all on the GDP. They do, however, push household expenditures up to a level equal or higher than the GDP as a whole. It is unclear whether this is actually the case as really reliable GDP estimates are not available. National accounts are still not fully developed; official GDP estimates could well be 'under-estimates'. For its part, however, BiH no longer creates the impression of being a country with a GDP per capita as low as some EUR 2000 [29]. From a political viewpoint, there may be little incentive to refrain from citing underestimates; low GDP figures may well prolong the grace period that international financial institutions grant when it comes to servicing foreign debt. If indeed they do underestimate ongoing economic activities, low GDP figures might prove costly in another way. Drawing a picture of the economy gloomier than reality might discourage investment, domestic and foreign.

As figures for the first quarter of 2006 confirm, foreign direct investment shows a shrinking tendency. Companies already in situ tend to reinvest part of their profits; newcomers, however, are rare. For many reasons, BiH is not very competitive as a location for greenfield investment. At the same time, scope for acquiring existing plants is limited, as privatization has almost come to a standstill. Privatizing companies capable of attracting foreign capital has met with little enthusiasm. Prominent examples are telecom companies and electricity suppliers. In both cases, the industry is split into three along ethnic lines.

At the beginning of 2006, BiH introduced value-added tax (VAT); it comprised a flat rate of 17% on all items. From a technical point of view, it proved a success; initial data point to a substantial increase in the revenue accruing to the Indirect Tax Authority. The reform may have reinforced taxpayer discipline; ultimately, however, it may also imply higher taxation on sales. In the final months of 2005, households and enterprises alike went on a shopping spree purchasing imported goods, whereafter imports in the first months of 2006 were unusually low. Exports did not display any such disruption. All these developments are very much in line with those in other countries in the region, such as Croatia, Macedonia or Serbia and Montenegro.

From a political point of view, introducing VAT has increased the likelihood of the parties in power losing votes in the elections scheduled for 1 October 2006. The previous indirect tax regime levied different tax rates on different products. For example, basic food or medicines were not taxed at all. Not surprisingly, the new rate (17%) has brought about a major increase in consumer prices. It had already become visible in the last quarter of 2005 only to gain additional momentum when the world market prices for mineral oil took off. Compared to mid-2005, the consumer price index in February 2006 (or, more precisely, the cost of living index as its substitute) rose by about 10%. From that month onwards, the index began to drop slightly. It would thus appear that the inflationary impact of introducing VAT has come to an end. Even if these slight month-on-month declines continue, the index throughout 2006 will still be much above the values for corresponding months in 2005. As a result, for 2006 as a whole an inflation rate of less than 5% is unlikely. Should public utilities go up in price as rumoured or oil prices continue to surge, the rate of inflation could easily rise to 7% or 8%.

[29] That figure is derived from calculations based on exchange rates, whereas calculations using the wiiw purchasing power estimates would yield a figure of some EUR 4600: albeit still on the low side.

Table BA

Bosnia and Herzegovina: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year	3798	3828	3832	3842	3845	.	.	.	.
Gross domestic product, BAM mn, nom.	10960.0	11651.1	12303.0	13497.0	14750.0	.	.	16570	18270
annual change in % (real)	4.5	5.5	3.0	6.0	5.5	.	.	6	6
GDP/capita (EUR at exchange rate)	1475	1556	1642	1796	1961	.	.	.	.
GDP including NOE, BAM mn, nom. [2]	15410	16170	16954	17980	19320	.	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	5140	5340	5500	5780	5990	.	.	.	.
Gross industrial production									
annual change in % (real) [3]	4.9	5.7	5.1	12.1	10.5	4.1	9.7	10	10
Net agricultural production, total									
annual change in % (real)	11.3	1.2	-7.3	7.1	.	.	.	.	.
Reg employees total, th pers., end of period	625.6	637.7	634.0	626.4	630.8	630.9	628.0	.	.
annual change in %	-2.3	1.9	-0.6	-1.2	0.7	1.3	-0.5	.	.
Reg. unemployed, th pers., end of period	422.2	441.9	459.6	491.3	524.1	499.9	530.0	.	.
Reg. unemployment rate in %, end of period	40.3	40.9	42.0	43.9	45.4	44.2	45.8	46	46
Average gross monthly wages, BAM	598	660	717	748	793	774.3	840.3	.	.
annual change in % (real, net) [4]	15.4	-0.6	7.3	3.6	3.0	.	.	.	.
Consumer prices, % p.a. [5]	3.2	1.3	1.1	0.7	2.9	.	.	6	4
General government budget, in % of GDP									
Revenues	49.7	44.0	43.2	41.3	.	.	.	.	.
Expenditures	53.1	44.2	42.4	39.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.3	-0.2	0.8	1.8	.	.	.	.	.
Public debt in % of GDP	48.2	42.2	34.0	.	.	.	.	.	.
Current account, EUR mn [6]	-826.2	-1251.7	-1443.7	-1436.6	-1695.5	-216.9	.	-1700	-1700
Current account in % of GDP	-14.7	-21.0	-23.0	-20.9	-22.5	.	.	-20.1	-18.2
Gross reserves of CB excl. gold, EUR mn	1378.7	1260.0	1421.7	1767.8	2145.3	1756.3	2269.3	.	.
Gross external debt, EUR mn [7]	2260.2	2193.4	2052.3	2061.4	2192.2	.	.	.	.
FDI inflow, EUR mn	132.8	281.8	337.6	489.0	239.7	59.4	.	.	.
Exports of goods, BOP, EUR mn [6]	1268.1	1168.5	1303.0	1677.0	2079.6	426.7	.	2500	3000
annual growth rate in %	3.4	-7.9	11.5	28.7	24.0	19.5	.	20	20
Imports of goods, BOP, EUR mn [6]	4576.4	4692.2	4974.1	5354.5	6084.7	1142.6	.	6600	7100
annual growth rate in %	8.3	2.5	6.0	7.6	13.6	8.7	.	8	8
Exports of services, BOP, EUR mn [6]	555.9	552.0	632.1	721.0	817.3	150.9	.	930	1050
annual growth rate in %	13.8	-0.7	14.5	14.1	13.3	12.6	.	14	13
Imports of services, BOP, EUR mn [6]	301.4	320.2	339.2	349.3	370.2	56.0	.	380	400
annual growth rate in %	5.5	6.3	5.9	3.0	6.0	-3.3	.	3	5
Average exchange rate BAM/USD	2.186	2.077	1.734	1.576	1.573	1.491	1.628	.	.
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 [8]	0.689	0.683	0.686	0.692	0.698	.	.	.	.
Purchasing power parity BAM/EUR, wiiw [8]	0.790	0.791	0.804	0.810	0.839	.	.	.	.

Note: 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) Costs of living. - 6) Converted from the national currency . - 7) General government foreign debt. - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

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

The poorer segment of the population has experienced a decline in real income; the government's attempts to offset this at various levels of government have not been firm enough to allay fears and resentment.

In economic terms, we can expect 'more of the same' for the future. Official GDP growth is likely to remain strong; in terms of growth, exports will continue to outstrip imports with the trade deficit possibly stabilizing at around EUR 4 billion: the figure for 2005. The IMF will provide for the development of the public sector's budget, so that larger deficits are unlikely to occur. The handling of internal public debt or, more exactly, of claims that generate debt will remain a major topic of concern. The EU will continue its efforts to support the country's gradual integration into European structures and further the adoption of the *acquis*. Whether a major change takes place on the political stage or not, reforms will continue to encounter all kinds of obstacles. In other words, the difficult political situation will continue to have an adverse impact on economic developments.

Vladimir Gligorov

Macedonia: policy stance eases

In the last couple of years growth has returned to Macedonia. In the first half of this year, growth prospects seem good as well. In part this is the consequence of increased inflows of transfers and investments from abroad, but the other part can be attributed to a somewhat eased monetary and fiscal policy stances, in particular in the second half of last year.

The main easing has come from the side of monetary policy. Interest rates have declined after years of a very restrictive stance. In the previous period the central bank argued that a more accommodative monetary policy would destabilize the exchange rate. However, the current easing has had no such consequences. In fact, at least judging by the development of foreign currency reserves, the stability of the denar has if anything been strengthened. This has been supported by the marked improvement of the current account last year, and this trend seems to be continuing this year too. Most of this is the result of the large increase in inflows of private transfers, though it is arguable that some of that inflow should be put in the capital account. It is not altogether clear how much of this is a real shift in financial flows and how much is due to statistical reasons. As the inflows of remittances do not tend to swing so wildly, and given that the level of foreign debt has been more or less the same for a long time now, it is quite possible that the current account has not run such deficits as was reported in the previous years. The easing of the monetary policy has not led to significant changes in the commercial banks' lending behaviour either. Unlike in most of the region, the credit boom is not all that pronounced in Macedonia. This is certainly because growth has been rather unimpressive even after the recent improvement.

There has been a change in fiscal policy too. After a period of fiscal consolidation following the large fiscal imbalances that had developed after the violent conflict in 2001, last year and this year too, a small fiscal deficit is being planned. Whether it will turn out to be 0.6% of GDP this year, as planned, or a bit higher, it will certainly contribute to the continuation of GDP growth. With all that, growth rates are still modest compared to those that are characteristic of recovering economies in transition. This is mostly because domestic demand is recovering only slowly while foreign demand is traditionally

Table MK

Macedonia: Selected economic indicators

	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year 2)	2034.9	2020.2	2026.8	2032.0	2035.0	.	.	.	.
Gross domestic product, MKD mn, nom.	233841	243970	251486	265257	284027	.	.	302800	324300
annual change in % (real) 3)	-4.5	0.9	2.8	4.1	3.6	2.9	.	3.5	4
GDP/capita (EUR at exchange rate)	1887	1981	2025	2130	2280	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5000	5210	5350	5690	6000	.	.	.	.
Gross industrial production									
annual change in % (real) 4)	-2.9	-4.8	4.1	-2.2	7.0	4.9	0.5	3	5
Gross agricultural production									
annual change in % (real)	-10.2	-2.3	4.5	6.8	2.2	.	.	.	.
Construction output, value added									
annual change in % (real)	-14.4	0.6	13.3	7.2	.	.	.	.	.
Consumption of households, MKD mn, nom.	163788	188179	191873	206610	.	.	.	.	.
annual change in % (real)	-11.6	12.4	-1.5	.	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	34716	40448	42110	47286	.	.	.	.	.
annual change in % (real)	-8.6	17.6	1.1	.	.	.	.	.	.
LFS - employed persons, th. avg.	599.3	561.3	545.1	523.0	545.3	507.4	.	.	.
annual change in %	9.0	-6.3	-2.9	-4.1	4.3	-2.4	.	.	.
Reg. employees in industry, th pers., avg.	122.5	110.9	106.7	101.5	97.6	98.2	94.0	.	.
annual change in % 4)	-4.8	-9.5	-3.8	-4.9	-3.9	-4.8	-4.3	.	.
LFS - unemployed, th pers., average	263.2	263.5	315.9	309.3	323.9	320.0	.	.	.
LFS - unemployment rate in %, average	30.5	31.9	36.7	37.2	37.3	38.7	.	37	37
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	17886	19025	19950	20771	21330	20965	22558	.	.
real growth rate, % (net wages)	-1.9	5.0	3.6	4.4	2.2	3.5	4.8	.	.
Consumer prices, % p.a.	5.5	1.8	1.2	-0.4	0.5	-0.4	2.7	3	3
Producer prices in industry, % p.a.	2.0	-0.9	-0.3	0.9	3.2	1.9	5.6	4	4
General governm. budget, nat.def., % GDP 5)									
Revenues	34.4	34.9	33.4	33.2	32.7	.	.	.	.
Expenditures	40.8	40.0	34.5	33.2	32.5	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.3	-5.0	-1.1	0.0	0.2	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	10.7	10.7	6.5	6.5	6.5	6.5	6.5	.	.
Current account, EUR mn 6) 7)	-272.1	-379.9	-132.1	-334.2	-65.5	-21.0	-18.5	-150	-150
Current account in % of GDP	-7.1	-9.5	-3.2	-7.7	-1.4	.	.	-3.1	-2.9
Gross reserves of NB, excl. gold, EUR mn	845.5	692.8	718.4	665.2	1041.4	634.4 I-II	798.3 I-II	.	.
Gross external debt, EUR mn 8)	1621.4	1513.2	1439.4	1475.7	1849.1	1515.9	1670.6	.	.
FDI inflow, EUR mn 7)	493.2	82.6	85.4	126.5	80.3	.	.	.	.
FDI outflow, EUR mn 7)	1.0	0.1	0.3	0.9	2.2	.	.	.	.
Exports of goods, BOP, EUR mn 7)	1291	1181	1208	1347	1640	482	450	1700	1800
annual growth rate in %	-9.9	-8.5	2.3	11.5	21.7	31.9	-6.7	4	6
Imports of goods, BOP, EUR mn 7)	1879	2035	1959	2243	2491	672	689	2700	2800
annual growth rate in %	-13.9	8.3	-3.7	14.5	11.0	13.9	2.4	8	4
Exports of services, BOP, EUR mn 7)	273	269	290	329	379	.	.	.	.
annual growth rate in %	-20.5	-1.6	7.8	13.4	15.4	.	.	.	.
Imports of services, BOP, EUR mn 7)	295	292	299	372	407	.	.	.	.
annual growth rate in %	1.3	-0.8	2.2	24.7	9.2	.	.	.	.
Average exchange rate MKD/USD	68.04	64.74	54.30	49.41	49.29	.	.	.	.
Average exchange rate MKD/EUR (ECU)	60.91	60.98	61.26	61.34	61.30	46.80	51.07	62	62
Purchasing power parity MKD/USD, wiiw	19.67	20.00	19.67	19.42	19.54	61.40	61.23	.	.
Purchasing power parity MKD/EUR, wiiw	22.97	23.18	23.18	22.96	23.26	.		.	.

Notes: 1) Preliminary. - 2) From 2002 according to census November 2002; 2005 wiiw estimate. - 3) According to the Ministry of Finance GDP in 2005 is 3.8%. - 4) Excluding small enterprises, from 2004 new methodology. - 5) Revenues excluding privatization incomes, expenditures excluding financing items. 2005 data projected. - 6) Including grants. - 7) Converted from USD. - 8) Medium- and long-term debt.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

not very strong. This year imports are growing faster than exports, as in the region as a whole. Also, foreign investments are not increasing, if the one time items, such as the sale of the distribution part of the electricity company, are excluded.

On the supply side, industrial production is faltering again in the first half of this year. There is very little in the way of reindustrialization to speak of in Macedonia, so the ups and downs of industrial production are driven by what is happening in one or the other of the larger companies. Services are not posting high growth rates either. Construction is doing well, as in the region as a whole. This is where much of the inflows of remittances go and this should be expected to continue. The political and social situation is stabilizing and this is helping investments in private housing and also in the communal infrastructure.

In early July parliamentary elections will be held. Those are important because they are seen as a test of the stabilization of democracy after the adoption and implementation of the law on decentralization that gave greater autonomy to local governments. If the elections are held in a free and fair atmosphere, as expected, and if the new government takes over smoothly, as is also expected, these proofs that democratization has matured in Macedonia should be a strong argument for the EU to start negotiations for membership with Macedonia. If that were to happen by the end of this year, it would add to the stability of this country and should help improve its economic prospects.

Vladimir Gligorov

Montenegro: chances and challenges

The declaration of independence of Montenegro has been met with positive response from the market. The stock exchange jumped 40% on the decision and the mood on the part of the business community was generally positive. Foreign investments were strong in the first quarter and overnight stays by tourists have risen by over 30% so far this year. If the interest by the investors is sustained and if the tourist season proves to be as good as it is expected to be, growth this year should come to about 5%, which is the fastest rate in a very long while.

Macroeconomic stability has been assured with a low inflation rate and shrinking budget deficit. The deficit for 2006 may turn out to be higher because of increased spending ahead of the referendum, but so far the data do not show that. As Montenegro is using the euro, the budget balance is the main anchor of stability. In the past couple of years the government has been able to contain the growth of expenditures and thus to implement quite significant fiscal consolidation. This has been supportive of the current account too, though the deficit has been growing. Its widening has to be expected given the speed of growth. Also, as in the region as a whole, the consolidation and privatization of the banking sector has led to a lending boom, which has put pressure on the trade deficit. This year imports are continuing to outrun exports, but the crucial services balance will depend on the strength of the tourism season.

Montenegro has inherited a relatively low level of foreign debt. It will also join the IMF and the World Bank with low obligations towards these institutions. It can be expected that Montenegro will request a programme with the IMF because the country can certainly use outside help in order to pursue a

Table Montenegro

Montenegro: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population th pers., mid-year [2]	612.9	615.9	620.1	625.0	630.0	.	.	.	.
Gross domestic product, EUR mn, nom. [3]	1244.8	1301.5	1433.0	1535.0	1642.0	.	.	1760	1900
annual change in % (real)	-0.2	1.7	2.3	3.7	4.1	.	.	5	5
GDP/capita (EUR at exchange rate)	2031	2113	2311	2456	2600	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4840	5030	5140	5460	5790	.	.	.	.
Gross industrial production [4]						.			
annual change in % (real)	-0.7	0.6	2.4	13.8	-1.9	4.0	4.4	4	4
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	6.9	5.9	1.0	3.5	.	.	.	.	.
Construction output total	.	.	.	.	.	.	.	.	.
annual change in %	.	.	.	.	.	.	.	.	.
Gross fixed investment, EUR mn, nom. [5]	226	183	166	145	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
LFS - employed persons, th, Oct [6]	214.4	220.6	.	187.3	185.0	.	.	.	.
annual change in %	-6.9	2.9	.	.	-1.2	.	.	.	.
Reg. employees in industry, th pers., avg.	36.7	35.8	34.1	.	.	.	.	.	.
annual change in %	.	-2.3	-5.0	.	.	.	.	.	.
LFS - unemployed, th pers., average [6]	57.5	57.7	.	71.8	.	.	.	.	.
LFS - unemployment rate in %, average [6]	23.7	20.7	.	27.7	28.0	.	.	28	28
Reg. unemployment rate in %,end of period [7]	.	.	32.9	29.3	25.2	29.1	25.2	.	.
Average gross monthly wages, EUR [8]	176	251	271	303	326	297	343	.	.
annual change in % (real, net)	8.0	.	9.3	9.1	6.7	5.7	11.7	.	.
Consumer prices, % p.a.	21.8	16.0	6.7	2.4	2.3	1.2	2.9	3	3
Producer prices in industry, % p.a.	.	14.5	4.5	5.8	2.1	3.1	0.9	3	3
Central governm. budget, nat.def., % GDP [9]	.	.	.	.	.	.	.	.	.
Revenues	17.8	17.7	23.6	24.3	.	.	.	.	.
Expenditures	20.8	20.5	26.6	26.4	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.1	-2.8	-3.0	-2.1	.	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn	-195.4	-163.4	-102.0	-119.6	-140.7	-18.6	.	-160	-150
Current account in % of GDP	-15.7	-12.6	-7.1	-7.8	-8.6	.	.	-9.1	-7.9
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	.	.	438.8	502.4	513.4	.	.	.	.
FDI net, EUR mn	10.6	89.2	38.7	50.6	374.7	161.2	.	.	.
Exports of goods, BOP, EUR mn [10]	235.4	322.6	270.6	452.1	434.5	93.7	.	470	500
annual growth rate in %	.	37.1	-16.1	.	-3.9	-8.2	.	8	6
Imports of goods, BOP, EUR mn [10]	722.9	747.3	629.9	868.6	940.3	145.9	.	950	1000
annual growth rate in %	.	3.4	-15.7	.	8.3	-28.9	.	6	5
Exports of services, BOP, EUR mn	150.2	171.7	191.4	249.5	314.5	21.3	.	.	.
annual growth rate in %	.	14.3	11.5	30.4	26.0	26.7	.	.	.
Imports of services, BOP, EUR mn	53.4	71.7	79.7	101.4	123.5	22.6	.	.	.
annual growth rate in %	.	34.3	11.1	27.2	21.8	5.2	.	.	.
Average exchange rate EUR/USD	0.90	0.94	1.13	1.24	1.24	1.31	1.20	.	.
Purchasing power parity EUR/USD, wiiw [11]	0.37	0.36	0.38	0.38	0.37	.	.	.	.
Purchasing power parity EUR/EUR, wiiw [11]	0.42	0.42	0.45	0.45	0.45	.	.	.	.

Notes.: 1) Preliminary. - 2) From 2003 according to census November 2003. 2004, 2005: wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) 2003 excluding private sector. - 6) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 7) In % of unemployed plus employment (excluding individual farmers). - 8) From 2002 including various allowances and new personal income tax system. - 9) Revenues excluding grants, expenditures excluding net lendig. - 10) From 2004 incl. trade with Serbia and Kosovo. - 11) 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.

sound macroeconomic policy. It needs technical support more than money, though investments into infrastructure are a priority in order to improve the access to its coast as well as to its mountain resorts.

The regional dimension is important for this small economy. Its tourist sector depends on the tourists from the region, in particular from Serbia and Kosovo. Also, its coast is a natural extension of the Croatian coast and there are significant spillover effects between the Dubrovnik area and the Kotor Bay area. In the future, the connection with the Albanian coast to the south will also be quite important. This part of the Adriatic Sea has longer summers and there are also potentials for the development of winter tourism. Therefore, the tourist prospects are more regional than being contained within the respective states.

The strategy of transition in Montenegro has been a very liberal one, though the realization has been rather patchy. The guiding idea is that the structure of the Montenegrin economy that will develop does not require strong state intervention, except in terms of investment in infrastructure and in human capital. Because of still significant regional differences and a rather old population, transfers have to take the bulk of public expenditures, but those could be financed by relatively low tax rates if significant inflows of foreign investments are attracted. Also, given that there is not so much to protect, except the aluminium plant and the steel-mill, tariffs can be quite low and the same goes for the non-tariff barriers. Finally, Montenegro has adopted the euro and does not intend to reintroduce its own currency, so price stability should not be a problem.

Thus, there are fair chances for success. There are also challenges. The first will come with the parliamentary elections next fall. After that, the process of EU integration should be restarted and Montenegro should be ready to sign a Stabilization and Association Agreement by the end of this or the beginning of the next year. The longer-term challenge is the process of democratization and the strengthening of the rule of law. Clearly, those will have to develop in parallel with the process of EU integration

Vladimir Gligorov

Serbia: shocks and confusion

Serbia has entered into a new phase of political instability. Its economic policy also lost coherence and direction. The economic consequences are still relatively mild, though there are three worrying signs. One is inflation that may get out of control. Another one is represented by the widening trade and current account deficits. Finally, economic activity seems to be slowing down. The government plans to sell the mobile telephone operator and a number of state-owned banks, so it should not face serious financial problems. It is also not expected to introduce any new reforms, because it will most probably have to face early election by the end of this year or early next year.

It was always well understood that this year will be a difficult one because a number of crucial, constitutional issues have to be resolved in and outside of Serbia that may shake its stability. The first shock has come with the result of the referendum on independence in Montenegro. Though the result had been expected, it has caught Serbia unprepared. There is a realization that Serbia needs to adopt it own constitution. It is, however, not clear whether this will prove to be politically feasible. The political parties will have to figure out whether that changes their electoral prospects and in which way. Thus, it may turn out that early elections will be needed for the constitution to be adopted, while the preferred sequence for the government is that the elections should follow the adoption of the constitution.

This dilemma may prove to be beside the point if it drags on, because the second shock will have to be absorbed soon, probably before this year's end. Kosovo will in all probability be granted independence by the international community. Though the Serbian public expects that outcome, it is quite unprepared for the new situation it will find itself in. The elections will have to be held in the wake of the decision on Kosovo, and it is hard to predict at this point in time what will be the results.

These political developments will take place in a context that is unfavourable for Serbia. At the beginning of May, the European Commission disrupted the negotiations on the Stabilization and Association Agreement with Serbia. The chances that those may be continued are slim: The government of Serbia would need to secure the transfer of Ratko Mladić, who is indicted for war crimes, to the Hague Tribunal. However, the government does not want to arrest him, while he does not want to surrender himself voluntarily. In the run-up to the crucial decisions on Kosovo and with early elections looming, it is unlikely that the government will gather the will to be more resolute than it has been in the past. Thus, the negotiations cannot be resumed and Serbia will not be able to enter into contractual relations with the EU. This will be a serious blow to the government because the improved relations with the EU have been its own tangible success.

These political uncertainties have had effects on the macroeconomic stability. The increasing macroeconomic instability has in turn started to impact on economic activity. Inflation has been speeding up as soon as this government took office in early 2004, close to two and a half years ago. Last year inflation climbed to over 16% and this year it can hardly manage to stay below 15%. Inflation was a way to improve the fiscal balance in the last couple of years and may be relied on to improve the election results this year. This fiscal dominance has led to a tightening of monetary policy in the form of ever increasing reserve requirements on loans that banks take abroad. Currently, 60% are kept with the central bank without interest. The effects so far have not been very encouraging. Strong credit growth has continued together with the costs of borrowing. Though data are not available, it is to be expected that households are continuing to borrow as are large firms, but small firms and entrepreneurs may be driven out of the market. That may be one of the reasons why there is growing uncertainty about the growth prospects of the economy.

Unlike the previous year, imports are growing faster than exports and the trade deficit is widening. Other balances in the current account are not moving very much in the opposite direction, so a widening of the current account deficit should be expected too. It is not easy to forecast the development of external balances because the exchange rate policy of the central bank is not clear, though the latest aim seems to have been to keep the dinar exchange rate for the euro fixed with the real exchange rate appreciating. There is an obvious rationale for that policy in terms of providing an anchor to inflation, but the development of the trade deficit may make this policy unsustainable.

Growth is driven mostly by consumption, which however is slowing down. Investment is also flowing into construction, but the pace of growth of investment in manufacturing seems to be winding down too. The government has been floating ideas to boost public investments, but those have been discouraged by the central bank and by the IMF due to fears of runaway inflation. Still, GDP growth

Table Serbia

Serbia: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population th pers., mid-year [2]	7736.4	7500.0	7480.6	7463.2	7450.0	.	.	.	.
Gross domestic product, CSD mn, nom.	708423	919231	1095402	1310300	1601000	.	.	1915000	2290000
annual change in % (real)	5.1	4.5	2.4	9.3	6.3	5.6	.	4	4
GDP/capita (EUR at exchange rate)	1540	2020	2251	2419	2583	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4560	5020	5170	5790	6300	.	.	.	.
Gross industrial production [3]									
annual change in % (real)	0.1	1.8	-3.0	7.1	0.8	-3.4	5.7	4	4
Gross agricultural production									
annual change in % (real)	18.6	-3.4	-7.2	19.5	-5.3	.	.	.	.
Construction output total									
annual change in % (real) [4]	-14.3	-7.4	10.8	3.5	-7.0	-20.5	.	.	.
Consumption of households, CSD mn, nom.	575195	784493	948591	1177080	1426621	.	.	.	.
annual change in % (real)	.	.	.	.	4.4	.	.	.	.
Gross fixed capital form., CSD mn, nom.	65498	120502	154544	253333	273852	.	.	.	.
annual change in % (real)	.	.	.	.	-2.8				
LFS - employed persons, th. Oct [5]	3105.6	3000.2	2918.6	2930.8	2900.0	.	.	.	.
annual change in %	0.4	-3.4	-2.7	0.4	-1.1	.	.	.	.
Reg. employees in industry, th pers., avg.	704.5	648.1	605.3	562.2	536.0	538.0 I-II	510.5 I-II	.	.
annual change in %	.	-8.0	-6.6	-7.1	-4.7	-4.9	-5.1	.	.
LFS - unemployed, th pers., average [5]	432.7	459.6	500.3	665.4	.	.	.	.	.
LFS - unemployment rate in %, average [5]	12.2	13.3	14.6	18.5	20.8	.	.	22	23
Reg. unemployment rate in %,end of period [6]	.	30.5	31.9	26.4	26.9	.	.	34	34
Average gross monthly wages, CSD [7]	8691	13260	16612	20555	25514	22166	28202	.	.
annual change in % (real, net)	16.5	29.9	13.6	10.1	6.4	5.0	10.9	.	.
Consumer prices, % p.a.	93.3	16.6	9.9	11.4	16.2	16.0	14.8	15	15
Producer prices in industry, % p.a.	87.7	8.8	4.6	9.1	14.5	13.5	14.3	15	15
General governm. budget, nat.def., % GDP									
Revenues	39.1	44.3	43.1	45.0	.	.	.	.	.
Expenditures	40.7	48.0	47.3	46.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-1.6	-3.7	-4.2	-1.5	.	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	16.4	9.5	9.0	8.5	8.5	8.5	8.5	.	.
Current account [8]	-354	-1348	-1362	-2274	-1687	-331	-479	-2000	-2000
Current account in % of GDP	-3.0	-8.9	-8.1	-12.6	-8.8	.	.	-10	-10
Gross reserves of NB, excl. gold, EUR mn	1138.6	2076.8	2728.2	3008.0	4753.7	3211.0	5142.0	.	.
Gross external debt, EUR mn	12609	10768	10858	10355	13064	10761	12616	.	.
FDI net, EUR mn [8]	184	504	1204	777	1196	262	179	.	.
Exports of goods, BOP, EUR mn [8]	2032	2348	2598	2997	3754	761	955	4030	4430
annual growth rate in %	13.3	15.5	10.7	15.4	25.2	44.0	25.6	10	10
Imports of goods, BOP, EUR mn [8]	4608	5774	6409	8341	8248	1479	2026	9400	10340
annual growth rate in %	31.0	25.3	11.0	30.1	-1.1	-14.7	37.0	10	10
Exports of services, BOP, EUR mn [8]	685	795	906	1171	1306	248	300	.	.
annual growth rate in %	49.3	16.0	13.9	29.3	11.6	-10.1	21.0	.	.
Imports of services, BOP, EUR mn [8]	413	657	720	1020	1293	273	329	.	.
annual growth rate in %	35.2	59.1	9.5	41.7	26.7	39.1	20.5	.	.
Average exchange rate CSD/USD	66.36	64.40	57.58	58.38	67.21	61.68	72.61	.	.
Average exchange rate CSD/EUR (ECU)	59.46	60.68	65.05	72.57	83.19	80.62	87.18	90	100
Purchasing power parity CSD/USD, wiiw	17.50	21.10	24.20	25.90	28.40	.	.	.	.
Purchasing power parity CSD/EUR, wiiw	20.10	24.40	28.30	30.30	34.10	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census 2002. 2005: wiiw estimate. - 3) From 2004 according to NACE and new weighting system. - 4) Gross value added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) Until 2003 jobseekers divided by labour force excl. farmers. - 7) From 2002 including various allowances. - 8) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

in the first quarter and probably in the second quarter as well could end up being around 3-4%, which would indicate a certain deceleration. In the second half of the year, growth should remain at about the same level, though there are indications that agricultural production will post a negative growth rate due to bad weather in the winter. Industrial production seems to be growing at a slower pace also and services are coming against the decline in demand due to slower growth of wages and salaries, in part because of the steep growth in unemployment.

Assuming that political decisions will have to be made in the next six to nine months, what political outcome can be expected to emerge? It is quite likely that the strongly nationalistic Radical Party, which is already the largest party in the Serbian parliament, will come out of the early elections strengthened. Even if it does not participate in the new government, it will have quite an influence on the policy that will be pursued by whoever is in the government. That may lead to a prolonged stalemate in the process of EU integration. It is not very likely, as things stand now, that Serbia will be able to sign the Stabilization and Association Agreement with the EU by the end of this year as envisaged, and that will probably have to be put off for as long as the political configuration in Serbia is being changed.

In addition, the already widespread reliance on the state will increase. The process of privatization of the public sector will be all but stopped and foreign investments will be invited on a selected basis. Regional cooperation will in all probability deteriorate and much stress will be put on the cooperation with out-of-the-region and out-of-the-EU countries, in particular with Russia and China. Preference will be given to economic cooperation with the USA, who is already the largest investor in Serbia.

The effects of these policies are hard to assess at this moment in time because the details are still to be worked out. It is quite likely that growth may get some boost from increased public consumption, but inflation may prove to be a powerful constraint on that. In any case, the prospects are worse now than any time since the assassination of primer minister Zoran Djindjić in early 2003.

Michael Landesmann

Turkey: caught in emerging markets turbulence

The most striking news over the past few weeks was the nearly 20% devaluation of the Turkish lira combined with a strong increase of the minimum lending rate by 175 basis points to 15% by the Central Bank on 7th June.[30] Turkey is thus one of the most pronounced examples of the recent adjustment processes taking place in international financial markets which have seen increases in interest rates worldwide (guided by the actions of the US Federal Reserve Bank) and a major rearrangement of international portfolios away from emerging markets and towards more home-biased portfolios in both the US and Europe. The reasons for such a rearrangement are explained in the introductory section of this report.

However, there are also reasons why the reaction to this change in the global environment was particularly strong in Turkey. Amongst the economic developments were deteriorating inflation rates

[30] On 25th June the Central Bank increased the rate by another 225 basis points to counteract the continuing pressure on the Turkish currency, so that the minimum lending rate stands now at 17.25%.

as well as the consistent current account imbalances. On the political front there were a number of signs that tensions were rising within Turkey between the current government and various opposition forces in preparation of a long-drawn out pre-election period (elections are to be held in 2007). On top of that is the problematic situation with respect to Turkey's EU accession process.

Year-on-year inflation rates, which had come down from 45% (CPI) and 48% (PPI) in 2002 to 8.2% and 5.9% respectively in 2005, nudged upwards to 8.8% in April and 9.9% in May 2006 (both CPI figures). Some of this increase is due to higher petroleum and imported commodity prices, but commentators found this turnaround nonetheless surprising. The inflation targeting strategy by the Central Bank to bring the yearly inflation rate down to 5% in 2006 now seems unattainable. Particularly high were the price increases of clothing and footwear, food and beverages and household equipment for the CPI, as well as agriculture and the metal industries for the PPI.

The trade accounts were seriously affected by the rise in fuel prices, as import growth amounted to 13.2% in the first quarter of 2006 and export growth to 4.3%. However, 7.6 percentage points of the increase in imports can be accounted for by growth in mineral fuels, mineral oils and other oil-related items. The exports/imports ratio in goods trade amounted to 61.8% in the first quarter of 2006 as compared to 62.3% in the first quarter of 2005. The current account deficit reached USD 8.6 billion in the first quarter of 2006 as compared to USD 6.2 billion in the corresponding quarter of 2005. The current account deficit amounted to 6.4% of GDP in 2005 and the expectation – before the recent turbulence – was that it would remain roughly at that level or increase slightly to 6.5% in 2006. Taking the short-run, terms-of-trade, effects of the recent devaluation into account, it might deteriorate to 7.0% in 2007, which would further support a cautious stance by international investors and lenders in the short/medium term.

In the last wiiw forecast report[31] we discussed at length the international financial accounts and pointed to the high inflows of foreign credits to the private sector. This fuelled both consumption and investment expenditure. Looking at the first quarter of 2006, the financial accounts showed a net inflow of USD 16.5 billion (i.e. almost double the current account's deficit of USD 8.6 billion). Of this amount, 1.2 billion was foreign direct investment, 3.6 billion portfolio investment, 9.2 billion were trade and financing loans to the corporate sector, and 2.8 billion credits to banks. In the first quarter of 2006, therefore, corporate and bank loans accounted for 67% of total net inflows of capital (currency reserves increased by over USD 7 billion). The picture was thus one of a high inflow of liquidity into the Turkish economy built on an expectation of continued high rates of economic growth (of about 6% per annum both in 2006 and 2007). This was on the foundations of impressive achievements over the 2002-2005 period in terms of conquering fiscal problems (public debt had declined from 93% of GDP in 2002 to 68% in 2005; interest payments on public debt had come down from 19% of GDP in 2002 to 9.4% in 2005; the consolidated budget balance from -16.2% of GDP in 2002 to -4.4% in 2005 with a primary surplus of 5%) and a sharp fall in inflation rates.

There were, therefore, a number of factors which made international investors react even more in the case of Turkey than in the case of other emerging markets when a reshuffling of international portfolios started to take place in May 2006 in the wake of rising interest rates in the US and in Europe

[31] L. Podkaminer, V. Gligorov et al., 'Strong Growth, Driven by Exports in the NMS and by Consumption in the Future EU Members', *wiiw Research Reports* No. 325, February 2006.

Table TR

Republic of Turkey: Selected economic indicators

	2001	2002	2003	2004	2005 [1)]	2005	2006 [1)]	2006	2007
						1st quarter		forecast	
Population, th pers., mid-year [2)]	68365	69302	70231	71152	72065	.	.	.	.
Gross domestic product, YTL mn, nom.	178412	277574	359763	430511	487202	94675	.	560000	626000
annual change in % (real)	-7.5	7.9	5.8	8.9	7.4	6.6	.	5.5	5.5
GDP/capita (EUR at exchange rate)	2386	2799	3028	3416	4040	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5370	5650	5810	6520	7210	.	.	.	.
Gross industrial production									
annual change in % (real)	-8.7	9.5	8.7	9.8	5.3	6.1	3.1	6	6
Gross agricultural production									
annual change in % (real)	-6.5	6.9	-2.5	2.0	5.6	.	.	.	.
Construction industry									
annual change in % (real)	-10.6	-5.6	-9.0	4.6	21.5	.	.	.	.
Consumption of households,YTL mn, nom.	128513	184420	239586	284631	328561	.	.	.	.
annual change in % (real)	-9	2.1	6.6	10.1	8.8	4.1	.	.	.
Gross fixed capital form., YTL mn, nom.	32409	46043	55618	76722	95307	.	.	.	.
annual change in % (real)	-31.5	-1.1	10.0	32.4	24.0	10.3	.	10	15
LFS - employed persons, th, avg.	21524	21354	21147	21791	22046	20838	20604	.	.
LFS - employed pers. in agricult. th, avg.	8089	7458	7165	7400	6493	.	.	.	.
LFS - employed pers. in industry th, avg. [3)]	4884	4912	4811	5017	5452	.	.		
LFS - employed pers. in services th, avg.	8551	8984	9171	9374	10101	.	.		
LFS - unemployed, th pers. average [4)]	1967	2464	2493	2498	2519	2750	2796	.	.
LFS - unemployment rate in %, average	8.4	10.3	10.5	10.3	10.3	11.7	11.9	11.5	11.0
Reg. unemployment rate in %, average	3.2	1.9	2.5	.	.	.	.	.	.
Average gross wages in manuf.industry (YTL/Hour)	1.95	2.68	3.30	3.74	4.20	.	.	.	.
annual change in % (real)	-14.6	-5.4	-1.9	2.5	2.0	3.2	.	.	.
Consumer prices, % p.a. [5)]	54.4	45.0	25.3	8.6	8.2	8.4	8.1	9.0	6.0
Wholesale prices in manufacturing, % p.a. [5)]	66.7	48.3	23.8	14.6	5.9	15.0	4.5	6.0	4.0
General governm. budget, EU-def., % GDP [6)]									
Revenues	.	32.3	26.8	26.6	30.7	.	.	26.0	25.4
Expenditures	.	45.2	38.2	32.3	31.8	.	.	27.4	26.4
Deficit (-) / surplus (+)	.	-12.9	-11.3	-5.7	-1.2	.	.	-1.4	-1.0
Public debt, EU-def., in % of GDP [6)]	105.2	93.0	85.1	76.9	69.6	.	.	64.5	60.8
Discount rate % p.a., end of period	60.0	55.0	38.0	38.0	23.0	32.0	17.0 [7)]	18.0	.
Current account, EUR mn [8)]	3787	-1613	-7106	-12550	-18553	-4725	-7173	-20500	-21500
Current account in % of GDP	2.3	-0.8	-3.3	-5.2	-6.4	.	.	-7.0	-6.5
Gross reserves of CB, excl. gold, EUR mn	20975	28370	29725	28962	40581	29001	48487	.	.
Gross external debt, EUR mn	126876	138026	128953	130217	136618	121984	.	.	.
FDI inflow, EUR mn [8)]	3742	1203	1549	2282	7782	561	879	.	.
FDI outflow, EUR mn [8)]	555	185	441	691	842	96	-149	.	.
Exports of goods, BOP, EUR mn [8)]	38376	42464	45279	53927	61801	13694	15753	73000	89000
annual change in %	15.4	10.7	6.6	19.1	14.6	18.9	15.0	18	22
Imports of goods, BOP, EUR mn [8)]	42543	50171	57667	73132	88142	18449	22994	106000	125000
annual change in %	-25.4	17.9	14.9	26.8	20.5	18.5	24.6	20	18
Exports of services, BOP, EUR mn [8)]	16969	14843	15868	18441	20776	2881	2997	.	.
annual growth rate in %	-19.4	-12.5	6.9	16.2	12.7	20.1	4.0	.	.
Imports of services, BOP, EUR mn [8)]	6773	6504	6580	8159	9551	1969	2039	.	.
annual growth rate in %	-22.6	-4.0	1.2	24.0	17.1	20.2	3.6	.	.
Average exchange rate YTL/USD	1.2253	1.5077	1.5003	1.4253	1.3440	1.3236	1.3289	1.60	1.60
Average exchange rate YTL/EUR (ECU)	1.0940	1.4307	1.6918	1.7714	1.6736	1.7377	1.5974	1.90	1.90
Purchasing power parity YTL/USD	0.4240	0.6115	0.7524	0.7930	0.7799	.	.	.	.
Purchasing power parity YTL/EUR	0.4859	0.7084	0.8817	0.9277	0.9379	.	.	.	.

Notes: 1) Preliminary. - 2) 2004 and 2005 SIS projections. - 3) Mining and quarrying; manufacturing; electricity, gas and water supply; construction. - 4) Civilian Labour Force: unemployed . - 5) From 2004 new methodology. - 6) According to ESA'95, excessive deficit procedure. - 7) CBRT lending interest rate. - 8) Converted from USD.

Source: CBRT-EDDS (Central Bank of Turkey, Electronic Data Distribution System), SIS (State Institute of Statistics), SPO (State Planning Organization), UT (Undersecretary of Treasury), Eurostat.

and an expectation of a slowdown of the US economy (and specifically of its importing capacity). Turkey had managed to massively reduce inflation rates, but they still hovered around 8% per annum and there was a very sizeable current accounts deficit. While there were important changes going on in the export structure, which was upgrading from more traditional labour-intensive commodities to more sophisticated industrial products, the overall export-import ratio (around 62%) did not indicate a turnaround and hence the situation could be interpreted as one where a devaluation was required to correct an 'over-valued' currency. Amongst emerging markets which had experienced a massive inflow of liquidity, Turkey was a prime candidate where such a correction could take place and such a situation easily initiates a self-fulfilling process. In the wake of general outflows from emerging markets to reduce the degree of risk in international portfolios, Turkey therefore experienced a particularly strong pressure on its currency and on stock market values.

Furthermore, developments inside Turkey and in Turkey's relationship to the EU did not help to instil a picture of stability and trust. There was a tussle over the (rather late) appointment of a new Governor of the Central Bank and an assassination of a judge which was seen as reflecting a sharpening of conflict between secularist and Islamic forces, and growing criticism in the business community and the military over government policies. At the same time, the EU embarked towards very hesitant accession negotiations with Turkey and the increasing perception of a tough stance being taken by a number of EU member states (and the Commission itself) at each stage of the negotiation process combined with a very uncertain final outcome, increased the feeling that the longer-run Turkish position in international economic relations was rather uncertain. The perception is thus different compared with even half a year earlier when the decision regarding the start of negotiations was highly welcomed by the international financial community.

What to expect next? One could take both an optimistic and a pessimistic stance as regards future developments. On the optimistic side, one could interpret recent developments as a healthy shock leading to an adjustment in an over-valued exchange rate and, at the same time, giving the monetary authorities (the new Governor of the Central Bank) the opportunity to show their determination in insisting on the continuation of a downward path of inflation and in fiscal prudence, as a deviating policy would lead to further punishment by international financial markets. The devaluation combined with a watchful control of domestic inflationary pressures could indeed tackle the rather vulnerable current account situation and thus add stability in external accounts to the already achieved stability in internal fiscal accounts. The pessimistic picture emerges from an uncertainty to which extent and with what time horizon an international adjustment of portfolio positions might continue to take place. In the case of a more protracted process, the pressure on the Turkish currency will persist, the fear of induced, imported inflationary pressures might lead to even stronger interest rate hikes and this could severely affect growth. Growth and restructuring was (and will continue to be) characterized by a high demand for imported capital equipment and other necessary inputs which can be badly affected by devaluation. Furthermore, the hard earned trust in the value of the domestic currency by domestic savers might be endangered, reducing the effectiveness by which domestic policy-makers can influence monetary developments. Finally, international investors will continue to be affected by monetary developments (in inflation and exchange rate expectations) and perceptions of Turkey's longer-run position with respect to the European Union.

Our own forecasts over the next two years reflect the uncertainty with regard to the bets regarding the optimistic and pessimistic outcomes, and we adjust modestly downwards our growth forecasts for the Turkish economy.

Part C: Russia and Ukraine; China

Country reports

Peter Havlik

Russian Federation: lower GDP growth, surging export revenues

Russia's GDP has been growing by 6% on annual average during the past five years. In the first quarter of 2006, the growth rate slipped to some 5% as the performance of the real sector of the economy (industry, agriculture, transport and construction) weakened. The main driver of growth was rising domestic demand (in particular private consumption) while the contribution of real net exports to GDP growth was again negative. However, the boom in nominal export revenues continues thanks to the high energy and metal prices. The sizeable expansion of imports notwithstanding, the trade surplus reached EUR 30 billion and the current account surplus EUR 24 billion (14% of GDP) in the first quarter of 2006. Due to significant improvements in the terms of trade, Russian domestic absorption can grow much faster than GDP – even with rising trade and current account surpluses. The consolidated government budget is enjoying record surpluses (in 2005 close to 8% of GDP; in the first quarter of 2006 nearly 14% of GDP); foreign exchange reserves approached EUR 200 billion at the end of May 2006. After repaying all outstanding IMF credits, in 2005 the government agreed with the Paris Club creditors to pay back USD 15 billion of debt ahead of schedule. USD 10 billion credit provided by the former USSR to Syria was written off. Additional debt repayments to the Paris Club (in particular to Germany) were agreed in June 2006.[32] The Stabilization Fund, established in 2004 and fed from a portion of windfall energy export revenues, exceeded EUR 50 billion in May 2006. After long discussions, it was finally decided that the Fund will be invested in USD- and EUR-denominated assets (each 45% of the Fund, the rest in GBP) and the operations managed by the Central Bank.

The highly favourable financial indicators notwithstanding, the growth of GDP and of manufacturing in particular is decelerating. Domestic consumer and investment demand is increasingly covered by imports, which are more competitive on the Russian market not only due to better quality but increasingly thanks to the real appreciation of the rouble. Production costs are rising as wages grow faster than labour productivity. Symptoms of a Russian Dutch-disease variety are thus becoming apparent as the bulk of export revenues stems from resource-based industries – revenues from oil and natural gas exports accounted for nearly 70% of total exports in the first quarter 2006 – and huge foreign exchange inflows exert appreciation pressures on the rouble. With a roughly constant nominal exchange rate over an extended period (around 28 RUB per USD) and persisting inflation, the rouble has appreciated in real terms back to the level before the August 1998 financial crisis. Due to the combined effects of foreign exchange inflows (with the related money supply expansion) and the growth of consumer demand, the annual inflation exceeds 10% (producer price inflation is even higher). As a rapid disinflation is unlikely, wiiw expects consumer prices to hover around 10% in both 2006 and 2007. Growing incomes and employment (and declining unemployment) make Russia attractive to foreign migrant workers, who mitigate the effects of adverse demographic trends (the latter figuring prominently in Mr. Putin's latest Presidential Address).

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32 Simultaneously with the reduction of government debts, the external indebtedness of the private sector is growing.

Table RU

Russia: Selected economic indicators

	2001	2002	2003	2004	2005 [1]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	145649	144964	144168	143474	142739	142824	142600	142500	142000
Gross domestic product, RUB bn, nom.	8943.6	10830.5	13243.2	16966.4	21598.0	4399.6	5722.3	26000	30000
annual change in % (real)	5.1	4.7	7.3	7.2	6.4	5.0	5.5	5.8	5.9
GDP/capita (EUR at exchange rate)	2345	2514	2641	3294	4285	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6440	6940	7510	8280	9040	.	.	.	.
Gross industrial production									
annual change in % (real)	4.9	3.7	7.0	6.1	4.0	3.2	3.0	4.0	4.5
Gross agricultural production									
annual change in % (real)	7.5	1.5	1.4	3.1	2.0	-0.1	1.3	.	.
Construction output total									
annual change in % (real)	9.9	2.7	14.4	10.1	10.5	5.0	-0.1	.	.
Consumption of households, RUB bn, nom.	4318.1	5400.3	6547.6	8132.6	10152.5	2207.7	.	.	.
annual change in % (real)	9.5	8.5	7.5	11.6	11.1	8.7	.	11	11
Gross fixed capital form., RUB bn, nom.	1689.3	1938.8	2432.2	3106.5	3926.1	606.0	.	.	.
annual change in % (real)	10.2	2.8	12.8	11.3	10.5	8.2	5.1	7	9
LFS - employed persons, th, avg. [2]	64400	66163	66527	67385	68283	67067	68300	.	.
annual change in %	0.2	2.7	0.5	.	1.3	1.5	1.8	.	.
Reg. employment in industry, th pers., avg.	14692	14534	14345	14301	.	.	.	.	.
annual change in %	1.0	-1.1	-1.3	-0.3	.	.	.	.	.
LFS - unemployed, th pers., average [2]	6416.0	5828.4	6227.5	6016.2	5608.5	5985.3	5793.7	.	.
LFS - unemployment rate in %, average [2]	9.1	8.1	8.6	8.2	7.6	8.2	7.8	7.5	7
Reg. unemployment rate in %, end of period	1.6	2.1	2.3	2.6	2.5	2.7	2.6	.	.
Average gross monthly wages, RUB	3240.4	4360.3	5498.5	6739.5	8550.0	7638	9397	.	.
annual change in % (real, gross)	19.9	16.2	10.9	10.7	10.2	8.4	10.3	.	.
Consumer prices, % p.a.	21.6	16.0	13.6	11.0	12.5	12.9	10.8	10	9
Producer prices in industry, % p.a.	19.1	11.8	15.6	24.0	20.7	23.3	14.7	14	13
General governm.budget, nat.def., % GDP									
Revenues	30.0	32.5	31.3	32.0	35.2	39.3	37.9	.	.
Expenditures	27.1	31.6	29.9	27.5	27.5	24.3	24.2	.	.
Deficit (-) / surplus (+), % GDP	3.0	0.9	1.3	4.5	7.7	15.0	13.6	.	.
Public debt, nat.def., in % of GDP [3]	44.1	37.0	28.6	21.7	14.9	.	.	.	.
Refinancing rate of NB % p.a., end of per.	25	21	16	13	12	13	12	.	.
Current account, EUR mn [4]	37885	30789	31330	47127	67695	15461	23250	80000	60000
Current account in % of GDP	11.1	8.4	8.2	9.9	11.0	12.8	13.7	10.8	6.8
Gross reserves of NB, excl. gold, EUR mn [4]	37026	42290	58531	88663	148094	103142	181240	.	.
Gross external debt, EUR mn [4]	169530	147067	148776	157423	214274	170165	.	.	.
FDI inflow, EUR mn [4]	3069	3660	7041	12422	11731	4573	.	.	.
FDI outflow, EUR mn [4]	2828	3736	8606	11085	10547	2382	.	.	.
Exports of goods, BOP, EUR mn [4]	113744	113468	120265	147357	195709	38274	56088	240000	250000
annual growth rate in %	0.2	-0.2	6.0	22.5	32.8	28.4	46.5	23	4
Imports of goods, BOP, EUR mn [4]	60022	64470	67304	78327	100682	19572	25993	125000	140000
annual growth rate in %	23.8	7.4	4.4	16.4	28.5	22.9	32.8	24	12
Exports of services, BOP, EUR mn [4]	12773	14393	14359	16321	19739	3627	4484	22000	24000
annual growth rate in %	23.6	12.7	-0.2	13.7	20.9	16.1	23.6	11	9
Imports of services, BOP, EUR mn [4]	22967	24848	23997	27132	31546	5608	6726	36000	40000
annual growth rate in %	30.9	8.2	-3.4	13.1	16.3	9.2	19.9	14	11
Average exchange rate RUB/USD	29.17	31.35	30.69	28.81	28.30	27.88	28.10	28	27
Average exchange rate RUB/EUR (ECU)	26.13	29.65	34.69	35.81	35.22	36.52	33.84	35	34
Purchasing power parity RUB/USD, wiiw	8.15	9.27	10.36	12.07	14.04	.	.	15	16
Purchasing power parity RUB/EUR, wiiw	9.52	10.74	12.20	14.25	16.70	.	.	18.4	19.8

Notes: 1) Preliminary. - 2) From 2004 according to census October 2002. - 3) wiiw estimate. - 4) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The pace of reforms remains unimpressive. Economic policy discussions during recent months have concentrated on the issue of how to use the Stabilization Fund and on the extent and contents of state investment programmes. As one of the rare reform steps, an agreement on the split of the state electricity company RAO UES into power generating and distribution parts was reached in June (the former part will be opened to private, possibly also foreign, investors). Meanwhile, Gazprom, Rosneft and other large state-owned (or controlled) corporations are expanding. The Russian energy and metals giants are also acquiring assets abroad, not least in the former Soviet republics. While launching the new state investment programmes (in health, education, housing and transport) and establishing special economic zones with tax privileges and legal guarantees, the government restricts access of foreign investors to 'strategic' sectors. The energy sector in particular has become one of the contentious issues in Russian-EU relations. Nonetheless, inflows of FDI are rising, partly thanks to returning Russian offshore capital, and the country's credit rating is improving. WTO accession may be delayed again (an agreement with the USA is still pending); the future of EU-Russian relations after the expiry of the Partnership and Cooperation Agreement in 2007 is unclear.

The main growth pillar during the past few years has been private consumption fuelled by rising incomes. Investment growth has been less impressive and the share of investment in GDP is still quite low (about 20%). The situation of most Russian companies, in particular those which are engaged in export activities, is quite comfortable and they can easily finance investments from own resources (or from bond issue and credits). Yet many companies prefer to invest abroad and Russian outward FDI is rising, partly at the expense of capital flight. Given the surging government revenues, the federal budget reckons with rising expenditures. Despite planned spending increases (targeting investments, salaries of health and education personnel, housing construction and agriculture), the 2006 federal budget envisages a surplus of 3.2% of GDP. The actual outcome will probably be at least twice as high owing to the rather conservative oil price assumption underlying the budget. Taking into account the diminishing contribution of real net exports to GDP, wiiw expects GDP growth below 6% in the coming years. With more money and power consolidation at home, Russian self-confidence is growing. However, sustainable and broader-based long-term growth will require more investments and economic restructuring, neither to be expected in the absence of stepped-up institutional changes and improved transparency of legal regulations. A separate issue is the looming threat of labour shortages and the danger of an oil price collapse.

Vasily Astrov

Ukraine: economy withstanding the gas price shock

The dramatic deceleration of economic growth in Ukraine observed throughout 2005 and in early 2006 appears to have reversed. The hike in the price of imported natural gas at the beginning of the year has not had any sizeable impact on growth or inflation, at least so far. According to preliminary data, in January-May the GDP grew by 4% year-on-year – faster than in 2005 (2.6%, according to revised figures). The growth was mainly driven by agriculture and services, particularly construction (+8.2% in value-added terms), whereas industrial output stayed flat for most of the period. However, in May industry picked up by an impressive 10%, largely due to the strong expansion of metals production. Still, on *average* in January-May 2006, metals were up only by 1.7%, and the production of chemicals – another major export industry – even marginally declined. Both metals and chemicals are highly energy-intensive branches and it is little surprise they were hit hardest by the gas price shock (more on that, see below). At the same time, some of the less energy-intensive industries performed well, and machine-building even grew by 11.5%.

Viewed from the demand side, there appears to be a shift in the sources of growth, with domestic demand increasingly making up for deteriorating net exports. In particular, fixed capital investments (+15.9% year-on-year in the first quarter) performed much better than last year, and the already booming consumption gained momentum once again. In January-April, retail trade turnover – a proxy for private consumption – was up 27.4% in real terms. Similarly to 2005, the booming consumption is backed by the strong growth of wages (especially in the public sector), pensions and other social payments enacted by the first 'orange' government, but also by the strong expansion of consumer credit. At the same time, the contribution of net exports to growth must have been strongly negative: in the first four months of 2006, exports of goods fell by nearly 4% in dollar terms, whereas imports jumped by 23%.

The growing trade deficit (USD 2.1 billion in January-April, according to the customs statistics) will inevitably translate into a worsening current account, which we expect to turn negative this year – after a 3.1% surplus in 2005. However, it is being easily financed by the FDI inflows increasingly targeting the biggest banks such as Ukrsibbank acquired by BNP Paribas of France and Ukrsotsbank by Banca Intesa of Italy. These two deals alone are of a magnitude comparable to the current account deficit expected for the year as a whole. Besides, the inflows of FDI are expected to accelerate following Ukraine's accession to the WTO. (The main remaining stumbling block in the WTO accession process – a bilateral agreement on market access with the United States – has been settled,[33] even though accession may be delayed somewhat and synchronized for political reasons with that of Russia.) Therefore, while the short-run dynamics of foreign exchange reserves may stay volatile,[34] in the medium term the National Bank should have no difficulties in maintaining the current 5.05 UAH per USD exchange rate peg. A weakening of the US dollar against other major currencies will make this task even easier.

Since January 2006, Ukraine has been formally paying a new border price of USD 95 per thousand cubic metres (th cm) for its natural gas imports – instead of USD 50 it used to pay previously for Russian gas under a barter arrangement. However, given the monopoly position of the state-owned energy company Naftohaz and the administrative price-setting in the domestic market, the price increase has been passed on to the final consumers only partly. As a result, Naftohaz has accumulated debt arrears to its supplier RosUkrEnergo of some USD 700 million, which are to be financed largely by external borrowing.

Starting from 2006, the gas price for industrial consumers was capped at USD 110 per th cm (excluding VAT and transportation costs). However, industrial producer prices rose only moderately (by 4.3% in May against December), as the most energy-consuming export industries facing international competition were unable to pass the rising cost of the energy inputs on to customers (given the stable exchange rate) and were forced to reduce their production volumes instead. In turn,

33 Almost simultaneously, the United States granted Ukraine 'market economy' status and abolished the trade discriminating so-called 'Jackson-Vanik amendment'.

34 As demonstrated by the recent developments, this volatility typically results from the sequence of one-time FDI-related foreign exchange inflows followed by current-account-related outflows.

Table UA

Ukraine: Selected economic indicators

	2001	2002	2003	2004	2005 [1)]	2005	2006	2006	2007
						1st quarter		forecast	
Population, th pers., end of period	48457.1	48003.5	47622.4	47280.8	46929.5	47166.2	46831.7	46600	46300
Gross domestic product, UAH mn, nom.	204190	225810	267344	345113	418529	79356	93086	480900	547800
annual change in % (real)	9.2	5.2	9.6	12.1	2.6	5.4	2.4	3.5	4.5
GDP/capita (EUR at exchange rate)	872	931	928	1100	1391	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4240	4620	5120	5920	6250	.	.	.	.
Gross industrial production									
annual change in % (real)	14.3	7.0	15.8	12.5	3.1	7.1	0.2	3	4
Construction output total									
annual change in % (real)	3.5	-5.8	26.5	17.2	-6.6	-5.9	5.0	.	.
Consumption of households, UAH mn, nom.	112260	124560	146301	180956	238040	.	.	.	.
annual change in % (real)	9.6	9.5	12.4	15.1	15.9	.	.	.	.
Gross fixed investment, UAH mn, nom.	32573	37178	51011	75714	93096	12638	16486	.	.
annual change in % (real)	20.8	8.9	31.3	28.0	1.9	4.5	15.9	7	10
LFS - employed persons, th, avg.	19971.5	20091.2	20163.3	20295.7	20748.2	20027.1	.	.	.
annual change in %	-1.0	0.6	0.8	0.7	2.2	3.0	.	.	.
Reg. employees in industry, th pers., avg. [2)]	3811.0	3578.1	3416.0	3408.3	3406.6	3414.0	3378.2	.	.
annual change in %	-6.2	-6.1	-4.5	-0.2	0.0	0.5	-1.0	.	.
LFS - unemployed, th pers., average	2455.0	2140.7	2008.0	1906.7	1557.0	1912.1	.	.	.
LFS - unemployment rate in %, average	10.9	9.6	9.1	8.6	7.0	8.7	.	6.8	6.6
Reg. unemployment rate in %, end of period	3.7	3.8	3.6	3.5	3.1	3.6	3.2	3	3
Average gross monthly wages, UAH	311.1	376.4	462.3	589.6	806.2	676.6	918.3	.	.
annual change in % (real, gross)	20.7	20.0	16.7	17.0	20.4	15.2	23.8	.	.
Consumer prices, % p.a.	12.0	0.8	5.2	9.0	13.5	13.5	9.7	11	9
Producer prices in industry, % p.a.	8.6	3.1	7.8	20.4	16.8	22.3	8.4	10	8
General governm.budget, nat.def., % GDP									
Revenues	26.9	27.4	28.2	26.5	32.0	30.2	35.3	.	.
Expenditures [3)]	27.2	26.7	28.4	29.7	33.9	26.6	34.9	.	.
Deficit (-) / surplus (+), % GDP	-0.3	0.7	-0.2	-3.2	-1.9	3.5	0.4	-2.5 [4)]	.
Public debt in % of GDP	36.5	33.5	29.0	24.7	18.7	.	.	.	.
Refinancing rate of NB % p.a., end of period	12.5	7.0	7.0	9.0	9.5	9.0	9.5	.	.
Current account, EUR mn [5)]	1565	3360	2559	5560	2030	1221	-618	-1500	-2500
Current account in % of GDP	3.7	7.5	5.8	10.6	3.1	10.7	-4.0	-1.9	-2.7
Gross reserves of NB excl. gold, EUR mn [6)]	3353	4088	5386	6838	16165	9068	13921	.	.
Gross external debt, EUR mn [7)]	13785	12247	19055	22528	32824	24643	33045	.	.
FDI inflow, EUR mn [5)]	884	734	1261	1380	6263	202	553	.	.
FDI outflow, EUR mn [5)]	26	-5	12	3	221	14	3	.	.
Exports of goods, BOP, EUR mn [5)]	19074	19770	21013	26906	28093	6499	6824	28000	29500
annual growth rate in %	12.1	3.6	6.3	28.0	4.4	9.0	5.0	0	5
Imports of goods, BOP, EUR mn [5)]	18853	19018	20555	23895	29004	5722	7896	33000	36300
annual growth rate in %	16.6	0.9	8.1	16.3	21.4	10.0	38.0	14	10
Exports of services, BOP, EUR mn [5)]	4459	4958	4615	6325	7503	1428	1809	8500	9000
annual growth rate in %	8.5	11.2	-6.9	37.0	18.6	10.5	26.7	13	6
Imports of services, BOP, EUR mn [5)]	3995	3743	3934	5329	6054	1285	1663	7000	7500
annual growth rate in %	16.4	-6.3	5.1	35.5	13.6	8.5	29.4	16	7
Average exchange rate UAH/USD	5.372	5.327	5.333	5.319	5.125	5.299	5.050	5	5
Average exchange rate UAH/EUR (ECU)	4.814	5.030	6.024	6.609	6.389	6.956	6.067	6	6
Purchasing power parity UAH/USD, wiiw	0.912	0.943	0.998	1.120	1.288	.	.	.	.
Purchasing power parity UAH/EUR, wiiw	0.988	1.014	1.092	1.229	1.423	.	.	.	.

Notes: 1) Preliminary. - 2) Excluding small enterprises. - 3) From 2004 including lending minus repayments. - 4) Central budget deficit passed by Parliament end December 2005. - 5) Converted from USD. - 6) Useable. - 7) Up to 2002 long-term debt only.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

the gas and electricity tariff hikes for households were postponed until after the March parliamentary elections; both were eventually raised by 25% on 1 May 2006. As a result of the move, the prices of services jumped by 3.6% in May, but the surge was mitigated by the continuous deflation of foodstuffs making up some 60% of the consumer basket. Thus, between December 2005 and May 2006, consumer prices rose by a mere 2.8%. However, in the second half of the year consumer price inflation will almost certainly pick up, given the 85% gas tariff hike scheduled for 1 July (one more, albeit a smaller, tariff hike is planned for 1 January 2007). In addition, the border price paid by Ukraine for imported gas may well rise further, for instance, to USD 130 per th cm, as suggested recently by the RosUkrEnergo officials, although the negotiations are still going on. Against the background of the planned hikes of gas, but also other regulated tariffs such as telecommunications and railways, the consumer price inflation in 2006 will be almost certainly double-digit once again.

Last but not least, economic prospects may be hampered by the policies of the renewed 'orange' coalition formed after the parliamentary elections held in March. The elections resulted in a triumph of the opposition parties, weakening the position of the pro-president 'Our Ukraine' and potentially forcing it to accept difficult compromises. Given the renewed nomination of Ms Tymoshenko for the post of prime minister and the participation of the Socialist Party in the newly formed coalition, a liberal and reform-oriented economic policy course may be problematic. Nevertheless, the coalition is unlikely to be stable and we expect a gradual acceleration of economic growth in 2006-2007, while both the budget and the external deficits will be generally kept in check.

Waltraut Urban

China: undamped growth of the economy

In the first quarter of 2006, the Chinese economy kept fast growth (10.2%). The rapid expansion of the economy was mainly driven by a surge of investment and supported by a record foreign trade surplus. Private consumption developed at a stable pace, inflation remained low. In the months to come, certain government measures to dampen growth and to prevent an overheating of the economy may become more effective. We thus expect the GDP growth for the whole year 2006 to reach 9.7%. For 2007, taking into account the predicted cooling down of the world economy, a growth rate around 9.5% is expected.

In the Chinese economy, investment in fixed assets takes an extremely high share by international standards (2005: 49% of GDP). This is a merit but a source of concern at the same time. In the first quarter of 2006, fixed asset investment rose by 27.7% (in nominal terms), significantly faster than in the same period of last year (22.8%) and in 2005 on average (25.7%) – despite several government measures in place to dampen investment (credit restraints, limitation of operating licences etc.). Correspondingly, new loans expanded at incredible rates of 70% during the first quarter and 123% in April alone (the total amount of outstanding loans in the first quarter was up 15%). In response, the People's Bank of China (PBoC) raised the benchmark lending rate (i.e. the one-year lending rate) from 5.5% to 5.85% on 27 April 2006. Within fixed asset investment, the fastest growing segments were investment in coal mining (43%) and in manufacturing (36.3%)[35], despite already existing surplus capacities in these fields. These surplus capacities are a consequence of overshooting

[35] *China Monthly Statistics* 3/2006.

investment attracted by high prices and high profits in the recent past. The government has earmarked about ten industries as being plagued by surplus capacities judged by various indicators such as capacity utilization, price developments, stocks etc. and is planning to increase the threshold for these industries by tightening rules governing land and cash supplies as well as environmental standards. Industries which may be affected by these measures include the automotive, steel, ferroalloy, aluminium and coke industries and probably also textiles.[36]

Investment in real estate development was up 20.2%, or 6.5 percentage points lower than in the same period of 2005. Probably, the various measures to restrict investment in this sector, which was considered seriously over-heated already last year, have had some impact. However, in May further rules regarding mortgage down payments and housing transactions were introduced in a bid to cool down the property sector and divert investment from luxury apartments to low-cost housing.[37] Given the various measures in place to dampen investment and taking into account a certain time lag for them to become effective, one may expect investment growth to decelerate in the course of the year.

Although exports expanded at a slower pace and imports rose faster than in the same period a year earlier, a record trade surplus of USD 23 billion resulted for the first quarter of 2006, due to the already existing imbalance between exports and imports by the end of 2005. Chinese exporters took particular advantage of the surge in global consumer electronics demand (mobile phones, digital music players etc.). For the rest of the year, the trade surplus is expected to increase further and it will probably reach USD 115 billion for the year as a whole. There are, however, some uncertainties with regard to the effect of pending anti-dumping procedures against Chinese products from the side of the USA and the EU, but the volume of trade potentially affected by these measures is not overwhelming. Also, the likely creeping revaluation of the Chinese currency will have no dramatic consequences for the development of foreign trade.

Foreign direct investment inflows during the first quarter amounted to USD 14.2 billion, up 6.4% from the same period last year. However, these figures do not comprise investment in the financial sector, which is only taken into account in the annual revision of FDI data. While foreign investments in the financial sector had been rather low in the past due to existing restrictions, they increased significantly in 2005 to reach USD 12 billion. For 2006, we may assume a further strong inflow of investment in the financial sector because by the end of this year, all existing limitations on foreign banks doing business in China will phase out as part of China's commitment to the World Trade Organization (WTO).[38]

For the first time, also foreign direct investment outflows, reflecting Chinese investment abroad, were published on a quarterly basis. They amounted to USD 2.68 billion in the first quarter of 2006, up

[36] Last year, China produced 348 million tons of steel out of its annual capacity of 470 million tons; the total production capacity of the aluminium industry reached 10.7 million tons, but national consumption stood at 7.12 million tons only; in the automotive industry, annual capacity now stands at 8 million units, already exceeding the projected sales of about 6 million; in the ferroalloys industry, the capacity utilization was only around 50% in 2005. (*China Daily, China Business Weekly*, 8-14 May 2006, p. 5.)

[37] As of 1 June the minimum down payment for a new apartment larger than 90 square metres will be raised from 20% to 30%. Also, the period during which a 5.5% transaction tax has to be paid when reselling a property was extended from 2 to 5 years (*China Daily*, 30 May 2006).

[38] See, for instance, W. Urban, 'China preparing for WTO deadline in banking', *wiiw Monthly Report*, No. 6, 2006, pp. 15-19.

Table CN

China: Selected economic indicators

	2001	2002	2003	2004	2005 [1)]	2005	2006 [1)]	2006	2007
						1st quarter		forecast	
Population, mn pers., end of period	1276.3	1284.5	1292.3	1299.9	1307.7	.	.	.	.
Gross domestic product, CNY bn, nom. [2)]	9731.48	10517.2	11739.0	15987.8	18232.1	3131.9	4339.0	20400	22700
annual change in % (real)	7.5	8.3	9.5	9.5	9.9	9.5	10.3	9.7	9.5
annual change in % (real) - revised	*8.3*	*9.1*	*10.0*	*10.1*	.			.	.
GDP/capita (USD at exchange rate) [2)]	921	989	1098	1486	1699	.	.	.	.
GDP/capita (USD at PPP - wiiw) [2)]	4441	4860	5385	6992	7926	.	.	.	.
Industrial value added [3)]									
annual change in % (real)	8.9	9.9	12.5	11.1	11.4	11.3	12.5	11	.
Agricultural value added									
annual change in % (real)	2.5	2.9	2.5	6.0	5.2	4.6	4.5	.	.
Retail trade turnover, CNY bn	3759.5	4191.1	4572.5	5395.0	6717.7	1511.2	1844.0	.	.
annual change in % (real)	10.9	10.6	9.2	10.5	12.0	12.1	12.2	.	.
Total investment in fixed assets, CNY bn	3689.8	4283.9	5427.6	7007.3	8860.0	1099.8	1390.8	.	.
annual change in % (nominal)	12.1	16.1	26.7	26.6	25.7	22.8	27.7	.	.
Employment total, mn pers., end of period	730.3	737.4	744.3	752.0	.	.	.	.	.
annual change in %	1.3	1.0	0.9	1.0	.	.	.	.	.
Staff and workers, mn pers., end of period [4)]	107.9	105.6	104.6	105.8	108.5	104.6	107.9	.	.
annual change in %	-4.2	-2.2	-0.7	0.8	2.6	1.0	3.1	.	.
Unemployment rate (urban) in %, end of per. [5)]	3.6	4.0	4.5	4.2	4.2	.	.	4.5	4.5
Average gross annual wages, CNY [6)]	10870	12422	14040	16024	18238	16440	18777	.	.
annual change in % (real) [7)]	15.2	15.5	12.0	10.5	.	14.8	.	.	.
Retail prices, % p.a.	-0.8	-1.8	-0.1	2.8	0.8	1.6	0.6	.	.
Consumer prices, % p.a.	0.7	-0.8	1.2	3.9	1.8	2.8	1.8	2.0	1.8
General government budget, nat.def., % GDP									
Revenues	16.8	18.0	18.5	16.5	17.4	.	.	.	.
Expenditures	19.4	21.0	21.0	17.8	18.4	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.5	-3.0	-2.5	-1.3	-1.1	.	.	-1.4	.
Refinancing rate of NB % p.a., end of per. [8)]	3.2	2.7	2.7	2.9	2.9	2.9	2.9	.	.
Current account, USD bn	17.4	35.4	45.9	70.0	161.0	.	.	190	150
Current account in % of GDP	1.5	2.8	3.2	3.6	7.2	.	.	7.3	5.0
Gross reserves of NB excl. gold, USD bn	212.2	286.4	403.3	609.9	818.9	659.1	875.1	.	.
Gross external debt, USD bn	170.1	171.7	194.0	223.0	280.0	233.4	.	.	.
FDI inflow, gross, USD bn	46.9	52.8	53.3	60.6	60.3	13.4	14.3	.	.
FDI outflow, gross, USD bn	7.1	2.8	1.8	2.1	11.0	.	.	.	.
Exports of goods total, USD bn [9)]	266.2	325.6	438.4	593.4	762.0	155.9	197.3	960	.
annual change in %	6.8	22.3	34.6	35.4	28.4	34.9	26.6	26	.
Imports of goods total, USD bn [9)]	243.6	295.3	412.8	561.3	660.1	139.3	174.0	845	.
annual change in %	8.2	21.2	39.9	36.0	17.6	12.2	24.8	28	.
Trade balance of goods, USD bn [9)]	22.6	30.3	25.5	32.1	101.9	16.6	23.3	115	.
Average exchange rate CNY/USD	8.277	8.277	8.277	8.277	8.206	8.280	8.035	7.8	7.5
Average exchange rate CNY/EUR	7.347	7.753	9.366	11.276	10.261	10.930	9.658	.	.
Purchasing power parity CNY/USD, wiiw [10)]	1.717	1.685	1.687	1.759	1.759	.	.	.	.
Purchasing power parity CNY/EUR, wiiw	1.967	1.951	1.977	2.058	2.115	.	.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary. - 2) In 2004 data for GDP and GDP per capita revised according to the national census 2005. - 3) Including construction. - 4) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 5) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 6) Average gross annual wages of staff and workers, defined as: total wages of staff and workers on duty per average number of staff and workers on duty. - 7) Staff and workers cost of living index is used as deflator for calculating real wage. - 8) Overnight rate. - 9) According to customs statistics. - 10) Purchasing power parity, ICP-method; see Ren Ruoen, The Vienna Institute Monthly Report 1996/2.

Sources: China Statistical Yearbook; China Monthly Statistics; China Daily etc.

280%. Chinese outward investment is developing very dynamically from a low base. The total stock of outward investment reported for the end of 2005 was USD 64.5 billion. Outward FDI is promoted by the Chinese government under the so-called 'go-abroad' policy, with the aims to secure raw materials (oil!) on the one hand and to gain better access to technology, established brand names and distribution channels on the other.[39] Outward investment is also backed by China's huge cumulated foreign exchange reserves. In February this year China surpassed Japan as the holder of the biggest foreign exchange reserves in the world. At the end of March, they came up to USD 875 billion, equivalent to more than one year's imports.

Data on aggregate private consumption are not available at a quarterly basis. However, retail sales of consumer goods (in real terms), which may be used as a proxy for private consumption, expanded by 12.2% year-on-year in the first quarter, slightly faster than in the same period last year (12.1%) and in 2005 on average (12%). Private consumption was supported by a relatively strong rise in incomes, also of the rural population, which still takes a share of around 60% of the total.[40] In real terms, per capita disposable income of urban households increased by 10.8% and that of rural households showed a year-on-year increase in the first quarter of 11.5%. Apart from the fast growth of the economy, this rise was supported by fiscal measures such as the scrapping of the so-called 'agricultural tax' and a doubling of the personal income threshold for taxation from 800 yuan to 1666 yuan with the beginning of the year, as part of the government's strategy to strengthen domestic consumption relative to foreign demand.

Despite high and accelerating GDP growth, consumer price inflation in the first quarter was moderate, reaching 1.2% only, significantly less than in the same period last year and also below that in 2005 on average. This was mainly due to a smaller rise of food prices, which have a big weight in the index. Producer prices rose faster than consumer prices (2.9%), partly because of rising fuel prices, but increased less than last year as well. For the months to come, a certain acceleration of inflation can be expected because of the increase in a number of regulated prices in January which will affect the whole economy with a certain delay (fees for water, electricity and fuels rose by 8.4%). For the year on average we thus expect consumer prices to rise by about 2%.

Fiscal policy will be a mixture of expansive and restrictive measures: The general government deficit is scheduled to amount to yuan 285 billion (USD 36 billion), probably reaching -1.4% of GDP, 0.3 percentage points more than in 2005. However, there will be a certain shift from investment expenditures to social expenditures and measures to support private consumption (incomes), such as the increase in salaries of public servants and tax relief. The amount of special bonds to support infrastructure investment will be reduced further to yuan 60 billion (USD 7.3 billion) in 2006 (2005: USD 9.7billion). Regarding monetary policy, the growth target for broad money supply (M2, money and quasi-money) is set at 16% for 2006, but in the first five months of the year growth rates were in each month higher than that and the amount of new loans during the first quarter (yuan 1.26 trillion) accounted already for half of the central bank's yuan 2.5 trillion loan growth target for this year. One

[39] For details see W. Urban, 'Chinese direct investment abroad: economic and political objectives', *wiiw Monthly Report*, No.1, 2006, pp. 4-7.

[40] The rise in consumption was particularly obvious in luxury goods such as cosmetics, furniture, catering and accommodation as well as cars. The sales of domestically made vehicles rose 36.9% year-on-year to 1.73 million units from January to March this year.

therefore may expect further measures to restrict money supply growth beyond the interest hike in April mentioned above.

On the supply side of the economy, provisional data show an increase in value-added of the primary sector (mainly agriculture and some mining) of 4.6%, nearly the same as the year before. But the prospects for the summer harvest are good and the growth of the agricultural sector may accelerate in the course of the year. The secondary sector (industry and construction) grew by 12.5%, somewhat faster than in the same period last year. The tertiary sector, representing various types of services, expanded by 8.9%.

To sum up, overall economic growth will remain strong throughout 2006. While growth of investment may lose momentum, that of consumption may accelerate due to restrictive measures on the one hand and public support on the other. Inflation is expected to rise moderately. Foreign trade will continue to expand fast and will again result in a huge trade and current account surplus. Foreign direct investment will rise further in the context of a certain restructuring from manufacturing to the services sector, in particular financial services. Chinese outward FDI is gaining importance.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2006 at constant PPPs

	1991	1995	2000	2003	2004	2005	2006	2007	2008	2010	2015
							projection assuming 4% p.a. GDP growth and zero population growth p.a.				
Czech Republic	9149	9973	13044	14864	15999	17359	18314	19230	19999	21631	26317
Hungary	7289	7467	10548	12889	13631	14260	14831	15172	15779	17066	20764
Poland	4497	6121	9404	10209	11060	11693	12278	12830	13343	14432	17559
Slovak Republic	6028	6774	9469	11293	12009	12907	13746	14640	15225	16468	20035
Slovenia	9523	9706	14642	16514	17925	18720	19469	20248	21058	22776	27710
Estonia	5885	5209	8262	10502	11662	13462	14660	15818	16451	17793	21648
Latvia	6219	4100	7022	8877	9696	11024	11961	12870	13385	14477	17613
Lithuania	8172	5032	7618	9840	10835	12192	12984	13789	14341	15511	18872
Cyprus	10451	12538	16262	17363	18750	19544	20287	21058	21900	23687	28819
Malta	9683	11715	15802	15945	15835	16235	16511	16825	17498	18925	23026
Bulgaria	4764	4746	5330	6465	6924	7526	7940	8337	8670	9378	11409
Romania	4097	4623	5013	6518	7293	8143	8550	8960	9318	10079	12262
Croatia	5932	5640	8119	9983	10609	11451	11909	12385	12881	13932	16950
Macedonia	4343	4050	5160	5353	5686	6000	6210	6459	6717	7265	8839
Turkey	4199	4608	5998	5810	6522	7208	7604	8023	8344	9024	10980
Albania	1516	2477	3549	4251	4638	4861	5114	5410	5627	6086	7405
Bosnia & Herzegovina	.	.	4873	5502	5778	5990	6349	6730	6999	7570	9210
Montenegro	.	.	4796	5135	5458	5792	6081	6386	6641	7183	8739
Serbia	.	.	4292	5174	5794	6302	6554	6816	7089	7667	9329
Russia	8133	5679	5979	7509	8279	9037	9561	10126	10531	11390	13858
Ukraine	5792	3276	3771	5121	5918	6245	6463	6754	7024	7597	9243
							projection assuming 2% p.a. GDP growth and zero population growth p.a.				
Germany	17589	18529	22501	23556	24608	25721	26235	26760	27295	28398	31354
Greece	10822	10911	14648	17623	18570	19237	19622	20014	20414	21239	23450
Spain	12465	13464	18562	21162	22098	23102	23564	24036	24516	25507	28162
Austria	18378	19536	25285	26266	27773	28855	29432	30020	30621	31858	35174
Portugal	10527	11649	16178	15833	16413	16709	17044	17384	17732	18448	20369
USA	21389	23199	30608	32143	34096	35583	36294	37020	37761	39286	43375
EU(15) average	15879	17009	22016	23585	24509	25277	25782	26298	26824	27907	30812
EU(25) average	14227	15320	20066	21639	22567	23353	23876	24411	24958	26088	29144

European Union (25) average = 100

	1991	1995	2000	2003	2004	2005	2006	2007	2008	2010	2015
Czech Republic	64	69	65	69	71	74	77	79	80	83	90
Hungary	51	49	53	60	60	61	62	62	63	65	71
Poland	32	40	47	47	49	50	51	53	53	55	60
Slovak Republic	42	44	47	52	53	55	58	60	61	63	69
Slovenia	67	68	73	76	79	80	82	83	84	87	95
Estonia	41	34	41	49	52	58	61	65	66	68	74
Latvia	44	27	35	41	43	47	50	53	54	55	60
Lithuania	57	33	38	45	48	52	54	56	57	59	65
Cyprus	73	82	81	80	83	84	85	86	88	91	99
Malta	68	76	79	74	70	70	69	69	70	73	79
Bulgaria	33	31	27	30	31	32	33	34	35	36	39
Romania	29	30	25	30	32	35	36	37	37	39	42
Croatia	42	37	40	46	47	49	50	51	52	53	58
Macedonia	31	26	26	25	25	26	26	26	27	28	30
Turkey	29	30	30	27	29	31	32	33	33	35	38
Albania	11	16	18	20	21	21	21	22	23	23	25
Bosnia & Herzegovina	.	.	24	25	26	26	27	28	28	29	32
Montenegro	.	.	24	24	24	25	25	26	27	28	30
Serbia	.	.	21	24	26	27	27	28	28	29	32
Russia	57	37	30	35	37	39	40	41	42	44	48
Ukraine	41	21	19	24	26	27	27	28	28	29	32
Germany	124	121	112	109	109	110	110	110	109	109	108
Greece	76	71	73	81	82	82	82	82	82	81	80
Spain	88	88	93	98	98	99	99	98	98	98	97
Austria	129	127	126	121	123	124	123	123	123	122	121
Portugal	74	76	81	73	73	72	71	71	71	71	70
USA	150	151	153	149	151	152	152	152	151	151	149
EU(15) average	112	111	110	109	109	108	108	108	107	107	106
EU(25) average	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1998-2005

EUR based, annual averages

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Czech Republic								
Producer price index, 2000=100	94.4	95.3	100.0	102.8	102.3	101.9	107.7	110.9
Consumer price index, 2000=100	94.3	96.2	100.0	104.7	106.6	106.7	109.7	111.8
GDP deflator, 2000=100	95.8	98.5	100.0	104.9	107.8	108.8	112.7	113.8
Exchange rate (ER), CZK/EUR	36.16	36.88	35.61	34.08	30.81	31.84	31.90	29.78
ER nominal, 2000=100	101.6	103.6	100.0	95.7	86.5	89.4	89.6	83.6
Real ER (CPI-based), 2000=100	104.5	105.6	100.0	93.4	84.7	89.1	88.7	83.1
Real ER (PPI-based), 2000=100	103.8	104.2	100.0	94.2	85.1	88.8	86.1	81.7
PPP, CZK/EUR	16.27	16.29	16.34	16.76	16.58	16.99	17.03	16.77
Price level, EU(25)=100	45	44	46	49	54	53	53	56
Average monthly gross wages, CZK	11801	12797	13614	14793	15866	16917	18041	19024
Average monthly gross wages, EUR (ER)	326	347	382	434	515	531	565	639
Average monthly gross wages, EUR (PPP)	725	786	833	883	957	995	1059	1135
GDP nominal, CZK mn	1996483	2080797	2189169	2352214	2464432	2577110	2781060	2978157
Employed persons - LFS, th., average 1)	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2	4706.6	4764.0
GDP per employed person, CZK	410318	436766	462670	495182	517205	544481	590885	625138
GDP per empl. person, CZK at 2000 pr.	428356	443352	462670	472166	479645	500256	524274	549567
Unit labour costs, CZK, 2000=100	93.6	98.1	100.0	106.5	112.4	114.9	116.9	117.6
Unit labour costs, ER adj., 2000=100	92.2	94.7	100.0	111.2	129.9	128.5	130.5	140.7
Unit labour costs, PPP adj., Austria=100	28.77	29.27	31.03	34.01	38.68	37.76	39.00	40.91
Hungary								
Producer price index, 2000=100	85.3	89.6	100.0	105.2	103.3	105.8	109.5	114.2
Consumer price index, 2000=100	82.8	91.1	100.0	109.2	115.0	120.4	128.6	133.2
GDP deflator, 2000=100	84.1	91.1	100.0	108.3	117.7	125.5	130.6	133.9
Exchange rate (ER), HUF/EUR	240.98	252.80	260.04	256.68	242.97	253.51	251.68	248.05
ER, nominal 2000=100	92.7	97.2	100.0	98.7	93.4	97.5	96.8	95.4
Real ER (CPI-based), 2000=100	108.6	104.7	100.0	92.4	84.8	86.1	81.8	79.5
Real ER (PPI-based), 2000=100	104.9	104.0	100.0	94.9	91.0	93.2	91.5	90.5
PPP, HUF/EUR	108.15	114.24	122.11	126.46	133.14	142.85	148.28	151.57
Price level, EU(25)=100	45	45	47	49	55	56	59	61
Average monthly gross wages, HUF	67764	77187	87645	103553	122482	137193	145521	158315
Average monthly gross wages, EUR (ER)	281	305	337	403	504	541	578	638
Average monthly gross wages, EUR (PPP)	627	676	718	819	920	960	981	1044
GDP nominal, HUF mn	10087434	11393499	13150766	14989800	16915259	18650746	20429456	21802561
Employed persons - LFS, th., average 2)	3674.7	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5
GDP per employed person, HUF	2745104	2990969	3410291	3875036	4370190	4755538	5237785	5588251
GDP per empl. person, HUF at 2000 pr.	3265774	3281843	3410291	3579547	3713967	3789342	4009043	4172211
Unit labour costs, HUF, 2000=100	80.7	91.5	100.0	112.6	128.3	140.9	141.2	147.6
Unit labour costs, ER adj., 2000=100	87.1	94.1	100.0	114.0	137.3	144.5	145.9	154.8
Unit labour costs, PPP adj., Austria=100	24.31	26.00	27.74	31.17	36.55	37.95	38.97	40.24
Poland								
Producer price index, 2000=100	87.8	92.8	100.0	101.6	102.6	105.3	112.7	113.4
Consumer price index, 2000=100	84.6	90.8	100.0	105.5	107.5	108.4	112.2	114.5
GDP deflator, 2000=100	87.9	93.2	100.0	103.5	105.8	106.3	110.5	113.5
Exchange rate (ER), PLN/EUR	3.923	4.227	4.011	3.669	3.856	4.398	4.534	4.025
ER, nominal, 2000=100	97.8	105.4	100.0	91.5	96.1	109.6	113.0	100.4
Real ER (CPI-based), 2000=100	112.1	113.9	100.0	88.6	93.3	107.6	109.5	97.3
Real ER (PPI-based), 2000=100	107.5	108.9	100.0	91.1	94.2	105.3	103.8	95.8
PPP, PLZ/EUR	1.931	1.995	2.070	2.121	2.118	2.160	2.184	2.198
Price level, EU(25)=100	49	47	52	58	55	49	48	55
Average monthly gross wages, PLN 3)	1233	1697	1894	2045	2098	2185	2273	2380
Average monthly gross wages, EUR (ER)	314	401	472	557	544	497	501	591
Average monthly gross wages, EUR (PPP)	639	851	915	964	990	1012	1041	1083
GDP nominal, PLN mn	600902	666308	744622	779205	807860	842120	922157	980884
Employed persons - LFS, th., average 4)	15354	14757	14526	14207	13782	13617	13795	14116
GDP per employed person, PLN	39137	45152	51261	54847	58617	61844	66848	69488
GDP per empl. person, PLN at 2000 pr.	44540	48426	51261	52987	55385	58189	60483	61214
Unit labour costs, PLN, 2000=100	74.9	94.9	100.0	104.5	102.5	101.6	101.7	105.3
Unit labour costs, ER adj., 2000=100	76.6	90.0	100.0	114.2	106.7	92.7	90.0	104.9
Unit labour costs, PPP adj., Austria=100	33.76	39.28	43.81	49.32	44.84	38.46	37.97	43.07

Notes: 1) From 2002 according to census 2001. - 2) From 1999 according to census 2001. - 3) From 1999 broader wage coverage. - 4) From 2003 according to census 2002.

(Table A/2 ctd.)

Table A/2 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Slovak Republic								
Producer price index, 2000=100	86.5	90.2	100.0	106.5	108.7	117.8	121.8	127.5
Consumer price index, 2000=100	80.7	89.3	100.0	107.1	110.6	120.0	129.0	132.5
GDP deflator, 2000=100	86.5	92.2	100.0	105.0	109.9	115.1	122.0	124.9
Exchange rate (ER), SKK/EUR	39.60	44.12	42.59	43.31	42.70	41.49	40.05	38.59
ER, nominal, 2000=100	93.0	103.6	100.0	101.7	100.3	97.4	94.0	90.6
Real ER (CPI-based), 2000=100	111.7	113.8	100.0	97.0	94.5	86.3	79.2	75.9
Real ER (PPI-based), 2000=100	103.7	110.1	100.0	96.6	92.7	83.7	79.9	77.0
PPP, SKK/EUR	17.24	17.87	18.26	18.70	18.80	19.96	20.97	21.17
Price level, EU(25)=100	44	41	43	43	44	48	52	55
Average monthly gross wages, SKK	10003	10728	11430	12365	13511	14365	15825	17274
Average monthly gross wages, EUR (ER)	253	243	268	286	316	346	395	448
Average monthly gross wages, EUR (PPP)	580	600	626	661	719	720	755	816
GDP nominal, SKK mn	781437	844108	934079	1020595	1111484	1212665	1355262	1472103
Employed persons - LFS, th., average	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6	2170.4	2216.2
GDP per employed person, SKK	355425	395905	444440	480574	522559	560226	624430	664246
GDP per empl. person, SKK at 2000 pr.	410675	429563	444440	457509	475527	486909	511833	531837
Unit labour costs, SKK, 2000=100	94.7	97.1	100.0	105.1	110.5	114.7	120.2	126.3
Unit labour costs, ER adj., 2000=100	101.9	93.7	100.0	103.3	110.2	117.8	127.8	139.4
Unit labour costs, PPP adj., Austria=100	25.97	23.66	25.35	25.81	26.80	28.26	31.21	33.12
Slovenia								
Producer price index, 2000=100	91.0	92.9	100.0	108.9	114.5	117.3	122.4	125.7
Consumer price index, 2000=100	86.5	91.8	100.0	108.4	116.5	123.1	127.5	130.7
GDP deflator, 2000=100	89.2	94.9	100.0	108.7	117.3	124.0	128.0	129.3
Exchange rate (ER), SIT/EUR	186.27	193.63	205.03	217.19	226.22	233.70	238.86	239.64
ER, nominal, 2000=100	90.8	94.4	100.0	105.9	110.3	114.0	116.5	116.9
Real ER (CPI-based), 2000=100	101.8	100.9	100.0	99.9	98.8	98.5	99.3	99.3
Real ER (PPI-based), 2000=100	96.3	97.4	100.0	98.4	97.0	98.3	98.5	100.8
PPP, SIT/EUR	137.39	142.35	147.57	156.42	167.32	176.31	174.64	175.05
Price level, EU(25)=100	74	74	72	72	74	75	73	73
Average monthly gross wages, SIT	158069	173245	191669	214561	235436	253200	267571	277279
Average monthly gross wages, EUR (ER)	849	895	935	988	1041	1083	1120	1157
Average monthly gross wages, EUR (PPP)	1151	1217	1299	1372	1407	1436	1532	1584
GDP nominal, SIT mn	3494600	3918974	4300350	4799552	5355440	5813540	6251244	6557698
Employed persons - LFS, th., average	901	886	901	916	910	897	943	949
GDP per employed person, SIT	3878579	4423221	4772863	5239686	5885099	6481093	6629103	6910114
GDP per empl. person, SIT at 2000 pr.	4349090	4662575	4772863	4819474	5018830	5226574	5178783	5345153
Unit labour costs, SIT, 2000=100	90.5	92.5	100.0	110.9	116.8	120.6	128.7	129.2
Unit labour costs, ER adj., 2000=100	99.6	98.0	100.0	104.7	105.9	105.8	110.4	110.5
Unit labour costs, PPP adj., Austria=100	66.57	64.82	66.43	68.51	67.49	66.57	70.64	68.82
Estonia								
Producer price index, 2000=100	96.5	95.3	100.0	104.4	104.8	105.0	108.1	110.3
Consumer price index, 2000=100	93.1	96.2	100.0	105.8	109.6	111.0	114.4	119.1
GDP deflator, 2000=100	90.8	94.9	100.0	105.6	110.2	112.5	115.9	123.1
Exchange rate (ER), EEK/EUR	15.783	15.647	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	100.9	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	105.1	102.1	100.0	96.6	95.2	95.8	95.0	93.2
Real ER (PPI-based), 2000=100	100.9	100.6	100.0	96.9	95.9	96.3	95.8	98.2
PPP, EEK/EUR	7.981	8.122	8.214	8.686	8.856	8.958	8.992	9.103
Price level, EU(25)=100	51	52	52	56	57	57	57	58
Average monthly gross wages, EEK [5)]	4125	4440	4907	5510	6144	6723	7287	8020
Average monthly gross wages, EUR (ER)	261	284	314	352	393	430	466	513
Average monthly gross wages, EUR (PPP)	517	547	597	634	694	751	810	881
GDP nominal, EEK mn	78028	81776	92938	104459	116915	127334	141493	164918
Employed persons - LFS, th., average	606.5	579.3	572.5	577.7	585.5	594.3	595.5	607.4
GDP per employed person, EEK	128652	141163	162337	180819	199685	214258	237604	271515
GDP per empl. person, EEK at 2000 pr.	141642	148748	162337	171275	181232	190489	204953	220588
Unit labour costs, EEK, 2000=100	96.3	98.7	100.0	106.4	112.2	116.8	117.6	120.3
Unit labour costs, ER adj., 2000=100	95.5	98.7	100.0	106.4	112.2	116.8	117.6	120.3
Unit labour costs, PPP adj., Austria=100	35.04	35.87	36.47	38.25	39.25	40.32	41.31	41.12

Note: 5) From 1999 excluding compensations from Health Insurance Fund.

(Table A/2 ctd.)

Table A/2 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Latvia								
Producer price index, 2000=100	103.5	99.4	100.0	101.7	102.7	106.0	115.1	124.1
Consumer price index, 2000=100	95.2	97.5	100.0	102.5	104.4	107.5	114.1	121.8
GDP deflator, 2000=100	92.0	96.4	100.0	103.1	106.8	110.6	118.2	128.8
Exchange rate (ER), LVL/EUR	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449	0.6711	0.7028
ER, nominal, 2000=100	118.1	111.4	100.0	100.5	104.0	115.2	119.8	125.5
Real ER (CPI-based), 2000=100	120.3	112.1	100.0	100.2	103.9	114.0	114.1	114.4
Real ER (PPI-based), 2000=100	110.0	107.4	100.0	99.9	101.9	109.9	107.7	109.6
PPP, LVL/EUR	0.2725	0.2781	0.2815	0.2866	0.2954	0.3097	0.3306	0.3511
Price level, EU(25)=100	41	45	50	51	51	48	49	50
Average monthly gross wages, LVL	133	141	150	159	173	192	211	246
Average monthly gross wages, EUR (ER)	202	226	267	283	297	298	314	350
Average monthly gross wages, EUR (PPP)	489	507	531	555	586	622	638	700
GDP nominal, LVL mn	3902.9	4224.2	4685.7	5219.9	5758.3	6392.8	7413.6	8903.8
Employed persons - LFS, th., average	986.1	968.5	941.1	962.1	989.0	1006.9	1017.7	1035.9
GDP per employed person, LVL	3958	4362	4979	5426	5822	6349	7285	8595
GDP per empl. person, LVL at 2000 pr.	4304	4526	4979	5262	5450	5739	6163	6671
Unit labour costs, LVL, 2000=100	103.1	103.7	100.0	100.6	105.7	111.7	114.0	122.7
Unit labour costs, ER adj., 2000=100	87.3	93.1	100.0	100.1	101.6	97.0	95.1	97.7
Unit labour costs, PPP adj., Austria=100	30.47	32.18	34.69	34.23	33.82	31.86	31.77	31.78
Lithuania								
Producer price index, 2000=100	84.8	86.2	100.0	97.0	94.3	93.8	99.4	110.9
Consumer price index, 2000=100	98.2	99.0	100.0	101.3	101.6	100.4	101.6	104.3
GDP deflator, 2000=100	99.6	99.0	100.0	99.5	99.7	98.6	101.4	107.4
Exchange rate (ER), LTL/EUR	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528	3.4528	3.4528
ER, nominal, 2000=100	121.4	115.5	100.0	96.9	93.6	93.3	93.3	93.3
Real ER (CPI-based), 2000=100	119.9	114.4	100.0	97.8	96.1	98.9	99.8	99.3
Real ER (PPI-based), 2000=100	138.2	128.4	100.0	101.1	99.8	100.6	97.1	91.2
PPP, LTL/EUR	1.8177	1.7597	1.7078	1.6674	1.6611	1.6704	1.6774	1.7077
Price level, EU(25)=100	40	41	46	47	48	48	49	49
Average monthly gross wages, LTL	930	987	971	982	1014	1073	1158	1270
Average monthly gross wages, EUR (ER)	207	231	262	274	293	311	335	368
Average monthly gross wages, EUR (PPP)	512	561	568	589	610	642	690	744
GDP nominal, LTL mn	44377	43359	45526	48563	51948	56772	62440	71084
Employed persons - LFS, th., average	1489.4	1456.5	1397.8	1351.8	1405.9	1438.0	1436.3	1473.9
GDP per employed person, LTL	29795	29770	32570	35925	36950	39480	43473	48228
GDP per empl. person, LTL at 2000 pr.	29921	30078	32570	36102	37056	40033	42878	44905
Unit labour costs, LTL, 2000=100	104.3	110.1	100.0	91.3	91.8	89.9	90.6	94.9
Unit labour costs, ER adj., 2000=100	85.8	95.4	100.0	94.2	98.1	96.3	97.0	101.7
Unit labour costs, PPP adj., Austria=100	27.31	30.04	31.63	29.36	29.78	28.84	29.56	30.14
Bulgaria								
Producer price index, 2000=100	82.8	85.1	100.0	103.8	105.0	110.1	116.7	124.8
Consumer price index, 2000=100	88.4	90.7	100.0	107.4	113.6	116.2	123.4	129.6
GDP deflator, 2000=100	90.4	93.7	100.0	106.7	110.7	113.1	118.6	123.0
Exchange rate (ER), BGN/EUR	1.9723	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	100.8	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	110.7	108.2	100.0	95.2	91.8	91.5	88.1	85.7
Real ER (PPI-based), 2000=100	117.5	112.7	100.0	97.5	95.8	91.8	88.6	86.8
PPP, BGN/EUR	0.5850	0.5908	0.6143	0.6430	0.6749	0.6830	0.7104	0.7202
Price level, EU(25)=100	30	30	31	33	35	35	36	37
Average monthly gross wages, BGN	183	201	225	240	258	273	292	320
Average monthly gross wages, EUR (ER)	93	103	115	123	132	140	150	163
Average monthly gross wages, EUR (PPP)	313	340	365	373	382	400	412	444
GDP nominal, BGN mn	22421	23790	26753	29709	32335	34547	38275	41948
Employed persons - LFS, th.,average	3034.8	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	2980.0
GDP per employed person, BGN	7388	8274	9573	11008	11803	12187	13097	14077
GDP per empl. person, BGN at 2000 pr.	8175	8828	9573	10317	10661	10771	11043	11448
Unit labour costs, BGN, 2000=100	95.6	97.1	100.0	99.2	103.0	108.2	112.9	119.0
Unit labour costs, ER adj., 2000=100	94.8	97.1	100.0	99.2	103.0	108.2	112.9	119.0
Unit labour costs, PPP adj., Austria=100	16.14	16.37	16.93	16.55	16.74	17.35	18.41	18.89

(Table A/2 ctd.)

Table A/2 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Romania								
Producer price index, 2000=100	45.1	65.2	100.0	138.1	169.9	203.0	241.8	267.2
Consumer price index, 2000=100	47.1	68.6	100.0	134.5	164.8	190.0	212.5	231.6
GDP deflator, 2000=100	46.9	69.3	100.0	137.4	169.6	210.3	242.0	270.9
Exchange rate (ER), RON/EUR	0.9989	1.6296	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234
ER, nominal, 2000=100	50.1	81.7	100.0	130.4	156.6	188.2	203.1	181.6
Real ER (CPI-based), 2000=100	103.1	116.7	100.0	99.1	99.2	105.4	103.8	87.0
Real ER (PPI-based), 2000=100	107.1	120.1	100.0	95.5	92.7	93.8	86.9	73.6
PPP, RON/EUR	0.3543	0.5097	0.7147	0.9547	1.1475	1.3946	1.5586	1.6311
Price level, EU(25)=100	35	31	36	37	37	37	38	45
Average monthly grross wages, RON	132	192	284	422	532	664	818	958
Average monthly gross wages, EUR (ER)	132	118	142	162	170	177	202	264
Average monthly gross wages, EUR (PPP)	372	377	397	442	464	476	525	587
GDP nominal, RON mn	37119.4	54573.0	80377.3	116768.7	151475.1	197564.8	246371.7	287186.3
Employed persons - LFS, th., average [6)]	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5	9157.6	9160.0
GDP per employed person, RON	3423	5064	7467	10916	16404	21422	26904	31352
GDP per empl. person, RON at 2000 pr.	7296	7305	7467	7942	9670	10186	11119	11572
Unit labour costs, RON, 2000=100	47.5	69.2	100.0	139.7	144.7	171.3	193.5	217.5
Unit labour costs, ER adj., 2000=100	94.9	84.7	100.0	107.1	92.4	91.0	95.3	119.8
Unit labour costs, PPP adj., Austria=100	29.90	26.41	31.31	33.05	27.75	26.99	28.72	35.16
Croatia								
Producer price index, 2000=100	88.8	91.2	100.0	103.6	103.2	105.1	108.8	112.1
Consumer price index, 2000=100	90.4	94.2	100.0	104.9	106.7	108.6	110.9	114.6
GDP deflator, 2000=100	92.0	95.5	100.0	104.0	107.8	112.1	115.8	119.5
Exchange rate (ER), HRK/EUR	7.1366	7.5796	7.6350	7.4690	7.4068	7.5634	7.4952	7.4002
ER, nominal, 2000=100	93.5	99.3	100.0	97.8	97.0	99.1	98.2	96.9
Real ER (CPI-based), 2000=100	100.3	103.5	100.0	95.3	94.9	97.0	96.2	93.9
Real ER (PPI-based), 2000=100	101.5	104.4	100.0	95.5	94.6	95.3	93.4	93.7
PPP, HRK/EUR	4.1132	4.1693	4.2339	4.3250	4.3498	4.4744	4.5193	4.5057
Price level, EU(25)=100	58	55	55	58	59	59	60	61
Average monthly gross wages, HRK	4131	4551	4869	5061	5366	5623	5985	6248
Average monthly gross wages, EUR (ER)	579	600	638	678	724	743	799	844
Average monthly gross wages, EUR (PPP)	1004	1092	1150	1170	1234	1257	1324	1387
GDP nominal, HRK mn	137604	141579	152519	165640	181231	198422	212826	229031
Employed persons - LFS, th., average	1544.0	1492.0	1553.0	1469.0	1528.0	1536.5	1562.5	1573.0
GDP per employed person, HRK	89122	94892	98209	112757	118607	129139	136209	145601
GDP per empl. person, HRK at 2000 pr.	96865	99339	98209	108400	110039	115229	117615	121858
Unit labour costs, HRK, 2000=100	86.0	92.4	100.0	94.2	98.4	98.4	102.6	103.4
Unit labour costs, ER adj., 2000=100	92.0	93.1	100.0	96.3	101.4	99.4	104.6	106.7
Unit labour costs, PPP adj., Austria=100	58.49	58.57	63.19	59.94	61.48	59.45	63.62	63.20
Macedonia								
Producer price index, 2000=100	90.4	90.3	100.0	102.0	101.1	100.8	101.7	104.9
Consumer price index, 2000=100	95.2	94.5	100.0	105.5	107.4	108.7	108.2	108.8
GDP deflator, 2000=100	89.9	92.4	100.0	103.6	107.1	107.5	108.9	112.6
Exchange rate (ER), MKD/EUR	61.07	60.62	60.73	60.91	60.98	61.26	61.34	61.30
ER, nominal, 2000=100	100.6	99.8	100.0	100.3	100.4	100.9	101.0	100.9
Real ER (CPI-based), 2000=100	102.5	103.6	100.0	97.2	97.5	98.7	101.4	103.0
Real ER (PPI-based), 2000=100	107.3	105.9	100.0	99.5	99.9	101.3	102.8	104.2
PPP, MKD/EUR	21.34	21.48	22.61	22.97	23.18	23.18	22.96	23.26
Price level, EU(25)=100	35	35	37	38	38	38	37	38
Average monthly gross wages, MKD [7)]	16008	16468	17958	17886	19025	19950	20771	21330
Average monthly gross wages, EUR (ER)	262	272	296	294	312	326	339	348
Average monthly gross wages, EUR (PPP)	750	767	794	779	821	861	905	917
GDP nominal, MKD mn	194979	209010	236389	233841	243970	251486	265257	284027
Employed persons - LFS, th., average	539.8	545.2	549.8	599.3	561.3	545.1	523.0	545.3
GDP per employed person, MKD	361231	383348	429919	390185	434620	461351	507189	520909
GDP per empl. person, MKD at 2000 pr.	401831	414910	429919	376587	405687	429253	465791	462567
Unit labour costs, MKD, 2000=100	95.4	95.0	100.0	113.7	112.3	111.3	106.8	110.4
Unit labour costs, ER adj., 2000=100	94.8	95.2	100.0	113.4	111.8	110.3	105.7	109.4
Unit labour costs, PPP adj., Austria=100	34.10	33.89	35.75	39.93	38.35	37.33	36.38	36.64

Notes: 6) Methodological break in 2001/2002. - 7) Until 1999 wiiw estimate.

(Table A/2 ctd.)

Table (A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Albania								
Producer prices, manufact.ind., 2000=100	91.4	93.9	100.0	92.8	97.5	99.3	111.4	.
Consumer price index, 2000=100	99.5	99.9	100.0	103.1	108.5	110.9	114.2	116.9
GDP deflator, 2000=100	94.3	96.0	100.0	103.4	106.0	113.5	115.6	118.1
Exchange rate (ER), ALL/EUR	168.72	146.96	132.58	128.47	132.36	137.51	127.67	124.19
ER, nominal, 2000=100	127.3	110.8	100.0	96.9	99.8	103.7	96.3	93.7
Real ER (CPI-based), 2000=100	124.0	108.8	100.0	96.0	96.0	99.5	91.6	88.9
Real ER (PPI-based), 2000=100	134.4	113.2	100.0	105.7	103.0	105.7	89.5	.
PPP, ALL/EUR	51.473	50.152	49.058	49.948	50.886	53.995	53.489	54.661
Price level, EU(25)=100	31	34	37	39	38	39	42	44
Average monthly gross wages, ALL [8)]	11509	12708	14963	17218	19659	21325	24393	26808
Average monthly gross wages, EUR (ER)	68	86	113	134	149	155	191	216
Average monthly gross wages, EUR (PPP)	224	253	305	345	386	395	456	490
GDP nominal, ALL mn	417009	480581	532977	590282	631338	714049	775864	835000
Reg. employment total, th., average [9)]	1096.4	1075.1	1066.6	1065.6	920.4	923.2	928.6	931.5
GDP per employed person, ALL	380347	447009	499675	553943	685971	773463	835509	896404
GDP per empl. person, ALL at 2000 pr.	403236	465504	499675	535687	646938	681666	723071	759021
Unit labour costs, ALL, 2000=100	95.3	91.2	100.0	107.3	101.5	104.5	112.7	117.9
Unit labour costs, ER adj., 2000=100	74.9	82.2	100.0	110.8	101.6	100.7	117.0	125.9
Unit labour costs, PPP adj., Austria=100	19.19	20.86	25.47	27.80	24.84	24.29	28.69	30.06
Bosnia and Herzegovina								
Producer price index, 2000=100	.	.	.	.	.	.	.	.
Consumer price index, 2000=100	90.3	95.3	100.0	103.2	104.5	105.7	106.4	109.5
GDP deflator, 2000=100	87.3	94.4	100.0	104.4	105.2	107.8	111.6	115.6
Exchange rate (ER), BAM/EUR	1.97	1.96	1.96	1.96	1.96	1.96	1.96	1.96
ER, nominal, 2000=100	100.8	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	108.3	102.9	100.0	99.0	99.8	100.6	102.1	101.3
Real ER (PPI-based), 2000=100	.	.	.	.	.	.	.	.
PPP, BAM/EUR	.	0.746	0.769	0.790	0.791	0.804	0.810	0.839
Price level, EU(25)=100	.	38	39	40	40	41	41	43
Average monthly gross wages, BAM	454	503	539	598	660	717	748	793
Average monthly gross wages, EUR (ER)	230	257	276	306	337	367	382	405
Average monthly gross wages, EUR (PPP)	.	674	701	757	834	892	924	945
GDP nominal, BAM mn	7559.0	8990.0	10050.0	10960.0	11651.1	12303.0	13439.8	14750.0
Reg. employees total, th., average	.	641.1	635.7	633.1	631.7	635.9	630.2	628.6
GDP per employed person, BAM	.	14023	15809	17312	18445	19349	21325	23465
GDP per empl. person, BAM at 2000 pr.	.	14859	15809	16588	17542	17949	19114	20303
Unit labour costs, BAM, 2000=100	.	99.3	100.0	105.7	110.4	117.2	114.8	114.6
Unit labour costs, ER adj., 2000=100	.	99.3	100.0	105.7	110.4	117.2	114.8	114.6
Unit labour costs, PPP adj., Austria=100	.	30.45	30.80	32.08	32.61	34.16	34.04	33.07
Montenegro								
Producer price index, 2001=100	.	.	.	100.0	114.5	119.7	126.6	129.3
Consumer price index, 2000=100	.	83.2	100.0	121.8	141.2	150.7	154.3	157.9
GDP deflator, 2000=100	.	.	100.0	122.0	125.5	135.0	139.5	143.3
PPP, EUR/EUR	.	.	0.35	0.42	0.42	0.45	0.45	0.45
Price level, EU(25)=100	.	.	35	42	42	45	45	45
Average monthly gross wages, EUR	.	.	151	176	251	271	303	326
Average monthly gross wages, EUR (PPP)	.	.	431	420	598	602	673	726
GDP nominal, EUR mn	.	.	1022.2	1244.8	1301.5	1433.0	1535.0	1642.0
Reg. employment total, th., average [10)]	.	146.4	143.2	140.9	140.6	141.4	143.1	144.5
GDP per employed person, EUR	.	.	7140	8832	9256	10135	10728	11365
GDP per empl. person, EUR at 2000 pr.	.	.	7140	7238	7379	7506	7692	7930
Unit labour costs, EUR, 2000=100	.	.	100.0	115.2	161.2	170.8	186.3	194.8
Unit labour costs, ER adj., 2000=100	.	.	100.0	115.2	161.2	170.8	186.3	194.8
Unit labour costs, PPP adj., Austria=100	.	.	17.00	19.30	26.29	27.50	30.49	31.04

Notes: 8) Excluding private sector. - 9) From 2002 according to census 2001. - 10) Excluding individual farmers.

(Table A/2 ctd.)

Table (A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Serbia								
Producer price index, 2000=100	34.5	49.4	100.0	187.7	204.2	213.6	233.1	266.8
Consumer price index, 2000=100	38.8	55.7	100.0	193.3	225.4	247.7	275.9	320.6
GDP deflator, 2000=100	.	52.6	100.0	189.8	235.6	274.1	299.9	344.7
Exchange rate (ER), CSD/EUR	.	11.74	15.04	59.46	60.68	65.05	72.57	83.19
ER, nominal, 2000=100	.	78.0	100.0	395.3	403.5	432.5	482.5	553.2
Real ER (CPI-based), 2000=100	.	137.5	100.0	209.0	186.7	185.7	190.0	191.5
Real ER (PPI-based), 2000=100	.	151.6	100.0	213.0	198.7	204.8	214.3	224.6
PPP, CSD/EUR	.	5.9	10.8	20.1	24.4	28.3	30.3	34.1
Price level, EU(25)=100	.	50	72	34	40	44	42	41
Average monthly gross wages, CSD [11]	.	1874	3551	8691	13260	16612	20555	25514
Average monthly gross wages, EUR (ER)	.	75	68	146	219	255	283	307
Average monthly gross wages, EUR (PPP)	.	318	329	432	543	587	678	748
GDP nominal, CSD mn	.	177625	355168	708423	919231	1095402	1310300	1601000
Employed persons - LFS, th., average	.	3103	3094	3106	3000	2919	2931	2900
GDP per employed person, CSD	.	57249	114805	228112	306388	375319	447072	552069
GDP per empl. person, CSD at 2000 pr.	.	108824	114805	120179	130023	136914	149076	160145
Unit labour costs, CSD, 2000=100	.	55.7	100.0	233.8	329.7	392.3	445.8	515.1
Unit labour costs, ER adj., 2000=100	.	116.4	100.0	206.7	285.6	316.9	322.8	325.4
Unit labour costs, PPP adj., Austria=100	.	16.94	14.61	29.75	40.03	43.84	45.41	44.56
Russia								
Producer price index, 2000=100	42.9	68.2	100.0	119.1	133.0	153.8	190.7	230.2
Consumer price index, 2000=100	44.6	82.8	100.0	121.6	141.1	160.2	177.9	200.1
GDP deflator, 2000=100	42.1	72.6	100.0	116.5	134.7	153.5	183.5	219.5
Exchange rate (ER), RUB/EUR	11.063	26.239	26.029	26.130	29.647	34.686	35.814	35.218
ER, nominal, 2000=100	42.5	100.8	100.0	100.4	113.9	133.3	137.6	135.3
Real ER (CPI-based), 2000=100	92.5	119.5	100.0	84.4	84.2	88.4	84.0	75.0
Real ER (PPI-based), 2000=100	95.5	141.7	100.0	85.3	86.1	87.6	74.7	63.7
PPP, RUB/EUR	3.574	6.035	8.335	9.518	10.740	12.200	14.250	16.700
Price level, EU(25)=100	32	23	32	36	36	35	40	47
Average monthly gross wages, RUB	1052	1523	2223	3240	4360	5499	6740	8550
Average monthly gross wages, EUR (ER)	95	58	85	124	147	159	188	243
Average monthly gross wages, EUR (PPP)	294	252	267	340	406	451	473	512
GDP nominal, RUB mn	2629623	4823234	7305646	8943582	10830535	13243240	16966400	21598000
Employed persons - LFS, th., average	58437	62475	64255	64400	66163	66527	67385	68283
GDP per employed person, RUB	44999	77203	113698	138876	163694	199065	251782	316300
GDP per empl. person, RUB at 2000 pr.	106816	106307	113698	119225	121501	129656	137213	144076
Unit labour costs, RUB, 2000=100	50.3	73.2	100.0	139.0	183.5	216.9	251.2	303.5
Unit labour costs, ER adj., 2000=100	118.4	72.7	100.0	138.4	161.1	162.7	182.5	224.3
Unit labour costs, PPP adj., Austria=100	17.15	10.41	14.39	19.63	22.25	22.18	25.30	30.26
Ukraine								
Producer price index, 2000=100	63.1	82.7	100.0	108.6	112.0	120.7	145.3	169.7
Consumer price index, 2000=100	63.6	78.0	100.0	112.0	112.9	118.8	129.5	147.0
GDP deflator, 2000=100	63.8	81.2	100.0	109.9	115.6	124.9	143.8	169.9
Exchange rate (ER), UAH/EUR	2.768	4.393	5.029	4.814	5.030	6.024	6.609	6.389
ER, nominal, 2000=100	55.0	87.4	100.0	95.7	100.0	119.8	131.4	127.0
Real ER (CPI-based), 2000=100	84.0	109.9	100.0	87.3	92.4	107.3	110.2	95.9
Real ER (PPI-based), 2000=100	84.2	101.3	100.0	89.2	89.8	100.4	93.6	81.1
PPP, UAH/EUR	0.6160	0.7680	0.9170	0.9884	1.0137	1.0918	1.2290	1.4228
Price level, EU(25)=100	22	17	18	21	20	18	19	22
Average monthly gross wages, UAH	153	178	230	311	376	462	590	806
Average monthly gross wages, EUR (ER)	55	40	46	65	75	77	89	126
Average monthly gross wages, EUR (PPP)	248	231	251	315	371	423	480	567
GDP nominal, UAH mn	102593	130442	170070	204190	225810	267344	345113	418529
Employed persons - LFS, th., average	22998.4	20048.2	20175.0	19971.5	20091.2	20163.3	20295.7	20748.2
GDP per employed person, UAH	4461	6506	8430	10224	11239	13259	17004	20172
GDP per empl. person, UAH at 2000 pr.	6994	8010	8430	9299	9725	10620	11827	11870
Unit labour costs, UAH, 2000=100	80.1	81.2	100.0	122.5	141.8	159.4	182.6	248.8
Unit labour costs, ER adj., 2000=100	145.6	92.9	100.0	128.0	141.7	133.1	138.9	195.8
Unit labour costs, PPP adj., Austria=100	16.76	10.59	11.44	14.43	15.56	14.42	15.31	21.00

Note: 11) Until 2000 wiiw estimate.

(Table A/2 ctd.)

Table (A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Austria								
Producer price index, 2000=100	96.9	96.2	100.0	101.5	101.1	102.7	107.7	110.0
Consumer price index, 2000=100	97.1	97.7	100.0	102.7	104.5	106.0	108.2	110.7
GDP deflator, 2000=100	97.6	98.3	100.0	101.8	103.0	104.5	106.5	108.7
Exchange rate (ER), ATS-EUR/EUR	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.0890	1.0644	1.0394	1.0540	1.0560	1.0638	1.0431	1.0370
Price level, EU(25)=100	108	106	104	105	106	106	104	104
Average monthly gross wages, EUR-ATS	2281	2334	2390	2428	2483	2530	2583	2645
Average monthly gross wages, EUR (ER)	2261	2334	2390	2428	2483	2530	2583	2645
Average monthly gross wages, EUR (PPP)	2095	2193	2299	2303	2351	2378	2477	2551
GDP nominal, EUR-ATS mn	192384	200025	210392	215878	220688	226968	237039	246113
Employed persons - LFS, th., average 12)	3625.9	3665.9	3685.0	3712.4	3763.5	3795.4	3744.0	3824.4
GDP per employed person, EUR-ATS	53058	54563	57094	58150	58638	59801	63312	64353
GDP per empl. person, EUR-ATS at 2000 pr.	54336	55527	57094	57143	56911	57226	59427	59225
Unit labour costs, EUR, 2000=100	100.3	100.4	100.0	101.5	104.2	105.6	103.9	106.7
Unit labour costs, ER adj., 2000=100	99.4	100.4	100.0	101.5	104.2	105.6	103.9	106.7
Unit labour costs, PPP adjusted	0.52	0.52	0.52	0.53	0.54	0.55	0.54	0.56

Note: 12) From 2004 new methodology.

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 the 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. PPPs for Albania, Bosnia and Herzegovina, Montenegro and Serbia are estimates of wiiw.

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, 1998-2005

annual changes in %

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Czech Republic									
GDP deflator	11.1	2.8	1.5	4.9	2.8	0.9	3.6	0.9	2.4
Exchange rate (ER), CZK/EUR	1.0	2.0	-3.4	-4.3	-9.6	3.3	0.2	-6.6	-3.5
Real ER (CPI-based)	-7.6	1.1	-5.3	-6.6	-9.4	5.3	-0.5	-6.4	-3.9
Real ER (PPI-based)	-5.0	0.4	-4.0	-5.8	-9.7	4.4	-3.0	-5.1	-4.0
Average gross wages, CZK	9.2	8.4	6.4	8.7	7.3	6.6	6.6	5.4	6.8
Average gross wages, real (PPI based)	4.1	7.4	1.4	5.7	7.8	7.0	0.9	2.4	4.2
Average gross wages, real (CPI based)	-1.3	6.2	2.4	3.8	5.4	6.5	3.7	3.5	4.2
Average gross wages, EUR (ER)	8.2	6.3	10.2	13.5	18.6	3.2	6.4	13.0	10.7
Employed persons (LFS) 1)	-1.4	-2.1	-0.7	0.4	0.8	-0.7	-0.6	1.2	0.1
GDP per empl. person, CZK at 2000 pr.	0.7	3.5	4.4	2.1	1.1	4.3	4.8	4.8	3.6
Unit labour costs, CZK at 2000 prices	8.5	4.8	1.9	6.5	6.1	2.2	1.8	0.6	3.2
Unit labour costs, ER (EUR) adjusted	7.4	2.7	5.6	11.2	17.4	-1.1	1.6	7.8	6.9
Hungary									
GDP deflator	12.6	8.4	9.7	8.3	8.7	6.7	4.1	2.5	6.6
Exchange rate (ER), HUF/EUR	14.2	4.9	2.9	-1.3	-5.3	4.3	-0.7	-1.4	-0.3
Real ER (CPI-based)	1.2	-3.5	-4.5	-7.6	-8.2	1.6	-5.1	-2.8	-4.5
Real ER (PPI-based)	1.2	-0.8	-3.9	-5.1	-4.2	2.5	-1.9	-1.1	-2.3
Average gross wages, HUF	18.3	13.9	13.5	18.2	18.3	12.0	6.1	8.8	12.7
Average gross wages, real (PPI based)	6.3	8.4	1.7	12.3	20.4	9.4	2.5	4.3	8.3
Average gross wages, real (CPI based)	3.5	3.5	3.4	8.2	12.3	7.0	-0.7	5.0	5.8
Average gross wages, EUR (ER)	3.6	8.6	10.4	19.7	25.0	7.4	6.8	10.4	13.1
Employed persons (LFS) 2)	1.8	0.6	1.2	0.3	0.1	1.3	-0.5	0.0	0.4
GDP per empl. person, HUF at 2000 pr.	3.0	3.6	3.9	4.0	3.8	2.0	5.8	4.1	3.9
Unit labour costs, HUF at 2000 prices	14.9	10.0	9.3	13.6	14.0	9.8	0.3	4.5	8.5
Unit labour costs, ER (EUR) adjusted	0.5	4.9	6.2	15.1	20.4	5.2	1.0	6.1	8.8
Poland									
GDP deflator	11.0	6.1	7.3	3.5	2.2	0.4	4.0	2.7	3.3
Exchange rate (ER), PLN/EUR	5.9	7.7	-5.1	-8.5	5.1	14.1	3.1	-11.2	-0.8
Real ER (CPI-based)	-4.1	1.6	-12.2	-11.4	5.3	15.4	1.7	-11.2	-2.6
Real ER (PPI-based)	-2.7	1.3	-8.2	-8.9	3.5	11.8	-1.4	-7.7	-2.1
Average gross wages, PLN 3)	15.7	10.6	11.6	8.0	2.6	4.2	4.0	4.7	5.8
Average gross wages, real (PPI based)	7.8	30.3	3.5	6.3	1.6	1.5	-2.8	4.0	2.3
Average gross wages, real (CPI based)	3.5	28.3	1.3	2.4	0.7	3.3	0.5	2.5	1.8
Average gross wages, EUR (ER)	9.2	27.8	17.6	18.1	-2.4	-8.7	0.9	17.9	6.7
Employed persons (LFS) 4)	1.2	-3.9	-1.6	-2.2	-3.0	0.6	1.3	2.3	-0.4
GDP per empl. person, PLN at 2000 pr.	3.8	8.7	5.9	3.4	4.5	3.2	3.9	1.2	3.7
Unit labour costs, PLN at 2000 prices	11.4	1.7	5.4	4.5	-1.9	0.9	0.1	3.4	2.1
Unit labour costs, ER (EUR) adjusted	5.3	-5.6	11.1	14.2	-6.6	-11.5	-2.9	16.5	2.9
Slovak Republic									
GDP deflator	5.2	6.5	8.5	5.0	4.6	4.7	6.0	2.4	5.2
Exchange rate (ER), SKK/EUR	4.2	11.4	-3.5	1.7	-1.4	-2.8	-3.5	-3.6	-2.2
Real ER (CPI-based)	-1.1	1.9	-12.2	-3.0	-2.6	-8.7	-8.3	-4.1	-6.5
Real ER (PPI-based)	-0.5	6.2	-9.1	-3.4	-4.0	-9.8	-4.5	-3.7	-5.8
Average gross wages, SKK	8.4	7.2	6.5	8.2	9.3	6.3	10.2	9.2	8.3
Average gross wages, real (PPI based)	5.0	2.8	-3.8	1.6	7.0	-1.8	6.5	4.3	2.2
Average gross wages, real (CPI based)	1.6	-3.0	-4.9	1.0	5.8	-2.0	2.5	6.3	1.4
Average gross wages, EUR (ER)	4.1	-3.7	10.4	6.4	10.8	9.4	14.1	13.3	10.7
Employed persons (LFS)	-0.3	-3.0	-1.4	1.0	0.2	1.8	0.3	2.1	0.6
GDP per empl. person, SKK at 2000 pr.	4.6	4.6	3.5	2.1	3.9	2.4	5.1	3.9	3.5
Unit labour costs, SKK at 2000 prices	3.7	2.5	3.0	5.9	5.1	3.8	4.8	5.1	4.6
Unit labour costs, ER (EUR) adjusted	-0.5	-8.0	6.7	4.2	6.6	6.9	8.6	9.0	7.0
Slovenia									
GDP deflator	6.8	6.4	5.4	8.7	7.9	5.7	3.2	1.0	5.3
Exchange rate (ER), SIT/EUR	3.3	4.0	5.9	5.9	4.2	3.3	2.2	0.3	3.6
Real ER (CPI-based)	-3.1	-0.9	-0.9	-0.1	-1.1	-0.3	0.8	0.0	-0.3
Real ER (PPI-based)	-3.9	1.2	2.6	-1.6	-1.5	1.4	0.3	2.3	0.6
Average gross wages, SIT	9.6	9.6	10.6	11.9	9.7	7.5	5.7	3.6	8.2
Average gross wages, real (PPI based)	3.4	7.3	2.8	2.8	4.4	4.9	1.3	0.9	2.9
Average gross wages, real (CPI based)	1.6	3.3	1.6	3.3	2.1	1.8	2.0	1.1	2.0
Average gross wages, EUR (ER)	6.1	5.4	4.5	5.7	5.3	4.1	3.4	3.3	4.4
Employed persons (LFS)	-0.6	-1.7	1.7	1.7	-0.7	-1.4	5.1	0.6	1.2
GDP per empl. person, SIT at 2000 pr.	4.4	7.2	2.4	1.0	4.1	4.1	-0.9	3.2	2.3
Unit labour costs, SIT at 2000 prices	4.9	2.2	8.1	10.9	5.4	3.3	6.7	0.4	5.7
Unit labour costs, ER (EUR) adjusted	1.6	-1.7	2.1	4.7	1.2	0.0	4.3	0.1	2.0

Notes: 1) From 2002 according to census 2001. - 2) From 1999 according to census 2001. - 3) From 1999 broader wage coverage. - 4) From 2003 according to census 2002.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Estonia									
GDP deflator	8.9	4.5	5.4	5.6	4.4	2.1	3.1	6.2	4.4
Exchange rate (ER), EEK/EUR	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-5.7	-2.9	-2.0	-3.4	-1.5	0.6	-0.8	-1.9	-1.5
Real ER (PPI-based)	-4.7	-0.3	-0.6	-3.1	-1.0	0.4	-0.6	2.5	-0.4
Average gross wages, EEK 5)	15.4	10.4	10.5	12.3	11.5	9.4	8.4	10.1	10.4
Average gross wages, real (PPI based)	10.8	11.8	5.4	7.6	11.1	9.2	5.3	7.8	7.7
Average gross wages, real (CPI based)	6.7	6.9	6.3	6.1	7.6	8.0	5.2	5.7	6.5
Average gross wages, EUR (ER)	14.6	11.4	10.5	12.3	11.5	9.4	8.4	10.1	10.4
Employed persons (LFS)	-1.7	-4.5	-1.2	0.9	1.4	1.5	0.2	2.0	0.8
GDP per empl. person, EEK at 2000 pr.	6.3	5.0	9.1	5.5	5.8	5.1	7.6	7.6	6.8
Unit labour costs, EEK at 2000 prices	8.6	5.1	1.3	6.4	5.4	4.1	0.7	2.3	3.3
Unit labour costs, ER (EUR) adjusted	7.8	6.0	1.3	6.4	5.4	4.1	0.7	2.3	3.3
Latvia									
GDP deflator	4.6	4.8	3.8	3.1	3.6	3.6	6.8	9.0	5.0
Exchange rate (ER), LVL/EUR	0.6	-5.7	-10.2	0.5	3.5	10.7	4.1	4.7	2.0
Real ER (CPI-based)	-2.7	-6.8	-10.8	0.2	3.7	9.7	0.1	0.3	0.3
Real ER (PPI-based)	-2.6	-2.4	-6.9	-0.1	1.9	7.9	-2.0	1.7	0.3
Average gross wages, LVL	11.1	5.8	6.1	6.3	8.8	11.3	9.6	16.5	9.7
Average gross wages, real (PPI based)	9.0	10.2	5.4	4.6	7.7	7.8	0.9	8.1	5.7
Average gross wages, real (CPI based)	6.1	3.3	3.4	3.7	6.8	8.1	3.2	9.2	5.7
Average gross wages, EUR (ER)	10.4	12.2	18.1	5.8	5.1	0.5	5.3	11.2	7.5
Employed persons (LFS)	-0.4	-1.8	-2.8	2.2	2.8	1.8	1.1	1.8	1.1
GDP per empl. person, LVL at 2000 pr.	5.2	5.2	10.0	4.3	3.6	5.3	7.4	8.3	6.4
Unit labour costs, LVL at 2000 prices	5.6	0.6	-3.6	2.0	5.0	5.7	2.0	7.6	3.1
Unit labour costs, ER (EUR) adjusted	5.0	6.7	7.4	1.5	1.5	-4.5	-1.9	2.8	1.0
Lithuania									
GDP deflator	5.1	-0.6	1.0	-0.5	0.2	-1.1	2.8	5.9	1.4
Exchange rate (ER), LTL/EUR	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	0.0	0.0	-3.5
Real ER (CPI-based)	-4.4	-4.6	-12.6	-2.2	-1.8	3.0	0.9	-0.5	-2.3
Real ER (PPI-based)	2.4	-7.1	-22.1	1.1	-1.3	0.9	-3.5	-6.1	-5.5
Average gross wages, LTL	19.5	6.2	-1.7	1.2	3.2	5.8	7.9	9.7	4.3
Average gross wages, real (PPI based)	25.0	4.4	-15.2	4.3	6.2	6.3	1.8	-1.6	0.0
Average gross wages, real (CPI based)	13.7	5.4	-2.7	-0.1	2.9	7.1	6.7	6.8	3.4
Average gross wages, EUR (ER)	20.4	11.7	13.5	4.4	6.9	6.0	7.9	9.7	8.0
Employed persons (LFS)	-5.2	-2.2	-4.0	-3.3	4.0	2.3	-0.1	2.6	0.2
GDP per empl. person, LTL at 2000 pr.	13.1	0.5	8.3	10.0	2.6	8.0	7.1	4.7	6.8
Unit labour costs, LTL at 2000 prices	5.6	5.6	-9.2	-8.0	0.6	-2.1	0.8	4.7	-2.3
Unit labour costs, ER (EUR) adjusted	6.4	11.1	4.8	-5.1	4.2	-1.9	0.8	4.7	1.2
Bulgaria									
GDP deflator	23.7	3.7	6.7	6.7	3.8	2.2	4.8	3.7	4.6
Exchange rate (ER), BGN/EUR	4.0	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-3.8	-2.7	-3.8
Real ER (PPI-based)	-13.6	-4.1	-11.3	-2.5	-1.7	-4.1	-3.5	-2.1	-4.3
Average gross wages, BGN	43.3	9.7	11.7	6.9	7.3	6.1	7.0	9.3	8.0
Average gross wages, real (PPI based)	20.7	6.7	-5.0	3.0	6.1	1.1	0.9	2.2	1.3
Average gross wages, real (CPI based)	20.7	6.9	1.2	-0.4	1.4	3.7	0.8	4.0	1.8
Average gross wages, EUR (ER)	37.7	10.6	11.7	6.9	7.3	6.1	7.0	9.3	8.0
Employed persons (LFS)	-0.8	-5.3	-2.8	-3.4	1.5	3.5	3.1	2.0	0.6
GDP per empl. person, BGN at 2000 pr.	4.8	8.0	8.4	7.8	3.3	1.0	2.5	3.7	4.4
Unit labour costs, BGN at 2000 prices	36.6	1.6	3.0	-0.8	3.9	5.0	4.4	5.4	3.5
Unit labour costs, ER (EUR) adjusted	31.3	2.4	3.0	-0.8	3.9	5.0	4.4	5.4	3.5
Romania									
GDP deflator	54.2	47.8	44.2	37.4	23.4	24.0	15.0	12.0	25.5
Exchange rate (ER), ROL/EUR	23.5	63.1	22.5	30.4	20.1	20.2	7.9	-10.6	14.2
Real ER (CPI-based)	-21.4	13.2	-14.3	-0.9	0.0	6.2	-1.4	-16.2	-4.8
Real ER (PPI-based)	-8.6	12.2	-16.8	-4.5	-2.9	1.1	-7.3	-15.3	-7.8
Average gross wages, ROL	56.4	45.7	47.8	48.6	26.1	24.8	23.3	17.0	30.7
Average gross wages, real (PPI based)	17.4	0.9	-3.7	7.6	2.5	4.4	3.5	5.9	3.3
Average gross wages, real (CPI based)	-1.7	0.0	1.5	10.5	2.9	8.2	10.2	7.3	6.7
Average gross wages, EUR (ER)	26.6	-10.7	20.7	13.9	5.0	3.8	14.2	30.9	14.4
Employed persons (LFS) 6)	-1.9	-0.6	-0.1	-0.6	.	-0.1	-0.7	0.0	-0.3
GDP per empl. person, ROL at 2000 pr. 6)	-3.0	0.1	2.2	6.4	.	5.3	9.2	4.1	5.4
Unit labour costs, ROL at 2000 prices 6)	61.2	45.5	44.6	39.7	.	18.4	12.9	12.4	24.9
Unit labour costs, ER (EUR) adjusted 6)	30.6	-10.8	18.1	7.1	.	-1.4	4.6	25.8	10.4

Notes: 5) From 1999 excluding compensations from Health Insurance Fund. - 6) In 2002 no comparable growth rates available due to methodological break in employment. Average 2000-2005 is calculated without 2002.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Croatia									
GDP deflator	8.4	3.8	4.7	4.0	3.6	4.0	3.3	3.2	3.8
Exchange rate (ER), HRK/EUR	2.5	6.2	0.7	-2.2	-0.8	2.1	-0.9	-1.3	-0.4
Real ER (CPI-based)	-1.7	3.1	-3.3	-4.7	-0.5	2.3	-0.9	-2.4	-1.6
Real ER (PPI-based)	2.4	2.9	-4.2	-4.5	-1.0	0.8	-2.0	0.3	-1.8
Average gross wages, HRK	12.6	10.2	7.0	3.9	6.0	4.8	6.4	4.4	5.4
Average gross wages, real (PPI based)	14.0	7.4	-2.5	0.3	6.5	2.8	2.8	1.4	1.9
Average gross wages, real (CPI based)	6.5	5.7	0.7	-0.9	4.3	2.9	4.3	1.0	2.0
Average gross wages, EUR (ER)	9.8	3.7	6.2	6.3	6.9	2.6	7.4	5.7	5.8
Employed persons (LFS)	-3.1	-3.4	4.1	-5.4	4.0	0.6	1.7	0.7	0.9
GDP per empl. person, HRK at 2000 pr.	5.8	2.6	-1.1	10.4	1.5	4.7	2.1	3.6	3.5
Unit labour costs, HRK at 2000 prices	6.5	7.4	8.2	-5.8	4.4	0.1	4.3	0.8	1.9
Unit labour costs, ER (EUR) adjusted	3.9	1.1	7.4	-3.7	5.3	-2.0	5.2	2.1	2.3
Macedonia									
GDP deflator	1.4	2.8	8.2	3.6	3.4	0.3	1.3	3.4	3.4
Exchange rate (ER), MKD/EUR	8.7	-0.7	0.2	0.3	0.1	0.5	0.1	-0.1	0.2
Real ER (CPI-based)	10.2	1.1	-3.5	-2.8	0.4	1.2	2.7	1.6	-0.1
Real ER (PPI-based)	3.0	-1.2	-5.6	-0.5	0.4	1.3	1.5	1.4	-0.3
Average gross wages, MKD	3.7	2.9	9.0	-0.4	6.4	4.9	4.1	2.7	4.4
Average gross wages, real (PPI based)	-0.3	3.0	-1.5	-2.4	7.3	5.2	3.2	-0.5	1.8
Average gross wages, real (CPI based)	3.8	3.6	3.1	-5.6	4.5	3.6	4.5	2.2	2.0
Average gross wages, EUR (ER)	-4.6	3.6	8.8	-0.7	6.3	4.4	4.0	2.8	4.2
Employed persons (LFS)	5.4	1.0	0.8	9.0	-6.3	-2.9	-4.1	4.3	0.0
GDP per empl. person, MKD at 2000 pr.	-1.9	3.3	3.6	-12.4	7.7	5.8	8.5	-0.7	1.8
Unit labour costs, MKD at 2000 prices	5.6	-0.4	5.2	13.7	-1.3	-0.9	-4.1	3.4	2.5
Unit labour costs, ER (EUR) adjusted	-2.8	0.4	5.0	13.4	-1.4	-1.4	-4.2	3.5	2.3
Albania									
GDP deflator	8.6	1.8	4.1	3.4	2.5	7.0	1.8	2.2	3.5
Exchange rate (ER), ALL/EUR	-0.1	-12.9	-9.8	-3.1	3.0	3.9	-7.2	-2.7	-2.8
Real ER (CPI-based)	-16.3	-12.2	-8.1	-4.0	0.0	3.6	-7.9	-2.9	-3.3
Real ER (PPI-based)	.	-15.8	-11.7	5.7	-2.5	2.6	-15.3	.	-4.6
Average gross wages, ALL	20.4	10.4	17.7	15.1	14.2	8.5	14.4	9.9	13.2
Average gross wages, real (PPI based)	.	7.5	10.5	24.0	8.6	6.5	2.0	.	10.1
Average gross wages, real (CPI based)	-0.4	10.0	17.7	11.6	8.5	6.1	11.1	7.3	10.3
Average gross wages, EUR (ER)	20.5	26.8	30.5	18.8	10.8	4.4	23.2	13.0	16.5
Registered employment, total 7)	-1.4	-1.9	-0.8	-0.1	-0.1	0.3	0.6	0.3	0.0
GDP per empl. person, ALL at 2000 pr.	10.1	15.4	7.3	7.2	4.4	5.4	6.1	5.0	5.9
Unit labour costs, ALL at 2000 prices	9.3	-4.4	9.7	7.3	9.4	2.9	7.8	4.7	7.0
Unit labour costs, ER (EUR) adjusted	9.5	9.8	21.6	10.8	6.2	-0.9	16.1	7.6	10.0
Bosnia and Herzegovina									
GDP deflator	6.9	8.1	6.0	4.4	0.8	2.5	3.5	3.6	3.4
Exchange rate (ER), BAM/EUR	0.1	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-12.4	-5.0	-2.9	-1.0	0.8	0.8	1.4	-0.7	-0.3
Real ER (PPI-based)	.	.	.	.	.	.	.	.	.
Average gross wages, BAM	.	10.8	7.2	10.9	10.4	8.6	4.3	6.0	7.9
Average gross wages, real (PPI based)	.	.	.	.	.	.	.	.	.
Average gross wages, real (CPI based)	.	4.9	2.2	7.5	9.0	7.5	3.6	3.0	5.4
Average gross wages, EUR (ER)	.	10.8	7.2	10.9	10.4	8.6	4.3	6.0	7.9
Registered employees, total	.	.	-0.8	-0.4	-0.2	0.7	-0.9	-0.3	-0.3
GDP per empl. person, BAM at 2000 pr.	.	.	6.4	4.9	5.7	2.3	6.5	6.2	5.3
Unit labour costs, BAM at 2000 prices	.	.	0.7	5.7	4.4	6.2	-2.0	-0.2	2.4
Unit labour costs, ER (EUR) adjusted	.	.	0.7	5.7	4.4	6.2	-2.0	-0.2	2.4
Montenegro									**2001-05**
GDP deflator	.	.	.	22.0	2.8	7.6	3.3	2.8	7.5
Average gross wages, EUR	.	.	.	16.8	42.6	7.8	11.7	7.8	16.7
Average gross wages, real (PPI based)	.	.	.	.	24.5	3.2	5.6	5.6	9.4
Average gross wages, real (CPI based)	.	.	.	-4.1	23.0	1.1	9.1	5.4	6.5
Registered employment, total	.	.	-2.2	-1.6	-0.2	0.6	1.2	1.0	0.2
GDP per empl. person, EUR	.	.	.	23.7	4.8	9.5	5.9	5.9	9.7
GDP per empl. person, EUR at 2000 pr.	.	.	.	1.4	1.9	1.7	2.5	3.1	2.1
Unit labour costs, ER (EUR) adjusted	.	.	.	15.2	39.9	6.0	9.0	4.6	14.3

Note: 7) From 2002 according to census 2001.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Serbia									
GDP deflator	.	.	90.1	89.8	24.1	16.3	9.4	15.0	36.8
Exchange rate (ER), CSD/EUR	.	.	28.2	295.3	2.1	7.2	11.6	14.6	38.6
Real ER (CPI-based)	.	.	-27.3	109.0	-10.7	-0.5	2.3	0.8	5.7
Real ER (PPI-based)	.	.	-34.0	113.0	-6.7	3.1	4.6	4.8	6.8
Average gross wages, CSD	.	.	89.5	144.8	52.6	25.3	23.7	24.1	54.5
Average gross wages, real (PPI based)	.	.	-6.5	30.4	40.2	19.8	13.4	8.4	16.6
Average gross wages, real (CPI based)	.	.	5.5	26.6	30.9	14.0	11.1	6.8	15.4
Average gross wages, EUR (ER)	.	.	-9.4	116.3	49.5	16.9	10.9	8.3	26.6
Employed persons (LFS)	.	.	-0.3	0.4	-3.4	-2.7	0.4	-1.1	-1.1
GDP per empl. person, CSD	.	.	100.5	98.7	34.3	22.5	19.1	23.5	45.9
GDP per empl. person, CSD at 2000 pr.	.	.	5.5	4.7	8.2	5.3	8.9	7.4	6.7
Unit labour costs, CSD at 2000 prices	.	.	79.6	133.8	41.0	19.0	13.6	15.5	44.9
Unit labour costs, ER (EUR) adjusted	.	.	-14.1	106.7	38.2	11.0	1.9	0.8	18.7
Russia									
GDP deflator	18.5	72.4	37.7	16.5	15.7	14.0	19.5	19.6	20.2
Exchange rate (ER), RUB/EUR	69.1	137.2	-0.8	0.4	13.5	17.0	3.3	-1.7	5.0
Real ER (CPI-based)	34.3	29.2	-16.3	-15.6	-0.2	5.0	-5.0	-10.7	-7.5
Real ER (PPI-based)	55.8	48.3	-29.4	-14.7	0.9	1.8	-14.8	-14.7	-12.5
Average gross wages, RUB	10.7	44.8	46.0	45.7	34.6	26.1	22.6	26.9	33.3
Average gross wages, real (PPI based)	3.3	-8.9	-0.4	22.4	20.4	9.1	-1.2	5.1	8.9
Average gross wages, real (CPI based)	-13.3	-22.0	20.9	19.9	16.0	11.0	10.4	12.8	15.1
Average gross wages, EUR (ER)	-34.6	-38.9	47.2	45.2	18.6	7.8	18.7	29.0	26.9
Employed persons (LFS)	-2.6	6.9	2.8	0.2	2.7	0.5	1.3	1.3	1.5
GDP per empl. person, RUB at 2000 pr.	-2.7	-0.5	7.0	4.9	1.9	6.7	5.8	5.0	5.2
Unit labour costs, RUB at 2000 prices	13.8	45.5	36.5	39.0	32.0	18.2	15.8	20.8	26.7
Unit labour costs, ER (EUR) adjusted	-32.7	-38.7	37.6	38.4	16.4	1.0	12.2	22.9	20.7
Ukraine									
GDP deflator	12.0	27.4	23.1	9.9	5.1	8.0	15.2	18.2	13.1
Exchange rate (ER), UAH/EUR	31.0	58.7	14.5	-4.3	4.5	19.8	9.7	-3.3	6.4
Real ER (CPI-based)	20.0	30.9	-9.0	-12.7	5.8	16.1	2.8	-13.0	-2.2
Real ER (PPI-based)	14.1	20.3	-1.3	-10.8	0.8	11.7	-6.8	-13.4	-3.6
Average gross wages, UAH	7.0	16.0	29.6	35.2	21.0	22.8	27.6	36.7	28.7
Average gross wages, real (PPI based)	-5.5	-11.5	7.2	24.5	17.4	13.9	5.9	17.1	14.2
Average gross wages, real (CPI based)	-3.3	-5.4	1.1	20.7	20.0	16.7	17.0	20.5	15.8
Average gross wages, EUR (ER)	-18.3	-26.9	13.3	41.2	15.8	2.5	16.3	41.4	20.9
Employed persons (LFS)	-3.2	-12.8	0.6	-1.0	0.6	0.4	0.7	2.2	0.6
GDP per empl. person, UAH at 2000 pr.	1.4	14.5	5.2	10.3	4.6	9.2	11.4	0.4	6.8
Unit labour costs, UAH at 2000 prices	5.5	1.3	23.2	22.5	15.7	12.5	14.5	36.2	20.5
Unit labour costs, ER (EUR) adjusted	-19.4	-36.2	7.6	28.0	10.7	-6.1	4.4	40.9	13.2
Austria									
GDP deflator	0.3	0.6	1.8	1.8	1.3	1.4	1.9	2.0	1.7
Exchange rate (ER), ATS-EUR/EUR	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Average gross wages, ATS-EUR	3.1	2.3	2.4	1.6	2.3	1.9	2.1	2.4	2.1
Average gross wages, real (PPI based)	3.6	3.1	-1.5	0.1	2.7	0.3	-2.7	0.3	-0.2
Average gross wages, real (CPI based)	2.2	1.7	0.0	-1.1	0.5	0.5	0.0	0.1	0.0
Average gross wages, EUR (ER)	2.3	3.2	2.4	1.6	2.3	1.9	2.1	2.4	2.1
Employed persons (LFS) [8)]	0.2	1.1	0.5	0.7	1.4	0.8	0.0	2.1	0.9
GDP per empl. person, ATS-EUR at 2000 pr.	3.4	2.2	2.8	0.1	-0.4	0.6	2.4	-0.3	0.9
Unit labour costs, ATS-EUR at 2000 prices	-0.3	0.1	-0.4	1.5	2.7	1.3	-0.3	2.7	1.2
Unit labour costs, ER (EUR) adjusted	-1.0	1.0	-0.4	1.5	2.7	1.3	-0.3	2.7	1.2

Note: 8) From 2004 new methodology.

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

Sources: National statistics and wiiw estimates.

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