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Transition Countries in 2003: Reforms and Restructuring Keep the Global Economic Slowdown at Bay

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Despite the unfavourable external economic climate over the past three years, the transition countries have displayed a reasonably good growth performance. The region as a whole has expanded more rapidly than the EU; it is also catching up in terms of productivity – especially in manufacturing. As of mid-2003, there are few signs of the protracted global economic slowdown threatening the transition countries' short- and medium-term growth prospects to any marked degree. Scheduled to join the EU in May 2004, a number of countries in Central and Eastern Europe which have attracted appreciable amounts of FDI recently improved their competitive position by securing larger export shares in the EU market. Russia continues to cash in on high revenues from energy exports; its GDP growth is accelerating while investments recover. Whereas some of the latecomers to reform and stabilization in the Balkans (Bulgaria, Romania and Croatia) have been rapidly catching up in many respects, the situation in most countries in the Western Balkans remains precarious.

The economies of the transition countries in Central and Eastern Europe will grow on average by about 3% in both 2003 and 2004 – somewhat faster than over the period 2001 2002 and outstripping the eurozone again. A slow, but steady acceleration of GDP growth is forecast for Poland. Russia and Ukraine will also experience swifter growth in 2003, only to take time out in 2004. Inflation continues to drop to single-digit annual rates throughout the region (with the exception of Romania, Serbia & Montenegro and Russia), yet it is still higher than in the eurozone (except perhaps for the Czech Republic and Poland). Unemployment displays a similar pattern. Given the current gaps in labour productivity and efficiency reserves, the present modest rates of economic growth do not make for the creation of additional jobs. Although generally quite high, current account deficits in the EU accession countries are of no immediate concern as their financing is secured via capital inflows. This is not the case in the Western Balkans; Russia and Ukraine, however, continue to enjoy current account surpluses, with Russia slowly starting to attract an increasing volume of FDI as well.

In all likelihood, the forthcoming EU accession of eight countries from Central and Eastern Europe will not lead to any dramatic changes in either the 'old' or 'new' EU member states. The integration of European production and trade structures that is already well advanced will continue at a gradual pace. A more pronounced impact might be seen in: services and agriculture; domestically-owned SMEs; border regions in both 'old' and 'new' EU member states; and peripheral areas of the enlarged EU. However, in preparing for EMU membership, the macroeconomic policy pursued, especially in fiscal and monetary areas, will play a crucial role in determining economic growth, employment and capital flows in the new EU member states.

Keywords: *Central and East European transition countries, Bulgaria, Croatia, Czech Republic, Hungary, Macedonia, Poland, Romania, Russia, Slovakia, Slovenia, Ukraine, Serbia and Montenegro, forecast, East-West trade, industry, EU enlargement, exchange rates*

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

Figure I

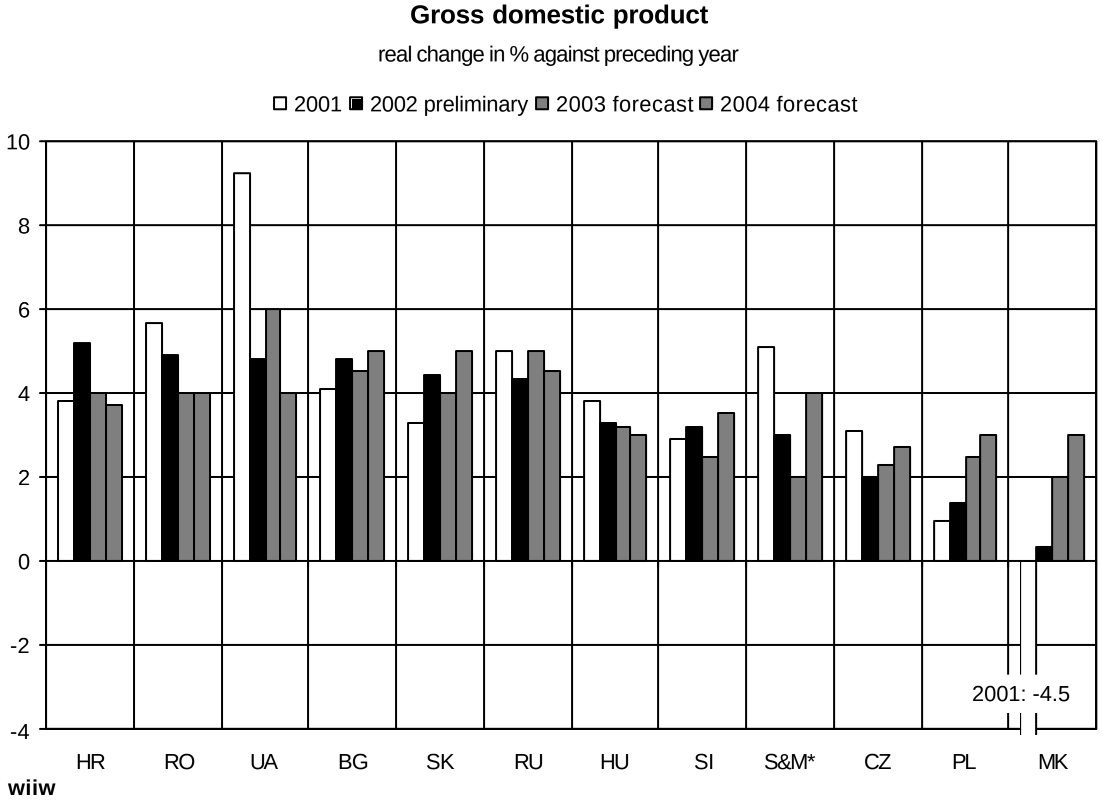
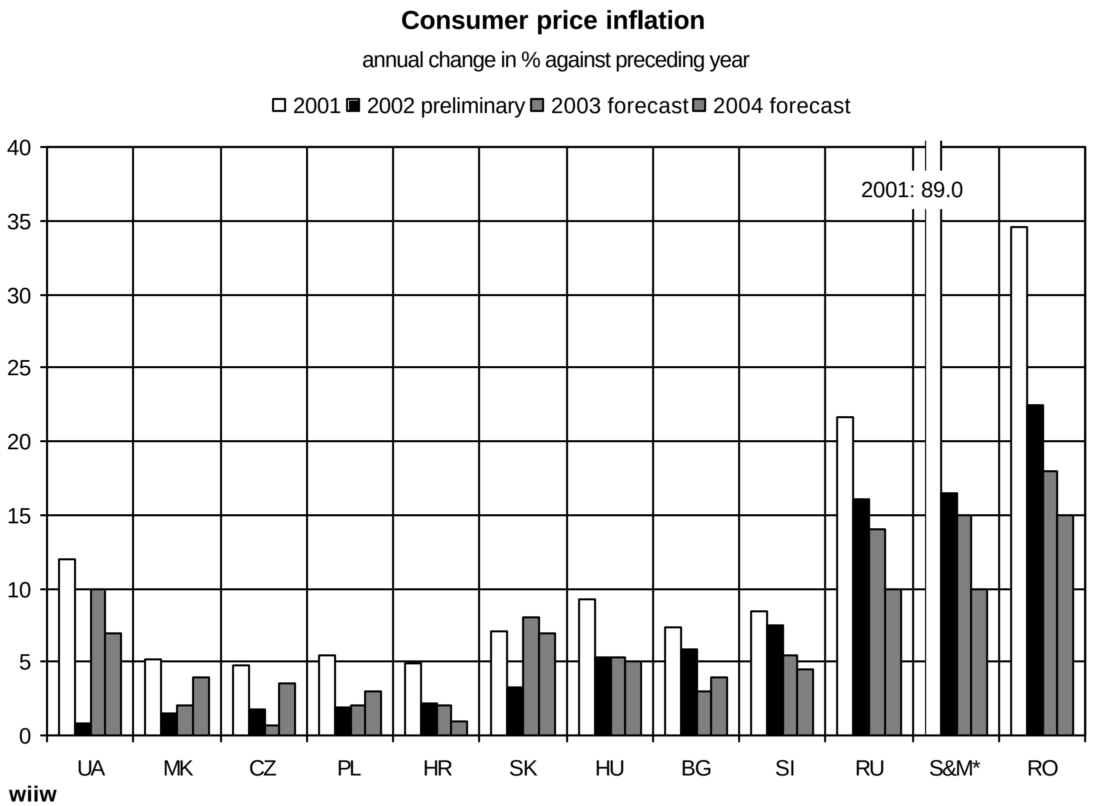


Figure II



*) S&M: Serbia & Montenegro.

OVERVIEW

*Peter Havlik**

Transition countries in 2003: reforms and restructuring keep the global economic slowdown at bay

Introduction

In a period of sluggish economic growth in the EU, 2001 and 2002 were remarkably good years for the majority of transition countries. Their economies grew, albeit modestly, with some former laggards recently outperforming the early reformers. Several countries even achieved record growth performances last year. The region as a whole expanded faster than the world economy average (and markedly faster than the eurozone where GDP increased by a meagre 0.8% in 2002), albeit at lower rates than in 2000, an exceptionally good year. Given the protracted global economic weakness, last year's GDP growth in the transition economies was fuelled mainly by domestic demand, mainly by rising private consumption. In most EU accession countries the trade deficits declined as well. The unfavourable economic climate in Western Europe (and especially in Germany, which is the main trading partner for most counties in Central and Eastern Europe) is definitely forcing the growth rate in the transition countries down. However, a combination of factors such as the progress already achieved in institutional reform and economic restructuring with resultant gains in competitiveness (often spurred by inflows of FDI) are starting to bear fruit and help outweigh the dampening effects coming from abroad. Unfortunately, the annual GDP growth of around 3% to 4% forecast for the coming years will not suffice to reduce the already high rate of unemployment in the majority of countries under review.

Most transition countries have managed to increase their export market shares in the EU – moreover, in a period when import demand was generally weak. The GDP growth in the EU accession countries in Central and Eastern Europe has been on average about 2 percentage points higher than in the eurozone. The Baltic States, Russia, Ukraine and other CIS republics are growing at a much faster pace. A slow, yet steady process of catching-up is expected to continue well into 2003 and 2004 as well. That notwithstanding, the depressed state of the West European economy may still bear serious implications for the transition countries, especially for those already closely integrated with the EU. With nearly 70% of the exports from Central and Eastern Europe destined for EU markets, these wide open economies will suffer, if West European (especially German) imports

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continue to stay flat – unless they manage to increase their market shares as a consequence of improved competitiveness. The available evidence suggests that this has indeed been the case: countries that have attracted large amounts of FDI have subsequently not only increased their market shares in the EU, but also improved their qualitative competitive position. As a result, they have managed to evade the worst effects of the protracted standstill in EU growth. Their current economic growth, however, is below its full potential and definitely insufficient to reduce the currently high unemployment levels or close the income gaps.

A related factor affecting the transition economies' short-term economic prospects are exchange rate movements, especially the recent strengthening of the euro vis-à-vis the US dollar (which has diminished the prospects of growth in the eurozone) and the real appreciation of the transition countries' currencies (which can be potentially detrimental to the countries' competitiveness). The high commodity prices on the world market (especially energy pries) have a decisive bearing on economic performance in Russia and (indirectly, via its trade with Russia) in Ukraine as well. Last but not least, the accession to the EU in May 2004 of eight countries from Central and Eastern Europe (CEECs: the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia and Lithuania) plus Malta and Cyprus will be a major step towards anchoring those countries in the Union's institutional framework, thus generally heightening investor confidence in the region. wiiw does not expect any immediate dramatic economic effects as a consequence of EU accession,[1] although the pursuance of domestic macroeconomic (especially fiscal and monetary) policies will become much more challenging and will have to be closely watched. In all probability, the net effect of EU transfers on economic growth in the CEECs during the first two post-accession years will be negligible. Despite their low share in the European economy, the higher trend growth rate of new EU member states will enhance competitiveness and economic dynamism in the enlarged EU as a whole. The next challenge facing Europe will be that of managing to integrate the Western Balkans and reconfiguring relations between an enlarged EU on the one side and Ukraine, Russia and other 'left-outs' farther east on the other.[2]

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1 More on the consequences of EU accession on the CEECs in selected areas see S. Richter (ed.) (2003), 'The Accession Treaty and Consequences for New Members', *wiiw Current Analyses and Country Profiles*, No. 18, May. For consequences on non-candidate countries see V. Gligorov, M. Holzner and M. Landesmann (2003), 'Prospects for Further (South-) Eastern EU Enlargement: from Divergence to Convergence?', *wiiw Research Reports*, No. 296, June, as well as 'The impact of EU enlargement on non-candidate countries in Eastern Europe and the CIS', *Economic Survey of Europe*, No. 1, UN ECE, 2003, pp. 149-183.

2 The new EU 'Neighbourhood programmes' will be launched in 2004 (nearly EUR 1 billon are foreseen for the period 2004-2006) in order to improve EU interventions on the Union's external borders after enlargement – see 'Wider Europe: Commission to strengthen cross-border co-operation with new neighbours', Communication from the Commission, Brussels, 1 July 2003.

GDP growth and productivity catching-up continue

Last year GDP in the CEECs increased by nearly 3% on average, about 2 percentage points more than in the eurozone (0.8%). Were it not for Poland (which carries a large weight – about 40% – in all CEEC economic aggregates), the average GDP growth in the

Table 1

Gross domestic product

real change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 1)	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast	Index 1995=100 2002
Czech Republic	4.3	-0.8	-1.0	0.5	3.3	3.1	2.0	2.6	2.2	2.3	2.7	111.7
Hungary	1.3	4.6	4.9	4.2	5.2	3.8	3.3	2.9	2.7	3.2	3.5	130.6
Poland	6.0	6.8	4.8	4.1	4.0	1.0	1.4	0.5	2.2	2.5	3.0	131.5
Slovak Republic	5.8	5.6	4.0	1.3	2.2	3.3	4.4	3.9	4.1	4	5	129.7
Slovenia	3.5	4.6	3.8	5.2	4.6	2.9	3.2	2.5	2.3	2.5	3.5	131.2
CEEC-5 2)	4.7	4.7	3.5	3.2	3.9	2.2	2.2	1.7	2.5	2.7	3.2	127.1
Bulgaria	-9.4	-5.6	4.0	2.3	5.4	4.1	4.8	3.4	3.8	4.5	5	104.7
Romania	3.9	-6.1	-4.8	-1.2	2.1	5.7	4.9	3.1	4.4	4	4	103.9
CEEC-7 2)	3.8	2.5	2.4	2.5	3.8	2.8	2.7	2.0	2.8	3.0	3.4	122.4
Estonia	3.9	9.8	4.6	-0.6	7.1	6.5	6.0	3.2	5.2	5.5	6.0	143.6
Latvia	3.7	8.4	4.8	2.8	6.8	7.9	6.1	3.7	8.8	6	6.5	148.1
Lithuania	4.7	7.0	7.3	-1.8	4.0	6.5	6.7	3.9	9.4	7	7.5	139.5
Croatia	5.9	6.8	2.5	-0.9	2.9	3.8	5.2	4.3	4.9	4	3.7	129.1
Macedonia	1.2	1.4	3.4	4.3	4.5	-4.5	0.3	.	.	2	3	110.8
Serbia & Montenegro 3)	5.9	7.4	2.5	-21.9	6.4	5.1	3.0	.	.	2	4	104.9
Russia	-3.6	1.4	-5.3	6.4	10.0	5.0	4.3	3.0	6.9	5.0	4.5	118.7
Ukraine	-10.0	-3.0	-1.9	-0.2	5.9	9.2	4.8	4.1	7.0	6	4	103.5
Armenia	5.9	3.3	7.3	3.3	5.9	9.6	12.9	7.4	11.3	7	5	158.9
Azerbaijan	1.3	5.8	10.0	7.4	11.1	9.9	10.6	4.7	7.9	6	6	171.0
Belarus	2.8	11.4	8.4	3.4	5.8	4.1	4.7	3.2	5.6	5	4	148.0
Georgia	11.2	10.6	2.9	3.0	2.0	4.5	5.4	3.7	4.4	3	5	146.4
Kazakhstan	0.5	1.7	-1.9	2.7	9.8	13.2	9.5	10.7	.	10	7	140.1
Kyrgyzstan	7.1	9.9	2.1	3.7	5.4	5.3	-0.5	-2.8	5.2	4	5	137.6
Moldova	-5.9	1.6	-6.5	-3.4	2.1	6.1	7.2	4.8	.	5	3	100.3
Tajikistan	-16.7	1.7	5.3	3.7	8.3	10.2	9.1	9.3	6.7	7	5	120.5 4)
Turkmenistan	0.1	.	.	.	.	.	.	.	.	.	.	.
Uzbekistan	1.7	5.2	4.4	4.4	4.0	4.5	3.0	.	.	4	3	130.5
CIS	-3.2	1.0	-3.6	4.6	8.3	6.0	4.8	4.0	7.0	6	5	118.6

Notes: 1) Preliminary. - 2) **wiiw** estimate. - 3) Gross Material Product. - 4) 1992 = 100.

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

accession countries would have been even higher (more than 3%). Estonia, Latvia, Lithuania and the Slovak Republic (as well as the later entrants, Bulgaria, Romania and Croatia) experienced the highest GDP growth (ranging between 5% and 7%) of all EU candidate countries in 2002. But the growth champions were the energy-rich countries in the CIS: Azerbaijan and Kazakhstan, as well as some of the poorer CIS republics (Armenia, Moldova and Tajikistan – see Table 1). In 2002 GDP growth decelerated in the Czech Republic (largely as a consequence of the floods), in Hungary (owing to deteriorating competitiveness), as well as in Russia and Ukraine. Poland's economy has been slowly recovering since the beginning of 2002; Serbia & Montenegro, as well as Macedonia, remain politically and economically fragile.

The cumulative GDP in the first-round EU accession countries rose by almost 30% over the period 1995-2002. The former growth champion Poland, and even more so Bulgaria and Romania, have been lagging behind; the three Baltic States, however, display higher than average growth dynamics. In Russia and Ukraine recovery in terms of GDP growth was impressive following the financial crisis in 1998. The GDP growth differential vis-à-vis the EU turned in favour of the CEECs after 1995: it reached 11.2 percentage points in cumulative terms up until 2002, and 1.3 percentage points per annum for the CEEC-8 over that period (Table 2). The rise in productivity (GDP per employed person) accelerated strongly in the CEEC-8, yet productivity growth was associated with a drop in employment levels. The cumulative 'productivity gain' of the CEEC-8 vis-à-vis the EU over the period 1995-2002 exceeded 20 percentage points. In Bulgaria and Romania, restructuring was delayed and productivity gains after 1995 were for the most part based on shedding labour; productivity growth remained below that of the EU in both countries. However, in Bulgaria a certain catching-up process in terms of macro-productivity vis-à-vis the EU started after the financial crisis in 1997/1998.[3]

In contrast to the CEECs, Russia – and even more so Ukraine – have fared extremely badly with respect to both GDP, employment and productivity; since 1995 both countries have only managed to reduce their productivity gap vis-à-vis the EU-15 marginally. Over the whole period 1990-2002, both Russia and Ukraine fell far behind both the EU-15 and the CEECs. Some countries in South-East Europe displayed a similar abysmal record of 'falling behind'.[4] The transition process has resulted in increased divergence across the

[3] Despite impressive improvements in the recent period, the productivity levels in the accession countries are still very low compared to the EU average, leaving ample space for further productivity growth after accession. In 2001, the average level of labour productivity (GDP per employed person, compared at current exchange rates) for all first-round accession countries taken together was only 26% of the average EU-15 level. Measured at purchasing power parities (PPPs), which correct for the currency undervaluation still prevailing in many accession countries, the average level of labour productivity was about 50% of the EU-15 – see wiiw (2003), 'Enlargement and Competitiveness', background study, commissioned by EU DG Enterprise, for the European Competitiveness Report 2003. For more detailed data on individual transition countries see Appendix, Indicators of Competitiveness, Table A/2.

[4] See Gligorov et al. (2003), op. cit.

continent, posing numerous challenges to future European integration. EU enlargement will most probably point up these disparities even more, thus strengthening the argument in favour of designing EU 'Eastern policies' anew.[5]

Table 2

Long-term GDP growth and productivity catching-up in selected transition countries vis-à-vis the EU-15

Country groups	**1990-1995**				**1995-2002**				**1990-2002**			
	growth rate in %		growth differential against EU in pp		growth rate In %		growth differential against EU in pp		growth rate in %		Growth differential against EU in pp	
	cumu-lated	annual average	cumu-lated	annual average	cumu-lated	annual average	cumu-lated	annual average	cumu-lated	annual average	cumu-lated	annual average
CEEC-8[1)]												
GDP	-4.7	-1.0	-12.5	-2.5	28.0	3.6	11.2	1.3	22.0	1.7	-3.9	-0.3
Employment	-13.3	-2.8	-11.3	-2.4	-0.3	0.0	-9.1	-1.2	-13.5	-1.2	-20.1	-1.7
Productivity	9.9	1.9	-0.2	0.0	28.3	3.6	20.9	2.6	41.0	2.9	22.8	1.5
CEEC-8 plus BG, RO												
GDP	-6.4	-1.3	-14.2	-2.8	23.2	3.0	6.5	0.8	15.4	1.2	-10.6	-0.7
Employment	-13.2	-2.8	-11.2	-2.4	-2.7	-0.4	-11.5	-1.6	-15.6	-1.4	-22.1	-1.9
Productivity	7.9	1.5	-2.2	-0.4	26.7	3.4	19.3	2.4	36.7	2.6	18.5	1.2
Russia												
GDP	-38.0	-9.1	-45.9	-10.6	18.7	2.2	1.9	0.0	-26.4	-2.5	-52.4	-4.4
Employment	-11.8	-2.5	-9.8	-2.1	-1.1	0.0	-9.9	-1.2	-12.9	-1.0	-19.5	-1.5
Productivity	-29.6	-6.8	-39.7	-8.7	20.0	2.3	12.6	1.3	-15.5	-1.4	-33.7	-2.8
Ukraine												
GDP	-52.2	-13.7	-60.0	-15.3	3.6	0.4	-13.2	-1.8	-51.5	-5.7	-77.5	-7.6
Employment	-6.1	-1.3	-4.1	-0.9	-15.3	-2.0	-32.1	-4.2	-20.5	-1.9	-27.1	-2.4
Productivity	-40.9	-12.6	-51.0	-14.5	22.4	2.5	15.0	1.5	-37.3	-3.9	-55.5	-5.3
EU-15												
GDP	7.9	1.5	-	-	16.8	2.2	-	-	26.0	1.9	-	-
Employment	-2.0	-0.4	-	-	8.8	1.2	-	-	6.6	0.5	-	-
Productivity	10.1	1.9	-	-	7.4	1.0	-	-	18.2	1.4	-	-

Notes: 1) Central and East European first-round accession countries, comprising the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. - 2) 1991-1995. - 3) 1991-2001. - 4) 1991-2002.

Remark: (Labour) productivity is defined as GDP per employed person. See Appendix, Indicators of Competitiveness for details on individual countries.

Sources: **wiiw** Database incorporating national statistics, **wiiw** calculations using AMECO.

Preliminary data for the first quarter of 2003 indicate a continuation of GDP growth in all EU candidate countries (markedly so in the Baltic States), and an acceleration of GDP growth in Russia, Ukraine and in most other CIS republics (Table 1). Figures 1a and 1b

5 Such policies should probably go beyond the 'New neighbourhood' programmes mentioned above – see I. Samson, 'Towards a Pan-European Economic Space', UN ECE, Geneva (forthcoming).

Figure 1a

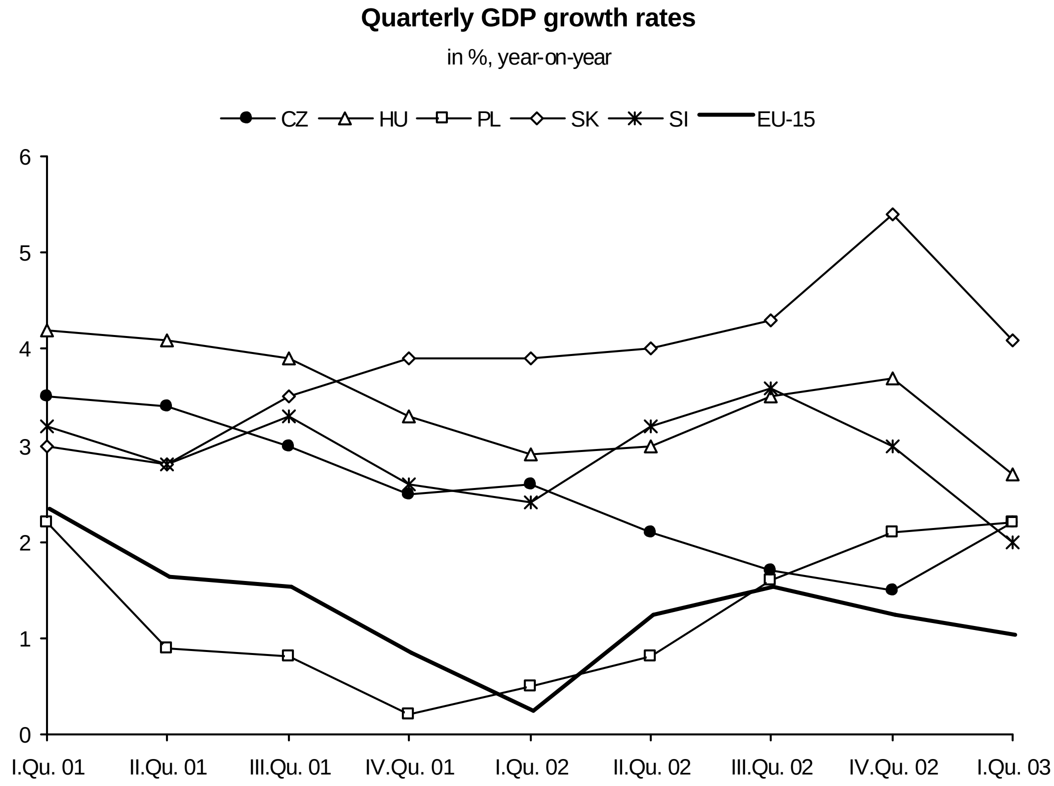
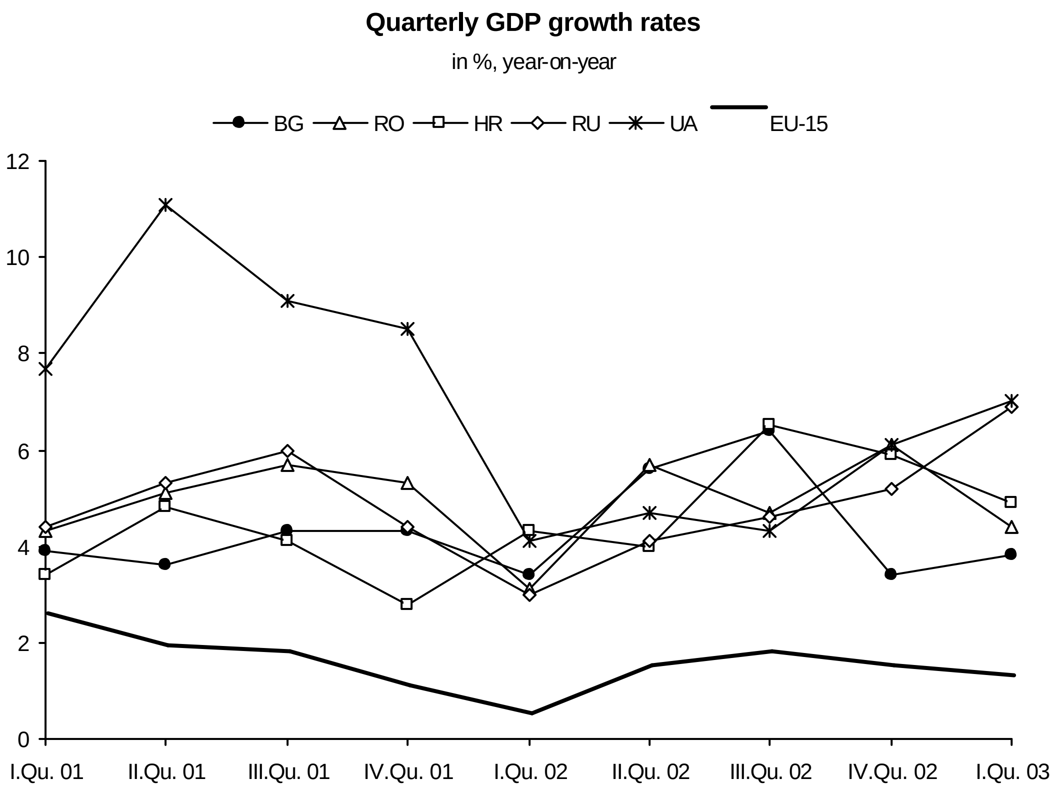


Figure 1b



Source: National statistics, Eurostat.

show that the quarterly GDP growth rates have been tracking those of the EU-15, albeit with a *higher trend growth rate* in the first-round accession countries (and even more so in the second-round accession countries, as well as in Russia and Ukraine).

Industry recovers despite sluggish external demand

Increasing industrial production, mainly driven by expanding exports, was a major contributor to the growth of transition economies over the past couple of years. In 2002 growth in industrial output slowed down to around 3% in the CEECs, with Slovakia and Romania outperforming the rest. In Russia and Ukraine, industrial growth also decelerated. Contrary to the higher industrial manufacturing dynamics prevailing in the CEECs, industry in the latter two countries (in common with the economy as a whole) is increasingly dominated by the energy and basic metals sectors. Developments during the first months of 2003 indicate an upturn in industrial output in most transition countries, the most impressive growth being recorded by the Czech Republic, Hungary, Poland, Slovakia, Bulgaria, Russia and Ukraine (Table 3). Although the robust industrial growth reported for

Table 3

Gross industrial production

real change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 1)	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast	Index 1995=100 2002
Czech Republic	2.0	4.5	1.6	-3.1	5.4	6.5	4.8	4.2	6.2	5	6	123.4
Hungary	3.4	11.1	12.5	10.4	18.1	3.6	2.6	-0.3	4.4	6	8	179.2
Poland 2)	8.3	11.5	3.5	3.6	6.7	0.6	1.5	-1.6	4.4	3	4	141.1
Slovak Republic	2.5	2.7	5.0	-2.7	8.6	6.9	6.5	1.1	11.0	8	8	133.0
Slovenia	1.0	1.0	3.7	-0.5	6.2	2.9	2.4	1.7	0.8	1.5	2	117.8
CEEC-5 3)	5.1	8.5	4.6	2.3	8.4	3.2	3.0	0.4	5.3	4.3	5.4	140.4
Bulgaria	5.1	-5.4	-7.9	-8.0	8.2	1.6	0.6	-4.4	17.2	4	5	93.2
Romania	6.3	-7.2	-13.8	-2.4	7.1	8.4	6.0	3.1	1.1	3	4	102.1
CEEC-7 3)	5.3	5.6	1.4	1.1	8.2	3.8	3.3	0.5	5.3	4.1	5.2	132.2
Croatia	3.1	6.8	3.7	-1.4	1.7	6.0	5.4	1.9	4.6	5.5	5	127.9
Macedonia	3.2	1.6	4.5	-2.6	3.6	-3.0	-5.3	-14.4	3.6	1	3	101.5
Serbia & Montenegro	7.6	9.5	3.6	-23.1	11.2	0.0	2.0	-4.1	-3.1	1	3	106.4
Russia	-4.0	1.9	-5.2	11.0	11.9	4.9	3.7	2.6	6.0	5	5	125.3
Ukraine	-5.2	-0.3	-1.0	4.0	12.4	14.2	7.0	5.9	10.7	9.0	7.0	133.6

Notes: 1) Preliminary. - 2) Sale. - 3) **wiiw** estimate.

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

the first months of 2003 is mainly attributable to a low base in the pre-year period (when industrial production practically stagnated), a clear upward trend over a longer-term period is shown in Figures 2a and 2b. In several CEECs (Hungary, the Czech and Slovak Republics and more recently in Bulgaria as well), an FDI-driven tendency towards re-industrialization is clearly visible (cf. the experience of Ireland during the 1990s).

In nearly all the transition countries under review, recent growth in industrial output has been associated with remarkable improvements in labour productivity. In 2002, the growth in labour productivity in industry accelerated noticeably once again, and the trend has been maintained in the first months of 2003. Upward longer-term productivity trends are shown in Figures 3a and 3b. In retrospect, labour productivity in industry over the period 1995-2002 doubled in Hungary and rose by close to 80% in Poland, Croatia, Macedonia and Ukraine (Table 4). In the CEEC manufacturing industry, production rose

Table 4

Labour productivity in industry

change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	Index 1995=100 2002
Czech Republic [2]	8.6	9.2	3.7	1.7	9.5	5.5	6.5	3.5	9.2	153.9
Hungary [3]	9.4	13.7	11.9	10.5	18.3	4.8	5.1	1.7	7.7	200.4
Poland [4]	9.1	11.2	4.7	11.8	13.6	4.2	7.4	5.5	7.6	180.5
Slovak Republic	2.5	4.8	9.1	0.2	12.1	5.9	6.3	3.1	9.5	148.2
Slovenia	9.2	4.4	5.4	3.1	8.4	3.5	5.6	4.8	3.1	146.8
Bulgaria [5]	7.0	-2.8	-3.8	2.2	18.1	2.1	2.0	-5.3	14.0	125.8
Romania [6]	7.5	-1.8	-7.4	11.3	13.8	6.9	7.0	2.5	3.0	141.7
Croatia [6]	11.3	11.9	8.7	3.9	4.3	9.6	9.8	5.6	6.0	176.5
Macedonia [7]	29.8	8.3	14.8	6.4	6.4	0.0	.	.	.	182.7 [8]
Serbia & Montenegro [7]	9.6	12.3	6.3	-19.1	16.4	3.4	10.1	.	.	140.2
Russia	2.9	8.6	0.8	11.8	10.1	5.0	6.1	.	.	154.6
Ukraine	3.0	8.2	2.2	9.6	28.3	12.5	.	.	.	180.2 [8]

Notes: 1) Preliminary. - 2) Enterprises with 100 and more, from 1997 with 20 and more employees. From 2001 calculated with sales. - 3) Up to 1998 enterprises with more than 10, from 1999 more than 5 employees. - 4) Year 2002 and quarterly data refer to enterprises with more than 9 employees. - 5) In 1996 public sector only. - 6) Enterprises with more than 20 employees (for Romania from 1999). - 7) Excluding small enterprises. - 8) Year 2001.

Source: **wiiw** Database incorporating national statistics.

much faster (6.4% per annum) than in the EU (2.1% per annum) over the period 1995-2002. This translates into a growth differential in favour of the CEECs of 4.3 percentage points per year. On the other hand, manufacturing employment *declined* palpably in the CEECs (by 2.1% per annum) while remaining more or less constant in the EU. As a result, the impressive speed at which the CEECs had caught up in productivity at

Figure 2a

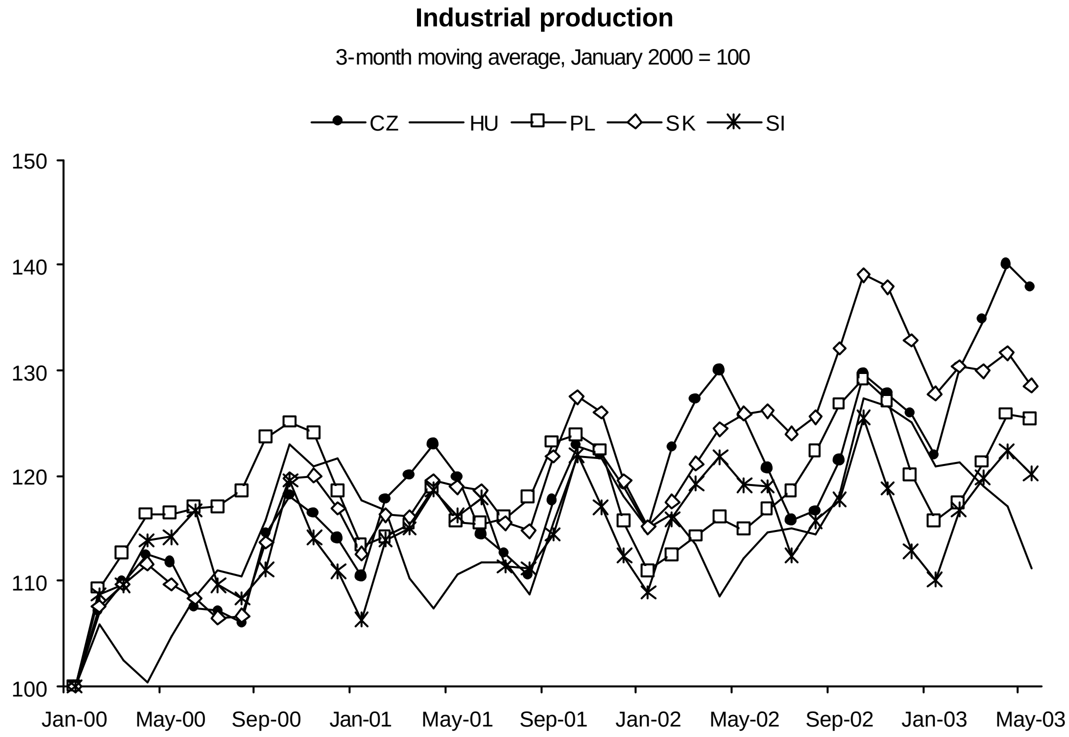
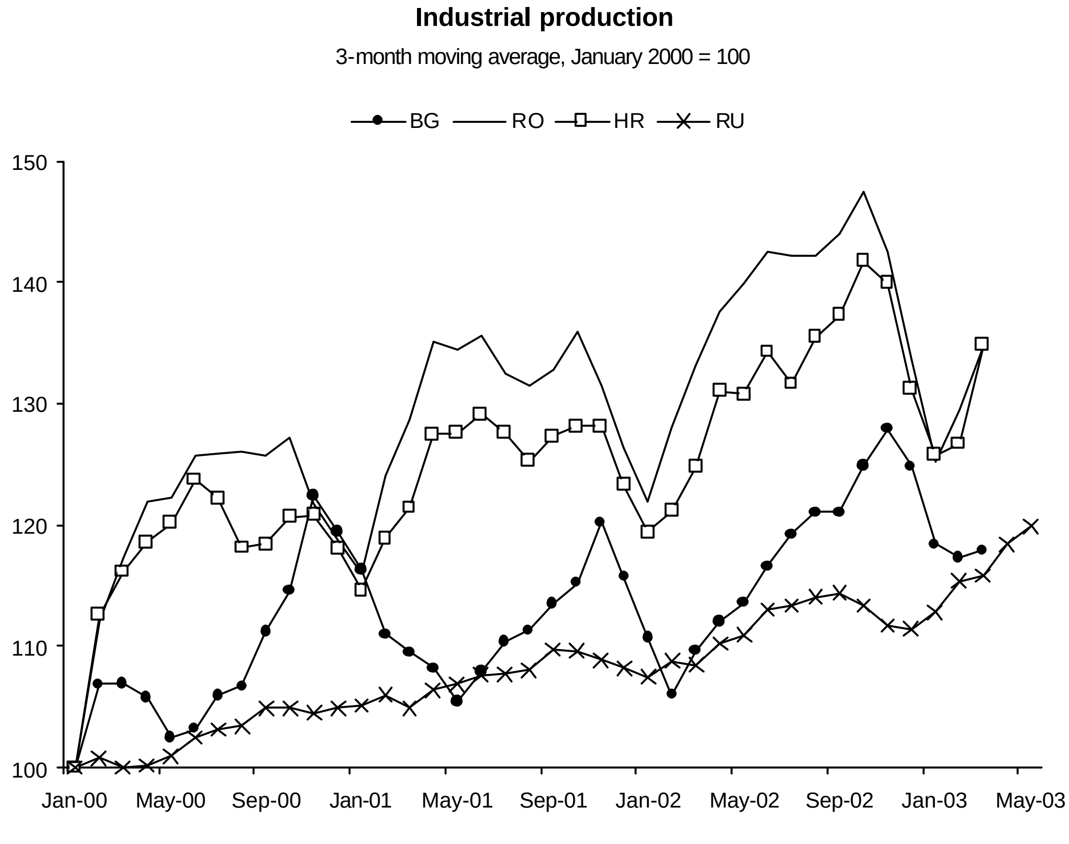


Figure 2b



Source: **wiiw** Monthly Database incorporating national statistics.

Figure 3a

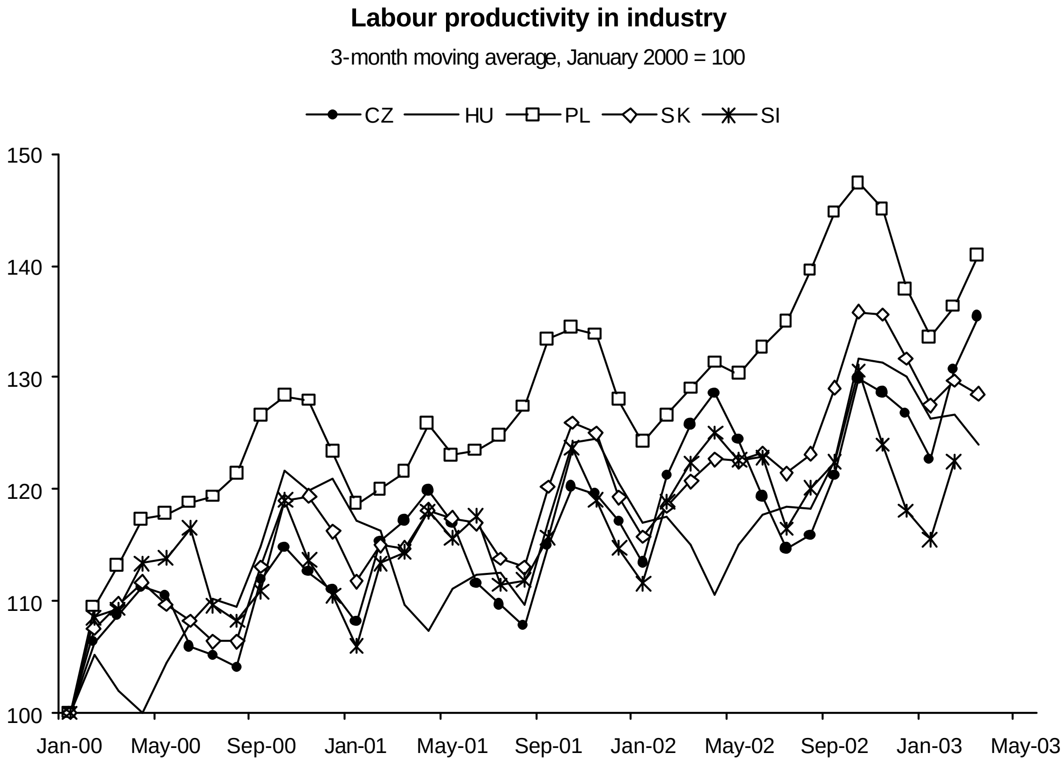
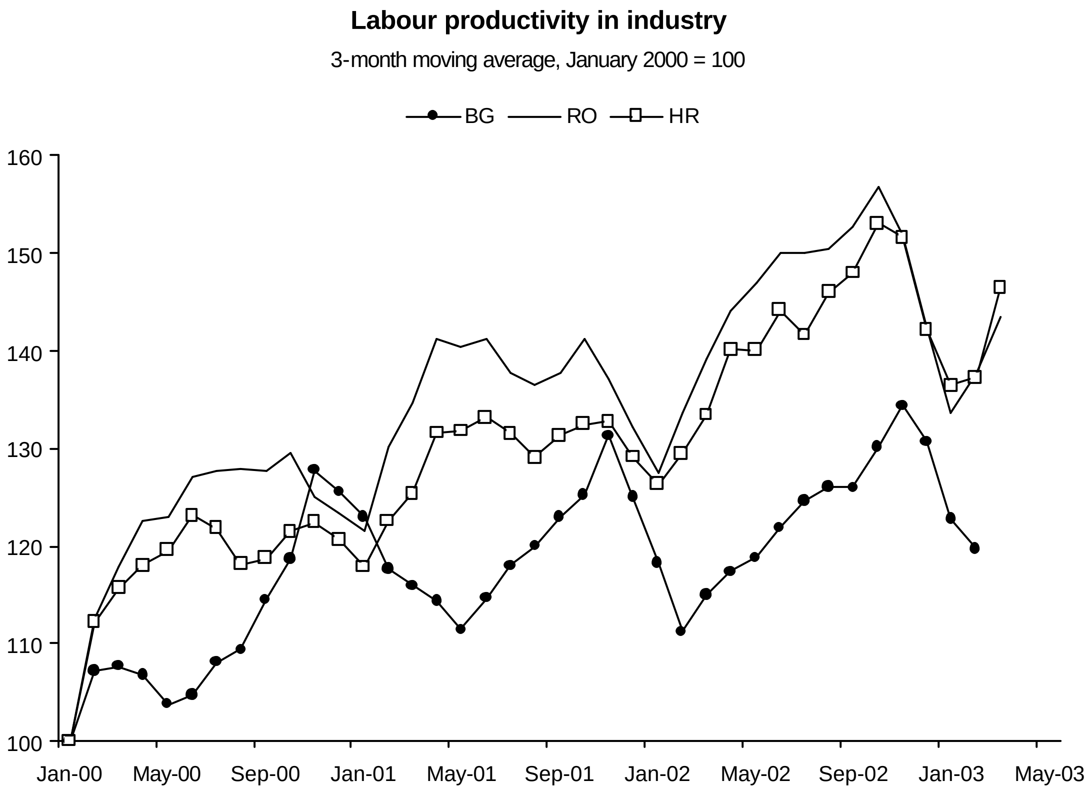


Figure 3b



Source: **wiiw** Monthly Database incorporating national statistics.

the GDP level was even more pronounced in manufacturing, however, it was associated with a pronounced drop in manufacturing employment. Over the period 1995-2002, the cumulative productivity gain in manufacturing amounted to 80% in the CEEC-8 and 16% in the EU (Table 5). The annual labour productivity growth differential was 6.5 percentage points in favour of the CEECs, exceeding by far the growth differential in terms of macro-productivity and indicating a strengthening of the CEECs' industrial base.

Table 5

Labour productivity catching-up in the CEECs vis-à-vis the EU-15 in manufacturing industry, 1995-2002

	Growth rate in %		CEECs' growth differential against EU-15 in pp			Growth rate in %	
	cumu-lative	annual average	cumu-lative	annual average		cumu-lative	annual average
CEEC-8[1)]					**EU-15**		
Production	54.0	6.4	38.6	4.3	Production	15.4	2.1
Employment	-14.0	-2.1	-11.9	-2.1	Employment	-0.9	0.0
Productivity	79.1	8.7	62.7	6.5	Productivity	16.4	2.2

Notes: Gross production and productivity in real terms. - 1) Central and East European first-round accession countries, weighted averages.

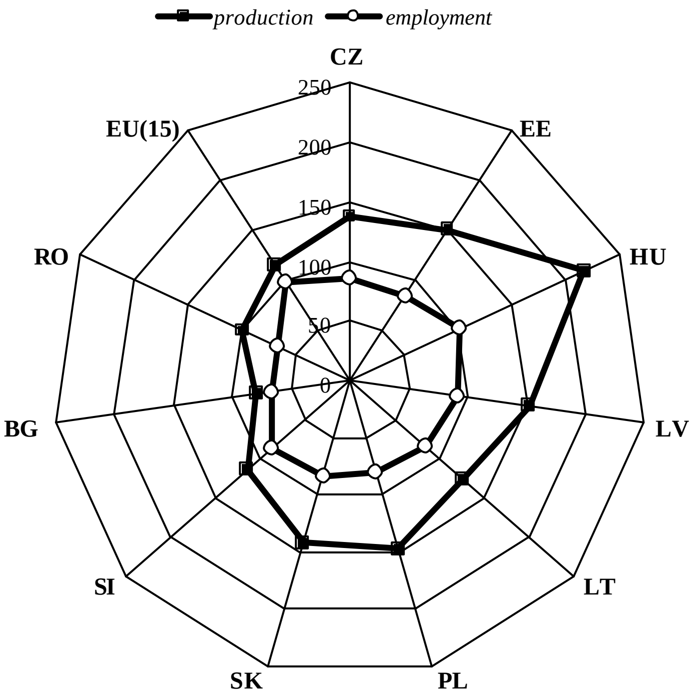
Sources: **wiiw** Database, incorporating national statistics, **wiiw** calculations using AMECO.

Figure 4 shows manufacturing production and employment indices for individual CEECs in comparison to the EU-15 for the period 1995-2002. It reveals impressive labour productivity growth in most CEECs (labour productivity increase is indicated by the difference between the production and employment index lines in Figure 4). Hungary even managed to increase slightly the number of manufacturing jobs; in the remaining CEECs productivity gains were associated with further lay-offs. Hungary's outstanding productivity performance in recent years resembles that of Ireland; Austria, Denmark and Finland, which have the best record in terms of productivity growth among the present EU member states, were outperformed in this respect by Estonia, Poland and Slovakia. In some CEECs and, as shown below, in a few industrial branches, productivity catching-up has been spectacular. Here again, however, in contrast to the EU where manufacturing employment has been stagnating, labour productivity growth in most CEECs has been linked to appreciable job losses.

An encouraging sign, at least in the more advanced CEECs, is that industry has been able in part to regain its previous position thanks to active restructuring and privatization efforts, both fostered by inflows of FDI. The structural changes behind these overall developments are characterized, first, by growing production specialization in nearly all CEECs: the transport equipment, electrical & optical equipment sectors showed the largest increases in production shares while the share of food & beverages declined most.[6] In Russia, on the other hand, industry has been increasingly dominated by energy and basic metals, although selected sectors of domestically oriented manufacturing (e.g. food & beverages) have also recovered following the financial crisis in August 1998. The same recovery pattern holds true for the food processing and consumer goods industry in Ukraine where, however, the shares of energy and metals in both industrial production and exports are also very high.

Figure 4

Manufacturing production, employment and labour productivity in the CEECs and EU-15, 2002 (1995 = 100)



Source: Own calculations based on **wiiw** Industrial Database and AMECO.

Compared to the initial phase of transition, the emergence of a new pattern of 'productivity winners and losers' can be detected among the various manufacturing branches – often running counter to the pattern observed in the initial period of 'passive' restructuring during the early 1990s. Looking at the relative labour productivity changes by individual branches (relative to the manufacturing industry average), one can clearly distinguish two groups of industries in the CEECs. The most obvious 'productivity winner' in the period 1995-2001 was the electrical & optical equipment industry, performing far above average in all

6 See wiiw (2003), op. cit., for more details.

Table 6

Relative productivity gains, winner and loser branches, 1995-2001
(average annual change in % for total manufacturing (D) and relative annual gains DA to DN, in percentage points) 1)

		Czech Republic	Estonia 2)	Hungary	Latvia	Lithuania 2)	Poland	Slovak Republic	Slovenia	Bulgaria	Romania
D	**Manufacturing total**	**7.2**	**10.6**	**12.7**	**7.5**	**6.4**	**9.6**	**8.2**	**3.6**	**2.2**	**5.4**
DA	Food products; beverages and tobacco	-3.9	-7.2	-8.8	-4.8	-4.3	-3.6	-4.1	-0.6	-2.0	6.7
DB	Textiles and textile products	-4.9	2.8	-6.5	0.5	-2.3	-1.4	-8.6	0.2	-0.6	-5.1
DC	Leather and leather products	-16.1	3.7	-9.1	-2.1	9.8	-2.6	0.3	-6.0	-2.0	-2.8
DD	Wood and wood products	-1.8	15.4	-8.0	-2.0	0.1	-1.7	-2.9	-8.6	6.1	-4.2
DE	Pulp, paper & paper products; publishing & printing	-1.7	0.8	-0.8	-0.6	-5.2	-1.2	3.6	-7.0	-4.9	-8.2
DF	Coke, refined petroleum products & nuclear fuel	-2.6	.	-7.9	.	-12.2	-4.7	-4.0	.	-1.5	0.5
DG	Chemicals, chemical products and man-made fibres	0.4	4.8	-9.5	-4.2	11.2	-0.8	-2.2	2.3	1.3	-3.6
DH	Rubber and plastic products	1.4	-2.6	-7.4	10.2	0.0	-0.2	-2.9	-2.0	-2.2	-7.6
DI	Other non-metallic mineral products	-0.4	4.6	-5.0	11.2	1.3	1.0	-2.4	1.6	5.3	1.1
DJ	Basic metals and fabricated metal products	-6.8	4.1	-6.1	3.3	-3.2	-1.7	-6.7	-2.1	2.8	-0.8
DK	Machinery and equipment n.e.c.	5.4	3.7	-6.9	-5.3	-2.7	0.7	-0.2	-1.5	3.3	4.6
DL	Electrical and optical equipment	13.3	7.0	18.7	18.1	24.0	4.4	2.7	3.3	7.4	-0.8
DM	Transport equipment	2.8	5.6	6.7	-0.2	13.3	6.3	18.8	6.5	-3.2	6.0
DN	Manufacturing n.e.c.	1.2	1.2	-5.3	1.0	-4.2	-0.6	0.8	3.1	7.2	6.3

Notes: 1) Calculations of relative gains: DA (1995-2001) - D (1995-2001) = relative gain DA. - 2) 1995-2000.

Sources: **wiiw** estimates based on national statistics, own calculations.

CEECs, followed by the transport equipment industry and manufacturing n.e.c. (mainly furniture – see Table 6). In the Baltic States, non-metallic mineral products and basic metals are also clear 'productivity winners'. Typical 'productivity losers' are the food & beverages industry, textiles & textile products, leather & leather products, wood & wood products, paper & printing, coke & petroleum products and chemicals. In general, we find some evidence that technologically more sophisticated industries have greatly improved their productivity performance, while sectors using more traditional technologies and labour with low skills have been falling behind. Moreover, productivity performance has been closely linked to the activity of foreign investors.

Not only does productivity have a bearing on competitiveness, but labour costs also play a role in shaping relative cost structures – and hence the competitive position of different countries and industries. Survey results show that in 2000 the average monthly labour costs in CEEC manufacturing amounted to just 14% of the EU average (gross wages, including indirect labour costs, converted at current exchange rates)[7]. In Slovenia, the average monthly labour costs in manufacturing were equal to EUR 1120 and reached just one third of the EU average in 2000. In Poland, which ranked second, they reached only 22% (EUR 730), and at the low end, labour costs in Bulgaria and Romania hovered around 5-7% of the EU average (EUR 170-200). Wage levels are positively correlated with varying sectoral productivity as those branches with better productivity performance can pay higher wages. Generally, CEEC labour costs (gross wages) have been growing quite fast recently, even in terms of domestic currencies (Figures 5a and 5b; see also Appendix, Indicators of Competitiveness). In the past couple of years, nominal wage growth was often pushed up by currency appreciation. Notably, nominal (EUR-based) wages in all CEECs (except Slovenia) rose faster than in the EU over the period 1995-2001 (where the annual wage growth was less than 4% over the same period). Although this can be considered a positive sign with regard to cohesion and income catching-up, the rapid wage increases are imposing a strain on international cost competitiveness – unless they are offset by a corresponding increase in productivity and other efficiency improvements (or exchange rate adjustments). Real wage growth in the CEECs was interrupted at the beginning of 2003 (Figure 5a).

Figures 6a and 6b show the development of unit labour costs (ULCs, which combine the growth of nominal wages in EUR and that of labour productivity) for industry as a whole. We can see that international cost competitiveness has not undergone any excessive deterioration recently (except in the Czech Republic and Hungary in 2002). On the contrary, at the beginning of 2003 ULCs in most CEECs (including the Czech Republic and Hungary) declined sharply – largely as a result of major gains in labour productivity. The

7 See Eurostat (2003).

Figure 5a

Real wages in industry

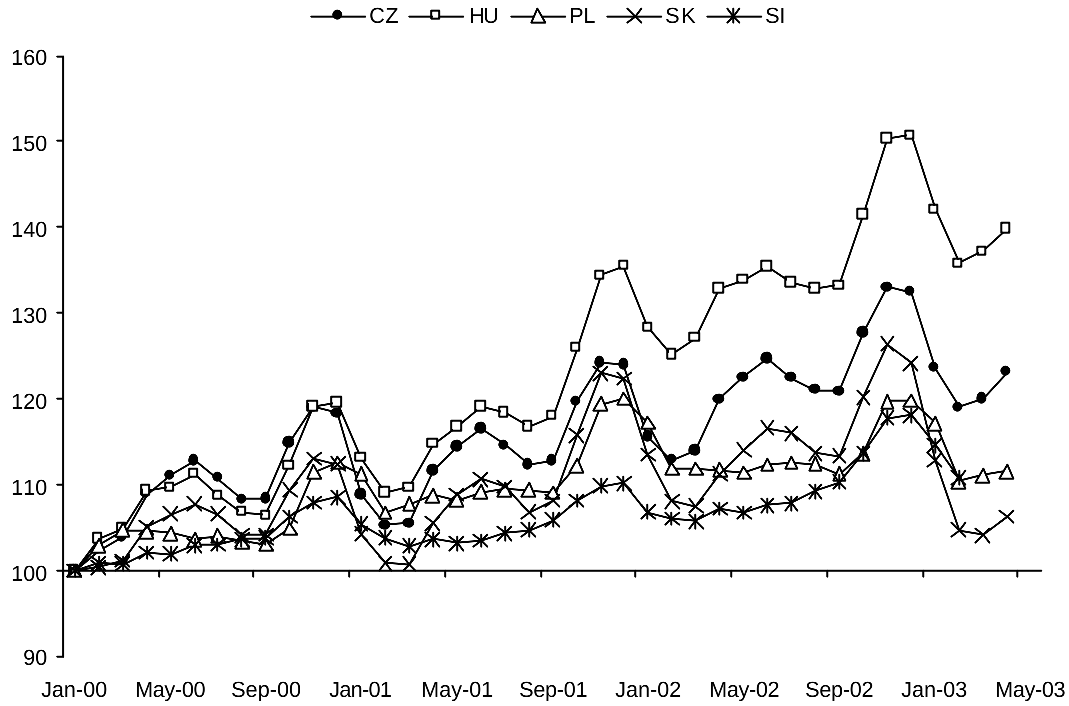
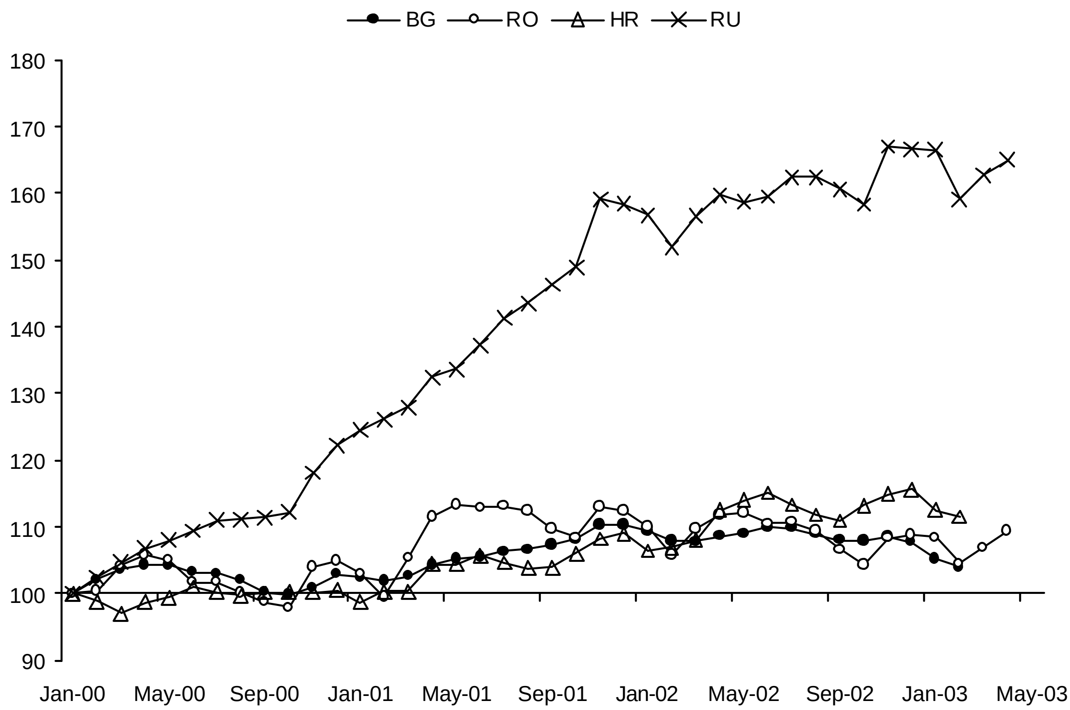


Figure 5b

Real wages in industry

3-month moving average, PPI adjusted, January 2000 = 100



Source: **wiiw** Monthly Database incorporating national statistics.

Figure 6a

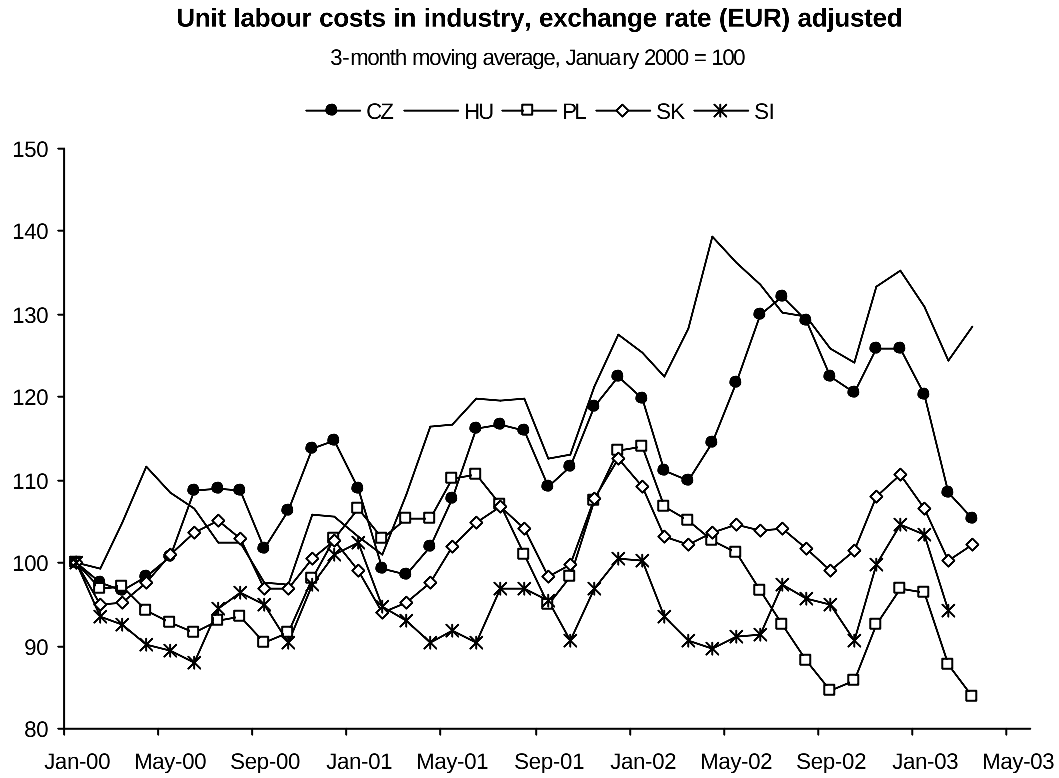
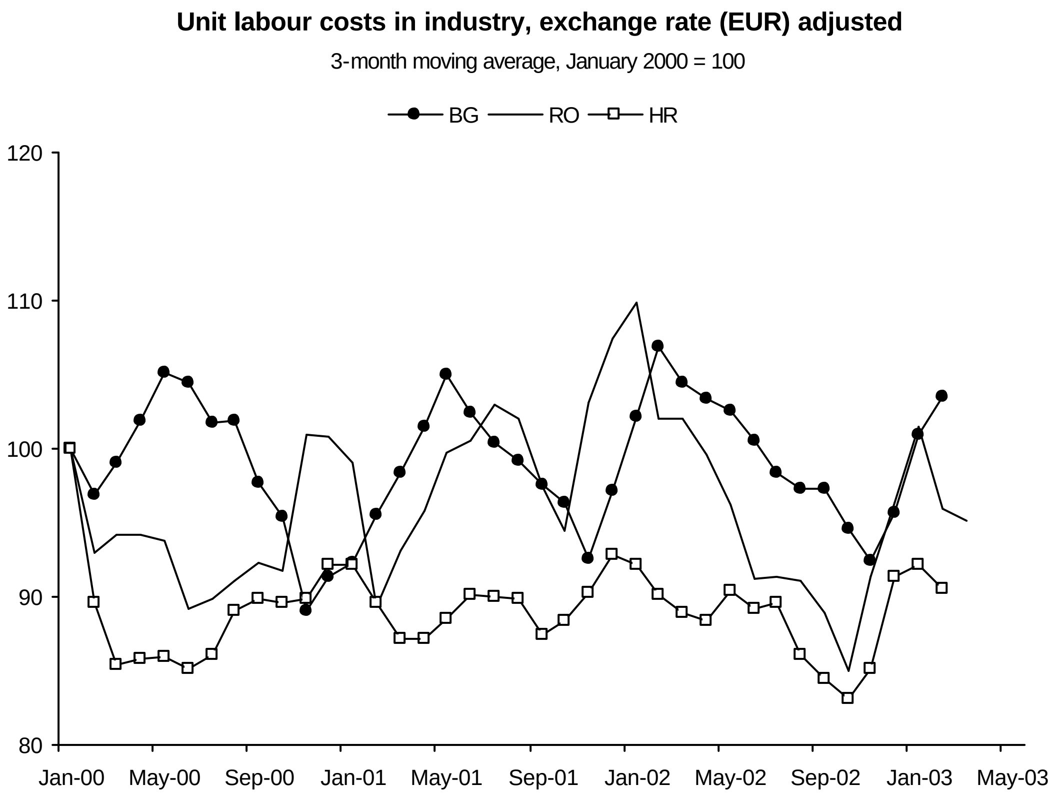


Figure 6b



Source: **wiiw** Monthly Database incorporating national statistics.

international competitive cost position of CEECs has thus been *maintained* and in some countries (and branches) even *improved*. Industries identified above as 'productivity winners' show either a lower increase (or a more rapid decline) in ULCs than the manufacturing industry average, i.e. a better than average cost-competitive performance; this also applies with respect to other competitors from the EU. This trend is usually to be observed in the technologically more sophisticated industries such as electrical & optical equipment, the transport equipment industry, but also in manufacturing n.e.c. (mainly furniture). Industries signalling a weaker than average competitive performance in most CEECs are mainly the 'productivity losers': the food & beverages industry, textiles, leather & leather products, wood products, paper & printing, coke & petroleum products and chemicals.[8] The latest evidence indicates that output growth in rubber & plastics as well as chemicals industries grew strongly in several CEECs (the Czech Republic, Hungary and in Slovakia), possibly indicating a diversification of industrial growth patterns.

Unwelcome side-effects of productivity growth: stubbornly high unemployment

But for a few exceptions (Hungary and Slovenia), unemployment in the transition countries remains stubbornly high. The present rates of GDP growth are obviously too low to permit the creation of additional jobs. Current efficiency reserves are still high and one can speak of 'jobless growth' in the CEECs. This applies not only to industry where the labour productivity growth has been most impressive. The services sector, though still less developed than in advanced market economies, is currently undergoing restructuring as well and not many new jobs are being created. The financial services and retail trade sectors in particular are presently shedding labour (partly due to the restructuring and concentration processes initiated by foreign investors). In some CEECs (mainly in Poland and Romania) hidden unemployment is high in agriculture.

According to labour force surveys (LFS), the average rate of unemployment in the CEEC region reached nearly 14% at the end of 2002 (Table 7), much higher than in the EU (8.3%). With unemployment rates close to 20%, the labour market situation is extremely critical especially in Poland, Slovakia and Bulgaria, and even more so in the majority of successor states to former Yugoslavia where up to one third of the labour force is unemployed. Moreover, the concentration of unemployed in the peripheral eastern regions and the high incidence of unemployment among the young, minorities and long-term jobless (in Poland, Slovakia, Bulgaria and many post-Yugoslav states) are giving rise to major social and political problems.

[8] See wiiw (2003), op. cit., for more details. We discuss here only labour productivity developments. Different rates of capital accumulation (and FDI) could account for some of the difference in labour productivity growth.

In most transition countries, there is little hope of improvement in the near future since economic restructuring is still incomplete and efficiency reserves in the economy are generally still high. The new EU member states (and the other transition countries as well) will require specific employment strategies (support of small and medium-sized enterprises, regional policies, training, etc.) in order to: (i) stabilize the labour market situation; (ii) keep employment levels in manufacturing; and (iii) create new employment opportunities in other sectors, while simultaneously maintaining the recent pace of productivity improvements.[9] Otherwise there is every danger of the present high rate of unemployment increasing still more. Needless to say, achieving productivity improvements in tandem with increasing employment during a period of sluggish global economic growth (in addition to the domestic fiscal consolidation requirements) is no mean task. One possibility would be to focus on creating low capital-intensive jobs (e.g. by supporting the construction of affordable housing). The latter approach could also help to alleviate the present housing shortages which often constitute one of the main barriers to increased labour mobility, the latter contributing to large differences in regional unemployment rates.

Table 7

Unemployment, LFS definition, annual averages

	2000	2001	2002	2003 March	2000	2001	2002 2)	2003 March	2003 forecast	2004 forecast
Czech Republic	455	421	377	390	8.8	8.1	7.3	7.6	7.6	7.5
Hungary	263	233	239	265	6.4	5.7	5.8	6.4	6	6
Poland	2785	3170	3431	3513	16.1	18.2	19.9	20.5	20.5	20.5
Slovak Republic	485	508	487	483	18.6	19.2	18.5	18.4	18	17
Slovenia	68	63	62	67	7.0	6.4	6.4	7.0	6.5	6
CEEC-5 2)	4055	4395	4596	4718	13.5	14.5	15.3	15.7	15.7	15.5
Bulgaria	567	664	592	500	16.9	19.7	17.8	15.6	18	17
Romania 3)	821	750	884	.	7.1	6.6	8.4	.	8	9
CEEC-7 2)	5443	5809	6072	.	12.1	12.9	13.8	.	13.9	14.1
Croatia	298	277	266	.	16.1	15.9	14.8	.	14.5	14
Macedonia	262	263	263	.	32.2	30.5	31.9	.	30	30
Serbia & Montenegro	481	490	517	.	12.6	12.9	13.8	.	15	15
Russia	7515	6416	5712	6470	10.5	9.1	8.0	9.1	7.5	8
Ukraine	2708	2517	2314	.	11.7	11.1	10.2	.	11	11

Notes: 1) Preliminary. - 2) **wiiw** estimate. - 3) From 2002 new methodology in accordance to EU definitions.
Source: **wiiw** Database incorporating national statistics, forecast: **wiiw**.

9 More on employment strategies in the CEECs see M. Celin (2003), 'European Employment Strategy: The Right Answer for the Candidate Countries?', *Die Union*, No. 1, European Commission, Representation in Austria, Vienna, pp. 51-64.

Private consumption and investment as recent growth stabilizers?

Last year's growth in private consumption was apparently fairly robust. Judged by proxy indicators such as development of wages and retail trade turnover (in the absence of detailed national accounts data), household consumption outstripped GDP growth in most countries (private consumption growth has been particularly high in Russia and Ukraine). Average real wages increased at a somewhat lower rate than GDP only in Slovenia, Croatia and Romania. However, since employment either stagnated or even declined in 2002 (except in Russia), total real wage incomes hardly grew at all. In most CEECs, the growth in private consumption has been associated with lower household savings. In general, the expansion of retail trade turnover has not been very impressive either (except in Hungary, Slovakia, Russia and Ukraine). Growth in both real wages and retail sales in the first quarter of 2003 remained strong in the latter countries (except Slovakia, but this time including the Czech Republic). However, in all likelihood this trend will bottom out in the course of 2003 (as has already happened in Slovakia at the beginning of the year), either on account of the governments' austerity measures aiming at fiscal consolidation or in the wake of administered price adjustments which will add to inflation and reduce the real wage growth. Except for Russia and Ukraine, no marked growth impulses arising from rising private consumption are thus to be expected in the near future.

Table 8

Gross fixed capital formation

real change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast	Index 1995=100 2002 [1]
Czech Republic	8.2	-2.9	0.7	-1.0	5.4	5.5	0.6	2.3	-2.5	0	5	117.0
Hungary	6.7	9.2	13.3	5.9	7.7	3.5	5.8	8.6	1.2	2	5	164.8
Poland	19.7	21.7	14.2	6.8	2.7	-8.8	-6.8	-12.8	-3.6	0	.	154.4
Slovak Rep.	30.9	14.3	11.0	-18.5	1.2	9.6	-0.9	-0.8	-2.0	3	7	148.8
Slovenia	8.9	11.6	11.3	19.1	0.2	-0.8	3.1	2.5	5.6	5.5	5.5	165.0
Bulgaria	-21.2	-20.9	35.2	20.8	15.4	23.3	9.3	4.6	15.8	.	.	158.3
Romania	5.7	1.7	-5.7	-4.8	5.5	9.2	8.3	4.8	6.8	6	5	120.3
Croatia	37.6	26.4	2.5	-3.9	-3.8	9.7	10.1	9.4	16.2	12	8	199.1
Macedonia	6.5	-4.3	-2.6	-1.4	-3.2	.	.	.	.	.	.	94.8 [3]
Yugoslavia [2]	-5.7	0.8	-2.2	-29.7	13.3	.	.	.	.	.	.	74.1 [3]
Russia [2]	-18.0	-5.0	-12.0	5.3	17.7	8.7	2.6	1.2	10.2	6.9	7.1	94.8
Ukraine [2]	-22.0	-8.8	6.1	0.4	14.4	20.8	8.9	9.6	23.1	10	15	113.9

Notes: 1) Preliminary. - 2) Gross fixed investment. - 3) Year 2000.

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

Given the need for the GDP to catch up (and in addition to the difficult external economic climate), the main growth impetus should come from expanding investments. In several countries, investment growth had already been quite robust in 2002 (except in the Czech Republic, Poland, Slovakia and Russia). Investment growth was particularly strong in Hungary, Bulgaria, Romania, Croatia and Ukraine (Table 8). Scattered evidence suggests that lively investment activity has continued on into 2003 in Bulgaria, Romania and Ukraine. In Russia, there has been an encouraging rebound in investments since late 2002. On the other hand, the majority of the more advanced CEECs are currently experiencing a drop in investment mainly related to cuts in public expenditure brought about by efforts to consolidate fiscal balances. In general, growth impulses coming from either domestic private consumption and/or investments will thus be rather weak in 2003.

High FDI inflows – still driven by privatization sales

An encouraging sign has been the steadily accelerating inflow of foreign direct investment (FDI) into the CEEC region. Contrary to the world-wide trend of weakening capital flows, the transition countries last year received about 15% more FDI than in 2001 (close to USD 33 billion). FDI flows continue to be unevenly spread among countries and are still driven by privatization-related sales.[10] The CEEC-5 have received about 60% of total inflows: the Czech Republic alone got more than USD 9 billion in 2002, while Hungary is now lagging behind. The total cumulative FDI stock in the transition countries had thus reached almost USD 220 billion as at end-2002. Apart from the Czech and Slovak Republics, FDI inflows have also been picking up recently in some countries in South East Europe (Bulgaria, Romania, Croatia, Serbia & Montenegro and Macedonia). There are also several (mostly energy-related) large FDI projects in the pipeline in Russia. Moreover, some of the money that fled Russia during the 1990s is now apparently coming back in the form of FDI; some Russian energy giants are at the same time expanding and diversifying their activities abroad.

FDI penetration (FDI stock in per cent of GDP) is rather high, especially in the Czech Republic (52%), Estonia (62%), Hungary (44%) and Slovakia (40%) – see Table 9. About 40% of the total FDI stock went into manufacturing industry in the CEECs, other preferred target sectors are banking, telecommunications and retail trade. Hungary, and more recently the Czech Republic, Poland and Slovakia as well, have been the most favoured destinations for manufacturing industry FDI projects, although several other countries (especially Bulgaria, Romania and Croatia) are also currently attracting a greater volume of FDI.

10 More detailed FDI data can be found in *wiiw-wifo Database – Foreign Direct Investment in CEECs and the Former Soviet Union*, wiiw and Wifo, July 2003.

Table 9

Foreign direct investment stocks in manufacturing industry, end-2001, in % of total manufacturing FDI

NACE code	Activities	Czech Republic	Estonia 2000	Hungary 2000	Latvia	Lithuania 2000	Poland	Slovak Republic	Slovenia
DA	Food products; beverages and tobacco	11.8	22.5	24.2	28.7	40.1	25.2	13.9	5.2
DB	Textiles and textile products	3.4	13.8	3.8	12.3	16.2	1.1	1.2	2.6
DC	Leather and leather products	0.1	.	0.6	0.5	0.0	0.1	0.8	.
DD	Wood and wood products	1.5	16.4	1.1	16.1	4.9	5.9	1.0	0.4
DE	Pulp, paper & paper products, publishing & printing	7.2	.	4.2	4.9	3.8	7.2	5.5	16.9
DF	Coke, refined petroleum products & nuclear fuel	2.3	1.0	8.2	0.0	6.4	.	7.5	.
DG	Chemicals, chemical products and man-made fibres	6.2	8.7	5.5	9.5	.	6.0	6.9	16.4
DH	Rubber and plastic products	6.2	1.1	4.7	3.2	4.0	2.8	1.7	10.9
DI	Other non-metallic mineral products	14.1	.	6.2	6.3	5.6	14.0	5.0	6.6
DJ	Basic metals and fabricated metal products	9.1	3.9	6.1	7.9	1.7	2.0	41.2	8.2
DK	Machinery and equipment n.e.c.	4.2	3.3	5.3	6.3	1.1	1.2	4.1	12.3
DL	Electrical and optical equipment	13.9	2.9	19.5	1.8	7.9	7.7	4.8	10.3
DM	Transport equipment	19.0	6.9	9.6	0.4	7.2	24.7	5.7	9.7
DN	Manufacturing n.e.c.	1.0	.	1.0	2.3	1.2	2.2	0.7	0.4
D	**Manufacturing**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
D	**Manufacturing FDI stocks, EUR million**	**11539.7**	**612.8**	**4079.3**	**428.7**	**721.8**	**24828.9**	**2327.6**	**1317.2**
	FDI stocks total, EUR million	**30717.2**	**2843.0**	**11079.7**	**2520.6**	**2509.2**	**60311.1**	**5313.0**	**3637.1**
	Share of manufacturing in total FDI stocks, in %	*37.6*	*21.6*	*36.8*	*17.0*	*28.8*	*41.2*	*43.8*	*36.2*
	Share of manufacturing FDI stocks in GDP, in %	*18.2*	*11.0*	*8.1*	*5.1*	*5.9*	*12.2*	*10.2*	*6.3*
	Share of total FDI stocks in GDP, in % (year 2002)	*52.1*	*62.1*	*44.3*	*30.5*	*27.2*	*22.8*	*39.8*	*21.4*

Remarks: Czech Republic: equity capital, reinvested earnings, loans.
Estonia: equity capital, reinvested earnings, loans.
Hungary: nominal capital based on corporation-tax declarations.
Latvia: equity capital, reinvested earnings, loans.
Lithuania: equity capital, reinvested earnings, loans.
Poland: equity capital, reinvested earnings gross; projects over USD 1 million capital based on PAIZ data.
Slovak Republic: equity capital, reinvested earnings - in the corporate sector.
Slovenia: equity capital, reinvested earnings, loans.

Source: wiiw-wifo FDI Database, national statistics.

Although FDI is certainly no panacea (it is usually rather import-intensive and may contribute to a worsening current account),[11] the phenomenon of accelerated foreign investments (and of FDI inflows in particular), together with their definitely positive effects on restructuring and competitiveness, is one of the main reasons why we are relatively optimistic about the current growth prospects of the CEECs. There is mounting evidence that enterprises with foreign investment participation are superior in terms of productivity, export performance, product quality and costs. In a few successfully restructured sectors (especially electrical, optical and transport equipment) where foreign investors have not only improved productivity, but also provided access to foreign markets, the cost benefits to the CEECs have been even greater than average – and are still improving. Owing to efficiency considerations, the multinational companies operating in the CEECs may even try to offset the effects of weaker global demand. Western European firms, but US, Japanese and Korean companies as well, are exploiting the CEECs' cost advantages (and especially their skilled labour) to an ever increasing degree; they are expanding production and increasing exports from these new locations, even when aggregate demand is low (they are also exploiting market growth possibilities in the financial and retail trade sectors). It is generally expected that EU enlargement will lead to additional FDI inflows to the CEECs – even after privatization is complete – since their attractiveness as production sites will improve after accession, investment risks will decline and domestic markets will grow. It is an open question, however, whether future FDI inflows will match the present privatization-related sales revenues and bridge the CEECs' structural deficits in the current account.

Solid export performance, trade balances improve

Although foreign trade developments in the transition countries have been extremely dynamic over the past few years, the growth in both exports and imports has recently slowed down – in line with a weaker global demand. In current EUR terms, CEECs' exports increased by 8% in 2002, yet by a mere 5% in the first quarter of 2003. A good sign is that exports have been growing faster than imports and trade deficits have declined (Table 10; this is not the case in former Yugoslav republics). The net effect of foreign trade on GDP growth has thus been positive in the majority of CEECs. Nearly 70% of CEEC exports and 60% of CEEC imports are traded with the EU. Manufacturing industry products, mostly electrical, optical and transport equipment, and wood products (including furniture) account for the bulk of this trade, as do textiles, basic metals and fabricated metal

[11] For a more detailed discussion see G. Hunya (2002), 'Recent Impacts of Foreign Direct Investment on Growth and Restructuring in Central European Transition Countries', *wiiw Research Reports*, No. 284, May; P. Havlik (2003), 'Restructuring of Manufacturing Industry in the Central and East European Countries', *Prague Economic Papers*, No. 1, 2003, pp. 18-35; K. Laski and R. Römisch (2003), 'From Accession to Cohesion: Ireland, Greece, Portugal and Spain and Lessons for the Next Accession', study commissioned by Bank Austria Creditanstalt, Vienna, April; 'Economic Growth and Foreign Direct Investment in the Transition Economies', *Economic Survey of Europe*, Spring 2001, UN ECE, Geneva.

products. One of the major recent achievements in most CEECs has been the drop in their traditional trade deficits with the EU; some countries (the Czech Republic, Hungary and Slovakia) had already achieved trade surpluses with the EU in the late 1990s (Table 11).

Over the period 1995-2001, the CEECs increased their market shares in trade with the enlarged EU-25 across a wide spectrum of industries. These gains occurred largely at the expense of a drop in the market shares of France, Germany, Sweden, Belgium and Denmark (Austria, Spain, Ireland and Portugal also gained). In structural terms, the CEECs as a (heterogeneous) group seem to be competing in the European market mainly with the exports of Spain, Portugal, Ireland, Austria, Germany and France. There is ample evidence of: (i) growing intra-industry trade (especially between the more advanced CEECs and the EU); and (ii) an impressive product qualitative improvement in CEEC exports.[12]

On the other hand, the dynamics and especially the structure of Russian exports (and to a large degree Ukrainian exports as well) differ significantly from those of the CEECs. A large part of Russian exports consists of energy carriers and basic metals; the share of the EU in exports is much lower (35% in the case of Russia, less than 20% in Ukraine), and both countries' trade performance is highly dependent on volatile commodity prices on the world market. In both 2001 and 2002, Russian exports stagnated (at a relatively high level) while imports have been growing fast. As a result, the traditional trade surpluses have been declining owing to robust growth in private consumption and the real appreciation of the rouble.

Available evidence for the first months of 2003 suggests somewhat slower – albeit still respectable – export and import growth in the CEECs, as well as some deterioration of their trade balances (especially in Hungary – see Table 10). Russian exports increased markedly thanks to both higher energy export prices (+45% in USD terms against the first quarter of 2002) and increased export volumes (+10% of both crude oil and natural gas).[13] In the first quarter of 2003 Russia managed to increase considerably its already large trade surplus. We expect the export growth to bottom out in the course of the year as the energy price effects will gradually wane and imports will continue to grow. In relation to the EU, CEEC exports once again increased somewhat faster than imports in the first quarter of 2003 (but both export and import growth was lower than in 2002); the CEEC trade surplus with the EU increased further (Table 11).

12 See wiiw (2003), op. cit., as well as M. Landesmann and R. Stehrer (2002), 'The CEECs in the Enlarged Europe: Convergence Patterns, Specialization and Labour Market Implications', *wiiw Research Reports*, No. 286, July.

13 See *CIS Statistical Bulletin*, No. 10, Moscow, May 2003, pp. 85 and 105.

Table 10

Foreign trade in Central and Eastern Europe and the main CIS States, in EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002 [1]	2001	2002	2002	2003	I-III 03 / I-III 02
							change in %		1 st quarter		in %
Czech Republic	Exports	23068	24640	31483	37251	40583	18.3	8.9	9859	10541	6.9
	Imports	25287	26386	34876	40675	43012	16.6	5.7	10146	10684	5.3
	Balance	-2219	-1746	-3393	-3424	-2429	.	.	-287	-143	.
Hungary [2]	Exports	20477	23491	30545	34082	36523	11.6	7.2	8920	8485	-4.9
	Imports	22871	26288	34856	37654	39939	8.0	6.1	9671	9655	-0.2
	Balance	-2394	-2797	-4312	-3572	-3416	.	.	-751	-1170	.
Poland	Exports	25145	25729	34383	40375	43400	17.4	7.5	10277	10783	4.9
	Imports	41539	43151	53122	56223	58307	5.8	3.7	13527	13901	2.8
	Balance	-16394	-17422	-18739	-15848	-14907	.	.	-3250	-3118	.
Slovakia	Exports	9541	9602	12880	14115	15252	9.6	8.1	3402	4207	23.7
	Imports	11635	10628	13860	16488	17515	19.0	6.2	3861	4359	12.9
	Balance	-2094	-1025	-980	-2372	-2263	.		-459	-152	.
Slovenia	Exports	8052	8037	9505	10349	10966	8.9	6.0	2653	2741	3.3
	Imports	8999	9482	10996	11345	11574	3.2	2.0	2819	2990	6.1
	Balance	-947	-1445	-1491	-997	-608	.	.	-166	-249	.
CEEC-5	Exports	86283	91499	118795	136172	146724	14.6	7.7	35111	36758	4.7
	Imports	110331	115935	147709	162385	170348	9.9	4.9	40023	41589	3.9
	Balance	-24049	-24436	-28915	-26213	-23624	.	.	-4912	-4831	.
Bulgaria [3]	Exports	3841	3734	5253	5714	6059	8.8	6.0	1357	1618	19.2
	Imports	4476	5140	7085	8128	8405	14.7	3.4	1776	2071	16.6
	Balance	-635	-1406	-1832	-2414	-2346	.	.	-419	-453	.
Romania	Exports	7412	7956	11219	12711	14678	13.3	15.5	3305	3768	14.0
	Imports	10569	9896	14128	17363	18898	22.9	8.8	4169	4532	8.7
	Balance	-3157	-1940	-2909	-4652	-4220	.	.	-863	-764	.
CEEC-7	Exports	97536	103188	135267	154597	167460	14.3	8.3	39773	42143	6.0
	Imports	125376	130971	168922	187875	197650	11.2	5.2	45967	48192	4.8
	Balance	-27840	-27782	-33656	-33278	-30190	.	.	-6194	-6048	.
Croatia [4]	Exports	4046	4027	4818	5210	5183	8.1	-0.5	1181	1362	15.4
	Imports	7477	7324	8588	10232	11316	19.1	10.6	2447	2751	12.4
	Balance	-3431	-3297	-3770	-5022	-6134	.	.	-1267	-1389	.
Macedonia	Exports	1170	1117	1431	1292	1178	-9.7	-8.9	278	274	-1.5
	Imports	1709	1665	2266	1891	2077	-16.6	9.8	506	494	-2.4
	Balance	-539	-548	-835	-599	-899	.	.	-228	-220	.
Serbia & Montenegro [5]	Exports	2518	1391	1808	2097	2399	16.0	14.4	524	366 [I-II]	
	Imports	4283	3081	3892	5391	6647	38.5	23.3	1511	904 [I-II]	
	Balance	-1766	-1690	-2084	-3294	-4249	.	.	-987	-538 [I-II]	
Russia [6]	Exports	66467	70820	113672	113448	113172	-0.2	-0.2	24635	28352	15.1
	Imports	51798	37061	48552	60025	64049	23.6	6.7	14090	14211	0.9
	Balance	14668	33759	65120	53423	49123	.	.	10545	14142	.
Ukraine	Exports	11283	10856	15771	18159	19004	15.1	4.7	4419	4607	4.3
	Imports	13103	11104	15104	17612	17967	16.6	2.0	4047	4225	4.4
	Balance	-1820	-248	667	547	1037	.	.	372	383	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs-free legal status. - 3) From 1999 according to new methodology. - 4) From 2000 according to new methodology. - 5) From 1999 excluding Kosovo and Metohia. - 6) Based on balance of payments statistics; including estimate of non-registered trade.

Source: **wiiw** Database incorporating national statistics.

Table 11

Transition countries' trade with the EU-15, EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002 [1)]	2001	2002	2002	2003	I-III 03 / I-III 03
							change in %		1 st quarter		in %
Czech Republic	Exports	14761	17052	21588	25682	27763	19.0	8.1	6935	7497	8.1
	Imports	16054	16945	21637	25139	25888	16.2	3.0	6224	6286	1.0
	Balance	-1293	107	-49	543	1875	.	.	711	1211	.
Hungary [2)]	Exports	14940	17906	22939	25315	27440	10.4	8.4	6787	6435	-5.2
	Imports	14664	16929	20354	21761	22468	6.9	3.2	5374	5425	1.0
	Balance	276	977	2586	3554	4972	.	.	1413	1010	.
Poland	Exports	17173	18127	24037	27942	29820	16.2	6.7	7237	7410	2.4
	Imports	27268	28016	32494	34512	35971	6.2	4.2	8377	8352	-0.3
	Balance	-10096	-9889	-8457	-6570	-6151	.	.	-1140	-941	.
Slovakia	Exports	5309	5701	7602	8450	9232	11.1	9.3	2118	2706	27.8
	Imports	5833	5493	6775	8207	8813	21.1	7.4	1922	2147	11.7
	Balance	-524	208	827	243	418	.	.	196	559	.
Slovenia	Exports	5271	5304	6060	6430	6509	6.1	1.2	1671	1702	1.8
	Imports	6242	6530	7451	7674	7871	3.0	2.6	1914	1998	4.4
	Balance	-972	-1226	-1391	-1244	-1362	.	.	-244	-297	.
CEEC-5	Exports	57453	64090	82227	93819	100763	14.1	7.4	24748	25750	4.0
	Imports	70061	73913	88712	97293	101011	9.7	3.8	23812	24208	1.7
	Balance	-12608	-9823	-6485	-3474	-249	.	.	936	1542	.
Bulgaria [3)]	Exports	1905	1942	2684	3126	3361	16.5	7.5	779	888	14.0
	Imports	2010	2486	3119	4002	4210	28.3	5.2	902	985	9.1
	Balance	-105	-544	-435	-876	-849	.	.	-124	-97	.
Romania	Exports	4783	5214	7163	8619	9843	20.3	14.2	2347	2592	10.4
	Imports	6097	6004	7996	9957	11030	24.5	10.8	2404	2533	5.3
	Balance	-1314	-790	-833	-1338	-1187	.	.	-57	60	.
CEEC-7	Exports	64141	71245	92074	105565	113967	14.7	8.0	27874	29230	4.9
	Imports	78168	82403	99827	111252	116251	11.4	4.5	27118	27726	2.2
	Balance	-14027	-11157	-7753	-5688	-2284	.	.	756	1504	.
Croatia [4)]	Exports	1927	1960	2619	2821	2742	7.7	-2.8	657	741	12.7
	Imports	4440	4136	4756	5844	6316	22.9	8.1	1308	1544	18.0
	Balance	-2513	-2175	-2137	-3023	-3574	.	.	-651	-803	
Macedonia	Exports	516	506	612	632	598	3.3	-5.5	156	154	-1.2
	Imports	620	677	861	803	940	-6.7	17.0	202	226	11.7
	Balance	-104	-172	-249	-171	-342	.	.	-46	-72	.
Serbia & Montenegro [5)]	Exports	965	504	700	897	981	28.2	9.3	.	.	.
	Imports	1847	1276	1610	2214	2833	37.5	27.9	.	.	.
	Balance	-882	-772	-910	-1317	-1852	.	.	.	.	.
Russia [6)]	Exports	20721	23290	39927	40933	39604	2.5	-3.2	.	.	.
	Imports	14047	10479	12061	17161	19254	42.3	12.2	.	.	.
	Balance	6674	12810	27867	23772	20351	.	.	.	.	.
Ukraine	Exports	1892	1986	2813	3323	3381	18.1	1.7	845	877	3.8
	Imports	2831	2249	3118	3820	4273	22.5	11.8	880	893	1.5
	Balance	-939	-263	-305	-497	-893	.	.	-35	-15	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) From 1999 according to new methodology. - 4) From 2000 according to new methodology. - 5) From 1999 excluding Kosovo and Metohia. - 6) Registered trade only.

Source: **wiiw** Database incorporating national statistics.

Recent trade dynamics has been affected not only by the sluggish West European demand, but also by movements in the EUR/USD exchange rate. The weakening of the USD has little *direct* bearing on CEEC exports since most of their trade is conducted with the eurozone.[14] But commodity imports (especially of energy) have become relatively cheap owing to a weaker USD (had it not been for higher energy prices the CEECs' terms of trade would have improved). On the other hand, Russia would have suffered trade losses as most of its exports are quoted in (weaker) USD, had it not been (yet again) for high energy prices at the beginning of 2003. In the CEECs, the strengthening of EUR vis-à-vis USD will have a dampening effect on inflation throughout the rest of 2003 owing to lower energy import prices, whereas the opposite will hold true for Russia. Last but not least, export and import growth rates for the first quarter of 2003 expressed in USD terms would be about 20 percentage points higher than the growth rates reported in Tables 10 and 11 (which are based on EUR) – in line with the fall of the USD in early 2003.

Inflation under control, currencies face appreciation pressures

There has been a persistent trend towards disinflation in the majority of transition countries over the past couple of years. In several CEECs recently (especially in the Czech Republic and Poland), price increases were even lower than in the eurozone (Tables 12a and 12b). Double-digit (annual) inflation persists only in Romania, Serbia & Montenegro and Russia. Producer price inflation was even negative in several countries (the Czech Republic, Hungary, Croatia and Macedonia) in 2002. In most countries, recent price increases (if any) resulted solely from adjustments in administered prices for utilities and services, and from adjustments to tax and excise rates in the wake of EU accession. The increases in VAT rates on certain services and the rise in excise duty on tobacco and alcohol prior to EU accession will be the main reason for temporary higher inflation in the CEECs over the period 2003-2004; their core inflation is as a rule very low.

In any case, it appears that high inflation is no longer a problem in most transition economies. On the contrary, in some of them (the Czech Republic, Hungary, Poland, Croatia and Macedonia) deflationary tendencies are currently a cause for concern – as is the case in Germany, Japan and the USA. The frequently claimed link between inflation and fiscal deficits has gone missing: despite the incidence of high (and recently even growing) budget deficits in several CEECs, inflation has been dropping. This missing link is forcibly illustrated by the recent developments in the Czech Republic, Hungary, Poland and Slovakia, all of which suffer from high and growing budget deficits (attaining 6-9% of GDP in 2002), while inflation drops. On the other hand, Russia has been enjoying comfortable

[14] See P. Kowalewski (2003), 'The weak dollar and its repercussions on Central and Eastern Europe', *The Vienna Institute Monthly Report*, No. 7, July, pp. 9-11.

Table 12a

Consumer price inflation

change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast
Czech Republic	8.8	8.5	10.7	2.1	3.9	4.7	1.8	3.7	-0.4	0.7	3.5
Hungary	23.6	18.3	14.3	10.0	9.8	9.2	5.3	6.2	4.6	5.3	5
Poland	19.9	14.9	11.8	7.3	10.1	5.5	1.9	3.4	0.5	2	3
Slovak Republic	5.8	6.1	6.7	10.6	12.0	7.1	3.3	4.7	7.6	8	7
Slovenia	9.9	8.4	7.9	6.1	8.9	8.4	7.5	8.1	6.3	5.5	4.5
Bulgaria	121.6	1058.4	18.7	2.6	10.3	7.4	5.8	8.2	0.6	3	4
Romania	38.8	154.8	59.1	45.8	45.7	34.5	22.5	26.9	16.7	18	15
Croatia [2]	3.5	3.6	5.7	4.2	6.2	4.9	2.2	3.2	1.7	2	1
Macedonia [2]	3.0	4.4	0.8	-1.1	10.6	5.2	1.5	1.7	2.0	2	4
Serbia & Montenegro	91.5	21.6	29.9	44.9	85.6	89.0	16.5	29.1	11.6	15	10
Russia	47.8	14.8	27.6	85.7	20.8	21.6	16.0	18.0	14.6	14	10
Ukraine	80.2	15.9	10.6	22.7	28.2	12.0	0.8	3.7	2.2	10	7

Notes: 1) Preliminary. - 2) Retail prices.

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

Table 12b

Producer prices in industry

change in % against preceding year

	1996	1997	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter
Czech Republic	4.7	4.9	4.9	1.0	4.9	2.9	-0.5	0.1	-0.6
Hungary	21.8	20.4	11.3	5.1	11.6	5.2	-1.8	-2.4	0.7
Poland	12.4	12.2	7.3	5.7	7.8	1.6	1.0	0.2	3.0
Slovak Republic	4.2	4.5	3.3	4.3	10.8	6.5	2.1	2.1	8.5
Slovenia	6.8	6.1	6.0	2.1	7.6	8.9	5.1	5.8	3.0
Bulgaria	130.0	971.1	18.7	2.8	17.5	3.8	1.2	0.0	7.9
Romania	49.9	152.7	33.2	44.5	53.4	41.0	24.6	26.4	23.3
Croatia	1.4	2.3	-1.2	2.6	9.7	3.6	-0.4	-2.6	3.4
Macedonia	-0.3	4.2	4.0	-0.1	10.7	2.0	-0.9	-1.9	1.5
Serbia & Montenegro	90.2	19.5	25.5	43.3	106.5	85.1	8.7	14.4	4.8
Russia	50.8	15.0	7.1	58.9	46.6	19.1	11.7	7.2	19.4
Ukraine	52.1	7.7	13.2	31.1	20.9	8.6	3.1	-0.3	7.8

Note: 1) Preliminary.

Source: **wiiw** Database incorporating national statistics.

budget surpluses ever since 2000, yet inflation remains relatively high (around 15% on annual average) owing to major foreign exchange earnings and growing hard currency reserves. The ongoing public finance reforms in the majority of CEECs (as well as in Russia and Ukraine) are therefore motivated mainly by efforts to secure the medium- and long-term sustainability of government budgets (including pension, health and social security systems) and create a favourable business climate for investments (by lowering the corporate tax rates), rather than being predominantly focused on taming inflationary pressures. Needles to say, these reforms are – just as everywhere else in Western Europe – politically controversial and difficult to implement.

The trend towards real currency appreciations – one of the few common features in the transition economies over the past few years – has helped to bring inflation down to single-digit levels in the majority of countries. Currency appreciations are quite natural since most countries started out on the transition process with excessive devaluations. The process of income catching-up is associated with real appreciations owing to the well-known Balassa-Samuelson effect.[15] Price levels in the transition countries are still rather low compared to the EU average, despite long lasting inflation differentials. Figures 7a and 7b show the recent developments of nominal exchange rates vis-à-vis EUR. Apart from Slovenia (and the exceptional case of Romania), the majority of currencies display either a trend towards nominal stability (Slovakia, Hungary, Bulgaria and Croatia) or even towards nominal appreciation. Given the inflation differentials mentioned above, nominal exchange rate stability implies appreciation in real terms.[16] The latter is shown in Figures 8a and 8b where we use producer price inflation (PPI, which as a rule has been lower than consumer price inflation – CPI) to deflate the nominal exchange rate indices. Since the beginning of 2000, real appreciation has been particularly high in the Czech and Slovak Republics, Hungary and Russia; some correction of longer-term appreciation trends has occurred since end-2002 in Poland and in Hungary. The stability of real exchange rates in Slovenia and Croatia has been a remarkable achievement on the part of the monetary authorities in both countries.[17]

High inflows of foreign exchange, be they currently from FDI as for instance in the Czech Republic and Slovakia, or from high energy export revenues as in Russia, exert an upward pressure on the nominal exchange rate. Moreover, monetary authorities' concerns about inflation (implicitly driven by their ambition to adopt the EUR as soon as possible) and the related policies of high interest rates have reinforced appreciation pressures. Over the past two years, nominal interest rates have been frequently adjusted downwards (see the

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15 See L. Halpern and Ch. Wyplosz (2001), 'Economic Transformation and Real Exchange Rates in the 2000s: The Balassa-Samuelson Connection', *Economic Survey of Europe*, No. 1, UN ECE, Geneva, pp. 227-239.

16 Real appreciation has of course been even more pronounced with respect to the US dollar due to the recent movements in the EUR/USD exchange rate.

17 Both countries have the highest price levels among the transition countries (measured by the exchange rate deviation index – ERDI) – see Table A/2 in the Appendix, Indicators of Competitiveness.

Figure 7a

Nominal exchange rate movements, 2000-2002 (base month January 2000)

(national currency vis-à-vis EUR)

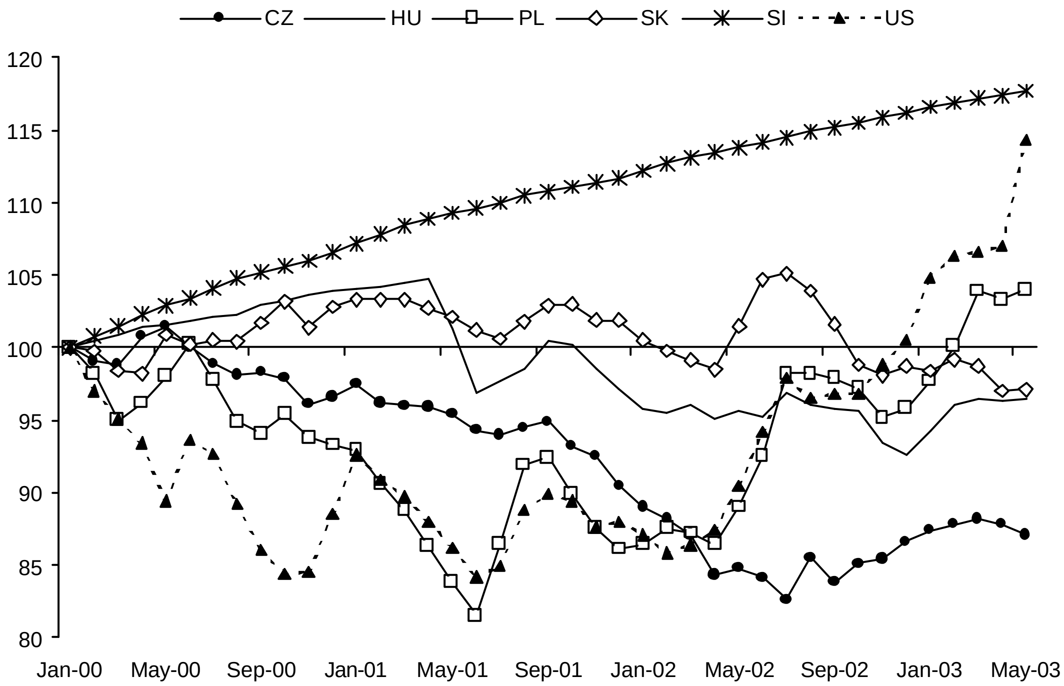
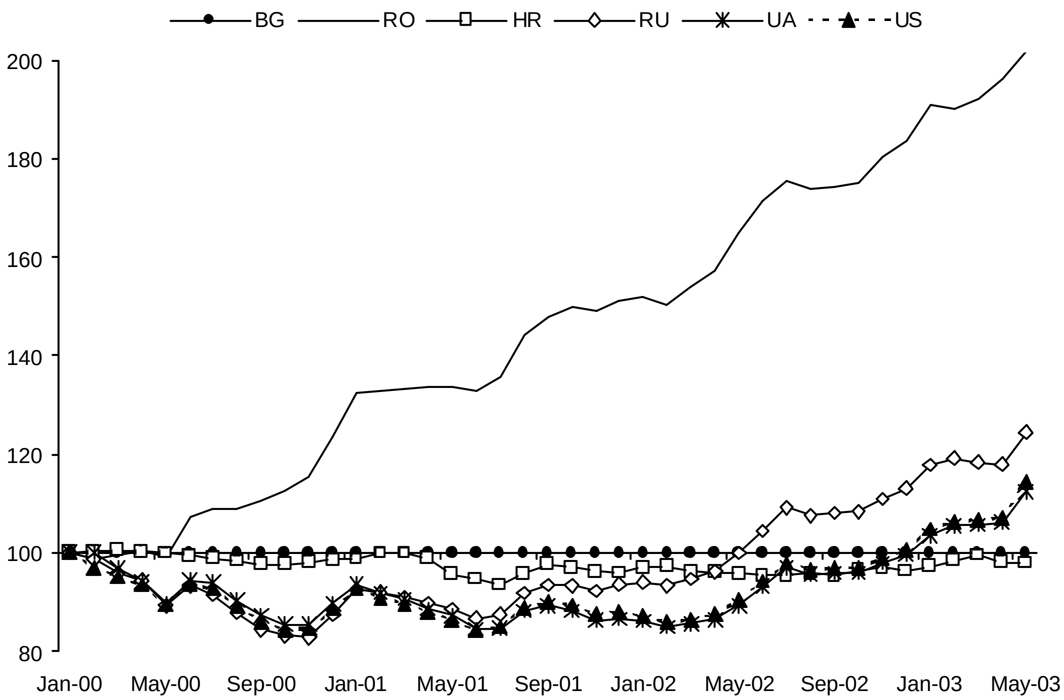


Figure 7b

Nominal Exchange Rate movements, 2000-2002 (base month January 2000)

(national currency vis-à-vis EUR)



Source: **wiiw** Monthly Database incorporating national statistics.

Figure 8a

Real appreciation*, 2000-2002 (base month January 2000)

(national currency vis-à-vis EUR, PPI-deflated)

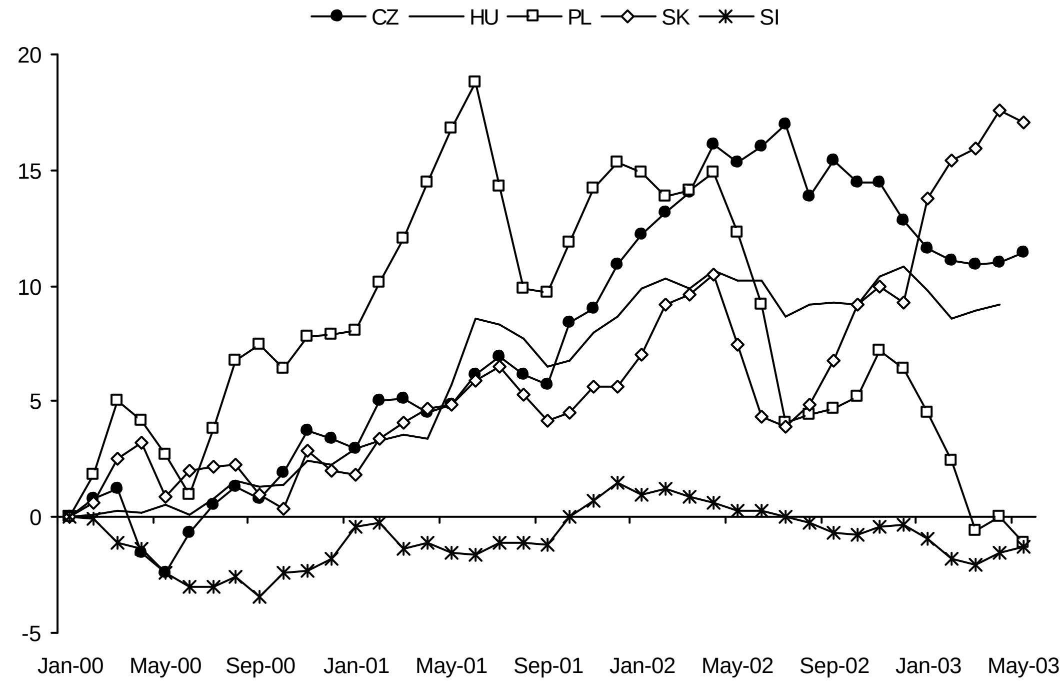
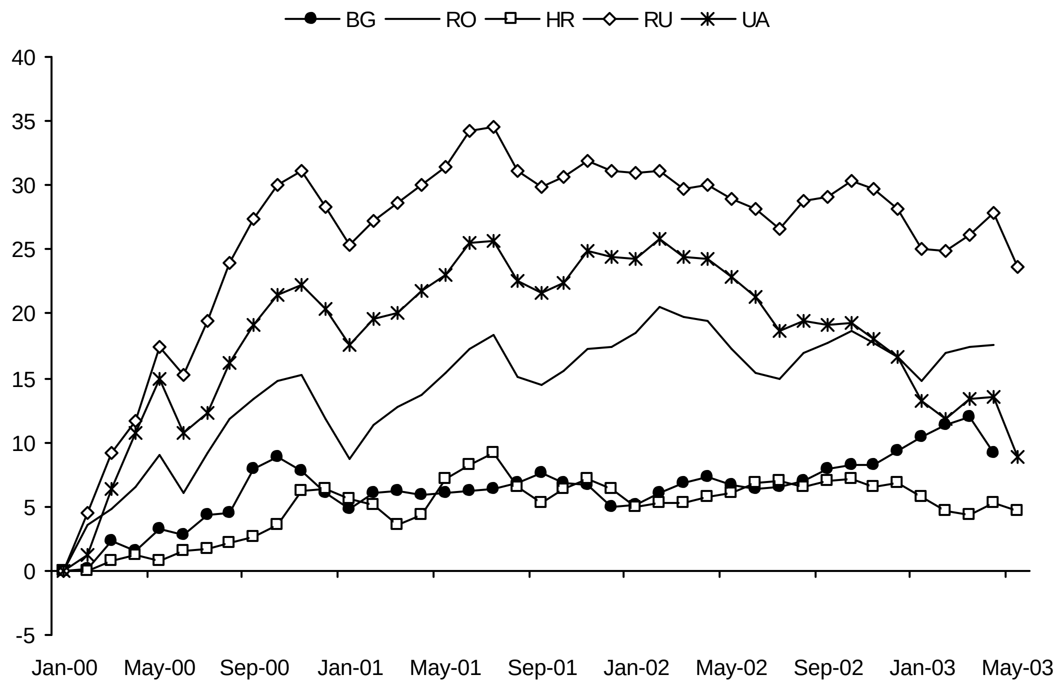


Figure 8b

Real appreciation*, 2000-2002 (base month January 2000)

(national currency vis-à-vis EUR, PPI-deflated)



*

An increasing line means a real appreciation.

Source: **wiiw** Monthly Database incorporating national statistics.

Figure 9a

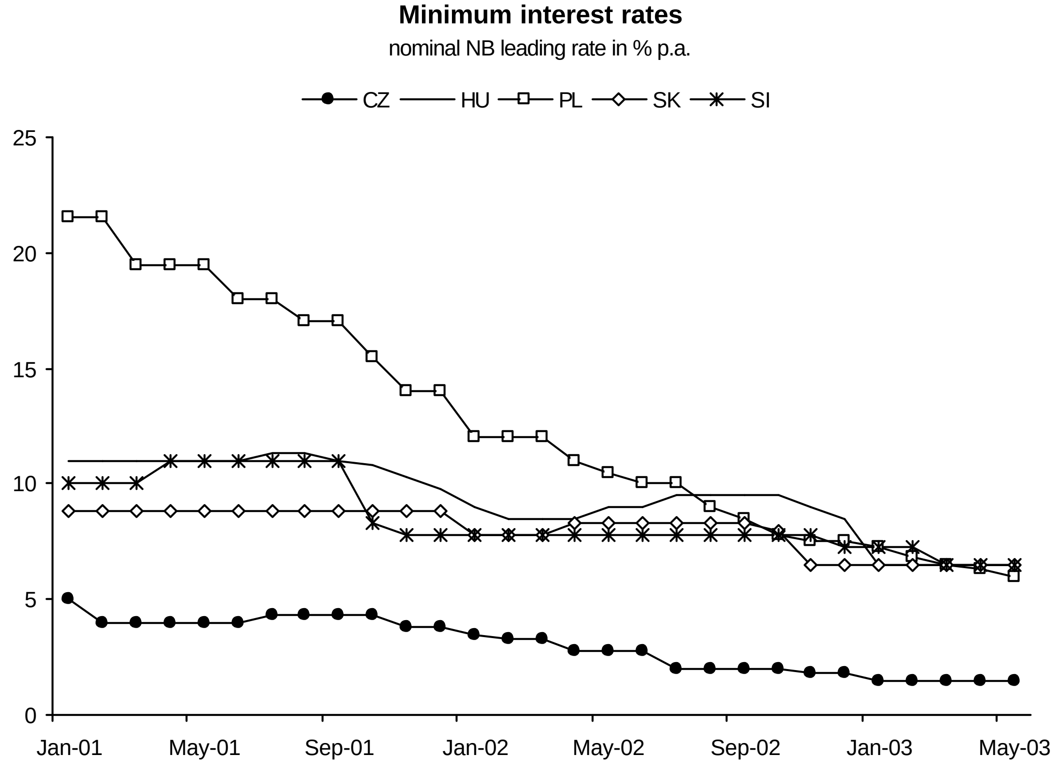
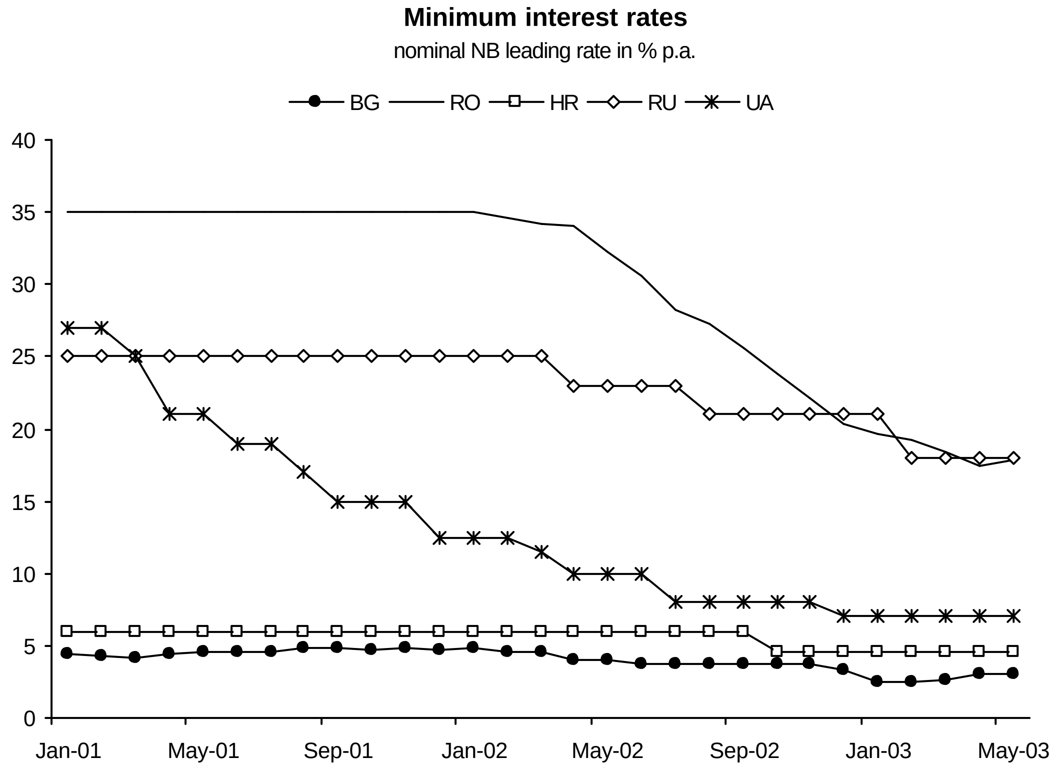


Figure 9b



Source: **wiiw** Monthly Database incorporating national statistics.

examples of Poland, Romania and Ukraine in Figures 9a and 9b), but the credit market in the majority of transition countries is still not working properly. Apart from the residual weaknesses of the financial sector (despite impressive restructuring initiated by foreign-owned banks in the more advanced CEECs) the reasons for this are numerous: high interest rate spreads, in some less advanced countries the persistent dismal state of the banking sector as commercial banks are in the process of restructuring or a situation where corporate credits are perceived as highly risky (especially in Russia and Ukraine). The result is that loans for business investments are hard to obtain, irrespective of the level of interest rates. Investments are typically financed from retained profits and amortization of fixed capital. This kind of credit constraint represents a significant barrier to growth, especially where the development of domestically-owned SMEs is concerned as they do not have access to international credit markets unlike their foreign competitors. This has also been one of the reasons why the gaps in performance between domestically-owned and foreign investment enterprises have been large and even widening.

Macroeconomic policy challenges related to EU and ERM accession[18]

For the immediate future, the conduct of monetary policy and the choice of exchange rate regime will be of crucial importance to the CEECs. As is well known, economist opinion is split over the desirability of the CEECs achieving rapid entry into the European Monetary Union (EMU), given that the minimum obligatory requirement is two years' 'successful' membership of the Exchange Rate Mechanism (ERM) framework).[19] Secondly, and more importantly, the monetary authorities in the CEECs (Central Banks, Monetary Policy Councils) which determine monetary and exchange rate policy are of a different opinion to the EU Commission and the European Central Bank (ECB). (Frequently different views are also held by the Central Banks and Finance Ministries in the CEECs.) The monetary authorities in the CEECs are, to varying degrees, very much in favour of rapid entry into the EMU, while the EU Commission and the ECB are more cautious in this respect, preferring a period in which nominal (inflation, interest rates) and real (GDP level) convergence is gradually achieved in line with the conditions for EMU entry as laid down in the Maastricht Treaty in 1991. The likely outcome of these divergent views will be that most CEECs will give overriding priority to swift EMU entry and subordinate most other economic policy goals to that target.

However, both strategies, be it staying out of the EMU for a longer period of time after EU accession or attempting to join very quickly, are hazardous. In short, staying out for a longer time means that CEEC currencies will continue to be subject to exchange rate

[18] This section draws on M. Landesmann, 'Economic Developments in Austria's CEE Neighbours' (forthcoming).

[19] See the contributions by D. Begg et al. (2002), 'Sustainable Regimes of Capital Movements in Accession Countries', *CEPR Research Paper*, No. 10, London; F. Coricelli and B. Jazbeg (2001), 'Real exchange rate dynamics in transition economies', *CEPR Discussion Paper,* No. 2869, London; Halpern and Wyplosz (2001), op. cit.; etc.

instability, partly as a reflection of their 'structural' current accounts deficits and partly as an obligation under the *acquis communautaire* to provide for complete capital account liberalization, with every possibility of speculative exchange rate attacks.[20] The swift entry strategy requires a period of almost complete nominal exchange rate stability in relation to the EUR (within a narrow ± 2.25% corridor around the central parity, originally stipulated in the Maastricht Treaty; not a broader corridor of ± 15% set up after exchange rate crises by the Amsterdam Council in 1997 for the new ERM-2 mechanism), together with a sustained disinflation. Using monetary policy tools to achieve this (i.e. relatively high temporary interest rates) can heighten still more a country's vulnerability to speculative attacks on the exchange rate. One way to solve this dilemma would be early accession to the EMU or no obligation to join the ERM at all.[21]

Apart from a focused use of monetary policy to achieve rapid EMU entry, the Maastricht criteria require, of course, the achievement of fiscal targets that are currently violated in the majority of the CEECs.[22] Once again, the overriding desire for swift EMU entry will call for rather dramatic adjustments in this respect. Moreover, in the event of a conflict between fiscal and monetary authorities, the latter can attempt to impose their will on the former. This tussle has been symptomatic of developments in Hungary and Poland over the past few years and explains much of the rather unstable and volatile macroeconomic experience of the two economies. In any case, first and foremost an attempt to secure relatively swift entry into the EMU flies in the face of the generally accepted logic of the Balassa-Samuelson process of necessary real appreciation in catching-up economies such as the CEECs.[23] Secondly, it might cause instability in the macroeconomic growth processes due to either over-restrictive monetary policy and/or speculative attacks on the exchange rates and/or undue speed in the fiscal consolidation process. We hence speak here of potential 'EMU dips' in the growth processes of the CEECs over the coming years.

The greater volatility of the business cycle and the possibility of the CEECs being structurally more prone to react to internal and external shocks also establishes a greater need for counter-cyclical policy.[24] This may justify a higher longer-term fiscal deficit target than the figure of 3% of GDP currently stipulated in the Stability and Growth Pact adopted in Maastricht, as it will also apply to the CEECs after their EU accession. In general, the CEECs will continue to undergo structural adjustment processes and a use of rigid fiscal

[20] There are no derogations in the Accession Treaties in the area of capital flows liberalization for CEECs.

[21] See Ch. Wyplosz (2003), 'Do not impose a currency crisis on Europe', *Financial Times*, 16 June 2003, p. 17.

[22] See Country Tables in the second part of this report. There are strong arguments that the application of Maastricht criteria to the (structurally and otherwise different) CEECs is misplaced – see, for instance, W. H. Buiter and C. Grafe (2002), 'Patching up the Pact: some Suggestions for Enhancing Fiscal Sustainability and Macroeconomic Stability in an Enlarged European Union', CEPR, Discussion Paper 3496, London, August.

[23] See Halpern and Wyplosz (2001), op. cit.

[24] There is some evidence for higher degrees of concentration and specialization of industry in the CEECs as compared with present EU member states – see wiiw (2003).

policy guidelines that ignore the specific situation of the CEECs will not be conducive to their income catching-up (real convergence) process. The present requirements of EMU membership thus clearly conflict with a significant Balassa-Samuelson catching-up process. Hence, as long as the EMU accession rules are not changed, a significant catching-up process would not allow EMU entry any time in the near future. Current debates concerning the reform of the Stability and Growth Pact will no doubt take on a new dimension after the accession of CEECs as the range of countries with different structural characteristics and income levels, inter-temporal and inter-generational trade-offs and trend growth rates will widen. A last point to be mentioned in the context of this brief discussion of macroeconomic policy dilemmas related to EU/ERM/EMU accession is the inconsistency between the goal of early EMU entry and the transitory stipulations imposed on labour flows between some present EU members (mainly Austria and Germany) and the acceding CEECs. These restrictions on labour flows for a period of up to seven years after EU accession obviously violate one of the key criteria for the 'optimum currency area' set up by Robert Mundell for countries participating in a currency union.[25]

High, yet sustainable, current account deficits

In the majority of CEECs, current accounts have been traditionally in deficit and their external position mostly fragile. With higher domestic growth, rising private consumption and investments – even with growing exports – imports have immediately picked up. The above-mentioned phenomenon of real currency appreciation, liberalized trade and capital transactions, growing integration into the world economy and, last but not least, a lower development level which requires income catching-up and high technology imports, are usually the straightforward explanations. But how large a current account deficit can be sustained under conditions prevailing in a transition economy? In the period 2001-2002, the average current account deficit in the CEECs amounted to over 4% of GDP – slightly less than in the previous years, but higher than 3%, which is usually regarded as sustainable. Moreover, these relatively high current account deficits occurred when the GDP growth was rather modest. The Czech Republic and Slovakia had higher current account deficits in 2002 (more than 6% and 8% of GDP, respectively – see Table 13). On the other hand, Russia and Ukraine still record sizeable (yet declining) current account surpluses.

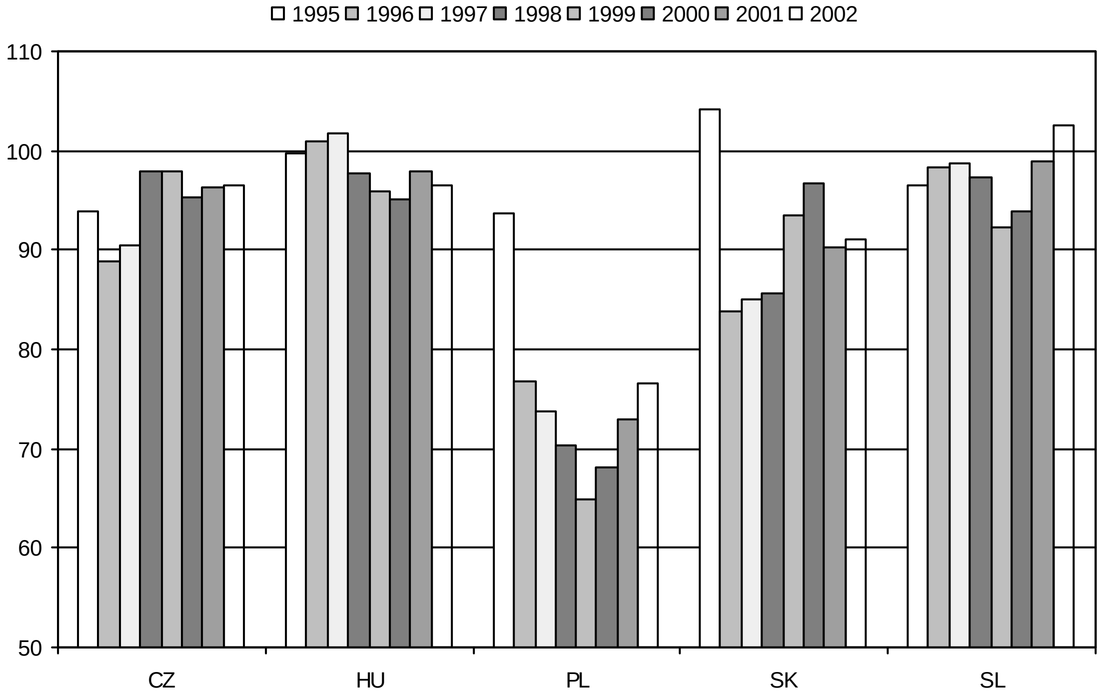
Increasingly, the current account positions of the transition countries (deficits in the case of CEECs) are determined not by merchandise trade balances (which are frequently improving), nor by trade in services (which is usually in surplus thanks to revenues from

25 See R. Mundell (2000), 'A Theory of Optimum Currency Areas', in R. Z. Aliber (ed.), *International Finance. Volume 2*, Edward Elgar, Cheltenham, UK and Northampton, Mass., pp. 510-518.

Figure 10a

Export coverage of imports (goods and services), in %

based on balance of payment statistics

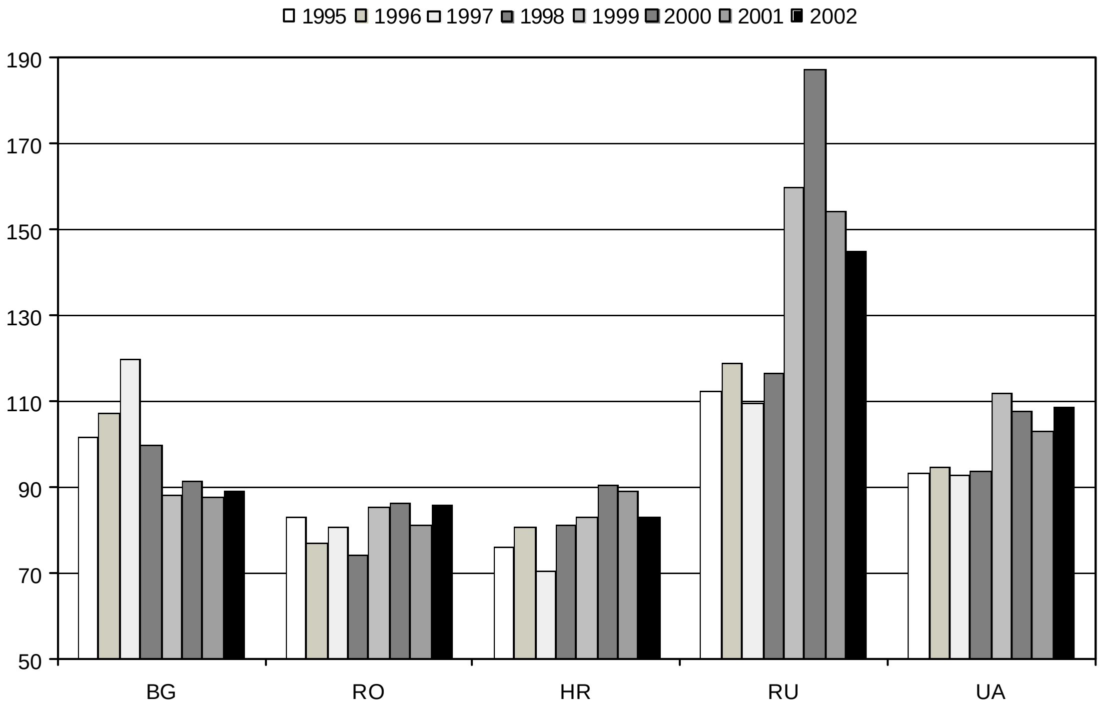


wiiw

Figure 10b

Export coverage of imports (goods and services), in %

based on balance of payment statistics



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transport services and tourism), but by the deficits in incomes transactions. The latter tend to increase as the current outflows related to investment incomes (and reinvested profits which are recorded as FDI inflows in the capital account) increase. With FDI projects maturing, the completion of privatization sales on the horizon and repatriation of profits on the rise, capital outflows may adversely affect the balance of payments. We do not expect this to happen in the near future, but the recent experience of Hungary (and the earlier experience of Ireland) should serve as a warning sign. Figures 10a and 10b show that in the majority of CEECs (except Slovenia in 2002), the coverage of imports (of both commodity and services, according to balance of payments statistics) by exports has been insufficient. These persistent 'structural' trade deficits, reinforced by the possibility of growing negative balances in income transfers, may lead to potentially unsustainable high current account deficits.

With the ongoing real appreciation of currencies, expanding domestic demand (which more or less automatically induces higher imports), growing income transfers abroad and sluggish growth in the major export markets, larger current account deficits thus seem virtually inevitable. This is indeed our forecast for the Czech Republic and Hungary (the Russian and Ukrainian current account surpluses are expected to decline further). At the present juncture – as in the course of the past few years – financing these deficits poses no immediate problems as capital inflows (predominantly FDI) are usually sufficient. In fact, in a situation where stock markets are depressed worldwide, yields on bonds are low and interest rates in general are falling, many transition countries serve as relatively safe havens for international investors. The prospect of the CEECs entering the EU only serves to reinforce this perception. However, in several of the countries mentioned above (and especially in some successor states to former Yugoslavia), the problems may be compounded in the near future – especially if the European economy remains sluggish. Needless to say, the problem may take on a completely new dimension when the privatization sales are complete – and this will come about very soon in the more advanced CEECs.

wiiw forecasts for 2003 and 2004: continuing modest GDP growth

The recovery of the eurozone economy has been repeatedly delayed. Recent forecasts reckon with an ongoing weak GDP growth in 2003 (0.7%) and with hardly any upswing in 2004 (+1.2%). The German (and Austrian) economy has been stagnating; GDP growth in both countries will most likely stay below 1%. Such a long period of sluggish economic growth is without precedent in the economic history of post-war Europe. It remains to be seen whether the currently discussed tax and labour market reforms in Germany, as well as the planned new infrastructure investments in Europe, will bring the depressed eurozone economy back on the growth path.

In this difficult international economic climate, the wiiw forecasts for GDP growth in the transition economies are relatively upbeat. We expect a modest acceleration of growth in the CEECs in 2003 (largely thanks to a recovery in Poland) and – provided that the business climate in Western Europe finally improves – GDP growth will pick up further in 2004 (Table 13). Russia and Ukraine are expected to grow faster in 2003, but will slow down somewhat in 2004. After a brief jump in 2003/2004, inflation will recede to low single-digit levels in the CEECs; a gradual disinflation process will continue in Russia and Ukraine. The rates of unemployment will stabilize at around 15% in the CEECs (with a broad variance across individual countries) and the current account deficits (4% of GDP on average) will be manageable. The economy of the enlarged European Union will gain more dynamism after the CEECs' accession in May 2004, but the transition countries' catching-up process will be slow.

In **Bulgaria**, relatively robust economic performance continued into the first quarter of 2003 with GDP growing by 3.8% year on year. Aggregate output was bolstered by a sharp upturn in the manufacturing sector, whose production grew at double-digit rates. Exports fared unexpectedly well against the backdrop of a general weakness in the country's major export markets. The government's fiscal position remains strong and the overall macroeconomic situation does not pose any immediate threats. The short-term outlook for the Bulgarian economy is positive: the government's goal of achieving 4.8% GDP growth in 2003 is a realistic target, definitely re-achievable in 2004.

For the **Czech Republic**, a GDP growth rate of above 2% in 2003 should be regarded as a relatively good result – even for the year 2004, should there be no significant recovery in the eurozone. However, we do expect some improvement in the international business climate and, as a consequence, GDP growth in the Czech Republic will be close to 3% in 2004. It is mainly the looming fiscal austerity package that will prevent growth from jumping even higher. The recent policy of very low interest rates could come to an end in the course of 2004 as a response to the likely re-emergence of inflation. Higher indirect taxation of tobacco and alcoholic beverages, and especially VAT adjustments for services, will be the main forces briefly nudging inflation upwards. The EU accession will trigger substantial institutional and structural changes in the longer run, but no immediate shocks, except for one. It will become clear that net revenues from the EU budget will be negligible at best – at least in the first years of EU membership and for the economy as a whole.

By early 2003 the **Hungarian** economy had entered an unsustainable growth path, characterized by declining, yet still high domestic absorption and deteriorating competitiveness amidst weak external demand. The result is slower, yet still remarkable economic growth, coupled with increasing external imbalances. On 4 June 2003, the government introduced corrective measures devaluating the forint and initiating a cut in budget expenditures. This package is a compromise reached between the central bank and the government: the former was concerned about the extent of the public deficit and its impact on inflation, the latter promoted a return to export-led growth. GDP growth may well reach 3% to 3.5% in the coming years. It is an open question whether the Hungarian exporters will be able to ride out the wave of the new business cycle under a substantially worse competitive position compared to previous years.

Since early 2002, the **Polish** economy has been slowly recovering from recession. However, despite the ongoing relaxation of monetary policy, fixed investment has contracted further. Fiscal policy is in disarray and likely to restrict GDP growth. Exchange rate developments, aided by a major rise in labour productivity, have contributed to good results in foreign trade. Overall, the political and economic situation is quite unstable: the latter all the more so because firms are generally pessimistic where their medium-term prospects are concerned. wiiw reckons with a gradual acceleration of GDP growth and low inflation, as well as with a persistent and very high rate of unemployment.

Romania is the only candidate country which has not yet received the official 'functioning market economy' status from the EU Commission. Especially targets related to privatization, enterprise reform and financial discipline have still not been met. The state-owned sector of industry (about 40% of the total) is not working under the hard budget constraint. Economic restructuring is still progressing slowly. GDP has been growing by about 4-5% per year while inflation remains close to 20%. Macroeconomic stability may be in danger as IMF surveillance is phasing out and elections are drawing near in 2004.

Thanks to robust export growth, the **Slovak** GDP will increase by 4% in 2003. The expected recovery in the eurozone may even accelerate both export and GDP growth next year. At the same time, domestic demand will also strengthen. All things considered, this will result in a higher GDP forecast for 2004. The inflation rate will exceed 8% in 2003, as the government has re-launched price deregulations and waived some excise taxes. The current account deficit will drop substantially, below 3% of GDP in 2003, and even more so in 2004, thanks to the expansion of exports. The external position will also benefit from the weak USD that helps to relieve the pressure on the negative trade balance due to cheaper imported fuels.

As a small open economy, **Slovenia** reacts quite sensitively to the weak external environment. Unlike the previous year, it has proved impossible in 2003 to offset the poor results achieved in trade with the EU by increasing exports to the successor states of former Yugoslavia. Thus, the Slovene economy might grow by some 2.5% this year, spurred mostly by domestic demand, especially higher investments. GDP growth might pick up more pronouncedly only after economic recovery in Western Europe has set in. Given the moderate growth of the economy, unemployment will remain at the current (modest) level. Inflation will slow down further in both 2003 and 2004. The current account will once again close with a slight surplus.

The outlook for the **Croatian** economy is encouraging and wiiw stands by its earlier forecasts. Owing to a slowdown in private consumption (resulting from the credit squeeze imposed by the National Bank), GDP growth will be somewhat lower in both 2003 and 2004. High investment, in particular on account of motorway construction and other infrastructure-related projects, will act as the major engine of growth. Pre-election factors will also play an important role during 2003. Next year may witness a more restrictive fiscal policy that might also translate into somewhat lower GDP growth.

Russian economic growth picked up firmly in the first months of 2003 as high revenues from energy exports supported the growth of both private consumption and investments. Rapidly rising foreign exchange reserves have exerted some inflationary pressures, but the main thrust behind price increases has come from administrative price adjustments. Overall economic developments are positive: employment is growing, the government budget is in surplus, foreign debt is being serviced on schedule and investments (including FDI) are picking up. The Duma elections in December 2003, and especially the presidential election in Spring 2004 (with V. Putin a clear winner), have led to a certain reform stalemate and engendered the usual political scrimmage. Barring a sharp drop in world market energy prices, Russian GDP will continue to grow by about 5% per year in the coming years with inflation gradually receding.

The **Ukrainian** economy grew by 7% in January-May 2003. The upturn has come about as a result of: a major upswing in investment, including investment in construction; higher export sales to Russia and the eurozone; increases in real wages and other private incomes; and growth in the provision of transportation services. Inflation has picked up considerably, but remains well below that of Russia. The country’s credit rating improved following placement of a USD 800 million eurobond and reductions in public and external debt ratios. In its relations with the EU, Ukraine has been struggling to keep the dialogue open regarding eventual accession, better market access and simplified visa regimes.

Industrial production in **Macedonia** was stagnant in the first half of 2003. This is an improvement after two years of decline. Foreign trade is recovering with both exports and imports growing; the trade and current account deficits are growing as well. Prospects for the next two years are moderately good. Macroeconomic stability does not seem to be threatened. Fiscal adjustment will be achieved gradually and should benefit from the economic recovery, which should accelerate in the next couple of years. There are some worries related to the fact that the immediate neighbours are not showing signs of faster growth. An acceleration of the region's EU integration will be helpful for Macedonia as this small country crucially depends on regional development.

In the third year of transition, industrial production in **Serbia** is declining. Similar developments were recorded in 2002, but then a temporary recovery had started in the second quarter. The current decline, starting in December 2002, persisted throughout the first half of this year. In **Montenegro**, however, industrial production grew by nearly 12% – though the high growth took place mostly in the first quarter of the year. Overall, industrial production declined by very close to 3% in Serbia and Montenegro in the first five months of 2003. Though GDP development is not known, there are signs of a transitional recession, at least in Serbia. This is because the squeeze on demand is being felt as foreign assistance and financing are decreasing while privatization and restructuring are causing a temporary fall in supply in a number of sectors. The worrying development is that the growing foreign trade deficit is threatening the stability of the Serbian currency. In Montenegro, fiscal consolidation has had a major influence on the sluggish growth of GDP.

Table 13

Overview developments 2001-2002 and outlook 2003-2004

	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			
	2001	**2002**	**2003 forecast**	**2004**	**2001**	**2002**	**2003 forecast**	**2004**	**2001**	**2002**	**2003 forecast**	**2004**	**2001**	**2002**	**2003 forecast**	**2004**
Czech Republic	3.1	2.0	2.3	2.7	4.7	1.8	0.7	3.5	8.1	7.3	7.6	7.5	-5.7	-6.5	-6.3	-6.4
Hungary	3.8	3.3	3.2	3.5	9.2	5.3	5.3	5	5.7	5.8	6	6	-3.4	-4.0	-4.9	-4.5
Poland	1.0	1.4	2.5	3.0	5.5	1.9	2	3	18.2	19.9	20.5	20.5	-3.9	-3.6	-3.4	-3.7
Slovak Republic	3.3	4.4	4	5	7.1	3.3	8	7	19.2	18.5	18	17	-8.5	-8.2	-2.9	-2.0
Slovenia	2.9	3.2	2.5	3.5	8.4	7.5	5.5	4.5	6.4	6.4	6.5	6	0.2	1.7	0.4	0.4
CEEC-5	2.2	2.2	2.7	3.2					14.5	15.3	15.7	15.5	-4.2	-4.2	-4.0	-4.0
Bulgaria	4.1	4.8	4.5	5	7.4	5.8	3	4	19.7	17.8	18	17	-6.2	-4.4	-3.4	-2.6
Romania	5.7	4.9	4	4	34.5	22.5	18	15	6.6	8.4	8	9	-5.5	-3.4	-2.7	-4.1
CEEC-7	2.8	2.7	3.0	3.4					12.9	13.8	13.9	14.1	-4.4	-4.1	-3.8	-4.0
Croatia [2)]	3.8	5.2	4	3.7	4.9	2.2	2	1	15.9	14.8	14.5	14	-3.2	-6.9	-6.6	-4.2
Macedonia [2)]	-4.5	0.3	2	3	5.2	1.5	2	4	30.5	31.9	30	30	-6.9	-8.8	-5.6	-5.3
Serbia & Montenegro [3)]	5.1	3.0	2	4	89.0	16.5	15	10	12.9	13.8	15	15	-5.4	-11.0	-10.3	-9.6
Russia	5.0	4.3	5.0	4.5	21.6	16.0	14	10	9.1	8.0	7.5	8	11.3	9.5	6.7	5.7
Ukraine	9.2	4.8	6	4	12.0	0.8	10	7	11.1	10.2	11	11	3.7	7.7	4.0	.

Notes: 1) LFS - Labour Force Survey, refers to ILO definition. - 2) Consumer prices correspond to retail prices. - 3) Excluding Kosovo and Metohia.

Source: **wiiw** (July 2003).

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR/ECU), from 2003 at constant PPPs

	1990	1995	1998	1999	2000	2001	2002	2003	2004	2005	2010	2015
										projection assuming 4% p.a. GDP growth and zero population growth p.a.		
Czech Republic	9829	11223	12295	12542	13168	13963	14639	14932	15380	15995	19460	23676
Hungary	7048	8190	9804	10385	11118	11841	12563	12965	13444	13982	17012	20697
Poland	4478	6267	7834	8269	8733	9390	9754	9998	10298	10710	13030	15853
Slovak Republic	7318	8191	10220	10487	10870	11539	12347	12841	13483	14023	17061	20757
Slovenia	9896	11543	13632	14516	15380	16179	17074	17501	18114	18838	22920	27885
Estonia	.	5894	8082	8203	8976	9821	10708	11297	11975	12454	15152	18435
Latvia	6884	4371	5771	6070	6633	7378	8080	8565	9121	9486	11541	14042
Lithuania	7182	5058	7293	7310	7771	8517	9346	10000	10750	11180	13602	16549
Cyprus	.	14150	16308	18137	19469	20548	21247	22096	22980	23899	29077	35377
Malta	.	9330	11064	11720	12726	12825	13319	13852	14406	14982	18228	22178
Bulgaria	4756	4977	5758	6005	6457	7008	7672	8018	8418	8755	10652	12960
Romania	5225	5736	5001	5054	5244	5681	6111	6356	6610	6875	8364	10176
Croatia	5852	5185	7566	7511	8054	8558	9239	9609	10041	10443	12705	15458
Macedonia	3859	3748	5414	5696	6016	5855	5992	6112	6295	6547	7965	9691
Russia	7738	5741	5044	5462	6132	6627	7110	7465	7801	8113	9871	12010
Ukraine	5750	3305	3337	3403	3689	4194	4548	4821	5014	5214	6344	7718
										projection assuming 2% p.a. GDP growth and zero population growth p.a.		
Austria	15611	19826	22538	23642	25865	25843	26740	27275	27821	28377	31330	34591
Germany	13856	19772	21696	22625	24072	23997	24548	25039	25540	26051	28762	31756
Greece	8440	11652	13330	14063	14635	14851	15819	16136	16458	16788	18535	20464
Portugal	9146	12540	14546	15350	15456	16071	16595	16927	17265	17610	19443	21467
Spain	11254	14052	16480	17481	18591	19498	20488	20898	21316	21742	24005	26503
Turkey	4321	5210	5706	5477	5720	5229	5516	5626	5739	5853	6463	7135
Japan	16878	21604	22288	22767	23963	24294	24745	25240	25744	26259	28992	32010
USA	21385	25679	29124	30509	32072	32283	33550	34221	34906	35604	39309	43401
EU(15) average	14204	18003	20337	21321	22664	23296	24033	24514	25004	25505	28159	31090

European Union (15) average = 100

	1990	1995	1998	1999	2000	2001	2002	2003	2004	2005	2010	2015
Czech Republic	69	62	60	59	58	60	61	61	62	63	69	76
Hungary	50	45	48	49	49	51	52	53	54	55	60	67
Poland	32	35	39	39	39	40	41	41	41	42	46	51
Slovak Republic	52	45	50	49	48	50	51	52	54	55	61	67
Slovenia	70	64	67	68	68	69	71	71	72	74	81	90
Estonia	.	33	40	38	40	42	45	46	48	49	54	59
Latvia	.	24	28	28	29	32	34	35	36	37	41	45
Lithuania	.	28	36	34	34	37	39	41	43	44	48	53
Cyprus	.	79	80	85	86	88	88	90	92	94	103	114
Malta	.	52	54	55	56	55	55	57	58	59	65	71
Bulgaria	33	28	28	28	28	30	32	33	34	34	38	42
Romania	37	32	25	24	23	24	25	26	26	27	30	33
Croatia	41	29	37	35	36	37	38	39	40	41	45	50
Macedonia	27	21	27	27	27	25	25	25	25	26	28	31
Russia	54	32	25	26	27	28	30	30	31	32	35	39
Ukraine	40	18	16	16	16	18	19	20	20	20	23	25
Austria	110	110	111	111	114	111	111	111	111	111	111	111
Germany	98	110	107	106	106	103	102	102	102	102	102	102
Greece	59	65	66	66	65	64	66	66	66	66	66	66
Portugal	64	70	72	72	68	69	69	69	69	69	69	69
Spain	79	78	81	82	82	84	85	85	85	85	85	85
Turkey	30	29	28	26	25	22	23	23	23	23	23	23
Japan	119	120	110	107	106	104	103	103	103	103	103	103
USA	151	143	143	143	142	139	140	140	140	140	140	140
EU(15) average	100	100	100	100	100	100	100	100	100	100	100	100

Sources: Benchmark Results of the 1996 Eurostat-OECD Comparison by Analytical Categories, OECD, 1999; Purchasing Power Parities and Real Expenditures, 1999 Benchmark Year, OECD, 2002; national statistics; WIFO; **wiiw** estimates.

Benchmark PPPs for 1996 and 1999 extrapolated with GDP price deflators. GDP per capita for OECD countries according to OECD *Economic Outlook* statistics converted into EUR.

Table A/2

Indicators of macro-competitiveness, 1995-2002

EUR based (ECU until 1998), annual averages

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.
Czech Republic								
Producer price index, 1989=100	241.6	253.0	265.4	278.4	281.2	295.0	303.6	302.0
Consumer price index, 1989=100	276.7	301.0	326.6	361.6	369.2	383.6	401.6	408.8
GDP deflator, 1989=100	253.5	275.8	297.8	329.5	339.1	342.5	364.0	373.5
Exchange rate (ER), CZK/EUR	34.31	34.01	35.80	36.16	36.88	35.61	34.08	30.81
ER nominal, 1989=100	206.7	204.9	215.7	217.9	222.2	214.5	205.3	185.6
Real ER (CPI-based), 1989=100	95.8	89.4	88.6	82.2	83.2	79.1	74.1	67.2
Real ER (PPI-based), 1989=100	98.3	93.7	94.9	91.0	91.9	88.5	83.4	75.9
PPP, CZK/EUR	11.91	12.68	13.38	14.53	14.75	14.67	15.24	15.26
ERDI (EUR based)	2.88	2.68	2.68	2.49	2.50	2.43	2.24	2.02
Average monthly gross wages, CZK	8172	9676	10691	11693	12666	13499	14640	15707
Average monthly gross wages, EUR (ER)	238	285	299	323	343	379	430	510
Average monthly gross wages, EUR (PPP)	686	763	799	805	859	920	961	1030
GDP nominal, bn CZK	1381.0	1567.0	1679.9	1839.1	1902.3	1984.8	2175.2	2275.6
Employment total, 1000 persons	4962.6	4972.0	4936.5	4865.7	4764.1	4731.6	4750.2	4796.0
GDP per employed person, CZK	278291	315158	340306	377970	399297	419485	457926	474481
GDP per empl. person, CZK at 1999 pr.	372270	387489	387428	388931	399297	415355	426549	430781
Unit labour costs, 1989=100	227.9	259.3	286.5	312.2	329.4	337.5	356.4	378.6
Unit labour costs, ER adj., 1989=100	110.3	126.6	132.8	143.3	148.2	157.3	173.6	204.0
Unit labour costs, PPP adj., Austria=100	20.99	24.98	27.32	29.77	30.40	32.27	35.08	40.48
Hungary								
Producer price index, 1989=100	286.7	349.2	420.4	467.9	491.8	548.8	577.3	567.0
Consumer price index, 1989=100	399.3	493.5	583.8	667.3	734.0	805.9	880.1	926.7
GDP deflator, 1989=100	348.8	422.7	500.9	564.1	611.4	672.0	729.8	807.9
Exchange rate (ER), HUF/EUR	162.65	191.15	210.93	240.98	252.80	260.04	256.68	242.97
ER, nominal 1989=100	250.0	293.8	324.2	370.3	388.5	399.6	394.5	373.4
Real ER (CPI-based), 1989=100	80.3	78.2	74.5	75.8	73.2	70.2	64.9	59.6
Real ER (PPI-based), 1989=100	100.2	97.3	90.0	92.1	91.9	88.6	84.2	81.3
PPP, HUF/EUR	66.36	78.67	90.69	100.22	107.17	116.03	123.10	132.99
ERDI (EUR based)	2.45	2.43	2.33	2.40	2.36	2.24	2.09	1.83
Average monthly gross wages, HUF	38900	46837	57270	67764	77187	87645	103553	122453
Average monthly gross wages, EUR (ER)	239	245	272	281	305	337	403	504
Average monthly gross wages, EUR (PPP)	586	595	631	676	720	755	841	921
GDP nominal, bn HUF	5614.0	6893.9	8540.7	10087.4	11393.5	13172.3	14849.6	16980.1
Employment total, 1000 persons	3678.8	3648.1	3646.3	3697.7	3811.5	3849.1	3859.5	3870.6
GDP per employed person, HUF	1526041	1889723	2342292	2728020	2989243	3422177	3847545	4386943
GDP per empl. person, HUF at 1999 pr.	2675150	2733209	2858722	2956947	2989243	3113330	3223142	3319797
Unit labour costs, 1989=100	277.2	326.6	381.9	436.8	492.2	536.6	612.4	703.1
Unit labour costs, ER adj., 1989=100	110.9	111.2	117.8	118.0	126.7	134.3	155.3	188.3
Unit labour costs, PPP adj., Austria=100	21.31	22.16	24.46	24.75	26.23	27.81	31.68	37.73
Poland								
Producer price index, 1989=100	2837.2	3189.0	3578.0	3839.6	4058.4	4375.0	4445.0	4489.4
Consumer price index, 1989=100	3818.1	4577.9	5260.0	5880.7	6309.9	6947.2	7329.3	7468.5
GDP deflator, 1989=100	2690.0	3194.4	3642.9	4073.4	4348.3	4655.9	4849.3	4914.4
Exchange rate (ER), PLN/EUR	3.135	3.377	3.706	3.923	4.227	4.011	3.669	3.856
ER, nominal, 1989=100	1966.1	2118.3	2324.1	2460.5	2651.1	2515.7	2300.9	2418.3
Real ER (CPI-based), 1989=100	66.0	60.8	59.3	57.1	58.1	51.2	45.5	47.9
Real ER (PPI-based), 1989=100	79.6	76.9	75.8	74.5	76.0	70.0	63.8	66.5
PPP, PLN/EUR	1.2740	1.4797	1.6652	1.8274	1.9245	2.0297	2.0652	2.0425
ERDI (EUR based)	2.46	2.28	2.23	2.15	2.20	1.98	1.78	1.89
Average monthly gross wages, PLN *)	691	874	1066	1233	1697	1894	2045	2133
Average monthly gross wages, EUR (ER)	220	259	288	314	401	472	557	553
Average monthly gross wages, EUR (PPP)	542	591	640	675	882	933	990	1044
GDP nominal, bn PLN	308.1	387.8	472.4	553.6	615.1	685.0	749.3	769.4
Employment total, 1000 persons	14735.2	15020.6	15438.7	15800.4	15373.5	15017.5	14923.6	14900.0
GDP per employed person, PLN	20909	25820	30595	35035	40011	45612	50210	51639
GDP per empl. person, PLN at 1999 pr.	33799	35146	36520	37398	40011	42599	45022	45691
Unit labour costs, 1989=100	2991.2	3640.0	4270.3	4823.1	6206.6	6505.0	6646.8	6831.7
Unit labour costs, ER adj., 1989=100	152.1	171.8	183.7	196.0	234.1	258.6	288.9	282.5
Unit labour costs, PPP adj., Austria=100	27.91	32.69	36.42	39.26	46.27	51.13	56.27	54.04

*) Methodological change in 1999 (broader wage coverage).

(Table A/2 ctd.)

(Table A/2 ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.
Slovak Republic								
Producer price index, 1989=100	262.6	273.5	285.8	295.3	307.9	341.2	363.4	371.1
Consumer price index, 1989=100	300.5	317.8	337.2	359.8	397.9	445.6	477.2	493.0
GDP deflator, 1989=100	230.0	240.1	256.2	269.5	286.8	305.2	321.6	334.3
Exchange rate (ER), SKK/EUR	38.45	38.40	38.01	39.60	44.12	42.59	43.31	42.70
ER, nominal, 1989=100	231.7	231.4	229.0	238.6	265.8	256.6	260.9	257.3
Real ER (CPI-based), 1989=100	98.8	95.7	91.1	90.5	92.4	81.5	79.2	77.2
Real ER (PPI-based), 1989=100	101.4	97.9	93.5	94.0	100.4	91.5	88.5	85.6
PPP, SKK/EUR	12.95	13.22	13.62	14.07	14.77	15.48	15.94	16.17
ERDI (EUR based)	2.97	2.90	2.79	2.81	2.99	2.75	2.72	2.64
Average monthly gross wages, SKK	7195	8154	9226	10003	10728	11430	12365	13511
Average monthly gross wages, EUR (ER)	187	212	243	253	243	268	286	316
Average monthly gross wages, EUR (PPP)	556	617	677	711	726	738	776	836
GDP nominal, bn SKK	568.9	628.6	708.6	775.0	835.7	908.8	989.3	1073.6
Employment total, 1000 persons	2146.8	2224.9	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0
GDP per employed person, SKK	265010	282524	321237	352498	391971	432412	465837	504755
GDP per empl. person, SKK at 1999 pr.	330547	337573	359676	375146	391971	406380	415443	433058
Unit labour costs, 1989=100	215.7	239.4	254.2	264.2	271.2	278.7	294.9	309.2
Unit labour costs, ER adj., 1989=100	93.1	103.5	111.0	110.7	102.0	108.6	113.0	120.2
Unit labour costs, PPP adj., Austria=100	18.60	21.42	23.95	24.15	21.95	23.38	23.97	25.03
Slovenia								
Producer price index, 1989=100	5601.3	5982.4	6347.2	6727.8	6869.0	7391.3	8048.9	8459.4
Consumer price index, 1989=100	7857.9	8635.7	9360.9	10100.5	10716.2	11670.2	12650.2	13598.9
GDP deflator, 1989=100	6868.3	7633.5	8303.1	8953.7	9542.1	10557.0	11524.4	12449.5
Exchange rate (ER), SIT/EUR	153.12	169.51	180.40	186.27	193.63	205.03	217.19	226.22
ER, nominal, 1989=100	4745.5	5253.6	5591.0	5772.9	6001.0	6354.5	6731.1	7011.3
Real ER (CPI-based), 1989=100	77.4	79.9	80.1	78.0	77.4	77.0	77.1	76.3
Real ER (PPI-based), 1989=100	97.3	101.6	102.8	99.8	101.6	104.6	103.1	102.4
PPP, SIT/EUR	96.83	105.26	113.76	120.39	126.58	137.94	147.10	155.08
ERDI (EUR based)	1.58	1.61	1.59	1.55	1.53	1.49	1.48	1.46
Average monthly gross wages, SIT	111996	129125	144251	158069	173245	191669	214561	235436
Average monthly gross wages, EUR (ER)	731	762	800	849	895	935	988	1041
Average monthly gross wages, EUR (PPP)	1157	1227	1268	1313	1369	1390	1459	1518
GDP nominal, bn SIT	2221.5	2555.4	2907.3	3253.8	3648.4	4222.4	4741.0	5284.5
Employment total, 1000 persons	745.2	741.7	743.4	745.2	758.5	768.2	779.0	783.5
GDP per employed person, SIT	2980876	3445175	3910621	4366460	4810186	5496691	6085681	6744745
GDP per empl. person, SIT at 1999 pr.	4141304	4306585	4494177	4653422	4810186	4968290	5038902	5169611
Unit labour costs, 1989=100	4492.9	4981.2	5332.5	5643.3	5983.5	6409.2	7074.1	7566.1
Unit labour costs, ER adj., 1989=100	94.7	94.8	95.4	97.8	99.7	100.9	105.1	107.9
Unit labour costs, PPP adj., Austria=100	49.72	51.63	54.12	56.05	56.42	57.09	58.61	59.09
Bulgaria								
Producer price index, 1989=100	2454.4	5645.0	60462.0	71789.8	73804.8	86741.7	90010.9	91073.6
Consumer price index, 1989=100	5702.9	12637.6	146392.9	173732.5	178203.6	196584.0	211052.2	223319.1
GDP deflator, 1989=100	2897.2	6399.9	67110.2	83015.2	86086.7	91854.7	98008.9	101733.2
Exchange rate (ER), BGN/EUR	0.087	0.220	1.896	1.972	1.956	1.956	1.956	1.956
ER, nominal, 1989=100	9338.4	23704.0	203894.4	212116.3	210349.5	210349.5	210349.5	210349.5
Real ER (CPI-based), 1989=100	209.9	246.5	186.8	166.7	163.2	151.4	144.4	139.3
Real ER (PPI-based), 1989=100	437.2	485.8	393.5	343.6	331.5	295.1	288.1	285.2
PPP, BGN/EUR	0.02104	0.04546	0.3885	0.4716	0.4825	0.5071	0.5286	0.5354
ERDI (EUR based)	4.13	4.85	4.88	4.18	4.05	3.86	3.70	3.65
Average monthly gross wages, BGN	8	13	128	183	201	225	240	272
Average monthly gross wages, EUR (ER)	87	60	67	93	103	115	123	139
Average monthly gross wages, EUR (PPP)	361	291	329	389	417	443	454	508
GDP nominal, bn BGN	0.9	1.8	17.4	22.4	23.8	26.8	29.7	32.3
Employment total, 1000 persons	3282.2	3285.9	3157.4	3152.6	3087.8	2980.1	2968.1	2992.2
GDP per employed person, BGN	268	536	5521	7112	7705	8977	10010	10803
GDP per empl. person, BGN at 1999 pr.	7970	7210	7082	7375	7705	8413	8792	9141
Unit labour costs, 1989=100	2712.7	5228.7	51394.5	70706.6	74239.8	75933.5	77680.7	84676.0
Unit labour costs, ER adj., 1989=100	29.0	22.1	25.2	33.3	35.3	36.1	36.9	40.3
Unit labour costs, PPP adj., Austria=100	11.78	9.28	11.04	14.76	15.42	15.78	15.90	17.02

(Table A/2 ctd.)

(Table A/2 ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.
Romania								
Producer price index, 1989=100	9961.1	14928.8	37725.0	50235.3	72589.7	111353.7	157008.9	195632.6
Consumer price index, 1989=100	9829.0	13643.6	34758.8	55300.0	80629.4	117450.2	157970.5	193513.9
GDP deflator, 1989=100	10633.6	15453.6	38220.3	58917.0	87060.2	125120.3	172536.9	213088.3
Exchange rate (ER), ROL/EUR	2629.51	3862.90	8090.92	9989.25	16295.57	19955.75	26026.89	31255.25
ER, nominal, 1989=100	15984.9	23482.7	49184.9	60724.9	99061.2	121311.6	158218.2	190001.5
Real ER (CPI-based), 1989=100	208.5	226.2	189.8	149.9	169.9	146.2	145.1	145.2
Real ER (PPI-based), 1989=100	184.4	182.0	152.2	140.6	158.7	132.6	124.2	119.9
PPP, ROL/EUR	554.52	788.18	2180.1	3298.2	4808.2	6806.5	9169.1	11051.2
ERDI (EUR based)	4.74	4.90	3.71	3.03	3.39	2.93	2.84	2.83
Average monthly grross wages, ROL	281287	426610	846450	1357132	1957731	2876645	4282622	5452097
Average monthly gross wages, EUR (ER)	107	110	105	136	120	144	165	174
Average monthly gross wages, EUR (PPP)	507	541	388	411	407	423	467	493
GDP nominal, bn ROL	72135.5	108919.6	252925.7	371193.8	545730.2	800773.1	1167242.8	1512256.6
Employment total, 1000 persons	9752.0	9436.0	9200.9	8917.7	8616.3	8524.5	8596.0	8600
GDP per employed person, ROL	7396995	11542984	27489384	41624621	63336954	93937838	135789065	175843791
GDP per empl. person, ROL at 1999 pr.	60561542	65029137	62616737	61507755	63336954	65363116	68517681	71843487
Unit labour costs, 1989=100	9711.4	13716.8	28264.5	46134.1	64628.8	92020.3	130688.4	158674.2
Unit labour costs, ER adj., 1989=100	60.8	58.4	57.5	76.0	65.2	75.9	82.6	83.5
Unit labour costs, PPP adj., Austria=100	18.89	18.83	19.30	25.79	21.85	25.42	27.27	27.07
Estonia								
Producer price index, 1992=100	299.9	344.3	374.6	390.4	385.7	404.6	422.4	424.1
Consumer price index, 1992=100	361.7	445.2	495.1	535.7	553.3	575.5	608.9	630.8
GDP deflator, 1992=100	333.5	411.3	457.7	502.4	524.8	559.9	589.2	613.5
Exchange rate (ER), EEK/EUR	14.819	15.074	15.670	15.783	15.647	15.647	15.647	15.647
ER, nominal, 1992=100	93.2	94.8	98.5	99.2	98.4	98.4	98.4	98.4
Real ER (CPI-based), 1992=100	28.4	24.0	22.9	21.7	21.1	20.8	20.1	19.8
Real ER (PPI-based), 1992=100	33.6	30.0	28.9	27.8	27.9	27.8	27.0	26.9
PPP, EEK/EUR	4.829	5.8255	6.093	6.564	6.764	7.108	7.308	7.425
ERDI (EUR based)	3.07	2.59	2.57	2.40	2.31	2.20	2.14	2.11
Average monthly gross wages, EEK	2375	2985	3573	4125	4440	4907	5510	6144
Average monthly gross wages, EUR (ER)	160	198	228	261	284	314	352	393
Average monthly gross wages, EUR (PPP)	492	512	586	628	656	690	754	827
GDP nominal, bn EEK	40.9	52.4	64.0	73.5	76.3	87.4	97.9	108.0
Employment total, 1000 persons	633.4	619.3	617.2	606.5	579.3	572.5	577.7	585.5
GDP per employed person, EEK	64567	84648	103767	121250	131757	152626	169456	184498
GDP per empl. person, EEK at 1999 pr.	101610	108002	118978	126650	131757	143061	150929	157828
Unit labour costs, 1992=100	386.1	456.6	496.1	538.0	556.7	566.6	603.1	643.1
Unit labour costs, ER adj., 1992=100	414.5	481.8	503.6	542.3	565.9	576.0	613.1	653.8
Unit labour costs, PPP adj., Austria=100	23.73	28.60	31.15	33.89	34.91	35.54	37.27	39.03
Latvia								
Producer price index, 1992=100	284.0	322.9	336.1	342.5	328.8	330.8	336.4	339.8
Consumer price index, 1992=100	355.4	417.9	453.0	474.3	485.7	498.3	510.8	520.5
GDP deflator, 1992=100	272.8	317.1	340.8	357.4	376.4	393.8	403.8	410.9
Exchange rate (ER), LVL/EUR	0.6818	0.6900	0.6574	0.6614	0.6237	0.5600	0.5627	0.5826
ER, nominal, 1992=100	78.5	79.5	75.7	76.2	71.9	64.5	64.8	67.1
Real ER (CPI-based), 1992=100	24.3	21.5	19.3	18.8	17.6	15.7	15.8	16.4
Real ER (PPI-based), 1992=100	29.9	26.8	24.7	24.3	23.9	22.3	22.4	22.9
PPP, LVL/EUR	0.2145	0.2438	0.2509	0.2583	0.2683	0.2765	0.2770	0.2751
ERDI (EUR based)	3.18	2.83	2.62	2.56	2.32	2.03	2.03	2.12
Average monthly gross wages, LVL	90	99	120	133	141	150	159	173
Average monthly gross wages, EUR (ER)	131	143	183	202	226	267	283	297
Average monthly gross wages, EUR (PPP)	417	405	478	516	525	541	574	629
GDP nominal, bn LVL	2.33	2.81	3.27	3.59	3.89	4.35	4.81	5.19
Employment total, 1000 persons	973.0	949.0	990.0	986.0	968.0	941.0	962.0	989.0
GDP per employed person, LVL	2394	2958	3303	3643	4018	4621	5003	5252
GDP per empl. person, LVL at 1999 pr.	3302	3511	3647	3836	4018	4416	4663	4811
Unit labour costs, 1992=100	395.8	410.7	480.6	507.5	512.4	494.4	498.0	525.2
Unit labour costs, ER adj., 1992=100	503.9	516.7	634.6	666.0	713.1	766.4	768.1	782.4
Unit labour costs, PPP adj., Austria=100	23.72	25.22	32.28	34.23	36.17	38.88	38.40	38.40

(Table A/2 ctd.)

(Table A/2 ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.
Lithuania								
Producer price index, 1992=100	914.0	1064.8	1128.7	1084.6	1117.2	1318.3	1301.2	1293.4
Consumer price index, 1992=100	1227.0	1528.8	1664.9	1749.8	1763.8	1781.4	1804.6	1810.0
GDP deflator, 1992=100	931.9	1132.7	1293.2	1362.6	1357.8	1369.9	1366.6	1366.5
Exchange rate (ER), LTL/EUR	5.1717	5.0118	4.5272	4.4924	4.2712	3.6990	3.5849	3.4605
ER, nominal, 1992=100	225.0	218.0	196.9	195.4	185.8	160.9	155.9	150.5
Real ER (CPI-based), 1992=100	20.2	16.1	13.6	13.1	12.5	11.0	10.8	10.6
Real ER (PPI-based), 1992=100	26.6	22.3	19.2	19.7	18.2	14.0	13.9	13.5
PPP, LTL/EUR	1.3500	1.6054	1.627	1.683	1.654	1.644	1.602	1.563
ERDI (EUR based)	3.83	3.12	2.78	2.67	2.58	2.25	2.24	2.21
Average monthly gross wages, LTL	481	618	778	930	987	971	982	1034
Average monthly gross wages, EUR (ER)	93	123	172	207	231	262	274	299
Average monthly gross wages, EUR (PPP)	356	385	478	553	597	591	613	661
GDP nominal, bn LTL	24.8	31.5	38.5	43.6	42.6	44.7	47.5	50.7
Employment total, 1000 persons	1643.6	1659.0	1669.2	1656.1	1647.5	1586.0	1521.8	1405
GDP per employed person, LTL	15077	19005	23077	26299	25862	28183	31212	36070
GDP per empl. person, LTL at 1999 pr.	21967	22781	24229	26206	25862	27934	31009	35841
Unit labour costs, 1992=100	1063.5	1318.3	1560.1	1723.6	1854.7	1688.3	1538.9	1401.1
Unit labour costs, ER adj., 1992=100	472.7	604.7	792.2	882.0	998.3	1049.3	986.8	930.8
Unit labour costs, PPP adj., Austria=100	15.57	20.65	28.19	31.72	35.43	37.25	34.51	31.97
Croatia								
Producer price index, 1989=100	365072.8	370183.9	378698.3	374153.9	383881.7	421118.3	436278.3	434533.3
Consumer price index, 1989=100	394858.7	408679.1	423391.3	447530.6	466326.7	495238.8	519505.8	530935.2
GDP deflator, 1989=100	309216.7	320477.1	344066.9	373062.5	387324.9	405475.9	417257.0	429563.9
Exchange rate (ER), HRK/EUR	6.76	6.80	6.96	7.14	7.58	7.63	7.47	7.41
ER, nominal, 1989=100	209442.2	210895.8	215699.6	221182.2	234912.7	236628.2	231483.2	229555.6
Real ER (CPI-based), 1989=100	68.0	67.8	68.3	67.5	69.7	67.6	64.6	63.9
Real ER (PPI-based), 1989=100	65.9	65.9	66.5	68.8	71.2	68.4	65.4	65.2
PPP, HRK/EUR	4.064	4.119	3.797	4.041	4.139	4.268	4.290	4.311
ERDI (EUR based)	1.66	1.65	1.83	1.77	1.83	1.79	1.74	1.72
Average monthly gross wages, HRK	2887	3243	3668	4131	4551	4869	5061	5366
Average monthly gross wages, EUR (ER)	427	477	527	579	600	638	678	724
Average monthly gross wages, EUR (PPP)	710	787	966	1022	1100	1141	1180	1245
GDP nominal, bn HRK	98.4	108.0	123.8	137.6	141.6	152.5	162.9	176.4
Employment total, 1000 persons	1417.4	1329.5	1310.9	1384.8	1364.5	1341.0	1348.3	1340.8
GDP per employed person, HRK	69410	81219	94447	99364	103759	113739	120825	131582
GDP per empl. person, HRK at 1999 pr.	86943	98160	106322	103163	103759	108647	112157	118644
Unit labour costs, 1989=100	253947.6	252664.5	263840.3	306241.5	335438.2	342731.6	345097.3	345891.2
Unit labour costs, ER adj., 1989=100	121.2	119.8	122.3	138.5	142.8	144.8	149.1	150.7
Unit labour costs, PPP adj., Austria=100	45.23	46.34	49.30	56.39	57.39	58.23	59.05	58.61
Macedonia								
Producer price index, 1989=100	170868.8	170357.8	177512.8	184616.7	184429.3	204156.7	208245.3	206371.4
Consumer price index, 1989=100	288886.7	295385.2	303065.2	302769.8	300643.1	318070.8	333667.1	341937.9
GDP deflator, 1990=100	42493.5	43708.8	45429.8	46050.2	47329.3	51225.9	53075.7	54047.9
Exchange rate (ER), MKD/EUR	49.15	50.08	56.20	61.07	60.62	60.73	60.91	60.98
ER, nominal, 1989=100	152643.3	155515.9	174525.6	189641.9	188247.5	188584.8	189169.5	189371.4
Real ER (CPI-based), 1989=100	67.7	69.2	77.2	85.5	86.6	83.9	82.1	81.9
Real ER (PPI-based), 1989=100	102.6	105.6	114.7	119.5	118.7	112.4	112.0	113.3
PPP, MKD/EUR	23.01	23.14	18.03	17.94	18.19	19.39	19.63	19.51
ERDI (EUR based)	2.14	2.16	3.12	3.40	3.33	3.13	3.10	3.13
Average monthly net wages, MKD	8581	8817	9063	9394	9664	10193	10552	11279
Average monthly net wages, EUR (ER)	175	176	161	154	159	168	173	185
Average monthly net wages, EUR (PPP)	373	381	503	524	531	526	538	578
GDP nominal, bn MKD	169.5	176.4	186.0	195.0	209.0	236.4	233.8	238.9
Employment total, 1000 persons	.	537.6	512.3	539.8	545.2	549.8	599.3	561.3
GDP per employed person, MKD	.	328212	363103	361231	383348	429919	390185	425570
GDP per empl. person, MKD at 1999 pr.	.	355399	378285	371265	383348	397216	347941	372668
Unit labour costs, 1990=100	.	.	.	.	.	.	.	.
Unit labour costs, ER adj., 1990=100	.	.	.	.	.	.	.	.
Unit labour costs, PPP adj., Austria=100	.	20.78	18.63	18.30	18.13	18.42	21.39	20.94

(Table A/2 ctd.)

(Table A/2 ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.
Russia								
Producer price index, 1989=100	899321	1356086	1559505	1670224	2653986	3890743	4631930	5176181
Consumer price index, 1989=100	388817	574672	659723	841807	1563235	1888388	2296280	2663684
GDP deflator, 1989=100	414251	603989	694937	823777	1420080	1955429	2304291	2655094
Exchange rate (ER), RUB/EUR	5.89	6.63	6.54	11.06	26.24	26.03	26.13	29.65
ER, nominal, 1989=100	848366	954960	941800	1592973	3778114	3747905	3762448	4268826
Real ER (CPI-based), 1989=100	279.7	218.4	191.4	258.3	334.3	280.8	237.4	237.0
Real ER (PPI-based), 1989=100	108.4	81.5	70.5	110.9	165.6	117.2	100.2	101.9
PPP, RUB/EUR	1.6795	2.395	3.050	3.549	6.035	8.185	9.423	10.596
ERDI (EUR based)	3.51	2.77	2.14	3.12	4.35	3.18	2.77	2.80
Average monthly gross wages, RUB	532.6	790.2	950.2	1051.5	1522.6	2223.4	3240.4	4426.0
Average monthly gross wages, EUR (ER)	90	119	145	95	58	85	124	149
Average monthly gross wages, EUR (PPP)	317	330	312	296	252	272	344	418
GDP nominal, bn RUB	1428.5	2007.8	2342.5	2629.6	4823.2	7305.6	9039.4	10863.4
Employment total, 1000 persons	66409	65950	64693	63812	63963	64327	64710	65650
GDP per employed person, RUB	21511	30444	36209	41209	75406	113570	139691	165474
GDP per empl. person, RUB at 1999 pr.	73740	71580	73993	71038	75406	82477	86088	88504
Unit labour costs, 1989=100	302358	462124	537568	619619	845256	1128470	1575654	2093406
Unit labour costs, ER adj., 1989=100	35.6	48.4	57.1	38.9	22.4	30.1	41.9	49.0
Unit labour costs, PPP adj., Austria=100	16.45	23.17	28.47	19.60	11.13	14.98	20.53	23.61
Ukraine								
Producer price index, 1989=100	19914767	30290361	32622718	36928917	48413810	58532296	63566073	65536621
Consumer price index, 1989=100	6786409	12229109	14172537	15674826	19233012	24656721	27615528	27836452
GDP deflator, 1989=100	7715454	12819488	15140086	16950568	21587839	26575880	29218423	30167424
Exchange rate (ER), UAH/EUR	1.928	2.322	2.113	2.768	4.393	5.029	4.814	5.030
ER, nominal, 1989=100	27739568	33408633	30401439	39821583	63212950	72357554	69260000	72375540
Real ER (CPI-based), 1989=100	524.0	359.0	287.7	346.8	454.5	415.2	363.4	384.5
Real ER (PPI-based), 1989=100	160.0	127.6	108.8	125.4	151.9	150.4	134.3	136.4
PPP, UAH/EUR	0.3201	0.5201	0.5563	0.6112	0.7680	0.9313	1.0002	1.0078
ERDI (EUR based)	6.02	4.46	3.80	4.53	5.72	5.40	4.81	4.99
Average monthly gross wages, UAH	73.0	126.0	143.0	153.0	177.5	230.1	311.1	376.4
Average monthly gross wages, EUR (ER)	38	54	68	55	40	46	65	75
Average monthly gross wages, EUR (PPP)	228	242	257	250	231	247	311	373
GDP nominal, bn UAH	54.5	81.5	93.4	102.6	130.4	170.1	204.2	220.9
Employment total, 1000 persons	23725.5	23231.8	22597.6	22348.7	21823.7	21268.5	20941.9	20100
GDP per employed person, UAH	2298	3509	4132	4591	5977	7996	9750	10992
GDP per empl. person, UAH at 1999 pr.	6429	5909	5891	5846	5977	6495	7204	7866
Unit labour costs, 1989=100	6821887	12811424	14583936	15723252	17844302	21286399	25944340	28749769
Unit labour costs, ER adj., 1989=100	24.6	38.3	48.0	39.5	28.2	29.4	37.5	39.7
Unit labour costs, PPP adj., Austria=100	10.06	16.26	21.20	17.63	12.44	12.97	16.27	16.94
Austria								
Producer price index, 1989=100	104.8	104.8	105.2	104.7	103.7	107.9	109.6	109.2
Consumer price index, 1989=100	121.1	123.3	125.0	126.1	126.8	129.8	133.3	135.7
GDP deflator, 1989=100	120.4	122.0	123.1	123.7	124.5	126.3	128.4	129.9
Exchange rate (ER), ATS-EUR/EUR	0.9471	0.9636	1.0017	1.0089	1.0000	1.0000	1.0000	1.0000
ER, nominal, 1989=100	89.5	91.0	94.6	95.3	94.5	94.5	94.5	94.5
Real ER (CPI-based), 1989=100	94.8	97.0	101.6	103.2	103.0	103.0	102.7	103.0
Real ER (PPI-based), 1989=100	98.1	100.5	105.0	105.9	105.9	106.6	106.3	106.8
PPP, ATS-EUR/EUR	1.0800	1.0697	1.0487	1.0581	1.0305	0.9883	1.0122	1.0013
ERDI (EUR based)	0.88	0.90	0.96	0.95	0.97	1.01	0.99	1.00
Average monthly gross wages, EUR-ATS	2140	2157	2180	2245	2295	2356	2396	2459
Average monthly gross wages, EUR (ER)	2260	2239	2177	2225	2295	2356	2396	2459
Average monthly gross wages, EUR (PPP)	1982	2016	2079	2121	2227	2384	2368	2456
GDP nominal, bn EUR-ATS	172.3	178.0	182.5	190.6	197.2	207.0	211.9	216.6
Employment total, 1000 persons	3439.5	3415.4	3424.5	3446.6	3478.8	3506.5	3522.5	3532.9
GDP per employed person, EUR-ATS	50090	52131	53289	55309	56673	59044	60144	61309
GDP per empl. person, EUR-ATS at 1999 pr.	51796	53199	53895	55667	56673	58202	58317	58756
Unit labour costs, 1989=100	120.8	118.5	118.2	117.9	118.4	118.3	120.1	122.3
Unit labour costs, ER adj., 1989=100	135.0	130.2	124.9	123.7	125.3	125.3	127.1	129.5
Unit labour costs, PPP adjusted	0.54	0.52	0.50	0.49	0.50	0.50	0.51	0.52

Employment: Employees + self-employed + farmers.

ER = Exchange Rate, PPP = Purchasing Power Parity, ERDI = Exchange Rate Deviation Index (all in terms of national currency per EUR). Till 1996 PPPs have been calculated using the benchmark PPPs for 1996 and extrapolated with GDP deflators, from 1997 using benchmark PPPs for 1999 and extrapolated with GDP deflators.

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

Sources: Benchmark Results of the 1996 Eurostat-OECD Comparison by Analytical Categories, OECD, 1999; Purchasing Power Parities and Real Expenditures, 1999 Benchmark Year, OECD, 2002; national statistics; WIFO; **wiiw** estimates.

Table A3

Indicators of macro-competitiveness, 1995-2002

annual changes in %

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.	1996-02 average
Czech Republic									
GDP deflator	10.2	8.8	8.0	10.6	2.9	1.0	6.3	2.6	6.7
Exchange rate (ER), CZK/EUR	0.7	-0.9	5.3	1.0	2.0	-3.4	-4.3	-9.6	-1.8
Real ER (CPI-based)	-4.9	-6.6	-1.0	-7.1	1.2	-4.9	-6.4	-9.4	-5.7
Real ER (PPI-based)	-2.2	-4.7	1.2	-4.0	1.0	-3.7	-5.8	-9.0	-4.2
Average gross wages, CZK	18.5	18.4	10.5	9.4	8.3	6.6	8.5	7.3	11.5
Average gross wages, real (PPI based)	10.2	13.1	5.3	4.3	7.2	1.6	5.4	7.8	7.4
Average gross wages, real (CPI based)	8.6	8.8	1.8	-1.2	6.1	2.6	3.6	5.4	4.5
Average gross wages, EUR (ER)	17.7	19.5	4.9	8.3	6.2	10.4	13.3	18.7	13.5
Employment total	0.7	0.2	-0.7	-1.4	-2.1	-0.7	0.4	1.0	-0.6
GDP per empl. person, CZK at 1999 pr.	5.2	4.1	0.0	0.4	2.7	4.0	2.7	1.0	2.5
Unit labour costs, CZK at 1999 prices	12.7	13.8	10.5	8.9	5.5	2.5	5.6	6.2	8.8
Unit labour costs, ER (EUR) adjusted	11.9	14.8	5.0	7.9	3.5	6.1	10.3	17.5	10.8
Hungary									
GDP deflator	25.5	21.2	18.5	12.6	8.4	9.9	8.6	10.7	15.0
Exchange rate (ER), HUF/EUR	30.3	17.5	10.3	14.2	4.9	2.9	-1.3	-5.3	6.9
Real ER (CPI-based)	4.8	-2.5	-4.8	1.7	-3.4	-4.2	-7.4	-8.2	-4.8
Real ER (PPI-based)	5.6	-2.8	-7.6	2.3	-0.2	-3.5	-4.9	-3.4	-3.4
Average gross wages, HUF	16.8	20.4	22.3	18.3	13.9	13.5	18.2	18.3	21.1
Average gross wages, real (PPI based)	-9.4	-1.1	1.6	6.3	8.4	1.7	12.3	20.4	8.1
Average gross wages, real (CPI based)	-8.9	-2.6	3.4	3.5	3.6	3.4	8.2	12.3	5.2
Average gross wages, EUR (ER)	-10.4	2.5	10.8	3.6	8.6	10.4	19.7	24.9	13.2
Employment total	-1.9	-0.8	0.0	1.4	3.1	1.0	0.3	0.3	0.9
GDP per empl. person, HUF at 1999 pr.	4.5	2.2	4.6	3.4	1.1	4.2	3.5	3.0	3.7
Unit labour costs, HUF at 1999 prices	11.7	17.8	16.9	14.4	12.7	9.0	14.1	14.8	16.8
Unit labour costs, ER (EUR) adjusted	-14.3	0.3	5.9	0.1	7.4	6.0	15.6	21.3	9.2
Poland									
GDP deflator	28.6	18.8	14.0	11.8	6.7	7.1	4.2	1.3	10.6
Exchange rate (ER), PLN/EUR	16.3	7.7	9.7	5.9	7.7	-5.1	-8.5	5.1	3.5
Real ER (CPI-based)	-6.2	-7.9	-2.6	-3.6	1.7	-11.8	-11.2	5.3	-5.2
Real ER (PPI-based)	-3.1	-3.5	-1.4	-1.7	1.9	-7.9	-8.8	4.2	-3.0
Average gross wages, PLN *)	31.6	26.5	21.9	15.7	10.6	11.6	8.0	4.3	16.3
Average gross wages, real (PPI based)	4.9	12.6	8.6	7.8	30.3	3.5	6.3	3.3	11.8
Average gross wages, real (CPI based)	3.0	5.5	6.1	3.5	28.3	1.3	2.4	2.4	7.9
Average gross wages, EUR (ER)	13.2	17.4	11.1	9.2	27.8	17.6	18.1	-0.8	16.6
Employment total	1.8	1.9	2.8	2.3	-2.7	-2.3	-0.6	-0.2	0.2
GDP per empl. person, PLN at 1999 pr.	11.8	4.0	3.9	2.4	7.0	6.5	5.7	1.5	5.2
Unit labour costs, PLN at 1999 prices	17.7	21.7	17.3	12.9	28.7	4.8	2.2	2.8	14.8
Unit labour costs, ER (EUR) adjusted	1.2	12.9	6.9	6.7	19.4	10.5	11.7	-2.2	10.9
Slovak Republic									
GDP deflator	9.9	4.4	6.7	5.2	6.4	6.4	5.4	3.9	6.4
Exchange rate (ER), SKK/EUR	1.4	-0.1	-1.0	4.2	11.4	-3.5	1.7	-1.4	1.8
Real ER (CPI-based)	-4.9	-3.2	-4.8	-0.6	2.1	-11.8	-2.8	-2.6	-4.0
Real ER (PPI-based)	-2.8	-3.5	-4.5	0.5	6.8	-8.8	-3.3	-3.3	-2.8
Average gross wages, SKK	14.3	13.3	13.1	8.4	7.2	6.5	8.2	9.3	11.1
Average gross wages, real (PPI based)	4.9	8.8	8.3	5.0	2.8	-3.8	1.6	7.0	4.9
Average gross wages, real (CPI based)	4.0	7.1	6.6	1.6	-3.0	-4.9	1.0	5.8	2.3
Average gross wages, EUR (ER)	12.8	13.5	14.3	4.1	-3.7	10.4	6.4	10.8	9.1
Employment total	1.7	3.6	-0.9	-0.3	-3.0	-1.4	1.0	0.2	-0.2
GDP per empl. person, SKK at 1999 pr.	4.7	2.1	6.5	4.3	4.5	3.7	2.2	4.2	4.6
Unit labour costs, SKK at 1999 prices	9.2	11.0	6.2	4.0	2.6	2.8	5.8	4.8	6.2
Unit labour costs, ER (EUR) adjusted	7.7	11.1	7.3	-0.2	-7.9	6.5	4.1	6.3	4.3
Slovenia									
GDP deflator	15.2	11.1	8.8	7.8	6.6	10.6	9.2	8.0	10.4
Exchange rate (ER), SIT/EUR	0.5	10.7	6.4	3.3	4.0	5.9	5.9	4.2	6.7
Real ER (CPI-based)	-8.8	3.2	0.2	-2.6	-0.7	-0.5	0.1	-1.1	-0.3
Real ER (PPI-based)	-6.9	4.4	1.2	-2.9	1.8	3.0	-1.4	-0.7	0.8
Average gross wages, SIT	18.4	15.3	11.7	9.6	9.6	10.6	11.9	9.7	13.2
Average gross wages, real (PPI based)	4.9	8.0	5.3	3.4	7.3	2.8	2.8	4.4	5.7
Average gross wages, real (CPI based)	4.3	4.9	3.1	1.6	3.3	1.6	3.3	2.1	3.3
Average gross wages, EUR (ER)	17.8	4.1	5.0	6.1	5.4	4.5	5.7	5.3	6.1
Employment total	-0.1	-0.5	0.2	0.2	1.8	1.3	1.4	0.6	0.8
GDP per empl. person, SIT at 1999 pr.	4.2	4.0	4.4	3.5	3.4	3.3	1.4	2.6	3.8
Unit labour costs, SIT at 1999 prices	13.5	10.9	7.1	5.8	6.0	7.1	10.4	7.0	9.1
Unit labour costs, ER (EUR) adjusted	13.0	0.1	0.6	2.5	2.0	1.2	4.2	2.7	2.2

*) Methodological change in 1999 (broader wage coverage). Growth in 1999 comparable according to new methodology.

(Table A/3 ctd.)

Table A3 (ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.	1996-02 average
Bulgaria									
GDP deflator	62.7	120.9	948.6	23.7	3.7	6.7	6.7	3.8	81.0
Exchange rate (ER), BGN/EUR	34.4	153.8	760.2	4.0	-0.8	0.0	0.0	0.0	68.1
Real ER (CPI-based)	-14.5	17.4	-24.2	-10.8	-2.0	-7.3	-4.6	-3.5	-6.6
Real ER (PPI-based)	-8.5	11.1	-19.0	-12.7	-3.5	-11.0	-2.4	-1.0	-6.9
Average gross wages, BGN	53.2	74.4	865.6	43.3	9.7	11.7	6.9	13.3	81.5
Average gross wages, real (PPI based)	-0.2	-24.2	-9.9	20.7	6.7	-5.0	3.0	12.0	-0.6
Average gross wages, real (CPI based)	-5.5	-21.3	-16.6	20.7	6.9	1.2	-0.4	7.1	-1.5
Average gross wages, EUR (ER)	13.9	-31.3	12.3	37.7	10.6	11.7	6.9	13.3	8.0
Employment total	1.3	0.1	-3.9	-0.2	-2.1	-3.5	-0.4	0.8	-1.5
GDP per empl. person, BGN at 1999 pr.	1.6	-9.5	-1.8	4.1	4.5	9.2	4.5	4.0	2.3
Unit labour costs, BGN at 1999 prices	50.7	92.8	882.9	37.6	5.0	2.3	2.3	9.0	77.4
Unit labour costs, ER (EUR) adjusted	12.1	-24.1	14.3	32.2	5.9	2.3	2.3	9.0	5.6
Romania									
GDP deflator	35.3	45.3	147.3	54.2	47.8	43.7	37.9	23.5	64.8
Exchange rate (ER), ROL/EUR	33.6	46.9	109.5	23.5	63.1	22.5	30.4	20.1	51.1
Real ER (CPI-based)	4.1	8.5	-16.1	-21.0	13.4	-14.0	-0.7	0.1	-5.8
Real ER (PPI-based)	3.3	-1.3	-16.4	-7.6	12.9	-16.5	-6.3	-3.5	-6.9
Average gross wages, ROL	54.8	51.7	98.4	60.3	44.3	46.9	48.9	27.3	63.9
Average gross wages, real (PPI based)	14.6	1.2	-21.5	20.4	-0.2	-4.2	5.6	2.2	-0.2
Average gross wages, real (CPI based)	17.1	9.3	-22.1	0.8	-1.1	0.9	10.7	3.9	-0.3
Average gross wages, EUR (ER)	15.8	3.2	-5.3	29.9	-11.6	20.0	14.1	6.0	8.5
Employment total	-2.8	-3.2	-2.5	-3.1	-3.4	-1.1	0.8	0.0	-2.1
GDP per empl. person, ROL at 1999 pr.	10.3	7.4	-3.7	-1.8	3.0	3.2	4.8	4.9	2.9
Unit labour costs, ROL at 1999 prices	40.4	41.2	106.1	63.2	40.1	42.4	42.0	21.4	59.3
Unit labour costs, ER (EUR) adjusted	5.1	-3.9	-1.6	32.2	-14.1	16.3	8.9	1.1	5.4
Estonia									
GDP deflator	31.3	23.3	11.3	9.8	4.5	6.7	5.2	4.1	10.7
Exchange rate (ER), EEK/EUR	-3.4	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.9
Real ER (CPI-based)	-22.9	-15.3	-4.6	-5.2	-2.8	-1.6	-3.2	-1.5	-5.8
Real ER (PPI-based)	-19.7	-10.8	-3.6	-3.7	0.3	-0.2	-3.0	-0.2	-3.6
Average gross wages, EEK	37.0	25.7	19.7	15.4	7.6	10.5	12.3	11.5	17.2
Average gross wages, real (PPI based)	9.1	9.5	10.0	10.8	8.9	5.4	7.6	11.1	10.6
Average gross wages, real (CPI based)	6.2	2.1	7.6	6.7	4.2	6.3	6.1	7.6	6.8
Average gross wages, EUR (ER)	41.9	23.6	15.1	14.6	8.6	10.5	12.3	11.5	16.1
Employment total	-6.2	-2.2	-0.3	-1.7	-4.5	-1.2	0.9	1.4	-1.3
GDP per empl. person, EEK at 1999 pr.	11.2	6.3	10.2	6.4	4.0	8.6	5.5	4.6	7.6
Unit labour costs, EEK at 1999 prices	23.2	18.2	8.7	8.5	3.5	1.8	6.4	6.6	8.9
Unit labour costs, ER (EUR) adjusted	27.6	16.2	4.5	7.7	4.4	1.8	6.4	6.6	7.9
Latvia									
GDP deflator	15.0	16.2	7.5	4.9	5.3	4.6	2.5	1.8	7.1
Exchange rate (ER), LVL/EUR	2.9	1.2	-4.7	0.6	-5.7	-10.2	0.5	3.5	-2.6
Real ER (CPI-based)	-15.1	-11.8	-10.3	-2.2	-6.7	-10.5	0.4	3.7	-6.4
Real ER (PPI-based)	-3.9	-10.4	-7.7	-1.6	-1.8	-6.6	0.1	2.7	-4.3
Average gross wages, LVL	24.5	10.3	21.6	11.1	5.8	6.1	6.3	8.8	11.6
Average gross wages, real (PPI based)	11.3	-3.0	16.8	9.0	10.2	5.4	4.6	7.7	8.3
Average gross wages, real (CPI based)	-0.4	-6.2	12.2	6.1	3.3	3.4	3.7	6.8	4.7
Average gross wages, EUR (ER)	21.0	9.0	27.6	10.4	12.2	18.1	5.8	5.1	14.6
Employment total	-3.5	-2.5	4.3	-0.4	-1.8	-2.8	2.2	2.8	0.3
GDP per empl. person, LVL at 1999 pr.	2.7	6.3	3.9	5.2	4.7	9.9	5.6	3.2	6.5
Unit labour costs, LVL at 1999 prices	21.2	3.8	17.0	5.6	1.0	-3.5	0.7	5.5	4.8
Unit labour costs, ER (EUR) adjusted	17.8	2.5	22.8	4.9	7.1	7.5	0.2	1.9	7.6
Lithuania									
GDP deflator	41.9	21.5	14.2	5.4	-0.4	0.9	-0.2	0.0	6.6
Exchange rate (ER), LTL/EUR	9.7	-3.1	-9.7	-0.8	-4.9	-13.4	-3.1	-3.5	-6.5
Real ER (CPI-based)	-19.0	-20.3	-15.3	-3.9	-4.4	-12.3	-2.0	-1.8	-10.2
Real ER (PPI-based)	-10.7	-16.2	-14.0	2.9	-7.7	-23.2	-0.5	-2.7	-10.7
Average gross wages, LTL	47.8	28.6	25.9	19.5	6.2	-1.7	1.2	5.2	13.6
Average gross wages, real (PPI based)	15.2	10.3	18.7	24.3	3.1	-16.7	2.5	5.9	7.2
Average gross wages, real (CPI based)	5.9	3.2	15.6	13.7	5.4	-2.7	-0.1	4.9	6.5
Average gross wages, EUR (ER)	34.7	32.7	39.3	20.4	11.7	13.5	4.4	9.0	21.5
Employment total	-1.9	0.9	0.6	-0.8	-0.5	-3.7	-4.0	-7.7	-2.6
GDP per empl. person, LTL at 1999 pr.	5.3	3.7	6.4	8.2	-1.3	8.0	11.0	15.6	8.5
Unit labour costs, LTL at 1999 prices	40.4	24.0	18.3	10.5	7.6	-9.0	-8.9	-9.0	4.7
Unit labour costs, ER (EUR) adjusted	28.0	27.9	31.0	11.3	13.2	5.1	-5.9	-5.7	12.0

(Table A/3 ctd.)

Table A3 (ctd.)

	1995	1996	1997	1998	1999	2000	2001	2002 prelim.	1996-02 average
Croatia									
GDP deflator	5.3	3.6	7.4	8.4	3.8	4.7	2.9	2.9	5.6
Exchange rate (ER), HRK/EUR	-4.7	0.7	2.3	2.5	6.2	0.7	-2.2	-0.8	1.5
Real ER (CPI-based)	-3.7	-0.3	0.8	-1.3	3.3	-3.0	-4.5	-1.0	-1.0
Real ER (PPI-based)	-1.1	0.0	0.8	3.4	3.5	-3.9	-4.3	-0.3	-0.2
Average gross wages, HRK	34.0	12.3	13.1	12.6	10.2	7.0	3.9	6.0	10.9
Average gross wages, real (PPI based)	33.0	10.8	10.6	14.0	7.4	-2.5	0.3	6.5	7.7
Average gross wages, real (CPI based)	31.3	8.5	9.2	6.5	5.7	0.7	-0.9	3.7	5.5
Average gross wages, EUR (ER)	40.5	11.6	10.6	9.8	3.7	6.2	6.3	6.9	9.2
Employment total	-1.4	-6.2	-1.4	5.6	-1.5	-1.7	0.5	-0.6	-0.9
GDP per empl. person, HRK at 1999 pr.	8.3	12.9	8.3	-3.0	0.6	4.7	3.2	5.8	5.3
Unit labour costs, HRK at 1999 prices	23.7	-0.5	4.4	16.1	9.5	2.2	0.7	0.2	5.3
Unit labour costs, ER (EUR) adjusted	29.7	-1.2	2.1	13.2	3.1	1.4	2.9	1.1	3.7
Macedonia									
GDP deflator	17.1	2.9	3.9	1.4	2.8	8.2	3.6	1.8	4.1
Exchange rate (ER), MKD/EUR	-3.8	1.9	12.2	8.7	-0.7	0.2	0.3	0.1	3.7
Real ER (CPI-based)	-14.3	2.1	11.6	10.7	1.3	-3.1	-2.1	-0.3	3.2
Real ER (PPI-based)	-4.0	2.9	8.6	4.1	-0.6	-5.3	-0.4	1.2	1.7
Average net wages, MKD	10.7	2.8	2.8	3.7	2.9	5.5	3.5	6.9	4.7
Average net wages, real (PPI based)	5.7	3.1	-1.4	-0.3	3.0	-4.7	1.5	7.9	1.4
Average net wages, real (CPI based)	-4.4	0.5	0.2	3.8	3.6	-0.3	-1.3	4.3	1.8
Average net wages, EUR (ER)	15.0	0.9	-8.4	-4.6	3.6	5.3	3.2	6.8	1.0
Employment total	.	.	-4.7	5.4	1.0	0.8	9.0	-6.3	.
GDP per empl. person, MKD at 1999 pr.	.	.	6.4	-1.9	3.3	3.6	-12.4	7.1	.
Unit labour costs, MKD at 1999 prices	.	.	-3.4	5.6	-0.4	1.8	18.2	-0.2	.
Unit labour costs, ER (EUR) adjusted	.	.	-13.9	-2.8	0.4	1.6	17.8	-0.3	.
Russia									
GDP deflator	143.9	45.8	15.1	18.5	72.4	37.7	17.8	15.2	36.3
Exchange rate (ER), RUB/EUR	126.2	12.6	-1.4	69.1	137.2	-0.8	0.4	13.5	30.9
Real ER (CPI-based)	-21.6	-21.9	-12.3	34.9	29.4	-16.0	-15.5	-0.2	-2.7
Real ER (PPI-based)	-29.8	-24.8	-13.5	57.4	49.3	-29.2	-14.6	1.7	-1.0
Average gross wages, RUB	119.6	48.4	20.2	10.7	44.8	46.0	45.7	36.6	42.3
Average gross wages, real (PPI based)	-34.7	-1.6	4.6	3.3	-8.9	-0.4	22.4	22.2	6.3
Average gross wages, real (CPI based)	-26.2	0.4	4.7	-13.3	-22.0	20.9	19.9	17.7	3.3
Average gross wages, EUR (ER)	-2.9	31.8	21.9	-34.6	-38.9	47.2	45.2	20.4	8.7
Employment total	-3.0	-0.7	-1.9	-1.4	0.2	0.6	0.6	1.5	-0.2
GDP per empl. person, RUB at 1999 pr.	-1.1	-2.9	3.4	-4.0	6.1	9.4	4.4	2.8	3.1
Unit labour costs, RUB at 1999 prices	122.0	52.8	16.3	15.3	36.4	33.5	39.6	32.9	38.1
Unit labour costs, ER (EUR) adjusted	-1.9	35.8	18.0	-31.9	-42.5	34.6	39.1	17.1	5.5
Ukraine									
GDP deflator	415.8	66.2	18.1	12.0	27.4	23.1	9.9	3.2	25.5
Exchange rate (ER), UAH/EUR	400.9	20.4	-9.0	31.0	58.7	14.5	-4.3	4.5	17.3
Real ER (CPI-based)	8.3	-31.5	-19.9	20.6	31.1	-8.6	-12.5	5.8	-5.0
Real ER (PPI-based)	-11.1	-20.3	-14.8	15.3	21.1	-0.9	-10.7	1.5	-2.6
Average gross wages, UAH	430.7	72.6	13.5	7.0	16.0	29.6	35.2	21.0	31.4
Average gross wages, real (PPI based)	-9.9	13.5	5.4	-5.5	-11.5	7.2	24.5	17.4	7.8
Average gross wages, real (CPI based)	11.3	-4.2	-2.1	-3.3	-5.4	1.1	20.7	20.0	3.9
Average gross wages, EUR (ER)	6.0	43.3	24.7	-18.3	-26.9	13.3	41.2	15.8	12.0
Employment total	3.0	-2.1	-2.7	-1.1	-2.3	-2.5	-1.5	-4.0	-2.7
GDP per empl. person, UAH at 1999 pr.	-14.8	-8.1	-0.3	-0.8	2.2	8.7	10.9	9.2	3.4
Unit labour costs, UAH at 1999 prices	522.9	87.8	13.8	7.8	13.5	19.3	21.9	10.8	27.1
Unit labour costs, ER (EUR) adjusted	24.3	55.9	25.1	-17.7	-28.5	4.2	27.3	6.0	8.3

ER = Exchange Rate

PPI = Producer price index

CPI = Consumer price index

Sources: National statistics and wiiw estimates.

COUNTRY REPORTS

Bulgaria: economic rebound continues

The economic rebound continued in the first quarter of 2003, despite the unfavourable external environment. Surprisingly – given the weak external demand – manufacturing sector output grew at double-digit rates in the first quarter, led by a surge in export activity. The continuing recovery is matched by an improving domestic business climate and generally positive economic expectations.

According to the preliminary national accounts, quarterly GDP increased by 3.8% year on year in the first quarter, boosted by the fast expansion of manufacturing output. Aggregate growth would have been higher if it were not for the weak performance in the agricultural sector whose output shrank by 1.8% year on year. On the demand side, both private consumption and, especially, gross fixed investment continued to grow strongly in the first quarter (by 7.1% and 15.8% year on year, respectively), providing support to domestic economic activity.

The recovery in the manufacturing industry continued for the fourth consecutive quarter and accelerated sharply in the first quarter of 2003, with total industrial output increasing by 17.2% from the same period of 2002. This robust performance was underpinned by the unexpectedly strong recovery of exports: in euro terms, quarterly exports increased by almost 20% compared to their level a year earlier. Both manufacturing production and exports expanded across the board in terms of products, industries and export destinations; as a result Bulgaria gained further market shares in its main EU markets such as Italy, Germany and Greece.

There are several features that make the current recovery look different from previous growth episodes during the past decade. First of all, this is the first case when the main supply push to aggregate output comes from a continuing, export-led upturn in the manufacturing sector. During the first decade of economic transformation, the Bulgarian manufacturing sector was the main loser of reforms, shrinking by almost 60% from its pre-transition level. In that period, the upturns in the manufacturing industry were short-lived and selective, usually only involving a few industries endowed with excessive capacities that benefited from favourable demand conditions. Secondly, the strong and broadly based export expansion in a rather unfavourable external environment suggests that the key factors of success should be sought for on the supply side. These are signs of a new type of manufacturing growth which originates in newly emerging, export-oriented manufacturing capacities. While the first decade of transition was a period of downsizing and scrapping of obsolete industries that could not prove their viability under market conditions, it appears that we are observing the positive outcomes of a process of re-industrialization in the country which started towards the end of the 1990s. Although somewhat belated and in a more modest scale – compared to the early reformers of

Central Europe – it likely has a similar effect on the Bulgarian economy, serving as the main engine of recovery. Thirdly, the strong export sales suggest that this new manufacturing capacity has been able to penetrate niches where it enjoys comparative advantage. This is especially pronounced in the labour-intensive textile industry, which was among the fastest growing in recent years and which benefits from the low-cost local labour. But it should also be noted that in the last couple of years there has been a resurgence in some technologically advanced, high value-added industries as well. Finally, one of the specific features of Bulgaria's re-industrialization is the fact that the small and medium-size enterprises emerge as the main basis of the new manufacturing industry. It turned out that in recent years, most greenfield investments in manufacturing – both by foreign and domestic investors – were made in small production units. While, with a few exceptions, Bulgaria turned out not to be very attractive to big investors (whose absence created the false impression of dearth of greenfield investment), on the whole recently there was a considerable amount of new investment, however, dispersed in numerous smaller-scale projects.

There were positive developments in the labour market as well. In May, the rate of registered unemployment fell to 14.3%, the lowest rate registered since September 1999; the recent labour force surveys suggest a similar dynamics of the unemployment rate. Notably, the manufacturing industry has been making a positive contribution to net job creation during the last couple of years, and this trend was upheld in the first quarter of 2003. The introduction in January of a new set of active labour market policies also contributed to the improvement of the situation in the labour market.

Inflation remained subdued in the first months of the year, despite a small, one-time surge in January prompted by the rise in some excise taxes. The inflationary pressures were largely mitigated by low imported inflation caused by the depreciating dollar and the general weakness in world market commodity prices. The planned rise in regulated energy prices (due to take place in the summer) is not expected to trigger a significant surge in the overall price level.

After a period of contraction in mid-2002, the trade and current account deficits started to swell again towards the end of the year and this trend continued in the first quarter of 2003. However, in relative terms, the magnitude of the external imbalances has been reduced considerably thanks to the depreciation of the dollar and the continuing economic expansion. As a percentage of GDP, the foreign official debt has shrunk by 10 percentage points, reaching 44.1% of GDP at the end of March. At the present dollar exchange rate, total public debt is estimated at around 50% of GDP, a level that does not pose immediate problems for macroeconomic management. This dramatic easing in the debt burden prompted some of the leading credit agencies to raise Bulgaria's credit ratings. Bulgaria's foreign currency credit ratings now stand just one notch below investment grade while S&P already granted the lowest investment grade to local currency ratings.

Progress in large-scale privatization was mixed. The biggest failure was the collapse of the negotiated sale of Bulgartabac, the tobacco monopoly, to a financial investor (allegedly backed by Deutsche Bank): the deal fell apart in the very last phase of fine-tuning the final terms of the contract. The reasons for the failure were complex, ranging from vested interests in the tobacco industry (which lobbied against the sale) to widespread allegations of corruption and conflict of interest. This fiasco was especially humiliating for the authorities as it came after a hasty change in the privatization law, especially tailored to this deal. The privatization of BTC (the Bulgarian Telecom) is also in limbo after a ruling by the Supervisory Board of the Privatization Agency about irregularities in the bidding and negotiation procedure. At the same time, the sale of the last remaining state-owned bank DSK (the successor of the mono-savings bank) to Hungary's OTP Bank for EUR 311 million is widely considered as the most successful privatization deal in Bulgaria so far.

In May the government survived a non-confidence vote initiated by the opposition United Democratic Forces. Despite the recent defection of ten deputies from the ruling party, the political situation remains relatively stable and the government still enjoys a comfortable majority in Parliament thanks to the continuing support by the Movement for Rights and Freedoms (the Turkish minority party). The short-term outlook for Bulgaria remains positive. The fiscal position of the government remains strong and the overall macroeconomic situation does not pose any immediate threats. The tourism industry expects a good season and if the pace of manufacturing output is maintained, the government's goal of achieving 4.8% GDP growth in 2003 can be regarded as a realistic target.

Table BG

Bulgaria: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., end of period	8230.4	8190.9	8149.5	7891.1	7845.5	.	.	.	.
Gross domestic product, BGN mn, nom.	22421.1	23790.4	26752.8	29709.2	32323.7	6958.6	7294.2	35200	38500
annual change in % (real)	4.0	2.3	5.4	4.1	4.8	3.4	3.8	4.5	5
GDP/capita (USD at exchange rate)	1543	1577	1542	1696	1978	.	.	.	.
GDP/capita (USD at PPP - wiiw)	6270	6540	7070	7680	8290	.	.	.	.
Gross industrial production									
annual change in % (real)	-7.9	-8.0	8.2	1.6	0.6	-4.4	17.2	4	5
Gross agricultural production									
annual change in % (real)	-1.5	2.7	-9.4	-0.6	4.1	.	.	.	.
Goods transport, public, mn t-kms [2]	84308	88538	88136	81937	76377	.	.	.	.
annual change in % [2]	-8.4	5.0	.	-7.0	-6.8	.	.	.	.
Gross fixed capital form., BGN mn, nom.	2919.8	3600.5	4206.0	5415.2	5858.9	1035.1	1213.1	.	.
annual change in % (real)	35.2	20.8	15.4	23.3	9.3	4.6	15.8	.	.
Construction output total									
annual change in % (real)	-0.2	8.0	8.1	12.8	-23.0	.	.	.	.
Dwellings completed, units	4942	9824	8795	5937	6153	.	.	.	.
annual change in %	-33.7	98.8	-10.5	-32.5	3.6	.	.	.	.
Employment total, th pers., average	3152.6	3087.8	2980.1	2968.1	2992.2	.	.	.	.
annual change in %	-0.2	-2.1	-3.5	-0.4	0.8	.	.	.	.
Employees in industry, th pers., average	802.5	722.5	662.0	658.4	649.1	649.8	667.0	.	.
annual change in %	-4.3	-10.0	-8.4	-0.5	-1.4	1.0	2.8	.	.
Reg. unemployed, th pers, end of period	465.2	610.6	682.8	662.3	602.0	659.0	581.3	550	520
Reg. unemployment rate in %, end of period	12.2	16.0	17.9	17.3	16.3	17.2	15.7	15	14
LFS - unemployment rate in %, average	14.1	15.7	16.9	19.7	17.8	19.5	15.6	18	17
Average gross monthly wages, BGN	183.3	201.0	224.5	240.0	272.0	255.7	272.0	.	.
annual change in % (real, gross)	20.7	6.9	1.3	-0.5	7.1	-0.7	1.1	.	.
Retail trade turnover, BGN mn	7214.2	8023.3	9725.9	10868.0	11642.0	.	.	.	.
annual change in % (real)	18.6	12.3	12.7	4.8	1.6	2.2	2.4	.	.
Consumer prices, % p.a.	18.7	2.6	10.3	7.4	5.8	8.2	0.6	3	4
Producer prices in industry, % p.a.	18.7	2.8	17.5	3.8	1.2	0.0	7.9	.	.
Central government budget, BGN mn									
Revenues	4449.5	5199.3	6120.9	6525.3	7289.4	1588.6	1937.0	.	.
Expenditures	4156.0	4736.8	6304.8	7189.5	7286.0	1377.4	1846.2	.	.
Deficit (-) / surplus (+)	293.6	462.5	-183.8	-664.2	3.4	205.6	90.8	.	.
Deficit (-) / surplus (+), % of GDP	1.3	1.9	-0.7	-2.2	0.0	3.0	1.2	.	.
Money supply, BGN mn, end of period [3]									
M1, Money	2960.8	3302.1	3976.3	4883.8	5542.7	4594.2	5089.2	.	.
Broad money	6814.2	7662.1	10061.3	12600.1	14146.5	12503.1	14001.4	.	.
Base rate of NB % p.a., end of period	5.2	4.5	4.7	4.7	3.4	4.5	2.6	.	.
Current account, USD mn	-61.4	-651.7	-701.6	-842.2	-677.4	-237.5	-391.0	-700	-600
Current account in % of GDP	-0.5	-5.0	-5.6	-6.2	-4.4	-3.4	-5.4	-3.4	-2.6
Gross reserves of NB excl. gold, USD mn	2679.4	2892.0	3154.9	3289.6	4406.8	2923.7	4435.2	.	.
Gross external debt, USD mn	10891.9	10913.9	11201.8	10618.7	10946.2	10474.8	11048.2	.	.
Exports total, fob, EUR mn [4]	3841.2	3733.8	5253.1	5714.2	6058.5	1356.8	1617.6	6800	7200
annual change in %	-12.1	-0.4	40.7	8.8	6.0	-3.0	19.2	12	6
Imports total, cif, EUR mn [4]	4475.8	5139.9	7084.9	8127.8	8404.6	1775.7	2070.5	9200	9600
annual change in %	2.6	16.4	37.8	14.7	3.4	-0.2	16.6	10	4
Average exchange rate BGN/USD	1.760	1.838	2.124	2.185	2.077	2.232	1.822	1.7	1.7
Average exchange rate BGN/EUR (ECU)	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.433	0.443	0.462	0.482	0.495	.	.	.	.
Purchasing power parity BGN/EUR, wiiw	0.472	0.483	0.507	0.529	0.535	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 new methodology. - 3) According to International Accounting Standards. - 4) From 1999 new methodology. Converted from the national currency to EUR at the official exchange rate.

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

Josef Pöschl

The Czech Republic: falling prices, rising output

The Czech economy continues to grow at an annual rate of some 2% despite the country's close ties to its western neighbours' stagnating economies. This success is attributable to the continued strengthening of the country's industrial sector as manifest in the relatively good foreign trade results. Under the given difficult conditions, exports grew more than 6% in euro terms outstripping imports by almost one percentage point. In this context, the massive inflow of foreign direct investment in recent years has played a key role. Foreign-controlled companies now account for about half of the industrial sector's revenues and generate some 70% of total exports. Industrial output grew by over 6% in the first quarter of 2003, driven mainly by growth in the manufacture of rubber and plastic goods (+19%) as well as transport equipment (+17%). Matched by a decrease in employment, the rise in industrial output implied a gain in labour productivity of close to 9%. Nominal wages increased at a lesser rate (around 5%), thus enabling companies to enjoy a decline in unit labour costs. Compared to the year before, the average exchange rate vis-à-vis the euro remained almost unchanged and the import price index was some 2% lower in the first quarter of 2003. Decreasing unit costs made for a slight year-on-year decrease in industrial producer prices.

From the final use point of view, GDP growth in the first quarter of 2003 was primarily the outcome of increased private consumption. Increases in both public consumption and inventories also exerted a positive impact on growth, whereas the net effect of foreign trade, comprising both goods and services, was negative owing to a switch from surplus to deficit in the balance of services, as emerging in the calculation at constant prices. Investment into fixed capital declined and thus influenced GDP growth adversely.

In May 2003 the consumer price index stood at exactly the same level as the year previous; it would have been lower, were it not for the hike in gas prices in April. The government will increase taxes on alcohol and tobacco products in October, prior to EU accession. This could well become the main reason for a positive rate of inflation for 2003 as a whole, ranging between 0 and 1%. This year it is unlikely that the country will experience the almost customary major increase in housing rents in July or yet another hike in energy prices. Non-regulated prices have tended to drop in recent months, thus confounding the received wisdom that budget deficits – in 2003 possibly one hovering above 6% of GDP – and low interest rates feed inflation.

Both the absence of inflation and the meagre GDP growth have had a negative impact on the development of revenues in the public sector. Given the sector's low indebtedness, less than 20% of GDP in 2002, there is still room for high deficits for some time to come.

However, the pressure in favour of budget consolidation is high – emanating from financial markets and the EU side and fuelled by domestic fears of failing to meet the criteria for entry into the Monetary Union. The government is preparing a package of measures encompassing both revenue and expenditure: an increase in indirect taxation combined with lower corporate income tax, accompanied by cuts in expenditures for social security, research and defence. The reform should reduce the deficit to less than 4% of GDP by 2006. Certain items in the package, however, will also dent the government's popularity: for example, the increase in value added tax on most services – from 5% to 22%. The latter will be one of the reasons for relatively high inflation in 2004, estimated to range between 3% and 4%. The increase in tobacco and alcohol prices scheduled for October 2003 will also be felt in 2004, as it means a permanent upward shift in the consumer price index.

Higher inflation is likely to alarm the monetary authorities. In 2004, the period of very low interest rates may come to an end. In that case it will become more difficult to maintain a constant exchange rate vis-à-vis the euro. Over the past months, the exchange rate has fluctuated within a narrow band, thus dispelling expectations of significant nominal appreciation. In this respect, the EU commissioner for Monetary Issues, Pedro Solbes, is trying to push through tough conditions: before adopting the euro, the exchange rate fluctuations should remain in the range of ± 2.25% for two years.

In June, 55% of the electorate participated in the EU referendum, 77% of whom agreed to entry, more than expected by most observers. Now, not much time is left to prepare for membership. Smooth integration into EU structures is the main challenge now facing the government, the National Bank and the corporate sector. The Ministry of Finance hopes that in the period 2004-2006, contributions to the EU budget totalling EUR 2.4 billion will be more than compensated by an inflow of EU funds totalling 3.4 billion. Attaining a surplus of this order could prove difficult since a large portion of the inflow will depend on the rate at which domestic projects are accepted by the EU. As for direct payment to farmers in the same period, the authorities will have to rely on the simplified allocation scheme. The administrative prerequisites for implementing the full scheme are too complex.

In 2003, GDP growth will be between 2.0% and 2.5%. There would appear to be nothing that could nudge it further upwards. The first quarter's preliminary results gave rise to some optimism, but that may prove premature. In 2004, higher growth, in the order of 2.5% to 3.0%, may come about should the business climate in Western Europe improve. Both budgetary and monetary policies are likely to keep the upswing modest. Unemployment will not change much, hovering around 7% and 8% (according to the Labour Force Survey methodology). All in all, the Czech economy will not yield exciting results, but its performance will be quite satisfactory given the current circumstances.

Table CZ

Czech Republic: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1)]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year [2)]	10294.9	10282.8	10272.5	10224.2	10189.4	.	.	.	.
Gross domestic product, CZK bn, nom.	1839.1	1902.3	1984.8	2175.2	2275.6	534.0	550.6	2340	2490
annual change in % (real)	-1.0	0.5	3.3	3.1	2.0	2.6	2.2	2.3	2.7
GDP/capita (USD at exchange rate)	5536	5347	5007	5593	6822	.	.	.	.
GDP/capita (USD at PPP - wiiw)	13320	13660	13800	15210	15740	.	.	.	.
Gross industrial production									
annual change in % (real)	1.6	-3.1	5.4	6.5	4.8	4.2	6.2	5	6
Gross agricultural production									
annual change in % (real)	0.7	0.6	-4.5	2.5	-4.4	.	.	.	.
Goods transport, mn t-kms	53591	54620	57343	57777	61400	.	.	.	.
annual change in %	-14.2	1.9	5.0	0.8	6.3	.	.	.	.
Gross fixed capital form., CZK bn, nom.	535.5	528.3	561.5	603.3	599.3	128.1	125.8	.	.
annual change in % (real)	0.7	-1.0	5.4	5.5	0.6	2.3	-2.5	0	5
Construction industry									
annual change in % (real)	-7.0	-6.5	5.3	9.6	2.5	3.7	-0.7	.	.
Dwellings completed, units	22183	23734	25207	24759	27291	6531	5017	.	.
annual change in %	32.4	7.0	6.2	-1.8	10.2	29.7	-23.2	.	.
Employment total, th pers., average [3)]	4865.7	4764.1	4731.6	4750.2	4796.0	4718.7	4739.9	.	.
annual change in %	-1.4	-2.1	-0.7	0.4	1.0	0.5	0.5	.	.
Employment in industry, th pers., average [3)]	1519.9	1468.7	1429.4	1470.6	1472.3	1465.9	1426.4	.	.
annual change in %	-2.0	-3.4	-2.7	2.9	0.1	2.0	2.7	.	.
Reg. unemployed, th pers, end of period	386.9	487.6	457.4	461.9	514.4	471.7	528.2	.	.
Reg. unemployment rate in %, end of period	7.5	9.4	8.8	8.9	9.8	9.1	10.0	10.3	9.8
LFS - unemployment rate in %, average	6.5	8.7	8.8	8.1	7.3	7.7	7.6	7.6	7.5
Average gross monthly wages, CZK [4)]	11693	12666	13499	14640	15707	14339	15407	.	.
annual change in % (real, gross)	-1.2	6.1	2.6	3.6	5.4	4.2	7.8	.	.
Retail trade turnover, CZK bn	.	.	.	.	.	.	.	.	.
annual change in % (real)	-6.8	3.0	4.3	4.5	2.7	4.2	3.3	.	.
Consumer prices, % p.a.	10.7	2.1	3.9	4.7	1.8	3.7	-0.4	0.7	3.5
Producer prices in industry, % p.a.	4.9	1.0	4.9	2.9	-0.5	0.1	-0.6	-0.5	1.0
Central government budget, CZK bn									
Revenues	537.4	567.3	586.2	626.2	705.0	148.8	158.4	.	.
Expenditures	566.7	596.9	632.3	693.9	750.8	164.5	190.2	.	.
Deficit (-) / surplus (+)	-29.3	-29.6	-46.1	-67.7	-45.7	-15.7	-31.8	.	.
Deficit (-) / surplus (+), % GDP	-1.6	-1.6	-2.3	-3.1	-2.0	-2.9	-5.8	.	.
Money supply, CZK bn, end of period									
M1, Money	404.0	447.8	497.7	583.6	692.3	568.8	683.6	.	.
M2, Money + quasi money	1241.4	1337.5	1412.3	1596.0	1647.3	1581.6	1621.8	.	.
Discount rate, % p.a., end of period	7.5	5.0	5.0	3.8	1.8	3.3	1.5	.	.
Current account, USD mn	-1255	-1462	-2718	-3273	-4523	-778	-553	-5200	-5800
Current account in % of GDP	-2.2	-2.7	-5.3	-5.7	-6.5	-5.3	-3.0	-6.3	-6.4
Gross reserves of NB incl. gold, USD mn	12617	12825	13139	14464	23709	14760	24744	.	.
Gross external debt, USD mn	24348	22861	21608	22374	26281	21566	26021	.	.
Exports total, fob, EUR mn [5)]	23067.9	24639.6	31482.7	37251.2	40582.9	9859.1	10541.4	43800	48200
annual change in %	16.4	6.8	27.8	18.3	8.9	7.6	6.9	8	10
Imports total, cif, EUR mn [5)]	25286.6	26386.0	34875.7	40674.8	43011.8	10145.7	10684.2	46200	50900
annual change in %	5.3	4.3	32.2	16.6	5.7	2.3	5.3	7	10
Average exchange rate CZK/USD	32.27	34.60	38.59	38.04	32.74	36.24	29.47	28.4	27.5
Average exchange rate CZK/EUR (ECU)	36.16	36.88	35.61	34.08	30.81	31.75	31.63	31	30
Purchasing power parity CZK/USD, wiiw	13.42	13.54	14.00	13.99	14.19	.	.	.	.
Purchasing power parity CZK/EUR, wiiw	14.53	14.75	14.67	15.24	15.26	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) Based on Labour Force Survey data. - 4) Enterprises with more than 20 employees. - 5) Converted from the national currency to EUR at the official exchange rate.

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

Sándor Richter

Hungary: corrective measures to stop drifting

After a dynamic growth period driven by an unprecedented export-led structural modernization (1997-2000) followed a growth episode that was driven by household consumption plus government spending determined by the political cycle (2001-2002). By early 2003 the Hungarian economy entered an unsustainable growth path, characterized by declining but still high domestic absorption and deteriorating competitiveness amidst weak external demand. The result is decelerated but still remarkable economic growth coupled with increasing external imbalances.

The GDP increased by 2.7% in the first quarter of 2003, a decline compared to any of the quarterly growth rates in the previous year and a marked setback with regard to the slightly improving growth performance over the year 2002. On the demand side, GDP growth rests solely on an expansion of household consumption (up 9.2% as compared to the first quarter of 2002); investments declined by 1.2%, the exports of goods and services stagnated while imports increased. On the supply side, growth is mainly due to the good performance of the services sector. The composition of the modest, 4.4% growth in manufacturing output shows that export sales are still the driving force. Domestic sales fell by 3.5% in the first quarter, while in export sales (63% of total sales) there was a 7.2% expansion. As in previous years, engineering performed better than average and this time production of chemical products and metallurgy did so as well. Productivity increased by 6.6% in the manufacturing sector, while gross real wages grew by 10.1%, hinting at a forthcoming deterioration of industrial competitiveness.

Real wages (whole economy) increased by 13.7% in the first quarter, mainly as a result of the 'mood improving' measures introduced by the government after the elections in 2002. The bulk of the impact is felt in the public sector (21.4% real wage rise), but the abolition of the tax on the minimum wage, the newly introduced minimum wage for graduates of higher education and, further, the demonstration effect raised the wage bill of the business sector as well. Here real wages increased by 9.7% in the first quarter. These threatening figures are partly explained by statistical effects, and in the second half of the year the rate of the real wage growth will drop to less extreme levels. Nevertheless, the rapid wage growth and the expansion of the retail trade turnover to close to 10% suggest that there was a strong expansion in household consumption in the first quarter of 2003.

The decline of investment in the first quarter is less worrisome than it seems at first glance because its composition changed for the better. The government gave up part of the over-ambitious investment programmes which, among others, led to the record general government deficit last year. After a decline in the past two years, investment in the manufacturing sector increased by 4.4% in the first quarter of 2003. In addition, there was a remarkable upturn in investment in agriculture and in financial intermediation.

The unemployment rate was higher than a year earlier (6.2% versus 5.7% in April) but the number of employed increased somewhat, due to the return of about 60,000 inactive persons to the labour market.

The economy's external position deteriorated in the first months of 2003. The volume of exports stagnated, that of imports increased. In January to April the deficit in merchandise trade (BOP) doubled as compared to the same period a year earlier. The traditional compensating item, the balance of services, closed with a substantially smaller surplus than in the respective period of 2002. The result is a considerably worse current account position (EUR -1580 million) than a year earlier (EUR -820 million). The really bad news is, however, the change in non-debt generating financing. In the first four months of 2002 the surplus in this item had covered more than half of the current account deficit, while in the same period this year, for the first time since transition began, more foreign capital left the country than was invested. This is caused by significant outward FDI via the expansion of Hungarian firms abroad, substantially less inward FDI than a year earlier and an improvement in the balance of portfolio investments. The latter, however, could not compensate for the changes in the other two positions. The consequence is increasing foreign debt.

In January to May the CPI inflation was 4.3%, considerably lower than in the respective period of 2002 (6.1%). This low rate, however, will not be maintained for the rest of the year. Inflationary pressure is present because of the further strong increase in household incomes coupled with a low saving propensity, long-due rises of a few centrally regulated prices and changes in some tax rates related to the country's accession to the EU. The central bank's policy relying on a strong forint in fighting inflation has failed: the forint became weaker at the end of May, and on 4 June it was also officially devalued (by 2.26%) via moving the centre of the ±15% intervention band from HUF/EUR 276.1 to HUF/EUR 282.36.

The devaluation of 4 June was part of a package; the other component was a HUF 76 billion cut in budget expenditures. This package was designed as a compromise between the central bank and the government, after the balance of the general government had amounted to HUF 408.7 billion in January to May 2003, corresponding to nearly half of the deficit projected for the whole year. Earlier the central bank had insisted on a strong forint policy, with the argument that it saw no readiness on the part of the government to revise the expansive fiscal policy and to start the consolidation of the budget. The above-mentioned measures can be seen as a response to the discouraging first-quarter macroeconomic data (slow GDP growth coupled with a high current account deficit). The new low edge of the intervention band guarantees that the forint may not become stronger than HUF/EUR 240.1. This is good news both for exporters and import-competing firms plagued by rapidly rising wage costs, weak external demand and a longer period of real appreciation. The central bank's new target exchange rate is HUF/EUR 250. As in early June the forint was weaker than that, ranging between HUF/EUR 250 to 269, on 11 June the base rate was raised from 6.5 to 7.5%, and as the forint still remained weak, the base rate was raised to 9.5% on 19 June. Despite this step, the exchange rate remained above HUF/EUR 260 until 1 July.

The delayed recovery of the European economy (and here particularly the stagnation in Germany) has made the revision of earlier forecasts necessary. The government and the central bank gave up their earlier GDP growth target (4 to 4.5%) and in early June 2003 spoke of a 3.5% growth rate that can be attained 'in the optimal case'. Realistically, the expansion of the Hungarian economy may turn out in the range of 3 to 3.5% this year. Exports may take off in the last months of 2003, but it is an open question how the Hungarian exporters will be able to ride out the wave of the new business cycle under the changed conditions (substantially worse competitive position compared to previous years). As imports are expected to be pulled by excessive household consumption and accelerating business sector investments, the current account deficit may reach 5% of GDP in 2003.

The government started the correction of the over-ambitious spending policy of the previous two years by cutting public investment. The decline in government-induced demand will surpass 1.5% of the GDP in 2003. Although the government's deficit target (4.5% of the GDP) will probably not be achieved, the overshooting will not be substantial (less than 0.5% percentage points). CPI inflation (annual average) will be about 5% in both 2003 and 2004.

The preparatory activities for Hungary’s accession to the EU on 1 May 2004 are making progress. However, the second monitoring report of the European Commission elaborated since December 2002 hinted at serious delays in two specific areas: financial controlling and agriculture. A major problem is the delay in establishing the agency that is to implement direct payments for the farmers and the integrated administrating and controlling system (IACS) for agriculture. Without these institutions, direct payments for farmers will not be made available. The Hungarian government intends to set up the required institutions in September 2003. The final evaluation of Hungary's preparedness for accession will be published in November. Other areas that have been mentioned as problematic were harmonization in public procurement, individual tax allowances, anti-discrimination, consumer protection, selected environmental protection measures, the law regulating the relations with Hungarian minorities in neighbouring countries and, finally, the liberalization of the gas market.

Table HU

Hungary: Selected Economic Indicators

	1998	1999	2000	2001	2002 1)	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., end of period 2)	10253	10222	10200	10175	10152	10167	10128	.	.
Gross domestic product, HUF bn, nom.	10087.4	11393.5	13172.3	14849.6	16980.1	3890.1	4394.4	18400	20000
annual change in % (real)	4.9	4.2	5.2	3.8	3.3	2.9	2.7	3.2	3.5
GDP/capita (USD at exchange rate)	4582	4690	4570	5087	6476	.	.	.	.
GDP/capita (USD at PPP - wiiw)	10620	11310	12180	12980	13580	.	.	.	.
Gross industrial production									
annual change in % (real)	12.5	10.4	18.1	3.6	2.6	-0.3	4.4	6	8
Gross agricultural production									
annual change in % (real)	0.7	0.4	-6.5	15.8	-4.4	.	.	2	.
Goods transport, mn t-kms	27144	26339	26399	26240	25816	5687	5407	.	.
annual change in %	9.5	-3.0	0.2	-0.6	-1.6	-1.6	-4.9	.	.
Gross fixed capital form., HUF bn, nom.	2384.6	2724.5	3179.8	3508.4	3786.3	573.7	575.5	.	.
annual change in % (real)	13.3	5.9	7.7	3.5	5.8	8.6	1.2	2	5
Construction industry									
annual change in % (real)	15.3	9.0	7.9	7.7	20.1	23.5	-13.5	-8	0
Dwellings completed, units	20323	19287	21583	28054	31511	4756	4437	.	.
annual change in %	-27.8	-5.1	11.9	30.0	12.3	19.7	-6.7	.	.
Employment total, th pers., average 3)4)	3697.7	3811.5	3849.1	3859.5	3870.6	3840.0	3859.6	.	.
annual change in % 3)4)	0.7	3.1	1.0	0.3	0.1	-0.5	0.5	0	0
Employees in industry, th pers., average 5)	795.9	834.0	844.8	833.9	817.7	830.0	803.5	.	.
annual change in %	1.6	0.8	1.3	-1.3	-1.9	-1.5	-3.2	.	.
Reg. unemployed, th pers, end of period	404.1	404.5	372.4	342.8	344.9	368.2	386.2	.	.
Reg. unemployment rate in %, end of period	9.6	9.4	8.6	7.9	8.0	8.5	8.9	.	.
LFS - unemployment rate in %, average	7.8	7.0	6.4	5.7	5.8	5.8	6.4	6	6
Average gross monthly wages, HUF 5)	67764	77187	87645	103553	122453	111739	128876	.	.
annual change in % (real, net)	3.6	2.5	1.5	6.4	13.6	11.8	13.9	9	.
Retail trade turnover, HUF bn	3682.8	4329.7	4822.0	5394.0	6105.0	1222.3	974.4	.	.
annual change in % (real)	12.3	7.9	2.0	5.4	10.7	14.0	9.9	.	.
Consumer prices, % p.a.	14.3	10.0	9.8	9.2	5.3	6.2	4.6	5.3	5
Producer prices in industry, % p.a.	11.3	5.1	11.6	5.2	-1.8	-2.4	0.7	.	.
Central government budget, HUF bn 6)									
Revenues	2624.4	3227.6	3681.0	4068.0	4365.8	1009.3	1110.5	.	.
Expenditures	3176.6	3565.8	4049.7	4470.9	5840.5	1196.2	1334.5	.	.
Deficit (-) / surplus (+)	-552.2	-338.1	-368.7	-402.9	-1474.7	-186.9	-224.1	.	.
Deficit (-) / surplus (+), % GDP	-5.5	-3.0	-2.8	-2.7	-8.7	-4.8	-5.1	.	.
Money supply, HUF bn, end of period									
M1, Money	1791.1	2135.6	2378.3	2775.9	3302.9	2644.2	3453.3	.	.
Broad money	4635.8	5399.5	6052.0	7089.8	8422.3	6985.2	7706.9	.	.
Refinancing rate, % p.a., end of period	17.0	14.5	11.0	9.8	8.5	8.5	6.5	.	.
Current account, USD mn	-2223	-2435	-2900	-1754	-2655	-421	-913	-4000	-4000
Current account in % of GDP	-4.7	-5.1	-6.2	-3.4	-4.0	-3.0	-4.7	-4.9	-4.5
Reserves total, excl. gold, USD mn	9312	10948	11202	10738	10359	9601	13591	.	.
Gross external debt, USD mn	27280	29190	30254	33166	40419	32423	44081	.	.
Exports total, fob, EUR mn 7)	20476.8	23491.0	30544.5	34082.0	36523.0	8920.0	8484.9	36160	38700
annual growth rate in %	21.1	14.7	30.0	11.6	7.2	9.4	-4.9	-1	7
Imports total, cif, EUR mn 7)	22871.2	26287.8	34856.3	37654.1	39939.1	9670.7	9655.1	40940	43400
annual growth rate in %	21.8	14.9	32.6	8.0	6.1	5.8	-0.2	2.5	6
Average exchange rate HUF/USD	214.45	237.31	282.27	286.54	258.00	278.44	226.95	227	225
Average exchange rate HUF/EUR (ECU)	240.98	252.80	260.04	256.68	242.97	244.07	243.63	250	247
Purchasing power parity HUF/USD, wiiw	92.53	98.38	105.92	112.33	122.99	.	.	.	.
Purchasing power parity HUF/EUR, wiiw	100.22	107.17	116.03	123.10	132.99	.	.	.	.

Notes: 1) Preliminary. - 2) Revised data according to census Feb 2001. - 3) Based on Labour Force Survey. - 4) From 1998 new sample; from 2002 according to census 2001. - 5) Enterprises with more than 10, from 1999 more than 5 employees. - 6) Excluding privatization revenues. - 7) Converted from the national currency to EUR at the official exchange rate.

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

Leon Podkaminer

Poland: shaky economic consolidation amidst political disarray

The first months of 2003 have not improved the overall economic performance very much. GDP growth in the first half of the year, estimated at somewhat above 2% (roughly the same as in the second half of 2002) has been driven primarily by private consumption. The latter remains fairly robust despite the continuing contraction in the real total wage bill as the household saving propensity is declining. This is reflected in a strong reduction in households' bank deposits, and is also responsible for the falling money supply. The long overdue cuts in interest rates also support private consumption. However, the growth of private consumption seems to be less pronounced than before. Despite falling interest rates the stock of credit extended to the enterprise sector virtually stagnates. There is little evidence of a revival in investment activities. In the first quarter of 2003, stocks increased very strongly – which may augur a renewed growth slowdown. On the other hand, foreign trade continues to support GDP growth. During the first five months of 2003, merchandise export revenues rose 4.8% in euro terms (and 27.4% in US dollar terms) while payments for merchandise imports fell 2% in euro terms (and rose 19.2% in dollar terms). The overall satisfactory performance of foreign trade can, at least partly, be attributed to the exchange rate developments. The zloty has weakened vs. the euro and thus strengthened the competitive position of the bulk of Polish exporting and import-competing firms. Also, some strengthening of the zloty vs. the dollar has made imports of primary commodities (including crude oil, the prices of which prices are quoted in dollar) cheaper.

Favourable exchange rate developments, lower interest costs and a lower burden of income taxation helped to improve the financial position of the non-financial corporate sector. The sector's net profit amounted to PLN 3.1 billion (vs. PLN 1.7 billion in the first quarter of 2002). Although in real terms profits currently reported are quite modest compared to those earned in the years 1994-1997, they are important for the initiation of a business investment take-off. Financial consolidation is particularly strong among larger export-oriented manufacturing firms. Mining and particularly construction firms continue to make losses.

The improvement in the profits of the non-financial corporate sector coincides with a fall in profits earned by commercial banks (from PLN 1.4 billion in the first quarter of 2002 to 1.1 billion in the first quarter of 2003). Banks' interest income declines as interest rates are falling. Besides, the banks bear the rising costs of the deteriorating quality of their assets. The improvements in foreign trade, and in the financial standing of the export sector, would probably have been less significant without strong gains in manufacturing labour productivity and declining production costs. In industry, the labour productivity rose close to 10% during the first five months of 2003 – well ahead of the average industrial wage.

Despite all these encouraging signs, the public mood is generally depressed, if only on account of a steady decline in employment and the unemployment staying at a very high level. More importantly, firms' attitudes, as revealed by business climate surveys, remain rather pessimistic. The current improvements generally tend to be viewed as temporary or seasonal. As before, weak domestic demand (and the associated phenomena such as bad financial position of customers, problems over payment arrears) is perceived as the major obstacle to expansion.

The long overdue relaxation of the monetary policy has produced positive results (also via its impact on the weakening of the zloty) without generating any recognizable signs of higher inflation. There is still some room for further cuts in interest rates. Nonetheless it is becoming obvious that the monetary policy is currently incapable of stimulating a strong investment recovery – and hence of starting an overall growth acceleration. However, the fiscal policy is in disarray. There has been an open conflict between the finance ministry, nominally responsible for the fiscal policy, and the minister of the economy and labour. The first draft budget for 2004, worked out under such conditions, bears many scars. It has many aspects, some of them clearly supportive of domestic demand. These positive aspects seem overshadowed by the desire to reduce the overall deficit, also on the ground that this would be necessary to meet the obligations implicit in Poland's forthcoming accession to the EU. The major novelty is the radical reduction in the corporate income tax from 27% to 19%. This is hoped to ignite domestic investment, and to accelerate FDI inflows. Whether or not lower corporate tax rates will produce the desired effects remains to be seen. In the end, the lower corporate income tax rate may only widen the budget deficit and necessitate further cuts in social transfers and in other productive public spending.

The Polish economy is thus still quite unstable. Some improvements, related especially to foreign trade, may have been primarily due to the currency's weakness vs. the euro. Should the zloty strengthen, e.g. under the impact of higher capital inflows, recovery may be postponed – especially if the business climate in the EU deteriorates further. The forthcoming EU accession will probably bring, at least initially, more disadvantages than clear benefits. Poland will have to lower, right away, its tariffs on many sensitive products (such as farm products, textiles and steel) supplied by some non-EU producers. On the other hand, the 'suitcase' exports to Ukraine and other countries of the CIS, which on balance bring several billion dollars of (net) revenue yearly, will be restricted by the introduction of visas to CIS citizens. Further costs related to the takeover of the *acquis* required by the EU will have to be borne. Payments to the EU budgets will have to be made while it is certain that the Polish authorities are still to learn how to extract transfers from the EU. Last but not least, the ambition nurtured especially by the National Bank to enter the eurozone 'as soon as possible' may prove costly.

Table PL

Poland: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1)]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., end of period	38667	38654	38644	38632	38610	38628	38591	.	.
Gross domestic product, PLN mn, nom.	553560	615115	684982	749311	769426	178556	184521	804400	853400
annual change in % (real)	4.8	4.1	4.0	1.0	1.4	0.5	2.2	2.5	3.0
GDP/capita (USD at exchange rate)	4098	4011	4078	4737	4884	.	.	.	.
GDP/capita (USD at PPP - wiiw)	8490	9010	9540	10310	10510	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	3.5	3.6	6.7	0.6	1.5 [2)]	-1.6 [2)]	4.4 [2)]	3	4
Gross agricultural production									
annual change in % (real)	5.9	-5.2	-5.6	5.8	.	.	.	.	.
Goods transport, mn t-kms	317052	310698	282559	253269	.	.	.	.	.
annual change in %	-3.8	-2.0	-9.1	-10.4	.	.	.	.	.
Gross fixed capital form., PLN mn, nom.	139205	156690	170430	157209	147838	25367	24680	.	.
annual change in % (real)	14.2	6.8	2.7	-8.8	-6.8	-12.8	-3.6	0	.
Construction output total									
annual change in % (real)	12.4	6.2	1.0	-6.4	-10.5 [2)]	-16.3 [2)]	-20.9 [2)]	.	.
Dwellings completed, units	80594	81979	87789	105967	97595	218638	27092	.	.
annual change in %	9.3	1.7	7.1	20.7	-7.9	-15.1	23.9	.	.
Employment total, th pers., average	15800.4	15373.5	15017.5	14923.6	14900.0	15100.0	14438.7	.	.
annual change in %	2.3	-2.7	-2.3	-0.6	-0.2	.	-4.4	.	.
Employees in industry, th pers., average	3378.7	3138.4	2955.0	2820.6	2495.0 [2)]	2507.0 [2)]	2426.0 [2)]	.	.
annual change in %	-1.6	-7.1	-5.8	-4.5	-5.7 [2)]	-6.8 [2)]	-3.2 [2)]	.	.
Reg. unemployed, th pers, end of period	1831.4	2349.8	2702.6	3115.1	3217.0	3259.9	3321.0	.	.
Reg. unemployment rate in %, end of period	10.4	13.1	15.1	17.5	18.1	18.2	18.7	18.5	18.5
LFS - unemployment rate in %, average	10.6	13.9	16.1	18.2	19.9	20.3	20.5	20.5	20.5
Average gross monthly wages, PLN [3)]	1232.7	1697.1	1893.7	2045.1	2133.2	2155.5 [2)]	2228.7 [2)]	.	.
annual change in % (real, net) [4)]	4.5	4.7	1.0	2.5	2.4	2.1 [2)]	2.9 [2)]	.	.
Retail trade turnover, PLN mn	291197	323687	360318	375438	.	.	.	.	.
annual change in % (real)	2.6	4.0	1.0	0.2	1.7 [2)]	5.8 [2)]	1.2 [2)]		.
Consumer prices, % p.a.	11.8	7.3	10.1	5.5	1.9	3.4	0.5	2	3
Producer prices in industry, % p.a.	7.3	5.7	7.8	1.6	1.0	0.2	3.0	.	.
Central government budget, PLN mn									
Revenues	126560	125922	135664	140527	143520	31275	33397	.	.
Expenditures	139752	138401	151055	172885	182922	47712	48827	.	.
Deficit (-) / surplus (+)	-13192	-12479	-15391	-32358	-39403	-16437	-15430	.	.
Deficit (-) / surplus (+), % GDP	-2.4	-2.0	-2.2	-4.3	-5.1	-9.2	-8.4	.	.
Money supply, PLN mn, end of period									
M1, Money	89920	111384	106456	118297	136267	114803	136211	.	.
M2, Money + quasi money	223678	268701	300424	328198	319777	319012	317874	.	.
Discount rate of NB % p.a., end of period	18.2	19.0	21.5	14.0	7.5	12.0	6.5	8	.
Current account, USD mn	-6841	-11553	-9952	-7166	-6700	-2346	-1442	-7000	-8000
Current account in % of GDP	-4.3	-7.5	-6.3	-3.9	-3.6	-5.4	-3.0	-3.4	-3.7
Gross reserves of NB excl. gold, USD mn	27325	26354	26564	25649	28660	26063	29989	.	.
Gross external debt, USD mn	59135	65365	69465	71797	81946	73135	.	.	.
Exports total, fob, EUR mn [5)]	25145.4	25729.3	34382.6	40374.7	43400.2	10277	10783	46000	49200
annual growth rate in %	10.3	2.3	33.6	17.4	7.5	3.6	4.9	6	7
Imports total, cif, EUR mn [5)]	41539.3	43151.2	53121.9	56222.7	58307.4	13527	13901	60600	64900
annual growth rate in %	10.8	3.9	23.1	5.8	3.7	0.6	2.8	4	7
Average exchange rate PLN/USD	3.49	3.97	4.35	4.09	4.08	4.13	3.90	3.86	3.91
Average exchange rate PLN/EUR (ECU)	3.92	4.23	4.01	3.67	3.86	3.62	4.18	4.25	4.30
Purchasing power parity PLN/USD, wiiw	1.69	1.77	1.86	1.88	1.90	.	.	.	.
Purchasing power parity PLN/EUR, wiiw	1.83	1.93	2.03	2.07	2.04	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with more than 9 employees. - 3) From 1999 including mandatory premium for social security. - 4) From 1999 real gross wages. - 5) Converted from the national currency to EUR at the official exchange rate.

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

Gábor Hunya

Romania: growing, but not yet a functioning market economy

Romania has been encouraged by the EU Commission to finalize accession negotiations by the end of 2004 and to joint the EU in the year 2007. In the first half of 2003, Romania opened all 30 chapters of the accession negotiations and closed 19 of them. The latest chapters, closed in June, were on taxation and free movement of goods.[26] The most immediate pressing issue is whether the country will, as the last among the accession countries, get the 'functioning market economy' status from the Commission in the autumn 2003 Regular Report. The government believes that it will be able to improve its position in the remaining months. While it can demonstrate progress in the development of most macroeconomic indicators, it has so far failed to meet the established targets regarding privatization and financial discipline.

The country is still in the course of catching up to its pre-transformation GDP level which requires high rates of economic growth despite a slump in its main foreign markets. After two years of economic growth in the range of 5%, a slowdown to about 4% can be expected for 2003. In the first quarter of the year, GDP was 4.4% higher than in the same period a year earlier. Gross value added increased only 3.5%; the rapid expansion of tax revenues made up for the rest of the growth. Despite an extraordinary increase in minimum wages, private consumption expanded by just 3.8% while government consumption stagnated. The most important growth item was gross fixed capital formation, up 6.8%. Its share in GDP surpassed 16%. The recovery of investments comprised first of all machinery and equipment investments, which indicates increasing restructuring efforts.

A slow shift in the output and export structure towards higher value-added goods is under way. While industrial output rose just 1.3% in the first four months and the main export industries (clothing and footwear) did not increase output, the production of electrical and transport equipment expanded. The latter also gained export shares, for the first time exceeding 20%, while the share of clothing in exports dropped below 25%. Merchandise exports increased dynamically up to March, but fell back in April. For the first four months, exports were 10% higher and imports 9% higher in euro terms than in the same 2002 period. The leu appreciated marginally against the currency basket consisting of 60% euro and 40% dollar. The widening gap between the strong euro and the weak dollar helped primarily the exporters of chemicals and oil derivates. Exporters of finished goods work mostly under processing contracts where only the Romanian value added matters. At constant euro prices, exporters of clothing and footwear earned in May 9% more lei than at the end of 2002, while consumer price inflation was only 5.6%. The floating exchange rate

[26] Some derogations could be achieved in both chapters. As to the free movement of goods, Bucharest will abolish all unchecked imports as of 2004. It also pledged to eliminate trade barriers and set up the Authority for Food Security. In the taxation chapter, companies with an annual turnover of less than EUR 35,000 will not need to pay value added tax for some more years.

regime seems to support competitiveness in an economy where the impact of capital inflows on the exchange rate is relatively small.

The current account deficit for the first quarter of 2003 was significantly lower than in the same period a year earlier (less than 2% of the GDP). Deficits on goods and services were to a large extent compensated by an increasing inflow of current transfers. Labour remittances from abroad have become one of the main currency earning activities. Revenues from FDI are small, but on the increase, with USD 389 million invested in the first quarter. A position that causes rising concern in the balance of payments is the unexplained increase of negative errors and omissions amounting to USD 654 million for the first three months. Had these been recorded in the current account, the deficit would be five times higher. Unrecorded net capital outflows started at the beginning of 2002, reversing earlier trend, but reached a high extent only in 2003. Local analysts assume either over-reporting of exports or capital flight. We may also consider unrecorded repatriation of Serbian deposits.

The major obstacle to becoming a functioning market economy is the failure of the state-owned sector, which comprises 40% of the industry, to function on the basis of hard budget constraints. Most of the 83 major companies put under special surveillance two years ago keep producing losses and their arrears to the budget, to utility companies and the rest of the economy do not decline. Insufficient competition, distorted prices and inefficient production prove that markets do not function in this part of the Romanian economy. The government's industrial policy, saving bankrupt companies and rescheduling the debts of troubled debtors, often delays restructuring instead of encouraging it. The Bank Assets Realization Agency (AVAB) plays a positive role as it aims to collect unserviced debt. AVAB recouped debts of some USD 372 million in the first five months of 2003. This was mostly achieved through the direct sale of the loss-making assets. AVAB's portfolio includes 1055 bankrupt companies, out of which 1002 are under liquidation procedure, and 53 are under reorganization process. AVAB also started to confiscate the personal wealth of managers of bankrupted state-owned firms.

The pace of enterprise reform is kept up by IMF and World Bank pressure. The Ministry of Industry and Resources is expected to send to the IMF a record of the payments received by the electricity and gas distribution companies every month. Energy sector privatization is seen crucial for fully enforcing discipline in payments to utilities, given the continued prevalence of weak corporate governance in the state-owned sector. Keeping down public sector wages and reducing over-employment in 22 companies are further closely monitored targets. These are difficult to meet as the authorities have to fight militant trade unions. Romania is not yet a 'functioning market economy'. It may nevertheless get that status in this year's Regular Report as a result of political negotiations. Reducing outside pressure will not help the Romanian transition process. With IMF surveillance phasing out and elections drawing near in 2004, slipping in macroeconomic stability may become a real danger. Disinflation may not continue at a rapid pace and the current account deficit may expand.

Table RO

Romania: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1)]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year	22502.8	22458.0	22435.2	22408.4	22391.0	.	.	.	.
Gross domestic product, ROL bn, nom.	371194	545730	800773	1167243	1512257	259019	327703	1850000	2210000
annual change in % (real)	-4.8	-1.2	2.1	5.7	4.9	3.1	4.4	4	4
GDP/capita (USD at exchange rate)	1859	1585	1645	1792	2043	.	.	.	.
GDP/capita (USD at PPP - wiiw)	5450	5510	5740	6230	6610	.	.	.	.
Gross industrial production									
annual change in % (real)	-13.8	-2.4	7.1	8.4	6.0	3.1	1.1	3	4
Gross agricultural production									
annual change in % (real)	-7.5	4.0	-14.8	22.7	.	.	.	.	.
Goods transport, mn t-kms [2)]	62364	45988	42131	40647	45961	9957	.	.	.
annual change in % [2)]	.	-26.3	-8.4	-3.5	13.1	11.0	.	.	.
Gross fixed capital formation, ROL bn, nom.	68111.6	96630.4	151947.2	238977.5	319645.1	39132.6	53615.7	.	.
annual change in % (real)	-5.7	-4.8	5.5	9.2	8.3	4.8	6.8	6	5
Construction output total									
annual change in % (real)	-0.5	-0.2	2.8	9.0	5.4	3.2	5.3	.	.
Dwellings completed, units	29692	29517	26376	27041	27302	3188	3704	.	.
annual change in %	-0.8	-0.6	-10.6	2.5	1.0	-7.7	16.2	.	.
Employment total, th pers., end of period	8812.6	8420.0	8629.0	8563.0	.	.	.	.	.
annual change in %	-2.3	-4.5	2.5	-0.8	.	.	.	.	.
Employees in industry, th pers., average	2272.0	1991.0	1873.0	1901.0	1882.0	.	.	.	.
annual change in %	-7.0	-12.4	-5.9	1.5	-1.0	0.6	-1.9	.	.
Reg. unemployed, th pers, end of period	1025.1	1130.3	1007.1	826.9	760.6	1257.4	779.2	.	.
Reg. unemployment rate in %, end of period	10.4	11.8	10.5	8.8	8.1	13.4	8.3	8	8
LFS - unemployment rate in %, average [3)]	6.3	6.8	7.1	6.6	8.4	10.0	.	8	9
Average gross monthly wages, ROL	1357132	1957731	2876645	4282622	5452097	5004791	6304419	.	.
annual change in % (real, net) [4)]	3.4	-3.8	4.6	4.9	3.7	4.4	9.6	.	.
Retail trade turnover, ROL bn	125513	160137	213569	287278	.	.	.	.	.
annual change in % (real)	20.6	-6.4	-7.0	1.9	0.8	-2.3	2.9	.	.
Consumer prices, % p.a.	59.1	45.8	45.7	34.5	22.5	26.9	16.7	18	15
Producer prices in industry, % p.a.	33.2	44.5	53.4	41.0	24.6	26.4	23.3	.	.
Central government budget, ROL bn									
Revenues	67216	93240	120342	148203	179206	34385	50977	.	.
Expenditures	77617	106887	149168	184012	226824	45613	58700	.	.
Deficit (-) / surplus (+)	-10401	-13647	-28826	-35809	-47618	-11228	-7723	.	.
Deficit (-) / surplus (+), % GDP	-2.8	-2.5	-3.6	-3.1	-3.1	-4.3	-2.4	.	.
Money supply, ROL bn, end of period									
M1, Money	22110	29669	46331	64309	88304	55881	79940	.	.
M2, money + quasi money	92530	134123	185060	270512	373712	275326	369451	.	.
Discount rate, % p.a., end of period [5)]	35.0	35.0	35.0	35.0	20.4	34.2	18.4	.	.
Current account, USD mn	-2968	-1469	-1363	-2223	-1573	-247	-170	-1500	-2500
Current account in % of GDP	-7.1	-4.1	-3.7	-5.5	-3.4	-3.1	-1.7	-2.7	-4.1
Gross reserves of NB excl. gold, USD mn	1374.8	1526.3	2469.7	3922.5	6125.7	4074.1	6323.0	.	.
Gross external debt, USD mn [6)]	9322.6	8770.7	10273.4	11924.5	15251.0	11616.8	15683.2	.	.
Exports total, fob, EUR mn [7)]	7412.4	7955.6	11219.2	12710.7	14677.5	3305.5	3767.9	15600	16500
annual growth rate in %	-0.3	7.3	41.0	13.3	15.5	6.2	14.0	6	6
Imports total, cif, EUR mn [7)]	10569.3	9896.0	14128.2	17362.5	18898.0	4168.6	4531.9	20200	21600
annual growth rate in %	6.3	-6.4	42.8	22.9	8.8	4.2	8.7	7	7
Average exchange rate ROL/USD	8875.6	15332.9	21692.7	29060.9	33055.5	32350.4	33155.4	32700	36400
Average exchange rate ROL/EUR (ECU)	9989.3	16295.6	19955.8	26026.9	31255.3	28344.3	33619.9	36000	40000
Purchasing power parity ROL/USD, wiiw	3028.9	4414.0	6213.2	8367.0	10221.0	.	.	.	.
Purchasing power parity ROL/EUR, wiiw	3298.2	4808.2	6806.5	9169.1	11051.2	.	.	.	.

Notes: 1) Preliminary. - 2) From 1998 new methodology in road transport. - 3) From 2002 new methodology in accordance to EU definitions. - 4) From 2000 excluding various social security contributions of employees. - 5) Reference rate of NB from February 2002. - 6) Medium- and long-term. - 7) Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

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

Zdenek Lukas

Slovakia: robust expansion backed by growing competitiveness

In the election year 2002, GDP rose by 4.4%; the major contributory aspect was 5.4% growth in private consumption, mostly fuelled by strongly rising household incomes. In the current year, however, domestic demand is losing momentum in its role as the main driving force behind the economic expansion. After a break in 2002, the new government has resumed to increase regulated prices. That has resulted in higher inflation, lower real wages and finally in the weakening of private consumption. Rather unexpectedly, and despite the real currency appreciation, Slovakia has so far managed to maintain its high GDP growth, as foreign sales have risen significantly. The foreign trade deficit has considerably diminished, although the EU economy remains depressed. According to the GDP concept, the foreign trade balance (goods and services in real terms) in the first quarter of 2003 even shifted to a surplus, accounting for 2.2% of GDP. That contributed significantly to the GDP growth of 4.1% in the first quarter of the year. Growth in private consumption decelerated to 2.6%, while gross fixed capital formation dropped by 2%.

The most important supply-side contributor to the GDP growth was gross industrial production, with an expansion of 8.8% in the first four months of 2003. At the same time, labour productivity rose by about 9%, while real wages dropped by 2%. Consequently, the country's competitiveness has improved primarily on account of declining unit labour costs, despite the real appreciation of the Slovak koruna. Growth rates were highest in production of electrical and optical equipment (17.9%), rubber and plastic products (16.5%) and leather and leather products (15.0%). However, with 8.9% growth transport equipment, due to its high share, contributed most to the growth of manufacturing output. Car production (VW Bratislava) dominates this latter sub-sector, where sales soared by 51%. Mostly thanks to performance abroad, output of the construction sector was up 1.9% in the first four months of 2003.

The situation on the labour market is slowly improving. The registered unemployment rate fell to 15.4% at the end of April 2003. A part of the drop went on account of more rigorous registration rules. Furthermore, the relatively strongly expanding economy is absorbing more labour. Also the new green-field investments are gradually creating more jobs.

The postponement of price deregulation resulted in a historically low inflation rate of 3.3% in 2002. However, the growth in regulated prices of housing, energy, water and public transport at the beginning of 2003 is fuelling inflation. In the first five months of 2003, consumer prices rose by 7.6% compared to 4.2% in the corresponding period in 2002. The core inflation (which excludes items whose prices are regulated and the impact of changes in taxation) amounted to 3.4%. Higher levies on fuels, beer and tobacco, taking effect on 1 July 2003, will additionally drive the inflation rate upward in the second half of the year.

The government deficit (including the costs of bank restructuring) accounted for more than 6% of GDP in the first quarter of 2003. The planned budget deficit for 2003, equivalent to less than 5% of GDP, will require greater fiscal prudence. The government is striving to fundamentally reform the tax system as of January 2004. The reform's main element is the introduction of a unified 19% rate for personal income tax, corporate profit tax, for income from capital and from other sources as well. Currently, the corporate tax amounts to 29%. In addition, companies would have free hand to decide on an own depreciation timetable for tax issues. The distribution of benefits from the personal income tax reform would be progressive in favour of higher incomes. The expected decline in revenues is to be compensated by unifying the current two-tier value added tax at the current upper rate of 20%. At the present time most goods and services are taxed at 14%. The impact on the 2004 budget is to be neutral. The administration believes that reducing corporate tax will stimulate stronger economic growth, stabilize budgetary revenues, and last but lot least, attract more FDI, which would eventually bring additional growth impulses. However, in the first stage after introducing the reform, a part of the population may have to cope with lower real incomes (mostly due to higher taxation for staples), despite the envisaged compensation for socially weak groups. Another very important reform step to be implemented in the short run is the stabilization of budgetary expenditures, such as healthcare, pension system, education and public administration.

The foreign trade deficit was nearly halved in the first four months of 2003 as compared to the same period a year earlier. Exports were up 21%, whereas imports rose 13%. Remarkably, exports to Germany increased most, by more than 40%. Germany is the largest single trading partner, absorbing 31% of Slovak exports. With nearly 40% growth, car exports dominated. Supported by FDI, exports are gradually shifting to high-value-added branches such as manufacturing of transport, electrical and optical equipment, which together account already for 43% of merchandise exports. The smaller foreign trade deficit resulted in a lower current account deficit, equivalent to 1.8% of GDP in the first quarter of 2003: less than one third of the figure for the same period last year.

Total FDI inflows in 2002 amounted to USD 4 billion, the highest annual sum in Slovak history. The lion's share, USD 2.7 billion, was invested by Gaz de France and Ruhrgas in a 49% stake in the Slovak gas utility. By concluding the deal, the largest part of the Slovak privatization programme has been completed. Consequently, the desired enduring strong FDI inflow in the future can be achieved just by green-field investment. The tax reform mentioned above may contribute to attracting future FDI. In spring 2003, the French car maker PSA Peugeot Citroen started to build an auto factory with a final annual output capacity of 300,000 cars in the Trnava industrial park, some 40 kilometres northeast of

Bratislava. Total FDI into this project, creating at least 3000 new jobs, is to amount to EUR 0.7 billion by 2006.

Thanks to the export expansion, GDP will grow by 4% in 2003. The expected upturn in EU demand may accelerate export growth in 2004. Furthermore, domestic demand will also increase. Thus, for 2004 we expect higher GDP growth (5%). The inflation rate will exceed 8% this year due to the above-mentioned price and tax adjustments. The current account deficit will decrease substantially, to 3% of GDP in 2003 and to 2% in 2004. Simultaneously, the external position benefits from the weak US dollar that relieves the negative trade balance in fuels.

Slovakia's small open economy is certainly very dependent on foreign capital and external relations in general. Accession to the EU will affect the country in many ways. While backward regions of Northern, Southern and Eastern Slovakia will benefit from an inflow of EU structural funds, Bratislava is in the best shape to take advantage of opportunities offered by the large EU market. The best scenario is that expanding exports backed by a rising number of FDI enterprises will gradually emerge as the main driving force of GDP growth. The country appears attractive to foreign investors mostly due to its abundance of cheap, skilled and disciplined labour force, good transport networks, etc. Slovak policy makers will be challenged to find the middle ground between rising, or at least sustainable, competitiveness and possible social hardships.

Table SK

Slovak Republic: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year	5390.7	5395.3	5400.7	5379.8	5378.6	.	.	.	.
Gross domestic product, SKK bn, nom.	775.0	835.7	908.8	989.3	1073.6	244.8	268.4	1170	1280
annual change in % (real)	4.0	1.3	2.2	3.3	4.4	3.9	4.1	4	5
GDP/capita (USD at exchange rate)	4080	3740	3642	3804	4403	.	.	.	.
GDP/capita (USD at PPP - wiiw)	11070	11430	11280	12030	12820	.	.	.	.
Gross industrial production									
annual change in % (real)	5.0	-2.7	8.6	6.9	6.5	1.1	11.0	8	8
Gross agricultural production									
annual change in % (real)	-5.9	-2.5	-12.3	8.2	.	.	.	.	.
Goods transport, mn t-kms	17808	19996	19829	18501	18182	4070	4074	.	.
annual change in %	0.8	12.3	-0.8	-6.7	-1.7	.	0.1	.	.
Gross fixed capital form., SKK bn, nom.	280.9	252.9	267.9	309.6	319.8	68.4	69.9	.	.
annual change in % (real)	11.0	-18.5	1.2	9.6	-0.9	-0.8	-2.0	3	7
Construction industry									
annual change in % (real)	-3.5	-25.8	-0.4	0.8	4.1	-3.4	3.0	.	.
Dwellings completed, units	8234	10745	12931	10321	14213	2763	2239	.	.
annual change in %	14.8	30.5	20.3	-20.2	37.7	16.6	-19.0	.	.
Employment total, th pers., average [2]	2198.6	2132.1	2101.7	2123.7	2127.0	2104.6	2130.8	.	.
annual change in %	-0.3	-3.0	-1.4	1.0	0.2	0.2	1.2	.	.
Employment in industry, th pers., average [2]	662.5	630.3	615.3	628.8	640.9	640.8	637.2	.	.
annual change in %	-0.5	-4.9	-2.4	2.2	1.9	2.2	-0.6	.	.
Reg. unemployed, th pers, end of period	428.2	535.2	506.5	533.7	504.1	546.3	478.7	.	.
Reg. unemployment rate in %, end of period	15.6	19.2	17.9	18.6	17.5	19.1	16.5	17	16
LFS - unemployment rate in %, average	12.5	16.2	18.6	19.2	18.5	19.4	18.4	18	17
Average gross monthly wages, SKK	10003	10728	11430	12365	13511	12287	13082	.	.
annual change in % (real, gross)	1.7	-2.8	-4.5	0.8	5.8	3.7	-1.0	.	.
Retail trade turnover, SKK bn [3]	379.4	442.1	481.1	301.1	328.0	75.1	72.2	.	.
annual change in % (real)	8.6	9.8	2.3	4.5	5.8	5.9	-6.3	.	.
Consumer prices, % p.a.	6.7	10.6	12.0	7.1	3.3	4.7	7.6	8	7
Producer prices in industry, % p.a.	3.3	4.3	10.8	6.5	2.1	2.1	8.5	.	.
Central government budget, SKK bn									
Revenues	177.8	216.7	213.5	205.4	220.4	47.9	46.4	.	.
Expenditures	197.0	231.5	241.1	249.7	272.0	63.1	64.2	.	.
Deficit (-) / surplus (+)	-19.2	-14.8	-27.6	-44.4	-51.6	-15.2	-17.8	.	.
Deficit (-) / surplus (+), % GDP	-2.5	-1.8	-3.0	-4.5	-4.8	-6.2	-6.6	.	.
Money supply, SKK bn, end of period									
M1, Money	147.2	153.9	187.2	228.5	246.1	210.3	240.9	.	.
M2, Money + quasi money	466.1	523.6	601.5	680.3	713.7	666.0	710.3	.	.
Discount rate, % p.a., end of period	8.8	8.8	8.8	8.8	6.5	7.8	6.5	.	.
Current account, USD mn	-1982	-980	-702	-1746	-1939	-312.4	-126.2	-900	-700
Current account in % of GDP	-9.0	-4.9	-3.6	-8.5	-8.2	-6.1	-1.8	-2.9	-2.0
Gross reserves of NB incl. gold, USD mn [4]	2923	3425	4077	4189	9196	4735	9758	.	.
Gross external debt, USD mn	11900	10518	10804	11043	13188	11200	13811	.	.
Exports total, fob, EUR mn [5]	9540.6	9602.2	12879.5	14115.4	15252.3	3401.6	4207.3	16800	18000
annual growth rate in %	11.9	0.6	34.1	9.6	8.1	-0.4	23.7	10	7
Imports total, fob, EUR mn [5]	11634.7	10627.7	13859.8	16487.8	17515.2	3860.5	4359.1	18000	18800
annual growth rate in %	12.3	-8.7	30.4	19.0	6.2	0.5	12.9	3	4
Average exchange rate SKK/USD	35.24	41.42	46.20	48.35	45.34	48.17	38.96	37.7	37.3
Average exchange rate SKK/EUR (ECU)	39.60	44.12	42.59	43.31	42.70	42.24	41.80	41.5	41
Purchasing power parity SKK/USD, wiiw	12.99	13.55	14.92	15.28	15.57	.	.	.	.
Purchasing power parity SKK/EUR, wiiw	14.07	14.77	15.48	15.94	16.17	.	.	.	.

Notes: 1) Preliminary. - 2) Based on Labour Force Survey. - 3) From 2001 according to NACE, excluding VAT. - 4) From January 2002 new valuation of gold. - 5) Converted from the national currency to EUR at the official exchange rate; from 1998 new methodology.

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

Hermine Vidovic

Slovenia: suffering from poor business climate in the EU

The information available for the first months of the year 2003 points to just a moderate overall economic performance. GDP grew by a mere 2.3% in the first quarter of the year, the lowest quarterly growth rate reported since 1995. The relatively poor result was mainly due to the sluggish export performance, while investment continued to grow. Industrial production remained below expectations, reporting even a slight decline in the first four months of the year. Manufacturing output was almost stagnant, only a few sub-sectors reported an increase in output, such as manufacture of coke, petroleum and nuclear fuel, electrical and optical equipment and chemicals. Labour-intensive industries such as the leather and textile industry, but also the wood industry saw substantial drops in their production activity.

The positive trends prevailing in construction during 2002 continued in the first quarter of 2003, with the volume of construction put in place up 8.5% in real terms. The rise resulted first of all from a marked increase in civil engineering, while (residential) building construction recorded a substantial decline. Retail trade turnover grew by just 1.7% in real terms in the first quarter of 2003, real net wages by 1.8%. During the first months of the year, intense corporate cross-border borrowing was recorded. In April foreign currency loans to the enterprise sector and other financial organizations were 30% higher than in April 2002.

Inflation is still very high compared to other accession countries. In the period January to May, consumer prices rose by 6.1% on average, the May-to-May inflation was 5.5%. The central bank and the government continued and intensified their cooperation in combating inflation. The Bank of Slovenia has announced to further pursue its moderately restrictive monetary policy, with emphasis put on the control of monetary aggregates and restrictions on consumption. The exchange rate policy resembles more or less the crawling band arrangement, where the exchange rate is strongly related to the interest rate. As announced, the Bank will in the near future continue the managed floating regime, which is seen as the best choice in the current circumstances. The government decided on a freeze of most administered prices until the end of April, thereafter price rises are not allowed to exceed the target inflation rate of 5% for 2003. By the end of May, the parliament passed a bill on the abolition of the indexation of interest rates (TOM); it was additionally decided to abolish the revaluation clause in all contracts concluded by the public sector.

After years of slight but steady increase, total employment fell by 0.5% during the first quarter of 2003; however, employment started to rise from February. Employment declines continued in manufacturing, in particular in the textile industry, the manufacture of coke and petroleum products and in electrical machinery and equipment. Registered unemployment decreased from February, mainly due to deletions from the register, but the registered unemployment rate remained at around 11%. The Labour Force Survey unemployment rate, traditionally much lower, increased from 6.5% in the last quarter of 2002 to 7% in the first quarter of 2003 – affecting first of all males.

The current account deteriorated slightly during the first quarter of 2003. This was largely the result of an increasing trade deficit, with imports growing faster than exports. In contrast to 2002, when Slovenia reported substantial growth rates in trade with the successor states of former Yugoslavia, in the first quarter of 2003 exports to that region fell by 1.2% whereas imports grew by 11%. Trade with Russia has been contracting as well. Trade with the EU performed below average: in particular exports to Germany (absorbing about one quarter of total exports) fell by 4%, those to France by 14%. The FDI inflow was less impressive than a year before when bank privatizations and several enterprise takeovers had resulted in a record inflow of foreign capital. In the first quarter of 2003 FDI worth EUR 74 million flew into the country, as against EUR 327 million in the same period a year earlier. External debt totalled USD 9.3 billion at the end of March, an increase by about 6% over the end of 2002, which is largely the result of the strengthening of the euro vis-à-vis the US dollar (most of Slovenia's foreign debt is denominated in euros).

The second monitoring report of the EU Commission (published in May 2003) stated that Slovenia and Lithuania were the only two accession countries having fulfilled all their commitments, but both 'need to continue with intense preparations'. By the end of May, Slovenia and the EU signed an agreement on the further liberalization of trade in agricultural products. The arrangement, taking effect on 1 July, foresees the liberalization of 90% of Slovenian agricultural exports to the EU, whereas the respective share on the import side is 75%.

Owing to the weak external environment, especially in Germany, and the relatively slow recovery of domestic demand, a revision of economic forecasts made earlier became necessary. The central bank and the government revised their target rates for GDP growth from 3.5-3.7% down to 3-3.1%. Assuming that the current trends will continue, a GDP growth rate below 3% cannot be excluded. Inflation will slow down to about 5.5% in 2003 and 4% in 2004. The current account might close with a slight surplus in both 2003 and 2004.

Table SI

Slovenia: Selected Economic Indicators

	1998	1999	2000	2001	2002 1)	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year	1982.6	1985.6	1990.3	1992.0	1995.7	.	.	.	.
Gross domestic product, SIT bn, nom.	3253.8	3648.4	4222.4	4741.0	5284.5	.	.	5710	6180
annual change in % (real)	3.8	5.2	4.6	2.9	3.2	2.5	2.3	2.5	3.5
GDP/capita (USD at exchange rate)	9878	10109	9527	9804	11022	.	.	.	.
GDP/capita (USD at PPP - wiiw)	14840	15810	16850	17730	18460	.	.	.	.
Gross industrial production									
annual change in % (real)	3.7	-0.5	6.2	2.9	2.4	1.7	0.8	1.5	2
Gross agricultural production									
annual change in % (real)	2.2	-1.3	2.4	.	.	.	.	.	.
Goods transport, mn t-kms 2)	36733	40041	37003	41505	36312	9585	9313	.	.
annual change in %	-3.0	9.0	-7.6	5.6	-12.5	-9.0	-2.8	.	.
Gross fixed capital form., SIT bn, nom.	800.6	999.2	1085.9	1132.0	1209.1	.	.	.	.
annual change in % (real)	11.3	19.1	0.2	-0.8	3.1	2.5	5.6	5.5	5.5
Construction output, in effect. working time									
annual change in % (real)	1.7	10.2	-1.2	-2.1	-3.4	-7.1	.	.	.
Dwellings completed, units 3)	6518	5142	6460	5475	4757	1267	.	.	.
annual change in %	7.1	-21.1	25.6	-5.8	-13.1	-15.8	.	.	.
Employment total, th pers., average	745.2	758.5	768.2	779.0	783.5	781.2	777.1	.	.
annual change in %	0.2	1.8	1.3	1.4	0.6	1.2	-0.5	.	.
Employees in industry, th pers., average	246.2	242.8	241.6	243.5	246.1	245.5	.	.	.
annual change in %	-0.9	-1.4	-0.5	0.8	1.1	1.0	.	.	.
Reg. unemployed, th pers, end of period	126.6	114.3	104.6	104.3	99.6	103.5	98.8	.	.
Reg. unemployment rate in %, end of period	14.6	13.0	12.0	11.8	11.3	11.7	11.3	10.5	10
LFS - unemployment rate in %, average	7.9	7.6	7.0	6.4	6.4	6.9	7.0	6.5	6
Average gross monthly wages, SIT	158069	173245	191669	214561	235436	225557	244095	.	.
annual change in % (real, net)	1.5	3.0	1.4	3.1	2.1	1.2	1.8	.	.
Retail trade turnover, SIT bn 4)	1346.7	1555.0	1557.4	1684.8	.	.	.	.	.
annual change in % (real) 5)	2.1	2.9	7.4	7.8	4.7	3.8	.	.	.
Consumer prices, % p.a.	7.9	6.1	8.9	8.4	7.5	8.1	6.3	5.5	4.5
Producer prices in industry, % p.a.	6.0	2.1	7.6	8.9	5.1	5.8	3.0	.	.
General government budget, SIT bn									
Revenues	1397.9	1590.0	1726.7	1967.8	2083.9	392.1	.	.	.
Expenditures	1423.5	1613.3	1781.4	2031.0	2241.5	520.8	.	.	.
Deficit (-) / surplus (+)	-25.6	-23.3	-54.7	-63.2	-157.6	-128.7	.	.	.
Deficit (-) / surplus (+), % GDP	-0.8	-0.6	-1.4	-1.4	-3.0	.	.	.	.
Money supply, SIT bn, end of period									
M1, Money	332.7	399.8	424.0	502.2	563.4	485.2	.	.	.
Broad money	1690.3	1912.9	2206.4	2877.4	3371.9	2970.7	.	.	.
Discount rate % p.a., end of period 6)	10.0	8.0	10.0	11.0	7.3	7.8	6.5	.	.
Current account, USD mn	-118.0	-698.4	-547.6	30.9	375.0	64.6	-30.2	100	100
Current account in % of GDP	-0.6	-3.5	-2.9	0.2	1.7	.	.	0.4	0.4
Gross reserves of NB excl. gold, USD mn	3638.5	3168.0	3196.0	4329.9	6980.2	4521.0	7114.5	.	.
Gross external debt, USD mn	4915	5400	6217	6717	8799	6680	.	.	.
Exports total, fob, EUR mn 7)	8051.9	8037.0	9505.1	10348.7	10965.8	2653.2	2741.5	11300	11800
annual growth rate in %	8.6	-0.2	18.3	8.9	6.0	1.6	3.3	3	4
Imports total, cif, EUR mn 7)	8999.4	9482.0	10995.7	11345.4	11574.2	2818.9	2990.1	12000	12400
annual growth rate in %	8.6	5.4	16.0	3.2	2.0	0.1	6.1	4	3
Average exchange rate SIT/USD	166.13	181.77	222.68	242.75	240.24	254.57	215.64	213	218
Average exchange rate SIT/EUR (ECU)	186.27	193.63	205.03	217.19	226.22	222.92	231.30	234	240
Purchasing power parity SIT/USD, wiiw	110.56	116.20	125.91	134.23	143.43	.	.	.	.
Purchasing power parity SIT/EUR, wiiw	120.39	126.58	137.94	147.10	155.08	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 new methodology in road transport. - 3) From 2001 dwellings for which building permits were issued. - 4) Including turnover tax; goods transport services, maintenance and repair of motor vehicles are not covered. - 5) Excluding turnover tax; maintenance and repair of motor vehicles are included. - 6) From 2002 main refinancing rate. - 7) Converted from the national currency to EUR at the official exchange rate.

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

Hermine Vidovic

Croatia: strong growth, weak external position

The main economic indicators point to a dynamic development during the first months of the year 2003. Driven primarily by domestic demand, most of all by strong (public) investment activities (up 16%), GDP grew by 4.9% in the first quarter. Industrial production rose by 5.8% in the period January-May, of which non-durable consumer goods were up 8.8% whereas the production of capital goods remained almost stagnant. Within manufacturing, with 5.5% output growth on average, publishing and printing, manufacture of fabricated metal products, non-metallic mineral products and radio, television and communication equipment grew faster than average. Substantial output declines were reported for manufacture of chemicals, other transport equipment and wood products.

Retail trade, though soaring by 7.6% in the first four months of the year, performed less dynamically than a year earlier when the turnover jumped by 13% in real terms. This is also reflected in the slower growth of corporate and household borrowing during the first quarter of 2003 as compared to the extraordinarily high growth rates observed in 2002. Thus, banks seem to have adjusted to credit restrictions imposed by the central bank at the beginning of the year. The construction industry has continued its upward trend in 2003 primarily related to the construction of the Zagreb-Split motorway and other infrastructure projects.

Following the introduction of stricter registration rules, the number of unemployed is falling. By the end of April, the unemployment rate stood at 20.4%, down from 23.2% in April last year. At the same time, employment slightly exceeded the previous year's level. A new labour law aiming at the liberalization of the labour market has entered the parliament procedure against strong opposition on the part of the trade unions.

Thanks to the shipbuilding industry, foreign trade developed dynamically during the first quarter of the year. Measured in current US dollar terms, exports expanded by almost 40%; imports grew slightly less, by 37%. The trade deficit was about one third higher than during the first three months of 2002 and the current account deficit increased from USD 875 million to USD 1 billion. Trade figures expressed in euro terms (eliminating the dollar depreciation against the euro and the kuna) present a different picture: accordingly, total exports expanded by 15.4%, while imports grew by 12.4%, resulting in a trade deficit of EUR 1.4 billion (10% higher than in the same 2002 period).

In the first quarter of 2003, foreign debt increased by USD 1.7 billion as against December 2002 and reached nearly USD 17 billion. According to the central bank, part of this increase (USD 330 million) is due to currency adjustments (most of the country’s debt is denominated in euro) whereas the actual rise of the debt is given as USD 1.36 billion. Until the end of the year, debt is expected to grow by a further USD 2.5 billion, thus reaching USD 19.5 billion. Looking at different debt indicators, we obtain an inconsistent picture. The debt to GDP ratio – about 87% of the (2002) GDP – is alarming, while the ratio of debt to exports of goods and services is not. The burden of the debt service is similarly ambiguous. Total debt service as a share to exports of goods and services is approaching the threshold of high indebtedness, while the burden of interest payments is still not worrisome. From the overview of these indicators it follows that Croatia is not facing immediate problems concerning its foreign debt. The medium-term assessment, however, has to be more cautious, especially in 2004 and 2005, when debt servicing (principal and interest payments) will amount to approximately USD 2.8 billion per year.

Fiscal developments are still lacking transparency and comparisons with previous years are next to impossible. During the first quarter of 2003 the consolidated central government budget closed with a HRK 2.6 billion deficit, similar to that in the same 2002 period. The deficit was almost exclusively financed via foreign sources (eurobond issue). According to the standby arrangement agreed upon with the IMF in February 2003, the general government deficit should not exceed 5% in 2003, a challenging task in view of the elections to be held in autumn. Contrary to news according to which the privatizations of the INA oil company and the biggest insurer might be delayed, the Croatian government has announced in an Addendum to the Letter of Intent submitted to the IMF in mid-June that the partial sale of INA may materialize by the end of the month and a 25% plus one share of Croatia Osiguranje will be offered to the catholic church and other investors (instead of selling 30% of the company at the Zagreb Stock Exchange as stated earlier).

In February 2003 Croatia submitted its application for EU membership, aspiring to enter the Union together with Bulgaria and Romania, who intend to accede in 2007. However, in a recent statement EU enlargement commissioner Verheugen declared that it was too early to say whether Croatia could catch up with the two countries. The EU Commission will have to prepare an opinion, which may take some time, as it requires an examination of the entire legislation and the political system of the country.

The outlook for 2003 is still positive and wiiw adheres to its forecast made earlier. Owing to a slowdown of private consumption as a consequence of the credit squeeze, GDP growth will be somewhat lower than in 2002 but with a 4% increase still satisfactory. Strong investment activities will continue due to motorway construction and other infrastructure projects. The current account and trade deficits will continue to grow.

Table HR

Croatia: Selected Economic Indicators

	1998	1999	2000	2001	2002 1)	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year 2)	4501	4554	4437	4437	.	.	.	.	.
Gross domestic product, HRK mn, nom.	137604	141579	152519	162909	176429	40456	43492	187200	196100
annual change in % (real)	2.5	-0.9	2.9	3.8	5.2	4.3	4.9	4	3.7
GDP/capita (USD at exchange rate)	4805	4371	4153	4403	5065	.	.	.	.
GDP/capita (USD at PPP - wiiw)	8240	8180	8820	9380	9990	.	.	.	.
Gross industrial production 3)									
annual change in % (real)	3.7	-1.4	1.7	6.0	5.4	1.9	4.6	5.5	5
Gross agricultural production									
annual change in % (real)	10.2	-3.5	-10.0	8.4	.	.	.	.	.
Goods transport, public, mn t-kms 4)	170107	146302	146852	142440	139417	30656	30236	.	.
annual change in %	-16.4	-14.0	.	-1.0	-2.1	-2.2	-1.4	.	.
Gross fixed capital form., HRK mn, nom.	32065.6	33025.0	33281.0	37252.0	43674.0	9810.0	11691.0	.	.
annual change in % (real)	2.5	-3.9	-3.8	9.7	10.1	9.4	16.2	12	8
Construction industry, hours worked 3)									
annual change in % (real)	0.7	-7.7	-9.1	3.6	12.8	10.6	19.2	.	.
Dwellings completed, units	12557	12175	12187	18088	.	.	.	.	.
annual change in %	0.3	-3.0	0.1	48.4	.	.	.	.	.
Employment total, th pers., average 5)	1384.8	1364.5	1341.0	1348.3	1340.8	1337.9	1339.7	.	.
annual change in % 5)	0.4	-1.5	-1.7	0.5	-0.6	0.9	0.1	.	.
Employees in industry, th pers., average	308.9	299.5	291.9	287.2	277.2	280.6	274.3	.	.
annual change in %	-3.4	-3.0	-2.5	-1.6	-3.5	-2.0	2.2	.	.
Reg. unemployed, th pers, end of period	302.7	341.7	378.5	395.1	366.2	415.4	355.8	.	.
Reg. unemployment rate in %, end of period	18.1	20.4	22.3	23.1	21.5	23.8	21.0	20	18
LFS - unemployment rate in %, average	11.4	13.6	16.1	15.9	14.8	.	.	14.5	14
Average gross monthly wages, HRK	4131	4551	4869	5061	5366	5133	5459	.	.
annual change in % (real, net)	6.0	10.1	3.4	1.6	3.1	-0.9	5.7	.	.
Retail trade turnover, HRK mn	.	.	.	.	.	.	.	.	.
annual change in % (real)	0.1	-3.5	10.0	10.0	12.5	13.0	7.6	.	.
Retail prices, % p.a.	5.7	4.2	6.2	4.9	2.2	3.2	1.7	2	1
Producer prices in industry, % p.a.	-1.2	2.6	9.7	3.6	-0.4	-2.6	3.4	.	.
Central government budget, HRK mn 6)									
Revenues	43809	46356	44636	53504	70929	14611	17028	.	.
Expenditures	42552	48879	50744	57813	74940	17225	19668	.	.
Deficit (-) / surplus (+)	1257	-2523	-6108	-4309	-4010	-2614	-2640	.	.
Deficit (-) / surplus (+), % GDP	0.9	-1.8	-4.0	-2.7	-2.3	-6.5	-6.1	.	.
Money supply, HRK mn, end of period									
M1, Money	13531	13859	18030	23704	30870	24375	29512	.	.
Broad money	57340	56659	73061	106071	116142	106245	118791	.	.
Discount rate % p.a., end of period	5.9	7.9	5.9	5.9	4.5	5.9	4.5	.	.
Current account, USD mn	-1452.8	-1397.8	-438.9	-616.8	-1546.7	-867.0	-1006.0	-1800	-1200
Current account in % of GDP	-6.7	-7.0	-2.4	-3.2	-6.9	-18.2	-16.4	-6.6	-4.2
Gross reserves of NB excl. gold, USD mn	2815.7	3025.0	3524.8	4704.2	5885.8	4885.5	6208.0	.	.
Gross external debt, USD mn	9683.3	9977.9	11054.8	11316.6	15241.7	11388.9	16996.0	.	.
Exports total, fob, EUR mn 7)	4046.2	4027.3	4818.0	5210.4	5182.5	1180.6	1362.3	5400	5500
annual growth rate in %	10.4	-0.5	18.9	8.1	-0.5	-0.3	15.4	4	2
Imports total, cif, EUR mn 7)	7476.9	7324.1	8588.5	10232.4	11316.3	2447.2	2751.5	12600	12900
annual growth rate in %	-7.2	-2.0	16.8	19.1	10.6	12.0	12.4	11	2
Average exchange rate HRK/USD	6.36	7.11	8.28	8.34	7.86	8.51	7.07	6.9	6.9
Average exchange rate HRK/EUR (ECU)	7.14	7.58	7.63	7.47	7.41	7.46	7.58	7.5	7.5
Purchasing power parity HRK/USD, wiiw	3.71	3.80	3.90	3.92	3.99	.	.	.	.
Purchasing power parity HRK/EUR, wiiw	4.04	4.14	4.27	4.29	4.31	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 19 employees. - 4) From 2001 new methodology. - 5) Including persons employed at the Ministry of Defence and Ministry of Internal Affairs. - 6) Methodological changes in June 2001 and January 2002 with respect to the stepwise inclusion of extrabudgetary funds. - 7) From 2000 new method of statistical processing. Converted from the national currency to EUR at the official exchange rate.

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

Peter Havlik

Russia: a turnaround in investments and higher GDP growth

Contrary to gloomy global economic trends, Russian GDP growth accelerated to nearly 7% in the first five months of 2003 – double the rate reported for the corresponding period of the previous year.[27] High world market prices for the main commodities of Russian exports (energy and metals) played a role, but there has been the long-awaited upturn in investment activity as well. Albeit starting from a very low basis, a 10% increase in investments is encouragingly good news as it may lay the foundations for more sustainable economic growth in the coming years. Private consumption and real household incomes have been growing for the fourth consecutive year by around 10% annually.

The recent investment recovery can be explained by several factors, both internal (domestic) and external. First, strong external demand and favourable prices have facilitated high revenues and profits in the Russian energy and metals sectors, which together account for about two thirds of total investments. Second, the global economic weakness, low interest rates and depressed yields on international bond and stock markets have made investments in Russia more attractive. Even the Russian banks have now apparently started to extend more credits to the real economy instead of seeking safe offshore havens. Last but not least, the robust economic growth during the last couple of years (more than 6% per year on average), together with the steady progress in reforms and political stability of Putin's presidency are apparently starting to bear fruit: The inflow of foreign investment was up 50% in the first half of 2003, while Russian investment abroad (and the capital flight) have dropped by nearly one third.

Export revenues in January to March 2003 were up more than 40% in US dollar terms compared to a year earlier (the average export price of crude oil was 50% higher than the year before); imports increased by more than 20%. The estimated foreign trade surplus exceeded USD 28 billion in the first half of 2003 and the current account surplus reached USD 21 billion (+46% compared to the first half of 2002). Foreign exchange reserves of the Central Bank have been growing steadily, reaching nearly USD 65 billion in June 2003, thus comfortably covering the annual value of imports. Even though export revenues are expected to bottom out with falling oil prices in the course of the year, the debt service problem of 2003 is definitely not relevant any more (during the period January to April 2003, Russia made scheduled debt service payments of USD 5.2 billion). The recent shift in the EUR/USD exchange rate is important for Russia. Apart from statistical effects on trade growth (in euro terms, export and import growth figures are about 20 percentage

27 Moreover, the revision of official Goskomstat national accounts data for the period 1995-2000 raised the GDP growth estimate to 6.4% in 1999 and to 10% in 2000, mainly due to new estimates of services and external accounts.

points lower than in US dollar terms), there are price and terms of trade effects as well. The bulk of Russian exports is quoted in US dollars, but the majority of imports is priced in euros. With the weakening of the dollar, export revenues in dollars buy less imports in euros. Although the strengthening of the euro was overcompensated by higher oil prices in dollars in the first months of 2003 (and the Russian terms of trade improved accordingly during that period), import prices expressed in roubles increased as well. A combination of lower oil prices and a stronger euro will make Russian imports more expensive, the terms of trade will deteriorate and may fuel inflation.

Inflation has been stubborn, with monthly CPI inflation hovering at around 1% and the producer prices increases even a bit higher. On an annual basis, the estimated average annual inflation in 2003 will remain close to 15% (about the same as in the previous year), which is more than the officially targeted 10-12% (but GDP growth is also higher than originally projected). Apart from monetary factors related to foreign exchange inflows, the growth of administered prices contributes to inflationary pressures; the core inflation is much lower. The Central Bank's policy aiming at the stability of the RUR/USD nominal exchange rate (implying some real appreciation against the dollar) is dampening inflationary pressures, though a stronger euro is pushing import prices up. Despite growing expenditure, the surplus in the federal budget exceeded 3% of GDP in the first quarter of the year. Industrial production grew by more than 6% year on year in the first months of 2003, largely thanks to expanding output in the basic metals and fuels sectors (+10%). Construction output (+13.6%) accelerated as well. The robust economic growth facilitates a stabilization and recently even some increase of employment; the rate of unemployment fell below 9% (according to the revised Labour Force Survey statistics) in April 2003.

All this largely positive news is clouded by the pre-election reform stalemate, lagging implementation of legal regulations and, last but not least, by growing structural distortions in the economy. The sound foundations for a sustainable development are still missing. The impressive GDP growth during the past couple of years has been a windfall of the rouble devaluation after 1998 and, more recently, of high world market energy prices again. The large part of manufacturing industry remains decimated. The recent upturn in investments is encouraging, but these remain concentrated in the energy (and related transport) sectors. Despite some increase in the first quarter of 2003, FDI inflows are still disappointingly low.

Though improving, the outlook for sustainable growth remains problematic as the country continues to be highly dependent on volatile commodity prices. We expect economic growth to hover around 5%; Putin's declared target of doubling the Russian GDP during the next decade would require 7% annual growth rates and appears unrealistic despite the high GDP growth in the first five months of 2003.

Table RU

Russia: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast
Population, th pers., end of period	146693	145925	145185	144321	144079	.	.	143500	143200
Gross domestic product, RUB bn, nom.	2629.6	4823.2	7305.6	9039.4	10863.4	2267.7	2900.4	12900	14900
annual change in % (real)	-5.3	6.4	10.0	5.0	4.3	3.0	6.9	5.0	4.5
GDP/capita (USD at exchange rate)	1844	1339	1785	2141	2403	.	.	.	.
GDP/capita (USD at PPP - wiiw)	5490	5950	6720	7260	7690	.	.	.	.
Gross industrial production									
annual change in % (real)	-5.2	11.0	11.9	4.9	3.7	2.6	6.0	5	5
Gross agricultural production									
annual change in % (real)	-13.2	4.1	7.7	7.5	1.7	5.5	1.1	.	.
Goods transport, bn t-kms	3147	3315	3480	3592	3793	918	.	.	.
annual change in %	-3.3	5.3	5.0	3.2	5.6	4.1	.	.	.
Gross fixed investment, RUB bn, nom.	407.1	670.4	1165.2	1599.5	1660.5	254.4	330.0	.	.
annual change in % (real)	-12.0	5.3	17.7	8.7	2.6	1.2	10.2	6.9	7.1
Construction output total									
annual change in % (real)	-5.0	6.0	17.0	9.9	2.7	2.6	13.6	.	.
Dwellings completed, th units	387.7	389.8	373.4	381.6	395.8	53.9	59.5	.	.
annual change in %	-9.9	0.5	-4.2	2.2	3.7	22.5	10.4	.	.
Employment total, th pers., average	63812	63963	64327	64710	65650	65100 [2]	64400 [2]	.	.
annual change in %	-1.4	0.2	0.6	0.6	1.5	2.8 [2]	-1.1 [2]	.	.
Employment in industry, th pers., average	14162	14297	14543	14692	14768	.	.	.	.
annual change in %	-5.0	1.0	1.7	1.0	0.5	.	.	.	.
Reg. unemployed, th pers, end of period	1929.0	1263.4	1037.0	1122.7	1309.0	1269.8	1628.0	.	.
Reg. unemployment rate in %, end of period	2.7	1.7	1.4	1.6	1.8	1.8	2.3	.	.
LFS - unemployment rate in %, average [3]	13.5	13.0	10.5	9.1	8.0	8.4	9.1	7.5	8
Average gross monthly wages, RUB	1051.5	1522.6	2223.4	3240.4	4426.0	3838.7	4794.3	.	.
annual change in % (real, gross)	-13.3	-22.0	20.9	19.9	16.6	17.2	10.8	.	.
Retail trade turnover, RUB bn	1077.0	1848.2	2416.2	3151.5	3861.7	845.9	1036.2	.	.
annual change in % (real)	-3.5	-6.3	8.8	10.6	8.9	8.9	8.4	.	.
Consumer prices, % p.a.	27.6	85.7	20.8	21.6	16.0	18.0	14.6	14	10
Producer prices in industry, % p.a.	7.1	58.9	46.6	19.1	11.7	7.2	19.4	15	10
Central government budget, RUB bn									
Revenues	325.9	615.5	1132.1	1590.7	2202.2	472.4	581.0	.	.
Expenditures	472.2	666.9	1029.2	1325.7	2046.0	364.3	490.0	.	.
Deficit (-) / surplus (+)	-146.3	-51.4	102.9	265.0	156.2	108.1	91.0	.	.
Deficit (-) / surplus (+), % GDP	-5.3	-1.1	1.4	2.9	1.4	4.7	3.3	.	.
Money supply, RUB bn, end of period									
M1, Money	342.8	526.8	879.3	1192.6	1499.2	1106.3	1513.9	.	.
M2, Money + quasi money	628.6	984.9	1560.0	2122.7	2843.6	2137.7	2991.0	.	.
Refinancing rate of NB % p.a., end of per.	60	55	25	25	21	25	18	.	.
Current account, USD mn	219	24616	46839	34959	32807	6761	11481	27000	25000
Current account in % of GDP	0.1	12.6	18.0	11.3	9.5	9.2	12.5	6.7	5.7
Gross reserves of NB, excl. gold, USD mn	7801	8458	24264	32542	44054	33179	51790	.	.
Gross external debt, USD mn	189200	178600	161400	150800	152100	149900	153500	.	.
Exports total, fob, EUR mn [4]	66467	70820	113672	113448	113172	24635	28352	117000	118000
annual change in %	-13.3	6.5	60.5	-0.2	-0.2	-11.0	15.1	3	1
Imports total, cif, EUR mn [4]	51798	37061	48552	60025	64049	14090	14211	65000	70000
annual change in %	-18.4	-28.5	31.0	23.6	6.7	15.2	0.9	2	8
Average exchange rate RUB/USD	9.71	24.62	28.12	29.17	31.35	30.78	31.66	32	34
Average exchange rate RUB/EUR (ECU)	11.06	26.24	26.03	26.13	29.65	26.98	33.98	35	37
Purchasing power parity RUB/USD, wiiw	3.26	5.54	7.47	8.60	9.80	.	.	11.2	.
Purchasing power parity RUB/EUR, wiiw	3.55	6.04	8.19	9.42	10.60	.	.	.	.

Notes: 1) Preliminary. - 2) Based on Labour Force Survey data. - 3) In 1998 data refer to October. - 4) Based on balance of payments statistics, including estimate of non-registered trade. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

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

Helen Boss Heslop

Ukraine: good results on several fronts

The Ukrainian economy grew by 7.3% in January-May 2003. This represents a remarkable improvement over the 4.8% recorded in 2002 as a whole. Demand in 2003 has been boosted by a strong pickup in investment, including construction, a revival of exports to Russia, by ongoing strong rises in real wages and money incomes, and by growth in transport services. In January-March 2003, both consumer- and, especially, producer-price inflation were more rapid than during the same period of 2002, but the rises appear benignly 'Keynesian', and remain well below Russia's. The currency has followed the dollar down, boosting export prospects, *cet. par.*, in the eurozone. Having met a large set of payments in March, the government in June easily raised USD 800 million worth in ten-year notes at 7.75%, despite the absence of an IMF agreement, as the debt-to-GDP ratio remains modest.

Industrial growth also accelerated in the first months of 2003. In the first five months of the year, measured value added in the construction sector was up 17.5% year on year; sales of electricity, gas and water rose 11.5%. Manufacturing, which accounts for over three-quarters of industrial production, grew an impressive 12.8%. This was both an acceleration on first-quarter figures and more than twice the rate recorded in January-May 2002. Within industry, in the first four months many of the usual suspects again outperformed: the food industry gained 15.9%, sales of forest products were up 20.4%, ferrous and non-ferrous metals were up 14% after a weak 2002, machine tools rose 21.1%, and certain chemicals also did well. Output of petroleum products was flat, however, after strong growth in 2002. Agricultural production stagnated in the first four months, and frosts have been blamed for major losses of winter crops, so a poor harvest and food price rises are forecast; state bodies are threatening to restrict exports in consequence. The reform-minded former deputy prime minister for agriculture has been arrested on corruption charges in connection with state-mediated exports of the 2002 bumper grain crop, to a chorus of western protests.

Budget revenues were about on target in the first quarter, even allowing a slight surplus, though VAT and other tax arrears persist. On the planned outlay side, wage, salary and VAT refund arrears remain problematic. In the energy sphere, about a quarter of gas remains unpaid for, affecting tax collections from the sector; still, prices charged have been raised much closer to world levels than in Russia. FATF (Financial Action Task Force) anti-money laundering sanctions have been called off.

Real wages and incomes continue to rise strongly. A flat income tax similar to Russia's is due to be levied beginning in January 2004, designed to increase revenue by widening the base and removing exemptions (shrinking the shadow economy). If this fails, it may prove difficult for the government to fund election-year planned increases in minimum wages and pensions without boosting inflation. Demographic data point to severe poverty and unemployment. Between 2 and 7 million citizens may be working illegally abroad, many on a seasonal basis, an outlet threatened by plans to tighten visa regimes in accession countries like Poland. Some 11% of the labour force is unemployed on ILO definitions. In Transcarpathia nearly half the population is below the poverty line, notwithstanding several years' rapid growth in the forest products sector. The UN projects that population will drop by a third by 2050.

Ukraine's international standing has moved out of the basement thanks to opportunities afforded by the Iraq conflict. Ukraine gained favour with the US by contributing specialist personnel both during and after the hostilities. The Kolchuga radar system, whose illegal sale to the Iraqis was allegedly approved by President Kuchma, has not been found; at any rate it was not blamed for losses of coalition air personnel.

Exports and trade generally benefited from the dollar's decline and Russia's oil-inflated current account surplus. The dollar value of exports surged 25% in the first quarter. Imports rose 27.4%, even as the trade balance remained strongly positive. Exports to Russia rose over a quarter, after falling in 2002. Measured in euros, goods exports to all destinations in the first quarter also managed a 4.3% rise on an annual basis; this effect should be more pronounced in the second quarter.

For internal reasons, and owing to Ukraine's weak record on reforms, EU enlargement officials have stopped dangling the carrot of possible future membership to the Kuchma government. Ukraine, Belarus and Moldova are presently in a less-favoured group than e.g. Albania or Serbia-Montenegro, or indeed, Turkey; the relationship suggested for Ukraine as of mid-2003 is similar to those offered North African and other African countries: no talk of eventual membership, but closer economic integration and enhanced political cooperation in exchange for political, economic and institutional reform, based on 'shared values'. An important incentive remains, however, the prospect of visa-free travel. The current PCA (Partnership and Cooperation Agreement) with the EU does not include significant preferential trade provisions, and has been poorly implemented in any event. Ukraine is therefore concentrating on its WTO negotiations, and may qualify in 2004. However Russia is pushing Ukraine to coordinate WTO concessions, and indeed the deal on the Odessa-Brody pipeline, with it. Timely creation of a 'common economic space' with Russia et al., to involve free trade, common external tariffs and adoption of the rouble, seems fanciful.

The pre-election season is beginning. Presidential elections are scheduled for the autumn of 2004, and according to the constitution, incumbents are not eligible for a third term.

There are rumours that President Kuchma may try to retain power and immunity from future corruption charges by engineering a change in the constitution to create an upper chamber of regions, where e.g. he might stay on as 'queen' or 'first senator for life'. Ex-Prime Minister Yushchenko remains the favourite to win the presidency under the current rules. One strategy which might spare President Kuchma the fate of e.g. his ex-Prime Minister Lazarenko, currently being prosecuted for money laundering and embezzlement in several countries, would be to hand-pick a successor such as, for example, Prime Minister Yanukovych. At present it seems likely that e.g. Yushchenko would defeat Yanukovych, but it is too early to say whether Kuchma will manage to wangle an honorary position for his retirement years – fences with both Russia and western countries are being mended, the economy is improving, Russia still has oil money to spend, and 16 months are a long time in politics.

Table UA

Ukraine: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., end of period [2]	50105.6	49710.8	49291.2	48415.5	48003.5	.	47879.4	47650	47350
Gross domestic product, UAH mn, nom.	102593	130442	170070	204190	220932	43699	48346	257500	286500
annual change in % (real)	-1.9	-0.2	5.9	9.2	4.8	4.1	7.0	6	4
GDP/capita (USD at exchange rate)	833	633	632	781	860	.	.	965	1045
GDP/capita (USD at PPP - wiiw)	3630	3710	4040	4600	4920	.	.	.	.
Gross industrial production									
annual change in % (real)	-1.0	4.0	12.4	14.2	7.0	5.9	10.7	9.0	7.0
Gross agricultural production									
annual change in % (real)	-9.6	-6.9	9.8	10.2	1.9	11.1	1.3	0	5
Goods transport, bn t-kms	391.7	388.0	394.1	393.8	.	.	.	.	.
annual change in %	-2.6	-0.9	1.6	-0.1	3.3	3.0	10.0	.	.
Gross fixed investment, UAH mn, nom.	13958.0	17552.0	23629.0	32573.0	37178.0	4804.8	.	.	.
annual change in % (real)	6.1	0.4	14.4	20.8	8.9	9.6	23.1	10	15
Construction output total									
annual change in % (real)	2.7	-8.0	9.1	16.7	-0.7	-5.0	.	.	.
Dwellings completed, units	70000	73000	62600	65000	.	.	.	.	.
annual change in %	-12.5	4.3	-14.2	3.8	3.2	4.6	-17	.	.
Employment total, th pers., average	22348.7	21823.7	21268.5	20941.9	20100	.	.	20000	.
annual change in %	-1.1	-2.3	-2.5	-1.5	.	.	.	.	.
Employees in industry, th pers., average [3]	4142.0	3932.0	3445.0	3806.0	.	.	.	.	.
annual change in %	-3.1	-5.1	-12.4	-6.1	.	.	.	.	.
Reg. unemployed, th pers, end of period	1003.2	1174.5	1155.2	1008.1	1034.2	1079.2	1109.4	.	.
Reg. unemployment rate in %, end of period	3.7	4.3	4.2	3.7	3.8	3.9	4.0	4	4
LFS - unemployment rate in %, average	11.3	11.9	11.7	11.1	10.2	10.6	.	11	11
Average gross monthly wages, UAH [3]	153.0	177.5	230.1	311.1	376.4	334.8	402.4	.	.
annual change in % (real, gross)	-3.2	-5.4	1.1	20.7	20.0	21.3	17.6	.	.
Retail trade turnover, UAH mn	19317	22151	28757	34417	39192	8206.6	9895.2	.	.
annual change in % (real)	-6.6	-7.1	8.1	13.7	14.8	16.8	12.4	.	.
Consumer prices, % p.a.	10.6	22.7	28.2	12.0	0.8	3.7	2.2	10	7
Producer prices in industry, % p.a.	13.2	31.1	20.9	8.6	3.1	-0.3	7.8	5	0
General government budget, UAH mn									
Revenues	28915.8	32876.4	49117.9	54934.6	60812.1	12689.0	15375.8	50021 [4]	.
Expenditures	31195.7	34820.9	48148.6	55528.0	59085.2	12028.4	13504.5	52056 [4]	.
Deficit (-) / surplus (+)	-2279.9	-1944.5	969.3	-593.4	1726.9	660.6	1871.3	-2035 [4]	.
Deficit (-) / surplus (+), % GDP	-2.2	-1.5	0.6	-0.3	0.8	1.5	3.9	-0.83 [4]	.
Money supply, UAH mn, end of period									
M0, Currency outside banks	7158	9583	12799	19465	26434	19646	26000	.	.
Broad money	15718	22070	32084	45555	64532	47345	69731	.	.
Refinancing rate of NB % p.a., end of period	74.2	45.0	27.0	12.5	7.0	11.5	7.0	.	.
Current account, USD mn	-1296	1658	1481	1402	3173	827	1082	1800	.
Current account in % of GDP	-3.1	5.2	4.7	3.7	7.7	10.1	11.9	4.0	.
Gross reserves of NB excl. gold, USD mn [5]	761	1046	1352	2955	4241	2962.3	4447.8	4500	.
Gross external debt, USD mn	11483	12438	10350	12100	10200	.	.	10563	11000
Exports total, fob, EUR mn [6]	11283	10856	15771	18159	19004	4419	4607	20200	21400
annual change in %	-10.1	-3.8	45.3	15.1	4.7	7.4	4.3	6	6
Imports total, cif, EUR mn [6]	13103	11104	15104	17612	17967	4047	4225	18700	19800
annual change in %	-13.2	-15.3	36.0	16.6	2.0	5.0	4.4	4	6
Average exchange rate UAH/USD	2.450	4.130	5.440	5.372	5.327	5.319	5.334	5.7	5.8
Average exchange rate UAH/EUR (ECU)	2.768	4.393	5.029	4.814	5.030	4.662	5.718	6.3	6.4
Purchasing power parity UAH/USD, wiiw	0.561	0.705	0.850	0.913	0.932	.	.	.	.
Purchasing power parity UAH/EUR, wiiw	0.611	0.768	0.931	1.000	1.008	.	.	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census 5 Dec 2001. - 3) Excluding small enterprises. - 4) Budget passed by Parliament end December 2002. - 5) Useable. - 6) Exports and imports of goods according to customs statistics, adjusted for oil, gas and non-declarable goods. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

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

Vladimir Gligorov

Macedonia: slow recovery in sight

Industrial production was stagnant in the first half of 2003. This is an improvement after two years of decline. Foreign trade is recovering with both exports and imports growing; the trade and current account deficits are growing as well. This is a sign of recovery, as recession is usually accompanied by a decline in foreign trade. This happens as a consequence of external or internal political shocks. Thus, though external imbalances are as a rule quite high, they usually do not act as a constraint on growth. This time around, however, assuming that regional and internal stability are going to last, external imbalances may start to become a problem for the Macedonian economy in a rather short period of time.

This is for two reasons. On the one hand, foreign aid and donations are bound to decline. On the other hand, borrowing may prove to be costly for Macedonia, at least initially. Though foreign debt is not very high, it is bound to grow as a consequence of high current account deficits. In this context, the recovery of foreign direct investment inflows is important, but these would have to be in the green-field sectors as there is not much left to privatize. Green-field investments, however, have not been much in evidence so far and that cannot change very fast.

Still, the government has a window of opportunity to use the increased stability and growing openness of the economy to turn things around. At the moment, the first order of business is fiscal consolidation. Because of the near civil war situation in 2001 and slow stabilization in 2002, the fiscal balance has deteriorated significantly. The government now has to cut and restructure expenditures. Cutting means less public investments, which is unfortunate in a post-conflict environment when reconstruction is needed. Restructuring will also most probably go against investments, because of the need to add to public employment in order to meet some of the multiethnic requirements of the new constitutional arrangement. The fiscal consolidation will take a couple of years and only after that the government may start planning to address some of the urgent investments to support development.

Macedonia has a remarkably stable currency and low inflation. The banking system is also performing reasonably well. As in other Balkan countries, it is supporting consumption, both private and public, more than business investments. There is no sign yet that this will change. Risks to lending to the state and privatized sectors are still too high while new private businesses have to initially look for finances outside of the banking sector. However, the liquidity of the economy is improving and so is its profitability, so that the risk to lending may be falling. That would be helpful not only for the growth of the amount of credits but for their duration too. At the moment, long-term credits are rather scarce.

Unemployment has been the main problem of Macedonia. In the past two years, the unemployment rate has decline somewhat, due mostly to increased public employment in security services. Economic recovery, though slow, has seen some increase in employment this year too. The public sector still needs to be restructured and thus the unemployment rate cannot be expected to decline fast. It is not clear either how much more employment can be created in the services sector. As industry will continue to face problems of restructuring and modernization, it will probably continue to shed labour. Thus, the labour market situation will continue to be difficult. The new government is trying to devise an employment strategy, mostly thinking of tax incentives for first-time job seekers. The results have been modest so far.

Prospects for the next two years are moderately good. Macroeconomic stability does not seem to be threatened. Fiscal adjustment will be achieved gradually and should benefit from the economic recovery, which should accelerate in the next couple of years. There are some worries from the fact that the immediate environment is not showing signs of accelerated growth. Though Macedonia's main trading partner is the EU, the immediate neighbours are quite important as well. Serbia and Kosovo are major markets and both are having problems. Other countries in the region are either of lesser importance as trading partners or the costs of doing business are high.

Finally, the speed of EU integration of the Balkans as a whole is crucial. If the accession of Bulgaria goes on as planned and if the process of Balkan partnership with the EU proves to be meaningful, Macedonia would benefit from the stability and, hopefully, also from accelerated growth of the region.

Table MK

Macedonia: Selected Economic Indicators

	1998	1999	2000	2001	2002 [1)]	2002	2003	2003	2004
						1st quarter		forecast	
Population, th pers., mid-year	2007.5	2017.1	2026.4	2034.9	2044.0	.	.	.	.
Gross domestic product, MKD mn, nom.	194979	209010	236389	233841	238890	.	.	248500	266200
annual change in % (real)	3.4	4.3	4.5	-4.5	0.3	.	.	2	3
GDP/capita (USD at exchange rate)	1784	1821	1771	1689	1805	.	.	.	.
GDP/capita (USD at PPP - wiiw)	5890	6200	6590	6420	6480	.	.	.	.
Gross industrial production									
annual change in % (real) [2)]	4.5	-2.6	3.6	-3.0	-5.3	-14.4	3.6	1	3
Gross agricultural production									
annual change in % (real)	4.3	1.0	1.0	-10.2	.	.	.	.	.
Goods transport, mn t-kms [3)]	1302	1219	1303	2773	.	.	.	.	.
annual change in % [3)]	10.8	-6.4	6.9	112.8	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	33982	34710	38332	34716	.	.	.	.	.
annual change in % (real)	-2.6	-1.4	-3.2	.	.	.	.	.	.
Construction output, value added									
annual change in % (real)	7.7	10.4	-1.1	-14.4	-7.5	.	.	.	.
Dwellings completed, units	3253	4479	5316	4431	.	.	.	.	.
annual change in %	-24.3	37.7	18.7	-16.6	.	.	.	.	.
Employment total, th pers., average [4)]	539.8	545.2	549.8	599.3	561.3	.	.	.	.
annual change in % [4)]	5.4	1.0	0.8	9.0	-6.3	.	.	.	.
Employees in industry, th pers., average [2)]	113.6	119.8	114.4	122.5	110.9	118.6	108.5	.	.
annual change in % [2)]	-3.4	5.5	-4.5	-4.8	-9.5	.	.	.	.
Reg. unemployed, th pers, end of period	.	.	.	.	.	.	.		
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.		
LFS - unemployment rate in %, average	34.5	32.4	32.2	30.5	31.9	.	.	30	30
Average net monthly wages, MKD	9394	9664	10193	10552	11279	10881	11571	.	.
annual change in % (real, net)	3.8	3.6	-0.3	-1.9	5.0	2.7	.	.	.
Retail trade turnover, MKD mn [4)]	33215.6	38247.9	50208.6	45975.8	48882.3	11002.6	13923.0	.	.
annual change in % (real, calc.)	1.5	16.4	18.7	-13.0	4.7	-2.5	.	.	.
Retail prices, % p.a.	0.8	-1.1	10.6	5.2	1.5	1.7	2.0	2	4
Producer prices in industry, % p.a.	4.0	-0.1	10.7	2.0	-0.9	-1.9	1.5	2	4
Central government budget, MKD mn									
Revenues	42655	50478	63097	63109	67571	17893	13864	.	.
Expenditures	42623	49761	57689	68885	71692	16878	14119	.	.
Deficit (-) / surplus (+)	32	717	5408	-5776	-4121	1015	-255	.	.
Deficit (-) / surplus (+), % GDP	0.0	0.3	2.3	-2.5	-1.7	.	.	.	.
Money supply, MKD mn, end of period									
M1, Money	15178	19694	22388	25324	26406	24788	22494	.	.
M2, Money + quasi money	26003	33720	41957	69785	64222	58378	61719	.	.
Discount rate, % p.a., end of period	8.9	8.9	7.9	10.7	10.7	10.7	.	.	.
Current account, USD mn [5)]	-269.3	-32.5	-75.3	-235.4	-324.5	-104.4	-115.7	-250	-250
Current account in % of GDP	-7.5	-0.9	-2.1	-6.9	-8.8	.	.	-5.6	-5.3
Gross reserves of NB, excl. gold, USD mn	306.1	429.9	429.4	745.2	720.6	.	.	.	.
Gross external debt, USD mn [6)]	1398.6	1438.5	1437.7	1443.9	1549.0	1405.0	1539.7	.	.
Exports total, fob, EUR mn [7)]	1170.2	1116.7	1431.4	1292.3	1177.6	277.7	273.6	1250	1250
annual change in %	7.3	-4.6	28.2	-9.7	-8.9	-12.1	-1.5	6	0
Imports total, cif, EUR mn [7)]	1709.5	1664.9	2266.1	1890.8	2076.5	505.9	493.8	2180	2290
annual change in %	9.0	-2.6	36.1	-16.6	9.8	16.8	-2.4	5	5
Average exchange rate MKD/USD	54.45	56.90	65.89	68.04	64.73	69.53	57.18	56	56
Average exchange rate MKD/EUR (ECU)	61.07	60.62	60.73	60.91	60.98	60.95	61.34	61	61
Purchasing power parity MKD/USD, wiiw	16.48	16.70	17.70	17.91	18.04	.	.	.	.
Purchasing power parity MKD/EUR, wiiw	17.94	18.19	19.39	19.63	19.51	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 according to NACE. - 3) Road and rail. - 4) From 2000 according to NACE. - 5) Including grants. - 6) Medium- and long-term. - 7) Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

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

Vladimir Gligorov

Serbia and Montenegro: entering transitional recession?

In the third year of transition, industrial production in Serbia is declining (the fall was close to 4% in the first five months of 2003 over the same period last year). Similar developments were recorded in 2002, but then a temporary recovery had started in the second quarter. The current decline, starting in December 2002, persisted throughout the first half of this year. In Montenegro, however, industrial production grew by nearly 12% – though the high growth took place mostly in the first quarter of this year. Overall, industrial production declined by very close to 3% in Serbia and Montenegro in the first five months of 2003.

GDP development is not known, but it is officially not expected to grow by more than 3% for the country as a whole this year. This may look optimistic for Serbia at this moment. In addition to the decline of industrial production, agriculture is expected to suffer from the drought. Finally, the trade deficit is widening. In Montenegro, the unknown factor is tourism. Currently, there are conflicting reports about the start of the tourist season.

Why do these developments resemble a transitional recession? Mostly because of the squeeze of demand. In Serbia, in the period 2001-2002, public expenditures grew significantly and money supply too. The former was the consequence of increased foreign inflows, both of grants and from privatization. As for the latter – growth of money supply – it came with exchange rate and price stability. Thus, base money almost doubled in 2001 and again in 2002. Broad money grew somewhat less in 2001, but much more in 2002, mostly because of the fast growth of foreign currency deposits in the aftermath of euro conversion. These trends were stopped or reversed at the turn of 2002/2003. In the first quarter, money supply shrank. In addition, there was some flight from dinars into foreign currencies, mainly euros. The central bank tried to defend the exchange rate by increasing the reserve requirement for banks, but then had to reverse its decision to avert adverse development. As a consequence, for the first time since the end of 2000, the dinar depreciated perceptibly, by about 5%, in the first half of 2003.

Public revenues also suffered in the first quarter, not only because of a decline in economic activity, but because of the closing-down of the Payments Bureau. Banks were slow in taking over the handling of payments and the budget under-performed. Even without that, public expenditures have to be held in check, partly because of the growth of the foreign debt service. The fiscal situation was improving in the second quarter, however.

The other sign of transitional recession is the effect of privatization. This and the next year should see a significant speed-up of privatization. This means that many enterprises are either preparing for privatization or are undergoing post-privatization restructuring. In both cases, production is, at least temporarily, suffering. It is difficult to assess now what will be the net effect of privatization on growth in the coming two years. This assessment is difficult also because the inflow of FDI has all but stopped. Unless the trend is reversed in the second half of the year, the budget will run into problems and the pressure on the exchange rate will increase.

The growing demand in the past two years did not translate into growth of production, but supported sizeable growth of imports. Exports have grown too, but so has the trade deficit. The growth of the latter continued in the first quarter of 2003. The current account deficit is also growing because of lower transfers. As a consequence, the deficit had to be partly financed from foreign currency reserves. The situation is delicate because the level of reserves is not particularly high. The reserves of the central bank probably cover between four and five months of imports, but the exchange rate market is quite sensitive to even slight negative changes. Also, while the central bank's reserves have recovered, those of the commercial banks have not. Clearly, the IMF will continue to support the central bank – a three-year Structural Adjustment Facility (SAF) programme is being implemented – but it seems reasonably clear that monetary policy has become quite vulnerable to adverse shocks.

Another indication of the problem is the low monetization of the economy. The central bank's reserves cover broad money, M2, more than 100%. In M3 there are only foreign currency deposits in addition to M2. M2 is about 10% of the GDP. M3 to GDP is less than 20%. From this, it can also be concluded that currency substitution in the banks is almost 50%. Of course, there is additional supply of money outside of the banking sector, which is also in foreign currencies. In addition to the halt in the inflow of foreign investments, there are some signs that private transfers are being withheld and there may be some capital flight out of the country.

The developments in Montenegro are somewhat different. Facing a decline in foreign financial support, the government has been going through fiscal consolidation last year and the effort will have to continue. Also, it is facing stubborn inflation, though the euro is the official currency in Montenegro. In 2002, inflation dipped just below 10%, but may accelerate this year because of the introduction of the VAT. Montenegro's trade deficit is also high, though higher incomes from tourism help. However, there are few foreign investments and tourism cannot probably grow very much without significant new investments.

Some of these negative developments are a consequence of the assassination of Prime Minister Zoran Djindjic in March 2002. It is probably more correct to say that this event has aggravated an already worsening trend. Political instability has become a major concern.

Clearly, it will persist until elections are held, which in Serbia may come as late as the end of 2004. In Montenegro, the elections in autumn 2002 have consolidated the power of the government, but stability has proved to be elusive because of the lack of reform.

The political situation in both states has been an obstacle to better cooperation in the Union that they have forged at the beginning of this year. Though the motivation for the creation of the Union has been more in the political problems which a break-up would entail, the explicit aim of the Union is to be a vehicle of EU integration. The EU has insisted on the harmonization of the foreign trade system of the two states as the minimal condition for the start of negotiations on a Stabilization and Association Agreement (SAA) with the EU. However, Serbia and Montenegro are becoming more and more reluctant to compromise. The most difficult issue is that of tariffs. Montenegro does not want to hike its low tariffs on imports, especially of food. By contrast, Serbia is increasingly worried about the growth of imports and the effect those have on its agricultural and food production. In Serbia, this has become an election issue while in Montenegro, any further rise in prices would be difficult to accept. Currently, both states are hoping that the EU will compromise and will start the process of Stabilization and Association without insisting on the harmonization of tariffs. Of course, the problem will re-surface once negotiations on the SAA start.

The growth prospects for this year are modest. Serbia is hoping that the inflow of FDI will surge in the second half of the year and will pave the way for a recovery in the next year. It is also expecting to wind down privatization of all but large state companies, mostly in utilities, and that the newly privatized sector will start to work more efficiently and contribute to an acceleration of growth. Still, the officially projected growth rates of 3% and 5% for this and the next year seem somewhat optimistic at this point. In Montenegro, similar growth rates seem also optimistic because fiscal consolidation will have to continue and a significant surge in investments is hard to envisage.

Table YU

Serbia & Montenegro: Selected Economic Indicators *)

	1998	1999	2000	2001	2002 [1]	2002 1st quarter	2003 1st quarter	2003 forecast	2004 forecast
Population, th pers., mid-year	10616.9	8372.7	8342.5	8326.4	8304.7	.	.	.	.
Gross domestic product, USD mn, nom. [2]	15487	10090	8670	11545	15686	.	.	19500	20900
annual change in % (real) [3]	2.5	-21.9	6.4	5.1	3.0	.	.	2	4
GDP/capita (USD at exchange rate) [2]	1459	1205	1039	1307	1889	.	.	.	.
Gross industrial production [4]									
annual change in % (real)	3.6	-23.1	11.2	0.0	2.0	-4.1	-3.1	1	3
Gross agricultural production									
annual change in % (real)	-3.2	-1.0	-12.9	17.2	-2.1	.	.	.	.
Goods transport, mn t-kms	45601	30026	32878	17456	5480	.	.	.	.
annual change in %	19.5	.	9.5	-46.9	-68.6	.	.	.	.
Gross fixed investment, YUM mn, nom.	17893.2	24867.8	59315.5	65845.8	.	.	.	.	.
annual change in % (real)	-2.2	-26.3	13.3	.	.	.	.	.	.
Construction output, value of work done									
annual change in % (real)	-0.8	-9.9	.	.	.	.	.	.	.
Dwellings completed, units	13096	13123	12732	12156	12776	.	.	.	.
annual change in %	-11.3	.	-3.0	-4.5	5.1	.	.	.	.
Employment total, th pers., average [5]	2504	2298	2238	2243	2201	2214	.	.	.
annual change in %	-0.1	.	-2.6	0.2	-1.9	-0.4	.	.	.
Employees in industry, th pers., average	884.4	804.5	764.7	739.0	684.0	711.3	.	.	.
annual change in %	2.4	.	-5.0	-3.4	-7.4	-5.3	.	.	.
Reg. unemployed, th pers, end of period	849.4	774.3	812.4	860.5	980.8	881.0	.	.	.
Reg. unemployment rate in %, end of period [6]	25.4	25.5	26.7	27.9	31.2	28.5	.	30	30
LFS - unemployment rate in %, average	13.7	13.7	12.6	12.9	13.8	.	.	15	15
Average net monthly wages, YUM	1063	1309	2588	5545	9113	7779	.	.	.
annual change in % (real, net)	2.0	-15.0	6.5	13.3	24.6	40.2	.	.	.
Retail trade turnover, YUM mn	48748	57697	119522	250312	325855	32112	.	.	.
annual change in % (real, calc.)	3.9	-13.5	11.6	10.8	11.7	17.1	.	.	.
Consumer prices, % p.a.	29.9	44.9	85.6	89.0	16.5	29.1	11.6	15	10
Producer prices in industry, % p.a.	25.5	43.4	106.5	85.1	8.7	14.4	4.8	10	10
General government budget, YUM mn									
Revenues	61360	79321	138749	320475	507008	108641	.	.	.
Expenditures	70739	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+)	-9379	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.1	.	.	.	.	.	.	.	.
Money supply, YUM mn, end of period									
M1, Money	10807.3	16332.0	26954.0	52686.0	88839.0	61745.0	82426	.	.
Broad money [7]	62352.0	75393.7	65522.0	107825.0	186966.0	134481.0	184561	.	.
Discount rate, % p.a., end of period	33.7	26.3	26.3	16.4	9.5	12.4	9.0	.	.
Current account, USD mn [8]	-1180	-1341	-339	-624	-1731	.	-614 [9]	-2000	-2000
Current account in % of GDP	-7.6	-13.3	-3.9	-5.4	-11.0	.	.	-10.3	-9.6
Forex reserves of NBY, USD mn	300	297	524	1169	2280	1477	2113	.	.
Gross external debt, USD mn	11500	12500	11418	11740	11839	.	12921 V	.	.
Exports total, fob, EUR mn [10]	2517.7	1391.1	1808.2	2097.0	2399.0	524.2	366.0 I-II	2500	2600
annual growth rate in %	6.7	-44.0	30.0	16.0	14.4	9.4	.	4	4
Imports total, cif, EUR mn [10]	4283.5	3080.8	3892.1	5390.7	6647.5	1511.3	904.0 I-II	6600	6600
annual growth rate in %	0.9	-26.4	26.3	38.5	23.3	9.1	.	-1	0
Average exchange rate YUM/USD	9.34	11.01	16.69	66.84	64.19	69.37	58.88	60	64
Average exchange rate YUM/EUR (ECU)	10.46	11.74	15.30	59.44	60.79	60.34	63.36	66	70

*) Note: From 1999 (GDP from 2000) excluding Kosovo and Metohia.

Notes: 1) Preliminary. - 2) Estimates based on World Bank method. From 1999 based on market exchange rate. - 3) Based on GMP in Dinar. - 4) Excluding private enterprises. - 5) Employees plus own account workers, excluding individual farmers. - 6) In % of unemployed plus employment. - 7) From 2000: at official exchange rate, excluding Montenegro, government deposits, household frozen foreign currency saving deposits. - 8) From 2000 including official grants. - 9) Serbia only. - 10) Converted from the national currency to EUR at the official exchange rate.

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

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