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Economic Prospects for Central, East and Southeast Europe

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Double-dip Recession over, yet no Boom in Sight

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Executive summary

Weak exports and suppressed domestic demand pushed nearly half of the Central, East and Southeast European (CESEE) economies into recession in 2012, including the Czech Republic, Hungary, Slovenia and nearly all Western Balkan countries. Elsewhere in the region, growth remained positive but was generally unspectacular, with the notable exceptions of Kazakhstan and Latvia. Also in countries that hitherto had been relatively immune to the euro area crisis (such as Russia, Poland, Ukraine and Turkey), growth dynamics progressively decelerated in the second half of the year. On the whole, 2012 was a disappointing year for the CESEE economies, confirming fears of a double-dip recession in the euro area adversely impacting large parts of the CESEE region. This rather poor performance stands in sharp contrast to the better dynamics in other 'emerging markets' in Asia and Latin America, and underscores the dependence of large parts of the CESEE region on the troubled euro area (not least in terms of policies pursued) and the structural weakness of many CESEE economies.

The crucial factor behind the disappointing CESEE growth performance has been the weakness of domestic demand. Import demand generally lagged behind export growth, and net exports contributed positively to GDP growth in 2012 – despite the anaemic external environment. High unemployment and stagnant wages, coupled with fiscal austerity and the ongoing (albeit in some cases decelerating) household deleveraging, continue to weigh heavily on the dynamics of private consumption in most CESEE countries, with the exception of Russia, Ukraine, Kazakhstan and the Baltic states. In turn, investment activity is suppressed by the lasting, and in some cases even deteriorating, perception of uncertain future prospects and by underutilized capacities in an environment characterized by weak demand – even though large parts of the corporate sector are awash with liquidity. In these circumstances, the investment dynamics in the region has been shaped by public investment projects, frequently supported by EU transfers (first of all in Estonia and Romania).

The protracted recession in the euro area will continue to be a drag on the economic growth of most CESEE countries also in 2013. By and large, those countries are small open economies held hostage to the excessive fiscal austerity pursued in the euro area and the sluggish progress on the part of its policy-makers in adequately addressing the structural roots of the crisis. At the same time, the private sector demand in the CESEE countries is unlikely to recover substantially either. Wherever there will be an increase in investments, it will be primarily funded via public money, with EU transfers playing an increasingly important role. In general, the prospects for 2013 are only marginally better than the previous year – largely on account of the somewhat less restrictive fiscal policies in some countries (Poland, Czech Republic) and a better performance of agriculture in others (Serbia, Romania). Slovenia and Croatia will still be unable to avoid another recession this year – notwithstanding the likely beneficial impact of inflows of EU funds in the latter case. The near-term economic prospects are generally better in the eastern part of the CESEE region, which is less dependent on the troubled euro area and are in no rush (or need) to pursue fiscal consolidation.

Even under the most optimistic scenario, in the medium and long term the CESEE countries will be generally unable to replicate the growth rates observed prior to the 2008-2009 crisis. In the Western Balkans, the bleak growth prospects and the high levels of unemployment may eventually imperil the fragile social and political stability of these countries.

Country summaries

GDP in **Bulgaria** grew only marginally in 2012, failing to produce a noticeable mark on the weak economic trajectory of the latest years. A short-lived recovery in private consumption during spring and summer could not be sustained and the deteriorating external environment in the closing months of the year brought renewed concerns of a possible new downturn. The policy stance seems frozen in expectation of the general elections in mid-2013. There is little chance of change in this constellation in the short run, at least until the elections, and the economic growth is likely to remain unimpressive.

In 2013 the **Czech** economy is exposed to a number of risks. Deep recession in the major export markets would have the most debilitating effects on the Czech economy. The continuing fiscal consolidation, which is likely to take place, could produce effects that are hard to calculate. Other risks do not seem serious. Monetary policy is not going to make irresponsible moves while the country's banks, corporate non-financial and household sectors are financially sound and resilient to imaginable disturbances.

Sluggish demand developments in the Scandinavian neighbourhood reduce the growth expectations for the **Estonian** economy for 2013. Public investment in transport and energy infrastructure triggered the revival in 2012 but will be reduced this year and thereafter. The improving situation on the labour market has allowed real wages to grow and will thus bolster household consumption developments in 2013 and 2014.

The **Hungarian** economy re-entered recession in 2012; the vision to put the economy to a new growth path with a growth rate of 5% to 7% has given way to a bitter struggle to keep the general government deficit below 3% of the GDP in order to get released from the excessive deficit procedure. Despite an improvement in important fiscal indicators, Hungary's position has remained fragile, as an important part of the improvement is due to temporary consolidation measures and not to genuine reforms.

The revival of previously depressed domestic demand backs high GDP growth in **Latvia**. Moreover, strong growth in exports to Russia and the Baltic neighbours counterbalances the flagging demand of the euro area. Falling consumer inflation rates and a reduction of the budget deficit to 1.4% of GDP in 2012 allows Latvia to head towards euro area accession in 2014.

The new **Lithuanian** centre-left coalition government headed by the Social Democrats raised minimum wages considerably which will bolster growth of household consumption. Public investment in the transport infrastructure will further trigger domestic demand, while lively Russian demand keeps the current account deficit low. Focusing on demand-side growth policies and a reduction of in-work poverty the Lithuanian government refrains from aiming at euro area accession as early as possible.

The **Polish** economy faces rather tough times in 2013. Growth seems likely to be very weak at first – but with falling inflation giving some limited boost to real disposable incomes and consumption. Public spending is likely to be temporarily increased, even if this would not be compatible with the declared fiscal consolidation strategies. Some acceleration of growth in the second half of the year should follow the improvements in foreign trade (primarily exports, driven by growth speed-up in the euro area and a likely corrective weakening of the Polish zloty).

In **Romania**, economic growth came almost to a halt in 2012. The recovery of agricultural production under normal weather conditions can in itself generate the forecasted 1.5% GDP growth in 2013. Bank deleveraging, bad debts and corporate insolvency will remain a drag on the economy. Fiscal expansion plans have been halted by the IMF. New taxes and tariffs will prolong the period of relatively strong inflation.

Prospects for **Slovakia** are less promising this year. Exceptionally high growth of production in the transport equipment sector and of its exports caused strong GDP growth in 2012, which will not be repeated this year. Due to this level effect GDP growth will slow down in 2013. However, net exports will probably stay the main driver of growth, supported by export markets outside the EU, which substitute for some export shortfalls coming from depressed European markets.

Slovenia's economy will face another year of recession in 2013 and should finally rebound in 2014 provided a strengthening of external demand and a recovery of investment activities. Restructuring of the banking sector, deleveraging of companies and fiscal consolidation will remain the most challenging tasks for the Slovenian authorities.

Croatia's economy is entering another year of recession in 2013. Given the need to consolidate public finances, a rapid recovery cannot be expected. Speeding up the stalling reform process becomes increasingly difficult due to high and persistent unemployment. Joining the EU in July 2013 may help to boost foreign investors' confidence, but positive effects from EU membership may be expected only in the medium term.

The **Macedonian** economy is more dependent on the neighbouring countries, as this is a small and landlocked country. So, as long as domestic demand remains subdued and the regional environment remains depressed and unstable, sluggish recovery, not fundamentally different from stagnation, will prevail.

In **Montenegro**, forecasts for this and the next two years are not all that different from that for the neighbouring countries and the Balkan region as a whole. Prospects in the medium term depend on the success of the tradable sectors, which in turn will depend on the regional and the developments in Europe and in Russia. The fact that the country is negotiating with the EU should prove helpful. The main hurdle, rule of law issue, has now been shifted to the beginning of the negotiations and will be a challenge. Once that is cleared, Montenegro can expect to be the next new member of the EU.

Turkey experienced a strong slowdown of growth to 2.9% in 2012 compared to 9.0% in 2010 and 8.5% in 2011. This was mostly due to policy reactions (particularly monetary policy) to an overheating economy characterized by very fast credit growth and sharply negative current accounts developments. Monetary policy has now eased somewhat, inflation has come down, and we expect Turkey to resume growth at 3.8% in 2013, 4.5% in 2014 and 5.0% in 2015.

In **Albania**, we expect stronger economic growth in 2013 based on a substantial increase in public wages and infrastructure investment boosting up aggregate demand. A similar rate of growth could be also maintained in the following years of 2014 and 2015 given an improvement of economic sentiment throughout Europe. However, there are considerable downward risks. A failure of the Albpetrol privatisation could endanger the financing of fiscal expansion and infrastructure investments. Also another drought could cause further shortage in the electricity supply, which apart from endemic corruption, is one of the major obstacles to more FDI in Albania in the medium run.

A significant speed-up of growth in **Bosnia and Herzegovina** is hard to expect this and the next two years. As in the Balkan region as a whole, sluggish growth appears to be the most probable post-crisis recovery prospect.

In **Serbia**, prospects for the next couple of years are rather modest because those depend on a continued recovery of investments and on weather being supportive of agriculture. In addition, political and social stability need to be preserved which may prove difficult to achieve.

Our forecast for **Kosovo** GDP growth is a stable 3% for 2013 and a reinforced growth of 5% in 2014. The improvement in 2014 will not only be due to improved external factors but also due to parliamentary elections likely to be held in early 2014. Thus, a fiscal stimulus can be expected to boost both consumption and investment. Budget deficit will not necessarily be affected too much altogether as there are substantial inflows of funds expected in the wake of the privatisation of the Post and Telecom of Kosovo (PTK) which is scheduled for mid-2013. The aim is to sell 75% of PTK, corresponding to the two business units Telecom (fixed telephony) and Vala (mobile telephony).

Kazakhstan's GDP growth in 2012 was primarily driven by expanding household and government consumption. We expect that shifting the focus of the government policies will cause a slowdown in private consumption growth to 6-5% in real terms in the coming years. Investment growth, by contrast, is expected to pick up and reach 9% in 2015. Improving investment dynamics will provide for an acceleration of overall real GDP growth: by 2015, GDP growth will reach 6.5%.

Russian economic growth was slowing down during 2012. The expected rate of GDP growth – below yet close to 4% in the coming couple of years – will be driven mainly by domestic demand. Any significant breakthrough in modernization and diversification of the economy is unlikely in the near future. The new role of shale gas and its impact on global energy prices may significantly affect Russia's export and budget revenues, its GDP growth and ultimately also the country's social and political stability in the medium and long run.

The plunging global prices of metals hit **Ukraine's** exports and pushed the economy into recession in the second half of last year – despite the ongoing boom in household consumption. Our forecast of a return to positive growth in 2013 is based on the assumption of a timely and 'controlled' currency devaluation, which would be crucial for the badly needed growth re-balancing. In the longer run, modernization and restructuring could be hampered by the country's increasing political isolation and the largely protectionist stance of the government.

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

JEL classification: C33, C50, E20, E29, F34, G01, G18, O52, O57, P24, P27, P33, P52

Table I

Overview 2011-2012 and outlook 2013-2015

	GDP real change in % against previous year					**Consumer prices** change in % against previous year					**Unemployment, based on LFS** rate in %, annual average					**Current account** in % of GDP				
	2011	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**	**2011**	**2012**	**2013**	**2014**	**2015**
			Forecast					**Forecast**					**Forecast**					**Forecast**		
NMS-10																				
Bulgaria	1.7	0.7	1.0	1.8	2.6	3.4	2.4	3.0	3.0	3.0	11.2	12.3	11.5	11.0	10.5	0.3	-0.7	-2.2	-2.5	-2.8
Czech Republic	1.9	-1.2	0.3	1.6	2.4	2.2	3.5	2.0	2.0	1.8	6.7	7.0	7.4	7.3	7.0	-2.9	-1.5	-1.6	-1.6	-1.9
Estonia	8.3	3.2	2.8	3.5	3.8	5.1	4.2	3.8	4.0	4.5	12.5	10.2	9.5	9.0	8.0	2.1	-2.0	-2.7	-3.5	-4.2
Hungary	1.6	-1.7	0.0	1.2	2.5	3.9	5.7	4.0	3.5	3.5	10.9	10.9	10.9	10.8	10.6	0.9	1.1	1.0	1.0	0.5
Latvia	5.5	5.4	3.8	4.3	4.5	4.2	2.3	2.8	3.5	3.5	15.4	14.9	13.5	12.5	11.5	-2.1	-1.8	-2.8	-3.6	-3.7
Lithuania	5.9	3.6	3.8	4.0	4.2	4.1	3.2	3.8	3.5	3.6	15.4	13.2	12.0	11.0	10.0	-3.7	-1.1	-2.0	-1.9	-2.0
Poland	4.3	2.0	1.5	2.7	3.5	3.9	3.7	2.8	2.5	2.0	9.7	10.3	11.0	10.8	10.5	-4.9	-3.4	-3.0	-3.5	-3.7
Romania	2.2	0.2	1.5	2.0	2.3	5.8	3.4	4.2	3.5	3.5	7.4	7.1	7.0	7.0	6.5	-4.5	-3.8	-4.2	-4.6	-4.9
Slovakia	3.3	2.0	1.0	2.4	3.0	4.1	3.7	3.0	3.0	2.0	13.5	14.0	14.5	14.0	13.0	-2.1	2.2	2.0	1.9	0.9
Slovenia	0.6	-2.0	-1.5	0.5	2.0	2.1	2.8	2.5	2.0	2.0	8.2	8.9	9.5	9.5	9.0	0.0	2.4	1.6	0.8	0.5
NMS-10 [1)]	*3.2*	*0.9*	*1.2*	*2.3*	*3.0*	*3.9*	*3.7*	*3.1*	*2.8*	*2.6*	*9.6*	*9.8*	*10.0*	*9.8*	*9.4*	*-3.1*	*-1.8*	*-2.0*	*-2.3*	*-2.6*
EA-17 [2)]	*1.4*	*-0.6*	*-0.3*	*1.4*	*.*	*2.7*	*2.5*	*1.8*	*1.5*	*.*	*10.2*	*11.4*	*12.2*	*12.1*	*.*	*0.2*	*1.5*	*2.2*	*2.3*	*.*
EU-27 [2)]	*1.5*	*-0.3*	*0.1*	*1.6*	*.*	*3.1*	*2.6*	*2.0*	*1.7*	*.*	*9.6*	*10.5*	*11.1*	*11.0*	*.*	*0.1*	*0.7*	*1.4*	*1.6*	*.*
Candidate countries																				
Croatia	0.0	-1.8	-0.5	1.5	2.5	2.3	3.4	3.0	2.0	2.0	13.5	15.7	16.5	16.0	15.5	-0.9	-0.7	-1.1	-1.3	-1.4
Macedonia	2.8	-0.6	1.0	1.7	2.0	3.9	3.3	3.0	3.0	3.0	31.4	31.0	31.0	31.0	30.0	-3.0	-3.2	-5.0	-4.8	-5.9
Montenegro	3.2	-1.0	1.0	2.0	3.0	3.1	4.1	3.0	3.0	3.0	19.7	20.0	20.0	19.0	19.0	-17.7	-15.0	-15.0	-15.0	-15.0
Turkey	8.5	2.9	3.8	4.5	5.0	6.5	9.0	7.8	6.0	5.0	8.8	8.2	8.0	7.8	7.5	-10.0	-6.0	-7.3	-7.5	-7.7
Potential candidate countries																				
Albania	3.1	1.0	2.8	3.3	3.0	3.4	2.0	4.0	4.0	2.0	14.3	14.0	14.0	13.0	13.0	-12.1	-10.4	-14.1	-15.0	-14.2
Bosnia and Herzegovina	1.0	-0.7	0.8	2.0	3.0	3.7	2.1	2.0	2.0	2.0	27.6	28.0	28.0	28.0	27.0	-8.7	-9.0	-9.5	-9.9	-10.1
Kosovo	4.5	2.7	3.0	5.0	4.0	7.3	2.5	3.0	4.0	4.0	45.0	44.0	43.0	41.0	39.0	-14.1	-11.3	-11.3	-15.5	-12.7
Serbia	1.6	-1.9	1.0	2.0	3.0	11.0	8.0	6.0	5.0	5.0	23.0	24.0	23.0	23.0	23.0	-8.9	-11.0	-11.0	-11.0	-10.1
Kazakhstan	7.5	5.0	5.0	6.0	6.5	8.3	5.2	7.0	6.0	6.0	5.4	5.3	5.0	5.0	5.0	7.2	4.3	5.1	5.7	5.7
Russia	4.3	3.4	3.6	3.8	3.7	8.5	5.1	5.0	5.0	5.0	6.6	5.7	6.0	6.0	6.0	5.2	4.1	3.0	2.2	2.0
Ukraine	5.2	0.2	1.5	3.0	4.0	8.0	0.6	2.5	4.5	4.0	7.9	7.9	7.8	7.7	7.5	-6.3	-8.2	-6.0	-6.7	-6.5

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

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

Source: wiiw (March 2013), Eurostat. Forecasts by wiiw and European Commission (Winter Report, February 2013) for EU and euro area.

Table II

Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2012

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-10* [1]	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	39.68	152.69	17.20	98.88	22.19	32.56	384.73	132.20	73.10	36.45	*989.7*	*12936.6*
GDP in EUR at PPP, EUR bn	87.10	213.16	23.75	164.15	32.34	52.85	645.63	257.25	103.63	42.96	*1622.8*	*12936.6*
GDP in EUR at PPP, EU-27=100	0.7	1.6	0.2	1.3	0.3	0.4	5.0	2.0	0.8	0.3	*12.5*	*100.0*
GDP in EUR at PPP, per capita	11900	20300	18400	16500	15900	17700	16700	13500	19200	20900	*16400*	*25800*
GDP in EUR at PPP per capita, EU-27=100	46	79	71	64	62	69	65	52	74	81	*64*	*100*
GDP at constant prices, 1990=100	130.4	146.6	152.8	124.5	112.0	122.4	200.1 [3]	134.1	171.6	154.4	*167.4*	*145.9*
GDP at constant prices, 2007=100	103.2	101.6	95.1	95.2	87.6	97.6	118.1	101.5	110.4	95.1	*107.0*	*99.7*
Industrial production real, 2007=100 [4]	88.0	98.4	103.6	94.4	105.3	107.9	118.7	108.0	123.7	91.9	*108.4*	*91.4*
Population, thousands, average	7330	10510	1294	9940	2035	2994	38560	19000	5410	2055	*99127*	*501756*
Employed persons, LFS, thousands, average	2940	4890	625	3870	886	1279	15600	9280	2330	920	*42619*	*216400*
Unemployment rate, LFS, in %	12.3	7.0	10.2	10.9	14.9	13.2	10.3	7.1	14.0	8.9	*9.8*	*10.5*
General gov. revenues, EU-def., in % of GDP	34.3	40.1	40.3	46.4	37.2	31.5	39.4	33.3	32.7	44.2	*33.5*	*45.5*
General gov. expenditures, EU-def., in % of GDP	35.3	43.6	41.5	49.2	38.5	34.3	42.8	36.1	37.6	48.2	*46.9*	*49.1*
General gov. balance, EU-def., in % of GDP	-1.0	-3.5	-1.2	-2.8	-1.5	-2.8	-3.4	-2.8	-5.0	-4.0	*-3.3*	*-3.6*
Public debt, EU def., in % of GDP	17.0	45.1	10.5	78.5	41.0	40.5	55.5	36.0	51.8	54.0	*50.1*	*86.8*
Price level, EU-27=100 (PPP/exch. rate)	46	72	72	60	69	62	60	51	71	85	*61*	*100*
Compensation per employee, monthly, in EUR [5]	507	1342	1197	1022	958	857	914	709	1174	2048	*955*	*2947*
Compensation per employee, monthly, EU-27=100	17.2	45.5	40.6	34.7	32.5	29.1	31.0	24.1	39.8	69.5	*32.4*	*100.0*
Exports of goods in % of GDP	52.4	68.8	73.3	78.0	43.7	70.3	38.0	34.1	86.2	58.8	*52.9* [6]	*33.9* [6]
Imports of goods in % of GDP	61.5	64.2	78.5	73.4	54.5	73.7	39.5	39.6	80.8	59.6	*53.5* [6]	*33.9* [6]
Exports of services in % of GDP	14.3	11.1	24.7	15.4	16.0	13.8	7.5	5.7	7.4	14.0	*18.7* [6]	*11.0* [6]
Imports of services in % of GDP	7.9	9.8	17.7	12.2	9.2	9.9	6.4	5.2	7.0	9.3	*7.9* [6]	*8.1* [6]
Current account in % of GDP	-0.7	-1.5	-2.0	1.1	-1.8	-1.1	-3.4	-3.8	2.2	2.4	*-1.8* [6]	*0.7* [6]
FDI stock per capita in EUR, 2011	5026	9214	9987	6499	4584	3664	3718	2855	7335	5681	*4846*	*10613*

NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-27 working day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-10 and EU-27 include transactions within the region (sum over individual countries).

Source: wiiw, Eurostat, AMECO.

Table III

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

	Croatia	Macedonia	Monte-negro	Turkey	Albania	Bosnia - Herzegovina	Kosovo	Serbia	Kazakhstan	Russia	Ukraine	*NMS-10* [1]	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	45.11	7.71	3.30	626.09	9.64	13.29	5.00	30.09	156.90	1561.26	136.31	*989.7*	*12936.6*
GDP in EUR at PPP, EUR bn	65.77	18.52	6.56	1022.52	22.39	25.42	10.7	62.43	183.55	1991.32	266.84	*1622.8*	*12936.6*
GDP in EUR at PPP, EU-27=100	0.5	0.1	0.05	7.9	0.2	0.2	0.1	0.5	1.4	15.4	2.1	*12.5*	*100.0*
GDP in EUR at PPP, per capita	15400	9000	10600	13600	7900	6600	5800	8800	10900	13900	5900	*16400*	*25800*
GDP in EUR at PPP per capita, EU-27=100	60	35	41	53	31	26	22	34	42	54	23	*64*	*100*
GDP at constant prices, 1990=100	108.0	120.0	.	237.2	205.6	.	.	.	173.5	116.2	69.3	*167.4*	*145.9*
GDP at constant prices, 2007=100	91.9	109.4	105.6	113.4	120.1	103.7	114.1	100.9	126.6	109.3	95.6	*107.0*	*99.7*
Industrial production real, 2007=100	84.5	88.1	65.1	113.7	156.9	113.9	101.3	90.0	120.5	107.6	87.0	*108.4*	*91.4*
Population, thousands, average	4280	2065	621	74885	2820	3843	1830	7130	16794	143000	45593	*99127*	*501756*
Employed persons, LFS, thousands, average	1420	645	200	24700	1200	814	.	2230	8508	71342	20350	*42619*	*216400*
Unemployment rate, LFS, in %	15.7	31.0	20.0	8.2	14.0	28.0	44.0	24.0	5.3	5.7	7.9	*9.8*	*10.5*
General gov. revenues, nat. def., in % of GDP	34.5 [3]	29.1	34.0	37.5 [3]	25.0	43.5	35.2	43.0	19.3	38.0	31.8	*33.5* [3]	*45.5* [3]
General gov. expenditures, nat. def., in % of GDP	39.0 [3]	32.9	40.0	39.8 [3]	28.0	46.5	36.3	50.0	22.3	36.5	35.4	*46.9* [3]	*49.1* [3]
General gov. balance, nat. def., in % of GDP	-4.5 [3]	-3.8	-6.0	-2.3 [3]	-3.0	-3.0	-1.2	-7.0	-3.0	1.5	-3.6	*-3.3* [3]	*-3.6* [3]
Public debt, nat. def., in % of GDP	53.0 [3]	36.0	51.0	36.8 [3]	59.4	43.1	6.2	63.0	12.7	8.0	36.8	*50.1* [3]	*86.8* [3]
Price level, EU-27=100 (PPP/exch. rate)	69	42	50	61	43	52	47	48	85	78	51	*61*	*100*
Average gross monthly wages, EUR at exchange rate	1044	497	727	630 [4]	283	660	360 [5]	508	532	668	295	*955* [4]	*2947* [4]
Average gross monthly wages, EU-27=100	35.4	16.9	24.7	21.4 [4]	9.6	22.4	12.2	17.3	18.1	22.7	10.0	*32.4* [4]	*100* [4]
Exports of goods in % of GDP	21.1	40.4	12.3	20.1	15.6	19.3	5.7	28.9	45.8	26.4	39.8	*52.9* [6]	*33.9* [6]
Imports of goods in % of GDP	35.3	63.7	55.2	28.2	34.2	50.6	47.0	47.9	23.4	16.7	51.5	*53.5* [6]	*33.9* [6]
Exports of services in % of GDP	21.2	10.4	30.6	5.2	18.7	11.4	11.4	10.6	2.4	3.1	11.2	*18.7* [6]	*11.0* [6]
Imports of services in % of GDP	6.4	10.1	11.1	2.5	16.6	3.1	6.0	9.9	6.2	5.4	7.7	*7.9* [6]	*8.1* [6]
Current account in % of GDP	-0.7	-3.2	-15.0	-6.0	-10.4	-9.0	-11.3	-11.0	4.3	4.1	-8.2	*-1.8* [6]	*0.7* [6]
FDI stock per capita in EUR, 2011	5566	1772	7241	1467	1063	1405	.	2462	4343	2463	1097	*4846*	*10613*

NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Albania, Bosnia and Herzegovina, Montenegro, Kosovo, Serbia, Kazakhstan, Russia, Ukraine.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 4) Gross wages plus indirect labour costs, according to national account concept. - 5) Average net monthly wages. - 6) Data for NMS-10 and EU-27 include transactions within the region.

Source: wiiw, Eurostat, AMECO.

Michael Landesmann and Vladimir Gligorov

The international environment: recession and slow recovery

2012 was a difficult year for the European economy: The euro area as a whole registered negative growth. From mid-2012 onwards growth in Germany decelerated markedly, while countries outside the euro area, such as the United Kingdom and Turkey, either shifted into negative growth territory or slowed down considerably (see Table 1).

The United States, on the other hand, showed signs of resuming growth in the order of 2% p.a. The housing market seemed to have bottomed out and the main cause for concern was the bitter political contretemps between the Republicans and Democrats regarding the future course of economic policy. Late in December, however, the so-called 'fiscal cliff' (which would have toppled the US economy into a credibility crisis) was averted and the relatively convincing victory of President Obama that secured him a second term has most likely nudged intra- and inter-party power structures in a direction that might lead to Congressional politics taking a less combative course over the next year or so. Elsewhere in the world, Japan has moved – after the election of a new government and a new prime minister – towards a change in its economic policy stance in an attempt to escape from the long-term deflationary trap confronting the country. Some observers saw this – together with the US Federal Reserve's (FED) commitment itself to lax monetary policy – as a move towards a competitive devaluation race that would be to the detriment of the euro area, given the latter's less flexible monetary policy set-up (and one in which exchange rate targets are not supposed to feature). Emerging markets witnessed a slow-down of growth in both China and India; by the end of 2012, however, China gave every indication of re-attaining a growth rate in excess of 8%. Economies in Latin America and other developing regions expressed concern over the impact of the quantitative easing policies being pursued in both the United States and Europe, which are currently generating high levels of liquidity in the global economy and laying the ground for major capital inflows and currency appreciation.

In this context, the European economy (and the euro area in particular) has remained an epicentre of potential instability for the global economy. One of the scenarios still being considered in mid-2012 was the high probability of the euro area 'breaking up' on several counts. Not only had the Greek debt situation not been resolved at that time (in the meantime, at least an agreement has been reached on the second support tranche and on fiscal/budgetary plans, although further debt write-offs of some kind are still on the agenda), but the prospects of resolving the public debt problem in Italy were also shrouded in uncertainty. Moreover, the banking crisis (compounded by complicated tensions between the regions and the central state) in Spain and Ireland was still simmering and – in the case of Spain – forever deepening. The differential developments in terms of competitiveness and public debt that persisted between France and Germany were a further reason for concern over the future of the euro area. Furthermore, while academics and analysts were busy discussing the ingredients needed to correct and reform euro area institutions in a way that would allow the Monetary Union to function effectively, policy-makers re-acted to events in a piecemeal manner and invariably at the very last minute.

Table 1

Gross domestic product

real change in % against preceding year

	2009	2010	2011	2012 [1]	2013	2014 Forecast	2015
EU-27 [2]	-4.3	2.1	1.5	-0.3	0.1	1.6	.
Euro area-17 [2]	-4.4	2.0	1.4	-0.6	-0.3	1.4	.
Germany [2]	-5.1	4.2	3.0	0.7	0.5	2.0	.
France [2]	-3.1	1.7	1.7	0.0	0.1	1.2	.
Italy [2]	-5.5	1.8	0.4	-2.2	-1.0	0.8	.
United Kingdom [2]	-4.0	1.8	0.9	0.0	0.9	2.0	.
Spain [2]	-3.7	-0.3	0.4	-1.4	-1.4	0.8	.
Greece [2]	-3.1	-4.9	-7.1	-6.4	-4.4	0.6	.
NMS-10 [3]	-3.6	2.2	3.2	0.9	1.2	2.3	3.0
SEE-6 [3]	-3.7	0.7	1.3	-1.1	0.7	1.9	2.7
Turkey [3]	-4.8	9.0	8.5	2.9	3.8	4.5	5.0
Russia [3]	-7.8	4.5	4.3	3.4	3.6	3.8	3.7
Ukraine [3]	-14.8	4.1	5.2	0.2	1.5	3.0	4.0
United States [2]	-3.1	2.4	1.8	2.2	1.9	2.6	.
Japan [2]	-5.5	4.7	-0.6	1.9	1.0	1.6	.
China [4]	9.2	10.4	9.3	7.8	8.2	8.5	8.5
India [4]	5.9	8.4	7.9	4.5	5.9	6.4	6.7

Note: SEE-6 refers to: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, and Serbia.
1) Preliminary. - 2) European Commission. - 3) wiiw. - 4) IMF.

Source: wiiw Database incorporating national and Eurostat statistics, IMF. Forecasts by wiiw, European Commission and IMF.

The above notwithstanding, some important decisions were taken. They included the first steps towards a banking union (ultimately, however, agreement was only reached on the first pillar comprising joint supervision and monitoring, while other steps such as launching efforts to initiate bank recapitalization/bank restructuring and introduce a joint deposit insurance system were postponed and are only likely to be realized in the medium to long term). The calls for a ‘fiscal union’ have not borne fruit except for an agreement to pursue a more forceful implementation of the old SGP fiscal criteria. The latter have now taken the form of ‘fiscal compacts’ that most countries have anchored in their constitutional or quasi-constitutional legislation. At the beginning of February 2013, a further accord was reached when the heads of state agreed upon the seven-year financial framework for the period 2014-2020 that still has to pass through the European Parliament. The framework scales down the overall EU budget from 1.08% (the initial European Commission proposal) to 1% of EU GNI; compared to the financial period 2007-2013, this represents a cutback in the EU budget of 0.12%. These developments reflect a victory for the ‘net payers’ in the EU membership and their disciplinarian stance. The fiscal austerity policies pursued in many member states had made any attempts to increase spending at the Union level unpalatable to national leaders. Further, the general public remained far from convinced that any strengthening of fiscal powers at EU level would contribute to a resolution of the economic crisis on the home front.

The outcome of all these developments is that the underlying structural and systemic problems of both the European Union and the euro area as the central core of the EU establishment remain mostly unresolved or insufficiently addressed. Of those problems the most fundamental ones are: (a) a Monetary Union (in which only a sub-set of EU members participate, while those that do not yet participate have – in most cases – decided to push the horizon of membership back in time) without a complementary fiscal union that would require the development of much more effective fiscal co-ordination mechanisms far beyond the fiscal compacts; the current course of fiscal policy developments are likely to keep the Union locked into a systemic bias towards deflation and low growth; (b) the lack of commitment towards a fully fledged banking union embracing all three pillars mentioned above; and (c) the lack of a credible resolution of the North-South imbalances that have become very apparent in the course of the current financial and economic crisis, giving rise to a dramatic decline in economic activity in tandem with excessively high unemployment rates in most economies in 'Southern Europe'. It now looks as though the prospects of these economies reaching the pre-crisis levels of GDP will only materialize by 2017 at the earliest. Given the current forecasts, the decade is well and truly 'lost'.

What are the prospects of these systemic and structural features being resolved in the medium- to longer-term? This leads us to the consideration of 'upside' and 'downside' risks related to the current economic forecast.

On the upside, it is possible that the southern EU economies are about to see a 'bottoming out' of the sharp contraction in economic activity that they have experienced since the beginning of the economic crisis. There are some indications that capital flight has stopped and funds have started to flow back into those countries. There are also indications that as a result of stringent austerity policies, government primary balances have moved into surplus. Secondly, Germany might well register growth rates in 2013 and 2014 higher than those indicated in current central forecasts. Thirdly, a better outcome might await the other emerging European economies, most of which we cover in this report.

On the downside, attention is drawn to the protracted banking crisis and lack of energetic bank consolidation and bank restructuring throughout Europe: a feature clearly distinguishing Europe from the United States where significant bank consolidation measures were already being implemented in the early phase of the financial crisis. This issue is all the more important for Europe as company financing in Europe depends more on bank funding than it does in the United States. Furthermore, were corporate debt and bad debt in the banking system to spill over into public debt (including local authority finances in federal states, such as Spain), it would continue the persistence of the bank debt-sovereign debt loop which has led to protracted credit constraints and fiscal austerity. This, in turn, keeps growth low, giving rise to deterioration in the debt-to-income ratio – and so the loop goes on. Furthermore, we do not know the extent to which current account reversals and the reasonably good export performances in the GIPS-countries over the past few years are indicative of a long-term turnaround or whether they merely reflect the impact of major recessions and hence a temporary reorientation of the supply side towards export markets. The issue of structural external imbalances will thus continue to plague the euro area for want of a credible policy framework to deal with those imbalances. Moreover, in a similar vein, the structural reforms, which have started in most GIPS-countries, will take some time to demonstrate whether they really lead to a long-term improvement in the supply-side performance of those economies. Finally, one might take a dim view of the ability of both the EU and the euro area to act in a forward-looking manner and implement further essential reforms so as to make up for the systemic deficiencies and thus avert further crises and a protracted period of low growth.

Against this background, most forecasts by international institutions have been rather cautious or even pessimistic, witness the latest Winter Forecast by the EU, in the sense that the assumed slow recovery is inadequate after years of sub-potential growth. By way of contrast, stock markets seem to have adopted a more bullish stance. Given that markets are forward-looking, that should mean that they are pricing in somewhat faster growth. In part, those sentiments may reflect the assessment that most of the risks that drove the developed economies into recession in the past year have declined, possibly even disappeared. Prominent among those risks were fiscal indecisiveness in the United States and faltering commitment to a common currency in Europe. Where the former is concerned, the US elections were quite decisive; where the latter is concerned, the announcement by the European Central Bank (ECB) that it will do whatever it takes to defend the euro also rang decisive. Of course, the balance of political power can change in the United States and the ECB commitment has not actually been put to the test. These are second order risks, so to speak, but for the moment they seem to have been brushed aside. The question thus arises as to the reason for market optimism not having a more decisive impact on forecasts relating to the development of the real economy in the short and even in the medium term.

One reason may be that there is increased awareness of the role of bubbles that some analysts see as a potentially disruptive force in the capital markets. More important is perhaps the uncertainty arising out of the changing monetary policy framework. At present, lax monetary policy is expected to last at least a few more years and probably longer in the case of the FED. Furthermore, the increased weight that monetary policy-makers allocate to growth and unemployment, primarily in the United States and the United Kingdom, makes it difficult to assess the order of rapid inflation that central banks are ready to accept in this new era of post-inflation targeting. This dilemma is especially pertinent in the euro area, as the ECB has remained hawkish on the issue of inflation, unlike the FED and the Bank of England – and given the change in policy direction unlike the Bank of Japan. Given this situation, it is not clear how supportive monetary policy is going to be, once inflationary expectations increase.

The other reason is the continuous pressure on public spending in the United States and the EU. Although severe fiscal stalemate is not to be expected in the United States, current plans provide for further fiscal adjustments directed towards lower deficits. In the EU, the fiscal framework will remain unaccommodating. If anything, it will tend to tighten still more – to all intents and purposes throughout the Union. With private consumption going into depression demand is not expected to improve to any marked degree. Accommodative monetary policy is supposed to act as a substitute for constrained fiscal policy; however, the firmness of the central banks' commitment will be sorely tried, if prices start to rise once economic recovery sets in.

Markets are perhaps being driven by an expectation that private investments will ultimately start to grow. Having undergone some restructuring over the past few years, the corporate sector displays no lack of liquidity. Thus, assuming that the previous year's relapse into recession was politically induced, viz. the fiscal stalemate in the United States and risks of the euro collapsing, and further assuming that those risks have since decreased, recovery better than that forecast is not altogether improbable. If that proves to be the case, it will take on especial importance for the emerging economies in Southern Europe.

International institutions are thus looking at continuing constraints on demand, especially in the developed world. Their conclusion is that recovery in the current year will be quite slow, while in vulnerable countries and regions recession may still continue for some time with expectations of economic growth possibly speeding up, albeit at a rather unimpressive rate, in the medium term. The capital markets appear to be expecting positive supply developments, the reasons being fewer risks, a measure of structural improvement, low or very low financing costs and improved investment opportunities. There is an expectation that supply will create its own demand, if the monetary policy framework remains accommodative. From that point of view, it is not altogether unlikely that recovery will be better than most current forecasts and will make itself felt in the medium term.

On the sober side, however, unresolved distributional issues evidenced in continued conflicts over fiscal policies persist in certain countries and regions, as well as across the globe, in addition to residual balance sheet problems both in the banks and in the financial sector in general. The fragile stability may prove susceptible to such factors as social tensions in Southern Europe, limitations on fiscal union in the EU and the euro area, and possibly policy mistakes in the context of global adjustments of exchange rates: something that could be seen as competitive devaluation or a symptom of currency wars. Thus, as has been the case throughout the current crisis, significant revisions of current forecasts are to be expected. At present, however, given that forecasts to date have been generally pessimistic, the risks may not be too strongly on the downside. Some exceptions, however, are to be found in the countries and regions discussed in greater detail in this report.

*Vasily Astrov**

Double-dip recession over, yet no boom in sight

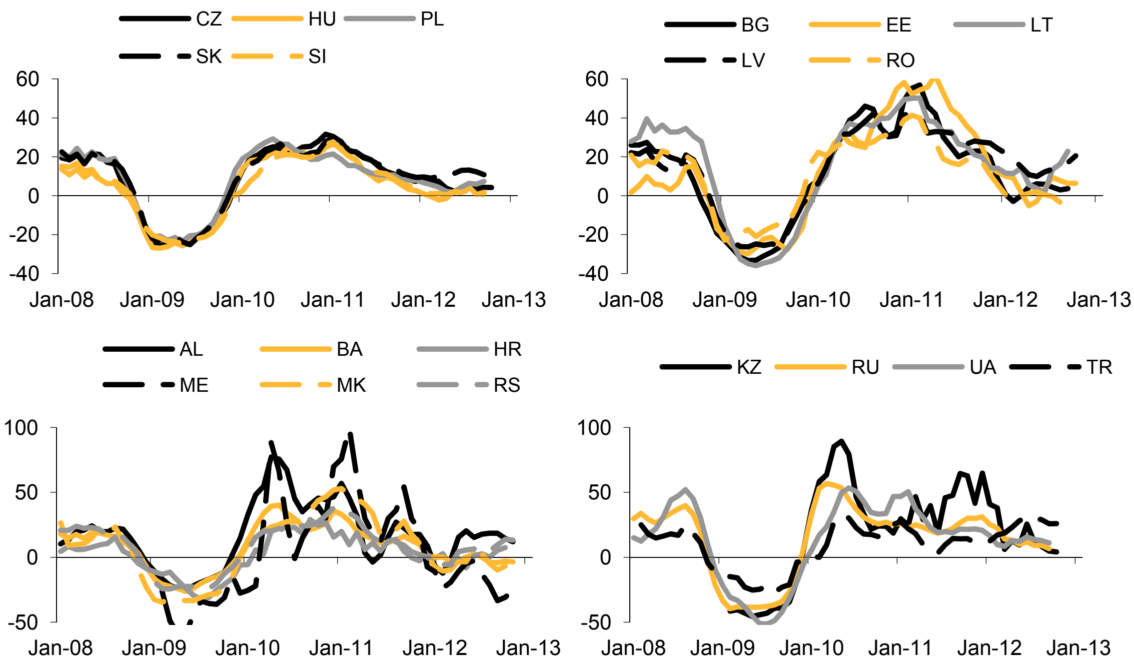
Euro area recession dragging exports down ...

Recession in the euro area continues to retard export performance of countries in Central, Eastern and Southeast Europe (CESEE). Impressively strong in both 2010 and 2011, those countries' export growth decelerated markedly and, in some cases, even went into reverse the year thereafter (see Figure 1).

Figure 1

Exports of goods (nominal, euro-based)

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



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Figure 2 shows – rather unsurprisingly – that growth dynamics in the export markets is an important factor governing the CESEE countries' export performance: it explains over half of the cross-country variations observed. For example, the recession in the euro area has obviously had more of a dampening effect on the new member states (NMS) in Central Europe, where more than 50% (in the Czech Republic over 60%) of their exports go to the euro area, rather than on countries such as

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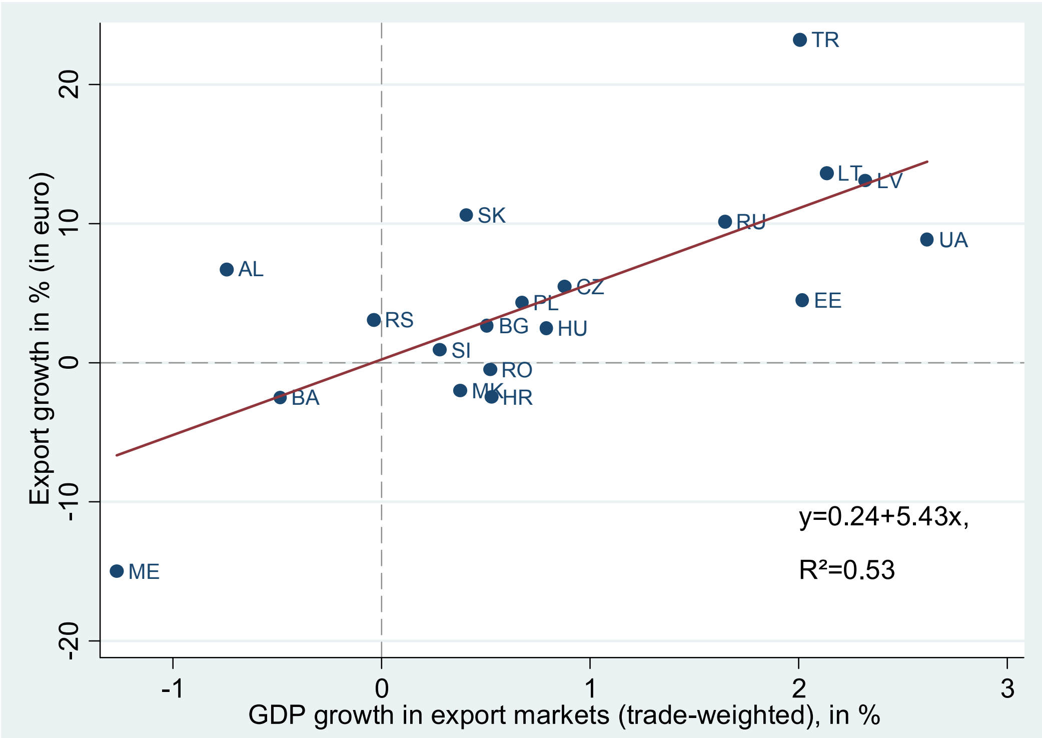
Ukraine, Turkey and the Baltic states, whose trade dependence on the euro area is considerably lower. Furthermore, divergent growth performance *within* the euro area has also mattered. In the NMS in Central Europe that trade mostly with Germany, export growth has remained in low single digits, whereas in most Western Balkan countries that trade more with crisis-torn Greece and Italy, it has turned negative, with declines of up to 15% in Montenegro and Kosovo. At the same time, tourism in Croatia and Montenegro, which in both countries is at least as important as industry, has continued to thrive, more than compensating for the shortfalls in the export of goods.

Figure 2

Growth in export markets and export performance, 2012



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

By way of contrast, Latvia and Lithuania, which trade more with Russia, recorded double-digit export growth, as did energy-exporting Russia and Kazakhstan. However, the relatively high export growth in euro terms recorded by the latter two countries should not be over-interpreted, as it reflects to a large extent the weakening of the euro against the US dollar. In dollar terms (the currency in which energy exports are typically invoiced), export growth in both countries was much lower.

It is interesting to analyse the export performance of 'outliers' in Figure 2. For instance, it demonstrates that Slovakia's export success last year can hardly be attributed to the country's lower dependence on the euro area (for example, when compared to its immediate neighbours, the Czech Republic and Hungary). In fact, in trade-weighted terms, Slovakia's export markets grew more slowly than those of the Czech Republic and Hungary. Instead, the decisive factor has been the competitive gains realized by Slovak export items (primarily motor cars) and the related inroads into export markets – both within the euro area and without. Albania has been another 'positive' outlier, albeit for entirely different reasons. Paradoxically the country has boosted its exports to crisis-torn Italy and Spain, above all by virtue of its increased oil exports, which in the meantime account for one quarter of Albania's total exports. As metals exporters hard hit by the plunging prices for metals,[1] Ukraine and Montenegro feature among the 'negative' outliers that deviate from the general pattern in Figure 2. In the case of Montenegro the problem is compounded by the unresolved legal issues surrounding the status of the country's one and only aluminium plant.

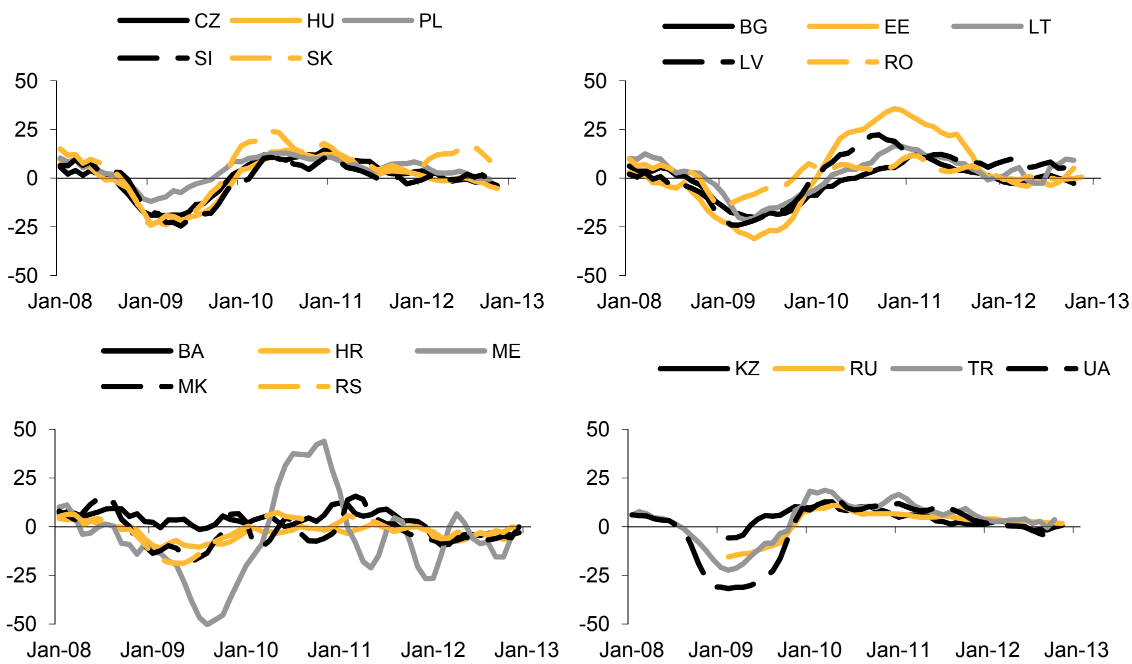
... and industrial production as well

By and large, the dynamics of industrial production in the CESEE countries has mirrored their export performance (see Figure 3). Figure 4 presents the production dynamics for 2012 in three important industries in the CESEE countries: metals, electronics and transport equipment. Interestingly, the cross-country differences to be observed in the geographic pattern of exports have a visible impact on the performance of individual industries and, in some cases, individual producers – at least when it comes to more sophisticated industrial branches such as the manufacture of transport equipment.

Figure 3

Gross industrial production

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



Remark: Data refer to NACE Rev. 2 except for BA; ME until 2009; RU, UA NACE Rev. 1

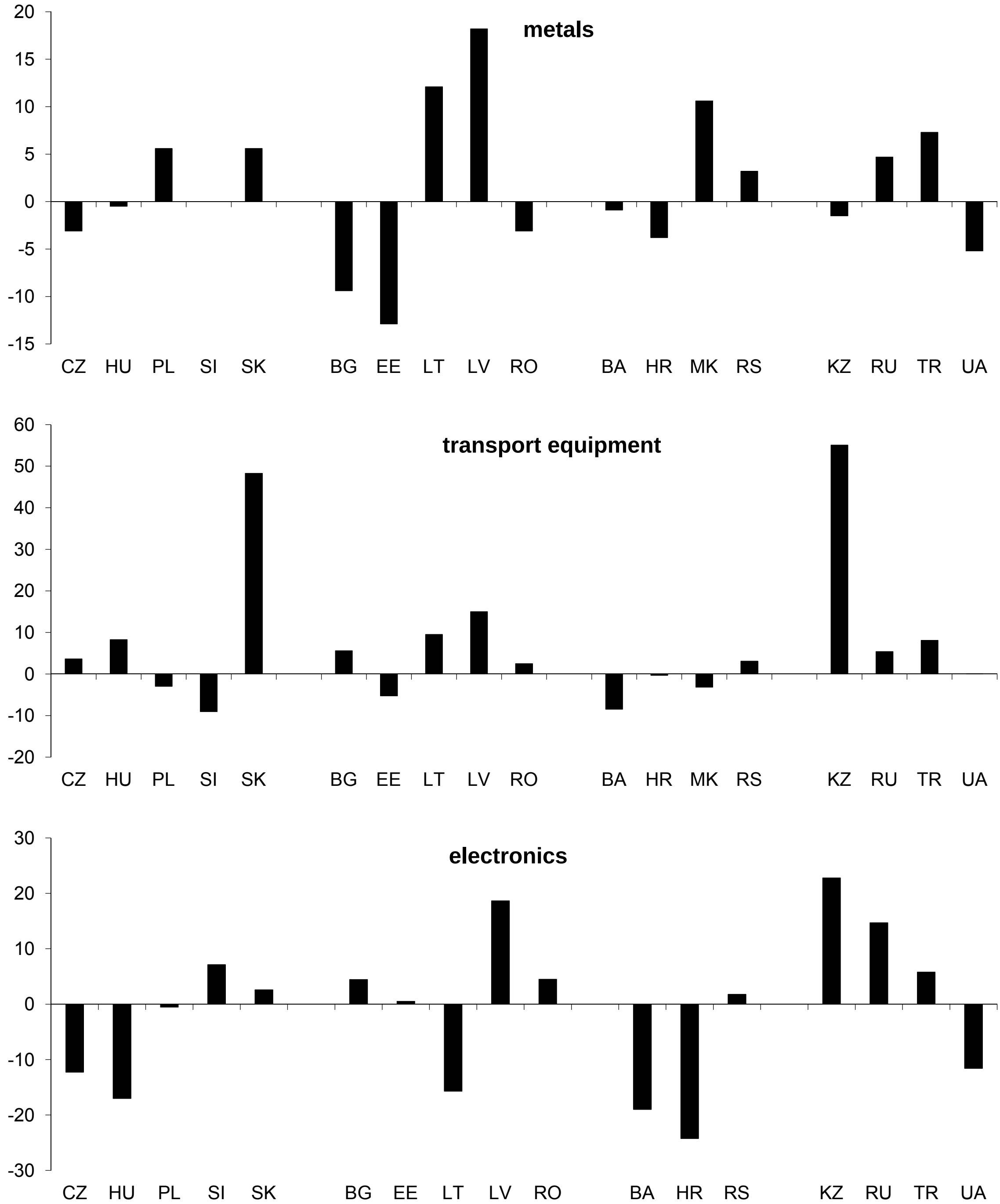
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

[1] For instance, steel prices declined by about 30% in 2012 on account of the weak global demand for investment goods.

Figure 4

Industrial production in 2012 by key branches

change in % against preceding year



Remark: NACE Rev. 2. AL, RU, UA NACE Rev. 1.

Source: National statistics and Eurostat.

For instance, the production of Renault cars in Slovenia that are sold in EU markets has declined, whereas the Dacia factory in Romania (also owned by Renault) was able to maintain production levels and even increase exports, mainly to countries in the Southern Mediterranean. A similar picture is to be observed in Slovakia. Whereas both Volkswagen and KIA have recorded high sales growth primarily on account of their exports to the more buoyant markets in the United States, China and Russia, the performance of PSA Peugeot-Citroen, which is also producing in Slovakia and only supplies EU markets, has been more modest. Overall, however, motor car production in Slovakia surged by an astonishing 44%; it was the key driver behind an impressive 10% growth in total industrial output. In Kazakhstan, the growth of motor car production was of similar magnitude, but starting from a much lower base. In essence, it represented a substitution of Chinese imports after Kazakhstan joined the Russia-led Customs Union and increased the duty on imported motor cars accordingly.

The geographic orientation of exports matters less where basic industries such as energy and metals are concerned, the output of which is more homogeneous and whose prices are largely shaped by global developments. Given the high (albeit stagnating) oil prices hovering around USD 100 per barrel, the previous year's modest growth in industrial production in energy-producing Russia and Kazakhstan may come as a surprise; it was primarily due to supply bottlenecks.

In the metals industry, which is particularly important in the Western Balkans and Ukraine, the price decline already mentioned has had a differentiated impact on individual countries, suggesting the prevalence of country-specific factors. In Serbia and Montenegro, for instance, US Steel and Russia's Rusal effectively shut down their mills in 2012, yet production in the US Steel mill in Slovakia supplying inputs to the country's booming car industry has been kept going. In Ukraine, the metals industry is ever-increasingly suffering from largely out-dated technologies and the high energy-intensity of production; it has thus become a drag on the country's growth prospects.

Economic growth too low to ease the labour markets

The anaemic economic performance (let alone recession) to be observed in most CESEE countries is not helping to lower the rate of unemployment, which leapt in the wake of the crisis in 2009 and, in most instances, has continued to rise slowly but steadily ever since. Nearly everywhere in the region, economic growth lies far below the benchmark of around 3%, the minimum generally required to sustain employment levels (see Box 1). GDP growth slower than that can be attained by simple labour productivity improvements such as the adoption of new technologies or better management and marketing, without entailing the need to hire additional labour. Further progress in economic restructuring – at least in the more advanced NMS countries – yields diminishing returns in the form of lower labour productivity increases, thus probably bringing the requisite GDP growth 'threshold' closer to levels observed in the 'old' EU (1.5-2%). However, under the circumstances currently prevailing in most CESEE countries, even that level of growth looks unattainable. To top it all, the fiscal austerity regime pursued in some NMS countries and the Western Balkans has led to lay-offs in the public sector – notably in Croatia, where they contributed to the dramatic 5% drop in employment in 2012 (see Figure 5).

Box 1

Estimating the employment elasticity of growth

We have estimated the employment elasticity of growth by running fixed-effects panel data regressions using annual data for the period 2000-2012 on the two sub-samples of countries: the 'advanced NMS countries' (all NMS countries except Romania and Bulgaria) and the 'remaining CESEE countries' (except Turkey). The elasticities obtained are 0.43 for the advanced NMS countries and 0.31 for the remaining CESEE countries, implying that on average, a 1% GDP growth is accompanied by a 0.43% growth in employment in the case of advanced NMS countries and by 0.31% growth in the case of the remaining CESEE countries.

In both cases, the F-test does not allow us to reject the null hypothesis of differences between the country-specific intercepts in a fixed-effects regression as being statistically insignificant. Given this, we ran pooled panel-data regressions on the same two sub-samples of countries for the same time period, which yielded the following results:

$\Delta\mathrm{empl}_{\mathrm{NMS}} = -1.12 + 0.42\Delta\mathrm{gdp}_{\mathrm{NMS}}$ for the advanced NMS, and

$\Delta\mathrm{empl}_{\mathrm{CESEE}} = -1.08 + 0.34\Delta\mathrm{gdp}_{\mathrm{CESEE}}$ for the remaining CESEE countries.

Setting $\Delta\mathrm{empl} = 0$ allows us to calculate the minimum GDP growth rate $\Delta\mathrm{gdp}^*$ which is required to keep the employment level at least constant. The 'threshold' values derived are 2.7% for the advanced NMS countries and 3.2% for the remaining CESEE countries.

Figure 5 illustrates that the cross-country variation observed in growth performance has been generally too small to explain the differences in the employment dynamics[2] and has been offset by other factors. For instance, in all three Baltic countries, employment expanded appreciably (by 2-3%) and unemployment rates declined accordingly. However, this can be only partly attributed to these countries' relatively high GDP growth: another important factor is the fact that this growth has to a large extent been accounted for by the labour-intensive services sector. This effect has been even more pronounced in Montenegro where expansion of the labour-intensive tourism sector has resulted in 2% growth in employment – despite a decline in overall GDP. Slovakia offers an example to the contrary. Its GDP growth in 2012 – though reasonably high – was driven primarily by an upturn in the manufacture of motor cars, which is relatively less labour-intensive. As a result, Slovakia's employment expanded only marginally in 2012 and only partly absorbed the increase in the labour force attributable to return migration, as result of which the unemployment rate even increased.

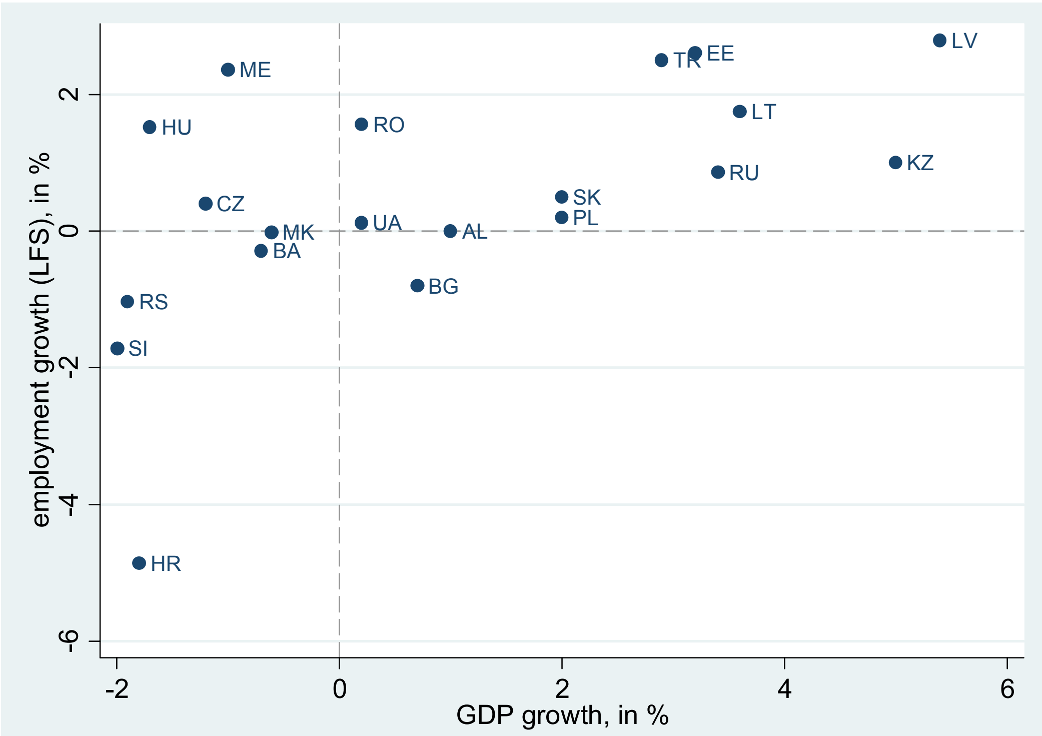
The population and labour force dynamics are having a more general effect on labour markets in the CESEE countries. Wherever the labour force is shrinking owing to demographic factors and/or net outward migration, even stagnating employment levels can be consistent with declining unemployment. By the same token, it can be safely assumed that the unemployment rates would have been (even) higher, had there been no shrinkage in the labour force. In that respect, the results of the

2 In a simple regression framework, GDP growth has the 'right' coefficient, but explains only 33% of the variation observed in the employment dynamics. For this reason, the corresponding regression line has been omitted from Figure 5.

most recent population censuses conducted in most CESEE countries in the course of 2011 may offer valuable insights – see Table 2. It can be seen from Table 2 that while the decline in population in many CESEE countries was a well-known phenomenon, its magnitude was grossly under-estimated in a number of cases. In particular, in both Bulgaria and Croatia, it transpired that the population was some 2% less than hitherto believed, in Lithuania 7%, in Romania and Latvia 10% and in Albania 12%. In Romania, the largest country in this group, the corresponding discrepancy amounted to more than 2 million fewer inhabitants in absolute terms.

Figure 5

GDP growth and growth in employment, 2012



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

To a large extent, the discrepancies reflect the high (and previously under-estimated) outward migration from those countries over the past decade. Their citizens have been entitled to EU-wide visa-free travel and (in the case of Latvians and Lithuanians) work in most EU countries for a number of years – not taking into account the sizeable volume of 'shadow' employment. Although no recent census has been conducted in Ukraine, anecdotal evidence suggests that outward migration from that country over the past decade has also been substantial, with Russia featuring as a prime destination.[3]

[3] Interestingly, Russia and Poland were the only two CESEE countries where the recent censuses yielded substantially higher population figures: by around 1 million people in Russia and some 300,000 people in Poland.

Table 2

Population

average, in 1000 persons

	2007	2008	2009	2010	2011 1)	2012 1)
Bulgaria	7660	7623	7585	7534	7348	7330
Czech Republic	10334	10424	10487	10520	10496	10510
Estonia	1342	1341	1340	1340	1295 2)	1294
Hungary	10056	10038	10023	10000	9972 2)	9940
Latvia	2276	2266	2255	2239	2058	2035
Lithuania	3376	3358	3339	3287	3029	2994
Poland	38121	38126	38152	38184	38534	38560
Romania	21547	21514	21480	21438	19070	19000
Slovakia	5397	5407	5419	5430	5398	5410
Slovenia	2018	2021	2040	2049	2053	2055
Croatia	4436	4435	4429	4418	4288	4280
Macedonia	2044	2047	2051	2055	2059	2065
Montenegro	626	629	632	619	620	621
Turkey	70215	71095	72050	73003	73950	74885
Albania	3161	3182	3194	3210	2814	2820
Bosnia and Herzegovina	3843	3842	3843	3843	3840	3843
Serbia	7382	7350	7321	7291	7160	7130
Kazakhstan	15484	15674	16093	16323	16559	16794
Russia	142115	141956	141902	142938	142961	143000
Ukraine	46509	46258	46053	45871	45706	45593

Note: Data in blue based on the new census, in black based on the old census.

1) Preliminary and wiiw estimate. - 2) First census results of the respective reference period.

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

Migrants leaving a country in search of jobs elsewhere are improving the labour market situation in their country of origin, while the related inflows of remittances are often an important source of (mostly consumption and housing) finance, with a significant impact on domestic spending. However, the implications are far-reaching not only for the labour markets of the countries involved. For instance, the new census figures imply that given the smaller populations, the per capita GDP levels of Romania, Bulgaria, Latvia, Lithuania, Croatia and Albania are 2-12% higher and their development gap with respect to the 'old' EU countries, for example, is accordingly narrower than previously assumed.

To date, the protracted euro area crisis has not led to a substantial wave of return migration to the CESEE countries, although – as mentioned above – Slovakia may offer an example to the contrary. In fact, outward migration from some CESEE countries to the 'old' EU may even accelerate somewhat in the years to come. This applies primarily to Bulgaria and Romania, where living standards are generally much lower than in Slovakia, for example. Citizens of both countries will be granted unrestricted access to the entire EU labour market with effect from January 2014 at the latest.[4] This

4 At the moment, nine EU countries – including Austria, Germany, France and the UK – are still restricting the right of Bulgarians and Romanians to work there.

also holds potentially true for Croatia, which will join the EU in July 2013 and whose citizens will acquire the right to work at least in certain EU countries immediately upon accession. Outward migration from those countries will probably help to ease conditions in the respective labour markets. This would appear particularly important in the case of Croatia with an unemployment rate approaching 16%. In other Western Balkan countries, however, where the labour market situation is even worse and cross-border labour mobility is restricted by the sheer fact that they are not (and will not be anytime soon) in the EU, unemployment is likely to stay stubbornly high, with potentially grave consequences for the social cohesion and political stability of those countries.

Flat incomes, fiscal austerity and deleveraging suppress private consumption

Deteriorating labour market conditions are suppressing the dynamics of wages and household incomes in general (see Figure 6). Even in those CESEE countries where unemployment has recently declined (such as the Baltic states), the decline started out from a high level and has apparently not been pronounced enough to provide a major boost to wages – at least in real terms. Only in the CIS countries did wages pick up markedly in 2012 – by up to 14% in Ukraine. It has to be borne in mind, however, that wage-setting in the CIS countries is typically more flexible than in the NMS countries, for example: their trade unions are (even) weaker and a larger proportion of wages is less formalized, i.e. paid unofficially. On that account, wages rather than employment absorbed the bulk of the shock during the 2009 crisis in the CIS countries, potentially pointing to a still existing 'catch-up' potential.

The cross-country differences to be observed in the wage dynamics can also be attributed in part to differences in the fiscal stance. In Ukraine and to a lesser extent Bulgaria, pre-election hikes in public sector wages and social spending fuelled the growth of wages and household incomes. Reverse developments were to be observed in a number of NMS and Balkan countries (for example, in Slovenia and the Czech Republic) where wage cuts in the public sector were important features of the budget consolidation programmes.

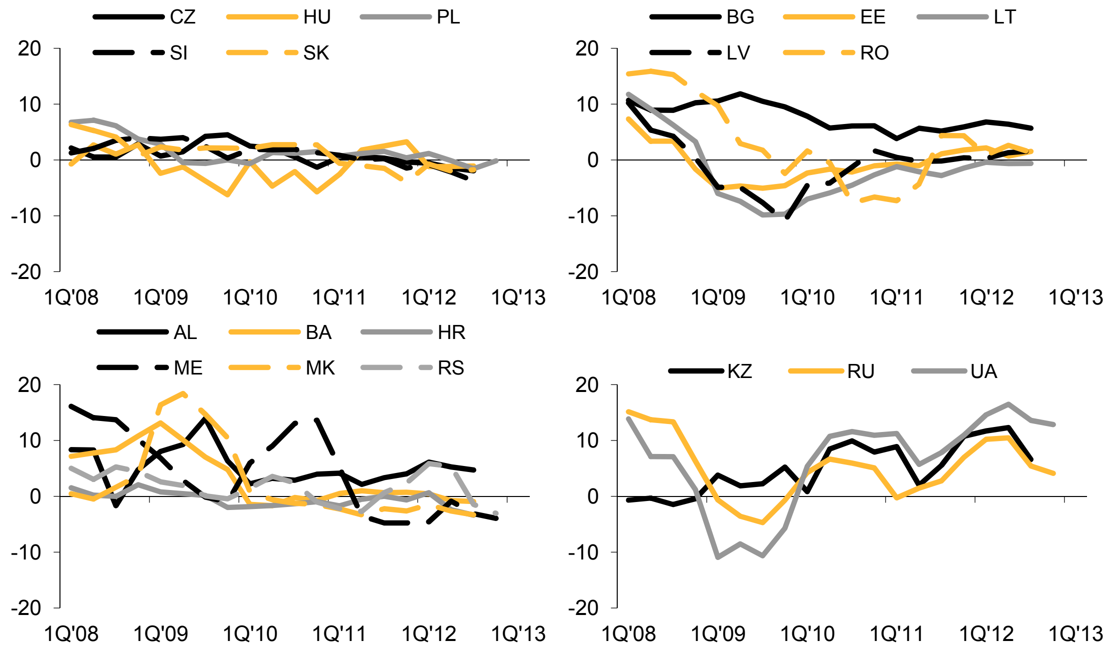
Another factor obviously affecting real wages and incomes has been the dynamics of consumer price inflation. By and large, inflationary pressures in the CESEE region remained fairly weak in an environment characterized by under-utilized capacities and relatively stable energy prices and exchange rates. However, in a number of instances, the performance of agriculture has played a crucial role – particularly in the poorer CESEE countries with a high share of food items in the consumer basket. For instance, the relatively abundant harvests exerted downward pressure on consumer prices in Turkey and Ukraine, and to a lesser extent in Russia. In Serbia, on the contrary, the dismal harvest was a major factor that prevented a drop in inflation, thus largely offsetting the pre-election wage hikes.

In the NMS countries, the dynamics of consumer price inflation has been primarily driven by fiscal policy moves. In Latvia, the real incomes of households were strengthened by lowering the VAT rate in a move to suppress inflation and so conform to the levels set in the Maastricht criteria for the adoption of the euro. Elsewhere, policy has shifted largely in the opposite direction. For instance, in the Czech Republic, Hungary and Poland, the fiscal austerity programmes involved hikes in indirect taxation and/or administrative fees that eroded the real purchasing power of households.

Figure 6

Real gross wages

change in % against preceding year



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

High unemployment and stagnant wages, coupled with prevailing uncertainties and the ongoing, albeit in some cases visibly decelerating, deleveraging of the household sector,[5] continue to weigh heavily on the dynamics of private consumption in most CESEE countries (see Figure 7). In this respect, Turkey presents a special case. The stagnation of household consumption in 2012 was the result of the Turkish government's deliberate efforts to 'cool down' an overheated economy by putting the brakes on credit expansion. Elsewhere in the region, the problem is rather the reverse. The authorities would probably be glad to see more buoyant household demand, but they often lack the appropriate tools (and in some cases political will) for such an undertaking.

Once again, the exceptions are to be found primarily on the 'fringes' of the region. In the Baltic states and CIS countries, private consumption has enjoyed a revival on the back of receding unemployment and recovering wages, respectively. Furthermore, in both Russia and Kazakhstan, where the banking sector is largely domestically owned and the overall mood is better, consumer lending has been on the rise. In Kazakhstan and Ukraine, however, the current pace of private consumption

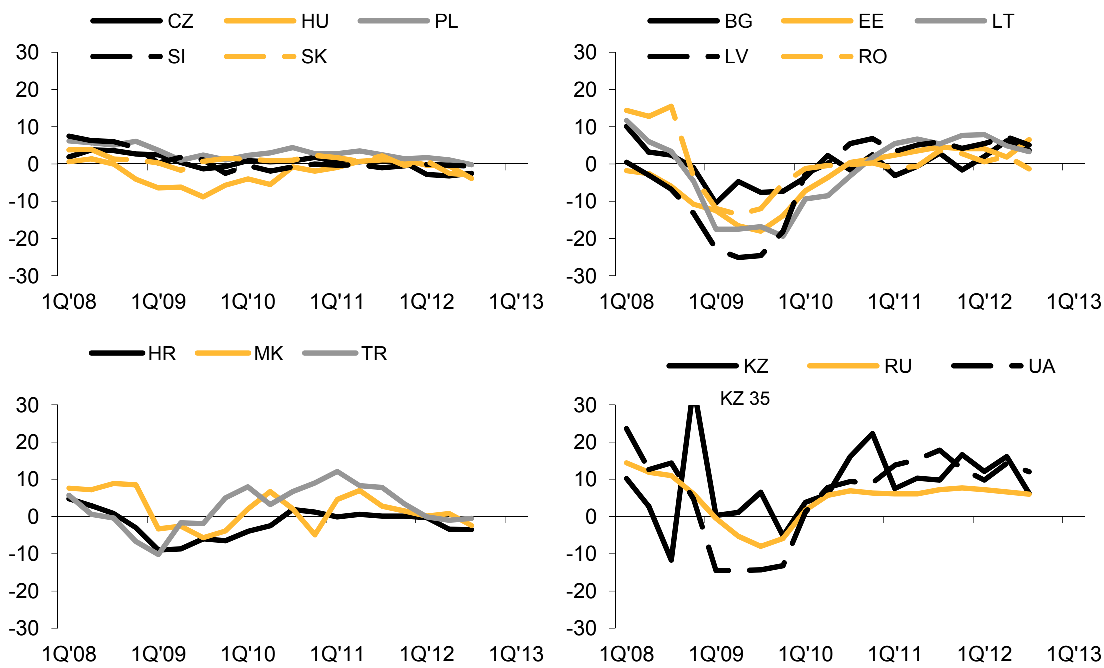
5 For more on that see special section in this report, 'Deleveraging in the CESEE countries: where has all the liquidity gone?'.

growth will hardly be sustained. For very different reasons, both countries are likely to re-balance and re-direct their growth paths – in the medium term at the latest – towards investments and net exports, respectively.

Figure 7

Household consumption

real change in % against preceding year



Source: National statistics and Eurostat.

Crucial role of public investments

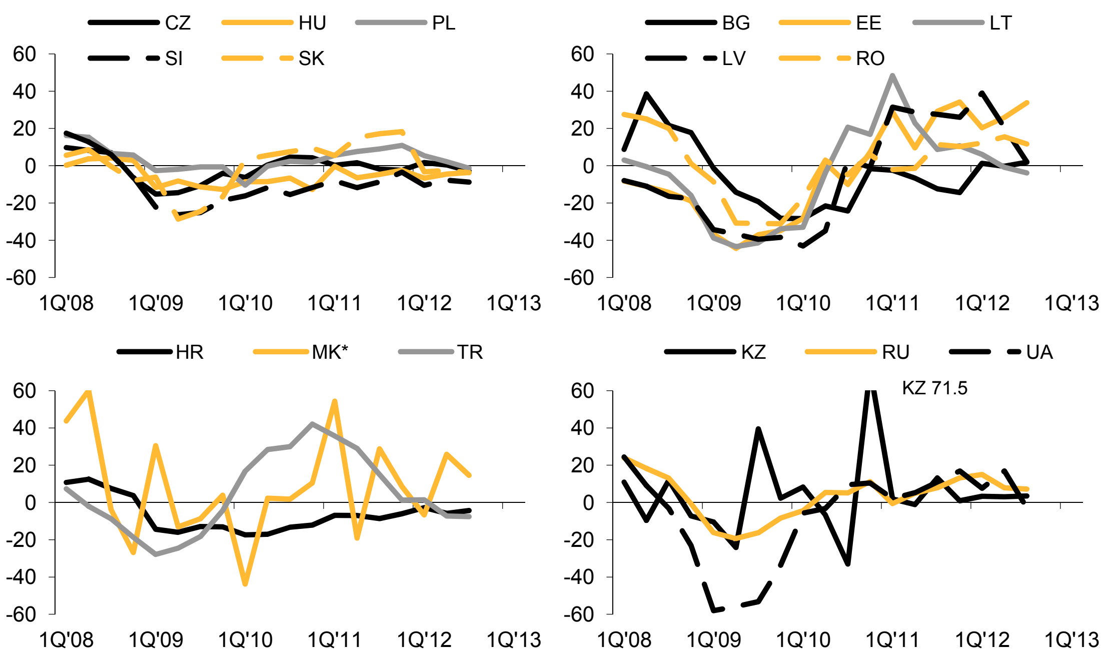
The modest recovery of fixed capital investments in the CESEE countries following the crisis in 2009, if it was observed at all, was a generally short-lived affair (see Figure 8). Those developments are also mirrored in the persistent weakness of the construction sector that has recently shown clear signs of deterioration in a number of instances (Figure 9). In most NMS countries in Central Europe as well as in Croatia, investment and construction have been contracting ever since the crisis in 2009, while in 2012 the volume of construction also fell markedly in Albania and Ukraine – and more moderately in Poland.

The dismal performance of the construction sector (and investments more generally) across the region is only partly a legacy of the recent 'bursts' of real estate bubbles. In the Baltic states, Bulgaria, Ukraine, and most recently in Slovenia as well, the bursting bubbles have indeed left lasting scars on the banking sector. The soaring non-performing loans have certainly contributed to a 'credit crunch' in those countries (inordinately high interest rates and stringent lending conditions), as has the ongoing external de-leveraging of the banking sector, with the European banks reducing their exposure in large segments of the CESEE region.[6] However, in the NMS countries in Central Europe, such as the Czech Republic, Slovakia, Hungary and Poland, which have not suffered real estate crises of the same magnitude, the dynamics of construction and investments has been equally – if not more – disappointing. As exemplified by the Czech Republic, even very low interest rates have been unable to trigger more buoyant investment demand. Overall, the role of high interest rates should not be over-estimated, given that large parts of the business sector are awash with liquidity and are typically financing investments from profits – if at all – rather than by taking out loans. More generally, investment activity is suppressed by the lasting, and in some cases deteriorating, perception of uncertain future prospects and underutilized capacities in an environment characterized by weak demand, while country-specific factors also play a role. In Russia, investments, particularly into the non-oil sector, continue to be deterred by weak institutions, widespread corruption and insecure property rights, whereas in Turkey they have been recently curtailed by strict monetary constrictions aimed at 'cooling down' the economy.

Figure 8

Gross fixed capital formation

real change in % against preceding year



Remark:* MK Gross capital formation.

Source: National statistics and Eurostat.

Under these circumstances, the dynamics of fixed capital investments in the region have been increasingly shaped by public investment projects. In Estonia and Romania, the double-digit invest-

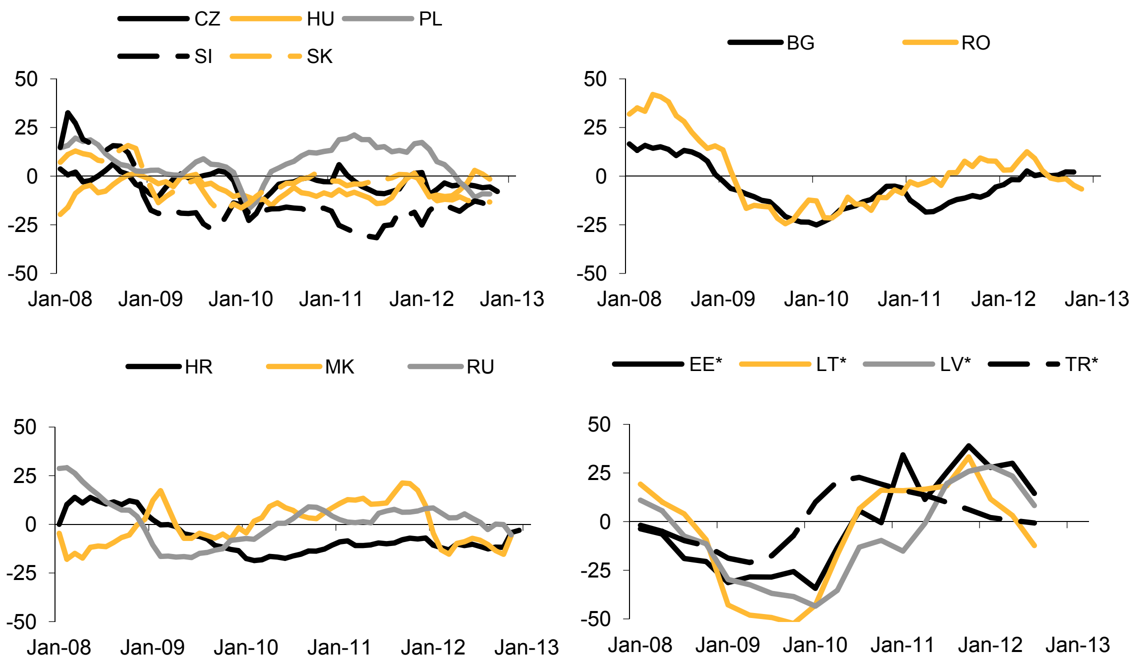
6 More on that see special section in this report 'Deleveraging in the CESEE: where has all the liquidity gone?'

ment growth in the previous year was primarily due to large-scale transport and energy infrastructure projects, partly financed by EU transfers. In Turkey, government-sponsored projects partially offset the decline in private investments, while in Ukraine investments in the first half of 2012 were driven by infrastructure projects ahead of the European football championships and came to a standstill once those projects were finished. In 2012 Latvia was the only CESEE-country where the revival in construction and investment activities stemmed primarily from the private sector. However, with large-scale infrastructure projects in transport and energy on the government agenda, public investments will play an increasing role over the next few years also in Latvia. A pick-up in infrastructure investment in the course of the current year is also projected for Lithuania, Poland, Croatia and Serbia: in the latter two cases, financed by EU transfers and foreign credits, respectively.

Figure 9

Construction

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



Remark: EE, LT, LV, TR quarterly data, change in % against preceding year.

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Conversely, the budget consolidation programmes currently underway in most other CESEE countries fall heavily on investments. Furthermore, while EU transfers within the framework of the EU Structural and Cohesion Funds continue to be an important source of investment finance in many NMS countries, they typically require co-financing from national budgets – funding that is not always forthcoming. For this and other reasons (such as the insufficient expertise in raising this type of finance), the absorption rates of EU transfers in the NMS countries are typically low – generally much lower than in the 'old' EU member states. The pursuit of budget austerity is suppressing investments not only directly, but in some cases indirectly as well – to the extent that public and private investments complement each other ('crowding-in'). Slovakia appears to be a case in point: the lack of a motorway connecting the more prosperous western part of the country with the more backward eastern part continues to be a drag on private investments in the latter region – notwithstanding the country's otherwise strong investment credentials.

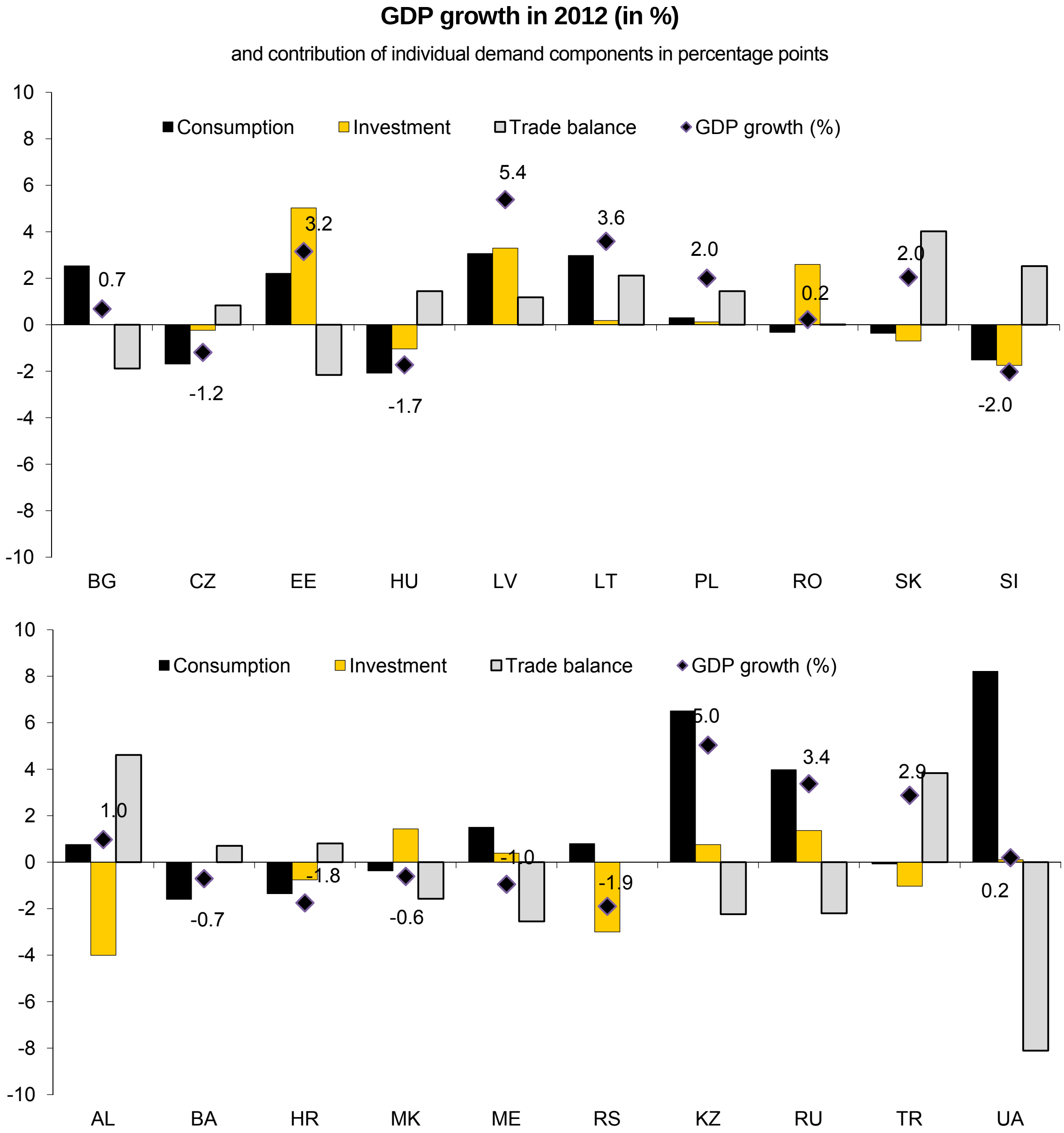
Net exports drive GDP growth – despite the weak external environment

In 2012, weak exports and suppressed domestic demand (partly due to fiscal austerity) pushed nearly half of the CESEE region into recession, including the Czech Republic, Hungary, Slovenia and all the Western Balkan countries, with the exception of Albania. Elsewhere, growth remained positive; however, it was generally unspectacular, with the notable exceptions of Kazakhstan and Latvia, where growth exceeded 5%. In countries that hitherto had been relatively immune to the crisis, growth dynamics also progressively decelerated in the second half of the year. In Russia and Poland, a 'soft landing' has come increasingly to the fore, while the 'touchdown' has been more abrupt in Turkey, Romania and particularly in Ukraine, whose economy slipped into recession as its metals exports collapsed. In the heavily agricultural countries, Romania and Serbia, poor harvests have also played a role, pushing food prices upwards and eroding the purchasing power of households.

On the whole, 2012 was a disappointing year for the CESEE economies, confirming fears of a double-dip recession in large parts of the region. This rather poor performance stands in sharp contrast to the better dynamics in other 'emerging markets' in Asia and Latin America. It also underscores the dependence of large parts of the CESEE region on the troubled euro area (not least in terms of policies pursued) and the structural weakness of some of its economies, such as Russia and Ukraine.

There is little doubt that both external and domestic factors are to be blamed for the CESEE countries' disappointing growth performance. Still, Figure 10 showing demand components for 2012 suggests that the crucial factor was the weakness of domestic demand. In the majority of CESEE countries (including nearly all the NMS countries, except Estonia and Bulgaria), net exports contributed positively to GDP growth – despite the anaemic external environment. This reflects the fact that generally speaking import demand has been lagging behind export growth. These developments have also been broadly mirrored in the nominal dynamics of exports and imports, with current account deficits declining and surpluses increasing. The most impressive turnaround has been in Slovakia. The country's current account switched from a 2% deficit to a 2% surplus, and Slovakia joined Hungary and Slovenia as yet another external surplus country among the NMS countries. From the point of view of external vulnerability, this is obviously a welcome development. However, in some CESEE countries where concerns over external sustainability matter most, the situation has hardly improved – with the important exception of Turkey. Ukraine is a case in point: here, net exports have been a huge drag on GDP growth, and the already high current account deficit widened still further, calling in question the wisdom – and indeed the sustainability – of the country's policy of maintaining an exchange rate peg to the US dollar.

Figure 10



Source: wiiw Database incorporating national and Eurostat statistics, wiiw estimates.

Outlook: 'muddling through' in the near term, gradual improvements thereafter

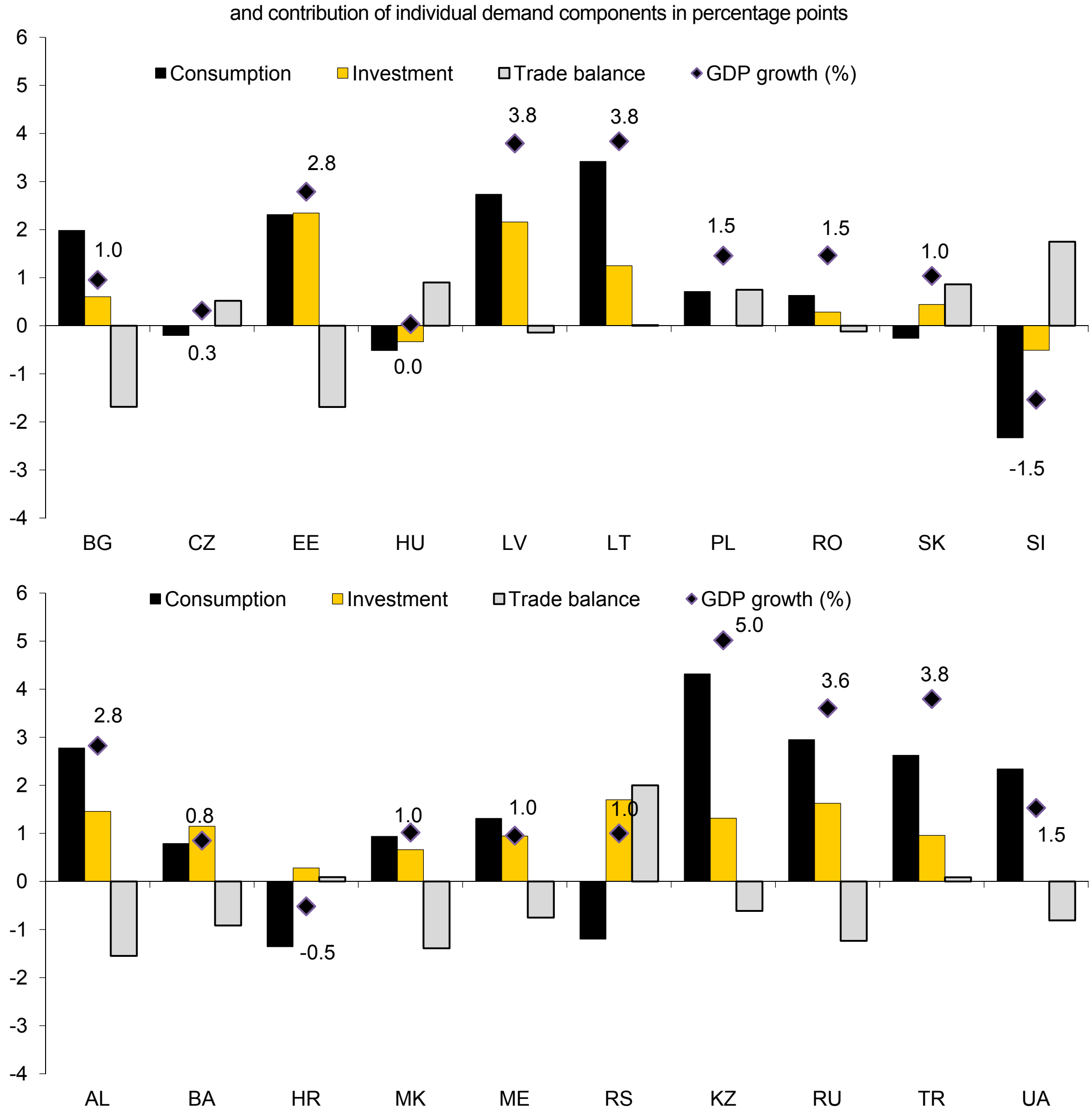
NMS prospects hinge on recovery in the euro area

The protracted recession in the euro area which will likely continue in 2013 will be a drag on the economic growth of the NMS countries – with the notable exception of the Baltic countries that trade relatively more with Russia. By and large, the NMS countries are small open economies held hostage to the excessive fiscal austerity pursued in the 'northern' euro area countries and the sluggish progress on the part of the euro area policy-makers in addressing the structural roots of the crisis (such as large internal imbalances and insufficient fiscal integration). At the same time, in the NMS countries private sector demand is unlikely to recover substantially given the high (and rising) unemployment, stagnant wages and credits, and persistent overall uncertainties. In those instances when investments increase, the increase will be primarily funded via public money, with EU transfers playing an important role. On a positive note, in Poland and the Czech Republic, the disappointing growth performance is likely to prompt the authorities to pursue fiscal austerity less rigorously, with less contractionary effects on the real economy.

Figure 11

GDP growth in 2013 (in %)

and contribution of individual demand components in percentage points



Source: wiiw forecast (March 2013).

In general, the NMS countries' prospects for 2013 are unimpressive and, on average, only marginally better than the previous year – largely on account of the expected negligible improvement in domestic demand (see Figure 11). While an expected moderate fiscal relaxation in the Czech Republic may bring GDP growth back into positive territory, in Poland it will at best offset a decline in private investments, resulting in rather unimpressive GDP growth of less than 2%. Elsewhere, the scope for a less restrictive fiscal stance will be constrained by other policy priorities: efforts to obtain release from the excessive deficit procedure set by the EU (viz. Hungary, Slovakia and Romania, in the latter case complemented by the potential need to comply with IMF requirements) and regain credibility in the eyes of financial markets (in Slovenia). At the same time, in Hungary, real incomes will be strengthened by the recent reduction in household energy tariffs and possibly other pre-election 'carrots', while in Romania agriculture is expected to recover after the dismal performance of the previous year. These factors may have moderately positive repercussions on economic dynamics in both countries, so that Hungary will probably avoid another recession this year and growth in Romania will accelerate slightly. On the other hand, Slovakia's export-led growth is likely to lose steam, as the extraordinarily high growth in motor car production and exports observed in the previous year is unlikely to be repeated. The abrupt decline in the car production in December 2012 may be a worrying signal in this respect. Slovenia will not be able to avoid another recession this year as it struggles to overcome the legacy of a recently 'burst' real estate bubble, reflected in a virulent banking crisis.

Overall, only in 2014 will a more deeply rooted economic recovery in the NMS countries finally start in line with the recovery projected for the euro area. The export-oriented industrial sector of the NMS is fundamentally strong and should take full advantage of the eventual euro area recovery next year and thereafter.

'Balkan tristesse'

The latter statement applies less to the Western Balkan countries, whose industrial base is considerably weaker and a key structural factor governing their generally high external deficits. Even with the euro area recovering, transmission to the Western Balkans will be more subdued – with the probable exception of Albania with its ever-increasing oil-exports and Kosovo with its dependence on remittances. Furthermore, for reasons of geographic proximity, the Western Balkan countries are more dependent on import demand in the crisis-torn 'southern periphery' (particularly Italy), which will probably remain depressed for some time to come. In the near term, the prospects of domestic demand recovering are hardly better than in the NMS countries, while policy options are generally more limited. Sovereign borrowing is generally more expensive, while the use of monetary policy is constrained by the reliance on fixed exchange rates (except in Serbia) and the use of euro as legal tender (in Montenegro and Kosovo). In addition, balance-of-payments constraints are making themselves felt: any marked policy loosening would likely backfire in the form of widening external imbalances, thus calling their sustainability into question. In this environment, the inflow of remittances – an important pillar of domestic demand and a source of trade deficit financing – will continue to be crucial, as will foreign aid in Bosnia and Herzegovina and Kosovo.

The expected return to marginally positive economic growth this year (Figure 11) will be largely due to government-sponsored infrastructure projects and a likely recovery of agriculture in Serbia – the largest country in the region, with positive spill-over effects in other West Balkan countries. Furthermore, starting from the second half of 2013, Croatia as an EU member will benefit from the inflow of EU transfers contributing to a slight recovery of fixed investments after four years of decline. However, the latter will be probably not sufficient to prevent the country from recording yet another recession this year. Finally, an acceleration of economic growth in Albania hinges crucially on the plans for a fiscal expansion programme, which may be jeopardized by uncertainties surrounding the success of the government privatization scheme.

In the medium and long term, the bleak growth prospects and the high levels of unemployment (which, in some cases, have been rising still further, particularly in Serbia and Croatia) may eventually imperil the fragile social and political stability of the Western Balkans. A sustainable growth strategy for the region would almost certainly require large-scale foreign investments in both the tradable sector and infrastructure. Those funds, however, are only likely to materialize once the lasting legacy of past ethnic conflicts is fully overcome and the prospects for EU integration improve. Against this background, the forthcoming increase in the serial production of Fiat cars for the US market in the Kragujevac factory in Serbia is an encouraging piece of news, as are the plans for increased energy production and exports in neighbouring Macedonia.

Cautious optimism elsewhere

The economic prospects are generally better in the eastern parts of the CESEE region, which are less dependent on the troubled euro area and are in no rush to pursue fiscal consolidation. An important exception is Ukraine; the country has gone into recession and desperately needs to adjust its overvalued exchange rate in the face of adverse terms-of-trade shocks. Furthermore, its long-term prospects for restructuring and modernization may be hampered by the country's increasing political isolation. In Turkey, gradual policy loosening after a successful re-balancing in 2012 should result in an acceleration of GDP growth this year and the years thereafter, although – despite trend improvements in the country's export performance – external deficits are likely to stay high and continue to act as a constraint on economic growth in the medium term. In Russia and Kazakhstan, high – even if potentially subsiding – oil prices will ensure smooth economic growth both this year and the years thereafter. However, in the long term, Russia's economic prospects are clouded by the bottlenecks looming on the oil production front and the likely decline in gas prices following the increased availability of shale and liquid natural gas on the European market. In both countries, the chances of economic diversification away from the energy sector are highly uncertain, especially in Russia where the political will for such diversification appears to be weakening under Putin's third presidency.

Russia's economic growth will also benefit the neighbouring Baltic countries, as will the latter's increased expenditure on public infrastructure. With the prospects for fulfilling the Maastricht criteria looking good, Latvia's accession to the euro area in January 2014 appears highly likely,[7] probably being followed by that of Lithuania in 2015 or 2016. Both countries have already followed fixed ex-

7 A final decision on Latvia's accession to the euro area is expected in June 2013.

change rate regimes for many years (in Lithuania in the form of a currency board) and should thus benefit from the forthcoming adoption of the euro via credibility gains and lower interest rates, while any related risks should be manageable – at least in the near future. The ‘internal devaluation’ strategy pursued in both countries over the past few years – however painful in social terms – has succeeded in restoring external equilibrium, so that the need for an exchange rate adjustment should be not all that high in the foreseeable future.

A new growth strategy?

Even under the most optimistic scenario, in the medium and long term the CESEE countries will be generally unable to replicate the growth rates observed prior to the 2008-2009 crisis. The relative scarcity of previous sources of growth, such as foreign capital (including foreign direct investment), under the present circumstances is raising the issue of an alternative growth model for the region, both within academic circles and among policy-makers. The latter could involve, for instance, a more active role being accorded to so-called ‘industrial policy’, including targeted support for the tradable sector. This issue is of particular relevance, for example, to countries such as Russia and Kazakhstan, where production and export diversification away from the low value-added and inherently volatile energy sector is both desirable and feasible – provided the political will and appropriate institutions are in place and wise use is made of the substantial financial resources that both countries have accumulated in their sovereign wealth funds. The scope for industrial policy is arguably less in the Western Balkan countries and Ukraine, which generally lack both the financial resources and appropriate institutions to support such a policy. They will probably have little choice but to rely primarily on foreign investment in order to upgrade their ailing industrial sector.

In the NMS countries, where industrial restructuring over the past decades has been more successful and will likely continue to bear fruit in the future as well, the major economic policy challenge arguably lies elsewhere: the task of identifying a way to re-direct their long-term economic growth more towards domestic demand. Strengthening domestic demand in those countries would most probably require increasing their (currently rather low) wage shares and upgrading their welfare systems. That, however, is diametrically opposed to the aims and objectives of the fiscal austerity programmes currently underway in most NMS countries.

Vladimir Gligorov

Special Section I: EU fiscal policy and fiscal risks

The fiscal policy stance adopted by the EU is not expected to change in the medium term. It is thus important to see: (i) how restrictive that stance has been; (ii) whether it has contributed to fiscal devaluation in countries with external imbalances; and (iii) what changes the structure of public expenditures has undergone. Furthermore, in view of the new multi-annual fiscal framework set up by the European Union and the number of off-budget funds and liabilities that have been introduced, it is interesting to speculate about the fiscal risks that the euro area and the EU have since assumed. Those risks may well be much larger than the outright fiscal liabilities projected in the EU budget.

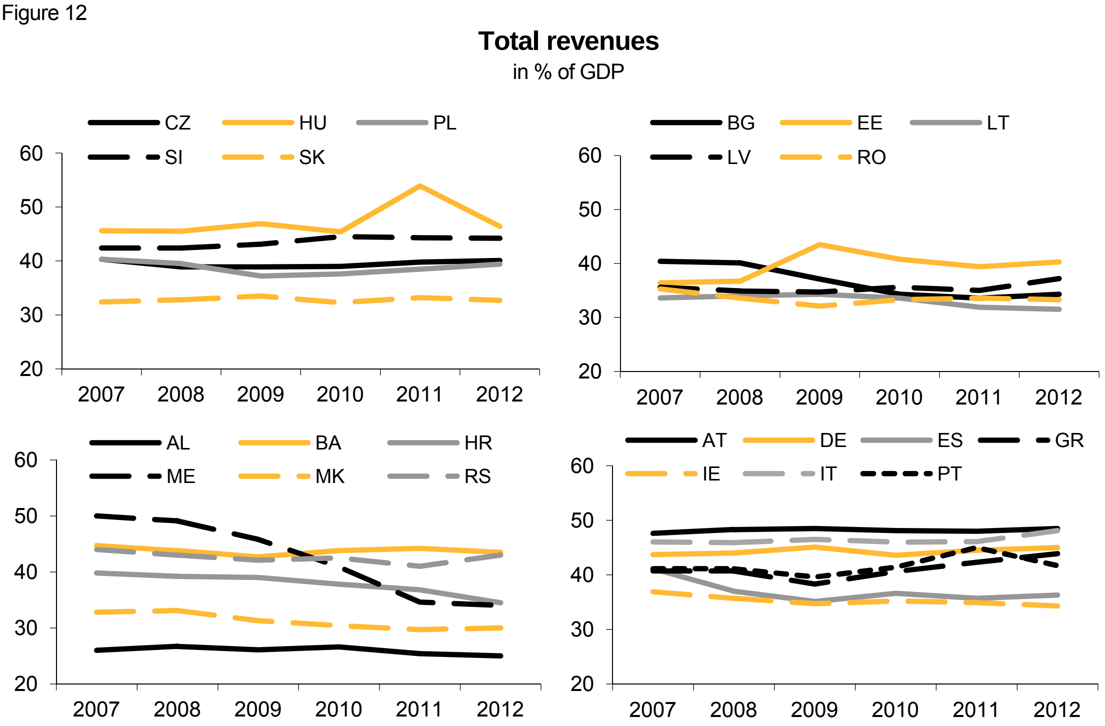
Revenues vs. expenditures

Fiscal deficit is one measure of the fiscal stance; however, it is also important to determine whether it has come about through lower revenues or higher expenditures because of the different impact they may have on the sustainability of the public debt and economic developments. In general, revenues as a percentage of GDP have either remained the same or, as is more often the case, declined over the period 2007-2011, albeit with some exceptions (Figure 12). Declines can be taken to show some fiscal relaxation (effective tax relief). This is more the case in the first few years of the crisis with tax hikes only entering the scene in the final couple of years. By and large, Central European countries have refrained from introducing effective tax cuts, Poland being an exception. The same appears to be the case in the Baltics, whereas Romania conforms to the general pattern and Bulgaria has suffered a significant decline in public revenue. The countries of South and Southeast Europe have witnessed declines in public revenue followed by some stabilization or increases in more recent years.

On the other hand, expenditures, as a percentage of GDP, increased almost uniformly in the initial years of the crisis, although the reverse was more characteristic of the biennium 2011- 2012, it being expected that consolidation will continue over the next few years (Figure 13). This pattern is plain to see in the Baltic countries, Romania and Bulgaria, as well as in the countries of Southern Europe, while initial increases have apparently not been reversed in Central Europe (with the exception of Slovakia). This pattern is consistent with the manner in which automatic stabilizers operate, except for the continued decline in expenditures in the past year that coincided with the return of recession.

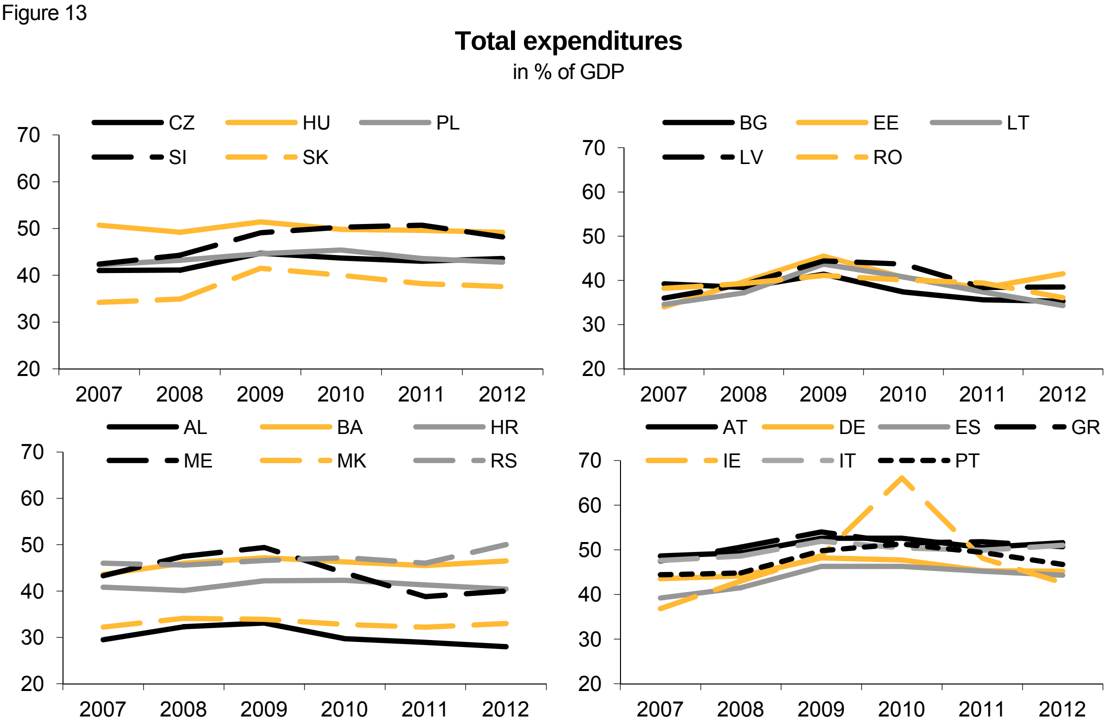
On the face of it, both increases in expenditure and effective tax cuts have been used. However, corrected by the variability of GDP, especially if account is taken of ratios of potential GDP, tax relief rather than increases in expenditures has played more of a role. Lower revenues tend to have less impact on growth, probably something like half that of increases in expenditure. Overall fiscal support has thus been relatively low, though not as a rule negative. Last year appears to have been different because revenue increases and expenditure cuts coincided with the return of recession. This will determine the fiscal stance in the future as well; hence, little support can be expected of fiscal policy.

Figure 12



ESA'95 definition for all EU countries, national definition for the rest of the countries.
Sources: Eurostat, Government Finance Statistics (IMF), National Ministries of Finance, National Banks.

Figure 13



ESA'95 definition for all EU countries, national definition for the rest of the countries.
Sources: Eurostat, Government Finance Statistics (IMF), National Ministries of Finance, National Banks.

Changes in taxes

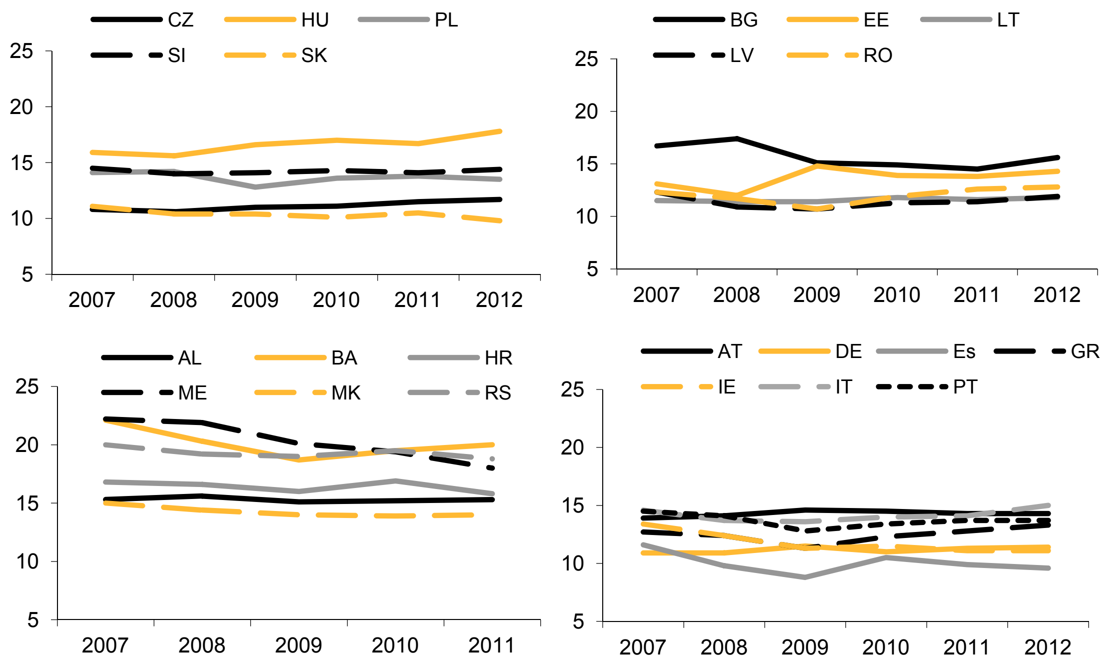
Most of the EU member states and the Balkan countries in Southeast Europe use the euro as their domestic currency in one way or another. As a consequence, nominal devaluation is not available or not necessarily the preferred option when addressing problems of competitiveness, despite their having taken place in countries with flexible exchange rates. Furthermore, wage deflation plus labour shedding does not support recovery and thus should not be the preferred adjustment strategy. An alternative approach is fiscal devaluation, which can take one of two forms: tariff hikes in tandem with export subsidies or VAT hikes matched by cuts in social contributions.

In general, it is hard to detect significant fiscal devaluation in most euro area and Balkan countries. In the majority of cases, tariff changes and export subsidies are not available, thus excluding that fiscal devaluation strategy to be pursued. As for the alternative strategy, it appears that, for the most part, revenues from VAT, as a percentage of GDP, have not increased, but have rather often decreased (Figure 14), while revenues from social contributions, again as a percentage of GDP, did not decline (Figure 15). In some cases, revenue from indirect taxes (primarily VAT) has shadowed changes in the growth of GDP (for instance, Bulgaria, Spain, Portugal and the Baltic countries), while Hungary stands out as an exception among the Central European countries and Estonia among the Baltic states.

Figure 14

Indirect taxes

in % of GDP



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

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

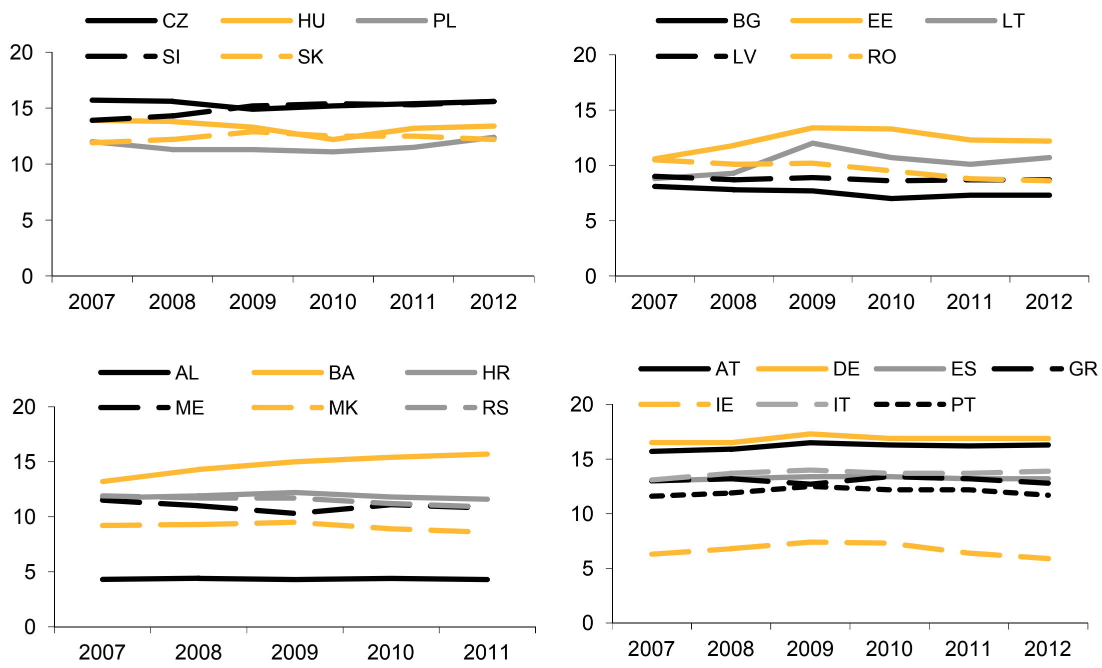
To all intents and purposes, social contributions in most countries have remained comparatively flat throughout the whole period. Hungary, Estonia, Lithuania and Bosnia and Herzegovina have seen increases and Germany some decreases. In general, social contributions have not been cut in order to target fiscal devaluation. Even in the countries in Southern Europe, which are often credited with lax tax systems and a significant share of informal employment, social contributions continue to be an appreciable and stable source of public revenue. Increasing informal employment would be one form of securing fiscal devaluation, at least in terms of lower labour costs. None the less, in many countries in Southern Europe there has been no significant shift from formal to informal employment, as both have tended to decline.

By and large, there has been little fiscal devaluation. Wage deflation and employment cuts have emerged as the adjustment policy of choice.

Figure 15

Social contributions

in % of GDP



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

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

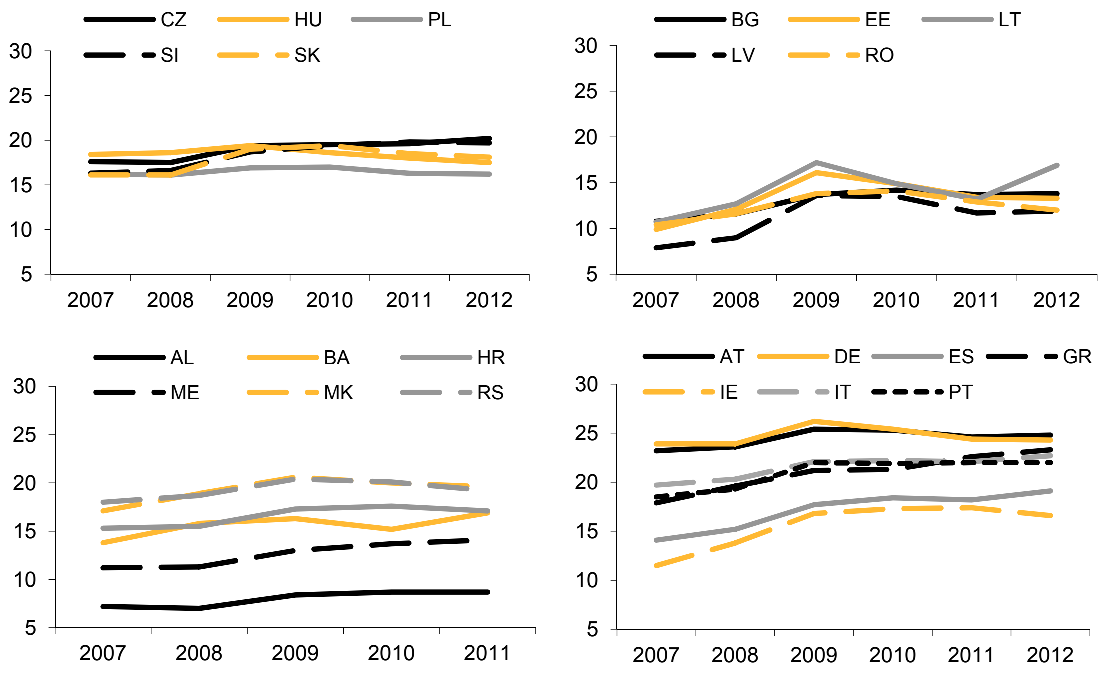
Public spending: consumption vs. investments

On the spending side, compensations to employees have for the most part held up well. Despite all reports of cuts in the public wage bill, few instances of a decline, though hardly any increases also, again as a percentage of GDP, are to be observed. Social benefits, which account for most of the increases in expenditures, have registered either an increase in the initial period of the crisis or no decrease in the final two years (Figure 16). The most profound changes are to be seen in those countries that have suffered steeper declines in GDP, such as the Baltic states and the countries in Southern Europe. For all the differences in the rates of recovery, overall stabilization can be observed, as can a minor increase in the final year despite the return of recession or slowdown in growth.

Figure 16

Social benefits

in % of GDP



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

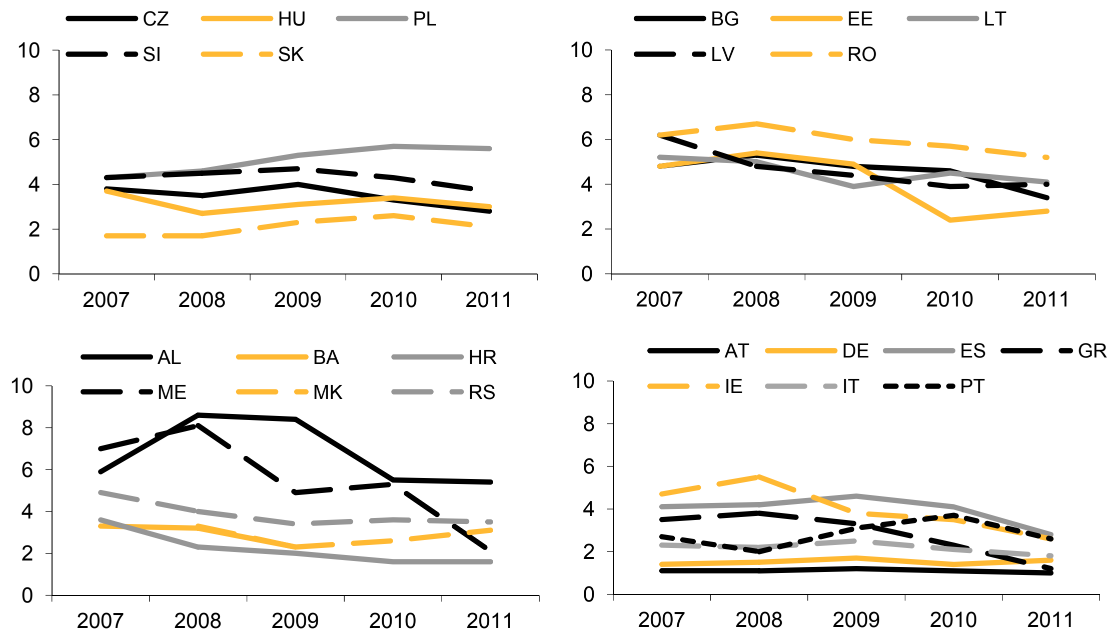
Sources: Eurostat, Government Finance Statistics (IMF), National Ministries of Finance, National Banks.

Public investments have declined (Figure 17), although there are exceptions (Poland throughout the period and Slovakia until the last couple of years, and some countries in Southern Europe in earlier years), while spending on goods and services (intermediate consumption) has tended to decline. In general, most of the changes in the expenditure-to-GDP ratio have come about as a result of changes in growth rates. In most countries, it is hard to detect much of a fiscal stimulus over and above the workings of the automatic stabilizers.

Figure 17

Public capital investments

in % of GDP



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

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

Fiscal risks

In the ultimate analysis, the EU multi-annual budget does not provide an accurate reflection of the fiscal risk being shared, especially in the monetary union. To the seven-year budget of less than a trillion euro (about 960 billion euro or 1 % of EU GDP) significant out-of-budget liabilities have to be added. Those liabilities comprise the stabilization fund, a possible bank resolution fund and potential losses incurred by the European Central Bank, as well as various forms of explicit and implicit transfers that may occur. Taken together, explicit fiscal obligations and other budget obligations, as well as possible fiscal risks and unbudgeted fiscal liabilities may be quite significant, yet they are difficult to quantify.

Why do these fiscal risks occur? Basically, if a monetary union is to be sustained, adjustments can be made to accommodate asymmetric shocks or the differentiated effects of a common shock via such measures as increasing labour mobility, sharing financial risks or effecting fiscal transfers – or via a mix of all three. There is every indication of increased labour mobility with some striking data about outward migration in the Baltic states and Balkan countries. The full extent of that channel of adjustment and the fiscal consequences of that increased mobility remain to be seen.

As the European Central Bank has recognized, the channel for sharing financial risks opened up by labour mobility has since become inefficient. The stability of the financial system has thus been bolstered by both the creation of the European Stabilization Mechanism (ESM) and a significant expansion of the ECB balance sheet. Moreover, the Banking Resolution Agency will have to be empowered to restructure banks: a function that will also require funds, possibly in addition to the financial resources already set aside in the ESM. The overall fiscal commitment, though not necessarily the net costs, will dwarf the seven-year budget.

Outright fiscal transfers have been ruled out and certainly do not feature in the EU budget, other than the funds earmarked for agriculture and cohesion. However, even if in a number of countries it is not feasible to assume common fiscal responsibility in some way (via euro bonds, a redemption fund or something to the same effect), some of the fiscal adjustment costs will have to be shared – be it in no other way than by write-offs of one kind or another. The extent of those fiscal risks will depend on social willingness to pay up as well as the rate of recovery.

It is hard to quantify those fiscal risks, but it may very well be the case that taken together, they will be a multiple of the EU budget.

Conclusion

Automatic stabilizers have been allowed to operate, though not fully and mostly in the early years of the crises. In the last year or two, both expenditure cuts and tax increase have been introduced. Throughout, there is little evidence of policies aimed at fiscal devaluation. By and large, the preferred policy of adjustment seems to have been wage and employment cuts.

Olga Pindyuk and Mario Holzner

Special section II: Deleveraging in the CESEE countries: where has all the liquidity gone?

Only in the core EU15 countries did the financial corporations avert a decrease in their assets during the crisis years. They managed to increase their total volume of assets at a steady rate over the period 2008-2011, despite reducing on a dramatic scale their exposure to the banking sector in the CESEE countries. Financial corporations in the NMS countries have significantly reduced their balance sheets. At the same time, in line with financial corporations in the core EU15, they have increased the share of currency and deposits in their assets. Their taking refuge in safe assets means that they are hoarding liquidity, which thus does not get channelled into the real sector of economy. As the liquidity of the corporate and household sectors starts to deteriorate, any prospects of investment and household consumption recovering will require that companies and household enjoy improved access to external financing.

In the March 2012 issue of Current Analyses and Forecasts[8], we analyzed the scope for deleveraging in the banking sector in the years since the outbreak of the crisis; the analysis covered the period up until September 2011. In this issue, we would like to bring the analysis up to date by including data for the period stretching from the fourth quarter 2011 to the third quarter 2012. As in the previous exercise, we use data emanating from the Bank of International Settlements (BIS). Those data are drawn from consolidated banking statistics on an ultimate risk basis (the country of ultimate risk is defined as the country in which the guarantor of a financial claim resides and / or the country in which the head office of a legally dependent branch is located). In the present issue, we have extended the scope of the exercise to include an analysis of the impact that deleveraging has on the balance sheets of individual sectors of the economy: financial corporations, non-financial corporations and households. We want to establish which sectors of national economies were affected by financial constraints in the wake of the crisis and to what extent, as well as determine whether signs of liquidity hoarding can be detected. The data on balance sheets come from sectoral national accounts statistics published by Eurostat (owing to data limitations we have only undertaken balance sheets analyses for the 10 new member states (NMS) up to the end of 2011).

Greece, Ireland, Italy, Portugal and Spain (the GIIPS countries) continue to be those countries most affected by the steps the European banks have taken to reduce their exposure, although some CESEE countries have accumulated similar funding losses in relative terms. Figure 18 compares the indices of the European banks' foreign claims on the GIIPS countries and four countries in Central and Eastern Europe (CEE). In June 2008 foreign bank claims peaked, whereafter they started to plummet in all nine countries shown in Figure 18. Of all nine countries, Greece and Ireland registered the largest decline in European banks' foreign claims – by 80% and 61% respectively in Sep-

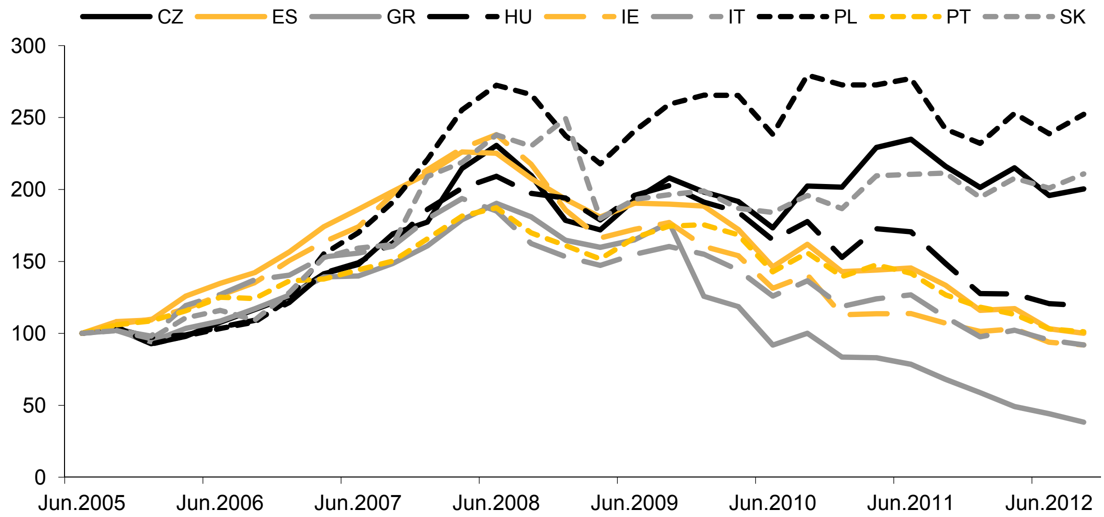
8 See 'Special topic: The European banking crisis and spillover effects in the countries of CESEE', *wiiw Current Analyses and Forecasts*, No. 9, Vienna, March 2012, pp. 54-61.

tember 2012 as compared to June 2008. In the period September 2011 to September 2012, the rapid decline continued in all GIIPS countries, which suffered losses ranging from 14% (Ireland) to 44% (Greece) on account of the foreign claims lodged by European banks. Among the CEE countries, the dynamics was quite heterogeneous. Whereas in Hungary the indicator was on a par with Portugal (20%), the Czech Republic experienced a milder decline (7%) in terms of foreign claims lodged by European banks. In Slovakia deleveraging stalled and in September 2012 Poland even recorded an increase of 4% year-on-year in such foreign claims.

Figure 18

Indices of foreign bank claims of European banks to GIIPS and CEE on ultimate risk basis

June 2005=100



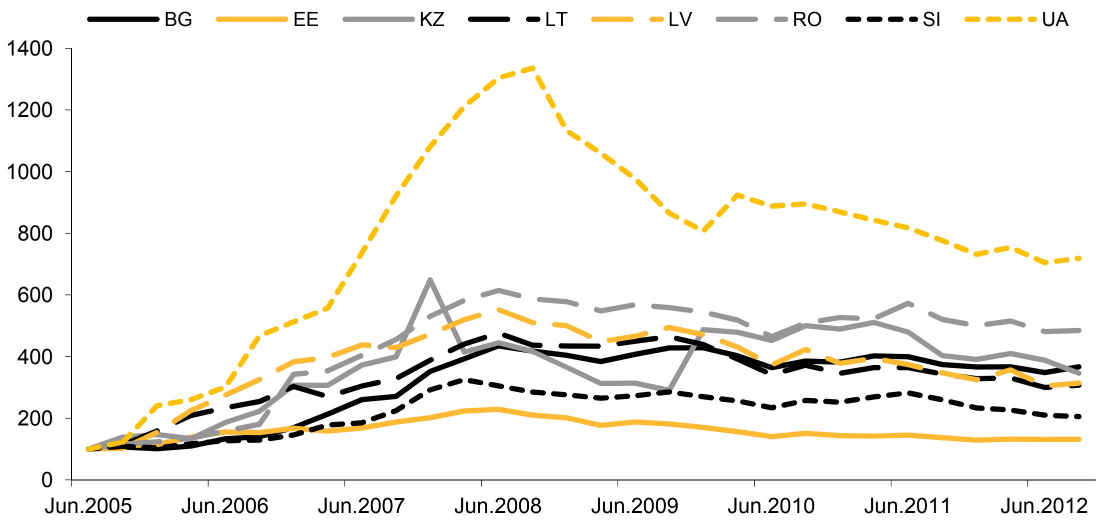
Source: BIS.

Figure 19 shows those countries in the CESEE-region that had been accumulating European bank claims at a spanking rate prior to the crisis. The most striking example is Ukraine, where foreign bank claims increased more than 13-fold in the period June 2005-June 2008. The setback in Ukraine was dramatic; by September 2012, the country had lost 45% of the European banks' foreign claims as compared to June 2008. Similar rates of decline were reported in Estonia, Latvia, Lithuania and Slovenia. In the latter country, most of the deleveraging activities occurred in the final four quarters of the period analysed when quite recently banking sector problems began to emerge. Over the period June 2008-September 2012, Bulgaria and Romania performed relatively better, having lost 16% and 21% of the European banks' foreign claims respectively. Throughout the period September 2011-September 2012, the European banks continued their deleveraging activities in all the countries analysed, although those activities slowed down noticeably in Bulgaria and Estonia.

Figure 19

Indices of foreign bank claims of European banks to selected CESEE on ultimate risk basis

June 2005=100

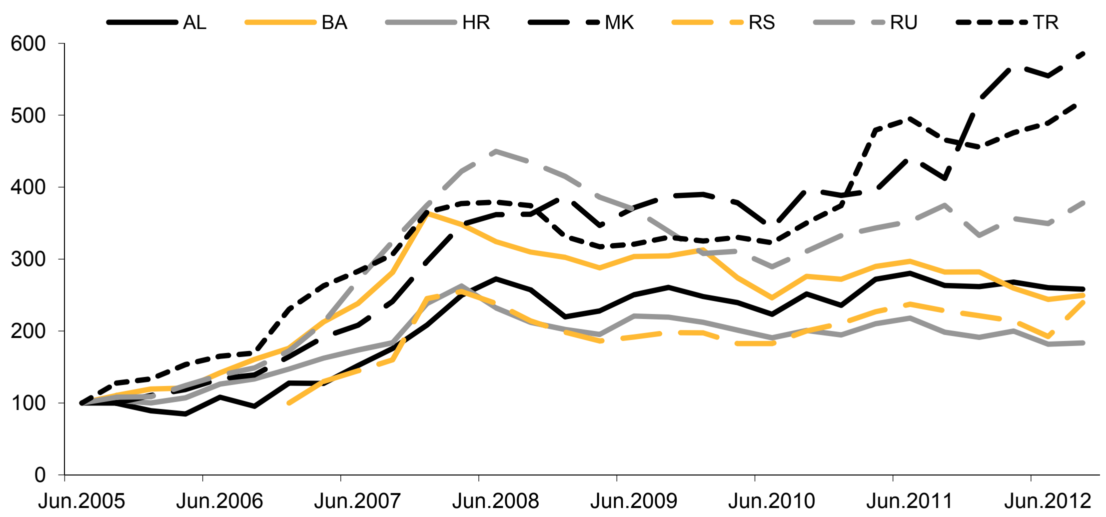


Source: BIS.

Figure 20

Indices of foreign bank claims of European banks to SEE and Russia on ultimate risk basis

June 2005=100



Source: BIS.

Figure 20 shows indices of the European banks' claims on the remaining CESEE countries. Overall, countries in Southeast Europe (SEE) registered better performance than their CEE neighbours.

Macedonia, Serbia and Turkey managed to avoid the European banks' deleveraging activities completely, with Macedonia showing a most striking performance of 62% growth in European banks' foreign claims over the period June 2008-September 2012. In Turkey the figure was 37% and in Serbia -1%. Although the increase in their foreign banks' exposure was of record proportions, Turkey and Macedonia still have a relatively low level of total financial corporation assets in GDP; this probably explains in part the positive dynamics during the current crisis. Bosnia and Herzegovina and Croatia were the least successful of the Balkan countries. As of June 2008 the European banks' foreign claims on those countries started to drop by 23% and 21% respectively, while during the past four quarters deleveraging has continued apace. Albania and Russia are examples of moderate deleveraging activities on the part of European banks. In the period June 2008–September 2012, European bank claims on those countries decreased by 5% and 16% respectively; over the past four quarters, deleveraging has come to an end in Russia and was negligible in Albania.

Financial corporations

Analysis of the sectoral balance sheets allows us to see how different sectors of the economy were affected by the crisis in general and financial constraints in particular. We begin with an analysis of those financial corporations that were directly hit by the European banks' reducing their exposure to the region. As Figure 21 shows, only in two NMS countries – the Czech Republic and Poland – did financial corporations assets not decrease during the crisis. Assets started to drop in 2010 in five NMS countries; a year later three more countries in the region suffered a drop in their assets. The balance-sheet cutbacks were particularly marked in the Baltic states (Estonia lost as much as 30% of its financial corporations' assets over the period 2009-2011). Bulgaria, Estonia, Lithuania, Slovakia and Slovenia started to register a decrease in their assets as far back as 2009, whereas in Hungary, Romania and Latvia, balance sheet reductions only kicked in in 2011. On the other hand, in the EU15[9] (excluding the GIIPS countries), financial corporations have been steadily increasing their assets. The financial corporations in the GIIPS countries had been accumulating assets at a record rate prior to 2010; over the period 2003–2010, their assets increased from 342% of GDP to 600% of GDP. The trend seems to have gone into reverse in 2011, when the share of financial corporation assets in GDP decreased – albeit only marginally – by 9 p.p.

The dynamics of total assets, however, does not show the whole picture; changes in the assets structure are also important for understanding the impact of the crisis, in particular, as a means for detecting liquidity hoarding. In times of economic downturns, banks tend to increase their liquid assets (i.e. they increase the share of currency and deposits in their assets) so as to heighten the security of their balance sheets. This holds true for Europe as well: for example, over the period January 2011–September 2012, the twelve largest European banks increased their deposits in central banks by 84%[10]. Aggregated sectoral accounts data show that in 2011, financial corporations increased the share of currency and deposits in their assets not only in the remaining EU15 countries, but also in all NMS countries, except Latvia, Romania and Slovakia (in the latter countries, bonds

[9] Here and further on indicators for the GIIPS countries and the remaining EU15 countries are calculated as simple averages; the United Kingdom is not included among the remaining EU15 countries.

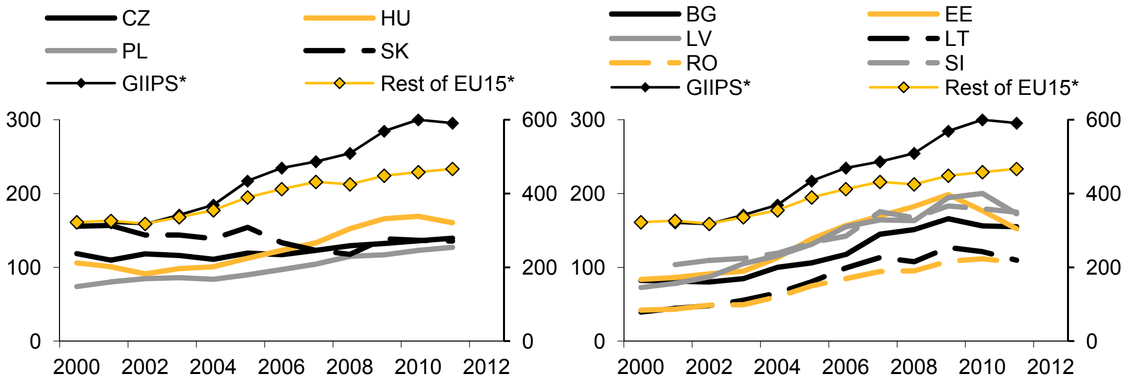
[10] D. Enrich, 'Large European Banks Stash Cash', *Wall Street Journal*, 13 November 2012.

assumed a greater share in portfolios in 2011) (see Figure 22). Although they have reduced the share of currency and deposits in their assets, Romanian and Latvian financial corporations still maintain that share at a relatively high level – exceeding the average level in the core EU countries.

Figure 21

Assets of financial corporations

% of GDP



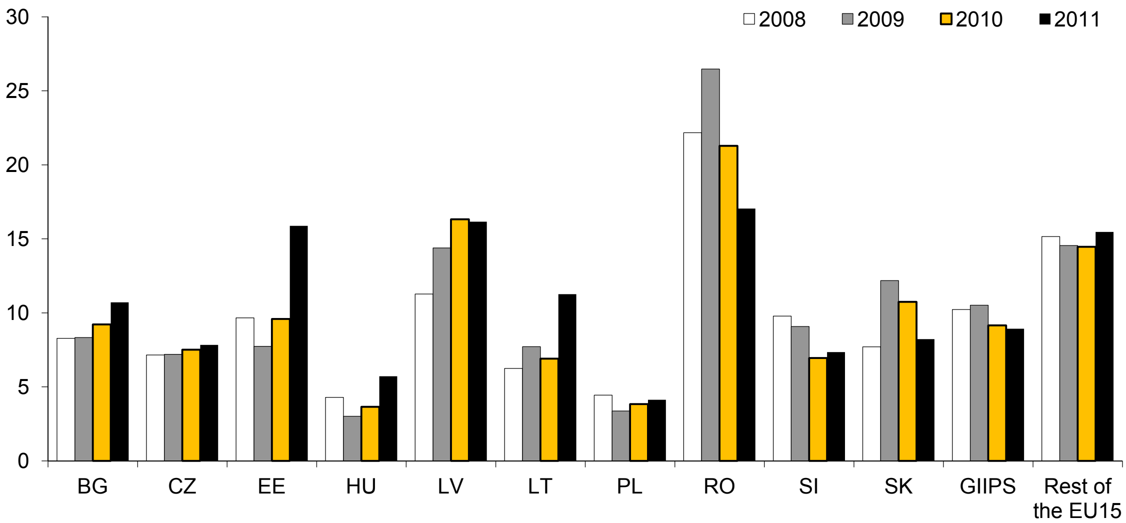
Remark: *Data shown on right-hand scale.

Source: Eurostat.

Figure 22

Currency and deposits

% of total assets of financial corporations

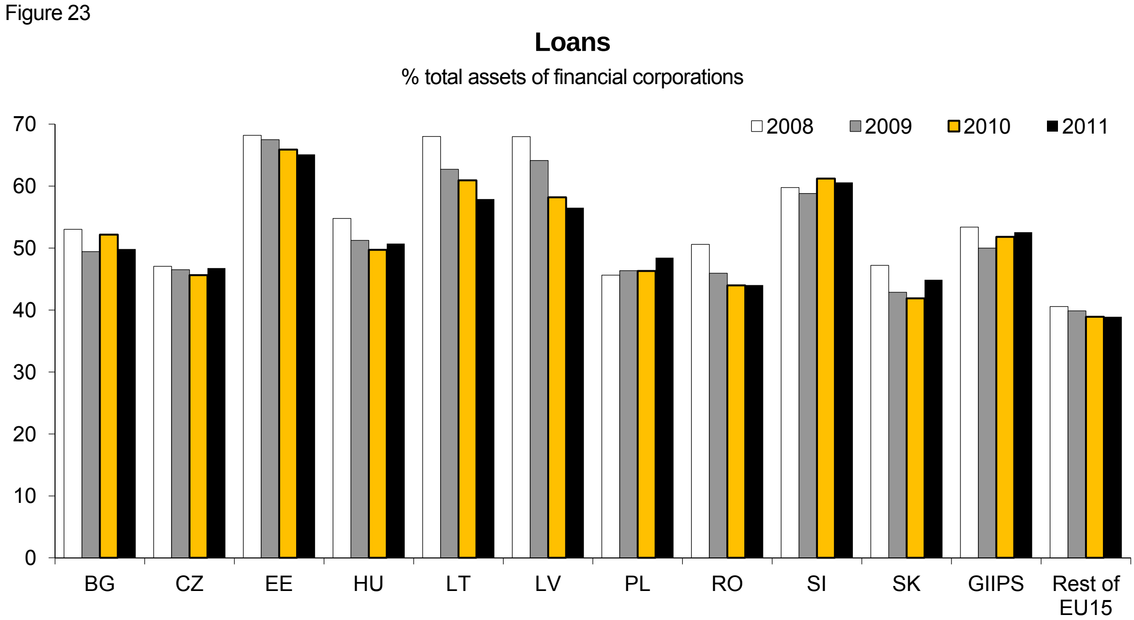


Source: Eurostat.

With an increase in the shares of both currency and deposits, as well that of equity and bonds in some countries, the share of loans in assets started to shrink. As can be seen in Figure 23, in all

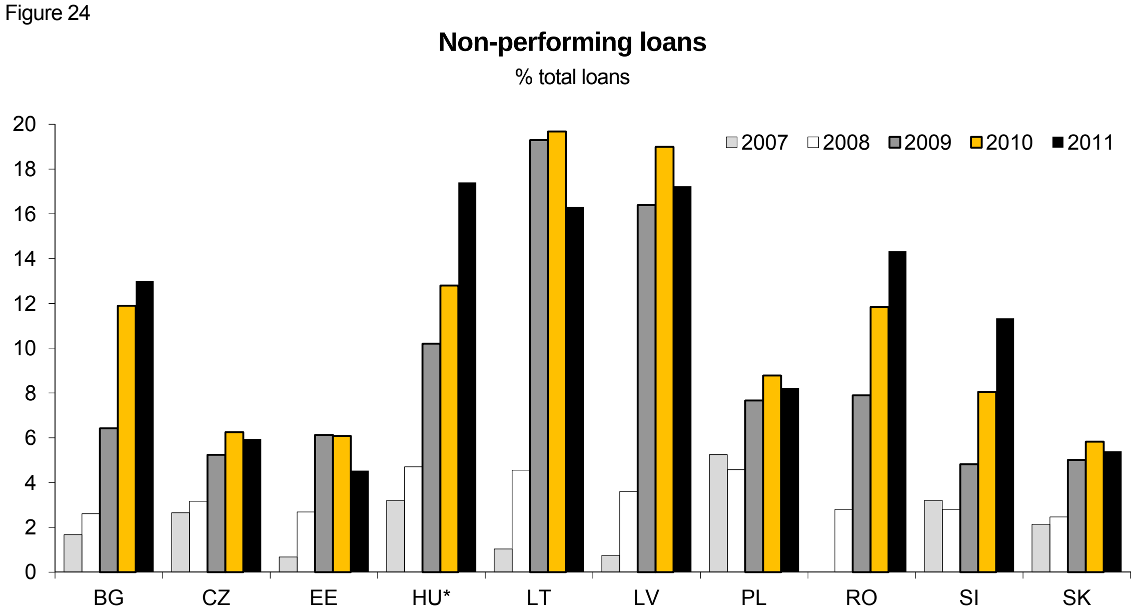
NMS countries apart from Poland and Slovenia, the share of loans in financial corporations' total assets decreased over the period 2008-2011; the most pronounced reductions occurred in Latvia (12 p.p.), Lithuania (10 p.p.) and Romania (7 p.p.).

Figure 23



Source: Eurostat.

Figure 24



Remark: Data for Hungary are for non-performing loans to non-financial corporations.

Source: National banks statistics, wiiw calculations.

The financial corporations' fleeing to safe assets can be explained by the perceived high risks associated with loans, all the more so given the poor quality of current loan portfolios. As data on non-performing loans (NPLs) show, the share of NPLs has increased dramatically over the past few years – up to 17% in Latvia and Hungary (see Figure 24). Only Estonia, Slovakia and the Czech Republic have managed to maintain relatively low NPL ratios – 4.5%, 5%, and 6% respectively. Thus, the process of writing off bad assets is still under way; we can expect further reductions in financial corporation balance sheets in most NMS countries.

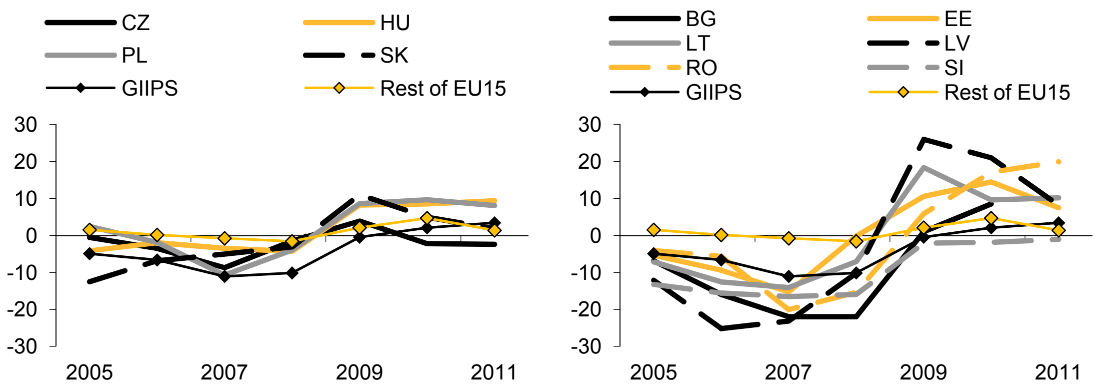
Non-financial corporations

The adjustment of non-financial corporation balance sheets can be captured at the macroeconomic level by changes in net lending or borrowing (NLB[11]), as suggested by Ruscher and Wolff (2011)[12]. NLB measures a corporation's net needs in terms of external finance (if negative) or, alternatively, its net financial investments (if positive). Corporate NLB is negatively associated with business cycles; positive NLB tend to be temporary. Pressure to deleverage can be caused by pre-crisis debt overhang and increased uncertainty prevailing in non-financial corporations, as well as by the higher costs of external financing due to a drop in asset prices, increased risk premia and the deleveraging activities of financial corporations. Corporate balance sheet adjustments are proven to have a major impact on investments and savings, as well as on wages and/or employment.

Figure 25

Non-financial corporations' net lending/borrowing

% of GVA



Source: Eurostat.

As of 2009, NLB as a share of non-financial corporations' gross value-added (GVA) turned positive in most NMS countries (apart from the Czech Republic and Slovenia). In 2011, it stood on average at 7% in the NMS countries (Figure 25). The most striking balance sheet adjustments took place in

11 NLB is either defined as net acquisition of financial assets less net incurrence of liabilities or as gross savings less investment and other capital expenditures.

12 E. Ruscher and G.B. Wolff (2011), 'Corporate balance sheet adjustment: stylized facts, causes and consequences', European Commission, DG-ECFIN, Economic Papers, No. 449.

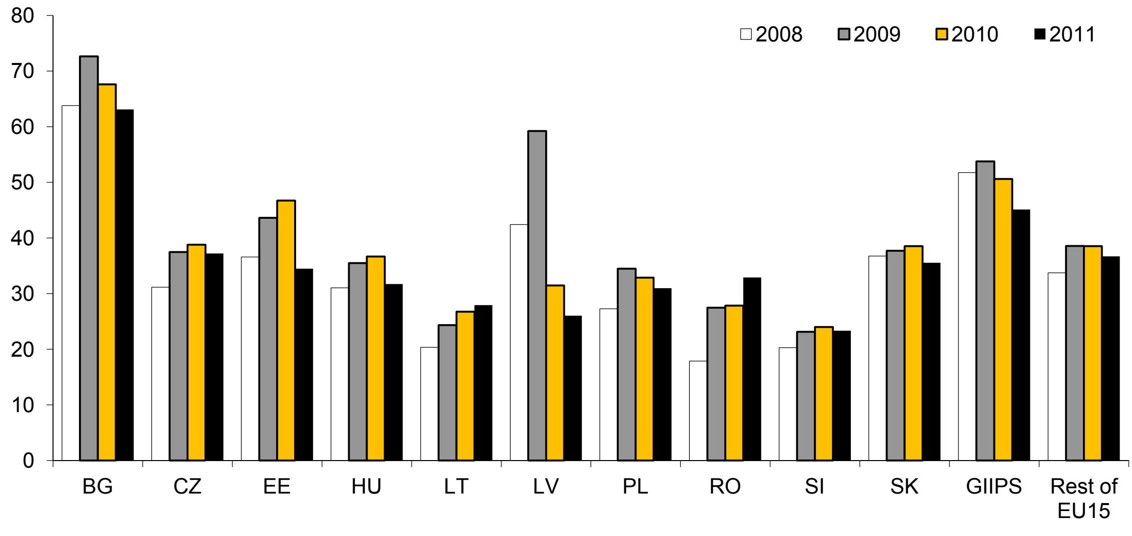
the Baltic states; for example, Latvian non-financial corporations lent 26% of their GVA in 2009. NLB turned positive in both the GIIPS countries and the core EU countries, although the changes in NLB were of lesser magnitude.

In 2011, some countries registered signs of a decrease in net lending; the value of NLB, though still positive, decreased in Estonia, Latvia, Poland, and Slovakia. This coincided with a tightening of liquidity in non-financial corporations that year (proxied by currency and deposits that they hold as a share of their GVA). Companies in most NMS countries stashed cash in the biennium 2009-2010, signalling their ample liquidity despite the limited access to external funding (see Figure 26). However, the situation would appear to have started shifting in 2011, when the share of currency and deposits in GVA decreased in all NMS countries – apart from Lithuania and Romania. The most dramatic deterioration in the liquidity of non-financial corporations was to be observed in Latvia, where the share of currency and deposits in GVA dropped by a third over the period 2009-2011. In 2011, non-financial corporations in most NMS countries displayed significantly lower liquidity compared to the core EU15 countries; particularly low levels were to be found in Slovenia, Latvia and Lithuania. Thus, there are some indications that non-financial corporations are beginning to suffer from the lack of access to external financing.

Figure 26

Currency and deposits of non-financial corporations

% of GVA



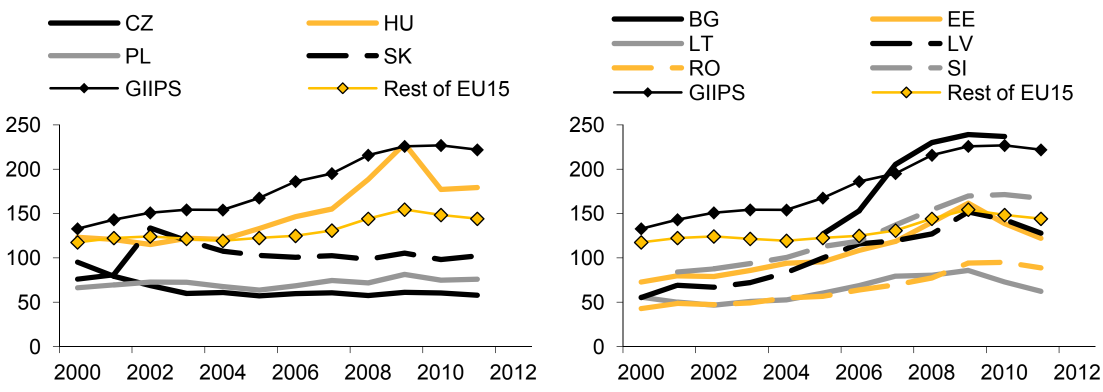
Source: Eurostat.

Signs of corporate debt overhang prior to the crisis can be found in several NMS countries as well as in GIIPS countries. In the period 2005-2008, non-financial corporation debt as a share of GVA increased dramatically in Bulgaria (by as much as 103 p.p.), Hungary (55 p.p.), Estonia (45 p.p.) and Slovenia (41 p.p.). In the GIIPS countries, the same indicator stood at 48 p.p. In 2010 deleveraging started in all NMS countries apart from Romania and Slovenia; the most dramatic deleveraging occurred in Hungary, where non-financial corporations reduced their debt as a share of GVA by 52 p.p. in one year alone (Figure 27). In 2011, that trend suffered a slight setback in Hungary, Slovakia and Poland, while corporations in other countries continued to deleverage.

Figure 27

Non-financial corporations' debt

% of GVA



Source: Eurostat.

It has transpired that numerous companies in the NMS countries have proven themselves incapable of servicing their debts. The share of NPLs in total loans to non-financial corporations has been on the rise since 2007, reaching double digits in 2011 in all the countries in the region, apart from Estonia and Slovakia. A further decrease in the debt burden of non-financial corporations is thus to be expected as NPLs are written off.

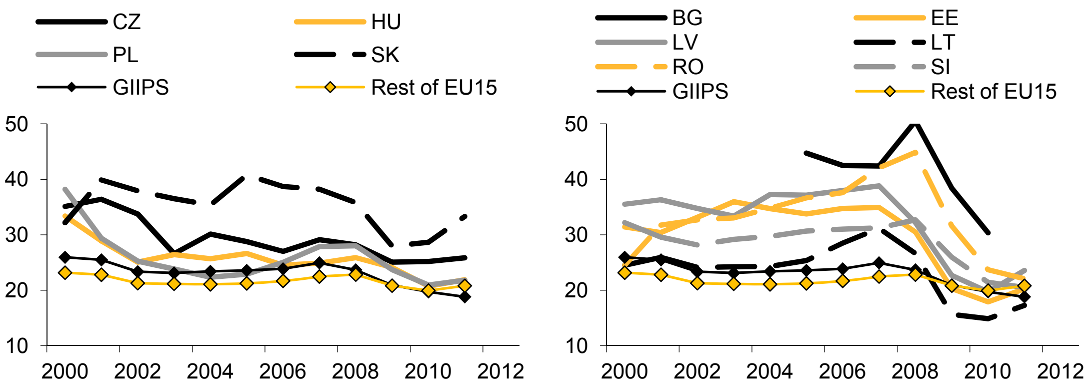
The rise in corporate sector savings in the NMS countries has been largely at the expense of investment and the compensation of employees (Figure 28 and Figure 29). Firms in all the NMS-countries have reduced their share of gross fixed capital formation (GFCF) in GVA on a massive scale – on average by as much as 10 p.p. during the period 2008-2011. This reduction is much higher than that in the GIIPS countries or the remaining EU15 countries (5 p.p. and 2 p.p., respectively). During the same period, double-digit decreases in that share were recorded in Romania (23 p.p.), Bulgaria (20 p.p.), Slovenia (12 p.p.), and Estonia (10 p.p.). Those countries had entered into unsustainably high volumes of investments prior to the crisis. In 2008, the share of GFCF in GVA rose to 51% in Bulgaria, 45% in Romania, 33% in Slovenia and 31% in Estonia. Slovakia is another country where this indicator (36%) was much higher in 2008 than in the core EU countries. Apparently Slovakia stands to benefit from a high influx of FDI, thus allowing the country to avert a massive drop in investment – by 2011, the share of GFCF in GVA had decreased by only 3 p.p.

In 2011, the share of GFCF in GVA started to increase in most NMS countries, the most pronounced increase being registered in the Baltic states and Hungary; only in Romania and Slovenia did the indicator drop further. Whether this trend reversal will hold depends on: (a) the speed and sustainability of economic recovery in those countries; and (b) an improvement in the companies' access to external funding. Developments in the financial sector and the high share of NPLs in corporate loans make it improbable that such access will improve in the short term.

Figure 28

Non-financial corporations' gross fixed capital formation

% of GVA

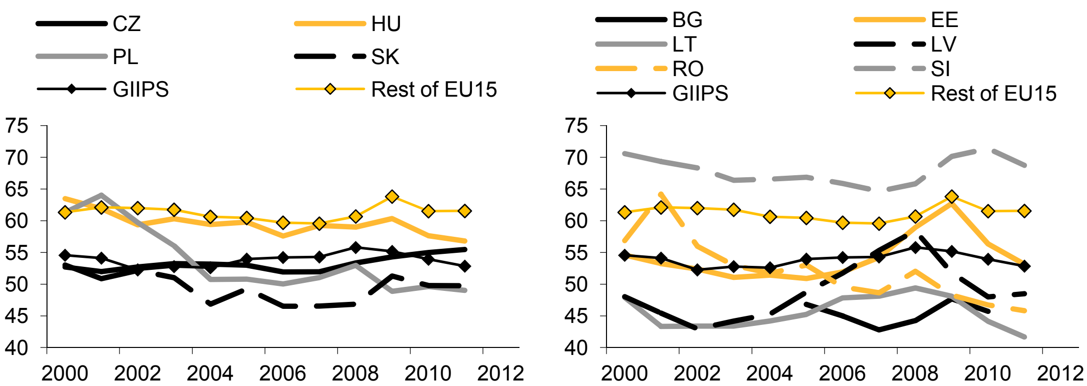


Source: Eurostat.

Figure 29

Non-financial corporations' compensation of employees

% of GVA



Source: Eurostat.

Compensation of employees has been less elastic than investment. In the company sector in the NMS countries the average share of employee compensation in GVA fell by 3 p.p. over the period 2008-2011: only slightly more than the drop in the core EU countries (see Figure 29). Several countries managed to avoid a reduction of that indicator (Bulgaria, Czech Republic, Slovakia and Slovenia). The most noticeable adjustment to employee compensation was to be observed in the Baltic states and Romania. In 2011, contrary to investment dynamics, the share of employee compensation in GVA continued to decline in most NMS countries, apart from the Czech Republic, Latvia and

Slovakia. This would seem to indicate that the impact on employees of corporate balance sheet adjustment is perhaps milder, yet more protracted than in the case of investment.

Households

Households have had a rough time over recent years throughout the European Union. According to national accounts, in most countries over the period 2008-2011 household disposable incomes have either stagnated or even slumped in real terms. Of the NMS countries only Poland, Slovakia and the Czech Republic have recorded any degree of growth over the same period. On average, households in the NMS countries have lost about 7% of their gross disposable income. The situation seems to be even worse in the GIIPS countries where (depending on the availability of data) the figure stands at 11%. Households in the EU core countries have fared somewhat better with disposable incomes rising by a meagre 1% (based on a simple average of only 6 out of 12 available data points). The most recent growth developments (2011) suggest some improvement (in most cases, however, only in the guise of a less rapid decline).

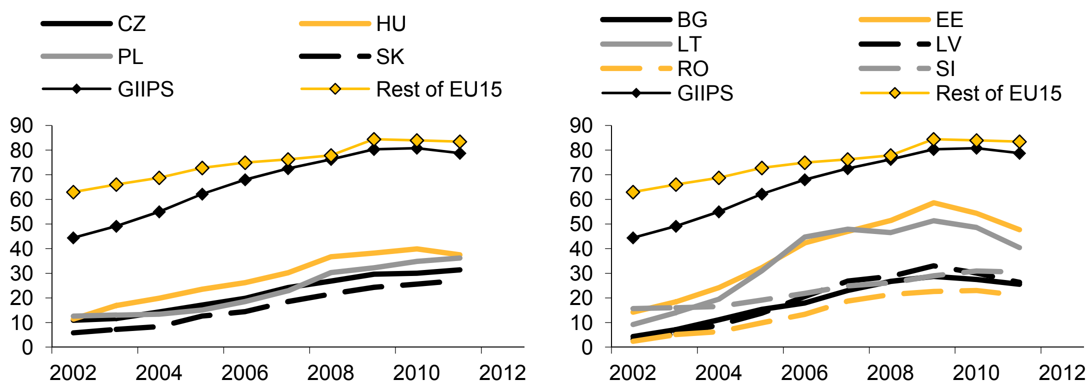
On average, household real final consumption expenditures developed a similar pattern over the period 2008-2011. However, results for individual countries diverged quite markedly. Whereas in Romania consumption declined less than real disposable income by as much as 9 p.p., in Estonia and Hungary the decline in consumption was 5 p.p. faster compared to the decline in real disposable income.

As Figure 30 shows, lower incomes were accompanied by deleveraging. As of 2010 the share of household debt in GDP began to decrease in many of the NMS countries, whereas in 2011 Czech, Polish and Slovak households were the only households to register an increase in their debt measured as a share of GDP. On average, the share of household debt in the NMS countries decreased by 2 p.p. in 2011 – on a par with the GIIPS countries.

Figure 30

Households' debt

% of GDP



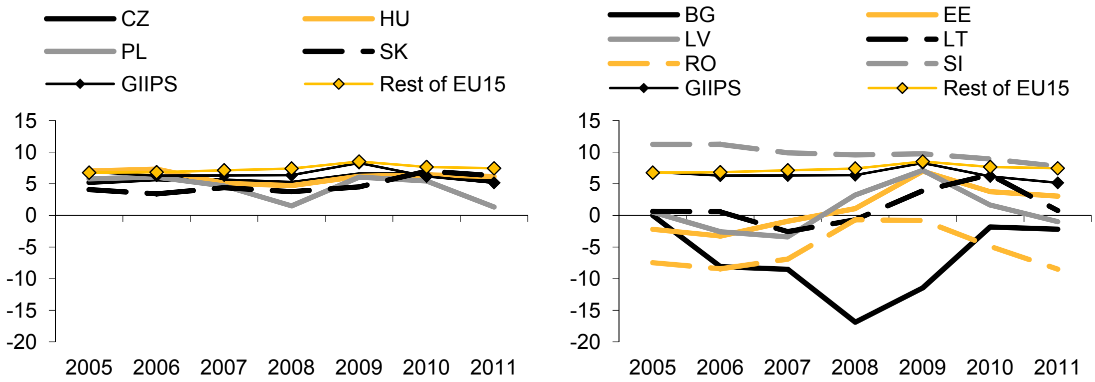
Source: Eurostat.

Concurrently, households have been drawing on their savings. As Figure 31 shows, gross savings rates in many NMS countries started decreasing back in 2010; by 2011 there were no exceptions to that trend. Only in Slovenia did the savings rate in 2011 stand level with that of the core EU countries; all other NMS countries registered savings rates lower than the average EU15 level. In the case of Bulgaria, Latvia and Romania, the savings rates were even negative.

Figure 31

Households' savings

% of GDP



Source: Eurostat.

In 2011 household net financial assets started to dip in all NMS countries; on average, their share in GDP decreased by about 7 p.p. that year. The most pronounced reductions were to be observed in Hungary and Estonia: 17 p.p. and 12 p.p., respectively.

These developments suggest that household liquidity has been diminishing and savings have had to be drawn on. It appears as though loans are no longer an option and banks are reluctant to lend, especially in view of the fact that in the average NMS country, the share of NPLs in total household loans had reached more than 10% by the end of 2011.

Summary and conclusions

The GIIPS countries continue to be those most affected by the European banks' decreasing their foreign claims, although some CESEE countries have accumulated similar funding losses in relative terms – up to 45% in the case of Ukraine compared to June 2008. Only Turkey, Macedonia and Serbia managed to avoid completely all reductions of foreign claims on the part of the European banks. Throughout 2012, European banks continued to reduce their claims in most of the CESEE countries; the trend was reversed only in Poland, Russia and Slovakia on account of the relatively healthy macroeconomic situation prevailing in those countries.

Contrary to the core EU15 countries, domestic financial corporations in most of the NMS countries, apart from the Czech Republic and Poland, reduced their financial assets in the period after 2009. At the same time, in 2011, financial corporations in both the remaining EU15 and NMS countries (apart from Latvia, Romania and Slovakia) increased their liquidity (measured by the share of currency and deposits in their assets). As a result, the share of loans in assets dropped in almost all NMS countries apart from Poland and Slovenia.

The financial corporations' seeking refuge in safe assets can be explained by the perceived high risks they associate with loans, in particular given the high share of non-performing loans in current loan portfolios. Bad assets are still being written off, and a further decrease in financial corporation loans in most NMS countries is to be expected.

Given the limited access to external finance, most non-financial corporations in the NMS countries (apart from the Czech Republic and Slovenia) became net lenders of funding as of 2010. Companies in most NMS countries stashed cash in 2009-2010, manifesting their ample liquidity despite the limited access to external funding. However, in 2011, the non-financial corporations' share of currency and deposits in GVA went down in all NMS countries, apart from Lithuania and Romania. Moreover, in 2011, some countries showed signs of a drop in net lending. Though remaining positive, the value of NLB decreased in Estonia, Latvia, Poland and Slovakia. Many companies in the NMS countries were unable to service their debts. The share of NPLs in total loans to non-financial corporations has been on the rise since 2007; by 2011 it had reached double digits in all the countries in the region, apart from Estonia and Slovakia. There is thus some indication that non-financial corporations are beginning to suffer from their lack of access to external financing.

The rise in corporate sector savings in the NMS countries has been largely at the expense of investment and employee compensation. In all the NMS countries, companies have reduced their share of gross fixed capital formation in GVA on a massive scale – on average by as much as 10 p.p. over the period 2008-2011. It transpired that employee compensation was less elastic than investment; in the company sector in the NMS countries, the average share of compensation of employees in GVA dropped by 3 p.p. over the period 2008-2011, only slightly more than in the core EU countries. If investment and employee compensation is to bounce back, the companies' access to external funding will have to be improved. As things currently stand in the financial sector and given the high share of NPLs in total corporate loans, it is highly improbable that this will happen in the short term.

The crisis has had a significant impact on households in the NMS countries. Reduction in employee compensation by non-financial corporations resulted in real disposable household incomes stagnating or even dropping over the period 2008-2011. In a situation marked by limited access to bank loans and relatively high levels of outstanding debt, household liquidity has been diminishing and savings dipping.

Thus, only in the core EU15 countries have financial corporations successfully averted a decrease in their assets during the crisis years. They managed to increase their total volume of assets at a steady pace over the period 2008-2011, despite having dramatically reduced their exposure to the banking sectors in the CESEE countries. Financial corporations in the NMS countries have reduced their balance sheets significantly. At the same time, in line with financial corporations in the core EU15 countries, they have been increasing the share of currency and deposits in their assets. Their seeking refuge in safe assets means that they too are hoarding liquidity, which thus does not get channelled into the real sector of economy. As the liquidity of both the corporate and household sectors begins to spiral downwards, any prospects of investment and household consumption recovering will require that companies and households alike enjoy improved access to external financing.

Doris Hanzl-Weiss and Michael Landesmann

Special section III: Structural adjustment and unit labour cost developments in Europe's periphery

The analysis of structural adjustment patterns in 'Europe's periphery' – the group of lower and middle-income economies in Europe – is important as the crisis has revealed major shortcomings in sectoral development patterns, such as pronounced expansion in construction and other non-tradable sectors to the detriment of tradables, across a number of those economies. These shortcomings have been reflected in soaring current account deficits and (in a significant number of cases) in major losses of competitiveness and relative shrinkage of the tradable sector.

We present first the recent sectoral patterns of growth in output and employment before and during the crisis (see also our earlier analysis in *wiiw Current Analyses and Forecasts* No. 10). Next, we analyse sectoral unit labour cost (ULC) developments and their components. ULCs are one of the indicators of competitiveness that enjoy wide use. Furthermore, a sectoral analysis that focuses on differentiated patterns of development between tradable and non-tradable sectors is an essential feature of any evaluation exercise as a vehicle for determining whether structural adjustment processes in the wake of the crisis have moved countries facing long-term competitiveness problems in the right direction. We distinguish three time periods: two periods before the crisis 2001-2004 and 2005-2008 and one period for the crisis 2008-2011. The distinction of the two periods prior to the crisis serves the purpose to check whether tendencies in unbalanced sectoral growth became more pronounced just before the outbreak of the crisis.

Patterns of structural change

We use a modified classification system and restrict ourselves to a limited number of sectors in order to avoid textual overload. The sectors in question are:[13] manufacturing (C), as the classic tradable goods sector; construction (F), depicting an important non-tradable part of the economy; tradable services (TS)[14], including for example financial and insurance activities; and non-tradable services (NTS)[15], with wholesale and retail trade featuring prominently, as well as non-market services[16]. Figures 32 and 33 show the sectoral contributions to both economy-wide GDP growth (Figure 32) and economy-wide employment growth (Figure 33). The performance of Central and Eastern European (CEE) economies is also compared with that of the GIPS countries (Greece, Italy, Portugal and Spain).

[13] Based on the NACE rev. 2 classification scheme.

[14] Tradable services (TS) include: Transportation and storage (H); Information and communication (J); Financial and insurance activities (K); and Professional, scientific and technical activities (M).

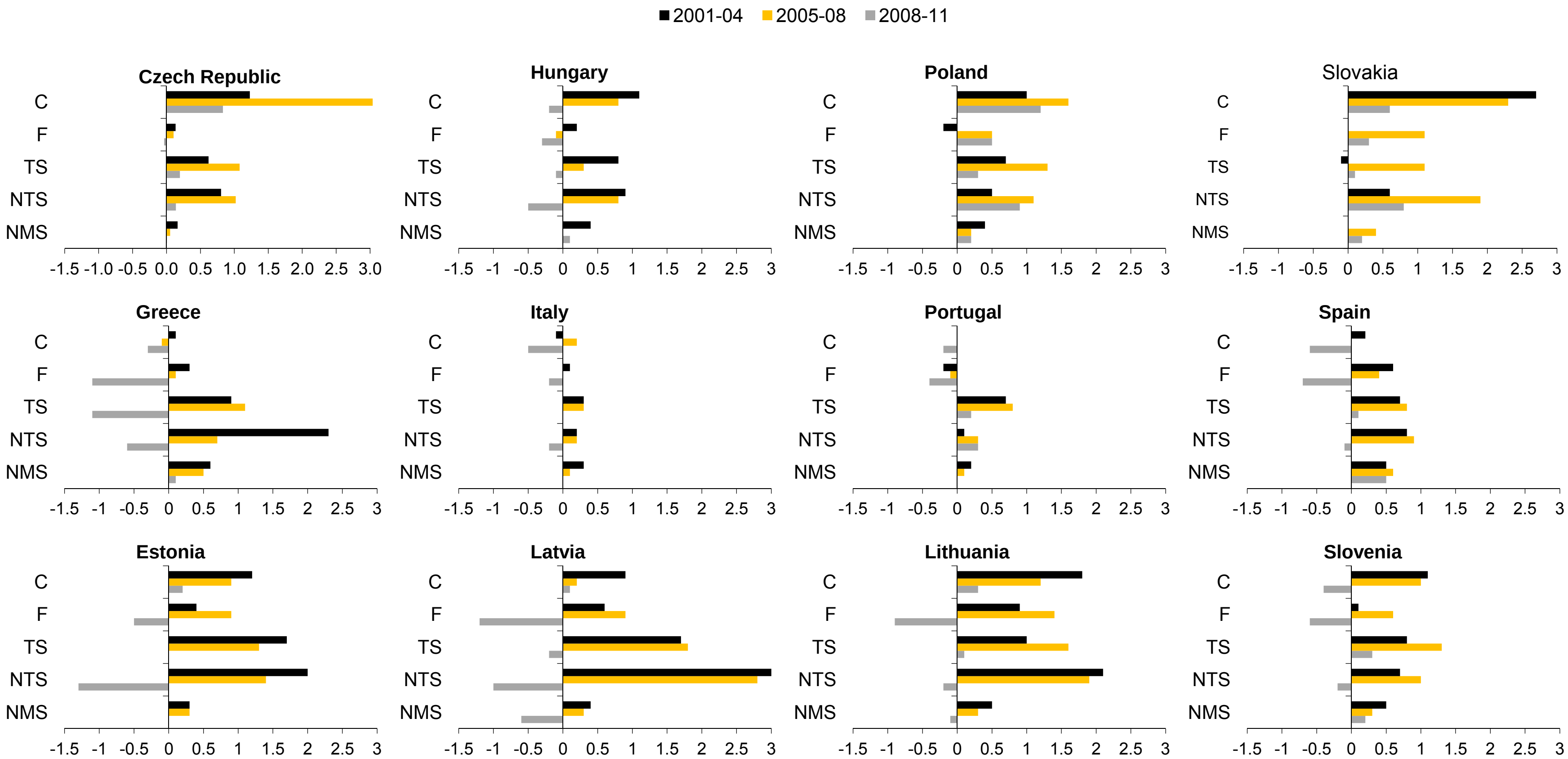
[15] Non-tradable services include: Wholesale, retail trade, repair of motor vehicles (G); Accommodation and food service activities (I); Real estate activities (L); Administrative and support service activities (N); Arts, entertainment and recreation (R); Other service activities (S); and Activities of households as employers & for own use (T).

[16] Non-market services include: Public administration and defence, compulsory social security (O); Education (P); and Human health and social work activities (Q).

Figure 32

Contributions to GDP growth rates at constant prices

averages over the time period



Portugal: 2008-10; Spain 2008-10

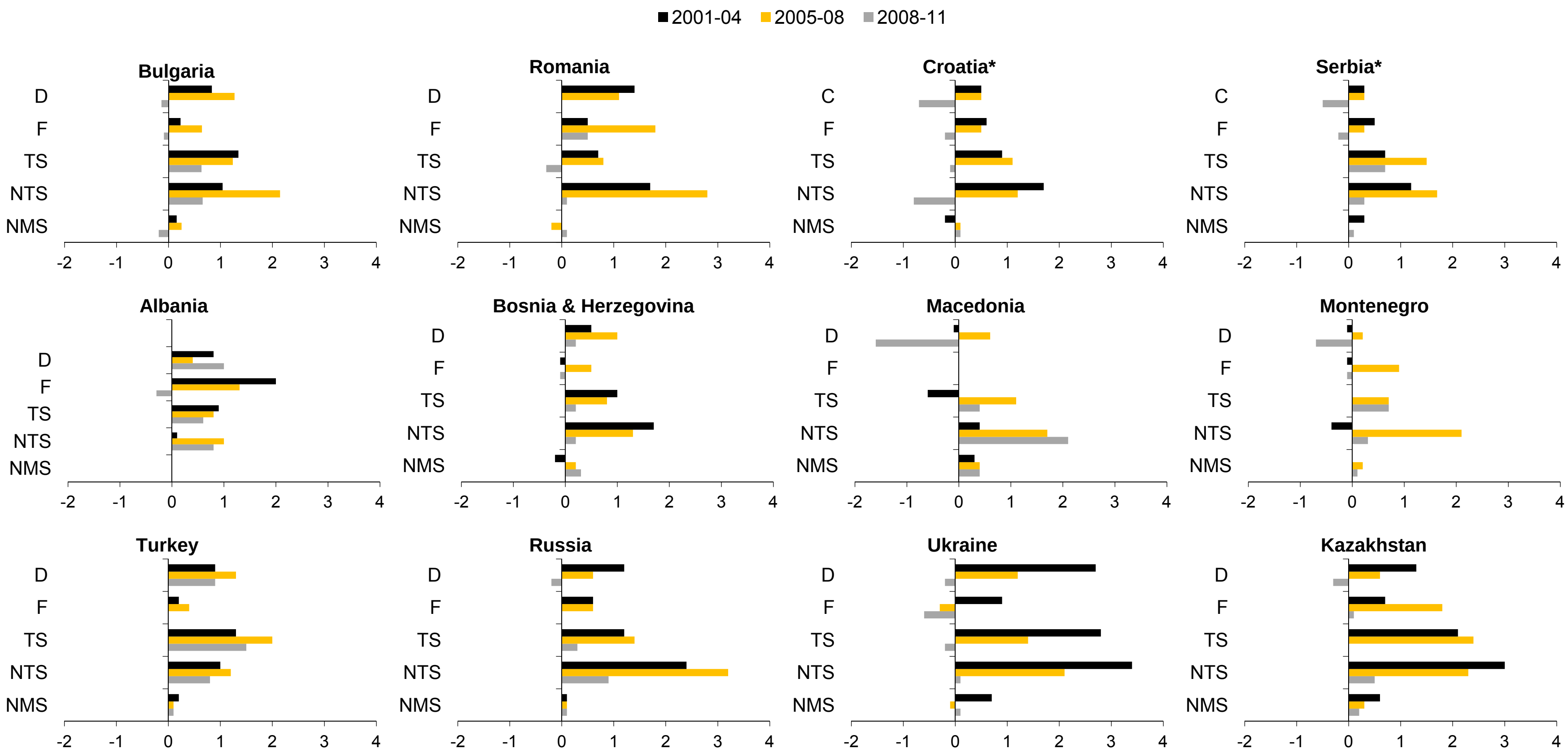
Notes: Based on NACE Rev. 2 classification scheme: C (Manufacturing), F (Construction), TS (Tradable Services H,J,K,M), NTS (Non-tradable Services G,I,L,N,R,S,T), NMS (Non-market Services O,P,Q). Contributions are calculated by multiplying the share in total GDP at current prices by real growth at preceding year prices.

Source: wiiw Database incorporating national and Eurostat statistics.

Figure 32b

Contributions to GDP growth rates at constant prices

averages over the time period



Kazakhstan, Russia, Ukraine: 2003-04; Bulgaria, Romania, Macedonia: 2008-09; Albania, Montenegro: 2008-10.
Based on NACE Rev. 1 classification scheme: D (Manufacturing), F (Construction), TS (Tradable Services I,J), NTS (Non-tradable Services G,H,K,O,P), NMS (Non-market Services L,M,N). Contributions are calculated by multiplying the share in total GDP at current prices by real growth at preceding year prices.

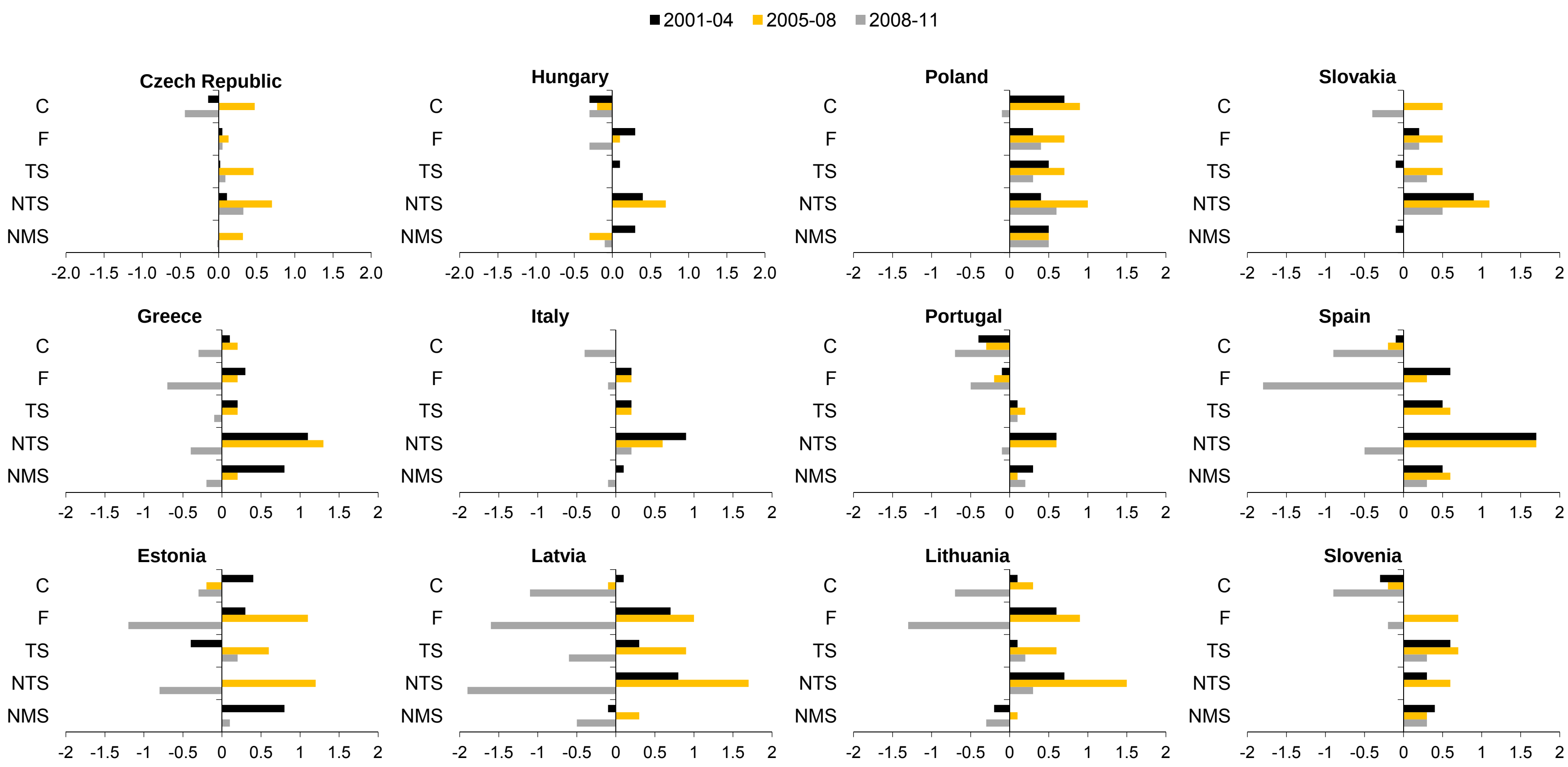
* Croatia 2008-09 and Serbia based on NACE Rev. 2 classification scheme: C (Manufacturing), F (Construction), TS (Tradable Services H,J,K,M), NTS (Non-tradable Services G,I,L,N,R,S,T), NMS (Non-market Services O,P,Q). Contributions are calculated by multiplying the share in total GDP at current prices by real growth at preceding year prices.

Source: wiiw Database incorporating national and Eurostat statistics.

Figure 33

Contributions to employment growth

averages over the time period



Portugal: 2008-10; Spain 2008-10

Notes: Based on NACE Rev. 2 classification scheme: C (Manufacturing), F (Construction), TS (Tradable Services H,J,K,M), NTS (Non-tradable Services G,I,L,N,R,S,T), NMS (Non-market Services O,P,Q). Contributions are calculated by multiplying the share in total employment by annual growth.

Source: wiiw Database incorporating national and Eurostat statistics

As for patterns of GDP growth, a distorted pattern of development was discernible in the GIPS countries prior to the crisis. Non-tradable sectors (construction and non-tradable services) contributed most to GDP growth in Greece and Spain. In Portugal and less so in Italy, the tradable services sector was the most important sector contributing to GDP growth. The contribution of manufacturing in the GIPS countries was negligible. In the CEE countries a more balanced picture emerges. Manufacturing contributed significantly to growth, especially in the Czech Republic and Slovakia (Figure 32).

The above notwithstanding, a distinct split became apparent across the region. In the Baltic countries, in particular, non-tradable services contributed primarily to GDP growth, closely followed by tradable services and construction. The same picture holds true for Croatia. In some countries, including Slovakia and Slovenia as well as Bulgaria and Romania, expenditures in the construction sector and non-tradable services increased strongly immediately prior to the crisis (period 2005-2008).

Adjustment processes during the crisis (2008-2011) were clearly pointed in the right direction in the Baltic countries: those countries registered a decline in the contribution of construction and non-tradable services on the one hand and a slight increase in manufacturing on the other. In Hungary and Slovenia, where manufacturing was still ailing, the picture is less positive, while in the GIPS countries, manufacturing and construction continue to decline.

On looking at employment patterns (Figure 33), it can be seen that prior to the crisis employment was created primarily in the non-tradable service sector. In all countries, the GIPS countries and CEECs alike, the non-tradable service sector contributed most to employment growth – with but two exceptions. In Slovenia, construction and tradable services contributed most, in Romania the construction sector.

In the crisis period (2008-2011), the construction sector suffered most in those countries that had enjoyed a construction boom in the period leading up to the crisis. This held true not only for Spain and the Baltic countries, but also for Slovenia and Bulgaria. Furthermore, in the wake of the crisis the manufacturing sector in all countries suffered a major decline in terms of employment. In Latvia, Lithuania, Greece and Bulgaria, a reduction in non-market employment occurred, reflecting the introduction of major fiscal consolidation programmes in those countries. In Latvia, the non-tradable sector (largely wholesale and retail trade) contributed most to the decline in employment – a reflection of the squeeze on household incomes in the course of adjusting to the crisis.

Sectoral unit labour cost developments

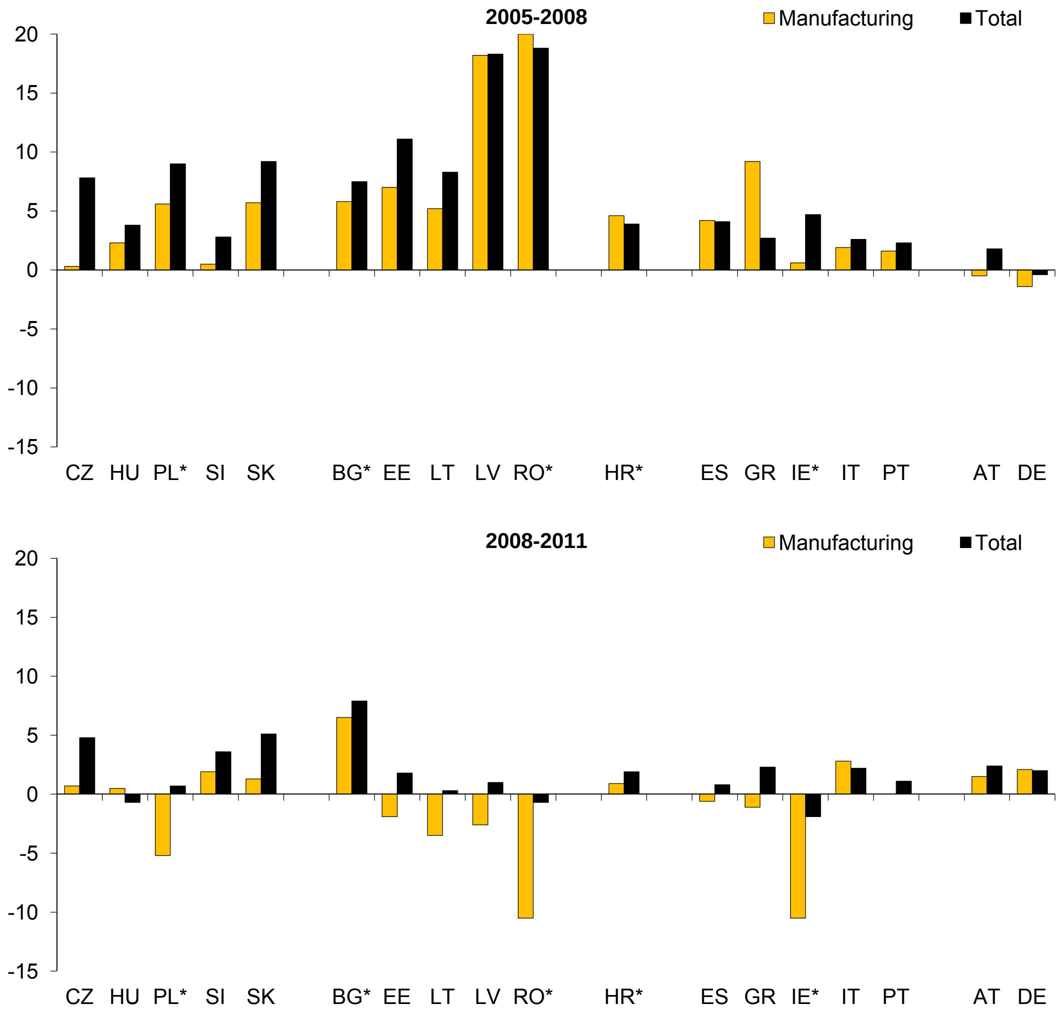
In this part we deepen our analysis of restructuring processes by focusing on one specific indicator of price competitiveness: unit labour costs (ULCs).[17] Once again, we emphasize the importance of understanding the different patterns across the different sectors of the economy, particularly of tradables and non-tradables, using the modified industry classification system adopted previously.

[17] See also for more information on economy-wide competitiveness indicators in the Appendix.

Figure 34

Overview development of Unit Labour Costs

average growth in %



Remark: BG, HR, IE, PL and RO are not fully comparable with other countries due to different classification used.

Source: Eurostat, Statistical Office of Romania and wiiw own calculations.

As a preliminary, we consider ULC developments across all countries and focus on differences between the economy as a whole and the manufacturing sector in particular. In order to save space, we single out the manufacturing sector as the principal tradable sector; the differences in developments between the manufacturing sector and the economy as a whole are then interpreted as an indication of the degree to which cost-competitiveness in the tradable sector has deteriorated or improved relative to all sectors of the economy. In Figure 34 we now neglect the period 2001-2004 and focus on developments in two periods: the pre-crisis period 2005-2008 and the crisis period 2008-2011[18]. For purposes of comparison, we also include Germany and Austria as advanced EU

[18] Owing to industry classification breaks we have slightly different periods for some of the economies.

member countries: economies with robust and competitive manufacturing sectors and hence key to assessing competitiveness in Europe's periphery.

The main patterns that the figures show are as follows:

- In general, ULCs rise more moderately in the manufacturing sector than in the economy as a whole which is natural as manufacturing is also a sector with generally higher relative labour productivity growth.
- None the less, exceptions to that general trend are also to be observed. A number of economies either experience very similar developments in terms of ULCs in manufacturing compared to the economy as a whole or the relative ULC position of their manufacturing sectors deteriorates in the pre-crisis period. Latvia, Romania, Croatia, Spain and Greece fall into this category.
- Moreover, some economies can be seen to have undergone major shifts during the crisis period, with ULCs in manufacturing dropping significantly (and competitiveness thus improving). Poland, Estonia, Lithuania, Latvia, Romania, and Ireland are among those countries.
- Furthermore, one group of economies displays a persistent and significant differential in terms of ULC developments in both periods (thus favouring the relative competitiveness of the manufacturing sector). This group includes the Czech Republic, Poland, Slovenia, Slovakia and Ireland. Yet another group of economies is characterized by low differentials or 'perverse' ULC developments in the manufacturing sector relative to the economy as a whole (i.e. by a deterioration in the relative ULC position of manufacturing). That particular group comprises Hungary, Spain, Italy, Portugal and Croatia. We consider developments in the latter group a problematic issue, unlike the pattern in the former group that we regard as a sign of healthy developments in the competitiveness of these economies.

In the following discussion of particular country experiences, we focus in greater detail on the various factors driving relative ULC developments across sectors and time-periods. The following decomposition formula is applied:

$$\Delta \text{ ULC} = \underbrace{- \Delta \text{ Output} + \Delta \text{ Employment}}_{\text{Change in labour productivity}} + \underbrace{\Delta \text{ Compensation Rate (in NCU)}}_{\text{Change in compensation per worker}} - \Delta \text{ Exch. Rate}$$

Exchange rate is defined as NCU/EUR (i.e. a positive change in the exchange rate indicates depreciation). Hence, for those countries that adopted the euro at a particular juncture or maintained a fixed currency regime in relation to the euro, changes in the exchange rate play no role in driving ULCs.

Using the above formula, we select a few country examples and discuss the pattern of ULC developments that occurred in the pre- and crisis periods.

First, we focus on ***Latvia***: a country that went through rather dramatic structural adjustment processes, which were already apparent in the growth and employment adjustments across sectors discussed above. We saw that over the period 2008-2011, Latvia experienced a sharp contraction in output particularly in construction and in non-tradable services, whereas the impact on manufacturing and tradable services was far less negative over the same period.

In terms of ULCs and their components, as shown in Figure 35b (Latvia), the country registered a steep rise in ULCs in the second period prior to the crisis (2005-2008) in the construction sector relative to the other sectors of the economy. In that period, wage compensation per worker in the construction sector rose by nearly 40% p.a.[19] while in the economy as a whole it grew by some 25% (detailed figures are available in Table 3). In that period, ULCs grew by 33.9% in the construction sector mainly driven by wage growth, while ULCs grew by 18.3% in the economy as a whole (see Table 4). Once the crisis struck, ULCs increased by a mere 1% in the economy as a whole, while decreasing by -2.6% in manufacturing and -4.4% in the construction sector. In that period, the crucially important component in the construction sector that drove ULCs down was a dramatic contraction in employment (-17.2%) accompanied by a decline in output of -15.7%. On the other hand, output in the manufacturing sector did not decline over the period 2008-2011 – in fact, manufacturing was the only sector where output did not decline (the decline in the economy as a whole was -4.5%). The developments favouring the tradable sector during the crisis period are also apparent, if one compares the tradable and non-tradable market services sectors. The data show that the decline in output (and employment) was more substantial in the non-tradable services sector than in the tradable services sector. Hence overall there was a clear shift during the crisis period towards tradable activities (manufacturing and tradable market services) and away from non-tradables (construction and other non-tradable market services). Furthermore, the Latvian case clearly shows – and this finding applies to all economies – that over the crisis period, relative ULCs across sectors are driven far less by differential movements in wage compensation, but much more by the differentiated movements in output and employment (and hence in labour productivity).

In the case of ***Slovenia*** (see Figure 35b), as in the case of Latvia, exchange rate adjustments only played a role in ULC developments in the first period (2001-2004). Thereafter, in the run-up to joining the euro area and then having acquired EMU-membership in 2007, devaluations could no longer contribute to improving the competitiveness of the Slovene economy. From that point on the two other variables, labour productivity and labour compensation, determined ULC developments. Moving straight to the period 2008-2011, the period of adjustment, quite striking differences between the Slovene and the Latvian economies are to be seen. The difference lies mostly in the productivity growth figures. In Latvia over the period 2008-11, productivity growth rates in the total economy, manufacturing and the construction sector were 2.1%, 8.8% and 1.9%, respectively, whereas the figures for the corresponding sectors in Slovenia were substantially lower 0.0%, 2.2% and -7.3%. If we take those figures together with the growth rates in compensation rates per worker, we obtain the corresponding ULC growth figures in Slovenia: for the economy as a whole +3.6% (Latvia 1.0%), manufacturing +1.9% (Latvia -2.6%) and the construction sector +10% (Latvia -0.5%). ULC devel-

[19] All growth rate figures refer to average per annum (p.a.) growth rates in the different periods.

opments in favour of manufacturing were corrected to a far greater degree in Latvia than in Slovenia. If we drill down behind the productivity growth figures, we can see that these productivity 'improvements' were due mostly to employment contraction in Latvia being much starker than in Slovenia.

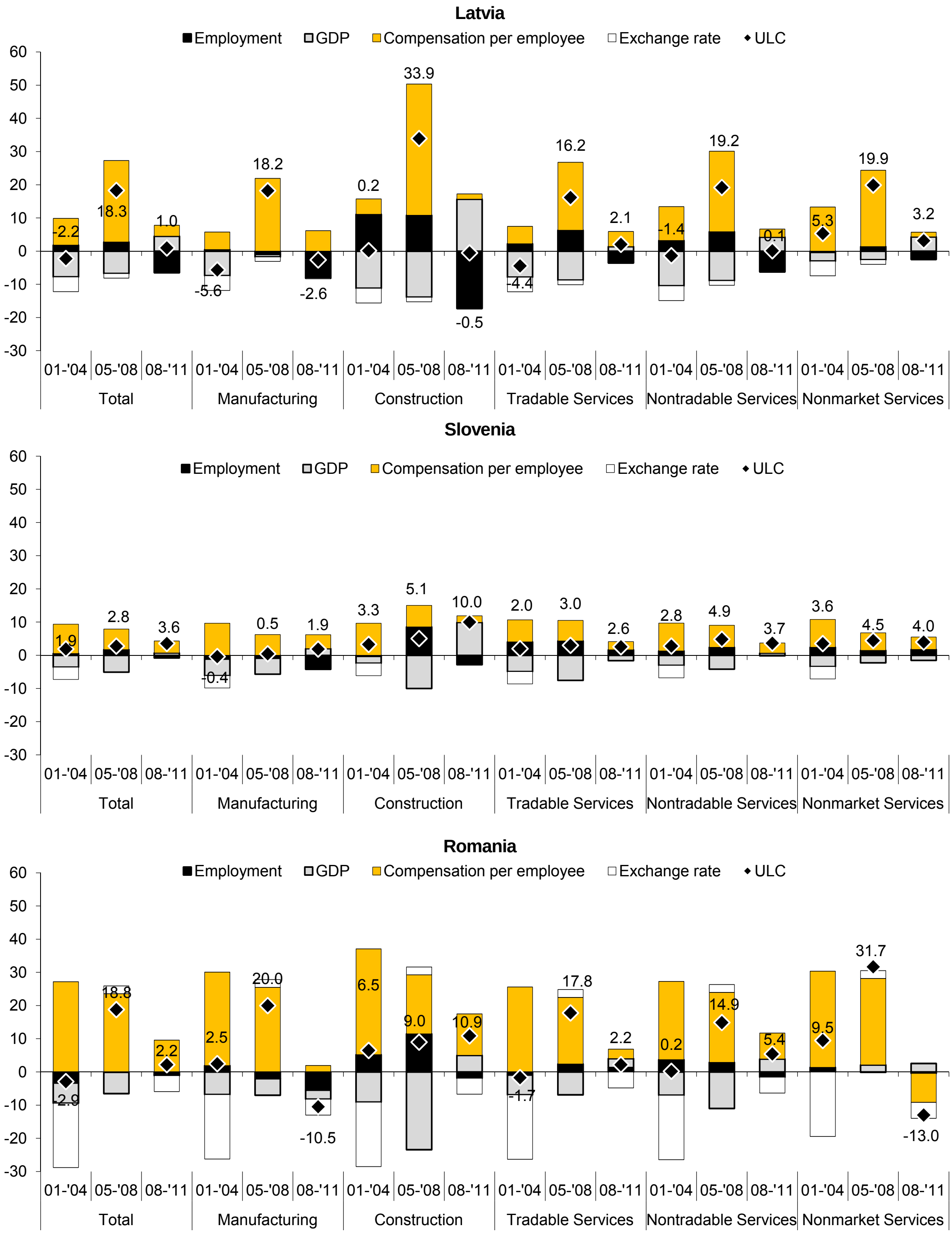
Romania also offers evidence (from the standpoint of ULC adjustments) of comparatively pronounced adjustments favouring the tradable sector. Furthermore, given the country's flexible exchange rate regime, exchange rate adjustments still play a role in contrast to the two economies discussed above. Concentrating on the adjustment process during the crisis period, we can see (Figure 35c) that ULC developments are strongly differentiated across sectors. For the period 2009-2011[20], we find that ULCs rose for the economy as a whole by 2.2% p.a., but dropped in manufacturing by -10.5%; they rose in the construction sector by 10.9%, while the tradable services also developed differently (+2.2%) in comparison to the non-tradable services sector (+5.4%). Hence, overall the tradable sectors (manufacturing and tradable services) improved their relative positions in terms of ULCs compared to the non-tradable sectors. Over and above that, Figure 35c also shows that devaluation contributed to a decline in ULCs (expressed in EUR) by 4.8% per annum; this devaluation, of course, only bears relevance for the tradable sectors as it contributes to improving their competitiveness. Hence taking the differential impact of exchange rate devaluation into account, the difference in the impact of adjustments favouring the tradable sector as against the non-tradable sector over the crisis period is even more pronounced.

If we look in greater detail at the different components which explain the different ULC developments across sectors in Romania, we can see that the manufacturing sector, whose relative ULC position was greatly improved, (a) benefited from a far more moderate increase in wages (growth in employee compensation rose by only 2% p.a. as against 9.6% in the economy as a whole); and (b) underwent a much more pronounced decrease in employment (-5.4%) as compared to the other sectors (-0.8% for the economy as a whole). Moreover, output developments were distinctly more positive (+2.7%) as against negative growth rates in the other private sector activities. Furthermore, the different ULC patterns between tradable and non-tradable *services* sectors was mainly due to the far more moderate wage growth in the former; that effect was further bolstered by the exchange rate devaluation benefiting the tradable sectors.

[20] We had to restrict the analysis of the crisis period for Romania to those years in light of an industry classification break in 2008.

Figure 35

Components of Unit Labour Costs, average growth in %



Remark: RO: Data are not fully comparable with other countries due to different revision of classification used.

Source: Eurostat, Statistical Office of Romania and wiiw own calculations.

The findings of the analysis thus far can be summarized as follows:

- The decomposition of relative ULC developments across sectors into employment, output, wage and exchange rate effects is of importance to understanding the manner in which the relative cost position of the tradable sectors improves or deteriorates (relative ULCs are one of the indicators of 'real exchange rates').
- Furthermore, an analysis by sector is important as drawing on information based solely on ULCs for the economy as a whole and then comparing those costs across countries can be quite misleading when assessing developments in different economies' competitiveness (which should be based on an assessment of competitiveness of the tradable sectors; see the differential developments shown in Figure 34 and Table 4).
- Although we have instances of differential developments in compensation rates across sectors in the short to medium term, differential developments in output and employment (and hence in productivity) play – in most instances – a much more important role in driving relative ULCs across sectors. Two issues follow from this. First, although 'wage flexibility' (across sectors) might be an important determinant of competitiveness in the longer run, in the medium and short term, the relative development of output and employment are a far more decisive factor in determining whether the tradable sector regains competitiveness. Thus, a sharp drop in output (and hence utilization levels), if not matched by an even greater drop in employment, would be detrimental to this particular indicator of competitiveness. Secondly, it is important to assess the extent to which in the course of a crisis, productivity developments such as these might be long- or short-term in nature (e.g. determining whether reductions in staffing levels are temporary or long-term).
- The example of Slovenia and its comparison with Latvia show that Slovenia failed to make a successful transition to adjusting to firmly fixed exchange rates (by virtue of its being a member of the euro area). Once exchange rate flexibility was lost, Slovenia did not manage to maintain (or restore in the crisis period) competitiveness in its tradable sector. In the case of Latvia, the adjustment processes during the crisis period were dramatic (in terms of both output and employment in the non-tradable sector), thus supporting a shift towards competitiveness.
- In economies with flexible exchange rates, exchange rate adjustments – as demonstrated in the case of Romania – continue to play a role in supporting a return to competitiveness. They can further accentuate the differential impact that ULC developments have on tradable as distinct from non-tradable activities.

Table 3

Overview development of components of Unit Labour Costs, by time period and sector, average growth in %

2005-2008

	Manufacturing					Construction					Tradable Services					Non-tradable Services					
	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	ER
CZ	1.8	13.8	11.8	5.5	12.2	1.4	1.7	0.3	5.5	12.2	3.1	6.0	2.9	5.5	12.2	2.7	4.4	1.6	4.2	10.8	-6.0
HU	-1.0	3.9	4.9	7.3	7.3	0.9	-3.0	-3.8	4.9	4.9	0.1	2.1	2.1	8.9	9	2.8	3.4	0.6	4.2	4.2	0.0
PL*	4.7	10.1	5.2	4.3	11.1	11.1	8.5	-2.3	3.1	9.8	5.8	7.8	1.9	4.1	10.9	4.5	4.0	-0.5	4.0	10.8	-6.1
SI	-0.8	4.8	5.7	6.3	6.2	8.6	10.0	1.2	6.4	6.4	4.3	7.5	3.0	6.2	6.2	2.4	4.1	1.7	6.7	6.6	0.1
SK	2.1	11.1	8.8	8.2	15	6.7	15.5	8.2	5.9	12.6	3.3	6.9	3.5	7.6	14.4	4.0	7.5	3.3	7.4	14.3	-6.0
BG*	1.9	6.2	4.2	10.3	10.3	19.3	13.7	-4.7	7.9	7.8	7.1	16.2	8.5	15.4	15.4	3.9	4.5	0.6	9.4	9.4	0.0
EE	-0.7	5.6	6.4	13.8	13.8	11.8	11.8	0.0	17.5	17.5	4.0	6.6	2.5	12.5	12.5	4.9	4.6	-0.2	12.0	12	0.0
LT	1.6	6.4	4.7	10.2	10.2	9.7	18.2	7.8	20.0	20	5.6	9.1	3.4	14.8	14.8	6.0	7.3	1.2	14.4	14.4	0.0
LV	-1.0	0.7	1.7	21.9	20.3	10.8	13.9	2.7	39.5	37.6	6.3	8.7	2.3	20.5	18.8	5.9	8.9	2.9	24.3	22.6	1.4
RO*	-2.0	5.0	7.1	25.5	28.5	11.5	23.4	10.7	17.8	20.6	2.4	6.9	4.4	20.1	23	2.9	11.0	7.9	21.1	24	-2.4
HR	1.2	3.5	2.3	6.0	7	3.4	7.0	3.5	6.1	7.1	1.9	5.8	3.8	5.8	6.8	3.6	4.8	1.1	6.0	7	-0.9
ES	-1.5	-0.1	1.4	5.7	5.7	1.9	3.0	1.1	5.3	5.3	4.5	5.5	0.9	3.2	3.2	4.7	3.0	-1.6	3.4	3.4	0.0
GR	1.6	-2.0	-3.5	5.3	5.3	2.5	1.2	-1.3	0.9	0.9	1.7	5.9	4.1	3.2	3.2	3.6	2.0	-1.6	3.4	3.4	0.0
IE*	-1.8	3.6	5.5	6.2	6.2	3.8	2.4	-1.4	4.3	4.3	4.4	7.2	2.7	5.7	5.7	3.0	5.3	2.2	6.7	6.7	0.0
IT	0.0	1.1	1.1	3.1	3.1	2.3	0.7	-1.6	2.8	2.8	1.4	1.8	0.3	2.8	2.8	1.8	0.7	-1.1	2.1	2.1	0.0
PT	-2.0	0.3	2.4	4.0	4	-1.9	-2.1	-0.2	4.6	4.6	1.9	4.9	2.9	3.7	3.7	1.8	1.2	-0.6	3.6	3.6	0.0
AT	0.9	5.4	4.4	3.9	3.9	1.9	0.4	-1.5	1.7	1.7	1.8	3.9	2.1	3.4	3.4	2.3	2.9	0.6	2.9	2.9	0.0
DE	0.2	3.3	3.1	1.7	1.7	-0.6	-1.1	-0.5	0.9	0.9	1.2	3.0	1.8	1.3	1.3	1.4	2.6	1.1	0.8	0.8	0.0

(Table 3 ctd.)

Table 3 (ctd.)

2008-2011

	Manufacturing					Construction					Tradable Services					Non-tradable Services					
	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	Emp	Out	Prod	Comp	Comp-EUR	ER
CZ	-1.8	3.3	5.2	2.7	5.9	0.6	-0.6	-1.2	1.1	4.2	0.6	1.0	0.4	2.7	5.9	1.2	0.7	-0.6	2.5	5.6	-3.0
HU	-1.2	-1.4	-0.1	3.1	0.4	-3.9	-6.7	-3.0	2.3	-0.4	0.1	-0.3	-0.4	2.5	-0.1	0.0	-2.1	-2.1	1.4	-1.3	2.7
PL*	-0.6	7.6	8.2	4.8	2.5	5.3	8.0	2.5	7.4	5.1	2.5	1.7	-0.9	5.9	3.7	2.7	3.4	0.7	4.6	2.4	2.2
SI	-4.2	-2.1	2.2	4.2	4.2	-2.8	-10.0	-7.3	2.0	2	1.7	1.6	-0.1	2.5	2.5	-0.1	-0.7	-0.6	3.1	3.1	0.0
SK	-1.8	4.1	6.1	4.4	7.4	2.0	3.6	1.6	4.9	8	1.9	1.0	-1.0	4.3	7.3	1.8	3.0	1.2	0.4	3.4	-2.8
BG*	-4.5	0.3	5.0	11.9	11.9	-5.2	-1.3	4.2	13.4	13.4	1.5	7.1	5.5	10.1	10.1	-0.8	0.2	1.0	9.7	9.7	0.0
EE	-2.0	0.0	2.0	0.0	0	-11.8	-5.9	6.7	3.4	3.4	1.2	-0.4	-1.6	0.7	0.7	-3.0	-5.1	-2.2	2.4	2.4	0.0
LT	-4.6	0.9	5.7	2.0	2	-14.2	-11.3	3.3	2.2	2.2	1.4	0.4	-1.0	2.1	2.1	1.1	-1.6	-2.6	-2.5	-2.5	0.0
LV	-8.1	0.0	8.8	6.2	5.9	-17.2	-15.7	1.9	1.6	1.4	-3.5	-1.4	2.2	4.6	4.3	-6.2	-4.2	2.1	2.5	2.2	0.2
RO*	-5.4	2.7	8.7	2.0	-2.7	-1.9	-5.0	-3.2	12.5	7.4	1.3	-2.7	-4.0	2.8	-1.9	-1.5	-3.9	-2.4	7.8	2.9	4.8
HR	-4.2	-3.6	0.6	1.8	1.5	-7.6	-7.6	-0.1	0.9	0.6	-0.5	0.4	0.8	2.5	2.1	-3.8	-1.9	2.0	2.1	1.7	0.3
ES	-5.5	-2.7	2.9	2.3	2.3	-15.5	-7.2	9.9	7.4	7.4	-0.9	0.8	1.7	1.9	1.9	-0.9	0.3	1.3	3.1	3.1	0.0
GR	-3.3	-4.2	-0.9	-2.0	-2	-10.5	-24.5	-15.6	-4.6	-4.6	-1.0	-6.0	-5.0	-2.2	-2.2	-1.0	-1.7	-0.7	1.4	1.4	0.0
IE*	-5.7	5.4	11.8	0.0	0	-20.4	-20.0	0.6	0.6	0.6	-1.6	-1.8	-0.2	1.7	1.7	-2.6	-4.2	-1.6	0.3	0.3	0.0
IT	-2.3	-3.4	-1.1	1.7	1.7	-1.6	-4.3	-2.7	3.1	3.1	0.1	-0.1	-0.2	0.8	0.8	0.6	-0.7	-1.3	1.8	1.8	0.0
PT	-3.2	-1.1	2.2	2.2	2.2	-3.8	-5.3	-1.6	1.5	1.5	1.1	1.0	0.0	1.0	1	-0.3	0.8	1.0	1.7	1.7	0.0
AT	-0.9	0.5	1.4	2.9	2.9	0.5	-2.6	-3.1	2.1	2.1	0.4	0.6	0.2	2.4	2.4	0.8	1.0	0.2	2.8	2.8	0.0
DE	-0.1	-0.5	-0.3	1.7	1.7	0.7	1.1	0.4	2.2	2.2	0.9	0.7	-0.2	2.0	2	1.1	0.9	-0.1	1.8	1.8	0.0

Abbreviations: Emp: Employment; Out: GDP; Prod: Productivity; Comp: Compensation per employee (NC); Comp-EUR: Compensation per employee (EUR).

Remark: BG, HR, IE, PL and RO are not fully comparable with other countries due to different classification used.

Source: Eurostat, Statistical Office of Romania and wiiw own calculations.

Table 4

Development of Unit Labour Costs, by time period and sector

average growth rates p.a. in %

	2001-2004					2005-2008					2008-2011				
	ULC-Total Economy and Sectors					ULC-Total Economy and Sectors					ULC-Total Economy and Sectors				
	ULC-T	ULC-M	ULC-C	ULC-TS	ULC-NTS	ULC-T	ULC-M	ULC-C	ULC-TS	ULC-NTS	ULC-T	ULC-M	ULC-C	ULC-TS	ULC-NTS
CZ	7.2	4.7	6.3	8.4	8.4	7.8	0.3	11.9	9.0	9.1	4.8	0.7	5.5	5.5	6.2
HU	8.2	3.5	9.8	9.5	9.9	3.8	2.3	9.1	6.8	3.6	-0.7	0.5	2.7	0.3	0.8
PL*	-3.4	-8.8	-5.8	-6.7	-3.3	9.0	5.6	12.4	8.9	11.4	0.7	-5.2	2.5	4.6	1.7
SI	1.9	-0.4	3.3	2.0	2.8	2.8	0.5	5.1	3.0	4.9	3.6	1.9	10.0	2.6	3.7
SK	5.0	-2.9	14.3	10.3	7.5	9.2	5.7	4.1	10.5	10.6	5.1	1.3	6.2	8.3	2.1
BG*	3.3	-1.4	3.2	1.5	9.0	7.5	5.8	13.2	6.4	8.7	7.9	6.5	8.9	4.4	8.5
EE	4.6	4.0	10.3	2.5	6.2	11.1	7.0	17.5	9.7	12.3	1.8	-1.9	-3.0	2.3	4.7
LT	2.3	0.2	1.4	3.9	7.2	8.3	5.2	11.3	11.1	13.0	0.3	-3.5	-1.1	3.2	0.2
LV	-2.2	-5.6	0.2	-4.4	-1.4	18.3	18.2	33.9	16.2	19.2	1.0	-2.6	-0.5	2.1	0.1
RO*	-2.9	2.5	6.5	-1.7	0.2	18.8	20.0	9.0	17.8	14.9	-0.7	-10.5	10.9	2.2	5.4
HR	1.4	2.7	2.8	-1.6	-0.9	3.9	4.6	3.5	2.8	5.8	1.9	0.9	0.6	1.3	-0.2
ES	2.9	2.0	4.2	3.0	3.2	4.1	4.2	4.2	2.3	5.1	0.8	-0.6	-2.3	0.2	1.8
GR	3.0	4.4	6.6	2.8	1.7	2.7	9.2	2.2	-0.9	5.1	2.3	-1.1	13.0	3.0	2.0
IE*	3.9	-2.0	6.8	2.4	5.1	4.7	0.6	5.8	2.9	4.4	-1.9	-10.5	-0.1	1.9	1.9
IT	3.1	3.6	3.5	1.9	3.8	2.6	1.9	4.4	2.5	3.2	2.2	2.8	5.9	1.0	3.1
PT	3.0	1.2	5.8	-1.0	4.0	2.3	1.6	4.9	0.7	4.3	1.1	0.0	3.1	1.1	0.7
AT	0.5	0.0	-1.0	0.5	1.1	1.8	-0.5	3.3	1.3	2.2	2.4	1.5	5.3	2.2	2.6
DE	0.4	-0.8	0.9	2.4	-0.7	-0.4	-1.4	1.4	-0.5	-0.3	2.0	2.1	1.8	2.3	1.9

Abbreviations: ULT-T: ULC Total Economy; ULC-M: ULC-Manufacturing; ULC-C: ULC-Construction; ULC-TS: ULC-Tradable Services; ULC-NTS: ULC-Nontradable Services.

Remark: BG, HR, IE, PL and RO are not fully comparable with other countries due to different classification used.

Source: Eurostat, Statistical Office of Romania, wiiw Annual Database, wiiw own calculations.

Table BG

Bulgaria: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	7623.4	7585.1	7534.3	7348.3	7330.0	7300	7270	7250
Gross domestic product, BGN mn, nom.	69295	68322	70511	75265	77600	80700	84600	89400
annual change in % (real)	6.2	-5.5	0.4	1.7	0.7	1.0	1.8	2.6
GDP/capita (EUR at exchange rate)	4600	4600	4800	5200	5400	5700	5900	6300
GDP/capita (EUR at PPP)	10900	10300	10700	11600	11900	.	.	.
Consumption of households, BGN mn, nom.	45766	42942	43990	45386	48300	.	.	.
annual change in % (real)	3.4	-7.6	0.0	-0.6	4.0	3.0	3.0	4.0
Gross fixed capital form., BGN mn, nom.	23283	19724	16077	15743	16200	.	.	.
annual change in % (real)	21.9	-17.6	-18.3	-9.7	0.0	3.0	5.0	6.0
Gross industrial production 3)								
annual change in % (real)	0.6	-17.4	1.1	5.8	-0.9	2.0	4.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	33.0	-1.6	-6.0	-2.5	-9.0	.	.	.
Construction industry 4)								
annual change in % (real)	12.2	-14.4	-14.5	-12.9	-0.8	.	.	.
Employed persons, LFS, th, average 5)	3360.7	3253.6	3052.8	2949.6	2940.0	2950	2980	3010
annual change in %	3.3	-3.2	-6.2	-3.4	-0.8	0.5	1.0	1.0
Unemployed persons, LFS, th, average 5)	199.7	238.0	348.0	372.3	410.0	383	368	353
Unemployment rate, LFS, in %, average 5)	5.6	6.8	10.2	11.2	12.3	11.5	11.0	10.5
Reg. unemployment rate, in %, end of period 5)	6.3	9.1	9.2	10.4	11.4	.	.	.
Average gross monthly wages, BGN	544.8	609.1	648.1	706.5	750.0	.	.	.
annual change in % (real, gross)	12.6	8.8	3.9	4.6	3.1	.	.	.
Consumer prices (HICP), % p.a.	12.0	2.5	3.0	3.4	2.4	3.0	3.0	3.0
Producer prices in industry, % p.a.	10.9	-6.5	8.6	9.4	4.4	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	40.1	37.1	34.3	33.6	34.3	.	.	.
Expenditures	38.4	41.4	37.4	35.6	35.3	.	.	.
Net lending (+) / net borrowing (-)	1.7	-4.3	-3.1	-2.0	-1.0	-1.5	-1.5	-2.0
Public debt, EU-def., % of GDP	13.7	14.6	16.2	16.3	17.0	18.0	18.0	19.0
Central bank policy rate, % p.a., end of period 6)	5.77	0.55	0.18	0.22	0.03	.	.	.
Current account, EUR mn	-8182	-3116	-534	104	-268	-900	-1100	-1300
Current account, % of GDP	-23.1	-8.9	-1.5	0.3	-0.7	-2.2	-2.5	-2.8
Exports of goods, BOP, EUR mn	15203	11699	15562	20265	20792	21600	22500	23800
annual growth rate in %	12.5	-23.0	33.0	30.2	2.6	3.9	4.2	5.8
Imports of goods, BOP, EUR mn	23802	15874	18326	22421	24386	25500	26700	28300
annual growth rate in %	14.7	-33.3	15.4	22.3	8.8	4.6	4.7	6.0
Exports of services, BOP, EUR mn	5355	4916	5012	5348	5671	6000	6300	6600
annual growth rate in %	12.5	-8.2	2.0	6.7	6.0	5.8	5.0	4.8
Imports of services, BOP, EUR mn	4045	3617	3143	3033	3146	3300	3450	3600
annual growth rate in %	12.8	-10.6	-13.1	-3.5	3.7	4.9	4.5	4.3
FDI inflow, EUR mn	6728	2438	1152	1746	1398	2000	2200	2300
FDI outflow, EUR mn	522	-68	174	169	169	.	.	.
Gross reserves of NB excl. gold, EUR mn	11928	11943	11612	11788	13935	.	.	.
Gross external debt, EUR mn	37246	37816	37026	35845	38400	.	.	.
Gross external debt, % of GDP	105.1	108.3	102.7	93.1	96.8	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.8355	0.8738	0.8746	0.8839	0.8909	.	.	.

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

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

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

Rumen Dobrinsky

Bulgaria:
Economic stalemate continues

The year 2012 did not bring an end to the period of weak economic performance which has marked Bulgaria's economy since the start of the global economic and financial turmoil. According to the latest estimates and projections, Bulgaria's GDP in 2012 is expected to have grown by less than 1%. All indications are that economic sluggishness is likely to stay in Bulgaria for some time to come, in line with our previous forecasts.

According to preliminary non-seasonally adjusted quarterly national accounts data, GDP grew by 0.9% year-on-year during the first three quarters of 2012. If anything, preliminary current statistics on the fourth quarter suggest that growth may have slowed further, if not turning negative. The dynamics of monthly industrial output is a clear early warning signal in this respect: year-on-year indices slipped into the red starting in September. While still in the positive territory, merchandise exports also slowed down in this period.

A gradual weakening of aggregate final domestic demand contributed significantly to the lacklustre economic performance in the second half of the year. Real private consumption, which had shown signs of a modest recovery in the second quarter, lost even this humble momentum in the third quarter. Monthly indices of real retail sales turned negative year-on-year starting in September. A modest recovery in gross fixed capital formation (boosted by an upturn in engineering construction) was by far not sufficient to offset the negative impact of flagging private consumption on final domestic demand.

The weak performance of the largest EU economies (Bulgaria's main markets) was probably the most important among the external factors shaping Bulgaria's economic environment. Thus during the first eleven months of 2012 merchandise exports to the EU dropped (in current value terms) by some 3% year-on-year. By contrast, exports to third countries were much more vibrant: in the same period, they grew in value by 13% year-on-year. Notably, exports to China more than doubled in 2012 and China overtook Russia as Bulgaria's eighth largest export destination. Exports to Turkey (Bulgaria's largest third country market) also grew robustly, by 13.6% year-on-year.

In the absence of new economic impetus, the situation in the labour market continued to deteriorate. In the third quarter of 2012, the number of unemployed (LFS measure) was 13.5% higher than in the same quarter of 2011 and the unemployment rate rose by 1.3 percentage points from an year earlier, to 11.5%. The average rate of unemployment for 2012 as a whole is expected to be above 12% and by this measure Bulgaria is in the range of high-unemployment EU member states.

There was a modest revival in banks' credit activity in the business sector while the net withdrawal of credit to households continued. At the same time, there are signs that the process of deterioration in the quality of banks' portfolios is probably coming to an end, with no further rise in the share of sub-standard loans in the latest months. This was probably one of the factors for the banks' renewed appetite for corporate lending. Another factor was the gradual waning of the net outflow of funds from the banking sector (including the net withdrawal of funds by parent banks from their Bulgarian branches). While the balance is still negative, in 2012 it was considerably lower than what was observed in the period 2009-2011.

A new development in 2012 – reversing years of change in the opposite direction – was a process of some 'de-dollarization' of credit: the rise in net bank credit to the corporate sector was mostly due to new credit extended in domestic currency. This partly reflects the changing composition of banks' portfolios, mirroring the ongoing, albeit diminishing, net outflow of funds borrowed on international markets.

On 15 January 2013, Bulgaria retired EUR 879.85 million of matured foreign debt, the last remaining chunk of a 2002 Eurobonds emission. In anticipation of this repayment, the Bulgarian government issued in July 2012 new five-year benchmark Eurobonds worth EUR 950 million with a 4.25% annual coupon. The receipts from the 2012 emission were temporarily parked in the fiscal reserve and then the fiscal reserve was debited to make the January 2013 repayment. What concerns other pending foreign obligations, the next repayment is due in 2015 when Bulgaria is to pay USD 1,086 million on another 2002 Eurobonds emission.

During the mandate of the GERB[21] government, the attitude of the Bulgarian authorities towards EMU accession underwent several swings. Back in 2009, the declared policy objective of the government was fast-track entry to ERM-2 and it was declared among the key national policy priorities. With the escalation of the euro debt crisis, accession to ERM-2 was gradually abandoned as an immediate policy goal. In that period there were public pronouncements that the authorities would put on hold the objective of EMU accession until the debt crisis in the euro area has been settled and even that the country would not seek membership in the euro area in its current state. In more recent pronouncements the authorities have softened this stance but nevertheless no concrete new plans and entry target dates have been announced.

The fiscal outturn for 2012 is likely to be better both than that in 2011 and compared to the target in the 2012 budget. The main factors for this outturn were higher than envisaged VAT revenue (largely thanks to the modest recovery of private consumption and related imports) and an ongoing restraint on selected items of public spending, especially public investment funded from national sources. As argued on previous occasions, this fiscal policy stance – which has been in place during the four years of ruling by the current government – has probably produced an unnecessary and lasting growth sacrifice for the economy, contributing at the same time to the worsening of the situation in the labour market.

21 GERB is the Bulgarian acronym for the name of the governing party: 'Citizens for European Development in Bulgaria'.

Ironically, the 2013 budget was adopted with very little, if any, public and policy debate during the process. This apathy was probably related to the upcoming in mid-2013 general elections, with none of the major political actors willing to open a comprehensive debate on potentially controversial issues. Besides, the arguments against GERB's fiscal policy stance have been raised time and again during their term in office, but the government kept acting unilaterally, never showing interest in entering into such debates.

As a result, the 2013 budget largely follows the spirit and structure of that of previous years. Its macroeconomic framework envisages GDP growth of 1.9% in 2013, which may be rather optimistic, and a deficit of 1.3% of GDP, the same as in the 2012 budget. However, counter to the traditional conservative fiscal planning approach in Bulgaria, the 2013 budget incorporates a very optimistic projection of public revenue which is more than 10% higher in nominal terms than the expected outturn in 2012.

There are only a few new structural elements that are part of the 2013 budget and which entered into force on 1 January 2013. Among them are the following:

- For the first time Bulgaria introduced a tax (equal to the 10% flat rate) on interest earned on bank deposits (except current accounts).
- The minimum monthly wage was raised from BGN 290 (EUR 148) to BGN 310 (EUR 158). The practical importance of this change is related to the fact that a number of other regulatory parameters are chain-linked to the minimum wage.
- The retirement age was increased by 4 more months, reaching 60 years and 8 months for women and 63 years and 8 months for men (with the objective to gradually reach 63 years for women and 65 years for men by 2020). Retirement conditions for those serving in the military were further tightened.

At the time of writing this report there was no change in the expectation for economic activity in Bulgaria to remain sluggish in the short run. It is not unlikely that some populist moves during the pre-election period might provide a temporary boost to private consumption. On the other hand, as regards the external environment, it is likely to remain a drag on economic activity. So on balance, GDP growth in 2013 is expected to remain anaemic, around or little higher than that seen in 2012.

The external environment will remain a major determinant of economic performance in Bulgaria as regards the period thereafter as well. However, much will also depend on the outcomes of the 2013 general elections, in particular, on whether the new government would be willing to consider options of a more growth-oriented and supportive policy stance.

Table CZ

Czech Republic: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	10424	10487	10520	10496	10510	10540	10570	10600
Gross domestic product, CZK bn, nom.	3848.4	3759.0	3799.5	3841.4	3840.0	3870	3960	4110
annual change in % (real)	3.1	-4.5	2.5	1.9	-1.2	0.3	1.6	2.4
GDP/capita (EUR at exchange rate)	14800	13600	14300	14900	14500	.	.	.
GDP/capita (EUR at PPP)	20200	19400	19500	20200	20300	.	.	.
Consumption of households, CZK bn, nom.	1856.7	1874.4	1899.0	1921.7	1890.0	.	.	.
annual change in % (real)	3.0	0.2	1.0	0.7	-3.0	0.0	1.0	2.0
Gross fixed capital form., CZK bn, nom.	1031.2	926.1	932.5	917.3	920.0	.	.	.
annual change in % (real)	4.1	-11.0	0.9	-0.7	-1.0	0.0	2.0	3.0
Gross industrial production								
annual change in % (real)	-1.9	-13.6	10.3	6.4	-1.2	1.0	4.0	6.0
Gross agricultural production (EAA)								
annual change in % (real)	6.8	-3.6	-7.0	8.6	-6.6	.	.	.
Construction industry								
annual change in % (real)	-0.2	-0.8	-7.1	-3.5	-6.6	0.0	2.0	4.0
Employed persons, LFS, th, average 3)	5002.5	4934.3	4885.2	4904.0	4890.1	4890	4900	4920
annual change in % 3)	1.6	-1.4	-1.0	0.4	0.4	0.0	0.2	0.5
Unemployed persons, LFS, th, average 3)	229.8	352.2	383.5	353.6	366.9	.	.	.
Unemployment rate, LFS, in %, average 3)	4.4	6.7	7.3	6.7	7.0	7.4	7.3	7.0
Reg. unemployment rate, in %, end of period	6.0	9.2	9.6	8.6	9.4	9.5	9.5	9.0
Average gross monthly wages, CZK 4)	22592	23344	23864	24436	24970	.	.	.
annual change in % (real, gross)	1.4	2.3	0.7	0.5	-1.1	0.0	1.0	2.0
Consumer prices (HICP), % p.a.	6.3	0.6	1.2	2.2	3.5	2.0	2.0	1.8
Producer prices in industry, % p.a.	0.4	-1.5	0.1	3.7	3.1	2.0	2.0	1.5
General governm.budget, EU-def., % of GDP								
Revenues	38.9	38.9	39.0	39.8	40.1	.	.	.
Expenditures	41.1	44.7	43.7	43.0	43.6	.	.	.
Net lending (+) / net borrowing (-)	-2.2	-5.8	-4.8	-3.2	-3.5	-3.5	-3.2	-3.0
Public debt, EU-def., % of GDP	28.7	34.2	37.8	40.8	45.1	46.9	48.1	48.0
Central bank policy rate, % p.a., end of period 5)	2.25	1.00	0.75	0.75	0.05	0.25	0.75	0.75
Current account, EUR mn	-3297	-3428	-5894	-4453	-2300	-2500	-2500	-3100
Current account, % of GDP	-2.1	-2.4	-3.9	-2.9	-1.5	-1.6	-1.6	-1.9
Exports of goods, BOP, EUR mn	84845	70983	86083	99580	105000	110000	121000	136000
annual growth rate in %	9.3	-16.3	21.3	15.7	5.4	5.0	10.0	12.0
Imports of goods, BOP, EUR mn	83811	67684	83991	95755	98000	100000	107000	120000
annual growth rate in %	10.4	-19.2	24.1	14.0	2.3	2.0	7.0	12.0
Exports of services, BOP, EUR mn	14910	13924	15812	16598	17000	19000	21000	23000
annual growth rate in %	17.9	-6.6	13.6	5.0	2.4	10.0	10.0	9.0
Imports of services, BOP, EUR mn	11949	11126	12839	13895	15000	17000	19000	21000
annual growth rate in %	13.7	-6.9	15.4	8.2	8.0	10.0	10.0	8.0
FDI inflow, EUR mn	4467	2082	4644	3868	6000	4000	4000	.
FDI outflow, EUR mn	2964	685	882	827	1300	1300	1300	.
Gross reserves of NB excl. gold, EUR mn	26386	28556	31357	30675	33457	.	.	.
Gross external debt, EUR mn	60511	61940	70498	72583	76000	.	.	.
Gross external debt, % of GDP	39.2	43.6	46.9	46.5	49.8	.	.	.
Average exchange rate CZK/EUR	24.95	26.44	25.28	24.59	25.15	25.25	25.00	24.75
Purchasing power parity CZK/EUR	18.24	18.46	18.49	18.09	18.01	.	.	.

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

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) From 2012 according to census March 2011. - 4) Until 2008 enterprises with 20 and more employees, including part of the Ministry of Defence and the Ministry of the Interior, from 2009 all enterprises covered. - 5) Two-week repo rate.

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

Leon Podkaminer

The Czech Republic:
In recession

In the third quarter of 2012 the GDP decline went on at 1.6% against the same period of 2011 (seasonally and working-days' unadjusted). The decline in household consumption moderated slightly (to -2.5%) while the contraction in government consumption temporarily halted. Gross fixed capital formation, which still grew (weakly) in the first half of the year, declined by 3% in the third quarter. The volume of exports of goods and non-factor services rose by 4.2% whereas the volume of imports remained almost flat (rising by 0.7%) in the third quarter. The decline in household consumption seems to have been even more pronounced in the fourth quarter, together with some temporary stabilization of gross capital formation (with rising inventories). Overall GDP must have declined in the fourth quarter again by over 1%.

The differential performances of exports and imports indicate that the recession continues to be deeply rooted in domestic developments, at least until now. The weakening of growth in the major destinations of Czech exports (Germany, Poland and Slovakia) has not yet led to their contraction (as was the case in 2009 when Europe was hit by deep recession). The Czech economy remains internationally competitive. The fact that the Czech currency has weakened (rather unexpectedly) strengthens the country's external position even further. It is generally assumed, correctly it seems, that foreign trade can remain a force positively contributing to Czech GDP growth even if stagnation in the country's foreign partners gets prolonged. However, foreign trade would be of little help if Europe enters a more serious recession.

The continuing weakness of household consumption is a fairly autonomous effect of anaemic labour market developments which are characterized by stagnant employment and modest nominal wage increases. Moreover, owing to the fiscally-motivated increases in the VAT rates and hikes in administered prices (housing rents and utilities) inflation in 2012 was again (as in 2011) raised by over 1 percentage point. These hikes were responsible for the erosion of real wages and other regular household sector incomes – and for the decline in household consumption. In addition, the household sector responds to its reduced disposable income with higher (gross) saving rates (reaching about 10.5% recently). The high uncertainties crippling household spending are also reflected in the sector's borrowing activities. Despite the relatively low interest rates on loans (consumer as well as mortgages), banks' unchanged lending standards and the unchanged (and low, at 5.2%) ratio of non-performing household loans, the demand for credit remains flat.

Despite the falling and low (7.5%) share of non-performing loans to the corporate sector, the standards for lending to that sector are gradually tightened. This tendency reflects banks' perceptions concerning the sector's prospects. But the tightening of the lending standards does only matter to a relatively small fraction of the corporate clients (e.g. in the energy sector). The corporate sector's aggregate demand for investment loans is almost flat, despite relatively low and falling interest rates charged by banks. This reflects the gloomy overall outlook – and overabundance of own financial resources[22].

The Czech National Bank has done all it possibly could to ease the strain felt by the economy. Its desperate decision to reduce the policy rate to zero (literally to 0.05%) may have helped to weaken the Czech currency. Otherwise, it has probably prevented an outright – and unnecessary – credit crunch. But the monetary policy alone, even if competently executed, could not help stop the current recession from deepening.

The fiscal policy meaningfully contributed to the recession in 2012. The fiscal 'effort' (i.e. additional discretionary measures reducing the public sector deficit) is estimated to have reached close to 1% of the GDP in 2012. Despite this the 3% public sector/GDP ratio target was missed – primarily because the tightening provoked (also through the VAT-induced inflationary erosion of wages) a recession instead of the 'planned' GDP stagnation.

The discretionary measures will continue to have effects in 2013, 2014 and 2015, with taxation and revenue measures equivalent to 0.9, 0.6 and 0.4 per cent of GDP respectively. The effort will also produce some additional inflation via a further increase in indirect tax rates. (The scales of the inflationary effects of the fiscal effort will be gradually diminishing in 2013 and beyond as compared with 2012.)

Currently, the authorities seem to believe that the public sector deficit will be lower than 3% of GDP in 2013. This presumes not only a continuation of consolidation, but also positive GDP growth (of about 0.7%) in 2013. Whether the fiscal consolidation plans will be consistently carried through in 2013 cannot be ascertained at present. The government of Petr Nečas disposes of a tiny (and not necessarily reliable) parliamentary majority. In January 2013 it narrowly survived the latest non-confidence vote. The government's eventual fall may result in a softening of the fiscal consolidation projects. A rather unusually open (and critical) evaluation of the need to strive for fiscal consolidation in the Czech Republic, expressed in an IMF document[23], may not have been lost on the Czech authorities in charge of the fiscal policy. If real growth in 2013 disappoints, the policy is now unlikely to enforce additional austerity measures (which had been its earlier intention). Rather, it is more likely to accept shortfalls in revenue and spending in excess of targets – and thus deficits larger than planned. In any case, even if the intensity of 'fiscal efforts' in 2013-2014 is not much lower than in 2012, it may have less of an impact on inflation and households' disposable incomes. For that reason the fiscal policy may prove to be less contractionary in 2013 (and beyond) than has been the case recently.

[22] Corporate clients' aggregate bank deposits exceed their liabilities by about 30%.

[23] See http://www.imf.org/external/pubs/ft/scr/2012/cr12115.pdf

In 2013 the Czech economy is exposed to a number of risks. Deep recession in major export markets would have the most debilitating effects on the Czech economy. But such a recession does not seem very likely now. In contrast, the continuing fiscal consolidation which is likely to take place could produce effects that are hard to calculate with any precision. It may prove neutral as far as growth is concerned – but it can also have negative, as well as positive, effects in this respect.

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

All in all, the country's economy, free of significant internal and external imbalances, may be well equipped to benefit from a euro area recovery, should this eventually materialize. Of course, the country's growth potential could be mobilized even if euro area stagnation drags on for some time. But such a mobilization would require a change in the economic policy orientation, which is unlikely to happen.

The second round of the presidential elections (held in January 2013) was won by Miloš Zeman (an earlier Social Democratic PM) who defeated Prince Karel Schwarzenberg (the current foreign minister, a liberal conservative). In contrast to Václav Klaus, whose second term in office has come to an end, the new president will help bring the Czech policies towards the EU on a more balanced track.

Table EE

Estonia: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1]	2013	2014 Forecast	2015
Population, th pers., average [2]	1340.7	1340.3	1340.2	1294.7	1294.0	1293	1292	1290
Gross domestic product, EUR mn, nom.	16235	13762	14323	15951	17200	18400	19800	21500
annual change in % (real)	-4.2	-14.1	3.3	8.3	3.2	2.8	3.5	3.8
GDP/capita (EUR at exchange rate)	12100	10300	10700	12300	13300	.	.	.
GDP/capita (EUR at PPP)	17200	14700	15500	17500	18400	.	.	.
Consumption of households, EUR mn, nom.	8689	7271	7287	7929	8500	.	.	.
annual change in % (real)	-5.4	-15.2	-2.4	3.6	3.5	3.7	3.8	4.0
Gross fixed capital form., EUR mn, nom.	4920	2949	2733	3460	4400	.	.	.
annual change in % (real)	-13.3	-38.3	-7.4	25.7	23.0	9.0	11.0	12.0
Gross industrial production								
annual change in % (real)	-5.2	-24.0	23.6	16.8	-0.5	3.0	8.0	10.0
Gross agricultural production (EAA)								
annual change in % (real)	-1.1	2.8	-4.0	9.7	0.9	.	.	.
Construction industry								
annual change in % (real)	-13.3	-29.8	-8.5	26.7	19.0	.	.	.
Employed persons, LFS, th, average	656.5	595.8	570.9	609.1	625.0	635	645	655
annual change in %	0.2	-9.2	-4.2	6.7	2.6	1.6	1.6	1.6
Unemployed persons, LFS, th, average	38.4	95.1	115.9	86.8	71.0	66.7	63.8	57.0
Unemployment rate, LFS, in %, average	5.5	13.8	16.9	12.5	10.2	9.5	9.0	8.0
Reg. unemployment rate, in %, end of period	4.6	13.3	10.1	7.3	6.0	.	.	.
Average gross monthly wages, EUR	825	784	792	839	889	.	.	.
annual change in % (real, gross)	3.2	-4.9	-1.8	0.9	2.0	.	.	.
Consumer prices (HICP), % p.a.	10.6	0.2	2.7	5.1	4.2	3.8	4.0	4.5
Producer prices in industry, % p.a.	8.0	0.7	3.2	4.3	2.6	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	36.7	43.5	40.8	39.4	40.3	39.5	39.0	39.0
Expenditures	39.7	45.5	40.7	38.3	41.5	40.3	39.0	38.5
Net lending (+) / net borrowing (-)	-2.9	-2.0	0.2	1.2	-1.2	-0.8	0.0	0.5
Public debt, EU-def., % of GDP	4.5	7.2	6.7	6.1	10.5	11.0	10.5	9.0
Central bank policy rate, % p.a., end of period [3]	7.02	2.83	0.92	1.00	0.75	.	.	.
Current account, EUR mn	-1486	470	420	339	-350	-500	-700	-900
Current account, % of GDP	-9.2	3.4	2.9	2.1	-2.0	-2.7	-3.5	-4.2
Exports of goods, BOP, EUR mn	8490	6460	8770	12056	12600	13000	14000	15200
annual growth rate in %	4.4	-23.9	35.8	37.5	4.5	3.0	8.0	9.0
Imports of goods, BOP, EUR mn	10531	7051	9035	12277	13500	14300	15500	17000
annual growth rate in %	-2.3	-33.0	28.1	35.9	10.0	6.0	8.0	10.0
Exports of services, BOP, EUR mn	3601	3200	3442	3900	4250	4500	4900	5350
annual growth rate in %	9.5	-11.1	7.6	13.3	9.0	6.0	9.0	9.0
Imports of services, BOP, EUR mn	2286	1809	2102	2660	3050	3350	3800	4300
annual growth rate in %	1.7	-20.9	16.2	26.5	14.7	10.0	13.0	13.0
FDI inflow, EUR mn	1181	1325	1207	185	1000	1000	.	.
FDI outflow, EUR mn	761	1115	106	-1049	360	500	.	.
Gross reserves of NB excl. gold, EUR mn [4]	2814	2758	1904	150	218	.	.	.
Gross external debt, EUR mn	19025	17204	16402	15504	16400	.	.	.
Gross external debt, % of GDP	117.2	125.0	114.5	97.2	95.3	.	.	.
Purchasing power parity EUR/EUR	0.7020	0.6966	0.6906	0.7044	0.7243	.	.	.

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

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

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

Sebastian Leitner

Estonia:
Nordic anaemia strains growth prospects

Foreign trade developments, which had backed the economic revival in 2010-2011, were adversely affected in 2012 by the remarkable slowdown of demand growth from Estonia's two most important trading partners, Finland and Sweden. Especially producers in the electronics industry, Estonia's major export sector, suffered. Although towards the end of 2012 some stabilization in foreign trade could be observed, we expect export growth to further slow down throughout the first half of 2013, driven by low expectations for recovery in the Nordic trade partners and the eurozone in general. However, as in 2012, the still more lively economic activity in the Baltic neighbours and especially in Russia will partly compensate for the stagnating external demand in Northern and Western Europe this year. Driven by domestic demand, growth of imports will again remain above that of exports in 2013, resulting in a negative contribution of net exports to GDP growth.

The strongest impetus to economic growth in 2012 came from gross fixed capital formation. Public investments in the transport and energy infrastructure were financed by EU funds and revenues from the sales of CO_2 emission certificates accrued in 2011. At the same time the corporate sector refrained from upgrading its equipment given the meagre outlook for external demand conditions. Exporting firms are reporting a fall in capacity utilization towards the end of 2012. During 2013 we expect that in the second half of the year enterprises will again raise their expenditures for capital replacement, given the rather favourable corporate balance sheets. Moreover, enterprises started to increase their loan stock again in the second half of 2012. Although the real estate market has bottomed out and dwelling prices are slightly rising again, households are reluctant to increase their debt burden substantially: as a result, investments in the housing sector are picking up only slightly. In general we expect growth in fixed investments to decline in 2013, since many of the government-financed infrastructure projects are to be completed this year.

The lively demand developments on the domestic market resulted in an improved situation on the labour market throughout 2012. Jobs in higher-skill service sectors and transport are still flourishing. At the same time employment in industrial sectors and construction stagnated and may even decline slightly in 2013. Total employment growth amounted to 2.6% in 2012 and will still reach 1.6% in 2013. Accordingly, the unemployment rate declined to below 10% in the second half of 2012. However, given the slowdown of economic activity, the decline in vacancies in past months and the high share of long-term unemployed (86%) in total unemployment, a further recovery of the labour market will take place only gradually in 2013 and also beyond.

In line with the recovery of the labour market, the increase in gross wages rose to almost 6% in nominal terms and 2% in real terms in 2012. We expect the rise in labour costs to act as a driver of overall price developments in 2013. Moreover, the completion of the opening of the electricity market in January this year will most likely cause a rise in the price of electricity for households of about 20% on average. This is likely to bring about an additional increase in consumer prices by up to one percentage point in 2013. Only in 2014, when the EstLink 2 cable – which will triple the transport capacity of electricity between the Estonian and the Finish grid – is to be launched, a slight fall in electricity prices is to be expected. Moreover, excise taxes on alcohol and tobacco are to be raised this year. However, given the low price increases of imports and the expected fall of the price of oil and gas, the consumer inflation rate is to fall slightly to 3.8% in 2013.

In spite of stagnant developments in the manufacturing and construction sectors the consumption activity of Estonian households remained rather lively also in the second half of last year. Consumer surveys show that spending plans have not deteriorated, while deleveraging of households has bottomed out. Thus we expect that also in 2013 domestic consumption will grow by 3.7% in real terms and thus substantially reinforce overall GDP growth.

Apart from the increase in excise taxes and a reduction of the unemployment insurance premium rates from 4.2% to 3% of labour costs, the 2013 budget approved last December does not foresee any major changes in the tax code. The Estonian government plans to cut the budget deficit from about 1.2% in 2012 to 0.7% in 2013. In the medium run, the government's fiscal strategy foresees a reduction of the share of general government revenues in GDP from 40% in 2012 to about 35% in the year 2016. The outspoken aim is a shift of the tax burden from labour to consumption which is to be effected inter alia by a reduction of the flat rate of the income tax from 21% today to 20% in 2015 and an increase of the tax-free minimum level in income taxation. At the same time the Estonian government aims at returning to a budget surplus in 2014. The most prominent measure cited on the expenditure side to bring down the share of the state in the economy is to gradually reduce public investments from more than 6% of GDP in 2012 to below 1.5% of GDP in 2016 – which seems unrealistic and would be detrimental to future growth prospects.

Given the meagre outlook for external demand in Northern Europe and the planned cutback in public investments, which had supported the overall economic activity in 2012, we expect GDP growth to slow down slightly in 2013 to 2.8%. The most likely scenario for the subsequent years is a restrained revival in the eurozone starting towards the end of 2013. Thus, external demand and corporate sector investments alike should somewhat speed up economic activity also in Estonia, resulting in GDP growth of 3.5% in 2014 and 3.8% in 2015. However, private consumption will remain an important pillar of economic activity in particular since deleveraging of households has bottomed out.

Sándor Richter

Hungary:
Efforts to get released from the excessive deficit procedure

The Hungarian economy re-entered recession in 2012: the GDP declined by 1.7%. Data from the past five years show that Hungary cannot close the gap that opened up in the wake of the crisis. Compared to the levels in the last pre-crisis year (2008), household consumption was by 11%, investment by 27% lower in 2012. The Visegrad region peers performed much better in the period concerned (see Table 1).

Table 1

Comparison of pre-crisis and 2012 consumption and investment levels of the Visegrad countries

	Consumption		Investment	
	2008	2012	2008	2012
Hungary	100	89	100	73
Czech Republic	100	99	100	88
Poland	100	109	100	108
Slovakia	100	98	100	95

Source: wiiw Database.

The vision to turn the Hungarian economy into a 'fairy tale' (a formulation invented by the Minister of Economy, György Matolcsy) with a growth rate of 5% to 7% coupled with a high degree of independence from multilateral institutions (EU, IMF) and foreign capital (except for investors operating in manufacturing) has given way to a bitter struggle to keep the general government deficit below 3% of the GDP in order to get released from the excessive deficit procedure in June this year. This is indispensable for securing the continuous flow of Cohesion Fund transfers from the EU budget, a vital source of investment amidst scarce alternative sources.

In 2012 household consumption decreased in accord with the pace of GDP decline. This is no surprise in view of the real wage drop of 3.4% and the high debt service payments of households indebted in foreign exchange (forex). The strong decline in investment is explained by 'hibernated' financial transmission in the country and diminishing opportunities for public investment as a consequence of successive waves of fiscal consolidation. For the business sector the uncertainties due to erratically changing regulatory environment and taxation rules in the past two years along with depressed domestic demand and, finally, the slowdown in export expansion gave enough reason for caution concerning investment decisions. The share of gross fixed investment in the GDP fell below

Table HU

Hungary: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average	10038	10023	10000	9972	9940	9920	9900	9880
Gross domestic product, HUF bn, nom.	26543	25626	26607	27886	28600	29800	31300	33200
annual change in % (real)	0.9	-6.8	1.3	1.6	-1.7	0.0	1.2	2.5
GDP/capita (EUR at exchange rate)	10500	9100	9700	10000	10000	.	.	.
GDP/capita (EUR at PPP)	16000	15300	15900	16500	16500	.	.	.
Consumption of households, HUF bn, nom.	13985	13551	13665	14360	14800	.	.	.
annual change in % (real) 2)	-0.5	-6.8	-3.0	0.5	-1.5	0.0	0.0	0.0
Gross fixed capital form., HUF bn, nom.	5760	5302	4867	4987	4880	.	.	.
annual change in % (real)	2.9	-11.1	-9.6	-3.6	-6.0	-2.0	0.0	5.0
Gross industrial production								
annual change in % (real)	-0.2	-17.6	10.5	5.5	-1.7	1.0	3.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	27.4	-10.6	-11.1	10.7	-11.0	.	.	.
Construction industry								
annual change in % (real)	-5.2	-4.4	-10.4	-7.8	-5.9	0.0	2.0	5.0
Employed persons, LFS, th, average	3879.4	3781.8	3781.2	3811.9	3870.0	3880	3890	3910
annual change in %	-1.2	-2.5	0.0	0.8	1.5	0.2	0.2	0.5
Unemployed persons, LFS, th, average	329.1	420.7	474.8	467.9	475.6	.	.	.
Unemployment rate, LFS, in %, average	7.8	10.0	11.2	10.9	10.9	10.9	10.8	10.6
Reg. unemployment rate, in %, end of period	10.9	13.6	13.3	12.5	12.8	.	.	.
Average gross monthly wages, HUF 3)	198741	199837	202525	213094	223100	.	.	.
annual change in % (real, net)	0.8	-2.3	1.8	2.4	-3.5	.	.	.
Consumer prices (HICP), % p.a.	6.0	4.0	4.7	3.9	5.7	4.0	3.5	3.5
Producer prices in industry, % p.a.	4.6	4.5	6.3	2.5	3.8	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	45.5	46.9	45.4	53.9	46.4	.	.	.
Expenditures	49.2	51.4	49.8	49.6	49.2	.	.	.
Net lending (+) / net borrowing (-) 4)	-3.7	-4.5	-4.5	4.3	-2.8	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	73.0	79.8	81.8	81.4	78.5	78.0	77.5	77.0
Central bank policy rate, % p.a., end of period 5)	10.00	6.25	5.75	7.00	5.75	.	.	.
Current account, EUR mn	-7728	-176	1030	917	1100	1000	1100	600
Current account, % of GDP	-7.3	-0.2	1.1	0.9	1.1	1.0	1.0	0.5
Exports of goods, BOP, EUR mn	72043	57397	68964	75238	77100	81000	89900	99800
annual growth rate in %	6.2	-20.3	20.2	9.1	2.5	5.0	11.0	11.0
Imports of goods, BOP, EUR mn	73233	55028	65749	71871	72600	75500	83700	92900
annual growth rate in %	6.9	-24.9	19.5	9.3	1.0	4.0	10.8	11.0
Exports of services, BOP, EUR mn	13804	13305	14634	15578	15270	16000	17600	19500
annual growth rate in %	9.8	-3.6	10.0	6.5	-2.0	5.0	10.0	11.0
Imports of services, BOP, EUR mn	12287	11319	11704	12355	12050	12500	13500	15000
annual growth rate in %	9.4	-7.9	3.4	5.6	-2.5	4.0	8.0	11.0
FDI inflow, EUR mn	4225	1475	1662	3325	7000	.	.	.
FDI outflow, EUR mn	1503	1365	949	3153	6000	.	.	.
Gross reserves of NB, excl. gold, EUR mn	23807	30648	33667	37242	33757	.	.	.
Gross external debt, EUR mn	123454	137120	138228	131944	126200	.	.	.
Gross external debt, % of GDP	117.0	150.0	143.1	132.2	127.6	.	.	.
Average exchange rate HUF/EUR	251.51	280.33	275.48	279.37	289.25	290	290	275
Purchasing power parity HUF/EUR	165.55	166.78	167.48	169.65	174.23	.	.	.

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

1) Preliminary and wiiw estimates. - 2) From 2012 including government financed transfers in kind. - 3) Enterprises with 5 and more employees. - 4) In 2011 including one-off effects. Without those effects general government budget balance is estimated to have attained -4.6% of GDP (Source: Portfolio.hu). - 5) Base rate (two-week NB bill).

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

17%. Net exports still provided a positive contribution to GDP change, just as in the previous years, but that was insufficient to compensate the decline in other components of the GDP.

The sunny side of the Hungarian economy, the good export performance, has been waning: exports sales of industry slightly decreased in 2012. While exports of the automotive cluster, providing one third of manufacturing exports, sustained their momentum with an 11% expansion, foreign sales of the other 'flagship cluster' – that of computer, electronic and optical equipment delivering traditionally about one fifth of manufacturing exports – dropped by 17%. Two other major branches of the economy performed poorly as well: Agriculture suffered a severe double-digit decline, and the performance of the construction sector dropped by 6%. The former was related mostly to unfavourable weather, the latter to falling investments.

The unemployment rate has hardly changed while significant rearrangement has taken place in the labour market. The employment rate increased last year, but this is principally due to an upturn in public work. Employment dropped both in the business sector and in the public sector without the so-called public workers – those who are obliged to participate in public work programmes in order to remain eligible for the welfare transfers (the provision of unemployment benefits was cut to 3 months).

In early 2012 the weak exchange rate of the forint, high CDS spreads and yields on government bonds put an agreement with the EU/IMF tandem about a financial assistance programme on the agenda. Through postponing the start of the negotiations again and again the government managed to preserve its prioritized independence from external influence on its economic policy. By the end of 2012 ample liquidity on the international markets and the increased risk appetite of international investors resulted in lower yields on HUF-denominated government bonds and in a stronger forint. This situation allowed the revolving of public debt, primarily through issuing forint-denominated bonds (about 44% of forint-denominated bonds are held by non-residents). In early 2013 first attempts to return to the international markets with forex-denominated bonds via the state-owned Eximbank proved to be successful. On 12 February the Government Debt Management Agency successfully placed 5- and 10-year USD-denominated government bonds in the value of EUR 2.5 billion. The yield on the 5-year bond was by 335 basis points over the corresponding US Treasury yields, that on the 10-year bond by 345 basis points. Direct sale of forex-denominated bonds to residents (EUR 1 billion, for institutional investors and households) started with remarkable success. These steps were sufficient to cover more than half of the sum to be raised in 2013 to ensure the refinancing of mature foreign exchange-denominated public debt.

In 2013 the general government balance remains in the focus of the economic policy. At least until the decision on whether Hungary will be released from the excessive deficit procedure, the government must maintain the impression that the 3% deficit threshold will be observed this and in the coming two years as well. That will not be easy with regard to the several uncertainties in the 2013 budget. The hoped-for revenues from the electronic road toll and from measures to diminish tax evasion may be significantly delayed or may not materialize at all. The sector-specific tax imposed on the telecom sector may be qualified as invalid by the European Court of Justice and the government may be compelled to pay back the whole sum collected up until now. These factors and a substantially slower GDP growth rate than the assumed 0.9% used while planning the budget create risks on the revenue side of the budget, amounting to more than 1% of the GDP. That means that on top of the 2012 restrictions, additional measures may become necessary later this year to observe the 3% deficit target. These considerations are also reflected in the most recent forecast of the European Commission on Hungary's budget deficit (3.4% of GDP this and the next year).

All that must be seen in the context of the forthcoming elections in early 2014. The government has already began with 'mood improving' steps: gas, electricity and district heating prices were reduced by 10% for households. Further similar steps to diminish various public utilies prices for households were mentioned as being under consideration. Though the government expects that the distributor companies will bear the burdens of this decision, the secondary exposure of non-household customers is unclear. Election cookies were promised for the single biggest block of voters, the pensioners, too. With regard to these uncertainties, improvised and poorly planned and implemented fiscal measures will most probably figure as key features of the 2013 economic policy.

In March this year the mandate of András Simor, the governor of the National Bank of Hungary, will end. The successor is unknown as yet, but no doubt a person loyal to the government will follow Mr. Simor. This, coupled with a Monetary Council where government loyalists constitute the majority, poses the risk of precipitate cuts of the policy rate and quantitative easing of the monetary policy, steps which may seriously weaken the forint. The growth stimulating effect of such measures anticipated by the government seems to be negligible in the current circumstances.

The predominantly foreign-owned financial sector has remained in disfavour with the government. Banks must bear a disproportionately large burden of the fiscal consolidation. The special tax levied on the financial sector has not been halved in 2013 and will not be levelled in 2014 with taxes imposed on banks in other EU countries as had been promised by the government. Additionally a new tax on financial transactions, hitting the banks hard, was introduced on 1 January this year. While parent banks inject capital from abroad into their affiliates in Hungary to avoid the latter's undercapitalization, liquidity made available by parent banks for their Hungarian affiliates has substantially diminished and that partly explains the further shrinkage of lending. As external sources of liquidity turned meagre, the government's successful attempt to sell both forint- and forex-denominated bonds for resident investors has the potential to crowd out bank deposits from households' saving instruments. No wonder that lending activities both to the corporate sector and households have further decreased. Deleveraging in the corporate and the household sectors carries on, the credit/deposit ratio has dropped to 110 and is sinking further. Insufficient financial intermediation is not solely a supply-side issue however; demand for credits is extreme weak as well, due to shrinking investment, stagnating consumption and diminished export opportunities.

Under the current relaxed mood in the financial markets, an agreement with the IMF may seem unnecessary. Despite an improvement in important fiscal indicators, Hungary's position has remained fragile, as an important part of the improvement is due to temporary consolidation measures and not to genuine reforms. Should the currently favourable investment climate for the emerging markets change to the worse, Hungary may easily become one of the countries being hit first and the hardest. Without a major policy change aimed at the restoration of investors' confidence, both domestic and foreign ones, without a return to established forms of interest reconciliation with social partners, a reconciliation with the banking sector based on observed agreements and fair and feasible burden sharing and, last but not least, without an easing of the extreme centralization of decisions in the hands of the Prime Minister, a real improvement in the economy cannot be started. In our baseline scenario, this turn will only take place if and when a clear victory of the alliance of the political parties of the current democratic opposition occurs. This scenario envisages a political and legal consolidation period in the second half of 2014 and a gradual return to a higher, investment- and export-driven growth path from 2015 onwards. An alternative scenario assumes the prolongation of the current 'unorthodox' economic policy for several more years and consequently a protracted crisis of confidence and marginal economic growth in a depressed society.

Table LV

Latvia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	2266.1	2254.8	2239.0	2058.2	2034.9	2023	2013	2003
Gross domestic product, LVL mn, nom.	16085	13070	12784	14275	15470	16500	17800	19300
annual change in % (real)	-3.3	-17.7	-0.9	5.5	5.4	3.8	4.3	4.5
GDP/capita (EUR at exchange rate)	10500	8600	8600	9800	10900	.	.	.
GDP/capita (EUR at PPP)	14600	12700	13200	14700	15900	.	.	.
Consumption of households, LVL mn, nom.	9904	7889	7947	8725	9400	.	.	.
annual change in % (real)	-5.8	-22.8	2.5	4.7	5.5	4.4	4.7	4.8
Gross fixed capital form., LVL mn, nom.	4770	2820	2330	3045	3600	.	.	.
annual change in % (real)	-13.7	-37.4	-18.1	27.9	15.0	9.0	11.0	13.0
Gross industrial production 3)								
annual change in % (real)	-3.2	-18.1	14.9	9.0	6.1	5.0	9.0	11.0
Gross agricultural production (EAA)								
annual change in % (real)	0.2	-0.7	-2.4	2.8	9.4	.	.	.
Construction industry								
annual change in % (real)	-3.1	-34.9	-23.4	12.4	14.5	.	.	.
Employed persons, LFS, th, average 4)	1124.5	983.1	940.9	970.5	885.6	905	915	925
annual change in % 4)	0.6	-12.6	-4.3	3.1	2.8	2.2	1.1	1.1
Unemployed persons, LFS, th, average 4)	90.5	203.2	216.1	176.4	155.5	140	130	120
Unemployment rate, LFS, in %, average 4)	7.5	17.1	18.7	15.4	14.9	13.5	12.5	11.5
Reg. unemployment rate, in %, end of period 4)	7.0	16.0	14.3	11.5	10.5	.	.	.
Average gross monthly wages, LVL	479	461	445	464	482	.	.	.
annual change in % (real, net)	6.2	-5.6	-6.5	0.3	1.5	.	.	.
Consumer prices (HICP), % p.a.	15.2	3.3	-1.2	4.2	2.3	2.8	3.5	3.5
Producer prices in industry, % p.a.	11.4	-4.6	2.8	7.4	3.3	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	34.9	34.0	35.3	35.0	37.1	37.0	36.5	36.0
Expenditures	39.1	43.7	43.4	38.4	38.5	38.4	37.3	36.0
Net lending (+) / net borrowing (-)	-4.2	-9.7	-8.1	-3.4	-1.4	-1.4	-0.8	0.0
Public debt, EU-def., % of GDP	19.8	36.7	44.5	42.2	41.0	38.0	36.0	34.0
Central bank policy rate, % p.a., end of period 5)	6.0	4.0	3.5	3.5	2.5	.	.	.
Current account, EUR mn	-3014	1598	532	-434	-400	-650	-900	-1000
Current account, % of GDP	-13.2	8.6	2.9	-2.1	-1.8	-2.8	-3.6	-3.7
Exports of goods, BOP, EUR mn	6531	5253	6813	8578	9700	10600	11800	13200
annual growth rate in %	8.5	-19.6	29.7	25.9	13.1	9.3	11.3	11.9
Imports of goods, BOP, EUR mn	10603	6575	8084	10765	12100	13400	15300	17700
annual growth rate in %	-4.3	-38.0	23.0	33.2	12.4	10.7	14.2	15.7
Exports of services, BOP, EUR mn	3088	2747	2754	3181	3550	3900	4400	4950
annual growth rate in %	14.1	-11.0	0.3	15.5	11.6	9.9	12.8	12.5
Imports of services, BOP, EUR mn	2169	1625	1647	1868	2050	2230	2500	2800
annual growth rate in %	9.9	-25.1	1.4	13.4	9.7	8.8	12.1	12.0
FDI inflow, EUR mn	869	68	284	1039	800	1000	.	.
FDI outflow, EUR mn	169	-44	14	44	170	200	.	.
Gross reserves of NB excl. gold, EUR mn	3514	4572	5472	4666	5373	.	.	.
Gross external debt, EUR mn	29763	29097	29978	29459	30100	.	.	.
Gross external debt, % of GDP	130.0	157.1	166.2	145.8	135.7	.	.	.
Average exchange rate LVL/EUR	0.7027	0.7057	0.7087	0.7063	0.6973	0.71	0.71	0.71
Purchasing power parity LVL/EUR	0.5051	0.4812	0.4632	0.4726	0.4783	.	.	.

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

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

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

Sebastian Leitner

Latvia:
Is this the path towards cohesion?

Experiencing a prolonged revival of economic growth also in 2012, Latvia is praised by international organizations and commentators as the 'success story' of applying harsh austerity measures in order to adjust external imbalances. Being a small open economy, the country could significantly improve its export performance via wage cuts and substantial layoffs resulting in productivity and unit labour costs improvements. However, the question remains whether Latvia will be able to continue its economic catching-up process towards Western Europe while preventing further boom-bust cycles in the future. The country's anticipated accession to the eurozone in 2014 will reduce the cost for refinancing the government and private debt burdens, but should not be expected to serve as a shelter against future economic backslides.

Latvian exporters continued to improve their competitive position in 2012 and increased their shares not only in the markets of their main trading partners but found also new niches for their products. Growth in exports abated compared to 2011, as it did throughout the European Union, but remained at a remarkably high pace. Slower growth in investments and a reduced pace of restocking resulted in imports evolving less swiftly. For 2013 we expect a further slowdown of export growth although the Baltic neighbours and Russia will back external demand growth. Thus the contribution of net exports to GDP growth will once again become negative.

Growth in gross fixed capital formation, which was particularly volatile last year, is expected to slow down in the first half of 2013. Exporters will be reluctant to expand their investments unless they see external demand speeding up again. Nevertheless, entrepreneurs report to have reached high levels of capacity utilization in 2012, for the first time after the onset of the crisis. Most likely the government will take advantage of the good progress of revenues and increase somewhat investments in the public infrastructure. The upcoming elections at the municipal level in June 2013 and at the national level in 2014, as well as Riga becoming European Capital of Culture in 2014, will be drivers of additional expenditures.

Employment continued to grow throughout 2012, most prominently in the non-tradable sectors, but also in manufacturing. In total, the increase amounted to about 3% year on year. However, due to the massive layoffs during the crisis and substantial emigration total employment is still about 15% below the level five years ago. Job creation will slow down this year but will still reach roughly 2% per annum. The unemployment rate dropped to about 13.5% of the active population towards the end of 2012. However, we expect economic growth in 2013 to be too low to bring about fast improvements on the Latvian labour market.

Latvian employees also experienced a slight speed-up of the increase in net wages last year, by 1.5% in real terms. This trend is most likely to strengthen, given the fall in the unemployment rate and still low consumer price inflation. Thus consumption of private households will become the main driver of economic growth in 2013.

The lively economic activity of 2012 resulted in increased tax revenues of the government. At the same time public expenditures were kept almost unchanged compared to 2011 in real terms. Thus the finance ministry could present a budget deficit of 1.4% of GDP for 2012. The budget for 2013, approved already in mid-November last year, foresees a deficit of 1.4% of GDP this year as well. The flat rate of the income tax was reduced from 25% to 24% from January 2013 onwards, while the untaxed income was left unchanged and the monthly guaranteed minimum income benefit was cut from EUR 65 to EUR 50. Child care benefits for parents with children up the age of 1½ years were substantially raised again as of January 2013 after having been cut back during the crisis. The medium-term budget plan foresees an increase of investments in the public transport and energy infrastructure.

Although the country has succeeded in overcoming the worst of the economic crisis, the deep scars in Latvian society remain apparent. Apart from the still high unemployment rate – which would be even higher by more than 2 percentage points if including discouraged workers who have abandoned their search for work – Latvia suffers from widespread poverty and high income inequality.. The changes to the income tax law, approved together with the 2013 budget, foresee a further reduction of the personal income tax rate to 22% in 2014 and 20% in 2015. This will not only reduce the income base of the government required to perform the necessary upgrading of public infrastructure, e.g. in health and education, but will moreover further increase the high levels of income inequality in the country.

The reduction of the VAT rate in 2012 will continue to hold down consumer inflation in the first half of the year. Thus the Maastricht criteria will most certainly be met at the time of assessment by the European Commission in late spring this year. The Latvian government started to campaign broadly for its aim to join the eurozone in 2014, which in December 2012 was supported by only one third of the Latvian population.

The upswing of economic growth has made Latvia a trustable debtor again to international lenders. Thus in December 2012 the Latvian government could place 7-year government bonds at the international markets, with a volume of about 10% of the public debt at an interest rate below 3% per annum. The money was inter alia used to make an early repayment of all outstanding obligations to the IMF that had accrued from the rescue package granted in 2008.

Given the stagnant economic development in the eurozone, GDP growth will decline also in Latvia, from 5.4% last year to 3.8% in 2013. The further outlook is based on the assumption of a general improvement of economic activity in Europe in 2014, which should allow Latvian producers to further exploit their export possibilities and increase entrepreneurs' appetite in general to expand their capacities. Thus we expect GDP growth to revive to 4.3% in 2014 and 4.5% in 2015.

Sebastian Leitner

Lithuania:
Economy continues to recover

The new centre-left coalition government which started to work in December last year had a turbulent start with headwinds from President Dalia Gribauskaite. Moreover, the parliamentary immunity of three members of one of the coalition partners, the centre-populist Labour Party, has been lifted due to accusations of illegal party financing. But the coalition seems to have overcome these challenges and its will to stay in power will serve as glue. Government measures – either already introduced or being planned – will lift the income of low- to medium-wage earners and thus foster the growth of domestic demand. In addition, a rise in public and private investment and the still comparably favourable external conditions in the neighbourhood will result in a slight strengthening of economic activity in 2013 and thereafter.

After slowing down markedly at the beginning of 2012, growth in exports of goods speeded up again in the second half of last year. Almost half of the nominal increase in exports achieved in 2012 however accrued from the outstanding harvest, which was 25% higher in 2012 than a year earlier, and from higher revenues of the Mazeiku Nafta refinery resulting inter alia from rising prices of oil products. Since both circumstances will most likely be less favourable this year and external demand from the Baltic neighbours will also weaken slightly we expect Lithuania's growth in goods exports to decline as well. Nevertheless, falling crude oil prices will also reduce the nominal growth of imports and thus the contribution of net exports to overall GDP growth will still remain balanced.

Entrepreneurs were reluctant to expand investments last year given the uncertain prospects for external demand. Moreover, households and companies refrained from taking up new credits to invest in dwellings and other construction activities. As a result, the construction output declined in 2012. As the Lithuanian refinery reduced its stock of crude oil in the phase of high prices, overall capital investment even declined. However, this year we expect private but even more so public investment activity to speed up again.

The new government led by the Social Democratic party has announced plans to step up investments in public infrastructure. Also considerable investments in the energy and transport infrastructure start being realized this year. With financial assistance from the EBRD and the Swedish bank group SEB an international container distribution centre will be constructed in Klaipeda, the most important Lithuanian port. To be finalized in 2015, the port will attract ocean-going container ships from all over the world which up to now have to reload their cargo to smaller vessels in German or Dutch ports in order to supply the eastern shores of the Baltic Sea. The handling volume is expected to increase up to four times. Another project, which will remove Lithuania's present complete de-

Table LT

Lithuania: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	3358.1	3339.5	3286.8	3029.3	2993.6	2979	2964	2949
Gross domestic product, LTL mn, nom.	111920	92032	95323	106370	112411	121100	130400	140800
annual change in % (real)	2.9	-14.8	1.5	5.9	3.6	3.8	4.0	4.2
GDP/capita (EUR at exchange rate)	9700	8000	8400	10200	10900	.	.	.
GDP/capita (EUR at PPP)	15400	12800	14100	16600	17700	.	.	.
Consumption of households, LTL mn, nom.	73097	62807	60586	67150	72400	.	.	.
annual change in % (real)	3.7	-17.8	-4.8	6.3	4.5	5.0	4.5	4.5
Gross fixed capital form., LTL mn, nom.	28369	15807	15589	18901	19700	.	.	.
annual change in % (real)	-5.2	-39.5	1.9	18.4	1.0	7.0	10.0	12.0
Gross industrial production (sales)								
annual change in % (real)	5.5	-14.6	6.7	7.4	4.6	6.0	8.0	8.0
Gross agricultural production (EAA)								
annual change in % (real)	8.8	1.0	-7.2	10.3	10.0	.	.	.
Construction industry								
annual change in % (real)	4.0	-48.5	-7.7	22.2	-3.5	.	.	.
Employed persons, LFS, th, average 3)	1520.0	1415.9	1343.7	1370.9	1278.5	1295	1315	1330
annual change in %	-0.9	-6.8	-5.1	2.0	1.8	1.3	1.5	1.1
Unemployed persons, LFS, th, average 3)	94.3	225.1	291.1	248.8	195.2	177	163	148
Unemployment rate, LFS, in %, average 3)	5.8	13.7	17.8	15.4	13.2	12.0	11.0	10.0
Reg. unemployment rate, in %, end of period 4)	4.4	12.5	14.4	11.0	11.4	.	.	.
Average gross monthly wages, LTL 5)	2151.7	2056.0	1988.1	2045.9	2137.0	.	.	.
annual change in % (real, net)	10.1	-7.2	-4.3	-1.4	1.0	.	.	.
Consumer prices (HICP), % p.a.	11.1	4.2	1.2	4.1	3.2	3.8	3.5	3.6
Producer prices in industry, % p.a.	18.2	-13.5	10.3	13.9	5.0	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	34.0	34.3	33.6	31.9	31.5	32.2	32.0	32.0
Expenditures	37.2	43.7	40.8	37.4	34.3	34.5	34.0	34.0
Net lending (+) / net borrowing (-)	-3.3	-9.4	-7.2	-5.5	-2.8	-2.3	-2.0	-2.0
Public debt, EU-def., % of GDP	15.5	29.3	37.9	38.5	40.5	39.5	38.0	36.0
Central bank policy rate, % p.a., end of period 6)	7.84	1.57	1.07	1.24	0.52	.	.	.
Current account, EUR mn	-4194	996	20	-1151	-370	-700	-700	-800
Current account, % of GDP	-12.9	3.7	0.1	-3.7	-1.1	-2.0	-1.9	-2.0
Exports of goods, BOP, EUR mn	16077	11797	15651	20151	22900	24500	28000	32000
annual growth rate in %	28.5	-26.6	32.7	28.8	13.6	7.0	14.3	14.3
Imports of goods, BOP, EUR mn	20280	12688	16990	21958	24000	26000	30000	34000
annual growth rate in %	20.8	-37.4	33.9	29.2	9.3	8.3	15.4	13.3
Exports of services, BOP, EUR mn	3240	2629	3088	3738	4500	5250	6350	7800
annual growth rate in %	10.5	-18.9	17.5	21.0	20.4	16.7	21.0	22.8
Imports of services, BOP, EUR mn	2835	2192	2274	2742	3220	3700	4300	4900
annual growth rate in %	14.7	-22.7	3.7	20.6	17.4	14.9	16.2	14.0
FDI inflow, EUR mn	1341	-9	604	1040	800	1000	.	.
FDI outflow, EUR mn	229	143	-4	40	10	50	.	.
Gross reserves of NB excl. gold, EUR mn	4458	4472	4788	6120	6203	.	.	.
Gross external debt, EUR mn	23009	22363	22976	23976	26000	.	.	.
Gross external debt, % of GDP	71.0	83.9	83.2	77.8	79.9	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
Purchasing power parity LTL/EUR	2.1710	2.1363	2.0627	2.1198	2.1270	.	.	.

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

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

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

pendency on Russian natural gas, is the planned LNG terminal also to be constructed in Klaipeda. In the future it will cover up to 25% of Lithuania's gas demand. The construction should start this year and will most probably be finalized at the beginning of 2015.

One of the first acts of the newly formed government was to deliver one of the main campaign pledges of the Social Democratic Prime Minister Algirdas Butkevicius, namely to raise the minimum gross wage of employees by 17% to EUR 289 (EUR 239 net). This affects about 200 ths employees or 15% of the workforce. The minimum wage has persistently been criticized to be not only very low in nominal terms but also as compared to the national average of gross wages. For comparison, minimum gross wages in 2013 amount to EUR 320 in Estonia and EUR 282 in Latvia, while the average gross wage amounts to EUR 640 in Lithuania. The government has announced to allow small businesses delays in tax payment in order for them to be able to adapt to the new situation.

The increase in the purchasing power of low-income earners will further support the growth of domestic demand this year, which has already evolved swiftly in 2012. The Prime Minister moreover established an expert group in order to deliver suggestions for changes in the personal income tax system, inter alia with the aim to reduce the tax wedge of low-wage earners. However, whether the idea articulated by some Social Democrats prior to the elections that the flat tax system should be replaced by progressive income taxation will be realized is far from clear. A decision on the issue is looming towards the end of the year.

Employment rose substantially in 2012, by 1.8%, driven by job increases in industry, transport and the high-skill service sectors alike. The unemployment rate fell from more than 15% to about 13%. Although we expect that employment will continue to grow by 1.3% in 2013, we also expect labour supply to increase more strongly this year. Recent figures show that during the two years of deep recession almost 10% of the labour force left the country, which will be a detrimental factor for medium- to long-term economic growth. Assuming that the situation of the labour market improves in Lithuania within the next two years some of the migrant workers may return to their home country.

The budget for 2013, passed in October last year by the outgoing conservative government, foresees a reduction of the budget deficit to 2.5% of GDP. Since tax income is to continue to expand rather favourably and the refinancing costs of public debt are likely to fall, the target seems realistic. Thereafter the Lithuanian government may opt for a slower pace in reducing the budget deficit further.

In January Prime Minister Butkevicius reiterated that the new government will aim at joining the eurozone at the beginning of 2015 and announced that a concrete programme is to be worked out. However, it will become a difficult task to depress consumer inflation in order to conform to the Maastricht criteria. In 2012 consumer prices increased by 3.2%; for this year we even expect a slight acceleration. Depending on the decisions taken by the Ecofin council in the case of Latvia, the Lithuanian government may also try to solve this problem by lowering the VAT rate in mid-2013. It may however very well be that a postponement of the entry date will be announced towards the end of the year.

A still rather favourable development of external demand from the Baltic neighbours and Russia, an expected upswing in investments and robustly evolving household demand is to result in GDP growth by 3.8% in 2013. The scenario for the years to come is based on the assumptions of an acceleration of overall external demand next year, while domestic demand, including expenditures for the public wage bill and investments, will speed up slightly. Thus, we expect GDP growth to increase to 4% in 2014 and 4.2% in 2015.

Leon Podkaminer

Poland:
Not so soft landing ahead

In the third quarter of 2012 Poland's GDP growth slowed down to a mere 1.4%. Consumption, both private and public, remained essentially flat. Gross fixed capital formation, which still looked strong in the first quarter of the year when it increased by 6.7%, fell 1.5% in the third. Inventories contracted further. All in all, domestic demand, falling slightly in the second quarter of 2012 (for the first time in 13 quarters), fell again in the third quarter – but this time already by 0.7%. External trade in goods and services saved the day, with the volume of imports reduced by 3.7% and the volume of exports rising still, by 0.7%.

Growth in the fourth quarter must have been even more disappointing. The volumes of industrial and construction output (sales) suddenly plummeted in December (by over 10% and 25% year-on-year, respectively). To some extent these developments reflect unfavourable weather conditions (early and harsh winter directly affecting construction and transport activities) as well as the fact that December 2012 had 2 working days less than the previous one.

The slowdown in household consumption growth mirrors the developments in real disposable incomes of the household sector. Stagnant employment and wages (whose real purchasing power has been additionally eroded by hikes in administered prices of energy and communal services) are just one ingredient of the weakening household consumption. Households' rising propensity to save is the second. Within 2012 the stock of household sector credit liabilities rose symbolically, by 0.2% in nominal terms. But simultaneously there was a quite strong (7.7%) increase in households' bank deposits. The reasons behind the households' increased propensity to save are manifold. Rising unemployment and enhanced uncertainties are decisive. Generally, the consumers seem to share the corporate sector's pessimistic short- and medium-term (up to six months) expectations. These expectations, revealed by the recent business climate surveys[24], have been worsening over time (though in some sectors, including construction, the managers suggest they 'see the light at the end of the tunnel'). Also, lending to households has been strongly suppressed by banks' compliance with the safety recommendations imposed by the national Financial Supervision Authority. These recommendations, generally considered to have been excessively restrictive, are being softened. This is unlikely to help much, given the current depressed consumer sentiments. On the other hand, the maintenance of irrationally high policy interest rates seems to be doing real harm to the financial position of the household sector.

The financial situation of the enterprise sector (non-financial firms operating outside agriculture and employing 49 persons or more), which had looked quite well in the first quarter of 2012, has been

[24] See http://www.nbp.pl/publikacje/koniunktura/raport_1_kw_2013.pdf.

Table PL

Poland: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	38126	38152	38184	38534	38560	38540	38530	38525
Gross domestic product, PLN bn, nom.	1275.5	1344.5	1416.6	1523.2	1610.0	1680	1770	1870
annual change in % (real)	5.1	1.6	3.9	4.3	2.0	1.5	2.7	3.5
GDP/capita (EUR at exchange rate)	9500	8100	9200	9600	10000	.	.	.
GDP/capita (EUR at PPP)	14100	14200	15300	16200	16700	.	.	.
Consumption of households, PLN bn, nom.	773.8	809.7	856.2	920.5	960.0	1000	1050	1110
annual change in % (real)	5.7	2.1	3.1	2.6	0.5	1.2	2.0	3.5
Gross fixed capital form., PLN bn, nom.	283.9	284.6	281.3	309.7	320.0	330	350	380
annual change in % (real)	9.7	-1.3	-0.4	9.0	0.6	0.0	4.0	6.0
Gross industrial production (sales) 3)								
annual change in % (real)	2.6	-3.7	11.1	6.9	1.2	1.5	5.0	7.0
Gross agricultural production (EAA)								
annual change in % (real)	0.3	6.1	-3.2	-1.0	3.5	.	.	.
Construction industry 3)								
annual change in % (real)	9.8	4.7	3.9	15.5	-5.2	.	.	.
Employed persons, LFS, th, average 4)	15799.8	15868.0	15960.5	16130.5	15600.0	15600	15630	15710
annual change in % 4)	3.7	0.4	0.6	1.1	0.2	0.0	0.2	0.5
Unemployed persons, LFS, th, average 4)	1210.7	1411.1	1699.3	1722.6	1800.0	1800	1780	1750
Unemployment rate, LFS, in %, average 4)	7.1	8.2	9.6	9.7	10.3	11.0	10.8	10.5
Reg. unemployment rate, in %, end of period	9.5	11.9	12.3	12.5	13.4	13.6	13.3	13.0
Average gross monthly wages, PLN	2942.2	3101.7	3224.1	3403.5	3540.0	3670	3790	3920
annual change in % (real, gross)	5.9	2.0	1.4	1.4	0.0	0.8	0.8	1.5
Consumer prices (HICP), % p.a.	4.2	4.0	2.7	3.9	3.7	2.8	2.5	2.0
Producer prices in industry, % p.a.	2.4	3.9	2.3	7.5	3.3	3.0	2.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	39.5	37.2	37.6	38.5	39.4	39.1	38.9	.
Expenditures	43.2	44.6	45.4	43.6	42.8	42.2	41.8	.
Net lending (+) / net borrowing (-)	-3.7	-7.4	-7.9	-5.0	-3.4	-3.4	-3.3	-3.0
Public debt, EU-def., % of GDP	47.1	50.9	54.8	56.4	55.5	56.5	56.0	56.0
Central bank policy rate, % p.a., end of period 5)	5.0	3.5	3.5	4.5	4.3	4.00	3.75	3.50
Current account, EUR mn 6)	-23818	-12153	-18121	-17974	-12900	-12000	-14900	-16500
Current account, % of GDP	-6.6	-3.9	-5.1	-4.9	-3.4	-3.0	-3.5	-3.7
Exports of goods, BOP, EUR mn 6)	120953	101715	124998	140137	146200	152200	160300	172300
annual growth rate in %	14.2	-15.9	22.9	12.1	4.3	4.1	5.3	7.5
Imports of goods, BOP, EUR mn 6)	141896	107140	133893	150193	152100	156700	166100	179400
annual growth rate in %	18.5	-24.5	25.0	12.2	1.3	3.0	6.0	8.0
Exports of services, BOP, EUR mn 6)	24207	20717	24718	26950	28800	31100	33600	37000
annual growth rate in %	15.2	-14.4	19.3	9.0	6.9	8.0	8.0	10.0
Imports of services, BOP, EUR mn 6)	20729	17294	22381	22905	24500	26200	28300	31700
annual growth rate in %	17.9	-16.6	29.4	2.3	7.0	7.0	8.0	12.0
FDI inflow, EUR mn 6)	10135	9339	10518	13642	3000	.	.	.
FDI outflow, EUR mn 6)	3071	3331	5489	5280	1000	.	.	.
Gross reserves of NB excl. gold, EUR mn	42299	52734	66253	71028	78403	.	.	.
Gross external debt, EUR mn	173736	194396	237359	248085	272000	280000	290000	310000
Gross external debt, % of GDP	47.8	62.6	66.9	67.1	70.7	.	.	.
Average exchange rate PLN/EUR	3.5121	4.3276	3.9947	4.1206	4.1847	4.20	4.20	4.15
Purchasing power parity PLN/EUR	2.3746	2.4767	2.4040	2.4424	2.4937	.	.	.

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

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

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

progressively worsening in the second and third quarters. The entire net (post-tax) profit of the sector earned in the first three quarters of 2012 reached PLN 67.2 billion (approximately EUR 16 billion) – down from PLN 77.4 billion earned during the first half of 2011. While profits of manufacturing increased by 8.7%, profits of other major sectors decreased. Construction, which had made a net profit of PLN 1.7 billion a year earlier, closed the first three quarters of 2012 with a net loss of PLN 0.8 billion. The weakening of profits has much to do with weakening demand and fiercer competition – both showing up in a mild producer price deflation (prevailing throughout much of 2012).

Despite the contraction of profits, the corporate sector still disposes of huge (and rising) own financial resources much of which are resting on the corporate sector's bank deposits.

The big boom in infrastructure investment (financed out of the public purse and supported by EU transfers) is already over, at least for the time being. Given the weakening domestic and external demand, no strong expansion of aggregate business investment is to be expected in the near future either. It must be stressed that the business sector can rely primarily on own means for the financing of expanded investment. Its dependence on bank loans is limited in this respect. Nonetheless, rather high interest rates on loans – a by-product of the National Bank's restrictive policy – surely must have some negative consequences for investment (and current) activities of the business sector.

The financial standing of the banking system remains strong. According to the recent (December 2012) Financial Stability Report of the National Bank of Poland, banks' own funds rose 12.4% in 2012 (due primarily to the accumulation of profits in 2011). Consequently, the average capital adequacy ratio has increased to over 14% in the first three quarters of 2012. Strong profits have been accruing to banks in 2012 as well. During the first three quarters of 2012 the net profits of banks rose to over PLN 12 billion (up from 11.8 billion the year previous). Slow GDP growth expected in the fourth quarter of 2012 and in the first half of 2013 will certainly affect the dynamics of banks' incomes and their risk absorption capacities negatively. By the end of September 2012 the shares of 'endangered' credits still did not look bad. (These shares stood at 11.4% for credits to the non-financial corporate sector and at 7.5% for credits to households.) The Financial Stability Report concludes (on conducting extensive analyses and stress tests) that Poland's banking (and broader financial) system continues to be well equipped to cope with the consequences of even unusually severe shocks hitting the economy.

The soundness of Poland's financial sector may have been due not only to the active involvement of the domestic financial supervision authority. Arguably, the restrictive orientation of the national monetary policy – maintained in times good as well as bad – may have played some positive role too. Currently though it is rather difficult to praise that orientation – not only because of the likely effects of monetary restrictiveness (stubbornly high interest rates) on consumption and investment. Worse still, that policy may have accelerated very high inflows of portfolio investment, preventing a depreciation of the domestic currency. But, given the stagnation of domestic demand, a measured depreciation may be of central importance for preserving positive trends in foreign trade (and thus for avoiding outright GDP recession).

All in all, the Polish economy faces rather tough times in 2013. Growth seems likely to be very weak at first – but with falling inflation giving some limited boost to real disposable incomes and consumption. Public spending is likely to be temporarily increased, even if this would not be compatible with the declared fiscal consolidation strategies. Some acceleration of growth in the second half of the year should follow first the improvements in foreign trade (primarily exports, driven by growth speed-up in the euro area and a likely corrective weakening of the Polish zloty) and then finally by a stronger revival in investment activities.

Gábor Hunya

Romania:
Sobered optimism

The performance of the Romanian economy deteriorated significantly in the second half of 2012. Economic growth came to a standstill (GDP up by 0.2%) for the whole year. The underperformance was due to devastating results in agriculture and on the farm consumption; lately also to falling exports and general consumer demand. The only bright spot, at least on paper, was gross fixed capital formation which grew by 13% in the first three quarters of the year. The investment miracle is mainly explained by public infrastructure projects finalized and transferred from inventories to fixed capital investments while gross capital formation rose only by 2.9%. Recovering investments and construction had positive if modest growth effects.

The restructuring of industrial production and exports continued in 2012 by declining shares of light industries, chemicals and metals and increasing shares of machinery and transport equipment. Romania has for some time become a country with processing industries integrated into European corporate networks and an export performance far above the pre-crisis level. The closure of the Nokia factory, however, triggered a decline in the production and exports of telecommunication equipment. At the same time, the production and exports of electronic products and other transport equipment got a significant boost. Also the car industry could uphold production despite falling domestic demand. Next to sluggish foreign demand, increasing production costs undermined the competitiveness of some chemical plants while numerous SMEs and state-owned enterprises suffered from high debts and mismanagement.

In the 2013 budget that has been agreed upon with the IMF, the government sets modest targets: the budget is based on GDP growth of 1.6%, a fiscal deficit of 2.4% and an average exchange rate of 4.5 RON/EUR. The wiiw forecast reckons with marginally lower growth and higher deficits but finds the government targets grossly in line with reality.

Expenditures of the 2013 budget have been set lower than proclaimed in the election campaign last year. The increase of the minimum monthly wage does not go up immediately to RON 800 but in two instalments as of February and July. Outlays are to increase for SME support and the finalization of EU projects which is especially necessary as the actual rate of structural and cohesion funds absorption was 14.92% of the disposable funds at the end of 2012. At the same time, investment projects financed from the government budget receive much lower funding than before bringing, among other things, the construction of the North-Transylvanian motorway, infamous for its exploding costs, to a standstill.

Table RO

Romania: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	21514	21480	21438	19070	19000	18950	18900	18900
Gross domestic product, RON mn, nom.	514700	501139	523693	556708	589500	634200	679200	729600
annual change in % (real)	7.3	-6.6	-1.1	2.2	0.2	1.5	2.0	2.3
GDP/capita (EUR at exchange rate)	6500	5500	5800	6900	7000	.	.	.
GDP/capita (EUR at PPP)	11700	11100	11400	13300	13500	.	.	.
Consumption of households, RON mn, nom.	327928	304667	327242	345047	364400	.	.	.
annual change in % (real)	9.0	-10.4	-0.3	1.2	0.0	1.0	1.5	1.5
Gross fixed capital form., RON mn, nom.	164279	122442	129422	144558	167900	.	.	.
annual change in % (real)	15.6	-28.1	-1.8	7.3	10.0	1.0	4.0	5.0
Gross industrial production 3)								
annual change in % (real)	2.6	-5.5	5.5	5.6	0.0	3.0	5.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	21.2	-2.2	1.0	8.9	-22.7	.	.	.
Construction industry 3)								
annual change in % (real)	26.7	-15.0	-13.2	2.8	-0.4	.	.	.
Employed persons, LFS, th, average	9369.1	9243.5	9239.4	9137.7	9280.0	9300	9300	9400
annual change in %	0.2	-1.3	0.0	-1.1	1.6	0.2	0.0	1.1
Unemployed persons, LFS, th, average	575.5	680.7	725.1	730.2	710.0	.	.	.
Unemployment rate, LFS, in %, average	5.8	6.9	7.3	7.4	7.1	7.0	7.0	6.5
Reg. unemployment rate, in %, end of period	4.4	7.8	7.0	5.2	5.6	.	.	.
Average gross monthly wages, RON	1761	1845	1902	1980	2079	.	.	.
annual change in % (real, net)	16.5	-1.5	-3.7	-1.9	1.7	.	.	.
Consumer prices (HICP), % p.a.	7.9	5.6	6.1	5.8	3.4	4.2	3.5	3.5
Producer prices in industry, % p.a.	15.3	1.8	6.3	8.9	6.0	.	.	.
General governm.budget, EU-def., % of GDP								
Revenues	33.6	32.1	33.3	33.6	33.3	.	.	.
Expenditures	39.3	41.1	40.1	39.4	36.1	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-9.0	-6.8	-5.7	-2.8	-2.8	-2.8	-2.8
Public debt, EU-def., % of GDP	13.4	23.6	30.5	33.4	36.0	36.0	37.0	37.0
Central bank policy rate, % p.a., end of period 4)	10.25	8.00	6.25	6.00	5.25	.	.	.
Current account, EUR mn	-16178	-4938	-5476	-5937	-5039	-6000	-7000	-8000
Current account, % of GDP	-11.6	-4.2	-4.4	-4.5	-3.8	-4.2	-4.6	-4.9
Exports of goods, BOP, EUR mn	33656	29091	37333	45274	45043	46400	50100	54100
annual growth rate in %	13.9	-13.6	28.3	21.3	-0.5	3.0	8.0	8.0
Imports of goods, BOP, EUR mn	52729	35959	44901	52683	52356	53900	58200	62900
annual growth rate in %	11.3	-31.8	24.9	17.3	-0.6	3.0	8.0	8.0
Exports of services, BOP, EUR mn	8751	7061	6622	7253	7517	7900	8500	9200
annual growth rate in %	27.1	-19.3	-6.2	9.5	3.6	5.0	8.0	8.0
Imports of services, BOP, EUR mn	8091	7352	6216	6913	6939	7300	8000	8800
annual growth rate in %	25.0	-9.1	-15.5	11.2	0.4	5.0	10.0	10.0
FDI inflow, EUR mn	9501	3490	2227	1814	1613	1800	.	.
FDI outflow, EUR mn	186	-61	-12	-24	57	0	.	.
Gross reserves of NB excl. gold, EUR mn	25977	28249	32606	33166	31206	.	.	.
Gross external debt, EUR mn	72354	81206	92458	98724	99209	.	.	.
Gross external debt, % of GDP	51.8	68.7	74.4	75.2	75.0	.	.	.
Average exchange rate RON/EUR	3.6826	4.2399	4.2122	4.2391	4.4593	4.42	4.45	4.50
Purchasing power parity RON/EUR	2.0425	2.1047	2.1414	2.2031	2.2916	.	.	.

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

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) Enterprises with 4 and more employees. - 4) One-week repo rate.

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

The revenue side of the government budget has been strengthened by several new measures. Micro enterprises are taxed according to their turnover and not their incomes. Agricultural producers and owners of herds are subject to new taxes. Additional taxes have been introduced on gas producers which are enjoying higher profits as a result of energy price rises: gas producers (Romgas and OMV-Petrom) will pay a tax of up to 60% on the additional income resulting from price hikes. As royalties on mining activities cannot increase under the present contracts until 2015, the government introduced an additional temporary tax of 0.5% of turnover on firms exploiting natural resources. Additional taxes have also been introduced on electricity and gas transporters.

The government has expressed its wish to sign a new stand-by agreement with the IMF, World Bank and the EU Commission similar to the one expiring in spring 2013. Such a treaty would provide emergency support in case of unforeseen financial difficulty, provided conditionalities are met. The most important of the targets, the fiscal stance, stayed prudent in the 2012 election year (unlike in earlier instances) and the government is committed to maintain fiscal prudence, thus the country is bound to leave the excessive deficit procedure in 2013. Further IMF conditions include measures to reduce public subsidies to the economy by restructuring and privatizing lossmaking public companies, stipulate reforms in the pension and the healthcare system, and set measures aiming at better targeting of social support. The government has grossly underperformed in terms of these structural reforms by delaying measures and their implementation. The prime minister spelled out hopes to obtain an extension by 3-5 months of the deadlines provided by the accord with the IMF on structural reforms. During this time, several state-owned companies will have to receive private management, undergo restructuring and minority shares should be floated on the stock exchange. Further companies that need a capital injection unavailable from the state budget are envisaged for privatization by auction, such as the freight transport company of the state railways, an act imposed against the government’s wish.

As to monetary policy, the liquidity steering of the National Bank of Romania (BNR) has become an issue of dispute in early 2013. The interest rate and amount of weekly REPO operations by which the BNR offers cash to commercial banks in exchange for state bonds constitute the main tools to steer the liquidity of commercial banks.[25] The policy rate was cut in several steps from 6% in December 2011 to 5.25% in April 2012 and has been kept at the same level in view of exchange rate deteriorations following political uncertainties before the December elections. The BNR considers limiting the amounts at REPO auctions, a faster and more effective method of action than modifying the policy interest rate, expecting also a stronger impact on the exchange rate. Domestic currency liquidity and the exchange rate are connected. Therefore, when the RON/EUR rate climbed above 4.5 in the last quarter of 2012, the BNR squeezed liquidity by curtailing the weekly REPO sales to RON 4 billion, leaving banks’ demand grossly unsatisfied. This policy continued also in the first weeks of January 2013 despite a remarkable firming of the domestic currency. A minority opinion emerged in the Board of the BNR advocating a relaxation of the liquidity squeeze with the aim of

25 The one-week REPO rate has been the ‘monetary policy interest rate’ since March 2011 which is fixed every month at the BNR Board meeting. The interest rates on the NBR's standing facilities, i.e. the deposit facility and the lending facility, have been set at +/- 4 percentage points around the monetary policy rate.

supporting economic growth. This opinion may get the upper hand in subsequent months if currency stability is maintained and inflation does not speed up.

The exchange rate and inflation are closely connected not only through market operations but also by influencing administered prices of energy, gas and excise duties. Starting 1 January 2013, the electricity price rose by 10% incorporating higher production and import costs as well as higher aid granted to producers of renewable energy. The excise duties paid for liquor, cigarettes, energy products and coffee increased mainly because of the higher exchange rate used in calculating them. Gas prices for the population will rise by 8% on 1 July and by an additional 2% from October and again by 10% in 2014 in accordance with the calendar for reducing price subsidies. In the case of companies the increase will be much harsher, putting an end to the competitive edge of energy-intensive industries. Cheap gas and electricity to major consumers had been one of the primary industrial policy tools of previous Romanian governments by which they breached EU norms stipulated by the accession agreement. The increase in energy prices to international level will put an end to the competitiveness of energy-wasting industries; the bankruptcy of the Oltchim chemical company may just have been the first victim.

The current account deficit shrank in 2012 on account of vanished FDI income and improved services balances while the trade balance (also exports and imports in euro terms) remained at the level of the previous year. The first instalments of the outstanding debt to the IMF were paid by depleting the National Bank's reserves.

2013 will be a peak year in the public debt repayment calendar with EUR 15.2 billion falling due. The government will have to demonstrate prudence in view of the necessary bond issue activity and/or depleting official reserves. Thus, however solid the current fiscal and monetary situation may look, risks are high unless the impact of the euro area monetary easing – which brought down public bond refinancing costs in January – proves lasting. A modest increase in household demand and investments is expected to give some boost to the economy while net exports may not have a positive contribution again due to sluggish external demand. The GDP growth in the wiiw forecast of 1.5% in 2013 may materialize already in case of recovering agriculture. The more optimistic forecast for subsequent years is based on the recovery of main foreign markets.

After a year of political uncertainty a new government was formed in December 2012 which enjoys the support of two-thirds of the MPs. In the election campaign the Social-Liberal coalition promised an end to fiscal austerity and to introduce wage increases and tax reliefs during the four-year legislative period. The coalition also committed to reduce VAT from 24% to 19% by the end of its term in 2016 and a lower value-added tax on foodstuffs. Another promise is to keep the current flat personal income tax of 16%, but later the proposed rates would be 8%, 12% and 16%. They also envisage a stepwise increase of the minimum wage to RON 1200 by 2016. However, in January 2013 the government agreed with the IMF to further reduce fiscal deficits towards 2% of GDP. It is quite likely that the outlined stimulus to consumption will suffer delay and the 3% average annual GDP growth anticipated by the government will not materialize, at least not in the first three years of the legislative period.

Doris Hanzl-Weiss

Slovakia:
Will export-led growth continue?

In 2012, Slovak GDP growth slowed down, but did well as compared to the other countries of the European Union: GDP grew by about 2%. Growth came exclusively from net exports: in the first three quarters of 2012 exports expanded by 9% – thanks to growing exports of cars not only to the shrinking European car markets but also to China, Russia and the US, while imports increased by merely 2%. Household consumption remained flat due to high unemployment and falling real wages. This was also a result of the surge of inflation that year, with consumer prices going up by 3.7%. Savings were on the rise due to negative future expectations. Government consumption slightly declined as fiscal consolidation was (slowly) on track. Gross capital formation fell by almost 12%, because of destocking and a drop in gross fixed capital formation by 3% (data for the first three quarters of 2012).

As regards branches, GDP growth came mostly from huge production increases in the transport equipment sector, surging by 44% in 2012. This was due to the three foreign-owned car manufacturers VW Bratislava, PSA Peugeot-Citroën and Kia – all located in the more prosperous Western region of Slovakia – introducing a third shift at the beginning of the year. (However, PSA Peugeot-Citroën then halted production at the end of the year for several days.) This translated into an increase in manufacturing production of about 12% in 2012. Other manufacturing sectors such as electrical equipment, textiles and clothing and the metals sector grew as well, while production of e.g. refining and chemicals was falling. The construction industry again did very badly in 2012; it shrank the fourth year in a row, resulting in a total contraction by one third compared to the 2008 level. The services sector, on the other hand, experienced small positive growth.

GDP growth was not reflected on the labour market: while employment increased somewhat at the beginning of 2012, its growth reversed in the second half. Unemployment went up at the end of 2012 probably in anticipation of changes in the Labour Code from January 2013 onwards – laying off people has become more expensive, the labour market less flexible. The unemployment rate climbed to 14%. Slovakia struggles with high long-term unemployment (9.2% of active population in 2012 Q3), high youth unemployment (34.4% of youth labour force in 2012 Q3) as well as with huge regional disparities, with regions in the East recording the highest unemployment rates (19.9% in the Košice region, which has a high number of Roma population). The main employer in the East is US Steel Košice with a workforce of 11,000 people. Recently rumours have appeared that US Steel wants to quit Slovakia (possibly due to heavy investment needs for environmental compliance) which would mean a setback to the region. However, unlike in Serbia, where US Steel left at the beginning of 2012, interest has been expressed for the Košice steelworks and the position of the company is there better (as regards products, smaller losses in 2011). US Steel became owner in 2000 and

Table SK

Slovakia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	5406.6	5418.6	5430.1	5398.4	5410.0	5420	5430	5440
Gross domestic product, EUR mn, nom.	66842	62794	65870	69108	73100	76000	80200	84300
annual change in % (real)	5.8	-4.9	4.2	3.3	2.0	1.0	2.4	3.0
GDP/capita (EUR at exchange rate)	11900	11600	12100	12800	13500	14000	14800	15500
GDP/capita (EUR at PPP)	18100	17100	17900	18500	19200	.	.	.
Consumption of households, EUR mn, nom.	37573	37637	37735	39003	40200	.	.	.
annual change in % (real)	6.0	0.1	-0.8	-0.5	-0.5	0.0	1.0	3.0
Gross fixed capital form., EUR mn, nom.	16576	13025	13851	15957	16100	.	.	.
annual change in % (real)	1.0	-19.7	6.5	14.2	-3.0	2.0	3.0	4.0
Gross industrial production								
annual change in % (real)	3.1	-14.1	18.3	7.2	10.3	3.0	4.0	4.0
Gross agricultural production (EAA)								
annual change in % (real)	10.6	-12.3	-8.2	8.7	-9.6	.	.	.
Construction industry								
annual change in % (real)	11.9	-11.2	-4.6	-1.8	-12.5	.	.	.
Employed persons, LFS, th, average 3)	2433.7	2366.3	2317.5	2351.4	2330.0	2330	2350	2370
annual change in % 3)	3.2	-2.8	-2.1	1.5	0.5	0.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	255.7	323.5	389.2	368.3	380.0	.	.	.
Unemployment rate, LFS, in %, average 3)	9.5	12.0	14.4	13.5	14.0	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	8.4	12.7	12.5	13.6	14.4	14.5	14.0	13.0
Average gross monthly wages, EUR	723	745	769	786	800	.	.	.
annual change in % (real, gross)	3.3	1.4	2.2	-1.6	-1.4	.	.	.
Consumer prices (HICP), % p.a.	3.9	0.9	0.7	4.1	3.7	3.0	3.0	2.0
Producer prices in industry, % p.a.	2.5	-6.6	0.1	4.4	2.1	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	32.8	33.5	32.3	33.2	32.7	.	.	.
Expenditures	34.9	41.5	40.0	38.2	37.6	.	.	.
Net lending (+) / net borrowing (-)	-2.1	-8.0	-7.7	-4.9	-5.0	-3.5	-3.0	-2.5
Public debt, EU-def., % of GDP	27.9	35.6	41.0	43.3	51.8	54.8	56.5	56.2
Central bank policy rate, % p.a., end of period 4)	2.50	1.00	1.00	1.00	0.75	.	.	.
Current account, EUR mn	-4021	-1627	-2453	-1429	1600	1500	1500	800
Current account, % of GDP	-6.2	-2.6	-3.7	-2.1	2.2	2.0	1.9	0.9
Exports of goods, BOP, EUR mn	49521	39721	48272	56960	63000	65000	68000	70000
annual growth rate in %	17.2	-19.8	21.5	18.0	10.6	3.0	4.0	3.0
Imports of goods, BOP, EUR mn	50280	38775	47494	55985	59100	61000	63000	66000
annual growth rate in %	17.2	-22.9	22.5	17.9	5.6	3.0	4.0	4.0
Exports of services, BOP, EUR mn	6001	4342	4397	4750	5400	5700	6100	6400
annual growth rate in %	16.8	-27.6	1.3	8.0	13.7	5.0	7.0	5.0
Imports of services, BOP, EUR mn	6488	5367	5141	5120	5100	5300	5600	6000
annual growth rate in %	36.6	-17.3	-4.2	-0.4	-0.4	4.0	5.0	7.0
FDI inflow, EUR mn	3323	-4	1336	1542	1500	500	.	.
FDI outflow, EUR mn	376	652	714	353	240	200	.	.
Gross reserves of NB excl. gold, EUR mn 5)	12674	481	541	659	620	.	.	.
Gross external debt, EUR mn	37286	45338	49262	52934	53000	.	.	.
Gross external debt, % of GDP	57.9	72.2	74.8	76.6	72.5	.	.	.
Purchasing power parity EUR/EUR	0.6813	0.6790	0.6790	0.6910	0.7054	.	.	.

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

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

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

supplies the automotive industry, machinery and electro-technical industries. The European steel industry is currently negatively affected by the crisis, i.e. declining demand, low prices, and strong decline in the construction sector. The main obstacle to investment in Eastern Slovakia is still the missing highway connection to Košice. According to the most recent plans, the D1 highway to Košice will be completed by 2019 at the earliest, as nine stretches still have to be built.

Slovakia started 2013 with the celebration of its 20-year independence. Czechoslovakia ceased to exist on 31 December 1992 and the two new independent states emerged on 1 January 1993. This split was also named the 'Velvet Divorce'. While Slovakia's GDP per capita stood at 60% of the Czech one in 1993, the growth performance in the years following the split was, contrary to some expectations, higher than in the neighbouring countries and catching-up was impressive: in 2012, Slovakia achieved nearly 96% of the Czech GDP per capita level (at current PPPs) and it even overtook Hungary in 2007. All three countries have a successful transport equipment industry today, with shares in manufacturing value added of 18% in Slovakia, 20% in the Czech Republic and 17% in Hungary (2011). Per capita car production is even higher in Slovakia than in the Czech Republic (2011: 118 compared to 114 motor vehicles per 1000 inhabitants), while total vehicle production was about 640,000 in Slovakia compared to 1,200,000 in the Czech Republic in 2011 (for comparison: 202,800 in Hungary). The basic metals industry declined in the Czech Republic to 15%, while it increased in Slovakia to 20% of manufacturing value added, illustrating the importance of US Steel. The success of the Slovak industry has been based on low unit labour costs which have been about the same as in Hungary yet below the Czech level. Today, good relations prevail between the two countries; the Czech Republic is Slovakia's second most important trading partner after Germany and also vice versa: Slovakia is the second largest export partner (after Germany) also for the Czech Republic.

The year 2013 brought about the abolishment of the famous flat tax in Slovakia, introduced back in 2004 at 19%. In the wake of the budget consolidation undertaken by the Social Democratic government in place since the March 2012 elections, a range of revenue-based measures have been in place either since September 2012 or the beginning of 2013. As of 2013, there has been a rise in the income tax rate to 25% for individuals with monthly salaries topping EUR 3246 (however, the impact will be largely symbolic and irrelevant for revenues taking into account the average monthly wage of EUR 800). More important is the increase in corporate tax from 19% to 23%. Other measures introduced before included a partial shift of pension contributions from the second to the first pension pillar, the extension of the basis of the bank levy or a special levy on corporations active in regulated businesses. In addition, the social contribution burden increased, a 5% tax rate was put on selected public officials and some administrative fees were raised (e.g. higher car registration fees for more powerful cars). Overall, the government strives to meet the EU-based fiscal consolidation targets of deficit to GDP ratios set at 2.9% for 2013, 2.4% in 2014 and 1.9% in 2015. However, the weaker than expected growth performance as well as additional demands by certain occupational groups (e.g. teachers calling for an additional 5% salary increase, or nurses) may put a threat thereon. Even for 2012 we estimate the budget deficit at 5% of GDP, far above the target of 4.6%. While the public debt level stood at 43.3% of GDP in 2011, it climbed to about 52% in 2012, also due to ESM contribution payments. Thus it will exceed the 50% threshold stipulated in the Constitutional Law on Budgetary Responsibility ('debt brake law') introduced in 2011. As a result the finance minister will have to inform the parliament and propose remedial steps.

Car production and exports have been the main drivers of growth. The number of cars produced is reported to have increased to more than 900,000 in 2012 which means a surge of more than 40%. Kia produced 292,000 cars last year, an increase of 15%. For this year Kia plans to produce 290,000 cars and to start production of a new car model. Volkswagen increased its production by 22% in the first half of 2012 and planned to double car production to 400,000. Overall, car production in 2013 will be about the same as in 2012. As regards new foreign investors, they might be discouraged by frequent changes of laws: this year – apart from changes in taxes and the labour code – there will be changes in the law on investment aid (making it stricter), procurement law, and the building law. On the other hand, the minister of economy has recently presented 41 measures to decrease administrative hurdles and to improve the economic framework conditions. A major deal at the beginning of this year is the sale of a 49% stake of Slovakia's main gas utility SPP to the Czech Energetický a Průmyslový Holding (EPH) from Germany's E.ON Ruhrgas and France's GDF Suez, who bought the share back in 2002. The economic sentiment indicator has declined since July last year. Interestingly, there was a quite strong upward trend in industrial confidence (a component of the economic sentiment indicator) in December and a small one in January as well. It remains to be seen whether this has been only temporary or the start of a new upturn.

Overall, future prospects are less promising: the exceptionally high growth figures in the transport equipment sector and its exports in 2012 will not be repeated. Due to this level effect, GDP growth will slow down in 2013 to about 1%. Net exports are nevertheless likely to remain the main driver of growth, as other demand components of GDP continue to be weak: in the course of fiscal consolidation, government consumption will probably decline; household consumption will remain flat as well and investment will recover only slightly. There are main risks to this scenario: growth prospects are fragile not only for Germany and the Czech Republic – Slovakia's main trading partners – but also for the rest of the EU. Exports outside the EU – China, Russia and the US, where growth prospects are more promising – might however substitute for some export shortfalls coming from depressed European markets.

Hermine Vidovic

Slovenia:
Caught in political storm

In 2012 Slovenia faced another year of recession accompanied by fiscal tightening, deleveraging of banks and enterprises, growing social unrest and escalating political turbulence. GDP dropped by another 2% owing to a decline in domestic demand: gross fixed capital formation fell by almost 10%, household consumption dropped for the first time since the outbreak of the crisis and government consumption continued to decrease. Only foreign trade did contribute positively to GDP growth. The slump in investments was reflected primarily in the construction sector, where output continued to decline (-15%). A recovery of the construction sector is not in sight yet: there is still a huge stock of unsold apartments on the market and large infrastructure projects are lacking finance due to fiscal consolidation.

Along with the slowdown in export growth, industrial production stagnated in 2012. In the automotive sector, one of Slovenia's major export industries, the output of vehicles fell by 9%. Owing to declining demand in 2012, Slovenia's car manufacturer Revoz (Renault) was forced to cut shifts and adjust working time to avoid layoffs. In December the company decided to stop serial production until mid-January 2013. On the other hand, remarkable increases in production were reported in the manufacture of computers and optical products and machinery and equipment.

In foreign trade merchandise exports almost stagnated in 2012, and imports contracted. Thus, the trade deficit was reduced markedly (by EUR 750 million) compared with a year earlier. Owing to the declining trade deficit in goods, along with a surplus in the services trade, the current account closed with the highest surplus since the country's gaining independence. In contrast to our earlier expectations, the inflow of FDI remained at a disappointing level of around EUR 100 million.

The labour market situation has further deteriorated. Based on Labour Force Survey data, employment fell for the fourth consecutive year and was down by almost 2%; the unemployment rate rose slightly to 9%, but remained below the EU average. Unemployment based on registration data soared to 12.8%. A labour market reform bill aimed at the flexibilization of the labour market – dealing among other things with the elimination of labour market segmentation, population ageing, notice periods and changes in severance payment regulations – will be discussed in early March. Radical changes, however, are not to be expected due to the rigid stance taken by both the trade unions and the employer associations.

In December the Slovenian parliament adopted the 2013 and 2014 budgets with the main goal of balancing the budget by 2015. Accordingly the deficit should be reduced to 2.8% of GDP in 2013

Table SI

Slovenia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	2021.3	2039.7	2048.6	2052.8	2055.0	2055	2055	2055
Gross domestic product, EUR mn, nom.	37244	35556	35607	36172	36450	36800	37720	39240
annual change in % (real)	3.4	-7.8	1.2	0.6	-2.0	-1.5	0.5	2.0
GDP/capita (EUR at exchange rate)	18400	17400	17400	17600	17700	17900	18400	19100
GDP/capita (EUR at PPP)	22700	20300	20500	21000	20900	.	.	.
Consumption of households, EUR mn, nom.	19310	19547	20112	20675	20830	.	.	.
annual change in % (real)	2.5	0.2	1.4	1.0	-2.0	-3.0	0.2	1.5
Gross fixed capital form., EUR mn, nom.	10663	8225	7169	6694	6230	.	.	.
annual change in % (real)	7.1	-23.2	-13.7	-8.1	-9.5	-3.0	0.0	2.0
Gross industrial production								
annual change in % (real)	2.4	-17.3	6.2	2.1	0.0	1.0	2.0	2.0
Gross agricultural production (EAA)								
annual change in % (real)	-1.9	0.0	0.1	-0.5	-10.9	.	.	.
Construction industry 3)								
annual change in % (real)	15.5	-20.9	-16.9	-25.6	-17.0	.	.	.
Employed persons, LFS, th, average	996	981	966	936	920	900	900	910
annual change in %	1.1	-1.5	-1.5	-3.1	-1.7	-2.0	0.0	1.0
Unemployed persons, LFS, th, average	46	61	75	83	90	.	.	.
Unemployment rate, LFS, in %, average	4.4	5.9	7.3	8.2	8.9	9.5	9.5	9.0
Reg. unemployment rate, in %, end of period	7.0	10.3	11.8	12.1	12.8	13.5	13.0	12.5
Average gross monthly wages, EUR	1391	1439	1495	1525	1525	.	.	.
annual change in % (real, net)	2.0	2.5	2.1	0.3	-2.1	.	.	.
Consumer prices (HICP), % p.a.	5.5	0.9	2.1	2.1	2.8	2.5	2.0	2.0
Producer prices in industry, % p.a.	3.9	-1.4	2.0	4.6	0.9	2.0	2.5	2.5
General governm.budget, EU-def., % of GDP								
Revenues	42.4	43.1	44.5	44.3	44.2	.	.	.
Expenditures	44.3	49.1	50.3	50.7	48.2	.	.	.
Net lending (+) / net borrowing (-)	-1.9	-6.0	-5.7	-6.4	-4.0	-4.0	-3.5	-3.0
Public debt, EU-def., % of GDP	22.0	35.0	38.6	46.9	54.0	58.0	60.0	63.0
Central bank policy rate, % p.a., end of period 4)	2.50	1.00	1.00	1.00	0.75	.	.	.
Current account, EUR mn	-2295	-246	-210	1	874	600	300	200
Current account, % of GDP	-6.2	-0.7	-0.6	0.0	2.4	1.6	0.8	0.5
Exports of goods, BOP, EUR mn	20296	16410	18762	21264	21446	22100	23200	24400
annual growth rate in %	2.5	-19.1	14.3	13.3	0.9	3.0	5.0	5.0
Imports of goods, BOP, EUR mn	22681	16909	19760	22307	21741	22000	22400	23300
annual growth rate in %	5.7	-25.4	16.9	12.9	-2.5	1.0	2.0	4.0
Exports of services, BOP, EUR mn	4956	4347	4616	4838	5085	5300	5600	5900
annual growth rate in %	19.5	-12.3	6.2	4.8	5.1	5.0	5.0	6.0
Imports of services, BOP, EUR mn	3533	3182	3331	3395	3387	3400	3500	3600
annual growth rate in %	14.0	-9.9	4.7	1.9	-0.2	1.0	2.0	4.0
FDI inflow, EUR mn	1330	-470	271	719	112	.	.	.
FDI outflow, EUR mn	1003	187	-160	81	-85	.	.	.
Gross reserves of NB excl. gold, EUR mn	623	671	695	642	593	.	.	.
Gross external debt, EUR mn	39234	40294	40723	40241	40632	.	.	.
Gross external debt, % of GDP	105.3	113.3	114.4	111.2	111.5	.	.	.
Purchasing power parity EUR/EUR	0.8114	0.8561	0.8467	0.8387	0.8485	.	.	.

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

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

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

and 2.5% in 2014, mainly owing to expenditure cuts. The reduction of spending is expected through ‘adjustments in the public sector’, particularly by the cut of the public sector wage bill by 5% including a reduction of the workforce, increased VAT for certain items, lower transfers to municipalities and by the pension reform through more restrictive pension regulations and lower indexation to wages. On the revenue side the government reckons with high and very likely unrealistic inflows from EU funds. On top, tax increases of e.g. rental income, capital gains, student work and higher VAT rates on certain groups of goods are envisaged. However, there remain uncertainties about the actual amount of the deficit, as it is not yet clear how much the government will have to set aside for state guarantees and further capital injections (as a consequence of rising bad loans) into state-owned banks.

The pension reform, which is very similar to the proposal rejected in 2011 by a referendum, was eventually adopted by the Slovenian government in December 2012 and became effective from January 2013. The new legislation envisages a gradual increase of the retirement age for both men and women to 65 years (instead of currently 58 years for men and 55 years for women) by 2019. Long-term insured with 40 years of contributions are exempted from this regulation and can retire at the age of 60. The number of contributory years will be extended from 35 to 40 for both men and women, as will be the period for the pension assessment base, from the current 18 to 24 years.

A successful USD bond issue in October 2012 and the constitutional courts’ ban on referenda concerning the establishment of both a bad bank and a state holding company have – for the time being – staved off the risk of a bailout. Following these court decisions, as well as due to a general easing of the situation in the euro area, the yields of Slovenian ten-year government bonds fell temporarily to below 5% at the beginning of January 2013, after exceeding 7% in August 2012. The government plans to establish the announced bad bank in April 2013, which is very controversially discussed among Slovenian economists mainly because of the arising costs. The bank is envisaged to take over non-performing real estate and commercial loans of Slovenian banks in exchange for bonds backed by up to EUR 4 billion in state guarantees. The actual size of non-performing loans is not clear: according to the IMF definition bad loans amounted to 14.4% (EUR 7 billion) of total loans by the end of November 2012 or about 20% of the country’s GDP.

In late December 2012 KBC Bank from Belgium announced to sell its 22% share in Nova Ljubljanska Banka for EUR 2.8 million or EUR 1 per share to the Republic of Slovenia, which thus increased its ownership in the bank to 86%. In January a Restructuring Plan for the bank, which received capital injections by the state twice during the past two years, was submitted to the European Commission. The programme envisages inter alia the sale of all leasing and factoring services of the bank, prohibits the financing of huge construction projects as well as funding for financial holdings. Expected losses of the Slovenian banking system are given by the Bank of Slovenia at EUR 660 million in 2012 (as against EUR 540 in 2011).

When the Slovenian anti-corruption commission in early January 2013 found that Prime Minister Janez Janša and the leader of the main opposition party and mayor of Ljubljana Zoran Janković had systematically and repeatedly violated the law by not reporting their assets thoroughly, all coalition parties (except New Slovenia NSi) requested both politicians to step down. Following the Prime Minister's refusal to resign, three parties out of five left the government coalition. On 27 February Slovenia's parliament dismissed Mr Janša's government by a vote of no-confidence and appointed Alenka Bratušek, the interim leader of the centre-left Positive Slovenia party, as prime minister designate. Ms Bratušek, a financial expert by profession, will have to form a new government coalition of very different parties in the coming weeks – a failure would lead to early elections. The latter would mean the postponement of reform measures, a further loss of credibility, the risk of a further downgrade, and also a bailout becoming more likely. At the beginning of February 2013 Standard & Poor's cut Slovenia's credit rating by one notch to A-, the same level as given by Fitch Ratings. The agency noted that the downgrade reflects Slovenia's higher than anticipated debt burden due to the announced support for the ailing state-owned banks, but also the rising risks related to policy implementation.

Weak external demand and the attempted fiscal consolidation are the main reasons for the continuation of recession in Slovenia in 2013, and the economy will rebound only slowly thereafter. wiiw expects the GDP to decrease by another 1.5% in 2013 as a consequence of the planned austerity measures which will contribute to a continued drop in domestic demand. A slight recovery is likely in 2014 resulting from rebounding foreign demand. The corporate sector will continue to deleverage and the restructuring of the banking sector is still ahead, pending on the establishment of the 'bad bank'. Recession coupled with rising unemployment both in 2013 and 2014 and a reduction of disposable income will dampen household consumption. Overall, it will be essential to continue on the reform path in order to regain credibility. The consequences of a renewed failure of reforms are not foreseeable yet.

Hermine Vidovic

Croatia:
Speed of reform lost momentum

Croatia’s economy continued its downward trend starting from 2009, with GDP declining by close to 2% in 2012. Gross fixed capital formation contracted for yet another year. Private consumption fell due to the decline in disposable income (rising unemployment), while the decrease in government consumption was mainly resulting from fiscal consolidation. The contraction in investments was felt primarily in the construction sector, where output continued to decline sharply (-11%). The slump in industrial production has become even worse than in the two preceding years, with output dropping by over 5%. In manufacturing almost all sectors recorded a decline in production, including the shipbuilding industry, Croatia’s single most important exporter. In January 2013 the European Commission gave green light to the privatization plans for the shipyard Brodosplit, envisaging state aid (support to the restructuring) to the shipyard in the amount of EUR 1.5 billion within a five-year period. The contract for Brodotrogir is initialled and should be signed soon, while the shipyard 3. Maj is to be sold to the Uljanik shipyard. The restructuring of the shipbuilding industry has been one of the major issues in Croatia’s accession negotiations with the EU and will be closely monitored by the Commission until accession.

In response to the poor industrial performance characterized by low competitiveness and only minor foreign direct investments the Croatian Minister of Economy has announced a new industrial strategy for the country covering the period 2014-2020. The strategy, which will be presented in the course of the year, will reportedly focus on a combination of old and new industrial branches such as metal-working, food processing, pharmaceuticals, textiles and leather industries, shipbuilding, ICT, creative industries and the automotive industries, i.e. including almost everything, and does not reveal any real specification so far. For the development of new branches the strategy envisages to encourage R&D investments by Croatian companies.

Based on customs statistics, external trade developments turned positive in the last quarter of 2012 mainly because of the export of ships. In the year as a whole, however, goods exports were only slightly up in nominal euro terms and imports almost stagnated. The resulting trade deficit fell by about EUR 200 million compared to a year earlier and reached EUR 6.5 billion. Thanks to a growing surplus in services trade due to rising earnings from tourism and a declining deficit in the income balance, the current account closed with a lower deficit than in 2011. At the same time the inflow of FDI fell substantially and amounted to only EUR 600 million.

Croatia’s labour market deteriorated markedly during 2012. Labour force survey data indicate that employment fell by close to 5% in the course of the year while the unemployment rate jumped to 15.7% (13.5% in 2011). Youth unemployment soared to over 40% and is, along with Spain and

Table HR

Croatia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., mid-year	4434.5	4429.1	4417.8	4288.0	4280.0	4280	4280	4280
Gross domestic product, HRK mn, nom.	343412	328672	326980	333956	339100	347500	359800	376200
annual change in % (real)	2.1	-6.9	-1.4	0.0	-1.8	-0.5	1.5	2.5
GDP/capita (EUR at exchange rate)	10700	10100	10200	10500	10500	10800	11200	11700
GDP/capita (EUR at PPP)	15800	14500	14400	15400	15400	.	.	.
Consumption of households, HRK mn, nom.	197936	188859	189314	194318	196900	.	.	.
annual change in % (real)	1.3	-7.6	-0.9	0.2	-2.0	-2.0	0.0	1.0
Gross fixed capital form., HRK mn, nom.	93930	80367	67254	62746	62300	.	.	.
annual change in % (real)	8.7	-14.2	-15.0	-7.2	-4.0	1.5	3.0	5.0
Gross industrial production 2)								
annual change in % (real)	1.2	-9.2	-1.4	-1.2	-5.5	1.0	2.5	3.0
Gross agricultural production								
annual change in % (real)	8.0	-0.8	-8.2	-1.0	.	.	.	.
Construction output 2)								
annual change in % (real)	11.8	-6.5	-15.9	-9.1	-11.0	.	.	.
Employed persons, LFS, th, average	1636	1605	1541	1493	1420	1390	1400	1410
annual change in %	1.3	-1.8	-4.0	-3.2	-4.9	-2.0	1.0	1.0
Unemployed persons, LFS, th, average	149	160	206	232	265	.	.	.
Unemployment rate, LFS, in %, average	8.4	9.1	11.8	13.5	15.7	16.5	16.0	15.5
Unemployment rate, reg., in %, end of period	13.7	16.7	18.8	18.7	21.1	21.0	19.5	18.0
Average gross monthly wages, HRK	7544	7711	7679	7796	7850	7900	7950	8000
annual change in % (real, net)	0.8	0.2	-0.5	-0.4	-2.5	.	.	.
Consumer prices, % p.a.	6.1	2.4	1.1	2.3	3.4	3.0	2.0	2.0
Producer prices in industry, % p.a. 3)	8.3	-0.4	4.3	6.3	7.0	5.0	3.0	3.0
General governm.budget, EU-def., % of GDP 4)								
Revenues	39.3	37.1	35.9	35.5	34.5	.	.	.
Expenditures	40.6	41.3	40.9	40.6	39.0	.	.	.
Net lending (+) / net borrowing (-)	-1.4	-4.2	-5.0	-5.1	-4.5	-4.0	-3.5	-3.0
Public debt, EU-def., % of GDP	29.3	35.8	42.2	46.7	53.0	56.6	60.6	63.0
Central bank policy rate, % p.a., end of period 5)	9.0	9.0	9.0	7.0	7.0	.	.	.
Current account, EUR mn	-4256.3	-2279.3	-449.9	-393.9	-300.0	-500	-600	-700
Current account, % of GDP	-9.0	-5.1	-1.0	-0.9	-0.7	-1.1	-1.3	-1.4
Exports of goods, BOP, EUR mn	9752.7	7674.5	9063.6	9774.0	9530.0	9800	10200	10700
annual growth rate in %	6.5	-21.3	18.1	7.8	-2.5	3.0	4.0	5.0
Imports of goods, BOP, EUR mn	20385.1	14881.6	14809.1	15921.9	15920.0	16400	17200	18200
annual growth rate in %	9.4	-27.0	-0.5	7.5	0.0	3.0	5.0	6.0
Exports of services, BOP, EUR mn	10090.6	8640.2	8649.4	9005.4	9550.0	9900	10400	10900
annual growth rate in %	10.7	-14.4	0.1	4.1	6.0	4.0	5.0	5.0
Imports of services, BOP, EUR mn	3236.9	2949.9	2875.7	2818.9	2880.0	3000	3200	3400
annual growth rate in %	17.8	-8.9	-2.5	-2.0	2.2	3.0	6.0	6.0
FDI inflow, EUR mn	4218.6	2415.0	297.5	1075.3	600.0	.	.	.
FDI outflow, EUR mn	970.2	888.1	-113.2	27.2	-250.0	.	.	.
Gross reserves of NB excl. gold, EUR mn	9121	10376	10660	11195	11300	.	.	.
Gross external debt, EUR mn 6)	39764	43745	46496	45733	46000	.	.	.
Gross external debt, % of GDP 6)	83.6	97.7	103.6	101.8	102.0	.	.	.
Exchange rate HRK/EUR, average	7.2232	7.3396	7.2862	7.4339	7.5175	7.5	7.5	7.5
Purchasing power parity HRK/EUR	4.9004	5.1169	5.1309	5.0661	5.1560	.	.	.

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

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) Domestic output prices. - 4) According to ESA'95, excessive deficit procedure. - 5) Discount rate of NB. - 6) From 2008 and 2009 new reporting systems.

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

Greece, among the highest in the EU. Registration data put the unemployment rate at 21% in December, the highest rate since 2003. Most of the newly registered unemployed came from the manufacturing industry, but for the first time also a higher number of employees who previously had worked in public administration, defence, health and education sectors were registered at the employment offices. The Ministry of Labour expects further employment cuts in 2013, thus a relaxation on the labour market can be expected only in 2014.

At the beginning of December the Croatian government adopted the 2013 state budget, which is based on the (ambitious) assumption of 1.8% GDP growth. The budget deficit is envisaged at 3.1% of the GDP, which is not only higher than projected in the 'Economic and Fiscal Policy Guidelines for the Period 2013-2015' adopted last July but also exceeding the 2012 level. In response, Standard & Poor's cut Croatia's sovereign credit rating from investment grade to junk, stating that the structural and fiscal reforms implemented so far have been insufficient to foster economic growth overhaul. In February 2013 also Moody's downgraded Croatia's rating to junk, reflecting the stalled recovery, lack of budget discipline and the vulnerability to external shocks.

Public debt rose from 47% of the GDP at the end of 2011 to an estimated 53% at the end of 2012. A large part of the debt increase was due to assuming the shipyards' debts by the government, the remainder accounted for the financing of the budget deficits.

So far 21 EU member states have ratified Croatia's accession treaty. Following protracted and tough negotiations on an unresolved banking dispute dating back to the dissolution of Yugoslavia, also Slovenia announced its willingness to ratify the treaty.

wiiw has revised its previous GDP growth forecast for 2013 downwards from 1% to minus 0.5%, since the expected slight rebound in (public) investment activities will not be sufficient to offset declining household demand and a recovery in Croatia's main trading partners is not yet in sight. A return to modest growth might be expected in 2014. Employment will continue to contract; the LFS unemployment rate is expected to increase to 16% in 2013 and will remain at high levels due to the poor prospects for GDP growth. Household consumption will remain suppressed as a consequence of high unemployment, household deleveraging and weak credit activity; joining the EU in July 2013 may help to boost foreign investors' confidence, but positive effects from EU membership might be expected only in the medium term. As for the time being, EU cohesion and structural funds may serve as one of the main sources of infrastructure investments in the country. Maintaining the stability of the exchange rate will remain the main goal of the Croatian National Bank; an early euro adoption is not in sight. The need to speed up structural reforms and further fiscal consolidation against the background of high unemployment will remain the major challenge for the years to come.

Table MK

Macedonia: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1]	2013	2014 Forecast	2015
Population, th pers., mid-year	2046.9	2050.7	2055.0	2058.5	2065.0	2070	2075	2080
Gross domestic product, MKD mn, nom. [2]	411728	410734	434112	461730	474200	493300	516700	542800
annual change in % (real) [2]	5.0	-0.9	2.9	2.8	-0.6	1.0	1.7	2.0
GDP/capita (EUR at exchange rate)	3300	3300	3400	3600	3700	.	.	.
GDP/capita (EUR at PPP)	8400	8500	8700	8900	9000	.	.	.
Consumption of households, MKD mn, nom. [2][3]	330399	314376	321524	345219	353000	.	.	.
annual change in % (real) [2][3]	7.4	-4.7	1.3	3.9	-1.0	1.0	2.0	2.0
Gross fixed capital form., MKD mn, nom. [2]	86403	81872	82968	94537	104500	.	.	.
annual change in % (real) [2]	5.4	-4.3	-2.7	10.0	7.0	3.0	4.0	5.0
Gross industrial production [4]								
annual change in % (real)	5.1	-8.7	-4.8	3.3	-6.6	3.0	5.0	5.0
Gross agricultural production (EAA)								
annual change in % (real)	5.4	-2.3	8.2	2.0	0.0	5.0	3.0	3.0
Construction output, hours worked								
annual change in % (real)	-9.1	-2.1	5.8	14.2	-7.0	5.0	5.0	5.0
Employed persons, LFS, th, average	609.0	629.9	637.9	645.1	645.0	654	664	674
annual change in %	3.2	3.4	1.3	1.1	0.0	1.5	1.5	1.5
Unemployed persons, LFS, th, average	310.4	298.9	300.4	295.0	290.0	.	.	.
Unemployment rate, LFS, in %, average	33.8	32.2	32.0	31.4	31.0	31.0	31.0	30.0
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD [5]	26229	29922	30225	30602	30600	.	.	.
real growth rate, % (net wages) [5]	1.9	25.0	1.4	-2.4	-2.7	.	.	.
Consumer prices, % p.a.	8.3	-0.8	1.6	3.9	3.3	3.0	3.0	3.0
Producer prices in industry, % p.a. [6]	10.1	-7.2	8.7	11.1	4.6	.	.	.
General governm.budget, nat.def., % of GDP [7]								
Revenues	33.1	31.3	30.4	29.6	29.1	.	.	.
Expenditures	34.1	33.9	32.9	32.1	32.9	.	.	.
Deficit (-) / surplus (+)	-0.9	-2.7	-2.4	-2.5	-3.8	-1.0	-1.0	-1.0
Public debt, nat.def., % of GDP [8]	27.9	31.7	34.8	35.0	36.0	36.0	36.0	36.0
Central bank policy rate, %, p.a., end of period [9]	7.00	8.50	4.11	4.00	3.73	4.0	4.0	4.0
Current account, EUR mn	-862.2	-457.1	-143.6	-224.3	-250.0	-400	-400	-525
Current account, % of GDP	-12.8	-6.8	-2.0	-3.0	-3.2	-5.0	-4.8	-5.9
Exports of goods, BOP, EUR mn	2692.6	1932.6	2530.1	3178.9	3115.0	3270	3600	3960
annual growth rate in %	8.9	-28.2	30.9	25.6	-2.0	5.0	10.0	10.0
Imports of goods, BOP, EUR mn	4455.1	3492.2	3977.9	4860.6	4910.0	5160	5680	6250
annual growth rate in %	21.9	-21.6	13.9	22.2	1.0	5.0	10.0	10.0
Exports of services, BOP, EUR mn	692.0	617.6	681.4	805.8	798.0	838	922	1014
annual growth rate in %	15.9	-10.8	10.3	18.3	-1.0	5.0	10.0	10.0
Imports of services, BOP, EUR mn	682.8	601.1	644.6	707.7	778.0	856	959	1055
annual growth rate in %	20.0	-12.0	7.2	9.8	9.9	10.0	12.0	10.0
FDI inflow, EUR mn	399.9	145.0	160.0	336.8	100.0	350	400	400
FDI outflow, EUR mn	-9.5	8.1	1.4	0.0	0.0	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1361.0	1429.4	1482.7	1801.9	1769.0	.	.	.
Gross external debt, EUR mn	3304.2	3780.4	4105.7	4846.6	5090.0	.	.	.
Gross external debt, % of GDP	49.2	56.4	58.2	64.6	66.0	.	.	.
Exchange rate MKD/EUR, average	61.27	61.27	61.52	61.53	61.53	61.5	61.5	61.5
Purchasing power parity MKD/EUR	23.93	23.65	24.15	25.19	25.61	.	.	.

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

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM reallocated to industries, including non-observed economy, real growth rates based on previous year prices). - 3) Including Non-Profit Institutions Serving Households (NPISHs). - 4) Enterprises with 10 and more employees. - 5) From 2009 including allowances for food and transport. - 6) Domestic output prices. - 7) Refers to central government budget and extra-budgetary funds. - 8) In 2011 and 2012 wiiw estimates. - 9) Central Bank bills (28-days).

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

Vladimir Gligorov

Macedonia:
Shaky stability

The adoption of the budget for this year triggered a conflict between the two largest Macedonian parties, which are the parties of the ethnic Macedonians. Ethnic Albanians have their own inter-party disagreements, but those surface mainly around election time. The Social Democrats, who are in opposition, walked out of the Parliament dissatisfied with the ruling Revolutionary Party throwing out all their amendments on the proposed budget law. Then they staged street protests and declared that they would not return to the Parliament before the government had resigned and presumably early elections were called. The likelihood of their extra-parliamentary protest succeeding is slim.

However, these political tensions are representative of the growing economic and social problems. The Macedonian pre-crisis policy strategy was to rely on a fixed exchange rate regime and tight income policy, including a balanced budget for the most part, with growth expected to be driven by net exports. This policy has succeeded in providing stability, but growth proved elusive – basically because the desired foreign capital inflows did not materialize and growth of exports was not as strong as intended. By and large, the country exports what it always did in perhaps larger quantities.

In the crisis, however, the government introduced a change in the form of somewhat increased reliance on public spending, primarily in development projects, but also in support of wages. In that, it proved to be highly selective, at least according to the opposition. It favoured and still favours party members and sympathizers to the detriment of the people supporting the opposition parties. Still, as a consequence of the somewhat supportive policies, there has been some improvement in the labour market and the decline of GDP has been rather shallow – as has the recovery been too. And last year, the economy fell into recession again. The government proposed a budget that the opposition thought was reckless and misguided and the political crisis erupted.

Still, with a somewhat more relaxed fiscal policy, the policy strategy has not really been changed. In fact, in the short and medium run, it can be expected that the stimulus that could come from public spending will be either small or non-existent. Apart from concerns with macroeconomic stability, i.e. mainly with the sustainability of the exchange rate, the borrowing costs continue to be punishingly high. So, even though the public debt to GDP ratio is low by most standards, the refinancing costs are unsustainable given the growth record so far and the expectations of sluggish recovery. As a consequence, short-term prospects are not encouraging, with perhaps some small positive growth rate this year. In the medium run, some modest acceleration can be expected on the assumption that the region as a whole will also do better. Macedonia's economy is more dependent on the neighbouring countries, as this is a small and landlocked country. So, as long as domestic demand remains subdued and the regional environment remains depressed and unstable, sluggish recovery, not fundamentally different from stagnation, will prevail.

Table ME

Montenegro: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1]	2013	2014 Forecast	2015
Population, th pers., mid-year [2]	628.8	631.5	618.8	620.0	621.0	622	623	625
Gross domestic product, EUR mn, nom. [3]	3085.6	2981.0	3103.9	3234.1	3300.0	3400	3600	3800
annual change in % (real) [3]	6.9	-5.7	2.5	3.2	-1.0	1.0	2.0	3.0
GDP/capita (EUR at exchange rate)	4900	4700	5000	5200	5300	.	.	.
GDP/capita (EUR at PPP)	10700	9700	10200	10500	10600	.	.	.
Consumption of households, EUR mn, nom. [3]	2814.8	2503.7	2550.7	2728.5	2900.0	.	.	.
annual change in % (real) [3]	12.1	-12.9	2.0	4.2	1.0	1.0	1.0	2.0
Gross fixed capital form., EUR mn, nom. [3]	1180.2	797.6	655.1	596.5	600.0	.	.	.
annual change in % (real) [3]	27.3	-30.1	-18.5	-10.3	2.1	5.0	5.0	5.0
Gross industrial production [4]								
annual change in % (real)	-2.0	-32.2	17.5	-10.3	-7.1	5.0	5.0	5.0
Net agricultural production	.	.	.	.		.	.	.
annual change in % (real)	10.3	2.6	-1.7	9.5	0.0	.	.	.
Construction output [5]	.	.	.			.	.	.
annual change in % (real) [3]	20.7	-19.2	-7.4	15.8	0.0	5.0	5.0	5.0
Employed persons, LFS, th, average [6]	218.8	212.9	208.2	195.4	200.0	210	215	220
annual change in %	0.6	-2.7	-2.2	.	2.4	4.0	2.5	1.0
Unemployed persons, LFS, th, average	45.3	50.9	50.9	47.9	50.0	.	.	.
Unemployment rate, LFS, in %, average	17.2	19.3	19.6	19.7	20.0	20.0	19.0	19.0
Unemployment rate, reg., %, average	15.1	14.0	16.5	15.9	15.3	16.0	16.0	15.0
Average gross monthly wages, EUR	609	643	715	722	727	.	.	.
real growth rate, % (net wages)	14.6	7.6	3.0	-2.0	-3.1	.	.	.
Consumer prices, % p.a.	7.4	3.4	0.5	3.1	4.1	3.0	3.0	3.0
Producer prices in industry, % p.a. [7]	14.0	-3.9	-0.9	3.2	1.3	.	.	.
General governm.budget, nat.def., % of GDP								
Revenues	49.1	45.8	40.9	34.6	34.0	.	.	.
Expenditures	47.5	49.4	43.9	38.8	40.0	.	.	.
Deficit (-) / surplus (+)	1.7	-3.6	-3.0	-4.1	-6.0	-4.0	-3.0	-2.0
Public debt, nat.def., % of GDP	29.0	38.2	40.9	45.9	51.0	53.0	53.5	53.0
Central bank policy rate, % p.a., end of period [8]	8.81	8.85	8.98	10.00	9.00	9	8	8
Current account, EUR mn	-1535.2	-830.3	-710.2	-573.4	-495.0	-510	-540	-570
Current account, % of GDP	-49.8	-27.9	-22.9	-17.7	-15.0	-15.0	-15.0	-15.0
Exports of goods, BOP, EUR mn	450.4	296.3	356.6	476.5	405.0	450	500	550
annual growth rate in %	-6.8	-34.2	20.4	33.6	-15.0	10.0	10.0	10.0
Imports of goods, BOP, EUR mn	2475.7	1617.9	1623.8	1782.8	1820.0	1910	2100	2310
annual growth rate in %	22.1	-34.6	0.4	9.8	2.1	5.0	10.0	10.0
Exports of services, BOP, EUR mn	776.0	731.5	801.0	906.1	1010.0	1160	1330	1530
annual growth rate in %	15.3	-5.7	9.5	13.1	11.5	15.0	15.0	15.0
Imports of services, BOP, EUR mn	404.9	331.0	336.8	316.8	365.0	380	400	420
annual growth rate in %	45.7	-18.3	1.8	-5.9	15.2	5.0	5.0	5.0
FDI inflow, EUR mn	655.7	1099.4	574.2	401.4	500.0	800	1000	1000
FDI outflow, EUR mn	73.7	32.9	22.1	12.3	20.0	20	50	50
Gross reserves of NB, excl. gold, EUR mn [9]	216.6	172.8	164.6	170.8	190.0	.	.	.
Gross external public debt, EUR mn	481.7	699.9	912.4	1063.7	1300.0	.	.	.
Gross external public debt, % of GDP	15.6	23.5	29.4	32.9	39.4	.	.	.
Purchasing power parity EUR/EUR	0.4596	0.4877	0.4917	0.4957	0.5027	.	.	.

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

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

Vladimir Gligorov

Montenegro:
More of the same

In the election held in the autumn of last year, the ruling coalition was re-elected, though this time around the opposition staged a much more credible challenge. Apart from the usual competition between Montenegrin and Serbian parties, a third party attracted a significant number of votes, but still not enough to take over the government from the party and its leaders that have run the country for about the past two decades. In the election, alternative economic models were discussed, but the main issues were social decline and corruption. With the outcome of the election, it cannot be expected that there will be any significant changes in the way things are done in Montenegro.

It is not altogether clear that much can be changed anyway. This is a small country that has little possibilities to develop either industry or agriculture and has to rely mostly on services. That means tourism and, potentially, financial and perhaps educational and IT services. Industrial production, or the little that is left of it, has been declining during the crisis and also last year. It is expected to recover somewhat this year and in the medium run, but its contribution to the GDP is not large and will not increase substantially. Similarly, some agricultural and food production has potential (wine, for instance), but these are niches, not backbone activities.

Tourism has been doing well during this crisis and has continued to support growing exports of services. However, overall exports have not performed all that well mainly because of the changing fortunes of the production of aluminium. The country's large and important plant has a turbulent history, with various foreign managers and owners, and is presenting the government with a constant dilemma – whether it is better to continue to subsidize it, or whether it would be best to close it down. Apart from the social and political costs that the choice of the latter alternative would bring, there is the issue of this plant providing the bulk of the export of goods.

With these fundamentals, the development model adopted by the government does not have obvious alternatives. The business community is pushing for more diversification and more government support, but the possibilities and the expected advantages are limited. The government will continue to rely on foreign investments in tourism and related activities as it has already been doing.

Macroeconomic stability was threatened early on into the crisis by possible failure of the banking sector, and that threat is not altogether over. The budget continues to support the fragile banks and will have to go on doing so in the future. It is still not severely fiscally constraint, though public debt may prove to be a problem if recovery is delayed. The forecasts for this year and the next two are not all that different from those for the neighbouring countries and the Balkan region as a whole. That may prove to be too slow for macroeconomic stability to be sustained without more determined efforts to deal with the solvency problems in the corporate and the banking sectors.

Still, the prospects in the medium term depend on the success of the tradable sectors and that will depend on the regional and the developments in Europe and in Russia. The fact that the country is negotiating with the EU should prove helpful. The main hurdle, which is rule of law issue, has now been shifted to the beginning of the negotiations and will be a challenge. Once that is cleared, Montenegro can expect to be the next new member of the EU.

Michael Landesmann

Turkey:
Recovery from credit brakes

Turkey, which had experienced a very strong and fast recovery in the years 2010 and 2011 with GDP growth rates of 9.0% and 8.5% respectively, switched to a drastic slowdown in growth in 2012 with GDP growth of only 2.9% for the year as a whole. This decline of growth was mostly the result of policy measures designed to break a cycle of overheating, characterized by very strong private sector credit growth (in real terms +20.6% in 2010 and +35.8% in 2011), strong deteriorations in the current account balance (-6.4% of GDP in 2010 and -10.0% in 2011), and substantial volatility of the exchange rate (TRY/EUR moved from 2.07 year-end in 2010 to 2.45 year-end in 2011).

The fear of vulnerability associated with strongly negative current accounts is a perennial worry of policy-makers in Turkey and hence there is a willingness to apply a range of tools to put the brakes on an overheating economy. The Turkish Central Bank (CBRT) applied a range of partly non-traditional methods (an interest rate corridor, effective liquidity management and reserve requirements; on this more below) to deal with the so-called ‘trilemma’ whereby the authorities attempt to steer the economy towards a low inflation path and at the same time avoid large inflows of capital which would put an undue upward pressure on the exchange rate, thus making the current account situation worse. Furthermore the government attempted to move towards a more restrictive fiscal policy scenario which was reinforced by the more recent publication of its Medium-Term Programme (2013-2015) which includes a Medium-Term Fiscal Framework.

If we look at more recent developments, the general assessment is that the Turkish economy is in a robust state: in early November 2012, Fitch upgraded Turkey’s foreign currency debt to investment grade which reflects also a widely held view that there are favourable medium-term growth prospects, the banking system is in a robust state, government debt burden is falling (already from quite low levels) and inflation – after the recent hike – is on a downward path.

Monetary policy has moved through a number of phases. From November 2010 through October 2011, the focus was on limiting short-term capital inflows: the interest rate corridor was widened by lowering the borrowing rate to discourage short-term capital inflows; banks’ reserve requirements were raised substantially and the banking supervision was tightened. The exchange rate depreciated and credit growth started to come down. After October 2011, monetary policy shifted to avoid excessive currency depreciation as it was feared to feed through to domestic inflation (rates had hiked up substantially also through high energy costs and high food prices): the CBRT provided less liquidity through the one-week repo facility which caused short-term interest rates to jump, but attempted to provide longer-term liquidity through one-month repo auctions; it also engaged in foreign

Table TR

Turkey: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014	2015
Population, th pers., average	71095	72050	73003	73950	74885	75700	76900	80000
Gross domestic product, TRY bn, nom.	950.5	952.6	1098.8	1298.1	1460.0	1630	1810	2000
annual change in % (real)	0.7	-4.8	9.0	8.5	3.0	3.8	4.5	5.0
GDP/capita (EUR at exchange rate)	7000	6100	7500	7500	8400	9200	10200	11100
GDP/capita (EUR at PPP - wiiw)	11700	10900	12200	13100	13600	.	.	.
Consumption of households,TRY bn, nom.	663.9	680.8	787.8	923.6	1000.0	.	.	.
annual change in % (real)	-0.3	-2.3	6.7	7.7	-0.5	3.2	4.5	5.0
Gross fixed capital form., TRY bn, nom.	189.1	160.7	207.8	282.8	290.0	.	.	.
annual change in % (real)	-6.2	-19.0	29.9	18.3	-5.0	5.0	9.0	12.0
Gross industrial production								
annual change in % (real)	-0.6	-9.7	13.1	8.9	2.9	5.0	6.0	7.5
Gross agricultural production 2)								
annual change in % (real)	4.3	3.6	2.4	5.6	3.3	.	.	.
Construction industry								
annual change in % (real)	-7.6	-16.3	18.7	11.2	0.0	5.0	9.0	12.0
Employed persons - LFS, th, avg.	21193	21271	22593	24099	24700	25600	26800	28000
annual change in %	2.1	0.4	6.2	6.7	2.5	3.5	4.5	4.5
Unemployed persons - LFS, th, average	2279	3053	2696	2324	2200	.	.	.
Unemployment rate - LFS, in %, average	9.8	12.6	10.7	8.8	8.2	8.0	7.8	7.5
Reg. unemployment rate, in %, average	.	.	.	.	.	.	.	.
Average gross monthly wages, manuf.ind., TRY	1590	.	.	.	.	.	.	.
annual change in % (real)	0	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	10.4	6.3	8.6	6.5	9.0	7.8	6.0	5.0
Producer prices in industry, % p.a. 3)	13.0	1.0	6.2	12.3	6.1	5.5	5.0	5.5
General governm.budget, EU-def., % of GDP 4)								
Revenues	32.0	33.5	36.7	39.5	37.5	37.0	36.8	37.0
Expenditures	34.8	40.4	39.4	41.4	39.8	39.5	39.4	39.5
Net lending (+) / net borrowing (-)	-2.8	-6.9	-2.7	-1.9	-2.3	-2.5	-2.6	-2.5
Public debt, EU-def., % of GDP 4)	40.0	46.1	42.4	39.2	36.8	36.0	35.5	35.2
Central bank policy rate, %, p.a., end of period 5)	17.50	9.00	6.50	5.75	5.50	.	.	.
Current account, EUR mn	-28108	-9551	-35135	-55363	-38011	-51000	-59000	-68000
Current account, % of GDP	-5.6	-2.2	-6.4	-10.0	-6.0	-7.3	-7.5	-7.7
Exports of goods, BOP, EUR mn	95484	78616	91292	103086	127035	145000	167000	192000
annual change in %	13.7	-17.7	16.1	12.9	23.2	14.0	15.0	15.0
Imports of goods, BOP, EUR mn	131095	96145	133986	166943	178063	192000	211000	236000
annual change in %	11.0	-26.7	39.4	24.6	6.7	8.0	10.0	12.0
Exports of services, BOP, EUR mn	23928	24251	26604	27929	32743	36000	39000	43000
annual growth rate in %	13.3	1.3	9.7	5.0	17.2	9.0	9.0	9.0
Imports of services, BOP, EUR mn	12186	12024	14759	15084	15683	17000	19000	21000
annual growth rate in %	6.8	-1.3	22.7	2.2	4.0	6.0	12.0	12.0
FDI inflow, EUR mn	13217	6085	6805	11453	9635	12000	12500	13000
FDI outflow, EUR mn	1707	1110	1108	1791	3178	3000	3500	4000
Gross reserves of CB, excl. gold, EUR mn	51022	49088	60411	60637	77150	.	.	.
Gross external debt, EUR mn	202074	186974	218537	235840	230000	.	.	.
Gross external debt, % of GDP	40.5	42.5	39.7	42.5	36.4	.	.	.
Average exchange rate TRY/EUR	1.9064	2.1631	1.9965	2.3378	2.3135	2.35	2.30	2.25
Purchasing power parity EUR/EUR	1.1385	1.2116	1.2387	1.3409	1.4386	.	.	.

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

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

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

exchange reserve sales. Monetary policy was seen as a mixed success: it brought down credit growth quite strongly and the economy slowed down substantially leading to a 'rebalancing of the economy' (through a sharp fall in domestic demand) but contributed to strong inflation instability. More recently, the emphasis has shifted towards more steady inflation targeting: the one-week repo rate was reduced in December 2012 by 25bps (the first reduction in 16 months) as demand conditions were seen as justifying the easing, but the Central Bank's flexible policy mix was maintained (specifically utilizing the wide interest rate corridor – with an overnight borrowing rate of 5% and an overnight lending rate of 9%) as the main policy tool to manage liquidity.

The current situation is one in which net exports are the main contributor to GDP growth (full year growth for 2012 has been estimated at 2.9%), while domestic demand had turned negative due to shrinking private investment activity (investment spending fell by 4.1% in the 3rd quarter despite strong government capital spending, after a 6.5% drop in the second quarter; the estimate for 2012 as a whole is -5.0%) and low private consumption spending (real private consumption growth was slightly negative for the year as a whole at -0.5%). The current accounts deficit, which had reached -10.0% of GDP by end-2011, has come down to -6.0% by end-2012. This was largely driven by a sharp decline in imports growth (imports growth was – in current euro – 6.7% for goods and 4.0% for services in 2012 as compared to +24.6% and +2.2% respectively in 2011; this reflected also energy price adjustments, energy being a major import item for Turkey) while exports of goods increased by 23.2% in 2012 (12.9% in 2011) which included substantial gold exports to Iran (in payment for energy imports) and growth of exports in services was also very considerable (+17.2% as compared to +5.0% in 2011).

Important for medium-term developments is that inflation rates have been easing (headline inflation was 6.2% in December 2012; as compared to 10.5% at end-2011) and this has eased inflation expectations which in turn creates the space for less restrictive monetary policy. Part of the inflation deceleration however stems from lower food prices due to a favourable harvest. The fiscal deficit (at 2.3% of GDP in 2012) was somewhat higher compared to the fiscal target of 1.5%; main reasons being losses from state enterprises and an underperformance of revenues due to the slowdown in household consumption. In the final quarter of 2012 there was evidence of some recovery in domestic demand which went along with a recovery of some credit growth which was benefitting from lowering of interest rates. The general tenor for the next two years is a steady recovery of economic growth to – our forecasts – 3.8% in 2013, 4.5% in 2014 and 5.0% in 2015. The underlying assumptions are that 4.5-5.0% growth reflects Turkey's sustainable growth rate without an accelerating deterioration in the current accounts, fiscal policy which sticks to its medium-term targets to bring public debt stock further down in a gradual manner from an already low level of currently 36.8% of GDP (it was 39.3% in 2011) to close to about 35.5% in 2015, but also a far from easy external environment both in the European Union and in the Middle East.

Let us cover two further issues regarding longer-term developments: one are rather interesting developments on the employment front, the other are developments on the export side. In the short run, the marked slowdown in growth in 2012 has led to an increase in the unemployment rate from 8.8% in 2011 to 10.1% in 2012. In the longer-run context, however, there was a significant improvement in a number of labour market indicators (see Gönenc et al., 2012): thus participation rates in all age groups, including those with traditionally very low rates, increased, e.g. that of the age group 20-24 rose from 2006 to 2001 from 49.5% to 54%, that of the age cohort 50-60 increased from 38 to 42%.[26] Gönenc et al. point out (p. 6) that over the past decade many new jobs have been created in the so-called 'Anatolian tiger' regions for the low-skilled outside traditional agriculture. This is driven by the emergence of new, first generation enterprises – mostly medium-sized (50-250 employees) – in previously non-industrial, low-income regions in inland Anatolia. Furthermore, these enterprises are quite strongly export-oriented, with employment and exports growing about 8% and 15% annually, respectively. They specialize in less sophisticated, relatively low-tech manufacturing activities such as textile, food, plastic and metal products; furthermore, while Western regions are strongly integrated with EU economies (and have undergone significant technological and structural upgrading over the past decade), the newly exporting regions trade more with countries in the Middle East and Northern Africa (MENA). These developments have strongly contributed to diversification and resilience in Turkey's employment and export performance.[27]

Reference cited:

R. Gönenc, O. Röhn, V. Koen and S. Saygili (2012), 'Structural Reforms to Boost Turkey's Long-Term Growth', OECD Economics Department, *Working Paper* 987, OECD, Paris.

[26] Nonetheless, participation rates remain very low for the very low-skilled (those without any school diploma which represent 18% in 2011), women and elderly (54-65 years) at 26%, 29% and 33% respectively in 2011.

[27] Further interesting features on the export and FDI front are: the importance of Turkish construction companies which have gained considerable market shares in expanding markets such as Russia, Kazakhstan, Turkmenistan, Saudi Arabia and Iraq; this has given Turkey second place after China in terms of share in the total number of global construction companies; exports of construction equipment and materials made up – in 2011 – 20% of Turkish exports. Alongside these developments Turkish Western regions – specifically the Istanbul region – are making inroads in advanced manufacturing and expanding their attraction to foreign investors also in banking, insurance, and transportation. Thus Microsoft's office in Istanbul e.g. is the company's centre for operations in 79 countries, Intel manages its operations in 64 countries from Istanbul, and Coca Cola in about 90 countries. See Gönenc et al. (2012), p. 7 and p. 18.

Mario Holzner

Albania:
Corruption of power plus electrification of the whole country

Although FDI in Albanian industry is still confined to very basic sectors such as commodities and energy, foreign investors have even there difficulties to succeed. Good contacts with the ruling elite might be an important factor of success, but even that might not be a guarantee. Recently especially investment projects in the energy sector have exemplified this point.

Certainly the publicly owned Czech energy company CEZ is currently experiencing all the nightmares a foreign investor may possibly experience in Albania. On 21 January 2013 the Albanian energy regulator ERE revoked the licence of the local unit of CEZ to operate the country's national electricity grid and appointed a new caretaker management, arguing that CEZ has not fulfilled its contractual obligations regarding imports of electricity and investment in the grid. This can be seen as an equivalent to an expropriation after the company’s accounts were already frozen earlier when CEZ announced that it would like to sell its majority share in the Albanian electricity distribution.

This is only the latest twist in a path of escalation that started with CEZ purchasing 76% of Albania’s power distributor in 2009 for EUR 102 million and investing a similar amount in the ailing grid. Since then CEZ has not been able to reduce the so-called ‘technical losses’, which are mostly due to electricity theft and unpaid bills and range between a third and a half of total Albanian electricity use. The relationship with the government deteriorated significantly when CEZ turned off power for local water utility companies that did not pay their bills. Also, due to low production in state-owned hydropower stations in 2012 drought periods, the supply price for electricity was raised while CEZ was not allowed by ERE to pass over the price increases to their customers. In turn CEZ stopped paying for electricity to the national electricity supplier KESH. CEZ is now asking for an international arbitration and wants to exercise a EUR 60 million guarantee from the World Bank that was negotiated before the privatization. However, the World Bank claims that both sides have failed to make privatization work and is trying to organize a USD 100 million emergency loan to ensure the supply of electricity in Albania.

Less dramatic, but quite indicative as well, is the case of a Pakistani businessman which is recently covered prominently in Albanian media. In 2007 the businessman hired the law firm of the daughter of Prime Minister Sali Berisha to mediate with local authorities over the construction of a power plant in Albania worth nearly EUR 100 million. Apart from seeking standard legal fees, the Prime Minister's daughter asked for an unusual success fee worth up to 3% of the total investment, as well as pressuring him to buy an expensive and inappropriate plot of land. Allegedly the local authorities killed the whole project when he refused to buy that land. The case has been raised by the socialist opposition in the wake of the starting election campaign for the 2013 midyear parliamentary elections.

Table AL

Albania: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	3182.0	3194.4	3210.0	2814.0	2820.0	2840	2850	2860
Gross domestic product, ALL bn, nom. 3)	1089.3	1148.1	1222.5	1302.0	1340.0	1430	1540	1620
annual change in % (real) 3)	7.5	3.3	3.8	3.1	1.0	2.8	3.3	3.0
GDP/capita (EUR at exchange rate)	2800	2700	2800	3300	3400	.	.	.
GDP/capita (EUR at PPP)	6400	6500	6600	7800	7900	.	.	.
Consumption of households, ALL bn, nom. 3)	861.9	910.0	970.0	1030.0	1060.0	.	.	.
annual change in % (real) 3)	6.7	3.0	2.5	3.0	1.0	3.0	5.0	3.0
Gross fixed capital form., ALL bn, nom. 3)	415.1	430.0	400.0	420.0	380.0	.	.	.
annual change in % (real) 3)	9.5	5.0	-7.0	4.8	-12.0	5.0	6.0	2.0
Gross industrial production 4)								
annual change in % (real)	8.7	10.6	18.6	10.0	0.0	5.0	7.0	6.0
Gross agricultural production								
annual change in % (real)	4.6	4.4	5.9	4.0	5.0	4.0	5.0	4.0
Construction output total 4)								
annual change in % (real)	10.9	0.4	-17.9	1.0	-15.0	6.0	3.0	2.0
Employed persons, LFS, th 5)	1123.3	1160.5	1185.0	1200.0	1200.0	1200	1220	1240
annual change in %	-6.2	3.3	2.1	1.3	0.0	0.0	1.7	1.6
Employment reg. total, th pers., end of period	974.1	899.3	916.9	928.1	930.0	930	950	970
annual change in %	3.7	-7.7	2.0	1.2	0.2	0.0	2.2	2.1
Unemployed persons, LFS, th 5)	168.6	185.0	196.0	200.0	200.0	200	190	180
Unemployment rate, LFS, in % 5)	13.0	13.8	14.2	14.3	14.0	14.0	13.0	13.0
Unemployment rate, reg., in %, end of period	12.7	13.9	13.5	13.3	13.0	13.0	12.0	12.0
Average gross monthly wages, ALL	34277	36075	34767	37060	39284	.	.	.
annual change in % (real, gross)	21.2	2.9	-7.0	3.1	3.9	8.0	4.0	3.0
Consumer prices, % p.a.	3.4	2.3	3.6	3.4	2.0	4.0	4.0	2.0
Producer prices in industry, % p.a.	6.5	-1.6	0.3	2.6	1.5	4.0	4.0	1.0
General governm.budget, nat.def., % of GDP								
Revenues	26.7	26.1	26.6	25.4	25.0	25.0	26.0	27.0
Expenditures	32.3	33.1	29.7	28.9	28.0	33.0	32.0	30.0
Deficit (-) / surplus (+)	-5.5	-7.0	-3.1	-3.5	-3.0	-8.0	-6.0	-3.0
Public debt, nat.def., % of GDP 6)	55.1	59.8	58.2	58.0	59.4	63.7	65.1	64.9
Central bank policy rate, % p.a., end of period 7)	6.25	5.25	5.00	4.75	4.00	3.75	4.0	4.0
Current account, EUR mn	-1381.2	-1329.8	-1018.5	-1122.1	-1000.0	-1450	-1700	-1700
Current account, % of GDP	-15.6	-15.3	-11.5	-12.1	-10.4	-14.1	-15.0	-14.2
Exports of goods, BOP, EUR mn	917.5	750.7	1171.5	1405.5	1500.0	1600	1700	1840
annual growth rate in %	16.7	-18.2	56.1	20.0	6.7	6.7	6.3	8.2
Imports of goods, BOP, EUR mn	3348.9	3054.4	3254.2	3647.1	3300.0	3850	4300	4510
annual growth rate in %	15.9	-8.8	6.5	12.1	-9.5	16.7	11.7	4.9
Exports of services, BOP, EUR mn	1687.8	1771.4	1750.7	1747.4	1800.0	1850	2050	2210
annual growth rate in %	18.7	5.0	-1.2	-0.2	3.0	2.8	10.8	7.8
Imports of services, BOP, EUR mn	1618.3	1597.5	1518.8	1612.7	1600.0	1700	1850	1940
annual growth rate in %	15.4	-1.3	-4.9	6.2	-0.8	6.3	8.8	4.9
FDI inflow, EUR mn	665.2	716.9	793.3	747.0	900.0	800	700	700
FDI outflow, EUR mn	55.4	28.2	4.8	30.1	20.0	30.0	40.0	50.0
Gross reserves of NB excl. gold, EUR mn 8)	1626.1	1607.8	1842.1	1853.1	1950.0	.	.	.
Gross external debt, EUR mn	3313.5	3567.5	3919.1	4599.5	5200.0	.	.	.
Gross external debt, % of GDP	37.4	41.0	44.2	49.6	54.0	.	.	.
Exchange rate ALL/EUR, average	122.80	132.06	137.79	140.33	139.04	139	136	135
Purchasing power parity ALL/EUR	53.48	55.55	57.86	59.69	59.86	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). Data partly estimated by wiiw. - 4) Gross value added. - 5) Survey once a year (June or September-October), wiiw estimate in 2010-2012. - 6) Until 2010 based on IMF data; wiiw estimate thereafter. - 7) One-week repo rate. - 8) Until 2008 foreign assets of NB.

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

Finally, an important influx of funds for the pre-election fiscal expansion of the ruling Democratic Party government should stem from the privatization of the state-owned oil company Albpetrol in late 2012. The winning privatization bid of EUR 850 million (or about 9% of Albanian GDP) was made by the Singapore-US consortium Vetro Energy. The majority shareholder of this company is Rezart Taçi, an Albanian businessman who allegedly belongs to Prime Minister Sali Berisha's inner circle. He is also the owner of Albania's largest chain of petrol stations (Taçi Oil) and has earlier privatized the state-owned refinery company ARMO. However, Vetro Energy has failed to make the required 20% contract guarantee payment. Hence, the energy ministry considered the first offer invalid and wants to continue evaluating the other offers. The next in line is the Chinese consortium Win Business, with an offer of only EUR 298 million (still about 3% of GDP).

A complete failure of the Albpetrol privatization would not only be a blow to the ruling party's election campaign but also endanger GDP growth in a situation where it seems that the European economic crisis has finally reached Albania as well. GDP growth in 2012 slowed down to just about 1% only. The construction sector in particular was hit by double-digit negative real growth rates in each of the first three quarters of 2012. Also housing prices started to drop and the Construction Confidence Indicator fell to a historic low in the 4th quarter of 2012. One of the reasons might be a drop in remittances (by more than 4% in the first three quarters of 2012 as compared to the same period of the previous year), presumably owing to the poor economic situation in the main host countries for Albanian migrant workers – Greece and Italy.

The only flourishing sector is the extractive industry. Despite mostly flat crude oil prices and a stable exchange rate, exports of mineral fuels denominated in Albanian lek increased by more than 35% in 2012. With a share of over a quarter of goods exports in 2012, mineral fuels contributed most to last year's overall increase in goods exports of about 8%. It is interesting to note that crisis-torn Italy and Spain are Albania's most important export markets with a share of 50% and 10%, respectively in 2012 (Spain's share more than doubled compared to 2011). Moreover, exports to these countries were even increasing as compared to 2011, again mostly due to a large and rising share of mineral fuel exports.

By contrast, domestic demand is in poor condition. Total new loans were falling in 2012 by about 3%. While new loans to businesses were still increasing, if by a mere 2%, new loans to households were plummeting by almost a quarter. The share of non-performing loans increased by nearly 5 percentage points to some 23% in the third quarter of 2012 as compared to a year earlier. However, it appears that banks are well-capitalized as the sector's capital adequacy ratio has slightly increased over the recent quarters to some 16%. Another indicator of sluggish domestic private demand is the 3% drop in retail trade volumes in the first three quarters of 2012 year-on-year. The only glimmer of hope here is the 6% growth rate of the category sale, maintenance and repair of motor vehicles, which is considered to be a forward-looking indicator.

In 2012 also government demand was anaemic. The latest general government figures from November 2012 show revenue growth only slightly above the inflation rate and expenditures stagnating year-on-year. This might be related to the fact that the government wanted to keep public debt below the legal ceiling of 60% of GDP. However, at the end of 2012 the Albanian parliament lifted this statutory limit, giving way to fiscal expansion in the run-up to parliamentary elections, to be held on 23 June 2013.

We expect stronger economic growth in 2013 (close to 3%) based on a substantial increase in public wages and infrastructure investment boosting aggregate demand. A similar rate of growth could be also maintained in the following years of 2014 and 2015 given an improvement of economic sentiment throughout Europe. However, there are considerable downward risks. A complete failure of the Albpetrol privatization could endanger the financing of fiscal expansion and infrastructure investments. Also another drought could cause further shortages in the electricity supply which, apart from endemic corruption, is one of the major obstacles to more FDI in Albania in the medium run.

Vladimir Gligorov

Bosnia and Herzegovina:
Some more certainty

After the local elections in Republika Srpska in Bosnia and Herzegovina and the election in Serbia last year, there is somewhat more of stability. The party in power in the former, which lost the local elections, and the new coalition government and the new president in the latter seem less committed to an eventual break-up of Bosnia and Herzegovina than was perhaps the case before. This has yet to translate into better intra-state cooperation, but some modicum of certainty can be said to have been achieved. In addition, if Serbia starts negotiating with the EU, which seems more of a possibility now than ever before, that would put pressure on Bosnia and Herzegovina too to improve internal cooperation in order to enhance its chances to advance its relations with the EU. Finally, there are some initiatives to reform the Federation of Bosnia and Herzegovina, which is – next to Republika Srpska – the other entity (an awkward term for the two state-like polities that constitute Bosnia and Herzegovina). This entity consists of ten cantons and has proved to be rather hard to manage. So, there is a need to increase its efficiency in order to improve the overall decision making capacity of the country.

These cautiously encouraging political developments come at a moment when the economy is in recession and can expect only modest recovery this year and perhaps some speed-up of growth in the medium term. As most other small basically continental Balkan economies, growth depends to a large extent on the performance of the tradable sector. Domestic demand is constrained by relatively constrained fiscal and income policies and the persistently depressed labour market. Private and public transfers sustain consumption and imports, but foreign investments in industry and tradable services are rather limited. Bosnia and Herzegovina cannot rely too much on agriculture and the possibilities to expand tourism are limited. So, its comparative advantages are in industry, both in manufacturing and energy and mining as well as in forestry. However, in the crisis, and last year in particular, industrial production has taken a beating due to the decline in external demand and financing.

In the short run, some recovery of industrial production can be expected and if political stabilization takes hold, some increase in foreign investments is likely. Those do not necessarily have to come from the EU countries but from Turkey, Russia and countries in the Middle East. Especially useful would be investments in infrastructure because this is a mountainous and not all that well connected country. In fact, one country where structural funds and funds to support agriculture of the EU could play quite a significant role is Bosnia and Herzegovina. Also, regional cooperation is crucial for it and somewhat more relaxed relations around this country should prove supportive for its economic development and further political stabilization.

With all that, a significant speed-up of growth is hard to expect this and the next two years. As in the Balkan region as a whole, sluggish growth seems like the most probable post-crisis recovery prospect.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1]	2013	2014 Forecast	2015
Population, th pers., mid-year	3842.3	3843.0	3843.1	3839.7	3843.0	3842	3842	3842
Gross domestic product, BAM mn, nom. [2]	24898	24202	24773	25666	26000	26700	27800	29200
annual change in % (real) [2]	5.6	-2.8	0.7	1.0	-0.7	0.8	2.0	3.0
GDP/capita (EUR at exchange rate)	3300	3200	3300	3400	3500	3500	3700	3900
GDP/capita (EUR at PPP)	6500	6200	6400	6600	6600	.	.	.
GDP by expend. approach, BAM mn, nom. [2]	26783	26378	26410	27240	.	.	.	.
annual change in % (real) [2]	4.9	-4.2	-0.6	2.0	.	.	.	.
Consumption of households, BAM mn, nom. [2]	21752	20927	21338	21918	21900	.	.	.
annual change in % (real) [2]	5.5	-4.6	0.1	-0.3	-2.0	1.0	1.0	2.0
Gross fixed capital form., BAM mn, nom. [2]	6744	5380	4779	5241	5400	.	.	
annual change in % (real) [2]	15.9	-19.4	-11.8	7.0	0.0	6.0	5.0	5.0
Gross industrial production								
annual change in % (real)	7.3	1.5	3.7	6.4	-5.2	5.0	7.0	5.0
Gross agricultural production								
annual change in % (real)	9.1	3.9	-7.1	2.0	.	.	.	.
Construction output total [3]								
annual change in % (real)	16.9	-7.2	-12.4	-5.1	.	.	.	.
Employed persons, LFS, th, April	890.2	859.2	842.8	816.0	813.7	810	812	820
annual change in %	4.8	-3.5	-1.9	-3.2	-0.3	-0.5	0.2	1.0
Employees total, reg., th, average	705.6	697.6	695.7	691.2	688.0	692	692	699
annual change in %	2.9	-1.1	-0.3	-0.6	-0.5	0.5	0.0	1.0
Unemployed persons, LFS, th, April	272.0	272.3	315.1	310.9	316.6	313	312	311
Unemployment rate, LFS, in %, April	23.4	24.1	27.2	27.6	28.0	28.0	28.0	27.0
Unemployment rate, reg., in %, end of period	40.6	42.4	42.7	43.8	44.0	44.0	44.0	43.0
Average gross monthly wages, BAM	1113	1204	1217	1273	1290	1310	1350	1400
annual change in % (real, net)	8.4	5.6	-1.1	-1.4	-0.9	.	.	.
Consumer prices, % p.a.	7.5	-0.4	2.1	3.7	2.1	2.0	2.0	2.0
Producer prices in industry, % p.a. [4]	8.6	-3.2	0.9	3.7	1.5	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP								
Revenues	44.0	43.0	43.8	44.2	43.5	43.5	44.0	44.0
Expenditures	46.2	47.5	46.3	45.5	46.5	46.0	46.5	46.0
Deficit (-) / surplus (+)	-2.2	-4.4	-2.5	-1.3	-3.0	-2.5	-2.5	-2.0
Public debt, nat.def., % of GDP [5]	30.8	36.2	39.6	40.7	43.1	43.0	44.0	45.0
Central bank policy rate, % p.a., end of period [6]	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-1771.3	-777.7	-719.3	-1141.9	-1200.0	-1300	-1400	-1500
Current account, % of GDP	-13.9	-6.3	-5.7	-8.7	-9.0	-9.5	-9.9	-10.1
Exports of goods, BOP, EUR mn [7]	3522.0	2920.2	3761.9	4347.2	2560.0	2700	3000	3300
annual growth rate in %	13.9	-17.1	28.8	15.6	-2.5	7.0	10.0	10.0
Imports of goods, BOP, EUR mn [7]	8344.6	6330.1	6994.1	7976.0	6720.0	7100	7600	8100
annual growth rate in %	15.4	-24.1	10.5	14.0	-2.5	5.0	7.0	7.0
Exports of services, BOP, EUR mn [7]	1131.9	1024.9	974.5	922.3	1520.0	1580	1640	1710
annual growth rate in %	6.6	-9.5	-4.9	-5.4	3.0	4.0	4.0	4.0
Imports of services, BOP, EUR mn [7]	467.7	461.7	407.4	378.6	410.0	420	440	460
annual growth rate in %	10.8	-1.3	-11.8	-7.1	-0.5	3.0	5.0	5.0
FDI inflow, EUR mn [7]	683.8	180.5	173.6	313.0	400.0	500	500	800
FDI outflow, EUR mn [7]	11.2	4.3	31.7	14.2	30.0	0	0	0
Gross reserves of NB excl. gold, EUR mn [8]	3218.9	3143.8	3267.6	3207.0	3150.0	3200	3200	3300
Gross external public debt, EUR mn	2168.0	2676.2	3215.4	3405.3	3700.0	4000	4000	4100
Gross external debt, % of GDP	17.0	21.6	25.4	25.9	27.8	29.4	28.2	27.5
Exchange rate BAM/EUR, average	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9982	1.0137	1.0071	1.0186	1.0227	.	.	.

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

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

Vladimir Gligorov

Serbia:
Weather holds the key

The official expectation is growth of 2% in 2013, then of above 3% in 2014 and a speed-up to 5% from 2015 onwards. This year, recovery should come from higher investments, increased exports, recovery of agriculture and stabilization of the labour market. In the medium term, employment and private consumption should also improve with persistently growing investments and exports. Also, agricultural production should continue to increase and become less reliant on the changing mood of the weather. How realistic is all that?

Recovery of agricultural production depends on the weather. Current forecasts assume a reversal to the mean level of production. If the weather is tolerably good, growth of agricultural production should be significant, compared to last year's fall of 18%. More than that would require some additional help from the weather conditions. Still, even with an exceptionally good year, the contribution of agricultural production to overall growth cannot be too large. Also, given that the mean level of production has stayed practically the same over a rather long period of time, a sustained contribution of agricultural production to overall economic growth cannot be expected.

What improved weather conditions this year could additionally help with is inflation. The variability of food prices plays quite a significant role in the speed-ups and decelerations of inflation. In those, changing weather conditions play a very important part through their effect on the supply of agricultural products and the prices of food in general. So, if the weather obliges this year, inflation should decelerate from the rate of above 12% at the end of last year to the targeted 5% to 6% rate at the end of this year. Of course, that is conditional on the exchange rate and monetary policy too as well as on the growth of GDP.

More important is the expected increase in exports of FIAT cars. Optimistic projections put the growth of exports at 25% this year. The net export effect is uncertain though. In the past, growth acceleration has tended to go together with a widening of the trade and current account deficits because of the high dependence of exports on imports (which is also the case with the car industry now) and due to increased inflow of foreign financing. Even with GDP declining by around 2%, the current account deficit widened due to increased government borrowing from abroad last year. Official projections count with declining trade deficits, but that may not be consistent with the planned increases of investments. Most of these investments are supposed to come from abroad, which means that trade and current account deficits will continue to be large and perhaps even widening until at some point growing exports catch up with imports. That is probably not a medium-term perspective.

Table RS

Serbia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th. pers., mid-year	7350.2	7320.8	7291.4	7160.0	7130.0	7100	7070	7040
Gross domestic product, RSD bn, nom. 2)	2661.4	2720.1	2881.9	3175.0	3400.0	3600	3900	4200
annual change in % (real) 2)	3.8	-3.5	1.0	1.6	-1.9	1.0	2.0	3.0
GDP/capita (EUR at exchange rate)	4400	4000	3800	4300	4200	.	.	.
GDP/capita (EUR at PPP)	9000	8400	8500	8700	8800	.	.	.
Consumption of households, RSD bn, nom. 2)	2023.6	2143.2	2282.8	2600.0	2800.0	.	.	.
annual change in % (real) 3)	6.0	-5.7	-2.0	-0.6	0.0	0.0	1.0	1.0
Gross fixed capital form., RSD bn, nom. 2)	632.4	510.2	512.3	700.0	700.0	.	.	.
annual change in % (real) 3)	8.0	-22.5	-10.0	26.9	-8.0	3.0	3.0	5.0
Gross industrial production 4)								
annual change in % (real)	1.4	-12.6	2.5	2.1	-2.9	3.0	4.0	5.0
Gross agricultural production								
annual change in % (real)	13.7	1.3	1.0	0.8	-18.0	10.0	5.0	10.0
Construction output 5)								
annual change in % (real)	4.7	-19.7	-7.1	7.7	4.0	3.0	3.0	5.0
Employed persons, LFS, th, average 6)	2821.7	2616.4	2396.2	2253.2	2230.0	2200	2200	2200
annual change in %	.	-7.3	-8.4	-6.0	-1.0	-1.0	0.0	1.0
Unemployed persons, LFS, th, average 6)	445.4	503.0	568.7	671.1	705.0	.	.	.
Unemployment rate, LFS, in %, average 6)	13.6	16.1	19.2	23.0	24.0	23.0	23.0	23.0
Unemployment rate, reg., in %, end of period	24.0	25.9	26.7	27.5	30.0	30.0	30.0	28.0
Average gross monthly wages, RSD 7)	45674	44147	47450	52733	57440	.	.	.
real growth rate, % (net wages) 7)	3.9	0.2	0.7	0.2	1.4	.	.	.
Consumer prices, % p.a.	13.5	8.6	6.8	11.0	8.0	6.0	5.0	5.0
Producer prices in industry, % p.a. 8)	12.4	5.6	12.7	14.2	5.5	.	.	.
General governm.budget, nat.def., % of GDP								
Revenues	42.9	42.1	42.5	41.0	43.0	.	.	.
Expenditures	45.6	46.6	47.2	46.0	50.0	.	.	.
Deficit (-) / surplus (+)	-2.6	-4.5	-4.7	-5.0	-7.0	-4.0	-4.0	-3.0
Public debt, nat.def., % of GDP	29.2	34.7	44.5	48.7	63.0	65.0	65.0	65.0
Central bank policy rate, % p.a., end of period 9)	17.75	9.50	11.50	9.75	8.00	6.0	5.0	5.0
Current account, EUR mn	-7054.0	-2084.4	-2082.2	-2770.6	-3300.0	-3300	-3350	-3150
Current account, % of GDP	-21.6	-7.2	-7.4	-8.9	-11.0	-11.0	-11.0	-10.1
Exports of goods, BOP, EUR mn	7416.0	5977.8	7402.4	8439.7	8700.0	9400	10300	11300
annual growth rate in %	16.2	-19.4	23.8	14.0	3.1	8.0	10.0	10.0
Imports of goods, BOP, EUR mn	15917.2	11096.3	12176.0	13758.1	14400.0	15400	16500	18200
annual growth rate in %	18.3	-30.3	9.7	13.0	4.7	7.0	7.0	10.0
Exports of services, BOP, EUR mn	2741.4	2500.0	2667.1	3032.1	3180.0	3400	3600	3800
annual growth rate in %	19.0	-8.8	6.7	13.7	4.9	7.0	7.0	5.0
Imports of services, BOP, EUR mn	2926.1	2481.7	2661.9	2869.6	2980.0	3100	3400	3700
annual growth rate in %	14.1	-15.2	7.3	7.8	3.8	5.0	10.0	10.0
FDI inflow, EUR mn	2017.5	1410.1	1003.1	1948.9	200.0	1000	1000	1000
FDI outflow, EUR mn	193.1	37.6	143.0	122.0	50.0	100	100	100
Gross reserves of NB, excl. gold, EUR mn	7939	10278	9555	11497	10295	.	.	.
Gross external debt, EUR mn	21088	22487	23786	24125	25500	.	.	.
Gross external debt, % of GDP	64.6	77.7	84.9	77.5	84.7	.	.	.
Exchange rate RSD/EUR, average	81.47	93.94	102.90	101.96	112.98	120	128	135
Purchasing power parity RSD/EUR	40.16	44.27	46.56	50.69	54.46	.	.	.

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

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

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

Finally, investments are expected to post high growth rates not only this year. Those should come from public and private sources. The government is determined to continue to borrow abroad to invest primarily in infrastructure. It has turned to Russia for credits for the modernization of the railway system and to China for investments in roads. Moreover, private investments are encouraged in agriculture and in industry. In addition to subsidies to foreign investors, the budget subsidizes credits for liquidity of the domestic companies, and there are other sweeteners as well that should support investments.

These interest rate subsidies of credits for liquidity are intended to ease the liquidity crunch that the economy is suffering from. So far, the effects have been that troubled companies have been able to refinance their financial obligations. There have been no noticeable effects on investments, which have declined also last year. The government has committed to start paying its own obligations regularly, or rather within 45 days. However, given the high inflation rate, this is still too long a period, though companies try to take advantage of the rising prices by delaying their payments even longer. Still, the main source of problems is in the loss making enterprises and in the growing non-performing loans in the banks.

Finally, the government has taken steps to reduce its fiscal deficit this year and plans to bring it down to practically zero in two years' time. This year this will be accomplished by some tax increases, but mainly with expenditures growing more slowly than inflation. So, public expenditures will be smaller in real terms. In the next two years, the same should be accomplished by public expenditures growing more slowly than the GDP. No nominal cuts are planned for now. With this strategy of fiscal consolidation, it is expected that public debt will reach 65% of GDP this year and should gradually decline over the period of about ten years. This rather crucially depends on the exchange rate because an increasing share of the public debt is in foreign currency. More important is the rising foreign debt, which is already growing towards 100% of GDP and will continue to increase due to persistent current account deficits and the intended reliance on foreign financing. This may prove unsustainable even in the medium run.

Prospect for the next couple of years are rather modest because those depend on the continued recovery of investments and on the weather being supportive of agriculture. In addition, political and social stability need to be preserved which may prove difficult to achieve.

Table XK

Kosovo: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1)]	2013	2014 Forecast	2015
Population, th pers., average	1720	1748	1775	1802	1830	1859	1888	1917
Gross domestic product, EUR mn, nom.	3940	4008	4291	4776	5000	5300	5800	6300
annual change in % (real)	7.2	3.5	3.2	4.5	2.7	3.0	5.0	4.0
GDP/capita (EUR at exchange rate)	2291	2293	2418	2650	2700	.	.	.
GDP/capita (EUR at PPP)	5102	5038	5296	5632	5800	.	.	.
Consumption of households, EUR mn, nom.	3647	3605	3822	4220	4300	.	.	.
annual change in % (real)	12.1	8.9	-0.2	5.9	-0.6	1.0	4.0	3.0
Gross fixed capital form., EUR mn, nom.	938	1027	1193	1374	1500	.	.	.
annual change in % (real)	27.8	20.4	8.6	15.5	6.6	8.0	10.0	9.0
Gross industrial production [2)]								
annual change in % (real)	32.7	-1.5	-5.6	19.2	-10.0	0.0	7.0	10.0
Gross agricultural production [2)]								
annual change in % (real)	19.9	19.3	0.5	26.3	0.0	4.0	4.0	3.0
Construction output [2)]								
annual change in % (real)	4.7	32.8	-27.7	11.2	3.0	2.0	6.0	4.0
Unemployment rate, LFS, in %, average	47.5	45.4	45.1	44.8	44.0	43.0	41.0	39.0
Reg. unemployed persons, th, end of period	336	339	335	325	264	.	.	.
Average net monthly wages, EUR	205	246	286	348	360	.	.	.
annual change in % (real, net)	-5.8	22.8	12.5	14.6	0.9	1.0	10.0	5.0
Consumer prices, % p.a.	9.4	-2.4	3.5	7.3	2.5	3.0	4.0	4.0
Producer prices in industry, % p.a.	1.3	3.8	4.7	5.7	0.3	.	.	.
General governm.budget, nat.def., % of GDP [3)]								
Revenues	33.0	36.7	33.8	35.3	35.2	35.0	37.0	38.0
Expenditures	33.0	32.6	35.1	35.5	36.3	36.0	39.0	38.0
Deficit (-) / surplus (+)	0.0	4.1	-1.3	-0.2	-1.2	-1.0	-2.0	0.0
Public debt, nat.def., % of GDP [3)]	.	6.2	6.1	5.3	6.2	6.9	8.3	7.6
Central bank policy rate, % p.a., end of period [4)]	13.8	14.1	14.3	13.7	12.7	.	.	.
Current account, EUR mn	-460.9	-412.1	-558.6	-673.6	-564.0	-600	-900	-800
Current account, % of GDP	-11.7	-10.3	-13.0	-14.1	-11.3	-11.3	-15.5	-12.7
Exports of goods, BOP, EUR mn	216.6	177.2	305.0	324.9	283.1	290	330	350
annual growth rate in %	22.2	-18.2	72.1	6.5	-12.9	2.4	13.8	6.1
Current account, % of GDP	1866.3	1828.9	2057.1	2383.9	2348.3	2400	2800	2600
annual growth rate in %	22.0	-2.0	12.5	15.9	-1.5	2.2	16.7	-7.1
Exports of services, BOP, EUR mn	392.4	479.8	530.1	634.0	570.3	600	630	650
annual growth rate in %	6.1	22.3	10.5	19.6	-10.1	5.2	5.0	3.2
Imports of services, BOP, EUR mn	240.8	285.3	386.1	352.8	297.8	310	350	330
annual growth rate in %	-7.2	18.5	35.3	-8.6	-15.6	4.1	12.9	-5.7
FDI inflow, EUR mn	366.5	291.4	365.8	394.6	238.5	700	400	500
FDI outflow, EUR mn	25.0	10.5	34.7	15.7	15.8	20	30	40
Gross reserves of NB excl. gold, EUR mn	670	576	634	575	806	.	.	.
Gross external debt, EUR mn	707	1146	1348	1427	1537	.	.	.
Gross external debt, % of GDP	17.9	28.6	31.4	29.9	30.7	.	.	.
Purchasing power parity EUR/EUR	0.449	0.455	0.457	0.471	0.468	.	.	.

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

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

Mario Holzner

Kosovo:
Corruption holds no passport

Kosovo's appearance in Western media is sporadic and often connected to negative news. Most recently a scandal about supposedly embezzled money in a passport production contract involving the private Austrian State Printing House and the Kosovo Ministry of the Interior supports stereotypes about doing business in the Balkans. It happens that the EUR 1.4 million allegedly stolen by a local intermediary consultant make exactly 10% of the overall sum as contracted for the delivery of 200,000 passports to Kosovo, which is informally known as the going local rate for a government bribe. However, there are now more and more signs of hope for a better future for a so far unfortunate country.

A normalization of Kosovo's relationship with its former hegemonic power Serbia is one of the preconditions for both countries' successful European integration process. In mid-January 2013 the two prime ministers agreed in EU-mediated talks that customs officials from both sides will operate under one roof at the border crossings between Serb-controlled Northern Kosovo and Serbia. Tariffs and taxes collected there will run into a fund collectively managed by the local Serbs, Prishtina and Brussels and benefit the Serb-dominated northern municipalities in Kosovo. Even if this does not sound like a major breakthrough it still appears that for the first time serious negotiations about the future status of Northern Kosovo have been conducted. Also the two sides have agreed to appoint liaison officers in order to facilitate future negotiations.

While apart from Serbia also a number of other states as well as international organizations have not yet recognized Kosovo as an independent state, the IMF has accepted Kosovo as a full member already back in 2009. A second stand-by arrangement in the amount of more than EUR 100 million was approved by the IMF Executive Board on 27 April 2012. So far the government of Kosovo has met all the conditionalities. One of the major objectives is the restocking of the government cash buffers; these were close to the IMF's recommended level of EUR 300 million (or about 6% of GDP) by the end of 2012. The overall agreement has rather a precautionary character and does not imply any smouldering current account crisis.

Nevertheless, the current account deficit of Kosovo is persistent and large, no matter whether accepting official statistics where it hovers around 12% of GDP or the IMF estimates that rather assume a deficit of around 17%. The difference seems to be inter alia in the treatment of unrecorded remittances. In any case, remittances are vast (somewhere around EUR 600 million) and hence a decisive factor in the financing of Kosovo's imports which are as large as about half of GDP. Interestingly, the revenues from the exports of goods make up only about half of the remittances. By far the most important host countries for migrant workers from Kosovo are Germany and Switzerland.

Close to 60% of all remittances are assumed to originate from these two countries, which makes a further improvement of growth there also indicative for growth development in Kosovo.

Other statistics where official sources differ from the IMF are related to the general government budget. While official figures like to include international grants in their revenue (and expenditure) data (both at about 35% of GDP in recent years), the IMF publishes figures not including official transfers, which amount to about 7% of GDP. Thus apart from the remittances also international aid is an important source of revenue to cover the huge trade deficit. Budget deficits are negligible and consequently public debt hardly exists (around 6% of GDP). The government has only recently started to auction three- and six-month treasury bills at annualized yields of between 2% and 3%. The intention is to issue bills with a maturity of 12 months in 2013, in an effort to lay the foundations for self-sustained budget financing.

After decades (or even centuries) of neglect, infrastructure is in a very poor state. The non-electrified railway network is still mostly based on the original tracks built in the 1870s by the Ottoman railway company Chemins de fer Orientaux. A low degree of passenger and freight traffic is kept alive using rolling stock from the 1960s. So far the government has mainly invested in the road construction of highway R7 from the capital Prishtina to the Albanian border. The construction started in 2010 and is scheduled to be finalized in 2013. Also the budget for 2013 includes a first allocation to initiate highway R6 to the Macedonian border. Given the huge needs for more infrastructure improvement, the enormous amount of idle workforce and the extremely low levels of public (and external) debt, the government of Kosovo should consider a substantial increase of its infrastructure budget and the issuing of long maturity treasury notes and treasury bonds.

Although the exact amount of idle workforce is somewhat ambiguous, it is in any case tremendous. In recent years more than 300,000 persons were officially registered as unemployed out of a population of less than two million inhabitants. Labour force surveys suggest that the unemployment rate is up to about 45%. Kosovo having Europe's highest fertility rate and youngest population, there is constant pressure on the labour market and so far emigration has been the main release valve. However, prolonged reliance on remittances and international aid might not be a good alternative to a sustainable growth strategy, especially in circumstances where policy options are limited.

Persistent current account deficits suggest, apart from missing productive capacities, a substantial lack of competitiveness. Average wages in Kosovo are at less than EUR 400 per month and GDP per capita at PPP is at less than EUR 6000. These are by far the lowest values among all the potential EU candidate countries. Still, a substantial devaluation could improve the country's competitiveness and make the development of an export industry that is able to cover the expenses for imports viable. However, the means for a real devaluation are very narrow, at best.

A nominal depreciation of the currency is impossible given the fact that the euro was adopted as national currency. Also, it is to be expected that euroization would remain high if an own national currency were to be introduced. However, this is very unlikely to happen anyway. Other equivalent ways of devaluation are equally improbable. Furthermore, an introduction of higher tariff rates and export subsidies is incompatible with European integration. A fiscal devaluation via an increase of indirect and a decrease of direct taxation is not a realistic option either given the fact that current taxes on income and wealth account for only about 11% of overall government revenues and the marginal income tax rate is only at 10%. Incomes policy is difficult to organize in Kosovo given that the two most important trade unions are in constant dispute and are confined to the public sector only. Finally, as a second best solution, massive investment in public infrastructure and utilities that has the ability to lower local cost of production would be a way to simulate a real depreciation as well as to stimulate economic development which is rather sluggish given the extremely low level of GDP.

Forecasting short-run GDP growth for Kosovo is still rather difficult as there is a lack of forward looking indicators and some of the few existing ones are not that indicative. One of them are the statistics on newly issued loans. However, these have not so far been that much correlated to real GDP developments as the figures are still quite low (the flow of new loans was less than 15% of GDP in 2012) and hence rather volatile. After two years of two-digit growth rates of new loans, the 2012 figure depicts a nominal drop of 7%. This is especially due to shrinkage in long-term loans to non-financial corporations, while consumer loans faced stagnation. In general the banking system appears to be sound. The share of non-performing loans (NPL) is very small by way of comparison. In September 2012 the NPL ratio was at 7%, which is one percentage point higher than a year earlier. Over the same period, the capital adequacy ratio of the financial sector increased slightly to almost 18%, which again seems to be rather favourable when compared to other countries in the region.

Overall the best indicators for growth in Kosovo remain the forecasts for the GDP growth rates of Germany and Switzerland, where most of Kosovo's diaspora is living and sending remittances from. The European Commission forecasts for Germany an almost stable growth development for 2013 (0.5%) and a substantial improvement in 2014 (2%). The Swiss State Secretariat for Economic Affairs expects a slight increase of growth in 2013 (1.3%) and also stronger growth in 2014 (2%) in Switzerland. Certainly downside risks cannot be neglected.

Our forecast for Kosovo's GDP growth is a stable 3% for 2013 and a reinforced growth of 5% in 2014. The improvement in 2014 will not only be due to improved external factors but also due to parliamentary elections likely to be held in early 2014. Thus, a fiscal stimulus can be expected to boost both consumption and investment. The budget deficit will not necessarily be affected too much altogether as there are substantial inflows of funds expected in the wake of the privatization of the Post and Telecom of Kosovo (PTK) which is scheduled for mid-2013. The aim is to sell 75% of PTK, corresponding to the two business units Telecom (fixed telephony) and Vala (mobile telephony).

Table KZ

Kazakhstan: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	15674.0	16093.5	16323.3	16558.7	16793.7	16950	17100	17200
Gross domestic product, KZT bn, nom.	16053	17008	21816	27572	30073	33500	37500	42300
annual change in % (real)	3.3	1.2	7.3	7.5	5.0	5.0	6.0	6.5
GDP/capita (EUR at exchange rate)	5800	5100	6800	8200	9300	10000	11100	12300
GDP/capita (EUR at PPP)	9200	9000	9700	10400	10900	.	.	.
Consumption of households, KZT bn, nom.	6871	7913	9721	11569	13400	15200	17100	19000
annual change in % (real)	7.8	0.6	11.8	10.9	10.0	6.0	6.0	5.0
Gross fixed capital form., KZT bn, nom.	4309	4727	5307	5772	6200	6800	7600	8800
annual change in % (real)	1.0	-0.8	3.8	3.9	3.5	5.0	7.0	9.0
Gross industrial production								
annual change in % (real)	2.6	2.7	9.6	3.8	0.5	4.0	7.0	10.0
Gross agricultural production								
annual change in % (real)	-6.9	14.6	-11.7	26.8	-17.8	12.0	5.0	5.0
Construction industry								
annual change in % (real)	1.7	-3.3	2.4	2.8	2.9	5.0	8.0	10.0
Employed persons, LFS, th, average 3)	7857.2	7903.4	8114.2	8301.6	8507.7	8590	8680	8770
annual change in %	3.0	0.6	2.7	2.3	1.0	1.0	1.0	1.0
Unemployed persons, LFS, th, average 3)	557.8	554.5	496.5	473.0	474.8	.	.	.
Unemployment rate, LFS, in %, average 3)	6.6	6.6	5.8	5.4	5.3	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period 3)	0.6	0.6	0.4	0.4	0.4	.	.	.
Average gross monthly wages, KZT 4)	60805	67333	77611	90028	102052	.	.	.
annual change in % (real, gross)	-1.0	3.2	7.6	7.1	7.8	.	.	.
Consumer prices (HICP), % p.a.	17.0	7.3	7.1	8.3	5.2	7.0	6.0	6.0
Producer prices in industry, % p.a.	36.8	-22.0	25.2	27.2	3.5	5.0	5.0	6.0
General governm.budget, nat.def., % of GDP								
Revenues	25.1	20.6	19.7	19.5	19.3	.	.	.
Expenditures	27.2	23.5	22.1	21.5	22.3	.	.	.
Deficit (-) / surplus (+)	-2.1	-2.9	-2.4	-2.1	-3.0	-2.0	-2.0	-1.5
Public debt, nat.def., % of GDP	8.3	12.3	14.4	11.8	12.7	14.0	15.0	16.0
Central bank policy rate, % p.a., end of period 5)	10.5	7.0	7.0	7.5	5.5	.	.	.
Current account, EUR mn 6)	4298	-2950	1322	9770	6823	8700	10800	12000
Current account, % of GDP	4.7	-3.6	1.2	7.2	4.3	5.1	5.7	5.7
Exports of goods, BOP, EUR mn 6)	48905	31504	46376	63551	71866	76700	84419	94500
annual growth rate in %	38.5	-35.6	47.2	37.0	13.1	6.7	10.1	11.9
Imports of goods, BOP, EUR mn 6)	26128	20769	24786	29125	36736	40000	44000	50500
annual growth rate in %	7.5	-20.5	19.3	17.5	26.1	8.9	10.0	14.8
Exports of services, BOP, EUR mn 6)	3007	3038	3203	3239	3801	4100	4300	4600
annual growth rate in %	15.5	1.0	5.4	1.1	17.3	7.9	4.9	7.0
Imports of services, BOP, EUR mn 6)	7556	7200	8534	7845	9806	11100	12500	14000
annual growth rate in %	-11.8	-4.7	18.5	-8.1	25.0	13.2	12.6	12.0
FDI inflow, EUR mn 6)	9732	9497	8750	9869	10986	11900	13100	13800
FDI outflow, EUR mn 6)	818	2266	5934	3311	1101	1400	1600	1700
Gross reserves of NB excl. gold, EUR mn	12630	14352	19044	19477	16746	.	.	.
Gross external debt, EUR mn	76278	78674	89283	96821	107000	.	.	.
Gross external debt, % of GDP	84.1	95.1	80.1	71.7	68.2	.	.	.
Average exchange rate KZT/EUR	177.04	205.68	195.67	204.11	191.67	197.6	197.6	200.2
Purchasing power parity KZT/EUR 7)	111.01	118.00	137.95	160.26	163.84	.	.	.

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

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

Source: National statistics (National Bank, Agency of Statistics etc). Forecasts by wiiw.

Olga Pindyuk

Kazakhstan:
Shift from consumption to investment promotion

Kazakhstan's real GDP increased by about 5% in 2012. Growth decelerated compared to 2011 by 2.5 p.p. – primarily due to a drop in production of the oil sector, ferrous metallurgy, and agriculture. Oil extraction decreased by 1.4% because of technical difficulties, which are perceived to be only temporary. In 2013, Kazakhstan's oil production is expected to increase by 9% to 1.73 million barrels per day (bpd)[28], in particular owing to the start of the Kashagan field operation[29]. During the first year, oil extraction in the new field is forecasted to be only about 100 thousand bpd, but in 2014, the volume may reach already 300 thousand bpd. World oil prices are assumed to remain near or slightly below USD 100 per barrel during 2013-2015, which should allow for a steady increase in Kazakhstan's oil exports. An increase in capacity of the Caspian Pipeline in 2013 will allow for the transport of increased volumes of oil.

Agriculture suffered from severe drought in 2012, which resulted in an output decline by 18%; provided weather conditions are not extreme during the forecast period, the sector will experience moderate growth. Ferrous metallurgy was affected by the sluggish global demand and the sector's output dropped by 12% in 2012. During 2013-2015, global demand for steel is forecasted to recover, which should boost Kazakhstan's ferrous metals production.

In contrast, the transport equipment sector demonstrated exceptionally strong growth in 2012: its output almost doubled. In particular, railway cars production picked up as the state has been creating joint ventures with foreign investors to produce different kinds of passenger and cargo trains – demand for these has been growing inside the country with the government supporting investment into the railroad infrastructure. Besides, production of passenger cars showed very fast growth, which is to a large extent a result of import substitution due to higher import tariffs imposed on cars along with the entry of Kazakhstan into the Customs Union with Belarus and Russia.

The construction sector remained anaemic in 2012 with only 2.9% growth. The sector has still been suffering from the housing bubble effects, so construction companies face difficulties in obtaining financing from banks. The government has announced its intentions to actively participate in the residential construction market, in particular through the state-owned National Welfare Fund 'Samruk-Kazyna', which is going to run construction projects. We forecast that the construction sector will gradually accelerate its growth over the forecast period to reach 10% year-on-year in 2015.

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28 According to the US Energy Information Administration forecast.

29 Kashagan is an oil field discovered in 2000, which is estimated to have commercial reserves of 9 to 16 billion barrels of oil – the largest field found in the world during the past 30 years. Full operation of the Kashagan field can potentially allow almost doubling the country's oil production.

Analysing Kazakhstan's GDP in terms of expenditures reveals that growth in 2012 was primarily driven by expanding household and government consumption. We estimate real household consumption growth in 2012 at 10% year-on-year, higher than the growth of real wages (7.7%) and real household incomes (about 6%) during that period. Double-digit consumption growth continues since 2010, and during all this time it has been faster than growth of wages or household income. A significant factor contributing to that trend is the fast increase in bank lending to finance households' consumption – this kind of short-term loans appears to be a safe harbour for banks in the high-risk and uncertain investment environment. During the first 11 months of 2012, newly issued household consumption loans were 67% higher than during the same period in 2011; in turn, for corporate loans this indicator was 29%. It has been already five years that Kazakhstan's banking sector is in crisis, but so far no light can be seen at the end of the tunnel as the cleansing of banks' balance sheets from bad assets has been advancing rather slowly. Non-performing loans by the most modest estimates still account for about 30% of total loans. The problem loans fund of the National Bank has turned out to be rather inefficient as it buys only non-real estate bad loans, and these constitute a minority of bad loans in the country's banking system. On the bright side, BTA, one of the country's biggest banks, managed to agree on a second restructuring, which decreases its debt by more than three times. Some banks started to set up Special Purpose Vehicles and transfer bad loans to them, but significant progress there is still to be seen.

Investment growth was rather weak in 2012 – according to our estimates, gross fixed capital formation increased by just about 3.5% in real terms. In particular, such meek results were caused by decline in investment into oil exploration and extraction. New investment into the oil sector (especially, the USD 20 billion worth 'Future growth' project in the Tengiz oil field) and ongoing projects of transport infrastructure development and modernization of refineries, which are financed in part from abroad, should support the investment dynamics in the years to come. Besides, the government has announced shifting its priorities from supporting consumption through multiple raises of pensions and salaries to infrastructure development, residential construction, human capital development, and industry diversification. Thus we expect to see a boost to investment from the government side. Shifting the focus of government policies will cause a slowdown in private consumption growth to 6-5% in real terms in the coming years. Investment growth, by contrast, is expected to pick up – to 5% in 2013, 7% in 2014, and 9% in 2015.

Exports of goods in 2012 increased only by about 3% in USD terms, reflecting the drop in oil and metals exports. Merchandise imports, on the other hand, grew quite fast, by about 15% in USD terms. (Export growth was mostly in physical terms, while in the case of imports, price increases accounted for more than half of the growth.) Such dynamics caused a narrowing of the current account surplus from 7.2% of GDP in 2011 to about 4.3% of GDP in 2012 (the decline in the trade surplus was partially offset by a decrease in the negative income balance due to lower profits of multinational oil companies). We expect that imports will continue to grow fast to satisfy the increasing investment demand. Exports will also pick up, but, notwithstanding increasing oil production, they will grow at a slower pace than imports. The current account surplus will remain at a hefty 5-6% of GDP during the forecasting period. Thus it will be improving investment dynamics providing for an overall real GDP growth acceleration: by 2015, GDP growth will reach 6.5%.

Peter Havlik

Russian Federation:
Slower growth, more state intervention to the rescue?

Russian economic growth was slowing down during 2012. Falling volumes of energy exports and the lack of progress in diversification are the main culprits for the disappointing growth performance, and our previous assessment regarding growth prospects remains broadly valid. Weaker demand in the euro area could be only partly overcompensated by buoyant household consumption and investments. In the short run – as long as the oil price stays near or even above USD 100 per barrel – Russia may comfortably live without any marked economic policy changes. However, the growth outlook may worsen due to the aggravated crisis in the euro area and, in the medium and long run, because of potentially declining energy prices as a result of shale and LNG gas effects. The expected rate of GDP growth – below yet close to 4% in the coming couple of years – will be driven mainly by robust domestic demand. The contribution of net exports to GDP growth is negative; it may even further deteriorate if import volumes grow faster than those of exports in case more shale gas is coming to Europe and little export diversification occurs. Though there is still a sizeable trade and current account surplus (the latter is estimated at more than 4% of GDP in 2012, about 1 pp less than in 2011), given the projected paths of export and import revenues and diminishing trade surpluses, even the Central Bank of Russia now reckons with a gradually deteriorating current account that will eventually turn into a deficit.

On the supply side, industry remained sluggish with a growth below 3% in 2012; construction output increased probably even less (both sectors were displaying a downward sloping trend in the course of the year 2012). Agricultural production declined last year as the strong upturn in 2011 could not be repeated. Bumper harvests boosted GDP growth in 2011 and dampened consumer price increases, the carry-on effects have also been instrumental in the reduction of consumer price inflation. Indeed, consumer prices increased by just 5% in 2012 on annual average; even producer price inflation fell to single digits. These developments, together with a slight increase in employment (and the related drop in unemployment), as well as another fiscal surplus, have been the main positive economic developments in the past 12 months.[30]

With persistent trade and current account surpluses, foreign exchange reserves are being continuously replenished (they reached nearly USD 540 billion at the beginning of 2013), despite sizeable capital flight: after more than USD 85 billion in 2011, the outflow of capital from Russia was probably of a similar magnitude in 2012. These capital outflows are partly linked to genuine

[30] Without revenues from oil and gas, the federal budget for 2012 would be in deficit amounting to more than 10% of GDP.

Table RU

Russia: Selected Economic Indicators

	2008	2009	2010	2011	2012 1)	2013	2014 Forecast	2015
Population, th pers., average 2)	141956	141902	142938	142961	143000	142500	142000	141500
Gross domestic product, RUB bn, nom. 3)	41277	38807	46322	55799	62357	69200	76600	84000
annual change in % (real) 3)	5.2	-7.8	4.5	4.3	3.4	3.6	3.8	3.7
GDP/capita (EUR at exchange rate)	8000	6200	8000	9500	10900	.	.	.
GDP/capita (EUR at PPP)	13000	11800	12500	13300	13900	.	.	.
Consumption of households, RUB bn, nom. 3)	19967	20986	23618	27168	30518	.	.	.
annual change in % (real) 3)	10.6	-5.1	5.5	6.4	6.6	4.5	5.0	4.5
Gross fixed capital form., RUB bn, nom. 3)	9201	8536	10014	12076	13767	.	.	.
annual change in % (real) 3)	10.6	-14.4	5.8	10.2	6.0	7.0	7.0	8.0
Gross industrial production 4)								
annual change in % (real)	2.1	-9.3	8.2	4.7	2.6	4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	10.8	1.4	-11.3	23.0	-4.7	.	.	.
Construction output								
annual change in % (real)	12.8	-13.2	3.5	5.1	2.5	4.0	5.0	5.0
Employed persons, LFS, th, average	70965.1	69284.9	69803.6	70731.8	71342.1	71500	71000	71000
annual change in %	0.6	-2.4	0.7	1.3	0.9	0.2	-0.7	0.0
Unemployed persons, LFS, th, average	4791.5	6372.8	5636.0	5020.0	4280.7	4300	4300	4300
Unemployment rate, LFS, in %, average	6.3	8.4	7.5	6.6	5.7	6.0	6.0	6.0
Unemployment rate, reg., in %, end of period	2.0	2.9	2.1	1.7	1.4	.	.	.
Average gross monthly wages, RUB	17290.1	18637.5	20952.2	23693.0	26690.0	.	.	.
annual change in % (real, gross)	11.5	-3.5	5.2	2.8	7.8	.	.	.
Consumer prices, % p.a.	14.1	11.8	6.9	8.5	5.1	5.0	5.0	5.0
Producer prices in industry, % p.a. 5)	21.4	-7.2	12.2	19.0	6.8	7.0	7.0	6.0
General governm.budget, nat.def., % of GDP								
Revenues	38.8	35.0	34.6	37.4	38.0	.	.	.
Expenditures	33.9	41.4	38.0	35.9	36.5	.	.	.
Deficit (-) / surplus (+)	4.9	-6.3	-3.5	1.6	1.5	0.0	0.0	.
Public debt, nat.def., % of GDP 6)	5.7	8.3	8.4	9.0	8.0	7.0	6.0	.
Central bank policy rate, % p.a., end of period 7)	13.00	8.75	7.75	8.00	8.25	.	.	.
Current account, EUR mn 8)	70546	34893	53588	70976	63245	50000	40000	40000
Current account, % of GDP	6.2	4.0	4.7	5.2	4.1	3.0	2.2	2.0
Exports of goods, BOP, EUR mn 8)	321353	217796	302039	374872	412840	440000	470000	500000
annual growth rate in %	24.2	-32.2	38.7	24.1	10.1	6.6	6.8	6.4
Imports of goods, BOP, EUR mn 8)	198876	137691	187448	232553	260913	300000	350000	400000
annual growth rate in %	21.8	-30.8	36.1	24.1	12.2	15.0	16.7	14.3
Exports of services, BOP, EUR mn 8)	34874	29859	33912	38797	49087	50000	55000	60000
annual growth rate in %	21.6	-14.4	13.6	14.4	26.5	1.9	10.0	9.1
Imports of services, BOP, EUR mn 8)	51424	44099	55550	64612	83937	95000	110000	130000
annual growth rate in %	21.1	-14.2	26.0	16.3	29.9	13.2	15.8	18.2
FDI inflow, EUR mn 8)	51107	26203	32635	37973	40000	50000	55000	60000
FDI outflow, EUR mn 8)	37882	31346	39598	48318	40000	40000	40000	40000
Gross reserves of CB, excl. gold, EUR mn	291920	290380	335251	350786	367368	.	.	.
Gross external debt, EUR mn	340692	325639	369524	417707	471094	.	.	.
Gross external debt, % of GDP	30.1	37.0	32.1	30.6	30.2	.	.	.
Exchange rate RUB/EUR, average	36.4	44.1	40.3	40.9	39.9	41	42	43
Purchasing power parity RUB/EUR 9)	22.4	23.1	25.8	29.4	31.3	.	.	.

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

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

outward FDI, and partly due to tax evasion and the lasting political uncertainties. At the same time, FDI inflows somewhat diminished. Widespread corruption and the generally hostile domestic investment climate have also played an important role whereas the expected reform-enhancing effects of WTO accession are yet to materialize.[31]

The consolidation of the banking sector continues, with credits to both households (including housing mortgages) and enterprises growing (the latter less sharply than the former ones). The share of non-performing loans on mortgages fell below 5% of the total as of end-2012. However, bank loans are used to finance less than 10% of total investment outlays and the overall investment rate remains fairly low. Indeed, the share of investment in GDP is planned to be increased from the current rate of about 20% to 25% by the year 2015 and further to 27% of GDP by the year 2018. With these ambitious targets in mind, a substantial improvement in the investment climate is required. In fact, President Putin required that Russia's Ease of Doing Business investment climate ranking should be raised from 118 in 2012 to 20 in the next couple of years.[32] New privatization plans will also be fostered: The government has announced ambitious plans to privatize – either fully or by selling minority stakes – a number of state-owned companies such as Sovkomflot (sea transport), Sberbank, VTB, Rosnano, Russian Railways, Aeroflot, Sheremetyevo Airport, Rosneft, Transneft, etc. Rosneft's recent purchase of TNK-BP from BP and AAR involving cash and shares settlement with BP may be considered as a specific kind of privatization since BP's share in Rosneft was raised to nearly 20% as a consequence of this transaction.[33] Unfortunately (as mentioned repeatedly in our previous assessments and elsewhere), the recent years have not been used for pursuing economic restructuring and institutional reforms which would bring about the badly needed improvements in the business climate. Russia is as dependent on exports of commodities as ever: oil and gas account for about two thirds of overall exports and for more than 10% of federal budget revenues. Restructuring, modernization and the 'innovation development' preached by former President Medvedev over a number of years and formulated in 'several reform strategies' have so far remained largely on paper. The latest economic reform blueprint aiming at 'achieving sustainable growth in the period of global instability' is currently being elaborated by an expert team headed by Putin's academic advisors S. Glazyev and A. Nekipelov. Their expert group should present specific policy recommendations for boosting economic growth, probably by recommending more interventionist economic policies (in particular increased public investments, R&D spending, government spending and overall efficiency). The new reform blueprint shall be presented to the government by the end of March 2013.[34]

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[31] The recent (November 2012) corruption scandals involve the Ministry of Defence and the prestigious space navigation project GLONASS. German Gref, the head of Sberbank and former Economy Minister, has recently complained that there is very little familiarity with WTO rules even at the government level. He also pleaded for more economic reforms and accelerated privatization (see his recent interview before the World Economic Forum in Davos – *Neue Zürcher Zeitung*, 24 January 2013, p. 19).

[32] In the 2013 ranking, Russia's position improved to 112 – see www.doingbusiness.org.

[33] See *Vedomosti*, 23 October 2012.

[34] See *Vedomosti*, 18 January 2013. In the meantime, the key economic policy tasks have already been adopted by the government (at the end of January 2013) – http://www.government.gov.ru/media/2013/2/4/54690/file/FINAL_N_16.pdf.

The deteriorating political and societal developments after the Medvedev-Putin tandem reshuffle are becoming more apparent; tensions within the ruling tandem have reappeared (visible e.g. in the varying reactions to the harsh sentence for the punk group Pussy Riot, in Putin's criticism of the draft 2013 budget, etc.). The strange coalition between the Orthodox Church and the political leadership which is gambling on the support from conservative parts of Russian society raises uneasy feelings among the liberal opposition, yet it is popular with the nationalists and populists. On the external front, Russian relations with the USA and the EU further worsened (conflict in Syria, Russian ban of USAID, child adoption and restrictions on foreign-supported NGOs, etc.). Russia also became more assertive in energy issues with pressures on Bulgaria, Moldova and Ukraine and Gazprom's disputes with the EU. On the more positive side, some political reforms (such as the reintroduction of regional governors' elections and easier registration of political parties) have been introduced as well. The opposition remains weak and split, it has not managed to gather any visible support.

Any significant breakthrough in modernization and diversification is unlikely in the near future. Furthermore, both economic and political uncertainties have recently increased and Mr Putin's current presidency is assumed to be much weaker than the previous ones; his approval ratings are diminishing while challenges – economic and otherwise – have been on the rise. External risks have also increased: a more pronounced recession in Europe and a slowdown in the global economy may result in lower oil prices. The new role of shale and LNG gas and its impact on global (and European) energy prices may significantly affect Russia's export revenues and budget in the medium and long run.[35] The wiiw baseline scenario assumes that oil prices will stay close to USD 100 per barrel in 2013 and thereafter. The 'horror scenario' (for Russia), with oil prices falling below USD 70 per barrel and the resulting severe consequences for Russian export and fiscal revenues, is unlikely – although the government allegedly makes contingency plans based on a scenario which assumes oil prices falling to USD 60 per barrel.[36] In our baseline scenario, a robust (yet unspectacular) growth rate of GDP of close to 4% during 2014-2015 is expected. This scenario assumes no abrupt policy changes or external shocks and is obviously charged with substantial downside risks. Export revenues grow slowly (if at all) due to stagnating volumes of exported oil and gas. Simultaneously, import volumes are expected to grow at a much faster rate as household consumption and investment continue to expand, both fuelled by the ongoing real currency appreciation. In the medium and long run, economic reforms and investment (including FDI) may eventually be stimulated by WTO membership effects.

[35] For example, Germany, Poland, Italy, Turkey and recently also Bulgaria have already succeeded in obtaining a rebate on gas purchases from Gazprom.

[36] A sudden and sustained drop in oil prices is one of the scenarios elaborated by the expert group for the 2013 World Economic Forum in Davos. In this situation, the expert group expects the government to 'strengthen its hold on the economy …, opening a range of uncertainties about the country's long-term economic future' – see www.weforum.org/issues/strategic-foresight.

Vasily Astrov

Ukraine:
Slipping into recession

According to preliminary estimates, the recession which had started in the third quarter of 2012 deepened in the fourth quarter (to -2.7% on a yearly basis), resulting in stagnating GDP for the year as a whole. The main reason for the rapid deterioration has been the poor performance of exports, particularly (but not only) of steel – Ukraine's most important export item. Partly, this is due to the weakness of global demand and the existing overcapacities, resulting in steel prices plunging by around 30% last year, but it is also a reflection of the structurally low competitiveness of the Ukrainian steel industry. Because of chronic under-investment in modernization during the 'boom' years, the production technologies are largely outdated and energy-intensive[37] – a massive disadvantage in the environment of high prices of Russian gas and domestically produced coal and electricity.[38] The 'scissors' of high production costs and an overvalued currency (more on that see below), on the one hand, and plunging world prices, on the other, imply that steel mills have been increasingly operating at a loss, cut production volumes, and in some cases shut down altogether. In 2012, metals output fell by 5% and exports by 15% (in US dollar terms), while the slump in increasingly uncompetitive oil refining was even more dramatic. Production and export dynamics in these two branches were progressively worsening towards the end of the year, suggesting that the full impact of the crisis may be yet to be felt. Thus, delayed reforms and the lack of restructuring backfire and pose a drag on economic growth.

All in all, we estimate that the negative contribution of net exports (of goods and services) to GDP growth in 2012 reached some 8 p.p., and was over-compensated by the positive contribution of domestic demand, particularly private consumption. Judging by the booming retail trade turnover (+14% in real terms), household consumption recorded double-digit growth for the second consecutive year, backed by impressive gains in nominal wages and the lasting price stability (at least according to the official CPI statistics). On the end-year basis, consumer prices fell by 0.2%, first of all thanks to declining food prices, particularly for sugar and vegetables. Anecdotal evidence suggests however that official CPI statistics could be potentially misleading. Apart from the issue whether the high share of food (50%) in the consumer basket underlying CPI calculations is still appropriate, it may come as a surprise why the price-dampening effect of the record-high harvest of 2011 has not died away yet, while the harvest of 2012 was more modest (agricultural production declined by 4.5% last year).

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37 One quarter of Ukrainian steel is still produced using open hearth furnaces, which e.g. have not been in use in Western Europe since the 1950s.

38 Ukraine's long-standing attempts to re-negotiate the gas contract terms with Russia have proved futile so far (in contrast to many EU countries).

Table UA

Ukraine: Selected Economic Indicators

	2008	2009	2010	2011	2012 [1)]	2013	2014 Forecast	2015
Population, th pers., average	46258	46053	45871	45706	45593	45470	45360	45250
Gross domestic product, UAH bn, nom. [2)]	948.1	913.3	1082.6	1302.1	1400.0	1460	1570	1700
annual change in % (real) [2)]	2.3	-14.8	4.1	5.2	0.2	1.5	3.0	4.0
GDP/capita (EUR at exchange rate)	2700	1800	2200	2600	3000	.	.	.
GDP/capita (EUR at PPP)	5900	5000	5400	5700	5900	.	.	.
Consumption of households, UAH bn, nom. [2)]	582.5	581.7	686.1	865.9	967.0	.	.	.
annual change in % (real) [2)]	13.1	-14.9	7.1	15.7	11.0	3.0	5.0	6.0
Gross fixed capital form., UAH bn, nom. [2)]	250.2	167.6	195.9	241.8	258.0	.	.	.
annual change in % (real) [2)]	-1.2	-50.5	3.9	7.1	3.0	0.0	6.0	6.0
Gross industrial production								
annual change in % (real)	-5.2	-21.9	11.2	7.6	-1.8	3.0	5.0	7.0
Gross agricultural production								
annual change in % (real)	17.1	-1.8	-1.5	17.5	-4.5	.	.	.
Construction output								
annual change in % (real)	-15.8	-48.2	-5.4	11.0	-13.8	.	.	.
Employed persons, LFS, th, average	20972.3	20191.5	20266.0	20324.2	20350.0	20350	20400	20450
annual change in %	0.3	-3.7	0.4	0.3	0.1	0.0	0.2	0.2
Unemployed persons, LFS, th, average	1425.1	1958.8	1785.6	1732.7	1750.0	.	.	.
Unemployment rate, LFS, in %, average	6.4	8.8	8.1	7.9	7.9	7.8	7.7	7.5
Unemployment rate, reg., in %, end of period [3)]	3.0	1.9	2.0	1.8	1.8	.	.	.
Average gross monthly wages, UAH [4)]	1806.3	1905.9	2239.2	2633.0	3025.0	.	.	.
annual change in % (real, gross)	6.8	-9.0	9.7	8.9	14.2	.	.	.
Consumer prices, % p.a.	25.2	15.9	9.4	8.0	0.6	2.5	4.5	4.0
Producer prices in industry, % p.a. [5)]	35.5	6.5	20.9	19.0	3.6	3.0	5.0	5.0
General governm.budget, nat.def., % of GDP								
Revenues	31.4	29.9	29.1	30.6	31.8	.	.	.
Expenditures	32.8	34.0	35.0	32.4	35.4	.	.	.
Deficit (-) / surplus (+) [6)]	-1.5	-4.1	-6.0	-1.8	-3.6	-3.5	-3.0	-2.5
Public debt, nat.def., % of GDP	20.0	34.8	39.9	36.3	36.8	37.5	36.0	35.0
Central bank policy rate, % p.a., end of period [7)]	12.00	10.25	7.75	7.75	7.50	.	.	.
Current account, EUR mn [8)]	-8721	-1242	-2274	-7359	-11209	-8000	-9500	-10500
Current account, % of GDP	-7.1	-1.5	-2.2	-6.3	-8.2	-6.0	-6.7	-6.5
Exports of goods, BOP, EUR mn [8)]	46274	28958	39321	49865	54272	59700	65700	75600
annual growth rate in %	27.2	-37.4	35.8	26.8	8.8	10.0	10.0	15.0
Imports of goods, BOP, EUR mn [8)]	57270	32046	45641	61540	70209	73700	84800	97500
annual growth rate in %	29.9	-44.0	42.4	34.8	14.1	5.0	15.0	15.0
Exports of services, BOP, EUR mn [8)]	12228	9936	12856	13954	15318	16800	18500	20400
annual growth rate in %	18.3	-18.8	29.4	8.5	9.8	10.0	10.0	10.0
Imports of services, BOP, EUR mn [8)]	11039	8248	9538	9576	10545	11600	12800	14100
annual growth rate in %	28.8	-25.3	15.6	0.4	10.1	10.0	10.0	10.0
FDI inflow, EUR mn [8)]	7457	3453	4893	5177	6458	6000	7000	7000
FDI outflow, EUR mn [8)]	690	116	555	138	976	1000	500	300
Gross reserves of NB excl. gold, EUR mn	21847	17825	25096	23593	17186	.	.	.
Gross external debt, EUR mn	72109	72113	88363	97940	104000	.	.	.
Gross external debt, % of GDP	58.6	85.8	86.0	83.4	76.3	.	.	.
Exchange rate UAH/EUR, average	7.708	10.868	10.533	11.092	10.271	11.0	11.0	10.5
Purchasing power parity UAH/EUR [9)]	3.453	3.962	4.407	4.968	5.247	.	.	.

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

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

Notwithstanding the faltering economic growth and nearly non-existent inflation, the revenues of the consolidated budget last year picked up by a healthy 12%, largely thanks to increased tax compliance. However, expenditures grew even more strongly (by 18%), driven in particular by the pre-election hikes in social spending. As a result, the budget deficit climbed to 3.6% of GDP (without taking into account subsidies to the loss-making state energy company Naftohaz), although its financing has been increasingly becoming less of a problem. Despite the rating downgrades by Moody's and S&P in December 2012, the government is having now little trouble to borrow – a reflection of abundant global liquidity, the improved perceptions of the situation in the euro area, and the related rise in the global appetite for risk. Still, given the 'overheated' private consumption and the potentially dangerous swings in financial markets' sentiments, the government would be well-advised to pursue some fiscal austerity. At the same time, the law on the central budget for 2013 envisages only moderate budget consolidation, targeting a 3.2% deficit against the backdrop of tax revenues stagnating in nominal terms.

Despite the impressive 16% rise of deposits, credits to the economy in 2012 were nearly stagnant (+2%): households were deleveraging for the fourth consecutive year, while corporate loans recorded only a modest increase. This implies that increased domestic deposits have been channelled to replace other sources of bank funding – notably foreign loans, as European banks advanced their withdrawal from Ukraine (see Box 2 below), and the banking sector as a whole continued deleveraging vis-à-vis abroad. Lending in foreign currency has been largely prohibited ever since the disastrous experience of the 2009 crisis, while hryvnia lending is effectively constrained by the exorbitant (around 20% p.a.) interest rates on deposits and correspondingly high interest rates on loans – which themselves reflect expectations of imminent hryvnia devaluation.

Box 2

European banks are leaving Ukraine

The weak credit dynamics in Ukraine is partly explained by the reduced exposure and, in a number of cases, complete withdrawal of European banks from the country. Initially, this trend was primarily driven by factors such as the general risk aversion and the need to comply with tighter (Basel-III) capital ratio requirements by way of reducing the balance sheets. However, it has been boosted recently by Ukraine's worsening economic prospects. Among European banks who either drastically reduced their presence in Ukraine or left altogether in 2012, were Sweden's SEB and Swedbank, Germany's Commerzbank, France's Société Générale, Turkey's FIBA and Austria's Erste Bank, while Austria's Volksbank International (including its Ukrainian subsidiary) was completely taken over by Russia's Sberbank. Also Greece's Alpha Bank and Eurobank as well as Italy's Unicredit (which via Bank Austria owns the 6th biggest Ukrainian bank Ukrsotsbank) are reportedly in the process of negotiating the sale of their Ukrainian assets.

Although the ongoing 'credit crunch' is not helping to revive the economy and inflationary pressures are nearly non-existent, monetary policy has remained rather restrictive. The main reason is that any liquidity sporadically injected by the National Bank in an attempt to boost lending to the real economy has ended up in the foreign exchange market, putting the currency under pressure. In these circumstances, any meaningful relaxation of monetary policy would almost certainly require higher flexibility of the exchange rate, i.e. essentially hryvnia devaluation to a more credible level: by around 10%, according to our estimates. So far, the (near) stability of the exchange rate has been preserved thanks to the combination of persistent forex interventions and administrative measures, such as the 50% surrender requirement for export proceeds and private transfers exceeding UAH 150,000 (some EUR 15,000). Also, the National Bank suggested imposing a 10-15% tax on the sale of foreign cash, effectively curbing household demand for foreign currency (although the corresponding law has not been adopted by the parliament). Still, the success of all these measures may be short-lived and, more importantly, they have done nothing to address the underlying external imbalances and the eroding export competitiveness.

Our relatively optimistic GDP growth forecast for 2013 is based on the assumption of a timely and 'controlled' currency devaluation, which should at least to some extent offset inefficiencies in the exporting sector, improve the trade balance, and thus enable a return to positive GDP growth. Needless to say, the risks lie primarily on the downside, especially if there is no change in the exchange rate policy and if the world steel prices stay at their currently depressed level or decline even further. Another advantage of a more competitive exchange rate is that it would reduce the need for costly foreign exchange interventions, thus 'freeing up' resources for the forthcoming debt repayments to the IMF (USD 5.8 billion due in 2013) without resorting to a new IMF programme, which is being currently negotiated.[39] In any case, the government will probably have little choice but to implement (at least partially) household gas tariff hikes in order to reduce the deficit of the state-owned energy company Naftohaz. This, along with the likely resumed food price pressures, should fuel consumer price inflation, although on annual average it should not exceed 2-3% due to the favourable carry-over effect from 2012.

In the medium and long run, Ukraine appears unlikely to replicate the earlier economic success of several Central European countries whose technological modernization and industrial restructuring was largely facilitated by massive inflows of FDI. This is not least because of the protectionist stance of Ukraine's ruling Party of Regions in tandem with domestic 'oligarchs', who are eager to preserve control over the industrial assets. 'Oligarchs' such as Rinat Akhmetov (System Capital Management, Metinvest) and Dmytro Firtash (RosUkrEnergo) have been the main beneficiaries of privatization which gained momentum since President Yanukovych came to power in early 2010. The privatization target for 2013 has been set at UAH 10.9 billion (some EUR 1 billion), with regional electricity and utility companies and coal mines featuring on the privatization list. Still, the inflows of FDI in the coming years should be facilitated inter alia by the newly signed PSA with Shell on the production of shale gas in Eastern Ukraine, with another PSA (with Chevron) involving shale gas production in Western Ukraine reportedly in the pipeline. Though potentially environmentally controversial, these projects should help reduce Ukraine's long-standing dependence on Russian gas starting from 2017.

[39] The previous IMF programme formally expired at the end of 2012, but was effectively frozen already in 2010, after Ukraine had refused to hike gas tariffs for households.

The parliamentary elections held in October 2012 did not bring about any major change in Ukraine's political landscape, and the incumbent prime minister Mykola Azarov retained his post. However, there has been a considerable re-shuffle both within the government and the National Bank, with persons personally close to President Yanukovych gaining an upper hand. At the same time, the departure from the government of moderately 'pro-European' Petro Poroshenko (economy minister and formerly a close ally of President Yushchenko) and Serhyi Tyhypko (deputy prime minister in charge of social issues and formerly chief negotiator with the IMF), and especially the murder charges brought up recently against Ms Tymoshenko[40] suggest that the prospects of the pending Ukraine–EU Association Agreement, including a Deep and Comprehensive Free Trade Agreement, being signed have not become any better. Since the prospects of joining the Russia-led Customs Union appear equally unlikely at this stage, Ukraine will most probably remain 'stuck' in-between and continue its traditional policy of manoeuvring between its two big neighbours in the foreseeable future.

[40] If proven, these accusations – particularly in combination with other (corruption) charges – may potentially result in a life prison term for Ms Tymoshenko.

Appendix

Selected indicators of competitiveness

Table A/1 **GDP per capita at current PPPs (EUR), from 2011 at constant PPPs and population**

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2013	2014 Forecast	2015
Bulgaria	4400	4600	5400	8200	10900	10300	10700	11600	11900	12000	12200	12500
Cyprus	10600	12800	16700	20900	24900	23500	23600	23700	23500	23100	22900	23800
Czech Republic	8800	11200	13500	17800	20200	19400	19500	20200	20300	20400	20700	21200
Estonia	5500	5300	8600	13900	17300	14700	15500	17500	18400	18900	19600	20300
Hungary	6800	7500	10300	14200	16000	15300	15900	16500	16500	16500	16700	17100
Latvia	6400	4600	6900	10800	14100	12000	12300	14700	15900	16500	17200	18000
Lithuania	7100	5200	7500	11900	15400	12900	14100	16600	17700	18400	19100	19900
Malta	9500	13100	16500	18100	20200	19900	21000	21500	22100	22500	23000	23900
Poland	4500	6200	9100	11500	14100	14200	15400	16200	16700	17000	17500	18100
Romania	4000	4800	5000	7900	11700	11100	11400	13300	13500	13700	14000	14300
Slovakia	5800	7000	9600	13500	18100	17100	17900	18500	19200	19400	19900	20500
Slovenia	8500	10900	15300	19700	22700	20400	20500	21000	20900	20600	20700	21100
NMS-12	5400	6500	8600	11800	14700	14200	14900	16100	16500	16700	17100	17600
Croatia	7000	6700	9500	12800	15800	14500	14400	15400	15400	15300	15500	15900
Macedonia	4300	4000	5100	6600	8400	8500	8700	8900	9000	9100	9300	9500
Montenegro	.	.	5600	6900	10700	9700	10200	10500	10600	10700	10900	11200
Turkey	3800	4400	8000	9500	11700	10900	12200	13100	13600	14100	14700	15400
Albania	1400	2000	3500	5000	6400	6500	6600	7800	7900	8100	8400	8700
Bosnia & Herzeg.	.	.	3900	5200	6500	6200	6400	6600	6600	6700	6800	7000
Serbia	.	.	5000	7100	9000	8400	8500	8700	8800	8900	9100	9400
Kazakhstan	3900	3000	4100	7300	9200	9000	9700	10400	10900	11400	12100	12900
Russia	7600	5300	6600	9900	13000	11800	12500	13300	13900	14400	14900	15500
Ukraine	4600	2600	2800	4700	5900	5000	5400	5700	5900	6000	6200	6400
Austria	18600	19700	25100	28200	31100	29400	31100	32400	33400	33700	34400	35100
Germany	18200	18900	22400	26100	29000	27000	29000	30300	31300	31600	32200	32800
Greece	12200	12300	16000	20400	23100	22100	21400	20100	19100	18300	18400	18800
Ireland	12400	15200	25100	32500	33100	30500	31600	32500	33400	33800	34500	35200
Italy	16900	17800	22400	23700	26100	24400	24700	25100	25100	25000	25200	25700
Portugal	10700	11300	15500	17900	19500	18800	19700	19500	19400	19200	19400	19800
Spain	12800	13400	18500	22900	25900	24200	24300	24700	25000	24700	24900	25400
USA	21400	23300	30600	35700	36700	34300	36000	37100	38600	39500	40500	41300
EU-27 average	13700	14700	19000	22500	25000	23500	24500	25300	25800	25900	26300	26900

European Union (27) average = 100

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2013	2014	2015
Bulgaria	32	31	28	36	44	44	44	46	46	46	46	46
Cyprus	77	87	88	93	100	100	96	94	91	89	87	88
Czech Republic	64	76	71	79	81	83	80	80	79	79	79	79
Estonia	40	36	45	62	69	63	63	69	71	73	75	75
Hungary	50	51	54	63	64	65	65	65	64	64	63	64
Latvia	47	31	36	48	56	51	50	58	62	64	65	67
Lithuania	52	35	39	53	62	55	58	66	69	71	73	74
Malta	69	89	87	80	81	85	86	85	86	87	87	89
Poland	33	42	48	51	56	60	63	64	65	66	67	67
Romania	29	33	26	35	47	47	47	53	52	53	53	53
Slovakia	42	48	51	60	72	73	73	73	74	75	76	76
Slovenia	62	74	81	88	91	87	84	83	81	80	79	78
NMS-12	39	44	45	52	59	60	61	64	64	64	65	65
Croatia	51	46	50	57	63	62	59	61	60	59	59	59
Macedonia	31	27	27	29	34	36	36	35	35	35	35	35
Montenegro	.	.	29	31	43	41	42	42	41	41	41	42
Turkey	28	30	42	42	47	46	50	52	53	54	56	57
Albania	10	14	18	22	26	28	27	31	31	31	32	32
Bosnia & Herzeg.	.	.	21	23	26	26	26	26	26	26	26	26
Serbia	.	.	26	32	36	36	35	34	34	34	35	35
Kazakhstan	.	20	22	32	37	38	40	41	42	44	46	48
Russia	55	36	35	44	52	50	51	53	54	56	57	58
Ukraine	34	18	15	21	24	21	22	23	23	23	24	24
Austria	136	134	132	125	124	125	127	128	129	130	131	130
Germany	133	129	118	116	116	115	118	120	121	122	122	122
Greece	89	84	84	91	92	94	87	79	74	71	70	70
Ireland	91	103	132	144	132	130	129	128	129	131	131	131
Italy	123	121	118	105	104	104	101	99	97	97	96	96
Portugal	78	77	82	80	78	80	80	77	75	74	74	74
Spain	93	91	97	102	104	103	99	98	97	95	95	94
USA	156	159	161	159	147	146	147	147	150	153	154	154
EU-27 average	100	100	100	100	100	100	100	100	100	100	100	100

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

Sources: wiiw Database incorporating national and Eurostat statistics, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 2008-2015

EUR based, annual averages

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Bulgaria								
Producer price index, 2005=100	133.8	125.1	135.9	148.6	155.1	159.7	164.5	169.4
Consumer price index, 2005=100	129.4	132.6	136.6	141.2	144.6	148.9	153.4	158.0
GDP deflator, 2005=100	126.6	132.0	135.7	142.5	145.9	150.2	154.7	159.4
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	119.3	121.1	122.2	122.5	122.2	123.4	124.9	126.1
Real ER (PPI-based), 2005=100	117.7	114.9	120.7	124.9	127.3	129.0	130.5	131.8
PPP, NC/EUR	0.8355	0.8738	0.8746	0.8839	0.8909	0.90	0.91	0.92
Price level, EU27 = 100	43	45	45	45	46	46	47	47
Average monthly gross wages, NC	545	609	648	707	750	800	850	910
Average monthly gross wages, EUR (ER)	279	311	331	361	383	410	430	470
Average monthly gross wages, EUR (PPP)	652	697	741	799	842	890	930	990
GDP nominal, NC mn	69295	68322	70511	75265	77600	80700	84600	89400
Employed persons, LFS, th.,average	3361	3254	3053	2950	2940	2950	2980	3010
GDP per employed person, NC	20619	20999	23097	25517	26395	27400	28400	29700
GDP per empl. person, NC at 2000 pr.	12815	12514	13390	14090	14232	14300	14400	14700
Unit labour costs, NC, 2005=100	157.6	180.5	179.5	185.9	195.4	207.4	218.8	229.5
Unit labour costs, ER adj., 2005=100	157.6	180.5	179.5	185.9	195.4	207.4	218.8	229.5
Unit labour costs, PPP adj., Austria=100	25.5	27.5	27.4	28.2	30.2	31.4	32.7	33.6
Czech Republic								
Producer price index, 2005=100	103.2	101.6	101.7	105.5	108.7	109.2	110.0	111.5
Consumer price index, 2005=100	111.7	112.4	113.7	116.2	120.3	122.7	125.2	127.4
GDP deflator, 2005=100	105.8	108.3	106.8	105.9	107.1	107.6	108.4	109.9
Exchange rate (ER), NC/EUR	24.95	26.44	25.28	24.59	25.15	25.25	25	24.75
ER nominal, 2005=100	83.8	88.8	84.9	82.6	84.4	84.8	83.9	83.1
Real ER (CPI-based), 2005=100	123.0	115.7	119.8	122.1	120.4	120.0	121.4	122.4
Real ER (PPI-based), 2005=100	108.4	105.1	106.4	107.4	105.7	104.0	104.0	104.4
PPP, NC/EUR	18.24	18.46	18.49	18.09	18.01	17.8	17.6	17.5
Price level, EU27 = 100	73	70	73	74	72	71	71	71
Average monthly gross wages, NC	22592	23344	23864	24436	24970	25500	26300	27300
Average monthly gross wages, EUR (ER)	906	883	944	994	993	1010	1050	1100
Average monthly gross wages, EUR (PPP)	1238	1264	1291	1351	1386	1430	1490	1560
GDP nominal, NC bn	3848	3759	3800	3841	3840	3870	3960	4110
Employed persons, LFS, th., average	5003	4934	4885	4904	4890	4890	4900	4920
GDP per employed person, NC	769298	761806	777767	783314	785260	791400	808200	835400
GDP per empl. person, NC at 2000 pr.	647012	625970	648139	658247	652209	654200	663300	676500
Unit labour costs, NC, 2005=100	110.8	118.3	116.8	117.8	121.5	123.7	125.8	128.0
Unit labour costs, ER adj., 2005=100	132.2	133.3	137.6	142.6	143.8	145.8	149.8	154.0
Unit labour costs, PPP adj., Austria=100	43.2	41.1	42.5	43.8	45.0	44.8	45.4	45.7
Estonia								
Producer price index, 2005=100	121.7	122.6	126.6	132.0	135.4	140.9	146.5	153.3
Consumer price index, 2005=100	123.3	123.6	127.0	133.4	139.0	144.3	150.1	156.8
GDP deflator, 2005=100	128.0	126.2	127.2	130.8	136.7	142.2	147.9	154.7
Exchange rate (ER), NC/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	113.7	112.9	113.6	115.8	117.5	119.6	122.2	125.2
Real ER (PPI-based), 2005=100	107.1	112.6	112.4	110.9	111.1	113.7	116.3	119.2
PPP, NC/EUR	0.7020	0.6966	0.6906	0.7044	0.7243	0.74	0.76	0.78
Price level, EU27 = 100	70	70	69	70	72	74	76	78
Average monthly gross wages, NC	825	784	792	839	889	960	1040	1130
Average monthly gross wages, EUR (ER)	825	784	792	839	889	960	1040	1130
Average monthly gross wages, EUR (PPP)	1176	1125	1147	1191	1228	1300	1370	1450
GDP nominal, NC mn	16235	13762	14323	15951	17200	18400	19800	21500
Employed persons, LFS, th., average	656.5	595.8	570.9	609.1	625.0	635	645	655
GDP per employed person, NC	24730	23098	25088	26188	27520	29000	30700	32800
GDP per empl. person, NC at 2000 pr.	15033	14240	15354	15579	15672	15900	16200	16500
Unit labour costs, NC, 2005=100	152.4	152.8	143.3	149.5	157.6	167.6	178.3	190.2
Unit labour costs, ER adj., 2005=100	152.4	152.8	143.3	149.5	157.6	167.6	178.3	190.2
Unit labour costs, PPP adj., Austria=100	54.3	51.3	48.3	50.1	53.7	56.1	58.8	61.5

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Hungary								
Producer price index, 2005=100	111.9	116.9	124.3	127.4	132.3	137.8	143.0	148.0
Consumer price index, 2005=100	119.1	123.9	129.7	134.8	142.4	149.5	155.5	161.0
GDP deflator, 2005=100	114.9	119.0	121.9	125.7	131.1	136.6	141.8	146.7
Exchange rate (ER), NC/EUR	251.51	280.33	275.48	279.37	289.25	290	290	275
ER, nominal 2005=100	101.4	113.0	111.1	112.6	116.6	116.9	116.9	110.9
Real ER (CPI-based), 2005=100	108.3	100.1	104.5	103.9	103.3	106.0	108.3	115.9
Real ER (PPI-based), 2005=100	97.1	95.0	99.4	95.1	93.1	95.2	97.1	103.9
PPP, NC/EUR	165.55	166.78	167.48	169.65	174.23	178.6	182.2	184.8
Price level, EU27 = 100	66	59	61	61	60	62	63	67
Average monthly gross wages, NC	198741	199837	202525	213094	223100	234300	243700	252200
Average monthly gross wages, EUR (ER)	790	713	735	763	771	810	840	920
Average monthly gross wages, EUR (PPP)	1200	1198	1209	1256	1281	1310	1340	1360
GDP nominal, NC bn	26543	25626	26607	27886	28600	29800	31300	33200
Employed persons, LFS, th., average	3879	3782	3781	3812	3870	3880	3890	3910
GDP per employed person, NC	6842116	6776265	7036745	7315617	7390181	7680400	8046300	8491000
GDP per empl. person, NC at 2000 pr.	4341444	4152123	4208579	4243397	4108395	4097800	4136300	4218000
Unit labour costs, NC, 2005=100	118.9	125.0	125.0	130.5	141.1	148.5	153.1	155.3
Unit labour costs, ER adj., 2005=100	117.3	110.6	112.6	115.8	121.0	127.0	130.9	140.1
Unit labour costs, PPP adj., Austria=100	42.7	37.9	38.7	39.6	42.1	43.4	44.1	46.3
Latvia								
Producer price index, 2005=100	142.7	136.2	140.0	150.4	155.4	159.7	165.2	171.4
Consumer price index, 2005=100	135.2	139.6	137.9	143.7	147.0	151.1	156.4	161.9
GDP deflator, 2005=100	151.7	149.9	147.9	156.7	161.1	165.5	171.2	177.6
Exchange rate (ER), NC/EUR	0.7027	0.7057	0.7087	0.7063	0.6973	0.71	0.71	0.71
ER, nominal, 2005=100	100.9	101.4	101.8	101.5	100.2	102.0	102.0	102.0
Real ER (CPI-based), 2005=100	123.6	125.8	121.2	122.9	124.1	122.8	124.9	126.7
Real ER (PPI-based), 2005=100	124.4	123.4	122.2	124.6	127.3	126.4	128.5	130.7
PPP, NC/EUR	0.5051	0.4812	0.4632	0.4726	0.4783	0.48	0.49	0.50
Price level, EU27 = 100	72	68	65	67	69	68	69	70
Average monthly gross wages, NC	479	461	445	464	482	520	560	610
Average monthly gross wages, EUR (ER)	682	653	628	657	691	730	790	860
Average monthly gross wages, EUR (PPP)	948	958	961	982	1,007	1080	1140	1220
GDP nominal, NC mn	16085	13070	12784	14275	15470	16500	17800	19300
Employed persons, LFS, th., average	1125	983	941	971	886	905	915	925
GDP per employed person, NC	14304	13295	13587	14709	17468	18200	19500	20900
GDP per empl. person, NC at 2000 pr.	7339	6903	7147	7307	8439	8600	8900	9200
Unit labour costs, NC, 2005=100	165.0	168.8	157.4	160.5	144.3	152.9	159.1	167.6
Unit labour costs, ER adj., 2005=100	163.5	166.6	154.6	158.2	144.0	149.9	156.0	164.4
Unit labour costs, PPP adj., Austria=100	50.3	48.3	45.0	45.8	42.3	43.3	44.4	45.9
Lithuania								
Producer price index, 2005=100	135.7	117.3	129.5	147.5	154.8	160.7	166.4	172.4
Consumer price index, 2005=100	122.0	127.1	128.6	133.9	138.1	143.4	148.4	153.8
GDP deflator, 2005=100	126.9	122.6	125.0	131.8	134.4	139.4	144.4	149.6
Exchange rate (ER), NC/EUR	3.453	3.453	3.453	3.453	3.453	3.45	3.45	3.45
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	99.9	99.9	99.9
Real ER (CPI-based), 2005=100	112.5	116.1	115.1	116.2	116.8	118.9	120.9	122.8
Real ER (PPI-based), 2005=100	119.4	107.8	115.0	123.9	127.1	129.8	132.1	134.2
PPP, NC/EUR	2.171	2.136	2.063	2.120	2.127	2.17	2.21	2.25
Price level, EU27 = 100	63	62	60	61	62	63	64	65
Average monthly gross wages, NC	2152	2056	1988	2046	2137	2330	2520	2730
Average monthly gross wages, EUR (ER)	623	595	576	593	619	680	730	790
Average monthly gross wages, EUR (PPP)	991	962	964	965	1005	1070	1140	1220
GDP nominal, NC mn	111920	92032	95323	106370	112411	121100	130400	140800
Employed persons, LFS, th., average	1520	1416	1344	1371	1279	1295	1315	1330
GDP per employed person, NC	73632	64999	70941	77591	87924	93500	99200	105900
GDP per empl. person, NC at 2000 pr.	53628	49019	52471	54412	60483	62000	63500	65400
Unit labour costs, NC, 2005=100	142.7	149.2	134.8	133.8	125.7	133.7	141.2	148.5
Unit labour costs, ER adj., 2005=100	142.7	149.2	134.8	133.8	125.7	133.8	141.3	148.6
Unit labour costs, PPP adj., Austria=100	38.3	37.8	34.2	33.8	32.3	33.7	35.1	36.2

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Poland								
Producer price index, 2005=100	106.4	110.5	113.1	121.6	125.6	129.3	132.6	135.2
Consumer price index, 2005=100	108.3	112.6	115.6	120.1	124.5	128.0	131.2	133.8
GDP deflator, 2005=100	108.7	112.8	114.4	118.1	122.5	125.9	129.2	131.8
Exchange rate (ER), NC/EUR	3.512	4.328	3.995	4.121	4.185	4.20	4.20	4.15
ER, nominal, 2005=100	87.3	107.6	99.3	102.4	104.0	104.4	104.4	103.2
Real ER (CPI-based), 2005=100	114.4	95.6	104.2	101.8	101.2	101.6	102.3	103.5
Real ER (PPI-based), 2005=100	107.2	94.4	101.2	99.7	99.1	100.0	100.8	102.0
PPP, PLN/EUR	2.375	2.477	2.404	2.442	2.494	2.52	2.54	2.54
Price level, EU27 = 100	68	57	60	59	60	60	61	61
Average gross monthly wages, PLN	2942	3102	3224	3404	3540	3670	3790	3920
Average monthly gross wages, EUR (ER)	838	717	807	826	846	870	900	940
Average monthly gross wages, EUR (PPP)	1239	1252	1341	1393	1420	1460	1490	1540
GDP nominal, NC bn	1276	1345	1417	1523	1610	1680	1770	1870
Employed persons, LFS, th., average	15800	15868	15961	16131	15600	15600	15630	15710
GDP per employed person, NC	80729	84731	88756	94433	103205	107700	113200	119000
GDP per empl. person, NC at 2000 pr.	65421	66196	68326	70472	74248	75400	77200	79500
Unit labour costs, NC, 2005=100	116.9	121.8	122.7	125.6	124.0	126.5	127.6	128.2
Unit labour costs, ER adj., 2005=100	133.9	113.3	123.6	122.6	119.2	121.2	122.3	124.3
Unit labour costs, PPP adj., Austria=100	51.3	40.8	44.7	44.1	43.6	43.5	43.3	43.2
Romania								
Producer price index, 2005=100	135.7	138.2	147.0	160.1	169.7	179.8	188.8	198.3
Consumer price index, 2005=100	120.7	127.4	135.2	143.0	147.9	154.1	159.5	165.1
GDP deflator, 2005=100	144.7	150.8	159.4	165.9	175.3	185.8	195.1	204.9
Exchange rate (ER), NC/EUR	3.683	4.240	4.212	4.239	4.459	4.42	4.45	4.5
ER, nominal, 2005=100	101.7	117.1	116.3	117.1	123.2	122.1	122.9	124.3
Real ER (CPI-based), 2005=100	109.5	99.4	104.0	106.0	101.5	104.6	105.7	106.0
Real ER (PPI-based), 2005=100	117.5	108.4	112.2	114.9	113.1	118.9	121.9	124.1
PPP, NC/EUR	2.042	2.105	2.141	2.203	2.292	2.39	2.47	2.54
Price level, EU27 = 100	55	50	51	52	51	54	55	56
Average monthly grross wages, NC	1761	1845	1902	1980	2079	2190	2300	2420
Average monthly gross wages, EUR (ER)	478	435	452	467	466	500	520	540
Average monthly gross wages, EUR (PPP)	862	877	888	899	907	920	930	950
GDP nominal, NC mn	514700	501139	523693	556708	589500	634200	679200	729600
Employed persons, LFS, th., average	9369	9244	9239	9138	9280	9300	9300	9400
GDP per employed person, NC	54936	54215	56680	60924	63524	68200	73000	77600
GDP per empl. person, NC at 2000 pr.	14054	13308	13160	13593	13411	13600	13800	14000
Unit labour costs, NC, 2005=100	151.9	168.0	175.2	176.6	187.9	195.2	202.0	209.5
Unit labour costs, ER adj., 2005=100	149.3	143.5	150.6	150.8	152.6	159.9	164.4	168.6
Unit labour costs, PPP adj., Austria=100	46.8	42.4	44.6	44.4	45.7	47.0	47.7	47.9
Slovakia								
Producer price index, 2005=100	104.1	97.2	97.3	101.6	103.7	105.8	107.9	110.0
Consumer price index, 2005=100	110.4	111.4	112.2	116.8	121.2	124.8	128.5	131.1
GDP deflator, 2005=100	107.1	105.8	106.5	108.1	112.1	115.4	118.9	121.4
Exchange rate (ER), NC/EUR	1.0377	1.0000	1.0000	1.0000	1.0000	1.0	1.0	1.0
ER, nominal, 2005=100	81.0	78.0	78.0	78.0	78.0	78.0	78.0	78.0
Real ER (CPI-based), 2005=100	125.7	130.4	128.6	129.8	131.2	132.5	134.1	134.1
Real ER (PPI-based), 2005=100	113.1	114.4	110.7	109.4	109.0	109.4	109.7	109.7
PPP NC/ EUR	0.6813	0.6790	0.6790	0.6910	0.7054	0.71	0.72	0.72
Price level, EU27 = 100	66	68	68	69	71	71	72	72
Average monthly gross wages, NC	723	745	769	786	800	820	850	890
Average monthly gross wages, EUR (ER)	697	745	769	786	800	820	850	890
Average monthly gross wages, EUR (PPP)	1061	1096	1132	1137	1134	1150	1170	1230
GDP nominal, NC mn	66842	62794	65870	69108	73100	76000	80200	84300
Employed persons, LFS, th., average	2434	2366	2318	2351	2330	2330	2350	2370
GDP per employed person, NC	27465	26537	28423	29390	31373	32600	34100	35600
GDP per empl. person, NC at 2000 pr.	20604	20150	21435	21835	22474	22700	23000	23600
Unit labour costs, NC, 2005=100	109.4	115.2	111.9	112.3	111.0	112.6	115.2	117.6
Unit labour costs, ER adj., 2005=100	135.1	147.6	143.3	143.8	142.2	144.3	147.7	150.7
Unit labour costs, PPP adj., Austria=100	38.6	39.8	38.8	38.7	38.9	38.7	39.1	39.1

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Slovenia								
Producer price index, 2005=100	110.9	109.4	111.5	116.6	117.6	120.0	123.0	126.0
Consumer price index, 2005=100	112.3	113.3	115.6	118.0	121.4	124.4	126.9	129.4
GDP deflator, 2005=100	110.8	114.7	113.5	114.7	117.9	120.8	123.2	125.7
Exchange rate (ER), NC/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	103.5	103.4	103.4	102.4	102.6	103.1	103.3	103.3
Real ER (PPI-based), 2005=100	97.6	100.4	99.1	98.0	96.5	96.8	97.6	98.0
PPP, NC/EUR	0.8114	0.8561	0.8467	0.8387	0.8485	0.86	0.86	0.86
Price level, EU27 = 100	81	86	85	84	85	86	86	86
Average monthly gross wages, NC	1391	1439	1495	1525	1525	1520	1550	1600
Average monthly gross wages, EUR (ER)	1391	1439	1495	1525	1525	1520	1550	1600
Average monthly gross wages, EUR (PPP)	1715	1681	1766	1818	1797	1780	1810	1870
GDP nominal, NC mn	37244	35556	35607	36172	36450	36800	37720	39240
Employed persons, LFS, th., average	996	981	966	936	920	900	900	910
GDP per employed person, NC	37390	36256	36860	38641	39620	40900	41900	43100
GDP per empl. person, NC at 2000 pr.	26056	24398	25075	26021	25956	26100	26300	26500
Unit labour costs, NC, 2005=100	107.8	119.1	120.4	118.3	118.6	117.6	119.0	121.9
Unit labour costs, ER adj., 2005=100	107.8	119.1	120.4	118.3	118.6	117.6	119.0	121.9
Unit labour costs, PPP adj., Austria=100	61.7	64.2	65.2	63.7	64.9	63.2	63.1	63.3
Croatia								
Producer price index, 2005=100	115.1	114.6	119.5	127.1	136.0	142.8	147.1	151.5
Consumer price index, 2005=100	112.7	115.4	116.6	119.3	123.4	127.1	129.6	132.2
GDP deflator, 2005=100	114.4	117.7	118.8	121.3	125.5	129.2	131.8	134.5
Exchange rate (ER), NC/EUR	7.223	7.340	7.286	7.434	7.517	7.5	7.5	7.5
ER, nominal, 2005=100	97.6	99.2	98.5	100.5	101.6	101.4	101.4	101.4
Real ER (CPI-based), 2005=100	106.5	106.2	106.0	103.1	102.7	103.9	104.1	104.1
Real ER (PPI-based), 2005=100	103.8	106.1	107.8	106.4	109.9	113.8	115.2	116.3
PPP, NC/EUR	4.900	5.117	5.131	5.066	5.156	5.22	5.24	5.24
Price level, EU27 = 100	68	70	70	68	69	70	70	70
Average gross monthly wages, HRK	7544	7711	7679	7796	7850	7900	7950	8000
Average monthly gross wages, EUR (ER)	1044	1051	1054	1049	1044	1050	1060	1070
Average monthly gross wages, EUR (PPP)	1539	1507	1497	1539	1522	1510	1520	1530
GDP nominal, NC mn	343412	328672	326980	333956	339100	347500	359800	376200
Employed persons, LFS, th., average	1636	1605	1541	1493	1420	1390	1400	1410
GDP per employed person, NC	209974	204742	212159	223756	238803	250000	257000	266800
GDP per empl. person, NC at 2000 pr.	152464	144541	148436	153226	158148	160800	162000	164900
Unit labour costs, NC, 2005=100	111.5	120.3	116.6	114.7	111.9	110.8	110.6	109.4
Unit labour costs, ER adj., 2005=100	114.3	121.3	118.4	114.2	110.2	109.3	109.2	107.9
Unit labour costs, PPP adj., Austria=100	54.9	54.9	53.8	51.5	50.6	49.2	48.5	47.0
Macedonia								
Producer price index, 2005=100	120.5	111.9	121.6	135.1	141.3	145.5	149.9	154.3
Consumer price index, 2005=100	114.3	113.4	115.2	119.7	123.7	127.4	131.2	135.2
GDP deflator, 2005=100	119.3	120.1	123.3	127.6	131.8	135.8	139.8	144.0
Exchange rate (ER), NC/EUR	61.27	61.27	61.52	61.53	61.53	61.5	61.5	61.5
ER, nominal, 2005=100	100.0	100.0	100.4	100.4	100.4	100.3	100.3	100.3
Real ER (CPI-based), 2005=100	105.5	103.6	102.7	103.5	104.2	105.2	106.5	107.5
Real ER (PPI-based), 2005=100	106.1	102.8	107.6	113.1	115.5	117.1	118.5	119.7
PPP, NC/EUR	23.93	23.65	24.15	25.19	25.61	25.9	26.3	26.5
Price level, EU27 = 100	39	39	39	41	42	42	43	43
Average gross monthly wages, MKD [1)]	26229	29922	30225	30602	30600	31800	33400	35100
Average monthly gross wages, EUR (ER)	428	488	491	497	497	520	540	570
Average monthly gross wages, EUR (PPP)	1096	1265	1252	1215	1195	1230	1270	1320
GDP nominal, NC mn	411728	410734	434112	461730	474200	493300	516700	542800
Employed persons, LFS, th., average	609.0	629.9	637.9	645.1	645.0	654	664	674
GDP per employed person, NC	676056	652061	680581	715766	735194	754300	778200	805300
GDP per empl. person, NC at 2000 pr.	504232	482955	490826	498914	496085	494200	495000	497400
Unit labour costs, NC, 2005=100	117.4	139.8	139.0	138.4	139.2	145.2	152.3	159.2
Unit labour costs, ER adj., 2005=100	117.4	139.9	138.5	137.9	138.7	144.7	151.8	158.7
Unit labour costs, PPP adj., Austria=100	36.5	41.0	40.7	40.3	41.2	42.3	43.7	44.8

1) From 2009 including allowances for food and transport.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Montenegro								
Producer price index, 2005=100	128.1	123.1	122.0	125.9	127.6	130.2	135.1	138.5
Consumer price index, 2005=100	115.3	119.2	119.8	123.5	128.6	132.4	136.4	140.5
GDP deflator, 2005=100	132.3	135.5	137.7	139.0	143.3	146.2	151.7	155.5
Exchange rate (ER), EUR/EUR	1	1	1	1	1	1	1	1
Real ER (CPI-based), 2005=100	106.3	108.9	107.2	107.2	108.7	109.8	111.1	112.1
Real ER (PPI-based), 2005=100	109.5	114.4	114.2	109.0	108.2	107.5	108.4	107.9
PPP, NC/EUR	0.4596	0.4877	0.4917	0.4957	0.5027	0.50	0.51	0.52
Price level, EU27 = 100	46	49	49	50	50	50	51	52
Average monthly gross wages, NC	609	643	715	722	727	760	790	830
Average monthly gross wages, EUR (PPP)	1325	1318	1454	1457	1446	1510	1530	1600
GDP nominal, NC mn	3085.6	2981.0	3103.9	3234.1	3300	3400	3600	3800
Employed persons, LFS, th., average	218.8	212.9	208.2	195.4	200.0	210	215	220
GDP per employed person, NC	14102	14002	14912	16553	16500	16200	16700	17300
GDP per empl. person, NC at 2000 pr.	7187	6968	7303	8029	7767	7500	7400	7500
Unit labour costs, NC, 2005=100	177.7	193.5	205.3	188.5	196.3	212.5	223.8	232.0
Unit labour costs, PPP adj., Austria=100	49.7	51.0	54.3	49.5	52.4	55.7	57.9	58.9
Albania								
Producer price index, 2005=100	111.1	109.2	109.5	112.4	114.1	118.6	123.4	124.6
Consumer price index, 2005=100	108.9	111.4	115.4	119.3	121.7	126.6	131.7	134.3
GDP deflator, 2005=100	111.4	113.6	116.6	120.4	122.7	127.4	132.8	135.6
Exchange rate (ER), NC/EUR	122.8	132.1	137.8	140.3	139.0	139	136	135
ER, nominal, 2005=100	98.9	106.3	111.0	113.0	112.0	111.9	109.5	108.7
Real ER (CPI-based), 2005=100	101.6	95.7	93.0	91.6	91.9	93.8	97.9	98.6
Real ER (PPI-based), 2005=100	98.8	94.4	87.7	83.6	83.6	85.6	89.4	89.2
PPP, NC/EUR	53.48	55.55	57.86	59.69	59.86	61.1	62.6	62.7
Price level, EU27 = 100	44	42	42	43	43	44	46	46
Average monthly gross wages, NC	34277	36075	34767	37060	39284	42100	46000	48300
Average monthly gross wages, EUR (ER)	279	273	252	264	283	300	340	360
Average monthly gross wages, EUR (PPP)	641	649	601	621	656	690	730	770
GDP nominal, NC bn	1089	1148	1222	1302	1340	1430	1540	1620
Employed persons, LFS, th., Oct	1123	1161	1185	1200	1200	1200	1220	1240
GDP per employed person, NC	969738	989300	1031614	1085000	1116667	1191700	1262300	1306500
GDP per empl. person, NC at 2000 pr.	743567	743563	755646	769334	777082	798900	811700	822600
Unit labour costs, NC, 2005=100	172.2	181.2	171.8	179.9	188.8	196.8	211.7	219.3
Unit labour costs, ER adj., 2005=100	174.1	170.4	154.9	159.2	168.6	175.8	193.3	201.7
Unit labour costs, PPP adj., Austria=100	34.6	31.9	29.1	29.7	32.0	32.8	35.5	36.4
Bosnia and Herzegovina								
Producer price index, 2007=100	102.4	99.1	100.0	103.7	105.3	107.4	109.5	111.7
Consumer price index, 2005=100	115.9	115.4	117.8	122.2	124.8	127.3	129.8	132.4
GDP deflator, 2005=100	122.5	122.5	124.5	127.7	130.3	132.7	135.5	138.2
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	106.9	105.4	105.4	106.0	105.5	105.5	105.7	105.7
Real ER (PPI-based), 2007=100	96.4	97.4	95.1	93.3	92.4	92.7	93.0	93.0
PPP, NC/EUR	0.9982	1.0137	1.0071	1.0186	1.0227	1.02	1.03	1.03
Price level, EU27 = 100	51	52	51	52	52	52	53	53
Average monthly gross wages, NC	1113	1204	1217	1273	1290	1330	1370	1430
Average monthly gross wages, EUR (ER)	569	615	622	651	660	680	700	730
Average monthly gross wages, EUR (PPP)	1115	1187	1208	1250	1261	1300	1330	1390
GDP nominal, NC mn	24898	24202	24773	25666	26000	26700	27800	29200
Employed persons, LFS, th., April	890.2	859.2	842.8	816.0	813.7	810	812	820
GDP per employed person, NC	27967	28167	29392	31453	31953	33000	34200	35600
GDP per empl. person, NC at 2000 pr.	19345	19477	19999	20865	20780	21100	21400	21800
Unit labour costs, NC, 2005=100	164.3	176.5	173.7	174.2	177.3	180.0	182.8	187.3
Unit labour costs, ER adj., 2005=100	164.3	176.5	173.7	174.2	177.3	180.0	182.8	187.3
Unit labour costs, PPP adj., Austria=100	44.3	44.8	44.2	44.1	45.6	45.5	45.6	45.8

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Serbia								
Producer price index, 2005=100	134.9	142.3	160.4	183.2	193.3	202.6	215.2	225.0
Consumer price index, 2005=100	135.7	147.3	157.4	174.7	188.6	199.9	209.9	220.4
GDP deflator, 2005=100	139.5	147.8	155.0	168.1	183.5	192.3	204.3	213.6
Exchange rate (ER), NC/EUR	81.47	93.94	102.90	101.96	112.98	120	128	135
ER, nominal, 2005=100	98.3	113.3	124.1	123.0	136.3	144.7	154.4	162.8
Real ER (CPI-based), 2005=100	127.3	118.8	113.4	123.2	117.0	114.5	110.7	108.1
Real ER (PPI-based), 2005=100	120.8	115.4	114.8	125.2	116.4	113.0	110.6	107.5
PPP, NC/EUR	40.16	44.27	46.56	50.69	54.46	56.2	58.6	60.1
Price level, EU27 = 100	49	47	45	50	48	47	46	45
Average monthly gross wages, NC	45674	44147	47450	52733	57440	60890	64570	68480
Average monthly gross wages, EUR (ER)	561	470	461	517	508	510	500	510
Average monthly gross wages, EUR (PPP)	1137	997	1019	1040	1055	1080	1100	1140
GDP nominal, NC bn	2661	2720	2882	3175	3400	3600	3900	4200
Employed persons, LFS, th., average	2822	2616	2396	2253	2230	2200	2200	2200
GDP per employed person, NC	943178	1039614	1202670	1409113	1524664	1636400	1772700	1909100
GDP per empl. person, NC at 2000 pr.	200289	208429	229904	248420	246237	252100	257100	264800
Unit labour costs, NC, 2005=100	163.1	151.5	147.6	151.8	166.8	172.8	179.6	185.0
Unit labour costs, ER adj., 2005=100	166.0	133.7	118.9	123.5	122.4	119.4	116.4	113.6
Unit labour costs, PPP adj., Austria=100	54.5	41.3	36.9	38.1	38.4	36.8	35.3	33.8
Russia								
Producer price index, 2005=100	155.7	144.5	162.1	192.8	205.9	220.3	235.8	249.9
Consumer price index, 2005=100	136.7	152.8	163.4	177.2	186.3	195.6	205.4	215.6
GDP deflator, 2005=100	154.7	157.7	180.1	208.1	224.9	240.9	256.9	271.6
Exchange rate (ER), NC/EUR	36.41	44.13	40.27	40.87	39.94	41	42	43
ER, nominal, 2005=100	103.3	125.2	114.2	115.9	113.3	116.3	119.1	122.0
Real ER (CPI-based), 2005=100	122.1	111.5	127.9	132.7	139.0	139.4	140.3	141.1
Real ER (PPI-based), 2005=100	132.6	106.0	126.0	139.8	149.2	152.9	157.0	159.4
PPP, NC/EUR	22.36	23.15	25.85	29.44	31.31	33.0	34.6	35.9
Price level, EU27 = 100	61	52	64	72	78	80	82	83
Average monthly gross wages, NC	17290	18638	20952	23693	26690	29290	32290	35430
Average monthly gross wages, EUR (ER)	475	422	520	580	668	710	770	820
Average monthly gross wages, EUR (PPP)	773	805	811	805	852	890	930	990
GDP nominal, NC bn	41277	38807	46322	55799	62357	69200	76600	84000
Employed persons, LFS, th., average	70965	69285	69804	70732	71342	71500	71000	71000
GDP per employed person, NC	581650	560111	663602	788877	874055	967800	1078900	1183100
GDP per empl. person, NC at 2000 pr.	171223	161680	167705	172625	176968	182900	191200	198300
Unit labour costs, NC, 2005=100	170.4	194.5	210.8	231.5	254.4	270.2	284.9	301.4
Unit labour costs, ER adj., 2005=100	164.9	155.3	184.5	199.7	224.6	232.3	239.1	247.1
Unit labour costs, PPP adj., Austria=100	39.8	35.3	42.1	45.3	51.8	52.6	53.4	54.1
Ukraine								
Producer price index, 2005=100	177.5	189.0	228.5	271.9	281.8	289.5	302.3	314.7
Consumer price index, 2005=100	154.1	178.6	195.4	211.0	212.2	217.5	227.3	236.4
GDP deflator, 2005=100	181.1	204.7	232.9	266.3	285.7	293.5	306.5	319.1
Exchange rate (ER), NC/EUR	7.708	10.868	10.533	11.092	10.271	11.0	11.0	10.5
ER, nominal, 2005=100	120.6	170.1	164.9	173.6	160.8	172.2	172.2	164.4
Real ER (CPI-based), 2005=100	117.8	95.9	106.0	105.5	111.6	104.7	107.5	114.8
Real ER (PPI-based), 2005=100	129.4	102.1	123.1	131.6	143.9	135.8	139.3	149.0
PPP, NC/EUR	3.4533	3.9617	4.4071	4.9678	5.2465	5.30	5.44	5.55
Price level, EU27 = 100	45	36	42	45	51	48	49	53
Average monthly gross wages, NC	1806	1906	2239	2633	3025	3190	3500	3860
Average monthly gross wages, EUR (ER)	234	175	213	237	295	290	320	370
Average monthly gross wages, EUR (PPP)	523	481	508	530	577	600	640	690
GDP nominal, NC mn	948056	913345	1082569	1302079	1400000	1460000	1570000	1700000
Employed persons, LFS, th., average	20972	20192	20266	20324	20350	20350	20400	20450
GDP per employed person, NC	45205	45234	53418	64065	68796	71700	77000	83100
GDP per empl. person, NC at 2000 pr.	13960	12362	12828	13460	13471	13700	14100	14600
Unit labour costs, NC, 2005=100	191.7	228.4	258.6	289.7	332.6	344.9	367.7	391.6
Unit labour costs, ER adj., 2005=100	158.9	134.2	156.8	166.9	206.9	200.3	213.6	238.3
Unit labour costs, PPP adj., Austria=100	39.0	31.1	36.4	38.5	48.6	46.2	48.6	53.1

(Table A/2 ctd.)

(Table A/2 ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015
							Forecast	
Austria								
Producer price index, 2005=100	114.0	105.5	110.8	120.0	122.9	125.2	127.4	129.7
Consumer price index, 2005=100	107.1	107.6	109.6	113.2	116.0	118.4	120.8	123.5
GDP deflator, 2005=100	105.7	107.3	109.1	111.5	108.0	110.1	112.0	114.0
Real ER (CPI-based), 2005=100	98.7	98.3	98.1	98.3	98.0	98.1	98.3	98.6
Real ER (PPI-based), 2005=100	100.3	96.9	98.4	100.9	100.9	101.1	101.1	100.9
PPP, NC/EUR	1.0904	1.1214	1.0970	1.1018	1.0962	1.095	1.100	1.098
Price level, EU27 = 100	109	112	110	110	110	110	110	110
Average monthly gross wages, EUR	3087	3162	3200	3270	3360	3430	3510	3620
Average monthly gross wages, EUR (PPP)	2831	2819	2917	2968	3065	3132	3190	3297
GDP nominal, NC mn	282744	276151	286400	300700	308800	317800	329200	341700
Employed persons - LFS, th., average	4090	4078	4100	4140	4200	4230	4270	4310
GDP per employed person, NC	69131	67722	69900	72600	73500	75100	77100	79300
GDP per empl. person, NC at 2000 pr.	60413	58303	59215	60154	62856	63000	63600	64300
Unit labour costs, NC, 2005=100	108.5	115.2	114.8	115.4	113.5	115.6	117.2	119.6
Unit labour costs, PPP adjusted	0.63	0.67	0.67	0.68	0.66	0.68	0.69	0.70

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

The development of unit labour costs is defined as average gross wages per employee relative to labour productivitiy (real GDP per employed person) .

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

Real exchange rates: Increasing values mean real appreciation.

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

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

Table A/3

Indicators of macro-competitiveness, 2008-2015

annual changes in %

	2008	2009	2010	2011	2012	2013	2014	2015	2005-08
							Forecast		average
Bulgaria									
GDP deflator	8.4	4.3	2.8	5.0	2.4	3.0	3.0	3.0	8.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	8.0	1.5	0.9	0.3	-0.2	1.0	1.2	1.0	5.5
Real ER (PPI-based)	4.4	-2.4	5.0	3.5	1.9	1.3	1.2	1.0	5.0
Average gross wages, NC	26.5	11.8	6.4	9.0	6.2	6.7	6.3	7.1	16.8
Average gross wages, real (PPI based)	14.1	19.5	-2.0	-0.4	1.7	3.6	3.2	3.9	6.6
Average gross wages, real (CPI based)	13.0	9.1	3.3	5.4	3.7	3.6	3.2	3.9	8.0
Average gross wages, EUR (ER)	26.5	11.8	6.4	9.0	6.2	6.9	4.9	9.3	16.8
Employed persons (LFS)	3.3	-3.2	-6.2	-3.4	-0.3	0.3	1.0	1.0	3.6
GDP per empl. person, NC at 2000 prices	2.8	-2.3	7.0	5.2	1.0	0.5	0.7	2.1	2.7
Unit labour costs, NC at 2000 prices	23.1	14.5	-0.6	3.6	5.1	6.2	5.5	4.9	13.7
Unit labour costs, ER (EUR) adjusted	23.1	14.5	-0.6	3.6	5.1	6.2	5.5	4.9	13.7
Czech Republic									
GDP deflator	1.9	2.4	-1.4	-0.8	1.2	0.5	0.7	1.4	1.3
Exchange rate (ER), EUR/NC	11.3	-5.6	4.6	2.8	-2.2	-0.4	1.0	1.0	6.3
Real ER (CPI-based)	14.1	-6.0	3.6	1.9	-1.4	-0.4	1.2	0.8	7.0
Real ER (PPI-based)	5.2	-3.0	1.2	0.9	-1.6	-1.6	0.0	0.4	2.9
Average gross wages, NC	7.8	3.3	2.2	2.4	2.2	2.1	3.1	3.8	6.6
Average gross wages, real (PPI based)	7.4	4.9	2.1	-1.3	-0.8	1.6	2.4	2.4	5.7
Average gross wages, real (CPI based)	1.4	2.7	1.1	0.2	-1.3	0.1	1.1	2.0	3.3
Average gross wages, EUR (ER)	20.0	-2.5	6.9	5.3	-0.1	1.7	4.0	4.8	13.4
Employed persons (LFS)	1.6	-1.4	-1.0	0.4	-0.3	0.0	0.2	0.4	1.5
GDP per empl. person, NC at 2000 prices	1.5	-3.3	3.5	1.6	-0.9	0.3	1.4	2.0	4.0
Unit labour costs, NC at 2000 prices	6.2	6.8	-1.3	0.8	3.1	1.8	1.7	1.8	2.5
Unit labour costs, ER (EUR) adjusted	18.2	0.8	3.2	3.7	0.8	1.4	2.7	2.8	9.0
Estonia									
GDP deflator	5.4	-1.4	0.7	2.9	4.5	4.1	4.0	4.6	8.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	6.7	-0.8	0.6	1.9	1.5	1.8	2.2	2.5	3.8
Real ER (PPI-based)	1.7	5.2	-0.2	-1.4	0.2	2.4	2.2	2.6	1.1
Average gross wages, NC	13.9	-5.0	1.1	5.9	6.0	7.9	8.3	8.7	15.4
Average gross wages, real (PPI based)	5.4	-5.7	-2.1	1.6	3.3	3.7	4.2	3.9	9.4
Average gross wages, real (CPI based)	3.0	-5.2	-1.6	0.8	1.7	4.0	4.2	4.0	8.4
Average gross wages, EUR (ER)	13.9	-5.0	1.1	5.9	6.0	7.9	8.3	8.7	15.4
Employed persons (LFS)	0.2	-9.2	-4.2	6.7	2.6	1.6	1.6	1.6	2.5
GDP per empl. person, NC at 2000 prices	-4.4	-5.3	7.8	1.5	0.6	1.5	1.9	1.9	2.9
Unit labour costs, NC at 2000 prices	19.1	0.3	-6.2	4.4	5.4	6.4	6.3	6.7	12.2
Unit labour costs, ER (EUR) adjusted	19.1	0.3	-6.2	4.4	5.4	6.4	6.3	6.7	12.2
Hungary									
GDP deflator	5.3	3.6	2.5	3.1	4.3	4.2	3.8	3.5	4.2
Exchange rate (ER), EUR/NC	-0.1	-10.3	1.8	-1.4	-3.4	-0.3	0.0	5.5	0.0
Real ER (CPI-based)	2.2	-7.6	4.4	-0.6	-0.6	2.7	2.2	7.0	2.7
Real ER (PPI-based)	-1.5	-2.1	4.6	-4.4	-2.1	2.2	2.0	7.0	-0.6
Average gross wages, NC	7.4	0.6	1.3	5.2	4.7	5.0	4.0	3.5	8.1
Average gross wages, real (PPI based)	2.7	-3.8	-4.7	2.6	0.9	0.8	0.2	0.0	4.3
Average gross wages, real (CPI based)	1.3	-3.3	-3.2	1.2	-0.9	0.0	0.0	0.0	2.6
Average gross wages, EUR (ER)	7.3	-9.8	3.1	3.8	1.1	5.0	3.7	9.5	8.1
Employed persons (LFS)	-1.2	-2.5	0.0	0.8	1.5	0.3	0.3	0.5	-0.1
GDP per empl. person, NC at 2000 prices	2.1	-4.4	1.4	0.8	-3.2	-0.3	0.9	2.0	2.3
Unit labour costs, NC at 2000 prices	5.2	5.1	0.0	4.4	8.1	5.3	3.0	1.5	5.6
Unit labour costs, ER (EUR) adjusted	5.1	-5.7	1.7	2.9	4.4	5.0	3.0	7.0	5.7
Latvia									
GDP deflator	12.9	-1.2	-1.3	5.9	2.8	2.8	3.4	3.8	13.7
Exchange rate (ER), EUR/NC	-0.4	-0.4	-0.4	0.3	1.3	-1.8	0.0	0.0	-1.4
Real ER (CPI-based)	10.8	1.8	-3.6	1.4	0.9	-1.0	1.7	1.5	5.4
Real ER (PPI-based)	4.5	-0.8	-1.0	2.0	2.2	-0.7	1.7	1.7	5.4
Average gross wages, NC	20.5	-3.8	-3.5	4.3	3.8	8.0	7.7	8.9	22.8
Average gross wages, real (PPI based)	8.1	0.9	-6.1	-2.9	0.4	5.1	4.1	5.0	10.2
Average gross wages, real (CPI based)	4.5	-6.8	-2.3	0.0	1.4	5.1	4.1	5.2	12.0
Average gross wages, EUR (ER)	20.0	-4.2	-3.9	4.6	5.1	5.7	8.2	8.9	21.1
Employed persons (LFS)	0.6	-12.6	-4.3	3.1	-8.7	2.2	1.1	1.1	2.5
GDP per empl. person, NC at 2000 prices	-3.8	-5.9	3.5	2.2	15.5	1.9	3.5	3.4	4.1
Unit labour costs, NC at 2000 prices	25.2	2.3	-6.8	2.0	-10.1	6.0	4.1	5.4	17.9
Unit labour costs, ER (EUR) adjusted	24.8	1.9	-7.2	2.3	-9.0	4.1	4.1	5.4	16.3

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014	2015	2005-08
							Forecast		average
Lithuania									
GDP deflator	9.6	-3.4	2.0	5.5	1.9	3.8	3.5	3.6	7.8
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Real ER (CPI-based)	7.2	3.1	-0.9	1.0	0.5	1.8	1.7	1.6	3.1
Real ER (PPI-based)	11.3	-9.7	6.7	7.8	2.5	2.2	1.8	1.6	6.4
Average gross wages, NC	19.4	-4.4	-3.3	2.9	4.5	9.0	8.2	8.3	17.0
Average gross wages, real (PPI based)	1.0	10.5	-12.4	-9.7	-0.5	5.1	4.5	4.5	5.4
Average gross wages, real (CPI based)	7.5	-8.3	-4.4	-1.2	1.2	5.0	4.5	4.6	10.6
Average gross wages, EUR (ER)	19.4	-4.4	-3.3	2.9	4.5	9.9	7.4	8.2	17.0
Employed persons (LFS)	-0.9	-6.8	-5.1	2.0	-6.7	1.3	1.5	1.1	1.4
GDP per empl. person, NC at 2000 prices	3.9	-8.6	7.0	3.7	11.2	2.5	2.4	3.0	5.5
Unit labour costs, NC at 2000 prices	14.9	4.5	-9.7	-0.8	-6.0	6.4	5.6	5.2	10.8
Unit labour costs, ER (EUR) adjusted	14.9	4.5	-9.7	-0.8	-6.0	6.4	5.6	5.2	10.8
Poland									
GDP deflator	3.1	3.7	1.5	3.2	3.7	2.8	2.6	2.1	2.8
Exchange rate (ER), EUR/NC	7.7	-18.8	8.3	-3.1	-1.5	-0.4	0.0	1.2	6.6
Real ER (CPI-based)	8.3	-16.4	9.0	-2.3	-0.6	0.4	0.7	1.2	6.5
Real ER (PPI-based)	3.9	-12.0	7.2	-1.4	-0.7	0.9	0.8	1.2	3.8
Average gross wages, NC	10.1	5.4	3.9	5.6	4.0	3.7	3.3	3.4	6.7
Average gross wages, real (PPI based)	7.5	1.5	1.6	-1.8	0.7	0.7	0.8	1.4	4.9
Average gross wages, real (CPI based)	5.6	1.4	1.2	1.6	0.3	0.8	0.8	1.4	4.0
Average gross wages, EUR (ER)	18.6	-14.4	12.6	2.3	2.4	2.8	3.4	4.4	13.6
Employed persons (LFS)	3.7	0.4	0.6	1.1	-3.3	0.0	0.2	0.5	3.5
GDP per empl. person, NC at 2000 prices	1.4	1.2	3.2	3.1	5.4	1.6	2.4	3.0	1.9
Unit labour costs, NC at 2000 prices	8.5	4.2	0.7	2.3	-1.3	2.1	0.9	0.4	4.6
Unit labour costs, ER (EUR) adjusted	16.9	-15.4	9.1	-0.8	-2.8	1.7	0.9	1.6	11.5
Romania									
GDP deflator	15.2	4.2	5.7	4.1	5.7	6.0	5.0	5.0	12.9
Exchange rate (ER), EUR/NC	-9.4	-13.1	0.7	-0.6	-4.9	0.9	-0.7	-1.1	2.4
Real ER (CPI-based)	-5.7	-9.2	4.6	2.0	-4.2	3.1	1.0	0.3	6.9
Real ER (PPI-based)	-1.7	-7.7	3.5	2.4	-1.6	5.2	2.5	1.8	8.1
Average gross wages, NC	26.1	4.8	3.1	4.1	5.0	5.3	5.0	5.2	21.1
Average gross wages, real (PPI based)	9.4	2.9	-3.1	-4.4	-0.9	-0.6	0.0	0.2	10.0
Average gross wages, real (CPI based)	16.9	-0.8	-2.8	-1.6	1.6	1.1	1.5	1.7	13.1
Average gross wages, EUR (ER)	14.2	-9.0	3.8	3.4	-0.2	7.2	4.0	3.8	24.0
Employed persons (LFS)	0.2	-1.3	0.0	-1.1	1.6	0.2	0.0	1.1	0.6
GDP per empl. person, NC at 2000 prices	7.2	-5.3	-1.1	3.3	-1.3	1.4	1.5	1.4	5.8
Unit labour costs, NC at 2000 prices	17.7	10.6	4.2	0.8	6.4	3.9	3.5	3.7	14.5
Unit labour costs, ER (EUR) adjusted	6.6	-3.9	4.9	0.1	1.2	4.8	2.8	2.6	17.2
Slovakia									
GDP deflator	2.9	-1.2	0.7	1.5	3.7	2.9	3.1	2.1	2.3
Exchange rate (ER), EUR/NC	8.0	3.8	0.0	0.0	0.0	0.0	0.0	0.0	6.4
Real ER (CPI-based)	8.3	3.7	-1.4	0.9	1.1	1.0	1.2	0.0	7.0
Real ER (PPI-based)	4.3	1.1	-3.2	-1.2	-0.3	0.3	0.3	0.0	3.9
Average gross wages, NC	8.1	3.0	3.3	2.2	1.8	2.5	3.7	4.7	8.3
Average gross wages, real (PPI based)	5.5	10.3	3.2	-2.1	-0.3	0.5	1.6	2.7	6.3
Average gross wages, real (CPI based)	4.0	2.0	2.6	-1.8	-1.9	-0.5	0.6	2.7	4.9
Average gross wages, EUR (ER)	16.8	6.9	3.3	2.2	1.8	2.5	3.7	4.7	15.2
Employed persons (LFS)	3.2	-2.8	-2.1	1.5	-0.9	0.0	0.9	0.9	2.9
GDP per empl. person, NC at 2000 prices	2.5	-2.2	6.4	1.9	2.9	1.0	1.3	2.6	4.8
Unit labour costs, NC at 2000 prices	5.5	5.3	-2.9	0.3	-1.1	1.5	2.3	2.0	3.4
Unit labour costs, ER (EUR) adjusted	14.0	9.3	-2.9	0.3	-1.1	1.5	2.3	2.0	10.0
Slovenia									
GDP deflator	4.1	3.6	-1.1	1.0	2.8	2.5	2.0	2.0	3.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	1.8	-0.1	0.0	-1.0	0.2	0.5	0.2	0.0	0.9
Real ER (PPI-based)	-2.2	2.9	-1.4	-1.1	-1.5	0.3	0.8	0.5	-1.2
Average gross wages, NC	8.3	3.4	3.9	2.0	0.0	-0.3	2.0	3.2	5.7
Average gross wages, real (PPI based)	4.3	4.9	1.9	-2.5	-0.8	-2.3	-0.5	0.7	2.5
Average gross wages, real (CPI based)	2.6	2.5	1.8	-0.1	-2.7	-2.8	0.0	1.2	2.0
Average gross wages, EUR (ER)	8.3	3.4	3.9	2.0	0.0	-0.3	2.0	3.2	5.6
Employed persons (LFS)	1.1	-1.5	-1.5	-3.1	-1.7	-2.2	0.0	1.1	1.4
GDP per empl. person, NC at 2000 prices	2.3	-6.4	2.8	3.8	-0.2	0.6	0.8	0.8	3.6
Unit labour costs, NC at 2000 prices	5.9	10.4	1.1	-1.7	0.3	-0.9	1.2	2.4	2.0
Unit labour costs, ER (EUR) adjusted	5.9	10.4	1.1	-1.7	0.3	-0.9	1.2	2.4	1.9

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Croatia									
GDP deflator	5.7	2.9	0.9	2.2	3.4	3.0	2.0	2.0	4.3
Exchange rate (ER), EUR/NC	1.6	-1.6	0.7	-2.0	-1.1	0.2	0.0	0.0	0.9
Real ER (CPI-based)	4.0	-0.2	-0.2	-2.8	-0.4	1.2	0.2	0.0	2.2
Real ER (PPI-based)	3.5	2.3	1.6	-1.4	3.3	3.5	1.3	1.0	0.9
Average gross wages, NC	7.1	2.2	-0.4	1.5	0.7	0.6	0.6	0.6	6.0
Average gross wages, real (PPI based)	-1.1	2.7	-4.5	-4.5	-5.9	-4.2	-2.3	-2.3	1.6
Average gross wages, real (CPI based)	0.9	-0.2	-1.5	-0.8	-2.6	-2.3	-1.3	-1.3	2.0
Average gross wages, EUR (ER)	8.7	0.6	0.3	-0.5	-0.4	0.6	1.0	0.9	6.9
Employed persons (LFS)	1.3	-1.8	-4.0	-3.2	-4.9	-2.1	0.7	0.7	1.1
GDP per empl. person, NC at 2000 prices	0.8	-5.2	2.7	3.2	3.2	1.7	0.7	1.8	2.9
Unit labour costs, NC at 2000 prices	6.2	7.8	-3.0	-1.7	-2.4	-1.0	-0.1	-1.1	3.0
Unit labour costs, ER (EUR) adjusted	7.9	6.1	-2.3	-3.6	-3.5	-0.8	-0.1	-1.1	3.9
Macedonia									
GDP deflator	7.5	0.7	2.7	3.5	3.3	3.0	3.0	3.0	5.5
Exchange rate (ER), EUR/NC	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	4.3	-1.8	-0.9	0.7	0.7	1.0	1.2	1.0	1.0
Real ER (PPI-based)	3.5	-3.1	4.7	5.1	2.1	1.4	1.2	1.0	1.3
Average gross wages, NC [1)]	8.7	9.0	1.0	1.2	0.0	3.9	5.0	5.1	6.0
Average gross wages, real (PPI based)	-1.3	17.5	-7.1	-8.9	-4.4	0.9	2.0	2.0	0.4
Average gross wages, real (CPI based)	0.3	9.9	-0.6	-2.5	-3.2	0.9	2.0	2.0	2.4
Average gross wages, EUR (ER)	8.5	9.0	0.6	1.2	0.0	4.6	3.8	5.6	6.0
Employed persons (LFS)	3.2	3.4	1.3	1.1	0.0	1.4	1.5	1.5	3.9
GDP per empl. person, NC at 2000 prices	1.7	-4.2	1.6	1.6	-0.6	-0.4	0.2	0.5	1.2
Unit labour costs, NC at 2000 prices	6.9	13.8	-0.6	-0.4	0.6	4.3	4.9	4.6	4.8
Unit labour costs, ER (EUR) adjusted	6.7	13.8	-1.0	-0.4	0.6	4.4	4.9	4.6	4.8
Montenegro									
GDP deflator	7.7	2.4	1.6	1.0	3.1	2.0	3.8	2.5	8.4
Real ER (CPI-based)	3.6	2.4	-1.5	0.0	1.4	1.0	1.2	1.0	1.6
Real ER (PPI-based)	-2.2	4.4	-0.2	-4.5	-0.8	-0.6	0.9	-0.5	2.3
Average gross wages, NC	22.5	5.6	11.2	1.0	0.7	4.5	3.9	5.1	19.1
Average gross wages, real (PPI based)	7.5	9.9	12.2	-2.1	-0.6	2.5	0.1	2.5	11.3
Average gross wages, real (CPI based)	14.1	2.1	10.6	-2.1	-3.3	1.5	0.9	2.0	14.3
Employed persons (LFS)	0.6	-2.7	-2.2	-6.1	2.4	5.0	2.4	2.3	4.0
GDP per empl. person, NC	14.4	-0.7	6.5	11.0	-0.3	-1.8	3.1	3.6	12.2
GDP per empl. person, NC at 2000 prices	6.2	-3.0	4.8	10.0	-3.3	-3.4	-1.3	1.4	3.5
Unit labour costs, NC at 2000 prices	15.3	8.9	6.1	-8.2	4.1	8.3	5.4	3.7	15.1
Unit labour costs, ER (EUR) adjusted	15.3	8.9	6.1	-8.2	4.1	8.3	5.4	3.7	15.1
Albania									
GDP deflator	4.7	2.0	2.6	3.3	1.9	3.8	4.3	2.1	3.4
Exchange rate (ER), EUR/NC	0.7	-7.0	-4.2	-1.8	0.9	0.0	2.2	0.7	1.0
Real ER (CPI-based)	0.4	-5.8	-2.8	-1.5	0.3	2.0	4.4	0.7	1.1
Real ER (PPI-based)	1.0	-4.5	-7.1	-4.7	0.0	2.3	4.5	-0.2	0.6
Average gross wages, NC	25.3	5.2	-3.6	6.6	6.0	7.2	9.3	5.0	15.8
Average gross wages, real (PPI based)	17.7	7.0	-3.9	3.9	4.4	3.0	5.1	4.0	11.5
Average gross wages, real (CPI based)	21.3	2.9	-7.0	3.1	3.9	3.0	5.1	2.9	12.7
Average gross wages, EUR (ER)	26.2	-2.1	-7.6	4.7	7.0	6.2	13.3	5.9	17.0
Employed persons (LFS)	-6.2	3.3	2.1	1.3	0.0	0.0	1.7	1.6	-1.0
GDP per empl. person, NC at 2000 prices	14.7	0.0	1.6	1.8	1.0	2.8	1.6	1.3	7.2
Unit labour costs, NC at 2000 prices	9.3	5.2	-5.2	4.7	4.9	4.2	7.5	3.6	8.0
Unit labour costs, ER (EUR) adjusted	10.0	-2.1	-9.1	2.8	5.9	4.3	9.9	4.4	9.1
Bosnia and Herzegovina									
GDP deflator	7.3	0.0	1.6	2.6	2.0	1.9	2.1	2.0	6.1
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.7	-1.4	0.0	0.6	-0.5	0.0	0.2	0.0	1.9
Real ER (PPI-based)	-3.6	1.0	-2.4	-1.9	-0.9	0.3	0.3	0.0	.
Average gross wages, NC	16.7	8.1	1.1	4.6	1.3	3.1	3.0	4.4	10.4
Average gross wages, real (PPI based)	7.4	11.7	0.2	0.9	-0.2	1.1	1.0	2.3	.
Average gross wages, real (CPI based)	8.5	8.6	-1.0	0.9	-0.8	1.1	1.0	2.3	5.7
Average gross wages, EUR (ER)	16.7	8.1	1.1	4.6	1.3	3.1	3.0	4.4	10.4
Employed persons (LFS)	4.8	-3.5	-1.9	-3.2	-0.3	-0.5	0.2	1.0	2.8
GDP per empl. person, NC at 2000 prices	0.8	0.7	2.7	4.3	-0.4	1.5	1.4	1.9	2.4
Unit labour costs, NC at 2000 prices	15.8	7.4	-1.6	0.3	1.8	1.5	1.6	2.5	7.9
Unit labour costs, ER (EUR) adjusted	15.8	7.4	-1.6	0.3	1.8	1.5	1.6	2.5	7.9

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

(Table A/3 ctd.)

Table A/3 (ctd.)

	2008	2009	2010	2011	2012	2013	2014 Forecast	2015	2005-08 average
Serbia									
GDP deflator	12.6	5.9	4.9	8.4	9.2	4.8	6.2	4.6	12.7
Exchange rate (ER), EUR/NC	-1.8	-13.3	-8.7	0.9	-9.8	-5.9	-6.3	-5.2	-2.9
Real ER (CPI-based)	7.5	-6.7	-4.5	8.7	-5.0	-2.2	-3.3	-2.4	6.1
Real ER (PPI-based)	3.9	-4.4	-0.5	9.0	-7.0	-2.9	-2.1	-2.8	3.7
Average gross wages, NC	17.9	-3.3	7.5	11.1	8.9	6.0	6.0	6.1	22.1
Average gross wages, real (PPI based)	4.9	-8.4	-4.6	-2.7	3.2	1.1	-0.2	1.4	9.6
Average gross wages, real (CPI based)	3.9	-11.0	0.6	0.1	0.9	0.0	1.0	1.0	9.0
Average gross wages, EUR (ER)	15.7	-16.2	-1.9	12.2	-1.7	0.3	-2.0	2.0	18.6
Employed persons (LFS)	6.3	-7.3	-8.4	-6.0	-1.0	-1.3	0.0	0.0	-0.9
GDP per empl. person, NC at 2000 prices	-2.3	4.1	10.3	8.1	-0.9	2.4	2.0	3.0	5.5
Unit labour costs, NC at 2000 prices	20.6	-7.1	-2.6	2.9	9.9	3.5	4.0	3.0	15.7
Unit labour costs, ER (EUR) adjusted	18.4	-19.4	-11.0	3.8	-0.8	-2.5	-2.5	-2.4	12.4
Russia									
GDP deflator	18.0	2.0	14.2	15.5	8.1	7.1	6.6	5.7	16.5
Exchange rate (ER), EUR/NC	-3.8	-17.5	9.6	-1.5	2.3	-2.6	-2.4	-2.3	-0.4
Real ER (CPI-based)	5.8	-8.7	14.8	3.7	4.8	0.3	0.7	0.5	8.1
Real ER (PPI-based)	9.9	-20.1	18.9	10.9	6.7	2.5	2.7	1.5	11.8
Average gross wages, NC	27.2	7.8	12.4	13.1	12.6	9.7	10.2	9.7	26.6
Average gross wages, real (PPI based)	4.8	16.1	0.2	-5.0	5.5	2.6	3.0	3.5	8.1
Average gross wages, real (CPI based)	11.5	-3.6	5.2	4.2	7.2	4.5	5.0	4.5	13.7
Average gross wages, EUR (ER)	22.3	-11.1	23.2	11.4	15.3	6.2	8.5	6.5	26.0
Employed persons (LFS)	0.6	-2.4	0.7	1.3	0.9	0.2	-0.7	0.0	1.3
GDP per empl. person, NC at 2000 prices	4.6	-5.6	3.7	2.9	2.5	3.4	4.5	3.7	5.6
Unit labour costs, NC at 2000 prices	21.6	14.2	8.4	9.9	9.9	6.2	5.5	5.8	19.8
Unit labour costs, ER (EUR) adjusted	16.9	-5.8	18.8	8.2	12.4	3.4	2.9	3.3	19.3
Ukraine									
GDP deflator	28.6	13.0	13.8	14.3	7.3	2.7	4.4	4.1	22.5
Exchange rate (ER), EUR/NC	-10.3	-29.1	3.2	-5.0	8.0	-6.6	0.0	4.8	-3.8
Real ER (CPI-based)	8.4	-18.6	10.6	-0.5	5.8	-6.2	2.7	6.8	7.9
Real ER (PPI-based)	14.5	-21.2	20.6	6.9	9.3	-5.6	2.6	6.9	10.7
Average gross wages, NC	33.7	5.5	17.5	17.6	14.9	5.5	9.7	10.3	32.3
Average gross wages, real (PPI based)	-1.3	-0.9	-2.8	-1.2	10.9	2.6	5.1	5.9	10.3
Average gross wages, real (CPI based)	6.8	-9.0	7.4	8.9	14.2	2.9	5.0	6.0	15.0
Average gross wages, EUR (ER)	20.0	-25.2	21.2	11.7	24.1	-1.5	10.3	15.6	27.3
Employed persons (LFS)	0.3	-3.7	0.4	0.3	0.1	0.0	0.2	0.2	0.8
GDP per empl. person, NC at 2000 prices	2.0	-11.4	3.8	4.9	0.1	1.7	2.9	3.5	4.2
Unit labour costs, NC at 2000 prices	31.1	19.2	13.2	12.1	14.8	3.7	6.6	6.5	27.0
Unit labour costs, ER (EUR) adjusted	17.7	-15.5	16.8	6.4	24.0	-3.2	6.6	11.6	22.2
Austria									
GDP deflator	1.7	1.5	1.6	2.2	-3.1	1.9	1.8	1.8	1.9
Real ER (CPI-based)	-0.4	-0.5	-0.2	0.2	-0.2	0.1	0.2	0.3	-0.3
Real ER (PPI-based)	0.2	-3.3	1.5	2.5	0.0	0.2	0.0	-0.2	-0.4
Average gross wages, NC	3.4	2.4	1.2	2.2	2.8	2.1	2.3	3.1	3.2
Average gross wages, real (PPI based)	-2.8	10.6	-3.6	-5.6	0.3	0.2	0.6	1.3	-0.6
Average gross wages, real (CPI based)	0.2	1.9	-0.7	-1.1	0.3	0.0	0.3	0.8	0.9
Employed persons (LFS)	1.5	-0.3	0.5	1.0	1.4	0.7	0.9	0.9	2.2
GDP per empl. person, NC at 2000 prices	-0.1	-3.5	1.6	1.6	4.5	0.2	1.0	1.1	0.6
Unit labour costs, NC at 2000 prices	3.5	6.1	-0.3	0.6	-1.7	1.9	1.4	2.0	2.7
Unit labour costs, ER (EUR) adjusted	3.5	6.1	-0.3	0.6	-1.7	1.9	1.4	2.0	2.7

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

Sources: wiiw Database incorporating national and Eurostat statistics, wiiw estimates. Forecasts by wiiw.

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