NBP

National Bank of Poland

Economic Institute
Bureau of World Economy and European Economic Integration

Analysis of economic situation in the countries of Central and Eastern Europe

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General information on CEE countries

	Area[a] (km^2)	Population[a]		GDP[b] (EUR bn)	GDP per capita (EUR)[b]	
		in thousand of inhabitants	per 1 km^2		current prices	PPP adjusted[a]
Bulgaria	110 879	7 564	69	34 118	4 600[a]	10 900
Czech Republic	78 867	10 507	133	147 879	13 100	19 200
Estonia	45 227	1 340	30	16 073	10 300	17 100
Lithuania	65 300	3 329	51	32 203	8 000	12 900
Latvia	64 559	2 248	35	23 160	8 200	12 200
Poland	312 685	38 167	122	362 415	8 100	14 300
Romania	238 391	21 462	90	137 035	5 500	10 900
Slovakia	49 035	5 425	110	64 778	11 700	17 200
Slovenia	20 273	2 046	100	37 135	17 300	22 700
Hungary	93 028	10 014	108	105 536	9 300	15 300

[a] 2010, [b] 2009
source: Eurostat.

Gross domestic product growth rate (in %; seasonally adjusted)

	2009	2010			2009	2010		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	q-o-q				y-o-y			
Bulgaria	-0.2	-0.5	0.5	0.7	-6.7	-0.8	-0.3	0.5
Czech Republic	0.4	0.6	0.8	1.0	-3.2	1.0	2.3	2.8
Estonia	1.4	1.0	1.9	0.7	-9.0	-2.7	3.0	5.1
Lithuania	-0.2	-0.1	0.5	0.6	-14.0	-0.6	-0.3	0.8
Latvia	-0.6	1.0	1.2	0.9	-16.7	-5.1	-2.6	2.5
Poland	1.4	0.7	1.2	1.3	2.8	3.1	3.8	4.7
Romania	-1.5	-0.3	0.3	-0.7	-6.9	-3.2	-1.5	-2.2
Slovakia	1.3	0.8	1.0	1.0	-4.2	4.6	4.4	4.2
Slovenia	0.1	-0.1	1.0	0.3	-6.1	-0.2	1.4	1.3
Hungary	0.0	1.0	0.4	0.8	-5.2	-1.1	0.6	2.2

source: Eurostat.

Executive summary

2010 saw gradual improvement in economic activity in the countries of Central and Eastern Europe (CEE). The majority of countries in the region have been recording quarterly increases in gross domestic product growth rate since the beginning of 2010. Moreover, GDP growth on annual basis kept increasing with every subsequent quarter of the year. As a result, GDP in the region in Q1-Q3 2010 period increased by 2.2% on annual basis (following a decline by 3.4% in 2009).

Although in Q3 2010, the annual economic growth rate was positive in nearly all countries, the pace of recovery was highly diversified. This diversity resulted from a different growth structures in the region in a pre-crisis period. More severe declines in GDP during the crisis and slower recovery were being observed in those countries where growth was mainly based on strong increase in consumption, supported by increased bank lending, i.e. overall in countries applying fixed exchange rate regimes. This situation also led to a substantial increase in external imbalances.

The recovery of international trade in goods (following a severe decline at the turn of 2008 and 2009) became the driving force of the economic recovery in CEE countries. Until Q3 2010, exports was the only category to have reached the level from before the crisis. Domestic demand, however, remained very low, mainly due to adverse conditions on the labour market.

Increase in external demand proved to be the stimulus for increased activity in the industry. Increase in foreign orders was (and remains) considerably higher than in domestic ones. Increase in trade output during 2010, which was observed in all countries in the region, contributed to stopping the growth in unemployment rate.

The increase in exports was primarily a result of an intensified trade in goods within regional and global manufacturing networks. This was reflected, above all, in a significant increase in exports of intermediate goods to "old EU" countries (especially Germany), which are the main investor in the manufacturing sector in Central and Eastern Europe. It was the intensified demand in the German export sector — influenced by the global economic recovery (stimulated, in particular, by the improving economic situation in the US and developing Asian countries) — that turned out to be the main cause of increased exports from CEE countries.

The decline in the global trade growth rate, anticipated in 2011, will be caused by slightly lower growth of economic activity in the global economy as compared to 2010. This will translate into lower growth rate of German exports, which in turn will contribute to decreased growth of imports, including imports from the countries of Central and Eastern Europe. However, in spite of the expected decrease in growth, exports will continue to increase at a significantly faster pace than domestic demand. Gradual acceleration of consumption and investments will support the increase in imports. While it is anticipated that in 2011 positive economic growth will be achieved by all countries in the region, it will remain considerably lower than it was before the crisis.

In 2010, the level of fiscal imbalance in the majority of CEE countries decreased as a result of improved economic conditions and adopted consolidation measures. This group of countries comprises of the Czech Republic, Bulgaria, Romania, Hungary and Latvia. Meanwhile in Slovakia, Poland and Slovenia, measures reducing the level of general government deficit will only enter into force in 2011. All CEE countries were subject to the excessive deficit procedure (EDP) except Estonia, where negative budget balance in 2010 amounted to 1.3% of GDP. The average level of ESA95 fiscal deficit in the countries of the region (excluding Estonia) was approx. 6.4% of GDP as compared to 7.1% of GDP in 2009. European Commission expects in its economic forecast (November 2010) improvement in the budgetary situation in the CEE countries(excluding Hungary and Estonia), which in turn will result in reduction of the growth rate of public debt. However, the level of fiscal deficit will continue to exceed the 3% of GDP reference value and in the majority of countries in the region, it will be necessary to take further consolidation measures.

COUNTRIES OF CENTRAL AND EASTERN EUROPE

Economic growth

Rebound in foreign trade, following the severe decline at the turn of 2008 and 2009, became the driving force of an economic recovery in Central and Eastern Europe. Until Q3 2010, export was the only category to have reached the level from before the crisis, while domestic demand remained very low, mainly due to further deterioration on the labour markets. The pace of economic recovery in the region was, however, diverse. Economies which followed the path of relatively balanced growth in the pre-crisis period reached the highest economic growth rates in the first three quarters of 2010. On the other hand, countries with the highest domestic and external imbalances observed a considerably slower improvement in their economic situation.

Positive quarterly GDP growth rates have been recorded in most CEE countries since the beginning of 2010. Moreover, GDP growth on annual basis kept increasing with every subsequent quarter of the year. As a result, in Q1-Q3 2010 period, GDP in the region increased by 2.2% as compared to the corresponding period of the preceding year (following a decline by 3.4% in 2009). The highest economic growth in the first three quarters of 2010 was recorded in Slovakia (4.4%), Poland (3.9%) and the Czech Republic (2.0%). Positive annual GDP growth rate was also observed in Estonia, Slovenia and Hungary. The level of real GDP remained practically unchanged (as compared to the previous year) in Lithuania. In the remaining CEE countries it continued to decrease. While in Bulgaria and Latvia, the scale of declines in GDP was noticeably smaller than in 2009, Romania remained the only country in the region which exhibited no significant traits of economic recovery.

In the majority of countries in the region, increased economic activity was the result of growing external demand and rebuilding of inventories.

The increase in exports was chiefly a result of an intensified trade in regional and global manufacturing networks. This was, above all, reflected in a high increase in exports of intermediate goods. Sales of finished goods also exhibited relatively high growth rate. The increase in exports of consumer goods was partially due to fiscal stimulation programmes in EU-15 states (especially new car subsidies) as well as to the shift in the imports structure towards cheaper products from the CEE region. These tendencies resulted in a prompt (in most countries, two-digit) increase in exports in the first three quarters of 2010 in all countries of the region as compared to the corresponding period of 2009. In the entire CEE region, the volume of goods and services exports increased by 13.5% in Q3 2010.

Due to this fast increase in exports, foreign trade balance had positive impact on the GDP growth rate in the first half of 2010. This impact, however, was reduced with every subsequent quarter and became negative already in Q3[1]. This was a result of gradual imports growth. In Q2 and Q3 2010 an increase in imports of intermediate goods, related predominantly to the growing demand in the export sector in the region was especially noticeable. Weak consumer and investment demand, in turn, continued to impede the growth of imports.

Table 1.1
GDP and its components growth rate (in %, y/y) in Central and Eastern Europe

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**4.1**	**-3.4**	**1.0**	**2.5**	**2.8**
Private consumption	4.7	-3.5	-0.8	0.2	1.6
Public consumption	4.6	1.3	0.8	0.3	1.6
Fixed capital formation	6.2	-11.7	-13.1	-4.9	-3.2
Exports	6.8	-10.3	12.8	15.7	13.1
Imports	6.8	-16.3	9.0	16.0	12.7

source: Eurostat

GDP growth was crucially and positively impacted by an increase in inventories. In 2010, the cycle of inventories was reversed. After a period of significant decrease in inventories in 2009, enterprises began to rebuild them. The contribution of the change in inventories to GDP growth increased with every subsequent quarter of 2010. In Q2 and Q3 it was definitely the highest of all GDP categories.

After three quarters of 2010, a slight increase in private consumption was recorded. This was caused, above all, by increased households spending in Poland (by 2.9% y-o-y), where it was characterised by positive growth throughout the entire crisis. Apart from Poland, only the Czech Republic exhibited higher private consumption as compared to the preceding year (0.7%). Other CEE countries experienced a decline of this factor. However, quarterly growth of consumption in Q3 2010 in five other countries in the region may indicate a reversal of this declining trend and Latvia experienced a decrease in the scale of this decline. The private consumption growth was negatively affected by continuously deteriorating conditions on the labour markets (albeit this deterioration was marginally slower than in 2009). The wage growth decreased. Moreover, the stagnation in the bank lending market was still visible. While the value of loans for households ceased to decline, however, banks continued to be extremely cautious with respect to granting new loans.

[1] The only exceptions in this respect were Bulgaria and Slovenia, where the impact of net exports, resulting from low imports, increased with every subsequent quarter of 2010 and remained the main factor influencing GDP growth.

Very slow consumer demand recovery was reflected in retail trade data. In Q4 2010, some countries in the region still experienced decreasing value of sales. The most severe declines took place in the durable goods sector. The number of newly registered cars in the region also decreased in 2010 (by more than 5%). A slight increase in the sales of new cars was registered in Poland, the Czech Republic and Slovenia, while in Bulgaria, Romania, Hungary and Slovakia the decrease in new registrations exceeded 20% y-o-y.

Most countries in the region, however, experienced an increase in consumer sentiment indicators. Improvement of consumer confidence was best visible in Baltic states (which previously had experienced the most severe decline in this respect). However, in the second half of 2010, the evaluation of current and future economic and financial situation of households deteriorated once again.

Although public consumption exhibited a slight growth in the entire region in the first three quarters of 2010, the situation in individual countries varied considerably. Public consumption increased in Poland, the Czech Republic, Slovenia and Slovakia but decreased in other countries as a result of lower spending related to the need for consolidation of public finance.

The declining trend in investment had not yet been reversed. In the first three quarters of 2010, fixed capital formation remained below the level from the previous year, which was strongly influenced by the fall in investment outlays in the construction sector. Low growth rate of bank loans for non-financial corporation was an additional factor to hamper the capital formation growth. Investment outlays increased only in Slovakia. Since Q2, investment expenditure have also been increasing in the Czech Republic, Lithuania and Poland, and in Q3 — also in Latvia. In other countries in the region gross fixed capital formation continued to decline.

Improvement in economic conditions in CEE countries resulted from increased activity in industry, which was fueled by a substantial increase in external demand. An increase in industrial output during 2010 was observed in all countries in the region. It mainly concerned the production of means of transport, machinery and equipment as well as durable consumer goods, i.e. the production increased most in the export-oriented sectors. The most considerable increases in output took place in the first half of 2010. This process decelerated slightly in the following months, especially in Q4 2010, which in turn may indicate the end of inventory rebuilding process, as well as diminishing role of external demand in economic growth in the CEE region in the following years.

Financial aid received during the crisis by some countries in the region from international institutions led by the EU and the IMF (Hungary, Latvia, Romania[2]) and — above all — commitments of these countries to reduce the general government deficit (among others, by increasing taxes and reducing of employment and wages in the public sector) also contributed to the decrease in domestic demand in 2010.

Labour market

The situation on labour markets in CEE countries in 2010 showed little signs of improvement. Unemployment rate reached its highest values in recent years. In the second half of 2010, this growth decelerated and a slight decrease in unemployment rates could be observed in the Czech Republic, Estonia, Latvia and Hungary. At the end of Q3 2010, the lowest unemployment rate in the region was recorded in the Czech Republic (6.9%), whereas the highest — still in Baltic states (17.5% on average).

Data concerning employment also indicate a minor improvement in the first three quarters of 2010. The annual employment growth remained negative in most countries, however, the number of the employed gradually began to rise in Poland, the Czech Republic, Hungary and Latvia. In other countries, the scale of decline in employment diminished. In spite of fast increase in industrial output, employment in industry continued to decrease. A decrease in the number of the employed was also observed in the services sector, in particular — in financial intermediation. Agriculture was the only sector to register an increase in employment in 2010.

Inflation and labour costs

In the first half of 2010 the significant decrease in inflation (certain countries with fixed exchange rate regimes even experienced deflation) resulted from lower core inflation (due to diminishing base effect related to increases in administered prices at the beginning of 2009[3]). Prices of food and energy remained relatively stable.

The situation changed starting from Q2 2010, when increased growth of consumer prices could be observed. It continued almost until the end of 2010. In June 2010, the annual HICP growth rate in the region amounted to 2.5% and it increased to 3.4% in November. The lowest annual HICP growth rate in November 2010 was

[2] Apart from the abovementioned CEE countries, international institutions also provided aid to other developing European states, i.e. Belarus, Kosovo, Moldavia, Serbia and Ukraine.

[3] In January 2010, many countries also experienced an increase in indirect tax rates (the Czech Republic – increased VAT rates, Romania – increased excise duty) and in administered prices (Lithuania – increased electricity prices); however, the scale of their impact on inflation was smaller than that of changes in early 2009.

recorded in Slovakia (1.0%) and the highest — in Romania[4] (7.7%).

The increase in inflation was caused mainly by supply factors. The aspect that proved to be particularly crucial was the increase in the prices of food, especially unprocessed food. The climbing prices of energy commodities also worked towards the rise of inflation (which became particularly visible in Q4 2010). At the same time, low domestic demand continued to exert minor influence on prices. Core inflation remained low throughout 2010 and even continued to fall in the second half of the year.

In spite of persisting negative trends on the labour market, an increase in annual wages growth rate was observed in the region. In Q3 2010 it was negative only in the Baltic states and Romania. However, a gradual growth in wages could be observed in Estonia and Latvia in the subsequent quarters of 2010.

The economic recovery which took place in 2010, together with continuing unfavorable situation on the labour markets, contributed to further decrease in growth of unit labour costs (ULC). Although in the second half of 2010 wages in CEE countries slowly began to rise, their increase was not as significant as the increase in labour productivity in this period.

Balance of payments

Although the decrease in external imbalances in CEE countries, started in 2009, continued during the first half of 2010, the pace of reduction of current account deficits (in the case of Baltic states — the pace of increase of surplus on this account) diminished. Across the CEE region, the current account deficit (calculated as 4Q moving average) fell from 1.7% in Q4 2009 to 1.3% of GDP in Q2 2010.

As in 2009, the improvement of the current account balance was primarily attributable to the decreasing goods account deficit. Strong external demand stimulated the growth of exports, whereas imports increased at a considerably slower pace. The remaining categories of the current account had no significant impact on its overall balance in the region.

The situation changed in Q3 2010, when Poland, the Czech Republic and Slovakia experienced an increase in the current account deficit for the first time since the beginning of 2009. Current account surpluses in the Baltic states also decreased. This change was mainly due to a higher deficit on the income account. The surplus on the services account also diminished. Changes on the goods account, however, exhibited varied tendencies. In Poland and Lithuania deficits in goods deepened, while the Czech Republic and Slovakia observed a decline in surpluses. This was due to accelerated growth of imports, caused by spurred domestic demand in Q3 2010. Other countries in the region, however, continued to exhibit the trends observed in preceding periods — either an increase in surplus (Hungary) or decrease in deficit on the goods account. Nevertheless, in general, the goods balance across the region did not change in Q3 and neither did the current transfers balance.

Early 2010 also saw a decline in foreign capital inflow to CEE markets. This was caused mainly by lower inflow of foreign direct investments. In Q2 and Q3 2010 the direct investments inflow increased, although in certain countries (Poland, Bulgaria and Romania), the declining tendency continued. In the first three quarters of 2010 an increased inflow of portfolio capital could still be observed, although it diminished with every subsequent quarter. This, however, did not concern Poland and the Czech Republic, where between Q1 and Q3 2010, record-level inflow of portfolio investments (especially in treasury bonds) was maintained. Other investment deficit in the CEE countries continued to deepen (in Q2 2010, the slight surplus on this account had already turned into a deficit). This resulted mainly from the repayment of foreign liabilities, incurred by commercial banks in preceding years.

Exchange rates and interest rates

In 2010, the situation in European financial markets was the key determinant of exchange rates fluctuations o floating exchange rate regime CEE currencies. The appreciation process of these currencies, which started in 2009, was interrupted on numerous occasions with periods of depreciation, caused by turmoil in peripheral states of the euro area and in Hungary.

The increase in risk aversion and, in consequence, the temporary depreciation of currencies of CEE countries, were caused by information about the sovereign debt crisis in Greece (April and May 2010), interrupted negotiations concerning prolongation of financial aid to Hungary by the IMF (July 2010), as well as the banking system crisis in Ireland (November 2010). Eventually, however, the currencies of Poland and the Czech Republic appreciated against the euro during 2010 (by 3.4% and 5.2%, respectively). Only the Hungarian forint depreciated in that period (by 2.8%), mostly due to domestic problems.

The speculations concerning devaluation of the Baltic states currencies, especially the Latvian lat, ended in 2010. These countries managed to increase their global competitiveness through the so-called "internal devaluation", i.e. depreciation of the real exchange rate via decrease in inflation and labour costs.

Although the monetary policy in 2010 remained eased, growing inflation indicates that some tightening is expected in the upcoming months. Out of central banks in the region, only the National Bank of Hungary decided to raise interest rates (twice, in November and December

[4] Romania experienced a considerable increase in inflation in July 2010 due to a rise of VAT rate by 5 pp.

2010, in total by 50 bp to 5.75%).[5] Interest rates of other CEE central banks in 2010 remained at their record low levels.

Fiscal policy

The level of fiscal imbalance in the CEE countries in 2010 remained high in spite of improved economic conditions. Its mean level in the region (except Estonia[6]) amounted to approx. 6.4% of GDP as compared to 7.1% of GDP in 2009. According to the autumn fiscal notification (October 2010), the reduction of general government deficit in 2010 will be the weakest in Slovakia and Slovenia — by approx. 0.1–0.2 pp of GDP — and the strongest in Lithuania and Latvia — by approx. 1.7 and 1.4 pp of GDP, respectively. Only in Poland fiscal deficit is expected to increase (by approx. 0.7 pp of GDP). In Slovakia, Poland and Slovenia, the process of reduction of structural imbalance of public finance will only commence in 2011.

According to the autumn economic forecast of the European Commission, the majority of countries in the region are expected to experience a reduction in general government deficit in 2011 to a mean level of 5.1% of GDP. A substantial adjustment is anticipated in Slovakia and Romania (by approx. 2.9 and 2.4 pp of GDP, respectively). Deterioration of fiscal balance is expected in Estonia and Latvia (by 0.9 and 0.2 pp of GDP, respectively) as well as in Hungary (0.9 pp of GDP); however, the EC's forecast does not take into account the effects of changes in the pension scheme in Hungary or measures adopted by Latvia at the end of 2010. As far as the former issue is concerned, it will result in substantial reduction of budget deficit below 3% of GDP. In Latvia, in turn, the budget deficit is to decrease from 8.5% of GDP in 2010 to 5.4% of GDP in 2011.

Baltic states are showing signs of "consolidation fatigue". In 2008 and 2009, the magnitude of adjustments implemented by these countries was considerable (approx. 10%–15% of GDP). However, the level of general government deficit in Lithuania and Latvia remains at the level over twice as high as the 3% of GDP reference value. In 2011, only Latvia is planning to continue measures aimed at reducing this deficit, although their scale (approx. 2% of GDP) will be significantly smaller as compared to previous years. The EC anticipates that the general government structural deficit in Baltic states will deepen between 2010 and 2012, unlike in other CEE countries(excluding Hungary).

The new Hungarian government has taken a number of controversial consolidation measures (changes in the pension system, temporary taxation of telecommunication companies, businesses in the energy sector, banks and retail chains). The cornerstone in reduction of the general government deficit (2011–2012) is law adopted at the end of 2010 resulting in actual abolishment of funded pension scheme. These solutions, together with other measures taken by Hungarian authorities (including the limiting independence of the central bank and the Hungarian Budget Council, eliminating the option to question the constitutionality of laws affecting budget revenue) sparked a negative reaction of financial markets and raised concerns of the EC. Due to temporary positive impact of changes in the pension scheme on the general government deficit and adopted tax reductions (CIT, flat PIT rate), in subsequent years it will be necessary to take additional consolidation measures. Hungarian authorities at the end of February 2011 are to present a fiscal adjustment programme aimed at cutting spending.

Within the entire time horizon of EC's forecast (2010-2012), the condition of public finances in the CEE countries is to improve (except for Hungary and Estonia), which will reduce growth of public debt. Its level in relation to GDP will exceed 60% only in Hungary.. Bulgaria will be the only country in the region to lower the general government deficit[7] below the 3% of GDP reference value in line with the deadline imposed under excessive deficit procedure (i.e. in 2011). Other countries will have to continue further consolidation measures.

All countries with funded pension schemes have adopted changes affecting its functioning. They were primarily motivated by deterioration of public finance due to the economic crisis, as well as disadvantageous regulations of Eurostat[8]. The changes involved a temporary reduction of contributions transferred to pension funds or suspension of their transfer (Baltic states, Hungary, Romania) or the option for the insured to leave the second pillar (Slovakia, Hungary). Hungary constitutes an extreme case, where the pension funds were actually disposed of. At the end of 2010, in Bulgaria, a decision was made to transfer funds collected in occupational pension funds for people who will take early retirement in the period between 2011 and 2014. Poland announced plan of reduction in contribution transferred to pension funds from April 2011.

Forecasts

It is expected that economic growth in the region will accelerate in the upcoming years, although it will remain considerably lower than in a pre-crisis period. In November 2010, the European Commission (EC) forecasted that GDP growth in the region would accelerate to 3.1% in 2011 and 3.7% in 2012. Export will remain the major driving force behind economic activity in the CEE countries. The contribution of domestic demand is, however, expected to grow gradually.

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[5] This decision was a surprise to financial markets and was caused, among others, by political factors.

[6] In Estonia, the general government deficit amounted to 1.7% of GDP in 2009; in 2010, according to the forecast presented by Estonian authorities in autumn fiscal notification (October 2009), it is estimated at 1.3% of GDP.

[7] Among CEE countries, Estonia is the only one which is not subject to EDP.

[8] According to it, private pension funds are not treated as a part of the general government.

In 2011 GDP is expected to grow in all countries in the region. The economies of Poland and Slovakia, which developed relatively fast in 2010, are to be accompanied in 2011 by other countries from the region, in particular by Baltic states. Romania and Slovenia are the only countries where the expected annual growth rate will not exceed 2%.

In comparison to the spring forecast, the EC only slightly verified its forecasts due to the persistently high uncertainty of the global economy prospects. Expectations were only raised for Poland and Estonia, while for Romania, the anticipated pace of growth in 2011 was decreased by 2 pp.

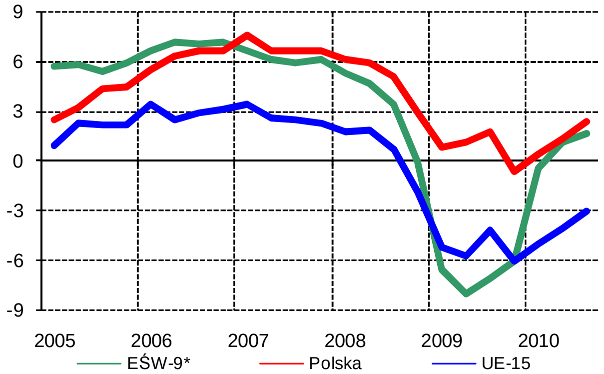
The forecasted improvement in economic recovery will be accompanied by changes in the structure of economic growth. The contribution of domestic demand will increase, while that of net exports will be declining. In 2011 private consumption should be on the increase in all countries in the region, especially in Poland, Hungary and the Baltic states. This will be caused mainly by the reversal of negative trends in the labour market. The EC's forecasts indicate a gradual decrease in the unemployment rate in the subsequent years, although in 2012 it will still be considerably higher than prior to the crisis in all countries in the region. Public consumption, however, is expected to decrease. In 2011, the adopted plans for fiscal consolidation in the CEE countries will negatively impact the contribution of public consumption to GDP growth in the majority of states (except for Bulgaria). In 2012, general government spending are expected to increase. The European Commission also anticipates an increase in fixed capital formation (by 6.3% in 2011 and by 7.3% in 2012). It is also expected that 2011 will see the end of the inventories rebuilding process and hence in the upcoming years, this category's contribution to GDP growth — which was extremely important in 2010 — will practically disappear.

The expected exports growth rate will be reduced in the subsequent years due to lower growth rate of global trade. It is also anticipated that the imports growth rate will decrease, however, slower growth of the export sector demand will be partially compensated by faster growth of import of consumer and capital goods. As a result, net exports contribution to GDP growth will become negative in the majority of countries in the region.

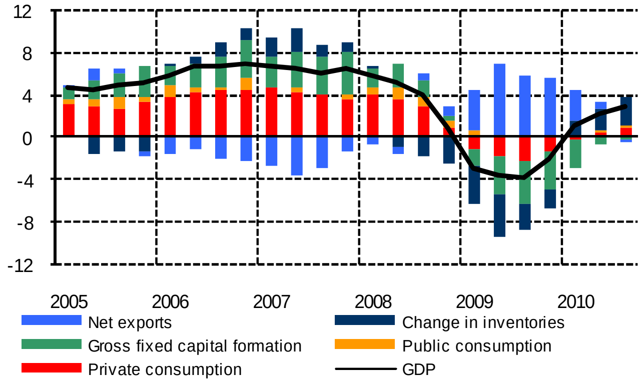
Inflation is also expected to increase. This will be a result of both demand (recovery of consumption and increased inflationary pressure from the labour market) as well as supply (persistently high prices for energy commodities and food) side factors. Moreover, numerous increases of intermediate taxes (mainly excise duty, and in the case of Poland, Slovakia and Latvia — also VAT rates) which will take place in 2011 will also affect the inflation rate. A significant decrease in inflation may only be observed in Romania due to the expiry of base effect related to the increase in VAT rates in mid 2010. According to the EC's forecast, inflation in the region in 2012 will remain on the level similar to the preceding year.

The deteriorating balance of foreign trade as well as growing deficit on the income account will most likely be the key factors of current account deficits widening (or, in the case of Baltic states, lowering of the surplus) in 2011 and 2012. Opposite trends will only be observed in the Czech Republic and Slovakia, where the current account deficits are to slightly decrease in the upcoming years due to the expected increase in the foreign trade surpluses.

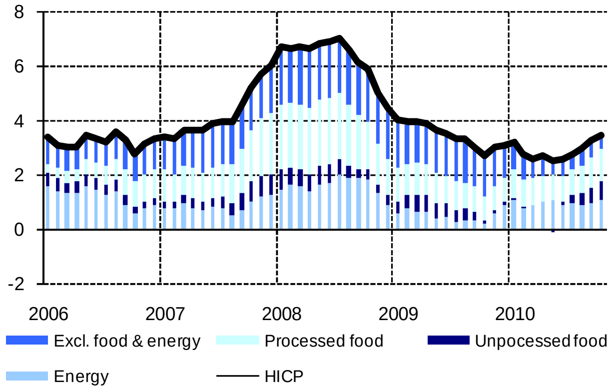
GDP growth rates (in %, y/y)



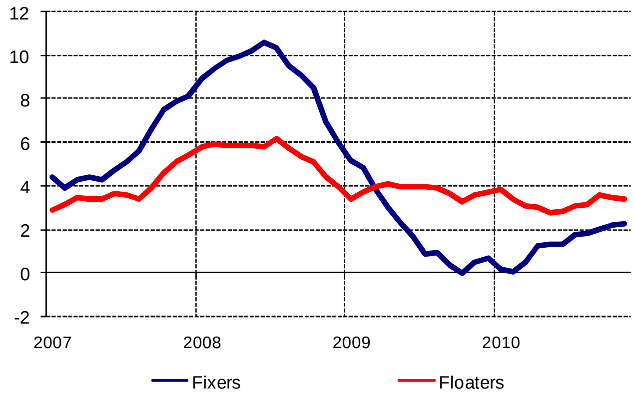
Contribution to GDP growth in CEE countries (in pp, y/y)



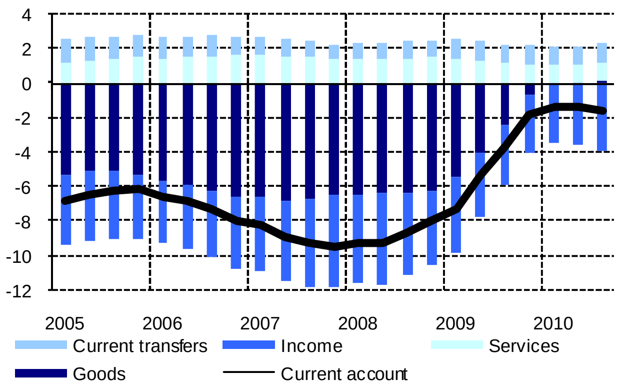
HICP and its components (in %, y/y)



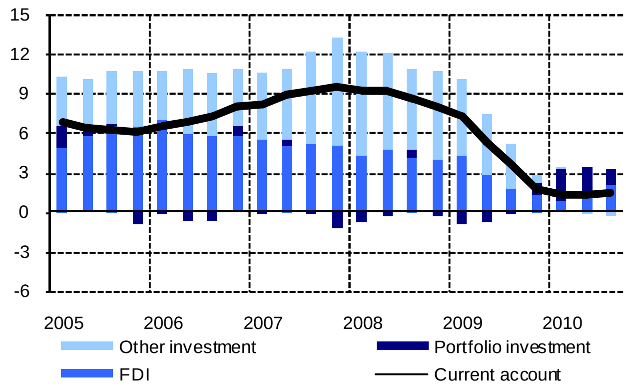
HICP (in %, y/y)



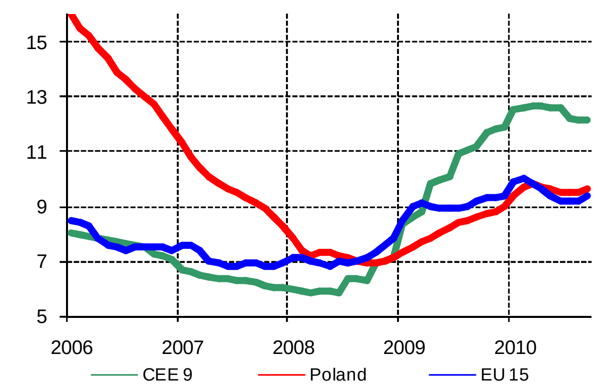
Current account and its components (in % of GDP, 4-quarter moving average)



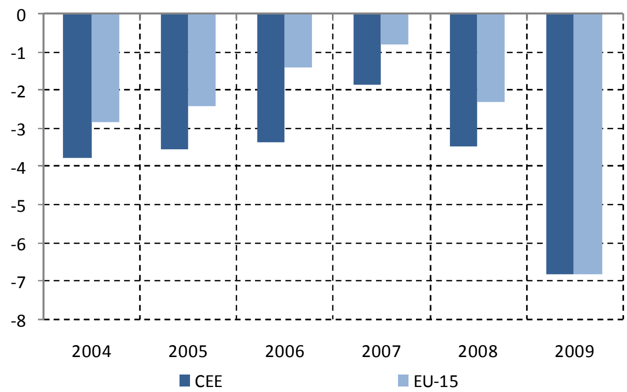
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%)



General government deficit (in % of GDP)



Source: Eurostat, CSOs

BULGARIA

The beginning of 2010 was marked by a gradual decline on the pace of GDP adjustment in Bulgaria. The effect of the still decreasing domestic demand was offset by a fast-growing demand from key business partners . As a result of this increasing disproportion between external and domestic demand, most of the alleviation of the effects of economic crisis came from net exports. The decrease in domestic demand, resulted largely from a maintained correction of household spending. Bulgaria was the only country in the region where the decrease in consumption was still intensifying in Q3 2010. Moreover, the GDP correction was further deepened by cuts in public spending.

Sharp reductions in private consumption in subsequent quarters stemmed mainly from a still restrained access to credit (including the effect of deteriorating creditworthiness of households), deteriorating conditions on the labour market and a precautionary increase in the savings rate.

Measures aimed at lowering the public deficit were the main cause for a negative contribution of public consumption to GDP growth in Q2 and Q3 2010.

Table 2.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**0.6**	**-6.3**	**-4.0**	**0.5**	**1.0**
Private consumption	-0.5	-7.6	-8.3	-3.2	-7.0
Public consumption	0.7	-1.1	0.3	-4.9	-3.5
Fixed capital formation	-2.6	-6.5	-12.8	-13.7	-5.0
Exports	4.8	-9.1	5.7	12.9	18.2
Imports	4.7	-15.4	-2.5	0.3	3.8

source: Eurostat

Concerning fixed capital formation, continuing declines in investment expenses were predominantly the result of low capacity utilization ratio (below 70% in Q2 this year) and an impeded access to investment funds. Lower level of investments was especially visible in sectors that had undergone the fastest development in preceding years, such as construction and financial services sectors.

Severe decline in domestic demand made Bulgaria the only country of the region which did not experience increased imports in the first three quarters of 2010. The increase in imports demand of the export sector (which in fact has relatively little significance in Bulgarian economy) and rebuilding of inventories merely caused the volume of imports to stabilize. Whereas increased exports reflected an improvement in the economic situation of Bulgaria's main trading partners, in particular, Germany and Turkey[9]. Therefore, already in Q2 2010, exports growth exceeded 12% y/y (as compared to -10.4% y/y in 2009). The highest increase in exports was recorded for intermediate goods, which had experienced the most severe decline in sales in 2009.

Retail sales, also point towards a possible continuation of decreases in household spending by declining at the beginning of Q4 2010. The most severe declines were observed for computers and telecommunications devices, household equipment as well as clothes and textiles.

Consumer sentiment indicators, having plummeted in 2009, exhibited a moderate growth trend until the end of Q2 2010. This resulted from an improvement in the perception of both the current economic situation and the perspectives for the Bulgarian economy.

Business confidence, after an increase in Q1 2010, stabilized at a considerably lower level than before the crisis. This moderate increase in confidence was recorded in all sectors apart from services. Industrial output, more dependent on foreign demand, appeared to exhibit a growth trend in Q2 and Q3 2010. The highest production growth took place in petrochemical, paper, chemical and automotive industries.

Labour market

Unemployment in Bulgaria is considered to be one of the main causes of the decline in private consumption in 2010. Its rate grew continuously from Q4 2008 until Q2 2010, when it stabilized at the level of 10%. At the end of 2010, the unemployment rate increased again, mainly due to seasonal factors. It appears that the Bulgarian labour market will require more time to stabilize that in other CEE countries. The annual rate of decline in employment in Q3 2010 was, apart from Lithuania, the highest in the region. The low activity in the Bulgarian economy as well as a relatively inflexible labour market were also reflected in persisting quarterly employment decreases. Even though since Q2 2010, the unemployment rate in Bulgaria has slightly decreased, this trend change arose in Bulgaria later than in the majority of other CEE countries.

Marked growth of unemployment and negative employment growth resulted since 2009 in sustained decreases in the unit labour cost.

[9] Between January and September 2010, Turkey became the fourth biggest market for Bulgarian exports (representing 8.1% of total exports). Over the first nine months of the last year, the value of sales to this market increased by 65.2%, i.e. more than for any other main trading partner. Such a considerable growth was due to the recovery of the value of exports, following its collapse at the turn of 2008 and 2009. The recovery of deliveries to Turkey was supported by high domestic demand in that state. In the first half of 2010, economic growth in Turkey exceeded 10%.

Inflation and labour costs

In 2010, inflation — measured with HICP, which had reached its minimum at the beginning of Q4 2009 — continued to grow and reached 4% in November last year (as compared to less than 1% in November 2009).

However, 2010 saw a significant change in the contributions of individual categories to the inflation rate. Weak internal demand, together with deteriorating conditions in the labour market (including the decrease in unit labour costs) contributed to the lowering of core inflation to nearly zero at the end of the previous year. Energy prices, in turn, following fuel prices on the global market, had a significant impact on inflation since the beginning of 2010 (1.5 pp in November last year). The contribution of food prices has also increased (up to 2.2 pp in November last year).

Table 2.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**0.9**	**2.0**	**2.8**	**3.3**	**4.0**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.7	0.8	1.1	1.1	1.1
Food and beverages	-1.0	-0.7	-0.6	0.0	1.1
Transport	-0.3	1.0	1.2	1.1	0.9
Housing	0.0	-0.2	-0.1	0.2	0.4
Other	0.4	0.3	0.5	0.3	0.3

source: Eurostat

Balance of payments

In 2010, the current account deficit continued to decline at a rapid pace. It dropped from 9.9% of GDP in 2009 to 1.8% of GDP in Q3 2010, which was predominantly due to the decrease of the negative trade balance. This was mainly the result of a persisting stagnation of imports, caused by limited investment activity and a weak consumer demand. Additionally, since Q1 last year, an increase in exports has been observed, reflecting — most of all — increased demand from the economies of EU states recovering from recession. Changes in the balance of other categories also contributed — albeit to a lesser extent — to the reduction of the current account deficit. The surplus on the services account increased, especially for tourist services. The negative balance on the income account decreased due to a lower outflow of direct investment profits. The surplus on current transfers, in turn, increased (approximately half of the balance increase in comparison with the corresponding period of 2009 resulted from increased transfers from the EU).

The year 2010 saw a further deepening in the decline of foreign capital inflow to Bulgaria. This was mainly the result of a decline in the inflow of direct investments and other investment. The smaller inflow of direct and portfolio investments resulted primarily from decreasing investments in services connected with the real estate and the manufacturing sector. Whereas, the outflow of other investments was caused mainly by repayments of foreign loans by banks and withdrawal of deposits by foreign parent banks. This situation contributed to the reduction of credit to the private sector, which is one of the main causes of the internal demand weakness.

Table 2.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-15.1**	**-9.9**	**-7.5**	**-4.7**	**-1.4**
Goods	-15.8	-11.9	-10.2	-8.9	-6.7
Services	3.6	3.7	3.8	4.5	5.1
Income	-5.1	-4.4	-4.2	-3.8	-3.8
Current transfers	2.2	2.7	3.1	3.5	4.1
Capital account	**1.2**	**1.4**	**1.0**	**0.4**	**0.6**
Financial account	**15.6**	**8.1**	**5.9**	**5.3**	**1.7**
FDIs	10.3	9.6	7.1	6.4	5.6
Portfolio investments	-2.0	-1.6	-0.6	-1.2	-1.4
Other investments	-1.5	-1.7	-1.8	-2.6	-2.5

source: Eurostat

Interest rates

Nominal interest rates on the Bulgarian interbank market were decreasing systematically over the last year. In 2010, the most pronounced drops of the three-month Sofibid rate took place in Q2 and Q3, whereas since Q4 2010, this rate has remained stable at a level not exceeding 2.1%.

Fiscal policy

than anticipated execution of state budget revenue prompted adoption of an amendment to the budget act in mid 2010. Income forecast was lowered by 2.8% of GDP and spending limits were reduced.[10]. In 2010, the balance of the National Social Insurance Institute (NIS) and the National Health Insurance Fund (NZOK) deteriorated due to lower revenue from contributions, related, among others, to their reduction (by 2 pp). This was reflected in an accumulation of arrears in the healthcare sector. The budgetary deficit forecast for 2010 was increased from 0.8% to 3.8% of GDP[11].

Plans for 2011 include reduction of the fiscal deficit to less than 3% of GDP, within the deadline set under EDP (to 2.75% of GDP according to the government's estimates[12] and 2.9% of GDP according to the EC). It will result from the improved economic situation and further

[10] By 20%, whereas subsidies for local governments – by 15%. The reductions did not apply to social assistance, education , transfers to the National Health Insurance Fund (NZOK) and Bulgarian National Railways as well as anti-crisis measures (financed by the reserve fund).

[11] Initially Bulgarian authorities intended to increase the VAT rate (from 20% to 22%-25%), but withdrew from this proposal because it could lead to deterioration of the country's economic situation.

[12] The general government deficit was increased by ¼ pp of GDP as compared to the draft budget act for 2011, presented by the government. This was due to adoption of higher spending in the education, culture, justice and other sectors.

cuts in expenditure[13] (such as extension of freezes on pension and disability allowances and of expenditure on wages by another year). Starting from 2011, the amount of social insurance contributions is to increase (by 1.8 pp). At the end of 2010, the authorities presented measures, providing for gradual increase of the minimum insurance period and increase of retirement age, starting from 2012 (by two years in total). Should the insured be granted early retirement between 2011 and 2014, their funds, collected by the occupational pension funds, shall be transferred to NIS (approx. 0.1% of GDP). Moreover, the Bulgarian government announced works on a draft act which provides for co-financing of medical services and introduction of additional, private health insurance scheme. Achievement of the adopted budget objective is subject to risk related to the optimistic macroeconomic assumptions.

Bulgaria's public debt remains, together with Estonia's, at the lowest level in the EU. The EC estimates that it will amount to 20.2% of GDP in 2011 and 20.8% of GDP in 2012. Its growth was lowered by financing the general government deficit by transferring resources accumulated by the reserve fund during the economic crisis and with high privatization receipts in 2011.

Forecasts

The European Commission anticipates that the Bulgarian economy will gradually return to a growth model basing on domestic demand. The EC expects GDP to rise by 2.6% in 2011, mainly as a result of a gradual increase in household spending and investment. Simultaneously a weakening of exports growth and increased (as compared to 2010) imports growth will contribute to a higher trade deficit (the current account deficit may rise to 5% of GDP). However, the realization of this forecast is largely dependent on the situation on the labour market and the availability of loans — the two main factors reducing domestic demand in 2009 and 2010.

According to expectations, unemployment will start do decrease in 2011, although its reduction will be considerably slower than the rise that took place during the crisis. This will translate into further lowering of wages and unit labour costs. The availability of loans, in turn, will depend mainly on the inflow of foreign capital and on the improvement on the real estate market, which is due to take place no sooner than at the end of 2011.

A low increase in consumer demand will limit the inflationary pressure. The increase in consumer prices in 2011 is expected to reach 3.4%. Thus, the main factor keeping inflation at this level would be increases in energy prices.

Risks to the forecast include a slower than expected economic recovery of Bulgaria's major trading partners, a delayed improvement on the labour market due to its relative rigidity, as well as a persisting decrease in capital inflow and potential effects of the fiscal consolidation.

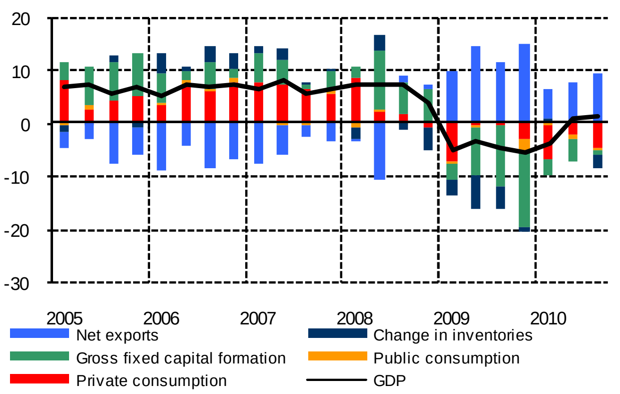
Table 2.4

Forecasts of main macroeconomic indicators

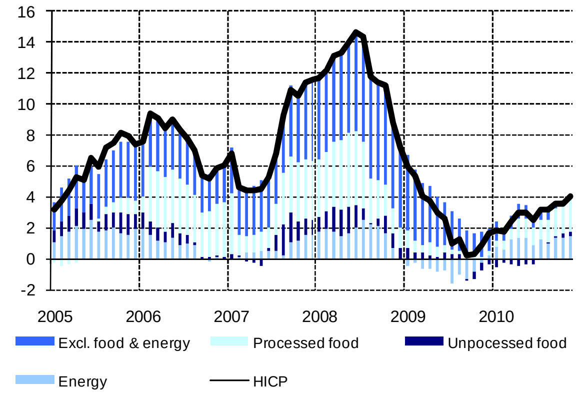
	EC	IMF	Consensus Economics
	11.2010 (05.2010)	10.2010 (04.2010)	12.2010 (05.2010)
GDP, in %, y/y			
2010	-0.1 (0.0)	0.0 (0.2)	0.1 (-0.1)
2011	2.6 (2.7)	2.0 (2.0)	2.6 (2.5)
2012	3.8	4.0 (4.0)	
Inflation, in %, y/y			
2010	2.9 (2.3)	2.2 (2.2)	2.7 (2.6)
2011	3.2 (2.7)	2.9 (2.9)	3.4 (3.0)
2012	3.1	3.0 (3.0)	
Current account balance, in % of GDP			
2010	-3.3 (-6.0)	-3.0 (-6.3)	
2011	-2.5 (-5.2)	-3.1 (-5.8)	
2012	-2.3	-3.5 (-5.9)	

[13] The budget act for 2011 does not provide for changes in tax rates except for increased excise duty for cigarettes and fuel, which results from adjustment to the minimum requirements of the EU provisions.

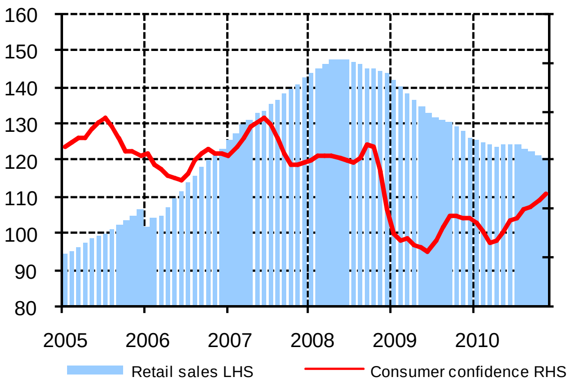
Contribution to GDP growth (in pp, y/y)



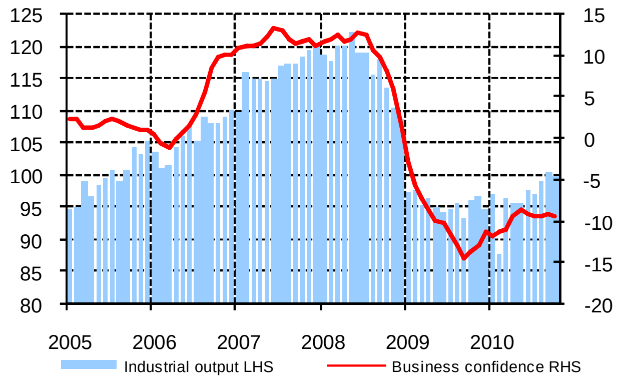
HICP and its components (in %, y/y)



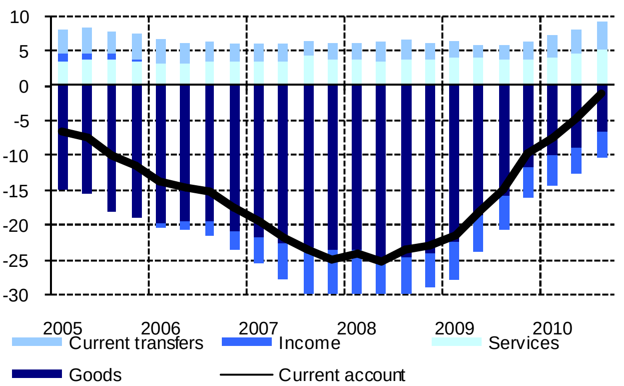
Retail sales (in %, y/y) and consumer sentiment index



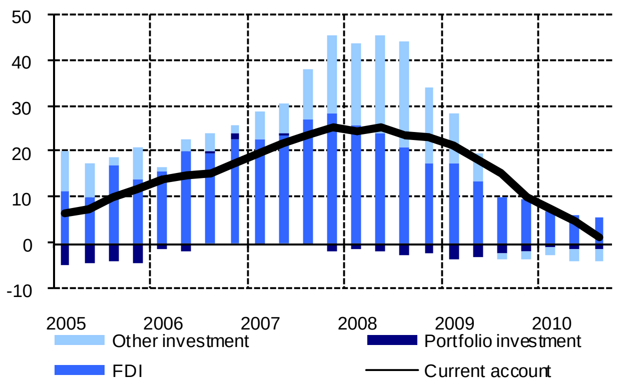
Industrial production (in %, y/y) and business sentiment index



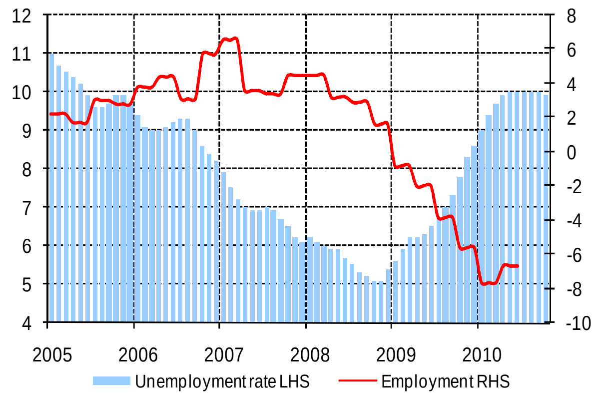
Current account and its components (in % of GDP, 4-quarter moving average)



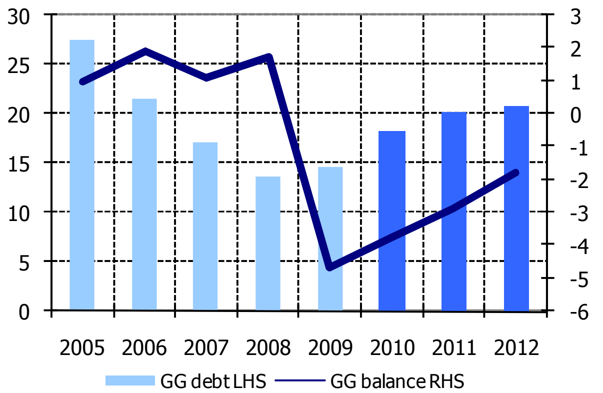
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

CZECH REPUBLIC

Economic growth

The recovery of the Czech economy, which began in the second half of 2009, accelerated during the first three quarters of 2010. During this period, gross domestic product increased by 2.0% y/y and only in Q3 — by 2.8% y/y. On quarterly basis, GDP in the Czech Republic has been continuously increasing since Q2 2009. Moreover, its growth rate has been increasing in the subsequent quarters. The Czech National Bank (CNB) latest forecast assumed further increase in GDP growth rate in Q4 2010. GDP in the Czech Republic is to rise by 2.3% over the entire year. The main factor contributing to the increase in late 2010 will be domestic demand, especially private consumption, whereas the impact of net exports is to decrease.

Economic growth in the first three quarters of 2010, in particular in Q2 and Q3, resulted predominantly from rebuilding of inventories. Additionally, a slow recovery of domestic demand was observed, especially in Q3 2010. Both consumption and investments had a positive contribution to GDP growth.

Private consumption in the Czech Republic grew over 2010. Increase in household consumption in the first three quarters of 2010 can be contributed most of all to an improvement in the labour market conditions, which was reflected in higher households disposable income. Consumer loans growth rate picked up slightly in 2010. However, banks continued to be reluctant in supporting consumer purchases of households. The analysis of private consumption indicates spending on durable goods, especially cars, and services grew most in 2010.

Table 3.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**2.7**	**-4.1**	**1.0**	**2.3**	**2.8**
Private consumption	3.4	-0.3	0.0	0.8	1.2
Public consumption	1.6	4.2	2.2	1.2	-0.5
Fixed capital formation	-1.1	-9.2	-5.6	-3.7	1.7
Exports	6.6	-10.8	14.0	13.7	14.1
Imports	5.0	-10.6	11.1	14.7	16.6

source: Eurostat

Following a period of a strong decline in fixed investment in Q1 2010, gross fixed capital formation rose in the following quarters. Since Q2 2010, a significant rise in investment in buildings and structures (especially in dwellings) was noticeable in the Czech Republic. In Q3 2010, expenditure on machinery and equipment also went up. However, the renewed growth in fixed investment observed in the Czech Republic over the first three quarters of 2010 may only be temporary, as it resulted from large-scale installation of photovoltaic cells. This is indicated by both the structure of investment growth and increase in imports over the last quarters. The Czech National Bank estimates that the effects of these investments increased nominal GDP in the Czech Republic by additional 0.4–0.7% in 2010.

Increased foreign trade in the Czech Republic could be observed since the beginning of 2010. In the first three quarters of 2010, exports rose by 12% due to recovery in the major trading partners economies, in particular Germany, Poland and Slovakia. At the same time, the increase in imports, caused by recovery of the domestic demand, was even higher (17% in the same period). As a result, the contribution of net exports to GDP growth in the first three quarters of 2010 remained negative (similarly to 2009).

Increased consumption in the Czech republic, resulted primarily from higher automobile sales (between January and October 2010, the number of newly registered cars in the Czech Republic rose by more than 5% as compared to the respective period of 2009). Retail trade data confirmed that fact. Not only did retail sales — apart from means of transport — not increase in 2010, but they even slightly declined as compared to 2009. This applied to a lesser extent to sales of food, which were relatively stable during the first ten months of 2010 and even started to grow moderately in July 2010. Sales of other commodities, especially electric and electronic devices as well as fuel in 2010 was lower than the year before.

A rapid increase in the consumer sentiment index, observed in the Czech Republic throughout most of 2009, slowed down considerably at the beginning of 2010. In the first half of 2010 it continued to grow slightly, which was a result of a relatively good assessment of the country's current economic situation. Prolonged deterioration on the labour market, caused the level of sentiment among Czech consumers to plummet since Q2 2010. Sub-indices describing future financial households situation as well as employment perspectives contributed most to the loss of the confidence.

Increase in external demand, as well as rebuilding of inventories had a noticeable influence on the Czech industrial output. Throughout the first three quarters of 2010, industrial output rose at a fast and stable pace (by 9.5% on annual basis). This growth resulted primarily from increased production in the manufacturing, especially in the metallurgical sector, as well as production of electronic devices and means of transport. Output volume in Q1-Q3 2010 period increased by more than 20% y/y in all of the abovementioned sectors. In spite of fast increase in 2010, in October that year, the level of industrial output remained 8% lower than in mid 2008.

The increase in industrial output in the Czech Republic in 2010 was accompanied by continuous improvement in business sentiment, which primarily resulted from higher number of orders, especially foreign ones. Moreover, entrepreneurs more and more often declared the intention to increase employment, especially in the industry.

Labour market

After a period of intense growth in 2009 and early 2010, harmonised unemployment rate in the Czech Republic began a systematic decrease in April 2010. Since August till October last year, it had remained at the level of approx. 6.9%.

At the same time, starting from Q2 2010, the declining trend in employment was reversed. In Q2, the number of employed (seasonally adjusted) rose by 0.3% and in Q3 — by additional 0.5% on a quarterly basis. This increase was mainly the result of a higher number of self-employed in the Czech economy, while the number of employed continued to decrease (albeit the scale of decline was becoming smaller and smaller). A decrease in employment could still be observed in industry. However, a recovery in this sector of economy caused that the number of employees was declining slower each quarter of 2010. During the first three quarters of 2010, employment in services slightly increased and the number of employed in agriculture remained practically unchanged.

Inflation and labour costs

Annual HICP growth rate in 2010 considerably increased as compared to 2009 (amounting to 1.9% and -0.4% in November 2010 and December 2009, respectively). Throughout 2010, inflation rate in the Czech Republic was among the lowest ones in the region, which is also reflected by the fact that in November 2010, the Czech Republic was one of few CEE countries (apart from Baltic states) to comply with the Maastricht criterion for price stability.

Inflation in the Czech Republic was largely determined by changes in administered prices, especially the increase in indirect taxes. In January 2010, VAT rate increased by 1 pp. (from 19 to 20%). Excise duty for alcoholic beverages, tobacco products and fuel also went up. Moreover, 2010 saw an increase in prices of gas and healthcare. CNB estimates that these changes affected the growth of overall inflation rate by 1.1 pp.

HICP growth rate accelerated in the second half of 2010, mainly as a result of growing food prices. Second increase in gas prices in July 2010 was an additional factor contributing to growing prices. On the other hand, declining growth of prices of other energy, especially fuel for private means of transport (base effect) contributed to a decrease in inflation[14].

[14] Depreciation of the Czech koruna in Q4 2010 and increase in prices of energy commodities may cause energy prices in the Czech republic to quickly rise in the first months of 2011.

In spite of minor recovery of consumption, observed since Q3 2010, core inflation in the Czech Republic remained at a very low level (-0.1% in November). Besides weak domestic demand, appreciation of the koruna, which contributed to a decline in import prices, also contributed to low core inflation.

Table 3.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**0.0**	**0.4**	**1.0**	**1.6**	**1.9**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.7	-0.3	0.0	0.5	0.8
Housing	1.0	0.1	0.2	0.5	0.5
Alcoholic beverages and tobacco products	0.2	0.3	0.4	0.5	0.4
Health	-0.2	0.0	0.2	0.3	0.2
Restaurants and hotels	0.0	0.1	0.1	0.1	0.1

source: Eurostat

Nominal wages in the Czech Republic in the first three quarters of 2010 was more than 2% higher than in the corresponding period of the preceding year. This meant c.a. half of the wage growth rate observed in 2009. Lower wage growth resulted from its decrease in the services sector (in particular in financial intermediation, where nominal wages dropped as compared to 2009). In industry, growth of wages increased moderately.

Accelerated economic growth and persisting downward trend for nominal wages resulted in further decrease in growth of nominal unit labour costs (ULC). Recovery on the labour market and minor increase in employment slightly countered this decrease. It was, however, too weak to fully reverse the downward trend of ULC growth observed in the Czech Republic since late 2008.

Balance of payments

The period of economic slowdown in the Czech Republic — similarly to other countries in the region — resulted in a decrease in external imbalances, albeit to a far lesser extent than in the Baltic states, Bulgaria or Romania. In the first three quarters of 2010, this trend was reversed and the current account deficit began to widen. In Q3, it already reached 2.7% of GDP (4q moving average), i.e. the level similar to the one observed between 2005 and 2007.

Balance of trade in goods in the Czech Republic remained positive during the first three quarters of 2010 and even slightly rose in comparison to 2009. Throughout 2010, this surplus gradually diminished in every consecutive quarter. Its decrease resulted mainly from extremely fast growth in imports in Q2 and Q3 2010. Exports growth rate remained at a similar level at the same time. Increased imports were observed primarily in the case of capital goods (such as photovoltaic cells) as well as durable consumer goods (except for cars).

The balance of services, however, significantly deteriorated, by c.a. 2 pp. of GDP over Q3 2010. This resulted primarily from increased imports of transport services (increased trade in goods).

Another factor to impact the growth of current account deficit in the Czech Republic was the deepening of income deficit. It resulted from both the increase in dividends paid to foreign investors and interest for foreign holders of Czech bonds. Apart from better condition of Czech enterprises (higher revenue and dividends), an additional factor contributing to higher outflow of income was the record-level inflow of foreign capital, in particular in the form of portfolio investments, observed since mid-2009.

During the analysed period, the current transfers balance improved slightly, although it remained negative. Deterioration of remittances balance was a key factor.

Table 3.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-1.9**	**-1.1**	**-1.2**	**-1.2**	**-2.7**
Goods	3.6	5.0	5.6	5.6	5.3
Services	1.1	0.7	0.1	-0.3	-0.7
Income	-6.1	-6.4	-6.4	-6.1	-7.1
Current transfers	-0.5	-0.4	-0.5	-0.4	-0.2
Capital account	**0.9**	**1.1**	**0.8**	**0.9**	**1.1**
Financial account	**2.1**	**2.7**	**2.1**	**2.2**	**5.0**
FDIs	0.2	0.7	1.3	1.8	3.5
Portfolio investments	1.4	3.1	3.5	3.1	4.6
Other investments	0.9	-1.0	-2.6	-2.7	-3.1

source: Eurostat

Inflow of foreign capital to the Czech Republic in the first three quarters of 2010 maintained the upward trend observed since mid 2009. In Q3 2010, inflow of foreign investments returned to the level last observed in 2005. The Czech Republic experienced increased inflow of both direct and portfolio investments. The negative balance of other investments also gradually diminished.

Q4 2009 saw the beginning of inflow of direct investments to Czech construction and financial intermediation sectors. These mainly comprised repayments of loans incurred by head offices of foreign companies from Czech branches. Additionally, in Q3 2010, an increased FDI net inflow to the industry sector (furniture manufacturing, energy, gas and water supply).

Foreign investors in 2010 continued to exhibit interest in Czech bonds. Inflow of portfolio investments, which increased as compared to 2009, was directed predominantly at the government debt securities market.

Interest rates and exchange rate

In 2010, the Czech National Bank (CNB) continued the loose monetary policy approach. In May 2010, CNB decreased the basic interest rate (2W Repo Rate) to the lowest recorded level of 0.75% (lower than in the euro area). The CNB interest rate has not changed since May 2010. Rates in the interbank market followed the same path. Three-month Pribor rate decreased from c.a. 1.5% in Q1 2010 to 1.2% in May and remained at this level until the end of 2010.

The yields of Czech bonds were determined by changing investors sentiment, mainly due to external factors (financial crises in Greece and Ireland, Hungary's decision not to prolong the credit agreement with IMF). Yields on 10-year treasury bonds in 2010 amounted to between 3.3% and 4.5%, reaching 3.8% at the end of the year.

Turmoil on the global, especially European, financial markets also contributed to high volatility of the exchange rate of the Czech koruna (CZK) in 2010 against EUR and in particular against USD (as a result of high volatility of EUR/USD exchange rate). In Q1 2010, appreciation of EUR/CZK exchange rate (which had begun in 2009) continued. This process was halted as a result of the sovereign debt crisis in Greece at the beginning of Q2 2010. It indirectly contributed to investors retreat from CEE region currencies; hence, the EUR/CZK exchange rate weakened considerably (by 4.5% in April last year). Relatively weak exchange rate of CZK against EUR was maintained until July. In spite of resolving the unrest related to insolvency of Greece, the koruna exchange rate in that period was affected by termination of the agreement between Hungary and IMF. Another period of appreciation of the koruna came between August and October 2010, after which it was stopped by the increase of unrest among investors due to revealed problems in the financial sectors in Ireland and Spain.

Fiscal policy

Throughout, execution of state budget revenue (in particular, from excise duty and direct taxes) was lower than anticipated in the budget act. In response, expenditure limits were reduced by 5%. However, Czech authorities decreased the budget deficit forecast for 2010 from 5.9% to 5.1% of GDP in their autumn fiscal notification (October 2010).

In 2011, the general government deficit in the Czech Republic is to decrease to 4.6% of GDP. This will be achieved mainly[15] through changes on the expenditure side. Cuts will be applied to current and capital expenditure (including 10-percent cuts on wages[16]),

[15] On the revenue side, the changes concern, among others, PIT on income of pensioners which exceeds the triple amount of average wage and abolishment of tax reliefs of MPs, the President and the highest authorities of the Czech Republic as well as of companies employing disabled persons (if their share in the number of employees exceeds 50%). Moreover, one-off flood tax (CZK 1,200) will be applicable in 2011. The above mentioned changes are to increase budget revenue by approx. 0.15% of GDP.

[16] Apart from teachers, whose wages are to increase by 3.5%.

sickness benefits[17] as well as certain other benefits[18] and support of housing development.

Within the time horizon of EC's forecast (2010-2012), the general government deficit of the Czech Republic will exceed the 3% of GDP reference value. It will therefore be necessary to take further adjustment measures in subsequent years. According to the Commission, the public debt will increase from 40.0% of GDP in 2010 to 45.2% of GDP in 2012.

The new Czech government announced that in the upcoming years, it will introduce crucial reforms of the pension and healthcare systems, including introduction of the funded pension scheme. The decrease in the budget revenue related to transfer of contributions to pension funds will be replenished by basic VAT rate rise. An alternative solution involving the establishment of a generation fund, whose resources would be devoted to support families, were also present in the debate. The Czech government pledged that changes to the pension system would enter into force as soon as in 2013. In March this year, the government is to present details of healthcare sector reform, providing for, among others, introduction of additional patient fees (e.g. for increased treatment standard or certain medical products).

Forecasts

The CNB GDP growth rate forecast for 2011 assume nearly double decrease as compared to 2010. The decline of domestic demand, predicted for 2011, is a result of planned public finance consolidation, which will affect the growth of both private and public consumption. The process of rebuilding of inventories, which was one of the main growth contributors in 2010, is also due to be completed. The impact of net exports on GDP growth, in turn, is expected to be slightly higher than in 2010, which will result, in particular, from decreased imports growth, related to the anticipated lowering of domestic demand. The expected exports growth rate should also decrease, albeit to a lesser extent.

Increase in GDP growth in the Czech Republic (to the level comparable to 2010) is anticipated to take place in 2012, when domestic demand, especially households consumption, should increase as a result of improved labour market conditions.

The rise in inflation, observed in the Czech Republic in 2010, should stop near the inflation target (2%) in early 2011 and remain at a stable level throughout 2011 and 2012. The increase in electricity prices, planned for the beginning of 2011, presents a risk to inflation growth, however, according to CNB, its effect should be compensated by the expiry of base effect, related to increases in indirect taxes in early 2010. Low consumption, anticipated in 2011, is not expected to start exerting strong inflationary pressure.

Current account deficit in 2011 may increase considerably, which will be related to possible deterioration of the foreign trade balance as well as higher deficits on the services and income accounts.

Table 3.4

Forecasts of main macroeconomic indicators

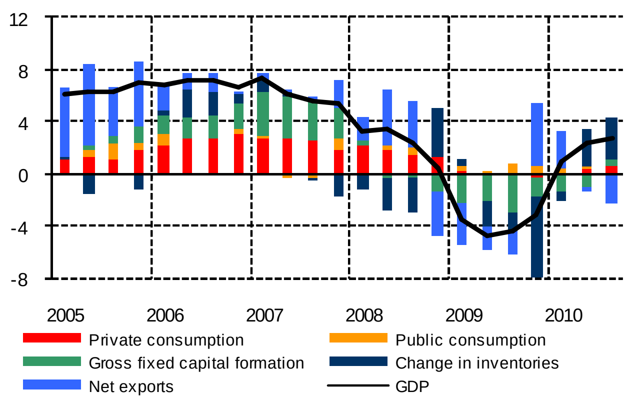
	ČNB	EC	OECD	IMF
	11.2010 (05.2010)	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	2.3 (1.4)	2.4 (1.6)	2.4 (2.0)	2.0 (1.7)
2011	1.2 (1.8)	2.3 (2.4)	2.8 (3.0)	2.2 (2.6)
2012	2.5	3.1	3.2	3.5 (3.5)
Inflation, in %, y/y				
2010	1.5 (1.4)	1.2 (1.0)	1.6 (1.8)	1.6 (1.6)
2011	1.9 (1.8)	2.1 (1.3)	1.9 (2.0)	2.0 (2.0)
2012	2.0	2.2	1.7	2.0 (2.0)
Current account balance, in % of GDP				
2010	-2.7 (-1.1)	-1.9 (-0.3)	-1.9 (0.1)	-1.2 (-1.7)
2011	-2.2 (-1.3)	-1.5 (-1.5)	-0.8 (-0.4)	-0.6 (-2.4)
2012	-2.5	-1.1	-0.7	-0.6 (-2.7)

ČNB – Inflation Report, Česká národní banka.

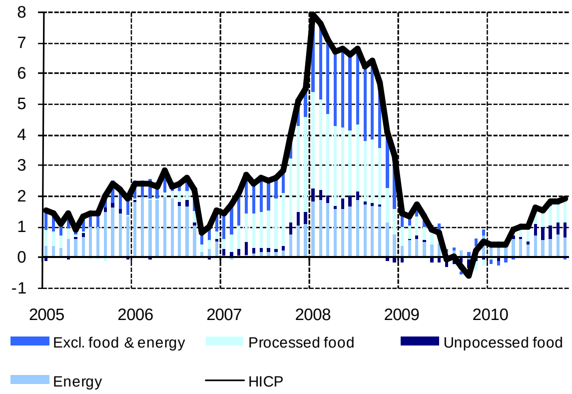
[17] The state will finance sickness absence for a period of three years starting from the 22nd, not the 15th (as is currently applicable) day of absence; moreover, the temporary reduction of the base for sickness benefit to 60% will be prolonged for an indefinite period of time and the reduction will be lower in the case of a longer leave (66%-72%).

[18] Including nursing allowance, benefits due to childbirth and unemployment benefits.

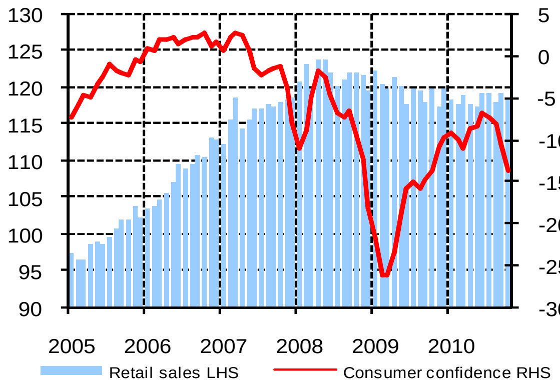
Contribution to GDP growth (in pp, y/y)



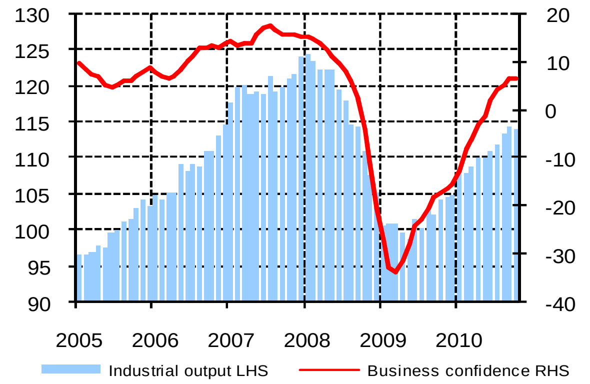
HICP and its components (in %, y/y)



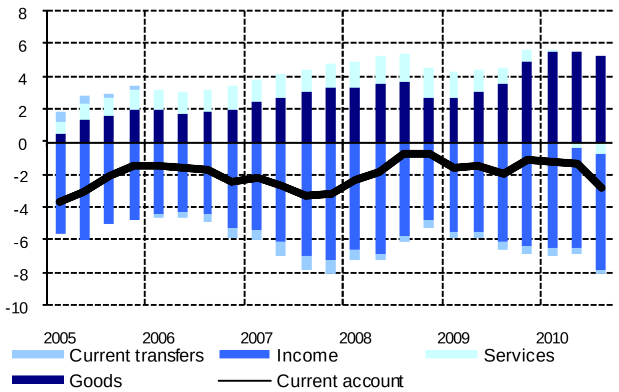
Retail sales (in %, y/y) and consumer sentiment index



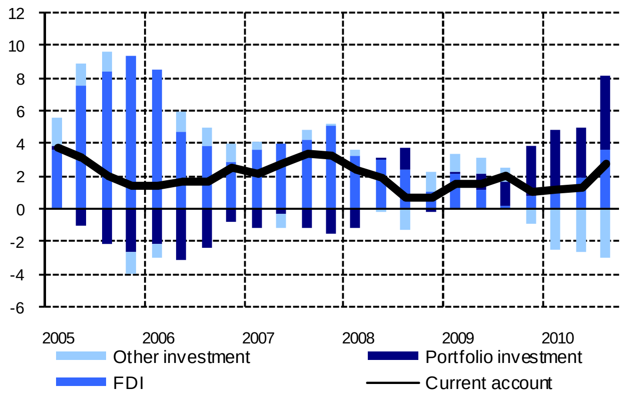
Industrial production (in %, y/y) and business sentiment index



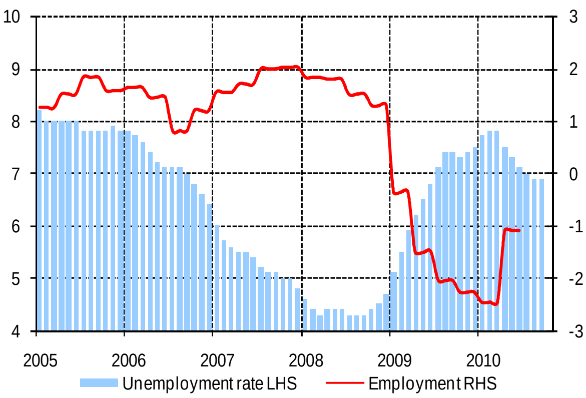
Current account and its components (in % of GDP, 4-quarter moving average)



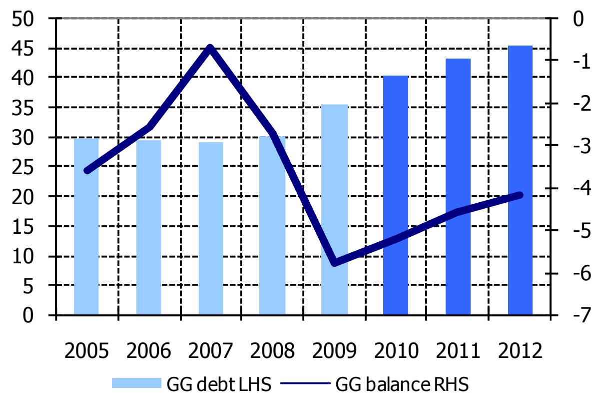
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ESTONIA

Economic growth

After two years of GDP decrease, with 2009 proving particularly severe (-13.9%), Estonian economy achieved positive growth rate in the first three quarters of 2010 (1.8 y/y). Available data indicate that the improved economic situation was mainly attributable to the rebuilding of inventories which during the crisis had been drastically reduced, among others, in response to rapidly falling consumer spendings of Estonian households. Increase in business inventories was reflected in growing volume of import (especially import of intermediate and investment goods), which exceeded the growth of export volume in Q2 and Q3 last year. As a result, net exports, which during the crisis absorbed the shocks of strong declines in GDP components, had negative impact on the growth of Estonian economy between April and September 2010.

Table 4.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**-3.6**	**-13.9**	**-2.7**	**3.0**	**5.1**
Private consumption	-4.0	-18.9	-7.8	-3.4	0.9
Public consumption	4.4	-0.5	-2.2	-2.7	-1.7
Fixed capital formation	-7.6	-34.4	-20.4	-16.6	-9.8
Exports	-1.1	-11.2	6.2	18.0	24.0
Imports	-7.9	-26.8	1.8	23.1	29.0

source: Eurostat

Although consumer demand remains weak, it improved moderately in the second half of 2010 as compared to the first two quarters of last year. Private consumption increased by 0.9% y/y in Q3 last year, after ten consecutive quarters of decline. Rebound in private consumption in Estonia is also reflected in data on retail sales, which indicate that since May 2010 it has once again been recording positive annual growth (1.5%) and its rate clearly increased between July and October (7.3%). On the other hand, Estonian consumer sentiment in the last months of 2010 deteriorated significantly in spite of systematic improvements observed until August last year. Deterioration of consumer confidence indicators was primarily due to increased concern about lack of opportunity to resolve quickly the problem of high unemployment and uncertainty about future financial situation of the consumers.

As opposed to private consumption, where certain recovery symptoms have been observed, investment demand so far has not exhibited any clear prospects for improvement in the foreseeable future. Although the scale of decline in investment expenditure in the first three quarters of 2010 decreased by nearly a half as compared to the corresponding period in 2009, the expenditure continues to plummet at almost two-digit rate (-9.8% y/y in Q3 2010). On the other hand, survey conducted among Estonian entrepreneurs suggests that the pressure on expanding the existing production capacity is gradually growing. It turned out that in Q3 2010 capital utilization in Estonian companies amounted to 68.8%, i.e. slightly more than the long-term average, while as regards Q4, it is expected to have exceeded 70%. Should the initial signs of recovery of consumer demand be confirmed, it would constitute an additional impulse for businesses to increase the existing production capacity.

Industrial output in Estonia maintained the upward trend in the first three quarters of 2010, with the highest acceleration being recorded between April and September last year. Moreover, in October, it approached the level observed immediately before the crisis. The dynamic growth of industrial output in the last months is mainly due to increasing foreign demand (approx. 70% of industrial manufacturing output goes to the markets of Estonia's trading partners), whereas the impact of domestic demand — albeit considerably smaller — is gradually growing.

In its latest forecast (based on data available until mid September 2010), the Bank of Estonia predicts that throughout 2010, GDP growth amounted to 2.5%, which would mean that in the last quarter of 2010, the economy developed almost as fast as in Q3, when it reached the highest rate in the entire last year (5.0% y/y).

Labour market

In Q1 2010, unemployment rate in Estonia reached its maximum level (19.0%), after which it began to drop and eventually amounted to 16.2% in Q3 last year. In spite of the observed decrease, the number of unemployed in the total of economically active population remains at its historical high, which is reflected, among others, by the fact that back in 2007 and in the first half of 2008, it fluctuated between 4 and 4.5%. Moreover, if one compares the unemployment rate in Estonia with similar indices for other EU states, it will turn out that in Estonia it is one of the highest; only Spain, Latvia and Lithuania have worse results in this respect.

According to available data, the first half of 2010 saw a deceleration of decline in employment in Estonia's economy — in Q2 last year, the scale of workforce reduction was 5.6% y/y, whereas in Q4 2009, employment plummeted by as much as 11.9% y/y. It appears, however, that in the upcoming quarters, entrepreneurs will not decide to increase the number of new full-time vanacies, since they will first endeavour to expand working hours, which had been drastically reduced in the wake of the recession caused by the financial and economic crisis.

Inflation and labour costs

In the first two months of 2010, annual HICP inflation in Estonia still remained below zero. It started to assume positive values in March and reached its temporary maximum in June (3.4%). The increase in consumer goods prices, observed in the first half of 2010, resulted primarily from growing prices of energy and means of transport. In July and August last year, inflation slightly decreased to 2.8%, which was caused mainly by lower global energy prices. Since September 2010, consumer goods prices in Estonia rose again; this increase is becoming more and more attributable to dynamically growing food prices, which had significantly smaller impact in the first half of the year. In November, according to the latest data, inflation accelerated to 5.0% y/y. The Bank of Estonia anticipates that throughout 2010 the annual growth of consumer goods prices will have amounted to 2.4%. Core inflation, on the other hand (excluding the prices of energy, food, alcoholic beverages and tobacco products), remained slightly below zero in the first six months of 2010 and started to fluctuate around 1.0% y/y between July and November.

Table 4.2
HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**-2.0**	**0.0**	**2.9**	**3.1**	**5.0**
Contribution to HICP growth rate (in pp)					
Food and beverages	-1.4	-0.8	0.3	0.9	2.4
Housing	-0.9	-0.5	0.7	0.7	0.9
Transport	0.0	1.2	1.1	0.5	0.6
Alcoholic beverages and tobacco products	0.0	0.2	0.3	0.5	0.6
Clothing and footwear	0.1	0.2	0.2	0.2	0.3

source: Eurostat

The decline in nominal wages in Estonian economy, observed since Q1 2009, was halted in Q2 2010, when employee wages increased by 1.2% y/y. In the subsequent quarter of the last year, wages rose even further, albeit to a lesser extent (0.9% y/y). The highest increases were recorded in the industrial manufacturing (3.9% y/y) and construction (3.0% y/y) sectors. The financial services sector, however, continues to experience decreases in nominal wages.

Although the decline of nominal wages in Estonia stopped in Q2 2010, increased unit labour costs have so far not been observed. In Q3 last year, their growth remained negative (-1.0% y/y), although smaller than in preceding quarters.

Balance of payments

After three quarters of 2010, the cumulative surplus on current account in relation to GDP decreased to 3.7% from 4,5% at the end of 2009[19], which was primarily due to increased deficit on the income account, which in turn resulted from the rise of non-residents' income on direct investments. Another factor behind this tendency was the decline of surplus in trade in services. On the other hand, deficit in trade in goods decreased during the same period (from -4.0% to -3.0% of GDP), although the scale of this decline proved insufficient to compensate for the negative impact of the abovementioned factors on the current account surplus.

Table 4.3
Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**1.7**	**4.5**	**4.8**	**4.1**	**3.7**
Goods	-6.3	-4.0	-3.4	-3.6	-3.0
Services	9.4	9.7	9.7	9.3	9.4
Income	-2.9	-2.7	-3.2	-3.4	-4.2
Current transfers	1.5	1.6	1.7	1.7	1.5
Capital account	**2.0**	**2.8**	**3.5**	**3.7**	**3.5**
Financial account	**-2.9**	**-6.6**	**-8.1**	**-7.5**	**-8.9**
FDIs	-2.0	0.7	1.9	5.5	7.6
Portfolio investments	-1.1	-10.4	-10.2	-9.5	-9.8
Other investments	-0.4	3.0	0.2	-3.6	-6.8

source: Eurostat

The period between January and September 2010 saw significant outflow of foreign capital from Estonia. Its scale was larger than throughout the entire year 2009 (-8.9% of GDP as compared to -6.6% of GDP). It resulted primarily from non-residents withdrawing deposits from the Estonian banking system, as well as residents opening deposits with foreign banks, which was reflected in negative balance of other investments. Similarly to 2009, inflow of capital was observed in the case of direct investments and outflow of capital — for portfolio investments.

Interest rates

On 1 January 2011, Estonia became a new member of the euro area, joining other 16 EU states which use the common euro currency[20]. The exchange rate from the Estonian kroon to euro has been irrevocably set at EEK 15.6466/EUR 1, i.e. at the level of central parity in ERM II, to which Estonia belonged since 28 June 2004.

Fiscal policy

In spite of extremely adverse macroeconomic conditions, Estonia implemented a package of ambitious

[19] For comparative purposes, calculations for 2010 also take into account the balance of current account and nominal GDP from Q4 2009.

[20] During the first two weeks of January, coins and banknotes denominated in the Estonian kroon will be gradually withdrawn from circulation. This means that during that period two currencies will be simultaneously present in circulation. To make it easier for consumers, retail vendors started to provide prices in both currencies on 1 July 2010 and will be obliged to do so until 20 June 2011.

consolidation measures in 2008 and 2009 (its magnitude has amounted to over 10% of GDP), which allowed for reduction of the general government balance below the 3% of GDP reference value. According to autumn fiscal notification (October 2010), fiscal deficit in 2010 will amount to approx. 1.3% of GDP, which will be the lowest level among all EU Member States, next to Sweden.

In 2011, it is expected that the budgetary deficit will rise to approx. 1.6% of GDP, which will be related primarily to a significant increase in investment expenditure[21]. Wages and employment in government administration will remain frozen; and once again, pension and disability benefits will not be subject to indexation. Moreover, starting from this year, contributions to pension funds will be resumed[22] after their suspension since mid 2009.

The EC expects that due to expiry of certain consolidation measures adopted in 2008 and 2009, the general government deficit in Estonia will increase to 2.7% of GDP in 2012. It is the only country, apart from Hungary, for which the EC anticipates deterioration of the public finance balance. The Estonia's public debt will grow between 2010 and 2012 at a faster pace than in 2008 and 2009 due to exhaustion of reserve funds. However, it will remain at the lowest level among all EU Member States (approx. 11.7% of GDP in 2012).

Before parliamentary elections (March 2011), the ruling party suggests a decrease in unemployment insurance contribution and in rates of income taxes, on the condition it will not threaten budget situation. Proposals include inter alia balancing of Estonian general government finances by 2013, which would allow for recovery of budget reserves, diminished by the economic crisis, as well as introduction of the fiscal rule to the Estonian Constitution. It is to prohibit the planning of deficit of the public finance sector in the conditions of economic growth.

Forecasts

In 2011 and 2012, the Bank of Estonia expects the pace of growth of national economy to rapidly accelerate as compared to 2010. It is estimated that GDP growth in this period will amount to 4.2% and 3.8%, respectively, as compared to 2.5% in 2010. The main source of growth for Estonian economy will be increasing private consumption due to expected higher household income from employment as well as recovery in business investments, related to, among others, relatively high degree of usage of production capacity. This, in turn, will cause a high increase in import volume, which will exceed the exports growth and thus translate into negative contribution of net exports to the economic growth of Estonia within the time horizon of the forecast.

HICP inflation forecast indicates a slight increase in prices of consumer goods and services in 2011 as compared to 2010, and subsequently a decrease to 1.7% in 2012. The expected drop in inflation will result from positive, albeit slower and slower, growth of private consumption within the time horizon of the forecast on the one hand, and from gradual expiry of the effect of taxes, raised in 2009 and 2010 to reduce the deficit in the public finance sector, on the other hand.

A deficit is anticipated to appear on the current account in 2011 and 2012 due to, among others, decreased surplus in foreign trade, which will result from faster growth of import volume over export volume and deterioration of negative income balance.

Table 4.4

Forecasts of main macroeconomic indicators

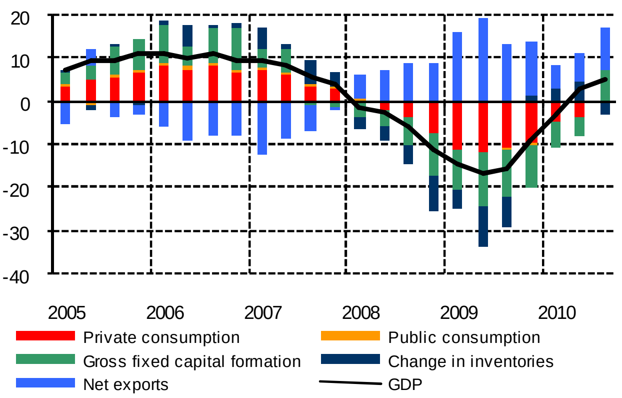
	EP	EC	OECD	IMF
	10.2010 (04.2010)	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	2.5 (1.0)	2.4 (0.9)	2.4 (0.1)	1.8 (0.8)
2011	4.2 (4.0)	4.4 (3.8)	3.4 (4.7)	3.5 (3.6)
2012	3.8 (3.3)	3.5	4.1	3.4 (3.3)
Inflation, in %, y/y				
2010	2.4 (1.3)	2.7 (1.3)	3.0 (1.5)	2.5 (0.8)
2011	2.7 (1.1)	3.6 (2.0)	3.4 (1.9)	2.0 (1.1)
2012	1.7 (1.3)	2.3	2.5	2.0 (1.3)
Current account balance, in % of GDP				
2010	1.3 (3.4)	4.1 (4.9)		4.2 (4.7)
2011	-2.6 (1.5)	1.4 (3.8)		3.4 (3.9)
2012	-2.8 (-1.2)	0.9		1.6 (2.0)

EP - Estonian Economy and Monetary Policy, Bank of Estonia

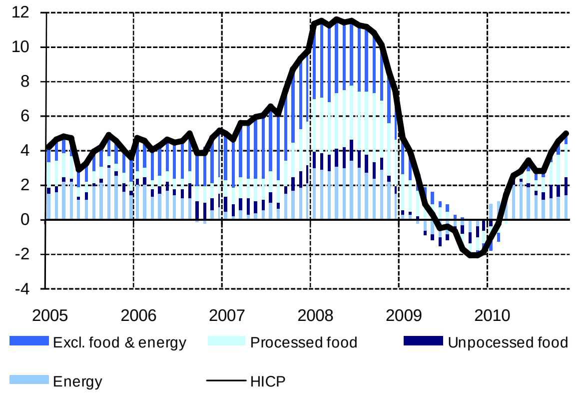
[21] Including expenditure on environmental protection, financed from sale of rights to carbon dioxide emission.

[22] In the amount of 2% of gross monthly salary. In 2012 the contribution rate to second pillar of pension scheme before their suspension (4%) will be restored.

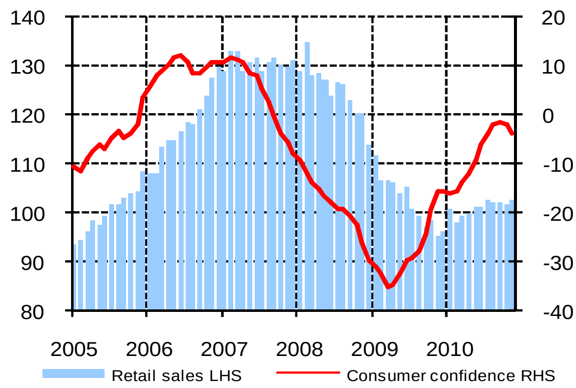
Contribution to GDP growth (in pp, y/y)



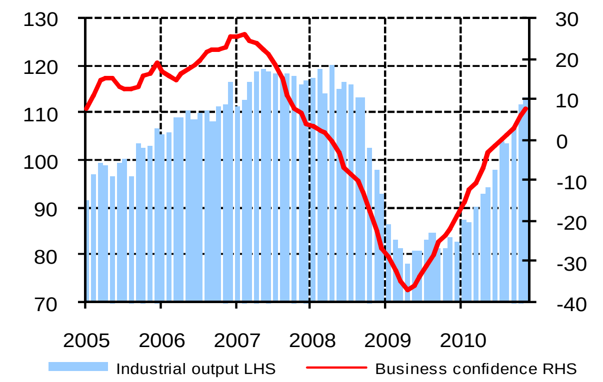
HICP and its components (in %, y/y)



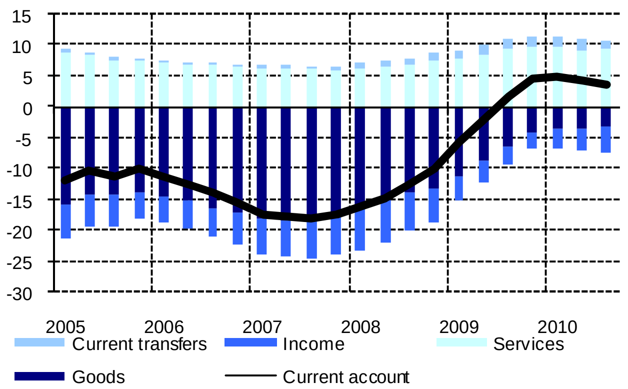
Retail sales (in %, y/y) and consumer sentiment index



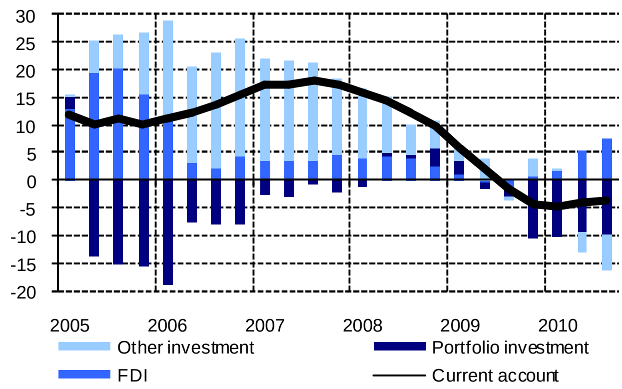
Industrial production (in %, y/y) and business sentiment index



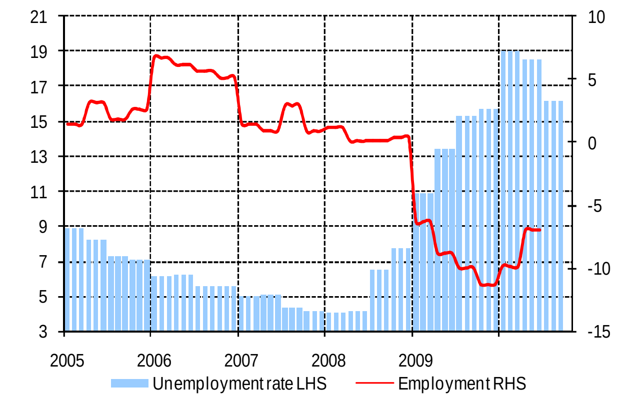
Current account and its components (in % of GDP, 4-quarter moving average)



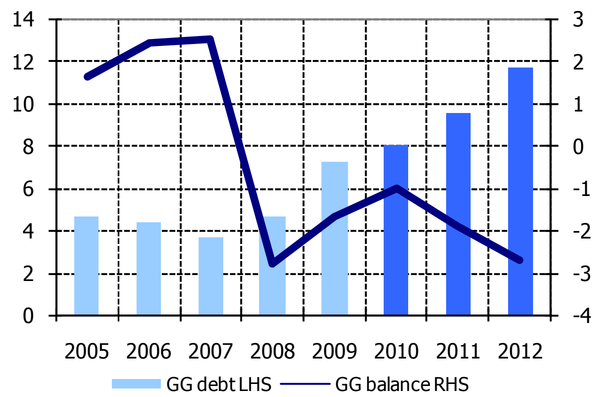
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

LITHUANIA

Economic growth

Since Q2 2010, Lithuanian economy began to slowly recover after the severe crisis which struck the country in 2009. Over the first three quarters of 2010, GDP slightly increased (by 0.1%) on annual basis, while in Q3 2010, its annual growth rate reached 0.8%.

Table 5.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**3.0**	**-14.8**	**-0.6**	**-0.3**	**0.8**
Private consumption	5.9	-16.9	-7.9	-8.2	-1.6
Public consumption	4.1	-1.2	-1.7	-1.2	-2.1
Fixed capital formation	-6.4	-39.1	-31.6	-4.7	15.9
Exports	11.5	-14.3	3.5	19.3	16.9
Imports	10.3	-29.4	3.0	15.5	20.2

source: Eurostat

The improvement in Lithuanian economy was primarily a result of inventories rebuilding. It was the only category which contribution to annual GDP growth was positive since the beginning of 2010.

During the first three quarters of 2010, private consumption remained lower than in the corresponding period of 2009 (by 6%). Only in Q3 did its growth by quarter become visible. Public finance consolidation, which was taking place in Lithuania from the beginning of 2010, also caused a decrease in government expenditure. Due to its reduction, the contribution of public consumption to GDP growth remained negative over the first three quarters of 2010.

Q2 2010 saw an acceleration of investments, although this was influenced by its extremely poor low level in Q1. Severe winter and the closing of the nuclear power plant in Ignalina caused Lithuania's fixed investment expenditure to fall to the lowest level since 2003. In the following months of 2010 fixed investment substantially accelerated, which applied to investment in both machinery and buildings. Although over the first three quarters of 2010 annual growth of investment expenditure was negative, in Q3 it already increased by 16% on annual basis.

Recovery of domestic demand in Lithuania took place in spite of persisting stagnation on the domestic credit market. At the beginning of Q4 2010, the value of the private sector loans was over 6% lower than a year before.

Positive contribution of net exports to GDP growth in 2009, decreased significantly in three quarters of 2010. In the first half of 2010, it remained positive, albeit considerably lower than in 2009. However, already in Q3, its contribution turned negative, which resulted primarily from fast increase in imports. In the first half of 2010 imports growth was mainly caused by increased demand for energy commodities, due to closure of the nuclear power plant). During a later period, spurred investment expenditure also stimulated the import of capital goods. The first three quarters of 2010 also saw growth of exports, although at a slower rate.

After the period of strong decline in retail sales in 2008 and 2009, in 2010 retail trade turnover started to pick up slowly. This increase applied primarily to selected durable goods (such as clothing, electronic equipment and computers) and fuels. The number of newly registered cars also increased (by 6% in the examined period). Sale of food, on the other hand, still remained low.

The slow growth in retail sales was accompanied by a much faster rise in consumer sentiment. In 2010 Lithuanian consumers' evaluation of both current and future economic conditions and their own financial standing kept improving. An improvement was also observed in the assessment of the labour market and prices prospects over the upcoming 12 months.

Nuclear plant in Ignalina closure caused a drop in Lithuania's industrial output in Q1 2010. It did not only influenced energy production, but also impacted reductions in the output of other industry sectors (especially metallurgy and metal casting). In the next two quarters, the industrial output in Lithuania, similarly to other countries in the region, grew thanks to increasing foreign demand. Increase in production was recorded in particular in the segments of capital goods, intermediate goods and durable consumer goods.

The decline in industrial output in Q1 2010 temporarily dampened business sentiment, which had been soaring since Q2 2009. Since Q2 2010, business sentiment in Lithuania started to improve once again, which was mainly caused by acceleration in industrial output and growing number of orders (mainly foreign ones).

Labour market

Unlike other Baltic states, which had been recording a gradual decrease in unemployment rate since Q2 2010, in Lithuania it continued to grow. In Q3 2010 harmonised unemployment rate in Lithuania reached 18.4% and was higher than in Latvia, which meant that unemployment in Lithuania was the highest in the region.

The number of employed in the economy continued to fall in the first half of 2010. A particularly significant decline in employment took place in Q1 2010 due to the economic slowdown observed in Lithuania in this period. The number of employed stabilised in Q2, however, this resulted mainly from an increase in employment in agriculture, whereas employment in other sectors of the economy continued to decrease. Preliminary estimates of the Lithuanian statistical office indicate a reversal of the downward trend in employment already in Q3 2010, when the number of employed was to increase by c.a. 2%.

Inflation and labour costs

After a period of rapid fall in inflation in 2009 which led to a deflation in Q1 2010, HICP growth rate in Lithuania increased at a fast rate over the following months of 2010 and amounted to 2.5% in November 2010. In spite of fast increase in inflation in Lithuania, 12-month average inflation remained lower than the reference value of the Maastricht inflation criterion.

In early 2010, the expiry of the base effect, related to increase in indirect tax rates and administered prices at the beginning of 2009, diminished the impact of growing energy prices (especially electricity[23]) on the annual inflation rate. However, in the subsequent months of 2010, the prices of energy contributed to inflation growth (also via the administrative decisions e.g. in July 2010 the prices of gas and solid fuels increased by more than 11%). Moreover, the increase in consumer prices was affected by growing prices of food.

Low consumer demand, resulting from continuously deteriorating situation in the labour market resulted in lack of growth of core inflation. Between January and November 2010, core inflation in Lithuania was practically unchanged and remained negative (-1.9% in November).

Table 5.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**-1.3**	**-3.9**	**-2.3**	**-0.3**	**1.7**
Contribution to HICP growth rate (in pp)					
Food and beverages	-1.4	-1.5	-0.5	0.4	1.6
Housing	-1.0	-1.7	-0.6	0.6	0.8
Transport	0.0	0.6	0.5	0.4	0.5
Alcoholic beverages and tobacco products	1.4	0.6	0.2	0.0	0.1
Education	0.1	0.1	0.1	0.1	0.0

source: Eurostat

After a rapid decline in nominal wages in 2009 and early 2010 (between Q4 2008 and Q1 2010 the average nominal wage in Lithuania plummeted by 12.5%), they started to grow gradually in Q2 2010. In Q2 and Q3 2010 the increase in wages amounted to nearly 3% and applied to almost all sectors of the economy (apart from IT services and financial intermediation), both in the public and the private sector. The highest increase in nominal wages was observed in construction, trade and transportation sector.

Annual growth rate of unit labour costs in Lithuania in 2010 was the lowest in the region. It primarly resulted from its rapid decline in Q1 2010, due to a sharp decrease in nominal wages. In the following quarters of 2010, only a slight increase in the ULC growth rate was observed, which was related to a minor improvement in labour market conditions. Economic recovery, in turn, which has been taking place in Lithuania since Q2 2010, hampered these increases and, as a result, the ULC growth rate remained negative.

Balance of payments

In 2009 in Lithuania, one could observe a period of rapid decline in the current account deficit, which even turned into a considerable surplus. However, in Q3 2010 this surplus dropped to 3.9% of GDP, from 5.3% of GDP in Q2 (moving average for 4 quarters). When taking individual quarters into consideration, in Q2 2010 current account balance in Lithuania was negative for the first time in six quarters. This decline resulted from deterioration of all current account categories.

Table 5.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-0.3**	**4.3**	**4.6**	**5.5**	**3.9**
Goods	-5.3	-3.1	-3.4	-3.4	-3.7
Services	2.1	2.0	2.3	2.8	2.5
Income	-0.5	1.0	1.4	1.1	0.5
Current transfers	3.4	4.4	4.3	5.0	4.6
Capital account	**2.8**	**3.4**	**3.1**	**3.2**	**2.5**
Financial account	**-1.9**	**-7.7**	**-8.1**	**-8.8**	**-6.9**
FDIs	1.3	-0.1	-0.9	-1.3	-0.8
Portfolio investments	1.7	2.9	8.0	7.9	9.1
Other investments	-5.3	-10.8	-14.1	-15.3	-13.8

source: Eurostat

Since the beginning of 2010, a deepening of the deficit on the goods account could be observed. It resulted from a fast growth of imports, which caught up with exports growth in the first three quarters of 2010 (both imports and exports growth rates amounted to approx. 30% y/y in the first 10 months of 2010). The increased imports mainly concerned cars, fuel, parts and accessories. Import of intermediate goods also registered a rise. 2010, in turn, saw an increase in the value of exported consumer goods — both food and durable goods.

Surplus on the services account in three quarters of 2010 was higher than in 2009. However, in Q3 its considerable decrease could already be observed.

Since Q2 2010, a fall in the income account surplus has also been noticeable. It resulted from lower investment income of Lithuanian entities on foreign investments, especially portfolio investments. Current transfers surplus also decreased, although it remained considerably higher (4.6% of GDP) as compared to the average from the last decade.

[23] Due to the closing of the nuclear power plant in Ignalina in early 2010, the prices of electric energy in Lithuania increased by 33.3% at once.

Between Q1 and Q3 2010, similarly to 2009, Lithuania experienced an outflow of foreign capital. Its pace, however, slowed down in Q3. The outflow of capital is primarily reflected in the deepening deficit on the other investments account, due to repayment of liabilities by the Lithuanian banking sector. Outflow of capital was also observed in case of the direct investments, which had not been recorded before. Net FDI outflow resulted both from an increase in Lithuanian foreign investments and a decrease in foreign direct investments in Lithuania.

Opposite trends could be observed in case of foreign portfolio investments. The first three quarters of 2010 saw the record level of their net inflow (more than 9% of GDP in Q3). Foreign investors were primarily interested in government bonds.

Interest rates

Regaining financial system stabilisation and increasing liquidity in the Lithuania's financial sector caused a rapid decrease in nominal interest rates on the interbank market in the first months of 2010. The 3m Vilibor rate fell from nearly 4% in January to 1.4% in May (a record low). The turmoil on the global financial markets connected with the sovereign debt crisis in the euro area peripheral countries in the following months of 2010 had no significant effect on the situation on the Lithuanian financial markets. In the second half of 2010, 3M Vilibor was stable and oscillated between 1.4% and 1.7%.

The yields of Lithuanian bonds in 2010 lowered from 7.5% in January to 5% in December. Similarly to the majority of countries in the region, the period of decline was interrupted with short-term increases in yields, resulting from higher aversion towards risk related to the development of situation in the euro area peripheral countries and in Hungary.

Both nominal and real (CPI-deflated) effective exchange rate in Lithuania depreciated in the first half of 2010, which contributed to the strengthening of Lithuanian exports. In the second half of 2010, depreciation was halted and the last months even saw a gradual strengthening of effective exchange rates of the litas. Appreciation of both nominal and real effective exchange rates were affected by strengthening of the litas against the currencies of trading partners as well as increase in inflation observed in the second half of 2010.

Fiscal policy

The fiscal imbalance in Lithuania in the last year remained at a high level (8.1% of GDP as compared to 9.2% of GDP in 2009) in spite of continuation of consolidation measures. The amendments reducing expenditure on, among others, maternity and child benefits (including their reduction by 10%), adopted in 2009, were effective since mid 2010. The cuts are to bring budget savings of approx. 0.8% of GDP.

In 2011, the Lithuanian government anticipates decrease in general government deficit by 2.3 pp of GDP, to 5.8% of GDP. The authorities decided to freeze wages in the public sector as well as pension, disability and social benefits in 2011. The contribution transferred to pension funds will remain at the reduced level[24] until the improvement of budget situation. On the revenue side, starting from 2011, PIT paid by self-employed is to decrease (from 15% to 5%). The achievement of the budgetary target for this year is subject to considerable risks due to optimistic macroeconomic assumptions and inclusion in the budget of more than 1% of GDP of additional revenue due to measures aimed at combating tax evasion.

The EC anticipates that in 2011 and 2012, fiscal imbalance in Lithuania will remain at the level of approx. 7.0%, which means a failure to correct excessive deficit by 2012. Decrease in general government deficit to below 3% of GDP will be impeded due to signs of consolidation fatigue, caused by the looming elections[25]. Moreover, in 2012, temporary measures such as cuts in pension, disability and unemployment benefits and freezing of wages in the public sector, are to expired. The EC forecasts that the public debt in 2012 will reach approx. 48.3% of GDP (as compared to 37.4% in 2010).

Forecasts

GDP growth in 2011, forecast in November 2010 by the Bank of Lithuania (LB), did not change as compared to previous forecasts. LB still anticipates a continuation of the slow recovery in the upcoming quarters. The expected growth structure, however, is to slightly change. The forecast assumes that the continued recovery will be based on the domestic demand recovery, in particular of fixed investment. At the same time, increasing consumption and investment will be accompanied by diminishing contribution of external demand; thus, the contribution of net exports to GDP growth will be decreasing and will reach a negative value as soon as in 2011. The stagnation persisting on the credit market, combined with persistently poor condition on the labour market, constitute the greatest threat to the recovery of domestic demand in Lithuania in 2011.

Increase in inflation in Lithuania, observed since mid 2010, is to continue into 2011 and will still be affected by the prices of food and energy, as well as planned increases in indirect taxes and administered prices. As compared to LB August forecast, the anticipated inflation was raised due to a faster than expected increase in prices in Q3 2010.

[24] The original amount of contribution transferred to pension funds in Lithuania was to be temporarily (2009-2010) reduced from 5.5% to 2%.

[25] To local governments – in February 2011; parliamentary – in autumn 2012.

The current account surplus which was built in 2009 and only slightly decreased in 2010 should remain in 2011, although it will be successively diminishing. Its decrease is to be affected primarily by the recovery of Lithuanian imports due to increasing domestic demand.

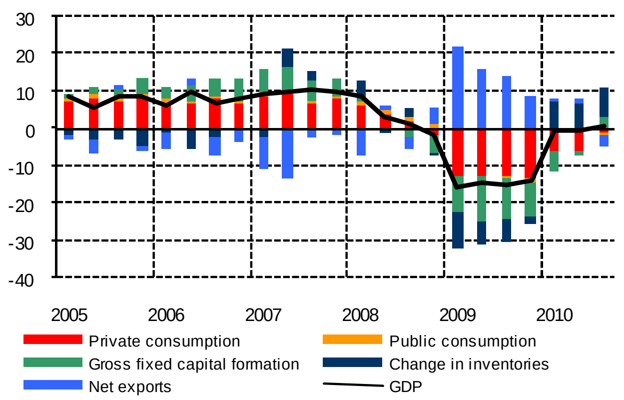
Table 5.4

Forecasts of main macroeconomic indicators

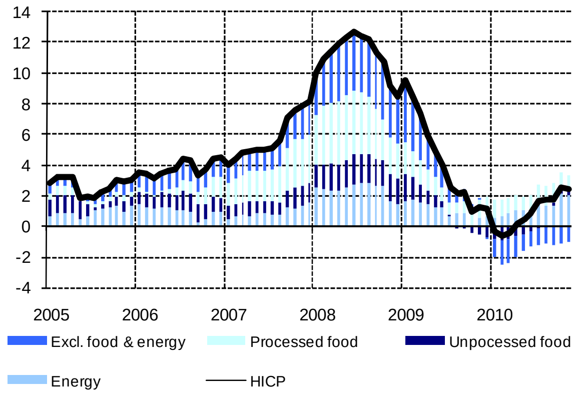
	LB	EC	IMF	Consensus Economics
	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)	12.2010 (05.2010)
GDP, in %, y/y				
2010	0.5 (0.5)	0.4 (-0.6)	1.3 (-1.6)	0.5 (-0.9)
2011	3.1 (3.1)	2.8 (3.2)	3.1 (3.2)	2.7 (2.3)
2012		3.2	2.6 (3.1)	
Inflation, in %, y/y				
2010	1.2 (0.4)	1.2 (-0.1)	1.0 (-1.2)	1.1 (0.5)
2011	2.3 (1.7)	2.3 (0.4)	1.3 (-1.1)	2.0 (1.0)
2012		2.7	1.3 (0.1)	
Current account balance, in % of GDP				
2010	1.4 (1.5)	2.6 (2.8)	1.9 (2.7)	
2011	-0.4 (0.6)	1.3 (2.0)	0.2 (2.6)	
2012		1.0	-0.6 (2.2)	

LB - Lietuvos bankas

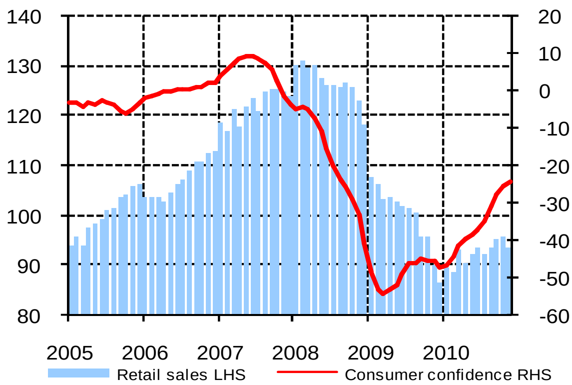
Contribution to GDP growth (in pp, y/y)



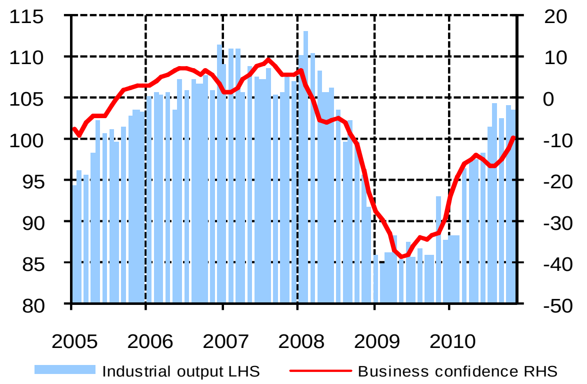
HICP and its components (in %, y/y)



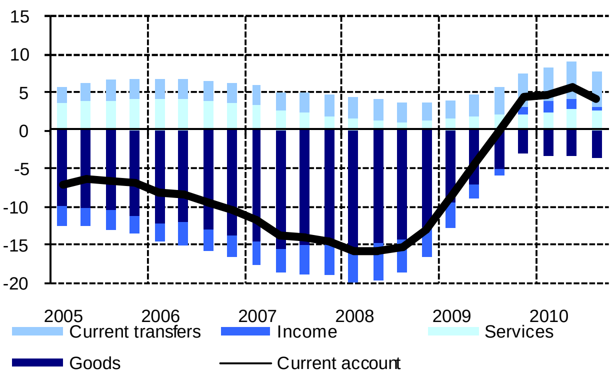
Retail sales (in %, y/y) and consumer sentiment index



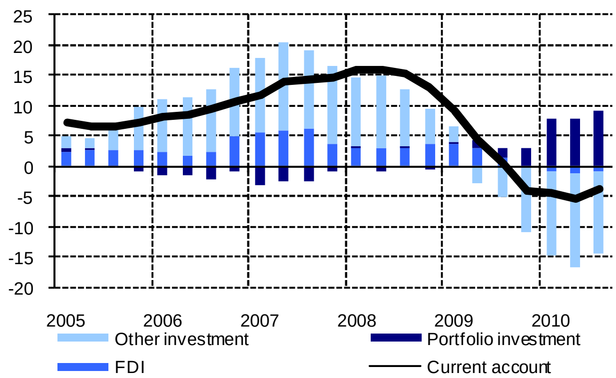
Industrial production (in %, y/y) and business sentiment index



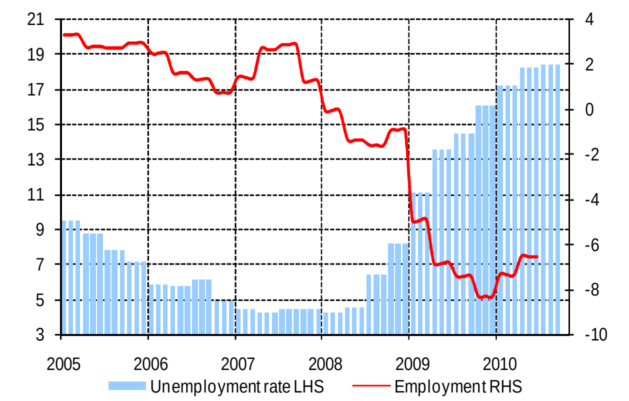
Current account and its components (in % of GDP, 4-quarter moving average)



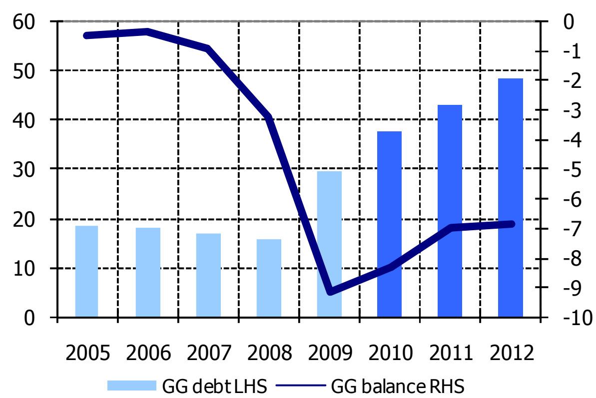
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

LATVIA

Economic growth

In early 2010, the downward trend in the GDP, observed in the two previous years, was halted. However, the scale of economic growth in the first three quarters of 2010 (on quarterly basis) remained relatively low, especially as compared to the severe decline of GDP in 2009 (by 18% — the most serious drop both in the CEE region and the entire EU). Thus, real GDP in Latvia in Q1-Q3 2010 period remained below the level from the previous year (by 1.8%). However, in the subsequent quarters of 2010, the scale of GDP decline systematically decreased on annual basis. In Q3 2010, GDP it already turned positive and amounted to 2.5%.

Table 6.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**-4.6**	**-18.0**	**-5.1**	**-2.6**	**2.5**
Private consumption	-11.1	-22.5	-6.1	-1.3	2.7
Public consumption	1.5	-9.2	-18.1	-11.4	-2.4
Fixed capital formation	-13.2	-37.7	-34.6	-30.0	-11.9
Exports	-1.3	-13.9	3.0	7.9	15.7
Imports	-13.6	-34.2	-4.9	10.0	13.1

source: Eurostat

Change in inventories was the only GDP category which had a positive contribution to the GDP growth rate in all of the first three quarters of 2010. Consumption and investment expenditure continued to have negative impact on economic growth.

Private consumption recorded a minor increase in early 2010 and remained at a comparable level over the subsequent quarters (increase in its annual growth results from low base effect). Recovery of private consumption in 2010, following a period of extremely strong decline in the preceding year, resulted primarily from the reconstruction of consumer confidence and of a time shift in their purchasing tendency. Since Q2 2010, the situation on the labour market has also slightly improved.

Fixed capital formation in the first three quarters of 2010 remained the main category which contributed to lower GDP growth. As compared to the corresponding period of 2009, the investments were more than ¼ lower. In spite of continuingly diminishing fixed capital formation in the first half of 2010, its contribution to annual GDP growth increased, primarily as a result of low base effect. Only in Q3 2010 could a considerable increase in fixed investment be observed (more than 6% q/q).

The factor which limited the domestic demand growth in Latvia in the first three quarters of 2010 was the continuously decelerating lending activity of commercial banks. The value of loans for both households and entrprises continued to decrease. Increasing rate of decline did not indicate a fast recovery of bank lending in Latvia. A moderate increase in the number of extended loans was only observed for the public sector ventures.

Apart from inventories, GDP growth was mainly fueled by net exports. Although this impact was lower than in 2009, such decrease was primarily due to the base effect. Positive contribution of foreign trade balance is mainly attributable to rapidly increasing exports. This resulted mainly from increasing demand from Latvia's trading partners, supported by the increase in competitiveness due to lower labour costs. At the same time, imports had also risen, driven mostly by the recovery in industry as well as gradually increasing private consumption.

After a period of a strong decline in 2009, retail sales in Latvia began to rise slightly in early 2010. This increase mainly concerned durable goods, e.g. between January and October 2010, the number of newly registered cars rose by more than 15% on annual basis. The increase in retail sale in Latvia was disproportionately high in relation to the scale of improvement on the labour market in 2010. The structure of consumer spending in this period (especially on durable goods) suggests that the increase in consumer expenditure in Latvia was caused by postponement of major purchases, which were made using the funds saved during the crisis. However, this trend may not last long, especially when taking into consideration the continuously decreasing lending activity of commercial banks. It may mean only a short-term increase in retail sales in Latvia.

Since the beginning of 2010, consumer sentiment in Latvia has improved. After a period of strong declines in 2009, the index began to rise quite rapidly. The increases mainly applied to sub-indices describing the condition of Latvian economy (current and expected in the upcoming months), as well as the financial households statnding.

Unlike other countries in the region, where the increase in industrial output could already be observed in mid 2009, Latvia experienced it no sooner than in early 2010. The volume of industrial output during the first nine months of 2010 was more than 13% higher than in the corresponding period of 2009. The increase in industrial output was primarily a result of the increase in external demand. In the first half of 2010, Latvian manufacturing sector experienced an 8 pp. increase in output intended for exports. For this reason, the biggest increase in production was observed in the case of capital and intermediate goods (such as paper, wood products, metals, machinery and equipment as well as means of transport). The production volume of consumer goods increased at a much slower pace and even decreased in case of durable consumer goods.

Business confidence index in Latvia, which had been increasing rapidly from Q1 2009 until Q2 2010, halted in the second half of 2010. Although the number of orders continued to increase, business assessment concerning the expected volume of output and employment, which had been growing in the previous period, slightly deteriorated.

Labour market

The situation on Latvian labour market in the first half of 2010 was not only one of the worst in the region, but also in the entire EU. In Q1, unemployment rate exceeded 20%. In spite of a slight improvement in Q2 2010 (decrease to 19.4%), it was still the highest among EU states, apart from Spain. Latvian statistical office estimates that in Q3 2010, unemployment rate dropped again, to 18%.

Since Q2 2010, the downward trend in employment, which could be observed in Latvia since early 2008, has been reversed. In Q2 and Q3 2010, the number of employed increased by c.a. 5% as compared to Q1 2010. The recovery of industrial output in Latvia was not accompanied by an increase in employment in industry. Its growth was mainly attributable to the increasing number of employed in the construction and agriculture (by more than 10%). Additionally, an increase in the number of employed was observed in services. The only exception was the public administration sector, which continued to experience the effects of fiscal tightening.

Inflation and labour costs

In 2010, the annual HICP rate in Latvia clearly increased, similarly to the majority of countries in the region. However, throughout this period, it was invariably the lowest in the region. The annual growth of consumer prices was negative from January until August 2010 and only went above zero in September. However, in November it already amounted to 1.7%.

Table 6.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**1.2**	**-0.4**	**0.5**	**1.8**	**2.5**
Contribution to HICP growth rate (in pp)					
Housing	-0.4	-0.3	0.1	0.8	1.7
Food and beverages	-1.0	-1.2	-0.5	0.3	1.1
Transport	0.5	0.4	0.7	0.6	0.4
Alcoholic beverages and tobacco products	1.6	1.4	1.0	0.9	0.2
Health	0.8	0.2	0.0	0.0	0.1

source: Eurostat

The 2010 increase in inflation in Latvia was mainly due to supply side factors. From January until November 2010, food prices rose by more than 6%, while energy prices — by more than 11%, which reflected their changes in the global market. The increase in food prices has already been visible since early 2010. An increase in energy prices was attributable not only to the rise in commodity prices but also to administrative decisions in mid 2010, concerning the prices of gas and heating energy. Back then, the prices of those goods rose by more than 20%.

An improvement in the situation in Latvian labour market in the second half of 2010 gradually started to manifest itself in increasing demand pressure and growth of core inflation. However, core inflation remained negative throughout 2010. In November it amounted to -2.5% as compared to -5% in May 2010.

After a period of decrease in nominal wages in 2009, especially in the public sector (due to the wide-range fiscal consolidation plan), wages in Latvia started to rise in early 2010. From the beginning of the year until September, the average wage in the economy increased by 3.5% and achieved positive growth for the first time since Q1 2009. It applied to both the private and the public sector, including the general government sector, where the increase in wages in the aforementioned period was the highest and amounted to more than 6%.

In 2010, like in the preceding year, a decrease in nominal ULC could be observed, and thus also further improvement of competitiveness through the so-called "internal devaluation". However, as soon as in Q3 2010, ULC growth increased noticeably, which was due to increasing wages and improved situation on the labour market. Accelerating economic growth in Latvia over the previous quarters, in turn, worked towards a decrease of ULC growth.

Balance of payments

The current account surplus in Latvia, after reaching 10.6% of GDP (4-quarter moving average) in Q1 2010, decreased significantly in the two following quarters. The main reason was the decreasing surplus on the income account, which fell by 4 pp. between Q1 and Q3 2010. Changes in other current account categories were considerably smaller.

The deficit in the goods slightly decreased due to a faster pace of growth of exports over imports. It should be noted that both exports and imports increased rapidly over the first three quarters of 2010 (by 28% and 19% in nominal terms, respectively). The increase in exports was concentrated in the main branches of Latvian industry. During three quarters of 2010, exports of wood products, metals, as well as of machinery and equipment soared by c.a. 50%. Imports of goods to Latvia also rose considerably, mainly durable consumer goods (such as electronic equipment and cars) but also capital goods and fuels.

The surplus of the Latvian income account successively diminished over 2010. Primarily it was a result of deteriorating balance of income on foreign investment, especially portfolio investment.

Balances of services and current transfers did not change significantly during the first three quarters of 2010 and continued to show a slight surplus.

Table 6.3
Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**3.3**	**8.6**	**10.6**	**8.6**	**6.5**
Goods	-10.3	-7.1	-6.2	-6.0	-6.0
Services	5.5	6.0	6.1	6.3	6.3
Income	5.5	6.3	6.8	4.7	2.7
Current transfers	2.7	3.4	3.9	3.6	3.5
Capital account	**2.1**	**2.4**	**2.5**	**2.2**	**2.3**
Financial account	**-5.5**	**-11.8**	**-14.0**	**-10.6**	**-8.8**
FDIs	-0.4	0.6	-0.5	0.5	0.3
Portfolio investments	0.5	0.7	0.8	0.7	0.5
Other investments	-6.5	-9.7	-2.8	2.2	-2.9

source: Eurostat

In 2010, similarly to 2009, an outflow of foreign capital was noticable. The largest-scale outflow took place in Q1 (4Q moving average) and its scale diminished during the two following quarters. The largest outflow of foreign capital was seen in a form of other investments, in spite of a considerable decrease in this deficit as compared to 2009. Starting from Q2 2010, net inflow of direct investments could be observed again, mainly to the manufacturing sector. As other countries in the region, Latvia also experienced an inflow of portfolio capital. However, it was considerably lower than in other countries in the region (such as Lithuania) and additionally decreased with every subsequent quarter of 2010.

Interest rates

As other Baltic states, Latvia experienced a considerable decrease in interest rates on the interbank market, resulting primarily from its over-liquidity. The 3m Rigibor rate decreased from almost 8% in early 2010 to less than 1% in December. The yields of government bonds also sharply decreased (from 15.5% in January to 7% in December 2010). The drop of interest rates is therefore the first sign indicating that the crisis on Latvian financial market has been at least partially averted.

The process of "internal devaluation", i.e. depreciation of real foreign exchange rates due to a decline in prices and labour costs, which began in early 2009, continued throughout the most of 2010. Between January and September 2010, CPI-deflated REER depreciated by 4%. This process, however, was halted in October and November 2010, when Latvian lat began to strengthen slightly against the currencies of the main trading partners.

Fiscal policy

The general government deficit in Latvia in 2010 will remain at a high level (8.5% of GDP as compared to 10.2% of GDP in 2009) in spite of high magnitude of adjustment measures (approx. 15% of GDP), which were the condition for obtaining EU and IMF assistance package .

In 2011, the Latvian government expects decrease in fiscal imbalance to 5.4% of GDP. The scale of consolidation measures will amount to approx. 2% of GDP[26]. They include primarily changes on the revenue side (such as VAT[27], real estate tax, introduction of tax on means of transport). At the same time, PIT was reduced (from 26% to 35%) and a relief in CIT for large investment projects was introduced. Authorities at the end of the last year have decided to maintain lower rates of contributions transferred to the second pillar of the pension system for two more years[28], due to difficult fiscal situation. Savings related to this step are estimated to amount to approx. 0.3% in 2011 and approx. 0.8% of GDP in 2012.

Within the time horizon of the EC's forecast, Latvia's general government deficit will exceed 7% of GDP; however, some of the consolidation measures adopted at the end of last year have not been taken into account. Lowering fiscal deficit to less than 3% of GDP in 2012 will require further austerity measures. High level of Latvian public debt (56.6% of GDP in 2012 as compared to 45.7% of GDP in 2010 and 19.7% of GDP in 2008) puts significant burden for the sector. Possible further state support to the banking system[29] may have negative impact on the general government deficit.

Forecasts

According to the European Commission Autumn 2010 forecasts, the economic recovery in Latvia, which has been observed since early 2010, will continue in the last quarter of 2010 and into the subsequent years. While GDP is expected to decrease again in 2010, this decline will be considerably lower than in 2009. In the upcoming years (2011 and 2012), Latvia is to return onto the path of relatively fast economic growth, which will be mainly a result of the domestic demand recovery. The contribution of net exports, in turn, is anticipated to decrease as a result of increased imports.

Following a period of disinflation in the first half of 2010, the growth of prices in Latvia accelerated. This trend will be maintained in 2011 and 2012. Inflation growth will be

[26] Thanks to the fact that last year the state budget revenue was higher than anticipated, the country succeeded in negotiating with international lenders a lower scale of expenditure cuts in 2011 (by approx. 1.2 pp of GDP) than conditions approved under assistance package.

[27] The basic rate will be increased from 21% to 22% in 2011 and the reduced rate – from 10% to 12%.

[28] Originally, in 2011, the contribution transferred to pension funds was to increase from 2% to 4%, while in 2012 — to 6%. The act adopted by the Latvian Seima provides for its increase from 2% to 6% starting from 2013. It should be noted that 2013 the original amount of contribution transferred to the second pillar of the pension system, i.e. 8% of the basis, will not be restored.

[29] Financial support to Parex bank in 2009 led to increase in the Latvian general government deficit by approx. 0.9% of GDP. In 2008, the state supported the banking system with approx. 4.2% of GDP.

affected by increasing prices of agricultural products on global markets, the increase in energy prices planned for spring of 2011 and growing inflationary pressure, resulting from increasing consumption.

According to the latest EC forecasts, the current account surplus, which showed up in 2009 and 2010 will not be observed in the following years. The return of deficit will result not only from deteriorating foreign trade balance, but also from an increase in deficit on the income account.

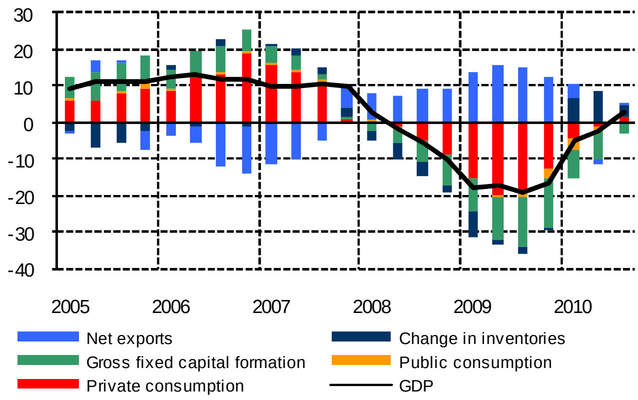
Table 6.4

Forecasts of main macroeconomic indicators

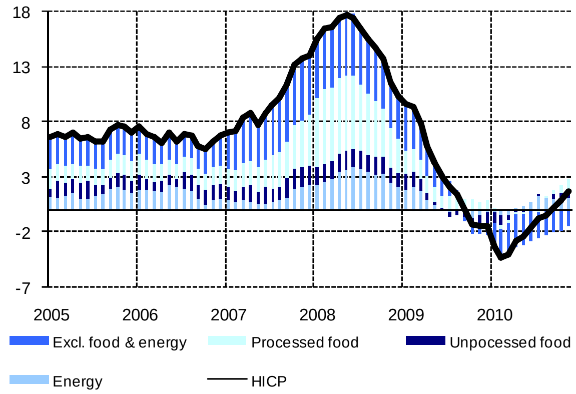
	MF	EC	IMF	Consensus Economics
	11.2010	11.2010 (05.2010)	10.2010 (04.2010)	12.2010 (05.2010)
GDP, in %, y/y				
2010	-0.4	-0.4 (-3.5)	-1.0 (-4.0)	-0.8 (-2.8)
2011	3.3	3.3 (3.3)	3.3 (2.7)	2.9 (-2.5)
2012	4.0	4.0	4.0 (3.8)	
Inflation, in %, y/y				
2010		-1.3 (-3.2)	-1.4 (-3.7)	-1.1 (-2.3)
2011	1.1	1.1 (-0.7)	0.9 (-2.5)	1.7 (0.7)
2012		1.8	1.0 (0.0)	
Current account balance, in % of GDP				
2010		3.9 (8.3)	5.5 (7.0)	
2011		-0.5 (4.6)	2.9 (6.3)	
2012		-2.9	0.8 (6.8)	

MF - Finance Ministry of the Republic of Latvia

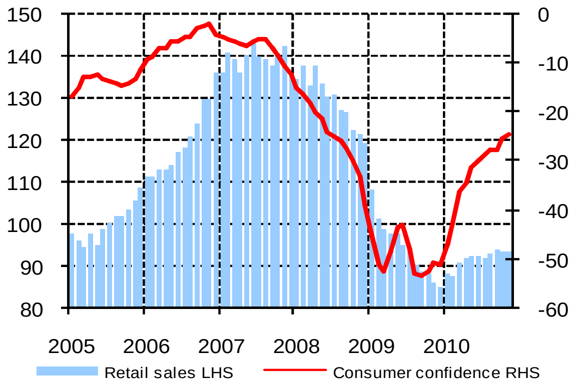
Contribution to GDP growth (in pp, y/y)



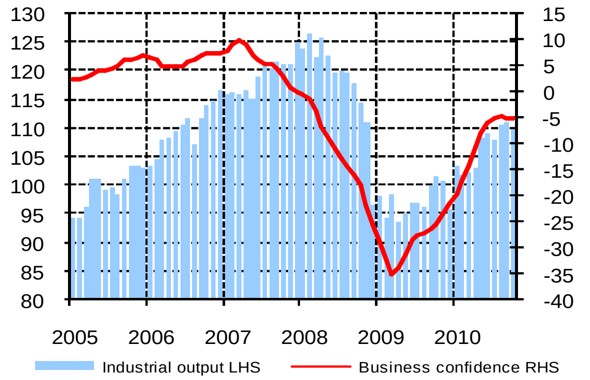
HICP and its components (in %, y/y)



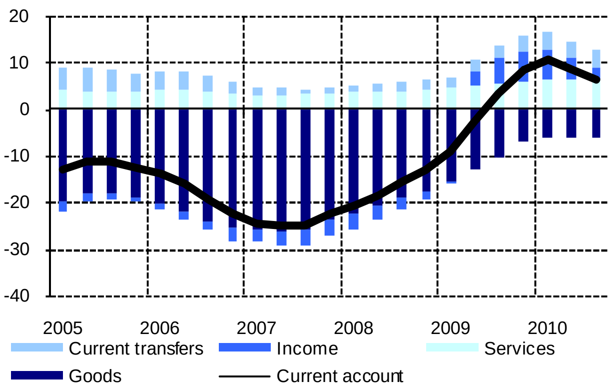
Retail sales (in %, y/y) and consumer sentiment index



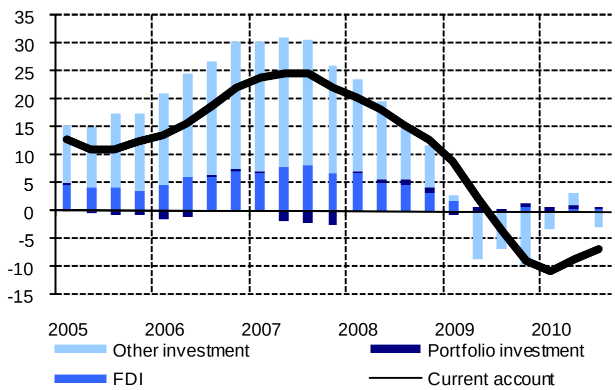
Industrial production (in %, y/y) and business sentiment index



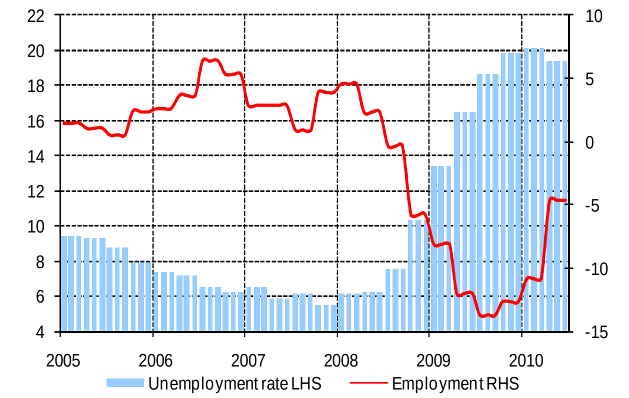
Current account and its components (in % of GDP, 4-quarter moving average)



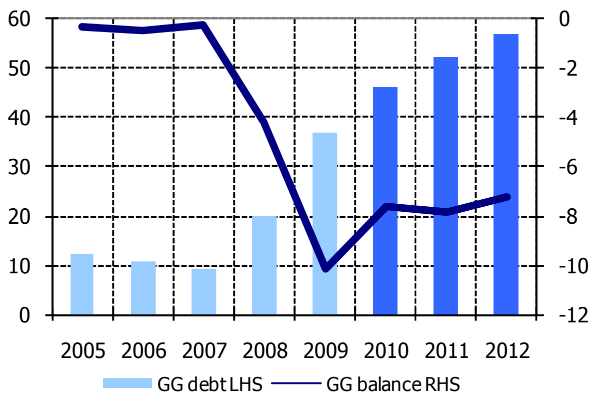
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

POLAND

Economic growth

In 2009, Poland was the only economy in the CEE region (and in the EU) which managed to maintain positive GDP growth rate. The recovery observed in the global economy in 2010 also contributed to acceleration of economic activity in Poland. In the first three quarters of 2010, GDP increased by 3.9% (as compared to 1.7% in 2009). Polish economy was therefore still one of the fastest-growing economies in the region.

The recovery process in Poland may seem slightly less dynamic than in other countries in the region (between Q1 and Q3 2010, GDP growth in Poland increased by 2.2 pp. as compared to 2009, whereas the average increase in other CEE states was by 7.8 pp.). On the one hand, this can be explained by highly diversified base effect (in 2009, GDP in the remaining countries of the region decreased by 7.1%), while on the other hand — by the scale of impact of the exports sector on domestic demand. While high domestic demand in 2009 mitigated, to a large extent, the effects of an external demand collapse, in 2010 exports played a slightly smaller role in boosting GDP in Poland than in other countries. The level of GDP in the countries of the region — apart from Poland — had not reached the level from before the crisis by Q3 2010.

Table 7.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**5.0**	**1.8**	**3.1**	**3.8**	**4.7**
Private consumption	5.9	2.2	2.1	3.0	3.6
Public consumption	7.5	1.9	2.2	3.3	4.5
Fixed capital formation	8.2	-0.8	-12.3	-0.7	0.2
Exports	7.1	-9.5	9.7	14.9	9.5
Imports	8.0	-13.5	7.9	15.9	9.7

source: Eurostat

Growth of Polish households expenditure, whose upward tendency continued throughout the entire crisis, was a key difference from other CEE states. It was mainly the effect of far milder deceleration of bank lending than one observed in other countries (due to much lower share of loans in consumption expenditure). Decreased growth rate of disposable income, caused by slower growth of wages, contributed slightly to the weakening of consumption.

Since the beginning of 2010, enterprises have been rebuilding their inventories, as a result of which this category's contribution to GDP in this period was positive. Moreover, an increase in public expenditure also had positive impact of economic growth.

The first three quarters of 2010 saw a reduction of fixed capital formation. This decrease proved even more severe than in 2009, which to a large extent was the effect of adverse weather conditions in Q1 2010. In the following quarters of 2010, the scale of decline in fixed investment diminished due to increased public expenditure (supported by EU funds) which stabilized in Q3 2010. Private investments, in turn, continued to decline (both when it comes to expenditure on buildings and on machinery and equipment).

The gradual improvement in the economic situation abroad until mid 2010 was accompanied by increasing rate of exports growth. Simultaneously, imports underwent a quick recovery, supported by increased demand in the exports sector (the sharpest increase in imports took place in the group including intermediate goods), gradual recovery of domestic demand as well as the exchange rate of the zloty, which was stronger than the year before. From Q2 2010, the recovery of imports was faster than growth of exports. As a result, the contribution of net exports to GDP growth in the first three quarters of 2010 was negative.

Industry had the most significant contribution to gross value added growth in the first three quarters of 2010. This trend could continue, as suggested by further increase in business confidence indices in Q4 last year. Manufacturing companies expected further increase in output, which was connected to a higher inflow of current orders (including foreign ones). Manufacturing enterprises more and more often declared increases in employment. However, on the other hand, the exports prospects slightly deteriorated.

Increased growth of retail sales in October and November last year may indicate further recovery of consumer demand in Q4 2010. As compared to other countries in the region, Poland experienced an increase in sales of durable goods. At the same time, the end of last year saw deteriorating sentiment among households (in particular, a decline in assessment of households financial standing during the upcoming 12 months), which may indicate a deceleration of the improvement in consumer demand.

Labour market

The Polish labour market condition in 2010 improved as compared to 2009, which was reflected both in increased growth of employment as well as relative stabilisation of unemployment rate (at the level of 9.6%, with its increase to 9.8% in late 2010 due to seasonal factors). Stabilisation of the unemployment rate — in spite of the observed recovery on the employment side, mainly in the private sector — was influenced by increased activity in the 45-59/64 age group (by 1.3 pp y/y). Since May 2010, the growth of employment in the enterprise sector has remained at a positive and increasing level. In total, average employment in the enterprise sector increased between January and November 2010 by 80 thousand (as compared to the decline by 109 thousand in the corresponding period of 2009). The increased growth rate of employment was observed in particular in services. However, from mid 2010, the economic recovery also translated into gradually increasing growth of employment in the industry and construction sectors. Nevertheless, an increase in wage pressure has not been recorded.

Inflation and labour costs

Until August 2010, the harmonised index of consumer prices (HICP) went down on an annual basis from 3.9% in January to 1.9% in July and August. The downward trend for the index in this period was supported by the zloty appreciation against major currencies, low consumer demand and a decreasing growth rate of unit labour costs in the economy.

Table 7.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**3.8**	**3.4**	**2.5**	**2.1**	**2.6**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.8	0.6	0.2	0.6	1.0
Housing	0.9	0.6	0.5	0.6	0.7
Alcoholic beverages and tobacco products	0.8	0.7	0.7	0.4	0.4
Transport	0.3	0.7	0.5	0.2	0.3
Health	0.2	0.1	0.1	0.1	0.1

source: Eurostat

Decreasing HICP growth rate between January and August 2010 was observed for the majority of main groups of goods and services. It resulted from the negative base effects connected with a considerable increase in the prices of food and non-alcoholic beverages in the corresponding period of 2009, the prices of housing-related services and increased excise tax rates for alcoholic products in 2009. The annual inflation rate during the analysed period went down also as a result of changes in regulated prices, i.e. lower increases of energy prices (electricity and heating) than in 2009. On the other hand, the inflation decline in the analysed period was slowed down by an increase in the prices of tobacco products (the effect of increased excise duty in 2009 and 2010) and growth in the fuels prices. Since August 2010, a gradual increase in HICP inflation has been observed. Index growth was affected by accelerated growth of prices of food and non-alcoholic beverages, related mainly to adverse weather conditions in spring and summer of 2010. It resulted in lower supply and increased prices of agricultural commodities on global markets. Another significant factor impacting the growth of HICP was increased growth of transportation related prices due to a rise in prices of oil on international markets.

The core inflation declined from 2.6% in January last year to 1.2% in July and remained at a similar level during subsequent months. It was influence by both limited demand, earlier zloty appreciation of the and — as a result — low growth of prices of imported goods.

Balance of payments

The current account deficit at the end of Q3 2010 (on annual basis) amounted to EUR 9.7 billion and hence increased as compared to the deficit of EUR 8.3 billion at the end of Q3 2009 (on annual basis). After a period of the current account deficit stabilization, widening of external imbalances was being observed again due to increased income deficit and lower surplus of current transfers and services. The deficit of trade in goods was gradually growing, although it has not yet returned to the level from before the crisis.

Inflow of funds onto the capital account in Q23 2010 was higher than at the end of Q3 2009, thanks to increasing inflow of EU funds and amounted to c.a. EUR 5.4 billion (as compared to EUR 3.9 billion, respectively).

Table 7.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-2.7**	**-2.2**	**-2.2**	**-2.2**	**-2.8**
Goods	-2.2	-1.0	-0.9	-1.1	-1.3
Services	1.2	1.1	1.0	0.9	0.9
Income	-3.3	-3.8	-3.8	-3.6	-3.7
Current transfers	1.6	1.5	1.5	1.5	1.3
Capital account	**1.2**	**1.6**	**1.4**	**1.3**	**1.6**
Financial account	**6.7**	**8.2**	**9.9**	**10.1**	**10.3**
FDIs	2.1	2.0	2.5	2.3	1.5
Portfolio investments	1.6	3.6	5.7	5.6	6.1
Other investments	3.6	3.1	1.9	2.2	2.7

source: Eurostat

Between Q4 2009 and Q3 2010, a continued net inflow of foreign capital to Poland was observed. The financial account surplus amounted to c.a. EUR 35.5 billion (as compared to c.a. EUR 21.0 billion at the end of Q3 2009). Continuously high net inflow of portfolio investments (in the amount of c.a. EUR 21.2 billion, as compared to EUR 5.1 billion in the corresponding period of preceding year) was a key factor standing behind higher capital inflows.

At the end of Q3 2010, foreign investors invested mainly in treasury bonds, issued both for domestic and foreign markets.

Net inflow foreign direct investments and other investments diminished. In the case of direct investments, to c.a. EUR 5.2 billion from EUR 6.5 billion at the end of Q3 2009, while in the case of other investments — to EUR 9.2 billion from EUR 11.2 billion.

Current account deficit (4q moving average) increased to 2.8% of GDP at the end of Q3 2010 (as compared to 2.7% at the end of Q3 2009), whereas the combined current and capital account deficit at the end of Q3 2010 amounted to 1.2% of GDP (as compared to deficit of 1.4% at the end of Q3 2009). 54% of the current account deficit in Q3 2010 (on 4-quarter basis) was financed by inflow of foreign direct investments (as compared to 78% at the end of 2009).

Interest rates and exchange rate

Sovereign debt and banking turbulences in peripheral countries of the euro area (Greece, Ireland, Portugal, Spain) initially supported the strengthening of currencies of emerging markets. The zloty, taking advantage of this trend, continued to appreciate against euro from late 2009 into the first months of 2010. On the other hand, Polish currency depreciated against the US dollar and Swiss franc, which were perceived by investors as more secure assets. However, sovereign rating cuts of threatened euro area states had adverse effect on the currencies of Central and Eastern European countries. Since April last year one could observe the beginning of a rapid depreciation of the zloty against the euro and continuation of the downward trend against the US dollar and Swiss franc. Optimism returned to international financial markets in August last year, which was reflected in increased global stock exchange indices as well as another appreciation of emerging currencies, including the zloty. This trend was maintained until October, after which the exchange rate of Polish currency against euro was gradually stabilising until the end of 2010. It was supported, among others, by IMF and EC's decision to provide Ireland with financial assistance. On the other hand, the decision of the Federal Reserve to commence the second round of quantitative easing of monetary policy in the US, interpreted by the investors as a sign of weakness of the recovery in American economy, led to strengthening of the dollar against euro, and thus also against the zloty, which persisted until the end of last year.

National Bank of Poland (NBP) main policy rate remained at record low from June 2009 until the end of 2010, amounting to 3.5%. In spite of unchanged NBP rate, the interbank rates decreased over the last year. 3m Wibor fell from 4.3% in early 2010 to 3.8% in Q3. It resulted from stabilisation of conditions in international financial markets and increased liquidity in the banking sector. Turmoil related to the sovereign debt crisis in Greece in the first half of 2010 did not affect interest rates on the interbank market. In Q4 2010, 3m Wibor slightly increased as a result of higher risk aversion, related to the banking crisis in Ireland as well as market expectations in the scope of NBP interest rate hikes.

Polish treasury bonds yields in 2010 were strongly affected by the situation on the euro area financial markets. In Q1 2010, as global financial crisis effects gradually waned, yields dropped. Information about the sovereign debt crisis in Greece as well as interrupted negotiations between the Hungarian government and the IMF concerning prolonged financial assistance impacted the increase of yields in Q1 and at the beginning of Q3 2010. Between August and October 2010, confidence returned to the European bonds market and the yields of Polish bonds decreased again. The outbreak of the Irish banking crisis in November 2010 caused another increase in yields of Polish bonds at the end of the year.

Fiscal policy

The general government deficit in Poland in 2010 amounted to approx. 8% of GDP as compared to 7.2% of GDP in 2009, which was related, inter alia to protracted significant expenditure growth (including co-financing of EU projects) and the operation of automatic stabilisers.

The first measures aimed at reducing the deficit in the public finance sector were only adopted in 2010. They mainly concerned a temporary increase in VAT[30], freezing of wages in government administration (except for teachers) and expenditure cuts on active policy in the labour market. The expenditure rule enacted in 2010 will cap growth of central budget discretionary expenditure[31]. NBP estimates that the magnitude of consolidation measures provided for in the *Budget act for 2011* will amount to approx. 1 pp of GDP[32]. Additionally, at the end of December last year, the government resolved to decrease the amount of contributions transferred to private pension funds. Starting from April this year, they would amount to 2.3% as compared to current 7.3% of the gross monthly salary[33], which would reduce the budget deficit by approx. 0.7% of GDP in 2011 and by approx. 1.0% of GDP in 2012. According to the Minister of Finance, J. Rostowski, thanks to this change and measures provided for in the budget act, this year's fiscal deficit would amount to approx. 6% of GDP.

According to the EC's autumn forecast (November 2010), in 2011 and 2012, general government deficit in Poland will remain at the level significantly exceeding the 3% of GDP reference value (6.6% of GDP in 2011 and 6.0% of GDP in 2010). However, this forecast does not take into account the changes in the funded pension scheme. Significant privatisation receipts (approx. PLN 30 billion between 2011 and 2013) and introduction of single treasury account (on one-off basis in 2011) will limit growth in the public debt. Within the time horizon of the

[30]Increase of basic and reduced VAT rates – for three years – from 22% to 23% and from 7% to 8%, respectively, and for certain unprocessed and low processed food products from 3% to 5% and for books and professional journals — from 0% to 5%. For basic food products (such as bread, dairy products, meat, cereal products and juices) the rate is to decrease from 7% to 5%. Additionally, should the relation of the public debt to GDP at the end of 2011 exceed 55%, another 1 pp increase in VAT rates will take place between 1 July 2012 and 30 June 2013 (i.e. from 5%, 8% and 23% to 6%, 9% and 24%), and by yet another 1 pp between 1 July 2013 and 30 June 2014. In subsequent years, rates are to decrease provided that the relation of the public debt to GDP does not exceed 55%. The VAT increases mechanism may be triggered also (for a period of 5 years), if the public debt relation is exceeded in 2012 or 2013.

[31] At 1% per annum in real terms, is not applicable to certain expenditure items (such as the public debt servicing, subsidies to local governments, Social Insurance Fund and Agricultural Social Insurance Fund). The rule is temporary and will be effective till correction of excessive deficit. The MoF estimates that the state budget savings related to introduction of the rule (in the conditions of 2010) will amount to: 0.2% of GDP in 2011, 0.5% of GDP in 2012, 1.0% of GDP in 2013 and 1.6% of GDP in 2014.

[32] *See Opinion of the Monetary Policy Council on the Draft Budget Act for the Year 2011* of 26 October 2010.

[33] Between 2013 and 2017, it is to gradually increase to 3.5%.

EC forecast, its level (according to ESA95) will be approximate to the Treaty reference value (59.6% of GDP in 2012).

Forecasts

In the next two years, Poland will remain one of the fastest-developing countries of Central and Eastern Europe and its economic growth will continue to be considerably higher than the average for the region. Increasing households expenditure, supported by recovery in investment will still be the main source for economic growth. The increase in private consumption will be primarily caused by improved situation on the labour market and accelerated growth of wages, as well as anticipated increase in banks lending activity. However, the impact of these factors may be slightly diminished by higher rates of indirect taxes.

The relatively high public investment growth, expected in 2011 and supported by inflow of EU structural funds related to, among others, implementation of EURO 2012 projects, will be accompanied by increased investments in the private sector.

Increased domestic and foreign demand should additionally support higher inflow of foreign capital.

Acceleration of domestic demand will be most likely reflected in imports growth being slightly higher than exports growth. As a result, contribution of net exports to GDP growth may be slightly negative negative. At the same time, the current account deficit will most likely deteriorate. Apart from the increase in negative foreign trade balance, it is also anticipated that the balance of income will decline, due to increased reinvested profits outflow.

An increase in core inflation is expected from the beginning of 2011, which will result from increased import prices, higher VAT rates, as well as gradual growth of wage pressure due to economic recovery, accompanied by improved conditions in the labour market. The prices of food and energy are also expected to undergo further increase.

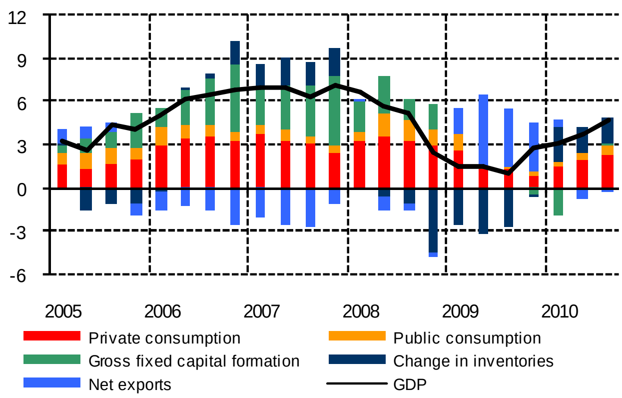
Table 7.4

Forecasts of main macroeconomic indicators

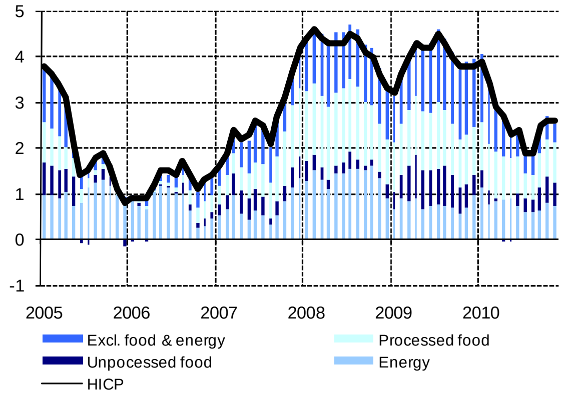
	NBP	EC	OECD	IMF
	10.2010 (06.2010)	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	3.5 (3.2)	3.5 (2.7)	3.5 (3.1)	3.4 (2.7)
2011	4.3 (4.6)	3.9 (3.3)	4.0 (3.9)	3.7 (3.2)
2012	4.2 (3.7)	4.2	4.3	3.9 (3.9)
Inflation, in %, y/y				
2010	2.5 (2.5)	2.6 (2.4)	2.4 (2.7)	2.4 (2.3)
2011	3.0 (2.7)	2.9 (2.6)	2.5 (2.8)	2.7 (2.4)
2012	3.0 (2.9)	3.0	3.1	3.0 (2.5)
Current account balance, in % of GDP				
2010		-2.7 (-2.8)	-2.4 (-1.6)	-2.4 (-2.8)
2011		-3.3 (-3.3)	-3.2 (-2.7)	-2.6 (-3.2)
2012		-3.7	-3.8	-2.9 (-3.4)

NBP — Inflation Report, National Bank of Poland

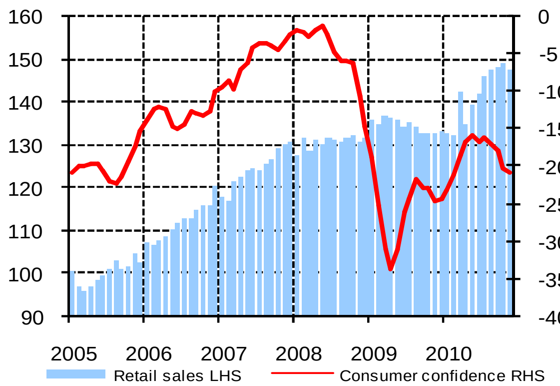
Contribution to GDP growth (in pp, y/y)



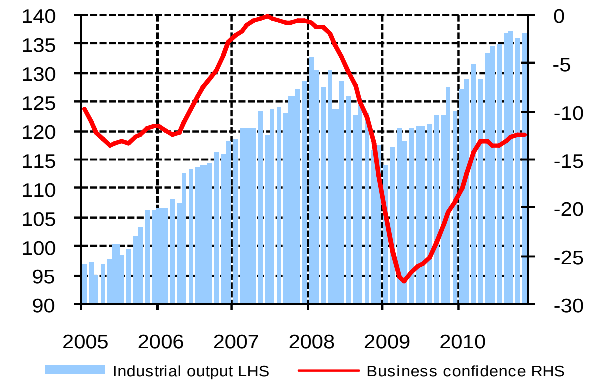
HICP and its components (in %, y/y)



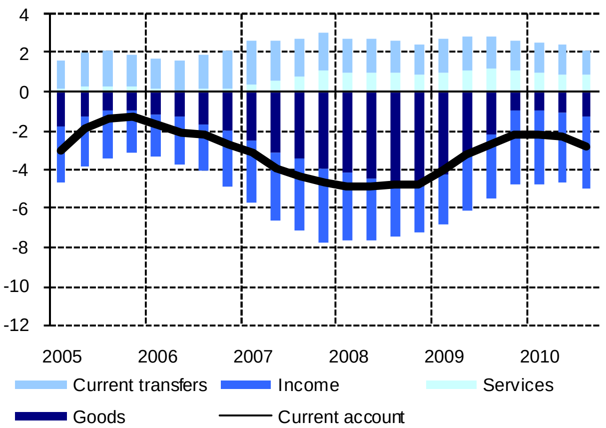
Retail sales (in %, y/y) and consumer sentiment index



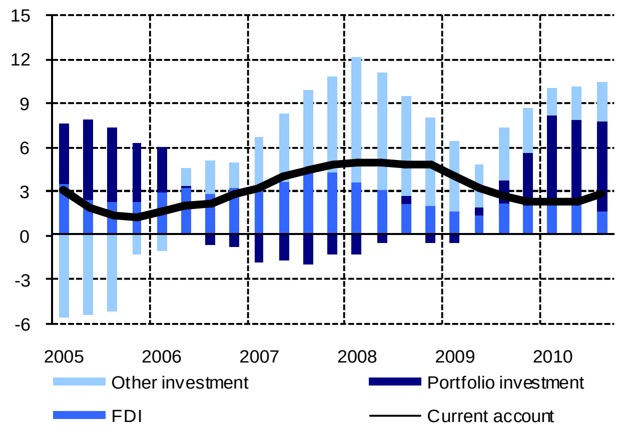
Industrial production (in %, y/y) and business sentiment index



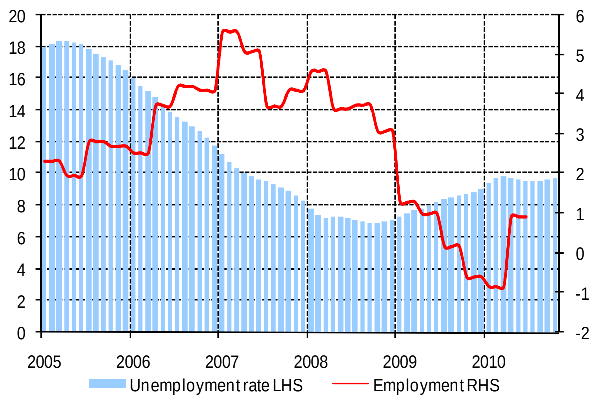
Current account and its components (in % of GDP, 4-quarter moving average)



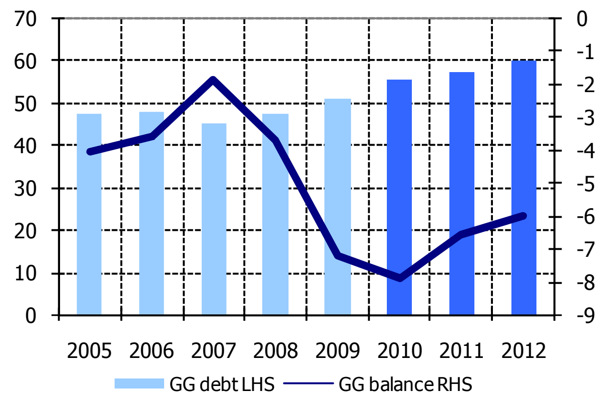
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ROMANIA

Economic growth

After a severe collapse in Romanian economy in 2009, 2010 saw a continuation of decline in GDP. This resulted primarily from further decrease in domestic demand, which began to slowly grow or at least stabilised at a low level in the majority of countries in the region. It is therefore expected that decrease in GDP in 2010 will be more severe in Romania than in other CEE countries.

Before the crisis, economic growth was based on domestic demand, supported by increases of pensions and wages in the public sector, as well as bank loans mainly in foreign currencies. As a result, the crisis hit Romania in times of high imbalance on the current account and in the budget, which amplified the tensions in local financial markets and reduced the possibility of the government's intervention[34].

Table 8.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**7.1**	**-7.1**	**-3.2**	**-1.5**	**-2.2**
Private consumption	9.2	-10.9	-2.7	0.3	-1.2
Public consumption	3.1	0.7	-4.4	-2.6	-0.5
Fixed capital formation	19.3	-25.3	-30.0	-1.2	-11.0
Exports	18.9	-5.2	15.7	19.6	16.5
Imports	17.1	-21.3	0.7	10.5	18.1

source: Eurostat

Only in Q2 2010 did Romania achieve positive economic growth on quarterly basis, due to an increase in private consumption. However, Q3 saw another drop in household consumption, related to VAT increase, wage and employment cuts in the public sector. As a result, real GDP also decreased. Another factor with negative impact on economic growth was the decrease in government expenditure due to the necessity of maintaining deficit at the level agreed on with the EU, IMF and World Bank.

Fixed capital formation continued on a downward trend (both construction investments and expenditure on machinery and equipment decreased), primarily due to disadvantageous perspectives for Romanian economy as well as political instability in this country. Investors still perceive Romania as a high-risk country. This assessment did not change even after fiscal consolidation[35].

On the other hand, the inventories rebuilding process worked towards dampening GDP decline. However, it appears that this cycle is coming to an end and thus its impact on GDP may be insignificant in the upcoming quarters.

Acceleration of import growth in the first three quarters of 2010 reduced the positive impact of net exports on GDP growth. Demand for import of supply and investment goods rose due to growing exports. Consumer import was negatively affected by reduced bank lending. Exports growth rates were higher than before the crisis, mainly thanks to increasing sales in the automotive and telecommunications sector. However, in Q3 2010 this growth rate decreased.

Weak private consumption was reflected in the level of retail sales, which decreased by 4.3% q/q in Q3. The most severe decline was observed for durable goods, such as cars and electronic devices. Consumer sentiment is oscillating around historically lowest levels due to adverse economic conditions and concerns over the labour market.

Industrial output, after a short-term downward adjustment in Q4 2009, grew continuously (by 4% during the first 3 quarters of 2010 as compared to the corresponding period of 2009), although it has not yet reached the level from before the crisis. Industry was the only sector to have experienced an increase in value added in 2010; output rose at the fastest rate in export-oriented sectors. The automotive industry achieved very good results over 2010, mainly thanks to increasing external demand (means of transport have a significant share in Romanian exports), which was supported by foreign subsidy schemes for purchase of new cars and competitive prices, which could be offered thanks to low labour costs. Dacia was characterised by one of the fastest growths among automotive brands in Europe. The number of newly registered cars from this brand rose by 10.5% within 10 months of 2010, increasing its share in the European passenger cars market to more than 2%. High sales were also observed for Nokia mobile phones produced in Romania. On the other hand, severe declines were still experienced in the construction sector (in Q3, value added decreased by 14.9% y/y).

Business sentiment slightly improved, due to, among others, the expected increase in foreign orders. On the other hand prospects for production remain adverse and thus some of the entrepreneurs moved their business to Bulgaria[36], where income tax is 6 pp lower, VAT — 4 pp lower and the minimum tax for companies is not applicable (Romania resigned from it in October 2010).

[34] In 2009, the financial situation deteriorated so much that Romania asked European institutions for support, which provided the country with a EUR 20 billion loan in tranches on the condition that it would take measures to reduce the budget deficit to 6.8% of GDP. An additional objective involves support of structural reforms and restoring financial markets stability.

[35] The Romanian government lowered wages and reduced employment in the budget sector, increased VAT rates, limited paid parental leave to 1 year, reduced unemployment benefits as well as increased the retirement age.

[36] http://www.reuters.com/article/idUSTRE6902UU20101001?pageNumber=1

They are also attracted by stable and low interest rates and inflation.

Labour market

In spite of deepening recession in Romanian economy, the increase in unemployment rate was relatively low. In subsequent months of 2010, it even gradually diminished. However, it appears to be related to the labour market being left by persons who have been discouraged by seeking employment and who had lost the right to unemployment benefit. Romanian enterprises, on the other hand, continued to reduce the number of jobs. The European Commission anticipates that the average annual unemployment rate will increase to 7.4% in 2010 (as compared to 6.8% in 2009). Unlike in other countries in the region, the downward trend in employment in Romania continues to deepen. In Q3 2010, employment was lower by 4.3% as compared to the preceding year (as compared to a decrease by 2.2% in Q2). Reforms concerning the labour market are currently being prepared; they are to increase its flexibility and regulate negotiation of wages.

Inflation and labour costs

Inflation in Romania clearly exceeds the growth of consumer prices in other countries of the region. While until mid 2010 it experienced a downward trend, after the VAT increase (from 19% to 24%) in July, it rose considerably. At the same time, the increase in food prices observed over the last months (caused, among others, by the effects of floods) resulted in the harmonised index of consumer proces (HICP) rising to 7.7% in November 2010.

Table 8.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**4.5**	**4.6**	**4.3**	**7.5**	**7.7**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.2	0.0	-0.1	1.3	2.3
Alcoholic beverages and tobacco products	1.8	2.7	2.1	2.4	1.7
Housing	0.4	0.5	0.6	1.3	1.4
Transport	0.5	0.8	0.7	0.7	0.8
Other	0.2	0.2	0.2	0.3	0.2

source: Eurostat

The biggest rise was observed for the prices of basic foods, on which the demand was focused during the period of intensified savings. The prices of alcoholic beverages and tobacco products also increased by 26.3%, which resulted, among others, from increased excise tax. Together with persistently high levels of fuel prices, it caused an increase in the contribution of energy and food to annual HICP growth to 5.9 pp. On the other hand, low demand — related to weak growth of wages and adverse labour market conditions— worked towards diminishing core inflation, which in November was estimated at 4.7%.

According to the National Institute of Statistics, the increase of VAT in July 2010 caused the monthly CPI inflation rate in this month to rise by 2.6 pp to 7.1%. NBR estimates that at the end of September 2010, contribution of this increase to CPI index amounted to 2.4% and CPI on its own would have amounted to 5.3%.

In October 2010, average net wage dropped by 2.5% on annual basis, among others due to the 25-% cuts of wages in the public sector. Reduction of wages and employment, together with increase in labour productivity in Q3 may cause a decrease in unit labour costs, which will be partially decelerated by economic slowdown.

Balance of payments

After a considerable reduction in 2009, the current account deficit started to deteriorate again in 2010, which resulted primarily from a decrease in surplus of current transfers (according to preliminary data, they dropped by nearly 1/3 y/y between January and October 2010) and deterioration of negative balance on the income account. At the same time, the deficit in trade continued to decrease due to a faster pace of growth of exports over imports. It was caused by recovery of foreign demand and still weak internal demand. Similarly to 2009, cars played a crucial role in the growth of exports.

Table 8.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-5.3**	**-4.4**	**-5.0**	**-5.5**	**-5.0**
Goods	-7.7	-5.9	-5.7	-5.8	-5.2
Services	0.0	-0.3	-0.5	-0.7	-0.6
Income	-1.4	-1.7	-1.6	-1.6	-1.9
Current transfers	3.8	3.5	2.8	2.6	2.6
Capital account	**0.4**	**0.5**	**0.6**	**0.6**	**0.4**
Financial account	**5.8**	**4.1**	**4.5**	**5.7**	**4.2**
FDIs	4.7	2.9	2.1	1.8	1.7
Portfolio investments	-0.5	0.4	1.8	1.5	0.8
Other investments	2.7	1.8	5.7	4.7	4.7

source: Eurostat

The collapse of inflow of direct investments and other investments in 2009 was alleviated by financial aid provided by the IMF[37]. Already in Q3 2010, the surplus of the financial account rose as compared to 2009, mainly due to the increase in other investments, where positive impact of the IMF loan is visible, as well as return of portfolio capital to Romania, related to lower risk-aversion as compared to 2009. Very low inflow of direct investments continues to reflect poor investment activity in this country.

[37] Subsequent tranches of the loan, however, have been moved to the beginning of 2011 and are subject to several conditions. The Romanian parliament has been obliged, among others, to adopt a budget plan for 2011 with target deficit level at 4.4% of GDP, a new pension act and consolidated act on wages in the public sector.

In late 2010, the current account deficit may reach 5.5% of GDP (as compared to 4.5% of GDP in 2009), primarily because of the expected decrease in transfers from Romanian citizens working abroad. This, however, constitutes a huge improvement against the two-digit imbalance observed between 2006 and 2008.

Interest rates and exchange rate

Until May 2010, the National Bank of Romania (NBR) continued the process of monetary policy easing (commenced in February 2009), together with decreasing inflation. Starting from January 2010, NBR lowered the official interest rate by jointly 175 bp. Since May, interest rates have not changed, which resulted from an increase in inflation far beyond the objective (2.5–4.5%). Since the probability of second round effect — related to an increase in VAT rates — is low, NBR is also not expected to increase interest rates in Q1 2011.

Short-term interbank interest rates were below the level of NBR rate, which was supported by over-liquidity in the market (average 1M ROBOR amounted to 5.1% in December). Long-term rates reached higher levels due to high-risk premium, related, among others, to political uncertainty (12M ROBOR amounted to approx. 7.0% in December).

Romanian leu, after a period of appreciation against euro in Q1 2010, remains at a stable level, albeit far below the value from before the crisis. The impact of political tensions (including the no confidence vote against the government and animosities within the coalition), information about postponement of payment of IMF funds to early 2011 or the protests of labour unions did not prove as strong as expected. In 2011, the level of currency will depend, among others, on the government's ability to fulfil its obligations towards IMF, as well as on the conditions of foreign markets.

Fiscal policy

According to the conditions of the assistance package of the IMF, EU and World Bank[38], the general government deficit in Romania in 2010 should not be higher than 6.8% of GDP as compared to 8.6% of GDP in 2009. Deterioration of budget revenue prompted the government to adopt consolidation measures, which involved two revisions of the budget act. The first one (June last year) primarily introduced wage cuts in the public sector by 25% and an increase of VAT rate from 19% to 24%[39]. Total reduction of the budget deficit was estimated at approx. 2% of GDP. The second revision (November 2010) provided for an increase in expenditure on social benefits (including pensions) as well as on agriculture and healthcare, with payments to cover hospitals' debts. Funds for the above measures were to come from additional payments from state energy and oil enterprises.

In 2011, Romanian authorities anticipate drop in fiscal deficit by 2.4 pp of GDP, to 4.4% of GDP. For 2011, total state budget expenditure in nominal terms has been frozen. Consolidation measures include, among others, postponement of pension and disability benefits indexation, prohibition of hiring new employees in the public sector and introduction of co-financing by patients in the healthcare sector. Reduction of the deficit stems also from changes adopted in mid 2010 in the pension scheme[40] and reduction of the period for which family benefits are granted.

The scale of reduction the budget deficit by Romania in 2011 and 2012 (by approx. 3.8 pp of GDP) will be the highest among CEE-Countries and one of the highest in the EU. However, it will not be sufficient to decrease general government deficit below 3% of GDP in 2012. Weaker improvement of the economic situation in the upcoming years, and further increase in the public sector liabilities and unstable political situation[41] poses risk to achievement of budget objectives. The public debt, within the time horizon of the EC forecast, will remain at a low level as compared to other countries in the region and the EU (30.4% of GDP in 2010 and 34.1% of GDP in 2012).

Forecasts

In November 2010, the European Commission decreased economic growth forecast for Romania due to relatively slow recovery of domestic demand, which is expected to increase by 1.5% in 2011. It will be primarily the effect of reconstruction of international trade and capital flows, related to the economic recovery anticipated across Europe (higher inflow of foreign direct investments is possible). It is expected that the industry sector will play a significant role in this, with 0.7% contribution to real GDP growth. Household consumption should grow by 1.8% due to increase in real wages (recovery of wages to 0.4% from the 3.6% decline in 2010, according to CNP), whereas investments are expected to grow by 4.2% since companies will attempt to adjust their production capacities to increasing internal demand. Better usage of EU funds brings hope for recovery of infrastructural investments. Government expenditure will remain at a reduced level as the government is not expected to change the current fiscal consolidation

[38] The assistance package was granted to Romania by the IMF, EU and World Bank in June 2009, after a rapid drop of foreign capital inflow. Its total value is EUR 20.0 billion.

[39] Originally, the Romanian government planned to reduce pension and disability benefits by 15%. After this step had been declared unconstitutional in June 2010, the authorities decided instead to increase the VAT rate from 19% to 24%. Other changes in taxation, include introduction of tax on income from savings (16-% rate) and tax on lotteries (25-% rate), increase of of payments from state-owned enterprise profit from 50% to 90% as well as PIT (flat rate at the level of 16%) imposed on pensions, disability and fringe benefits .

[40] These concerned, among others, increasing and equalising the pension age for men and women, changing the benefit calculation formula, tightening the disability benefits scheme and eliminating pension privileges of uniformed services.

[41] 2010 saw three no-confidence votes against the present government. Moreover, the opposition appealed against individual public finance consolidation measures and the budget act for 2011 to the Constitutional Court.

scheme. To strengthen internal demand in 2011, wages in the public sector are planned to increase by 15%[42].

NBR estimates that the economy will grow no sooner than in Q2 2011 due to poor improvement in private consumption. Many Romanians continue to have a pessimistic view of the future (sentiment at historical low), while according to research concerning situation in enterprises, conducted by A.T. Kearney, as many as 2/3 of managers are convinced that enterprises will suffer from the effects of the crisis throughout the year. Investors remain discouraged by political instability and high risk related not only to Romania itself, but to the entire region. Net exports will have negative impact on GDP due to the anticipated increase in import of capital goods supporting investments.

According to the EC, economic growth in 2012 should already reach 3.8%. Long-term threats will be mainly related to the possibility of permanent loss of foreign capital confidence.

In 2011, inflation will be boosted by the expected acceleration of growth of wages, which remained at a very low level in 2010, and — at least until mid 2011 — by further increase in food prices due to flood effects. NBR anticipates that CPI inflation will decrease no sooner than in Q3 2011 to 4.3% due to the expiry of the effect of VAT increase. Moreover, HICP growth, anticipated by the EC, is to maintain the downward trend, albeit not to the extent expected by NBR. In late 2011, according to the central bank, the annual inflation index should be within limits of the inflation target, i.e. 3% +/-1 pp.

Within the time horizon of the EC forecast, the current account deficit may slightly deteriorate due to increasing import of investment goods by companies which attempt to meet the growing demand. On the other hand, the anticipated improvement in European labour markets will have positive impact on the increase in surplus of the current transfers in 2011.

Table 8.4

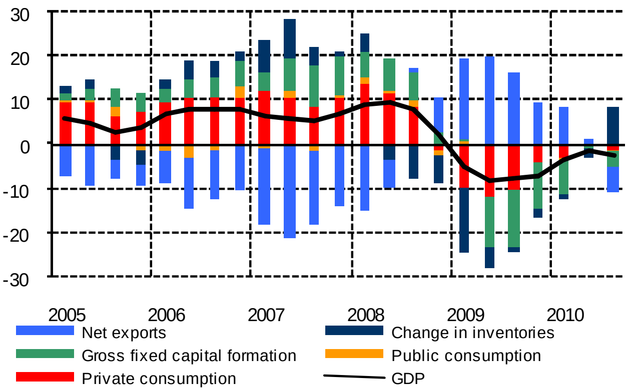
Forecasts of main macroeconomic indicators

	CNP/NBR	EC	IMF	Consensus Economics
	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)	12.2010 (05.2010)
GDP, in %, y/y				
2010	-1.9	-1.9 (0.8)	-1.9 (0.8)	-1.9 (0.6)
2011	1.5	1.5 (3.5)	1.5 (5.1)	1.5 (3.3)
2012	3.9	3.8	4.4 (5.0)	
Inflation, in %, y/y				
2010	8.2 (3.7)	6.1 (4.3)	5.9 (4.0)	6.3 (4.4)
2011	3.4 (2.8)	5.5 (3.0)	5.2 (3.1)	5.4 (3.6)
2012		3.2	3.0 (3.0)	
Current account balance, in % of GDP				
2010	-5.7	-5.5 (-4.4)	-5.1 (-5.5)	
2011	-5.5	-5.6 (-5.6)	-5.4 (-5.5)	
2012	-4.9	-6.2	-5.1 (-5.5)	

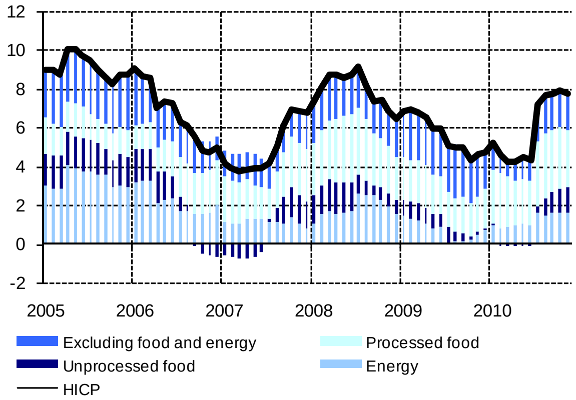
GDP and current account balance forecast - Comisia Naţională de Prognoză (CNP), inflation forecast - Banca Naţională a României

[42] http://www.bloomberg.com/news/2010-12-14/romania-state-workers-wages-to-rise-15-in-2011.html

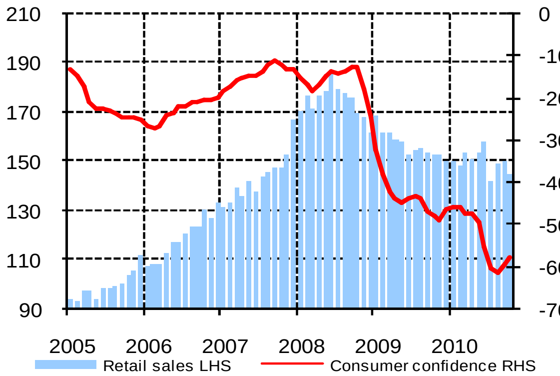
Contribution to GDP growth (in pp, y/y)



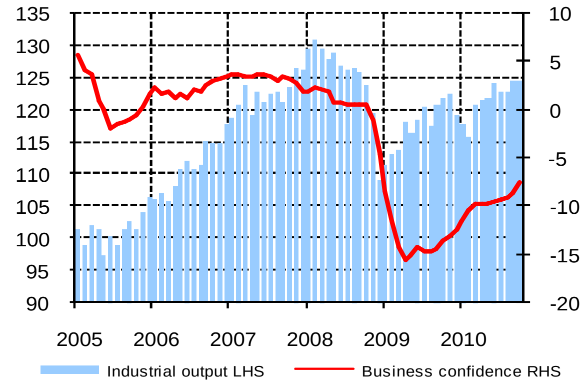
HICP and its components (in %, y/y)



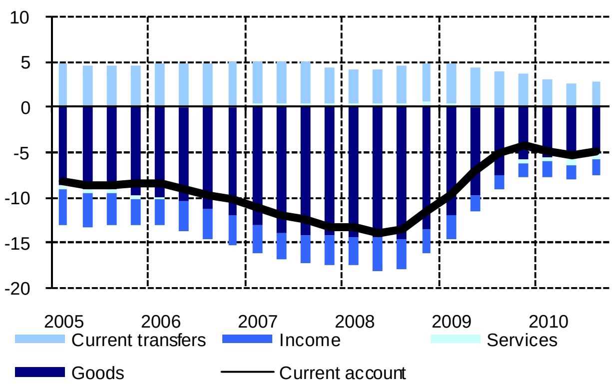
Retail sales (in %, y/y) and consumer sentiment index



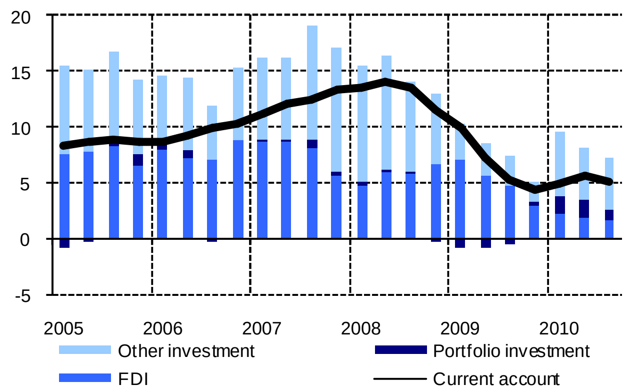
Industrial production (in %, y/y) and business sentiment index



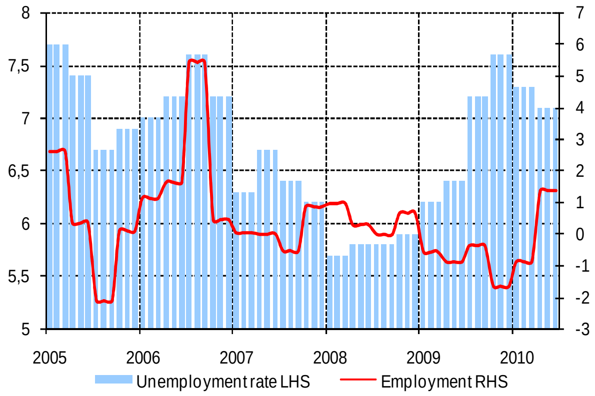
Current account and its components (in % of GDP, 4-quarter moving average)



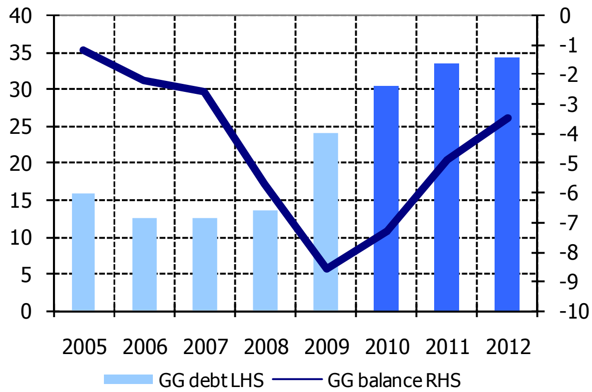
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVAKIA

Economic growth

In the first three quarters of 2010, Slovak economy developed at a rate of 4.4% y/y, which means that it had not yet recovered from previous year's real GDP decline (-4.8% y/y), which was recorded for the first time since the establishment of independent Slovak state in 1993. In the first half of 2010 the main source of growth was the revival of foreign demand, related to the ongoing recovery in of major trade partners (Germany in particular). In Q3 2010, the main engine of economic growth was taken over by domestic demand due to rebuilding of inventories and increasing fixed capital formation in Slovak enterprises. The recovery of investment demand was accompanied by a clear increase in the import volume of goods and services, whose growth was higher than that of exports, which in turn translated into negative contribution of foreign trade to GDP growth in Slovakia.

Table 9.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**6.4**	**-4.8**	**4.6**	**4.4**	**4.2**
Private consumption	6.1	-0.7	0.0	-1.1	-0.5
Public consumption	4.3	2.8	5.6	-1.0	1.7
Fixed capital formation	6.8	-10.5	-5.5	3.4	5.8
Exports	3.2	-16.5	18.6	16.2	15.0
Imports	3.3	-17.6	10.9	16.1	16.5

source: Eurostat

In spite of improving global situation, resulting — among others — in increased demand for Slovak export goods, the country's foreign trade turnover in the first three quarters of 2010 remained lower than before the outbreak of the economic crisis. Although the annual growth of volume of both export and import came close to that observed in the years before the recession (16.6% and 14.5%, respectively), it resulted primarily from the statistical low reference base in 2009. Between January and August 2010, the structure of both exports and imports experienced a visible increase in (foreign and domestic) demand for intermediate goods (by 27% in both cases, as compared to the corresponding period of the preceding year) and for machinery and equipment (by 21% and 24%, respectively, as compared to the corresponding period of the preceding year).

The growth of fixed capital formation in Slovak enterprises, observed during the first three quarters of 2010 (1.2% y/y), as compared to its severe decline in 2009 (-19.7% y/y), as well as dynamically growing volume of import, in particular of machinery and equipment, may indicate that companies used the period of crisis to modernize and expand existing production capacity. On the other hand, the persistently low investment growth may result from the still weak consumer demand, which is due to continuous difficulties in the domestic labour market as well as lack of pressure on rapid increase in investments due to low capital utilization in Slovak enterprises. The surveys conducted by the EC in October 2010 indicate that in the first three quarters of 2010, the capital utilization in Slovak enterprises was between 55 and 60%, i.e. far below the long-term average (75%).

However, a sustainable improvement in consumer demand has not been observed, which is reflected not only in weak data concerning retail sales, but also consumer sentiment among Slovak households, indicating that difficulties continued both in the scope of the current financial situation of consumers and of employment outcome in the next six months. In the second half of 2010 annual growth of retail sales fluctuated close to zero, which still amounted to a certain progress, taking into consideration its recent declines (by approx. 10% y/y). However, it still remains lower than it was before the crisis.

In the first three quarters of 2010, industrial output in Slovakia maintained its upward trend, commenced in the second half of 2009. Moreover, in October 2010, it returned to the level before the outbreak of crisis. Sentiment among Slovak entrepreneurs also improved, as is reflected by the increasing ESI (*Economic Sentiment Index*), calculated by the EC. In November 2010, the index approached the level of long-term average.

In its last forecast, prepared on the basis of data for Q3 2010, the National Bank of Slovakia anticipates that GDP increased by 4.2% over the entire 2010, i.e. by the same amount as in the first three quarters of the preceding year. This means that in spite of the fact that in Q4, the country's economy most likely accelerated as compared to the previous quarter, the scale of this growth proved insufficient to compensate for lower GDP pace in Q3 last year, resulting from negative contribution of net exports.

Labour market

In the first half of 2010 unemployment rate in Slovakia increased to 14.5%, from 14.1% in Q4 2009. In Q3 2010, it rose by another 0.1 pp and eventually reached 14.7% in October.

Considerable percentage of long-term unemployed (i.e. those unemployed for at least a year), which is one of the highest among all EU states, remains the most serious issue of Slovak labour market. According to the latest Eurostat data, in Q2 2010, persons aged 20-64 and remaining outside the labour market constituted as much as 64% of all unemployed in Slovakia. On the one hand, this indicates a discrepancy between qualifications of workers and the needs of the local labour market, which has been visible for a long period of time; on the other hand, it suggests that the unemployment rate in

Slovakia, anticipated in the following several years, will not fall to one-digit level without introduction of appropriate structural reforms.

Employment decline in Slovak economy decelerated in the first half of 2010, when the number of employed decreased by 2.7% y/y, whereas in Q4 2009 it was lower by 4.0% y/y. Clear cutting down on the scale of employee reduction has been observed in the industry sector, where employment dropped on average by 5.9% in the first two quarters of 2010 y/y as compared to the decrease by 10.6% y/y in the second half of 2009.

Inflation and labour costs

In the first two months of 2010, the annual HICP inflation in Slovakia remained negative (-0.2%); in March, it reached 0.3% and ever since then has recorded positive values. In subsequent months, growth rate of consumer goods prices accelerated to 0.7% y/y. In the abovementioned period, the inflation was primarily affected by higher food prices (5.2%), resulting mainly from the base effect, related to a considerable drop in these prices in 2009. In the second half of 2010 inflation in Slovakia increased to 1.0% y/y. Similarly to the six first months of 2010, in the second half of this year, growth in consumer goods prices was mainly attributable to food, whereas prices of other goods and services (mainly energy carriers and housing) maintained a downward trend. It is expected that over the entire 2010, HICP inflation will amount to 0.7%. Core inflation, i.e. after excluding the prices of energy, food, alcoholic beverages and tobacco products, remained at a stable level in the second half of 2010 (0.4% y/y).

In spite of the fact that the situation in Slovak labour market was still difficult in 2010, growth of nominal and real wages remained positive and close to 2009 level. In the first half of 2010 average monthly wages in Slovak enterprises rose by 2.8% y/y in nominal and by 2.0% in real terms. In Q3 2010, wages of Slovak employees increased faster — by 3.7% y/y and 2.6% y/y in current and constant prices, respectively. An increase in wages was noted almost in all sectors of the economy, except for agriculture, mining and some groups of services.

Table 9.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**0.0**	**0.0**	**0.7**	**1.1**	**1.0**
Contribution to HICP growth rate (in pp)					
Food and beverages	-1.0	-0.5	0.2	0.6	0.9
Other	0.1	0.1	0.1	0.1	0.2
Alcoholic beverages and tobacco products	0.5	0.4	0.4	0.4	0.1
Restaurants and hotels	0.2	0.1	0.1	0.1	0.1
Health	0.4	0.3	0.2	0.2	0.1

source: Eurostat

Balance of payments

The first half of 2010 saw further decrease in current account deficit in Slovakia, both in nominal terms (by 40% as compared to corresponding period of the previous year) and in relation to GDP (to -2.4%, from -2.9% at the end of 2009). It was due to the surplus in trade in goods and services, whose positive impact was not diminished by negative balances of other components of the current account, i.e. income and current transfers.

Table 9.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-3.8**	**-2.9**	**-2.3**	**-2.4**	**-2.7**
Goods	0.3	1.5	2.1	2.1	1.5
Services	-1.6	-1.8	-1.6	-1.5	-1.4
Income	-1.6	-1.8	-2.1	-2.3	-2.1
Current transfers	-0.9	-0.9	-0.7	-0.7	-0.8
Capital account	**1.7**	**1.4**	**1.4**	**1.3**	**1.8**
Financial account	**4.1**	**3.9**	**3.3**	**0.5**	**0.9**
FDIs	0.0	-0.6	-0.5	0.7	0.8
Portfolio investments	-1.6	-1.4	-3.3	-3.5	-2.8
Other investments	5.6	6.0	7.1	3.4	2.9

source: Eurostat

The period between January and August 2010, unlike in 2009 and in the years preceding the global economic crisis, saw an outflow of net foreign capital from Slovakia. It resulted mainly from of the outflow of portfolio capital, resulting on the one hand from sale of Slovak government bonds by foreign investors, and on the other hand — from increased investment of Slovak residents in foreign debt instruments. As for both direct investments and other investments, an inflow of capital has been observed, although its scale was insufficient to compensate for the outflow of capital due to portfolio investments.

Fiscal policy

general government deficit forecast in 2010 was raised by the Slovak government in the middle of last year from 5.5% of GDP to 7.8% of GDP due to, among others, anticipated deterioration of local government balance resulting from floods and high expenditure on projects co-financed by the EU and capital injections made by central government to certain state enterprises.

At the beginning of September 2010, the leaders of the four coalition parties adopted a consolidation package, aimed at reduction of the budget deficit in 2011 by approx. 2.4 pp of GDP. Measures on the expenditure side include state budget spending cuts by 10% (among other things wages, except for teachers) and savings due to improved efficiency of the public procurement system. Changes on the revenue side concern increase in VAT rates (from 19% to 20%[43]), excise duty[44] as well as abolition of certain tax exemptions and lump sum

[43] VAT for meat, fish, milk, eggs and honey increase from 6% to 20%. The VAT reduced rate of 10% applied to books and pharmaceuticals remained unchanged.

[44] Beer, cigarettes and fuel used for agricultural purposes. Moreover, excise duty in 2011 will cover CNG, used as fuel for automobiles, and reliefs for bio-components in motor fuels are to be abolished.

reduction in PIT. Moreover, the package provides for, among others, introduction of new charges for state material reserves and the National Energy Fund, as well as increase in highway tolls. According to the budget act, the general government deficit in 2011 will amount to 4.9% of GDP as compared to 7.8% of GDP in 2010.

The EC estimates that in 2011 and 2012, the scale of budget deficit reduction in Slovakia, apart from Romania, will be the highest among the CEE countries(approx. 3.2 pp of GDP). However, the deadline to correct excessive deficit procedure (2013) would not be met. The public debt, within the time horizon of the EC forecast, will be considerably lower than the 60% of GDP reference value. In 2012, it is to amount to 47.4% of GDP as compared to 42.1% of GDP in 2010.

Forecasts

According to the forecast published in December 2010 and based on data for Q3 last year, the National Bank of Slovakia anticipates that in 2011 and 2012, the economy will develop slower than in the previous year. It is expected that real GDP will grow by 3.0% in 2011 and by 4.0% in 2012. Lower anticipated growth of Slovak economy will result primarily from implementation of the public finance consolidation scheme, involving reduction of budget expenditure on the one hand and increase in income tax on the other hand, which should have even more effect on the already weak consumer demand of Slovak households. Although the latest forecast does not differ substantially from the previous one (from September 2010) with respect to the direction and growth of GDP, the two forecasts exhibit considerable discrepancies when it comes to the assessment of the impact of public finance consolidation on economic growth. Currently, this factor constitutes the main risk, indicating the possibility of even lower growth rate of Slovak economy than the one specified in the forecast. The main driving force of economic growth in Slovakia in 2011 will be net exports, mainly due to the expected high growth of exports volume. On the other hand, fixed capital formation will continue to drag on the Slovak economy. However, the reversal of this trend is expected as soon as in 2012, which should translate into positive contribution to GDP growth. The role of consumer demand in stimulating Slovak economy will also increase. Taking the above into account, it should be expected that contribution of net exports to GDP will decrease.

With respect to inflation in 2011 and 2012, the National Bank of Slovakia anticipates that as compared to the previous year, the consumer goods prices will rise by 3.9% and 2.6%, respectively. The above forecast is based on two main assumptions: that in the forecast horizon euro will gradually depreciate against the dollar, which will translate into increased prices of import goods, and that global prices of agricultural raw materials will increase, which will result in higher food prices on domestic market. Additionally, increased inflation in Slovakia will be impacted by the announced increase in VAT and other charges, which, according to central bank's calculations , should translate into growth of the general level of prices by 1.0 and 0.1 pp in 2011 and 2012, respectively. The balance of risk for the inflation forecast, on the other hand, remains relatively stable.

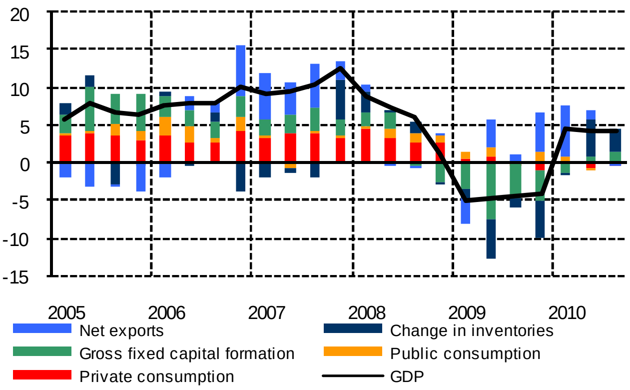
Table 9.4

Forecasts of main macroeconomic indicators

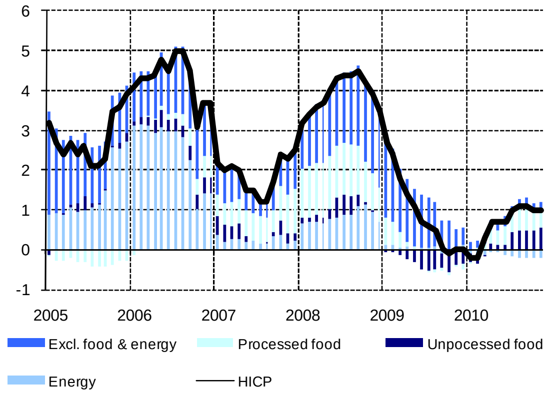
	NBS	EC	OECD	IMF
	12.2010 (06.2010)	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	4.2 (3.7)	4.1 (2.7)	4.1 (3.6)	4.1 (4.1)
2011	3.0 (4.3)	3.0 (3.6)	3.5 (3.9)	4.3 (4.5)
2012	4.0 (4.4)	3.9	4.4	4.4 (4.4)
Inflation, in %, y/y				
2010	0.7 (0.8)	0.7 (1.3)	0.8 (0.8)	0.7 (0.8)
2011	3.9 (2.7)	3.2 (2.8)	3.4 (2.2)	1.9 (2.0)
2012	2.6 (2.9)	2.8	2.9	2.4 (2.4)
Current account balance, in % of GDP				
2010	-3.1 (-3.3)	-2.9 (-4.5)	-3.1 (-0.9)	-1.4 (-1.8)
2011	-1.3 (-2.0)	-1.9 (-4.1)	-0.9 (-3.0)	-2.6 (-1.9)
2012	-0.4 (-0.9)	-1.7	-0.3	-2.5 (-1.8)

NBS – Medium Term Forecast, Národná Banka Slovenska

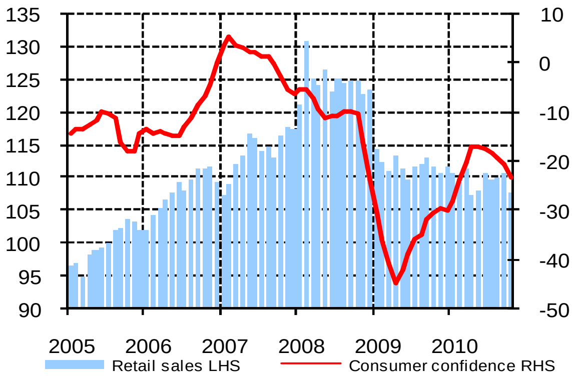
Contribution to GDP growth (in pp, y/y)



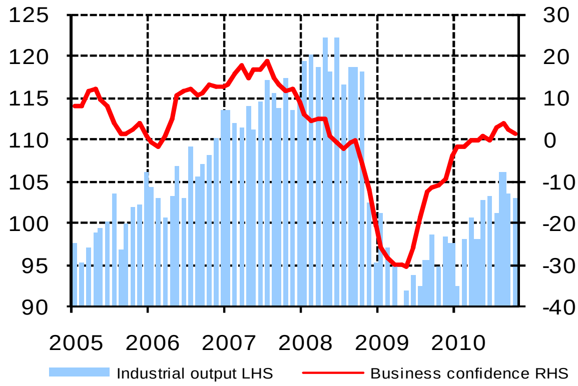
HICP and its components (in %, y/y)



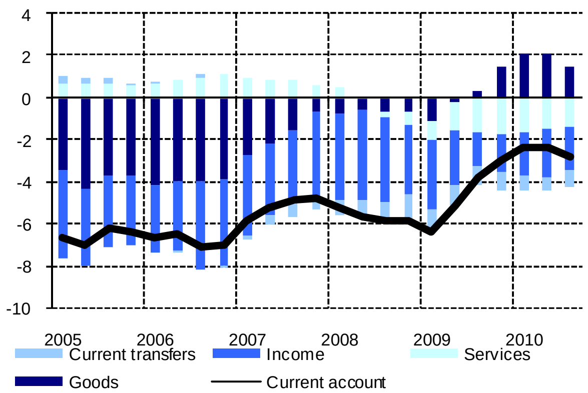
Retail sales (in %, y/y) and consumer sentiment index



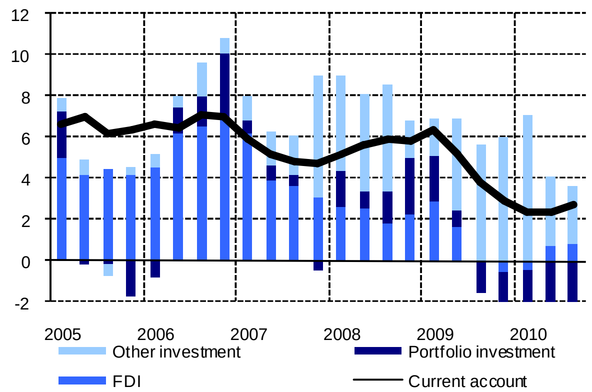
Industrial production (in %, y/y) and business sentiment index



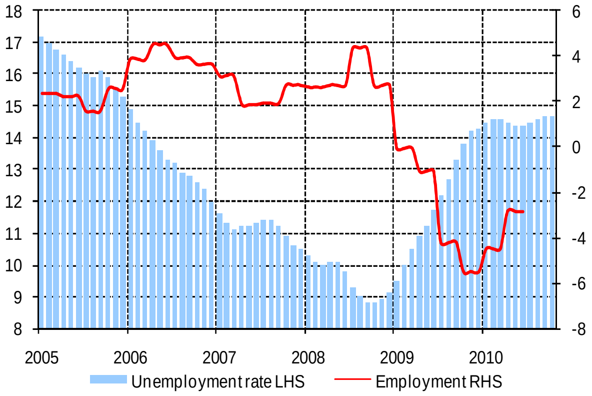
Current account and its components (in % of GDP, 4-quarter moving average)



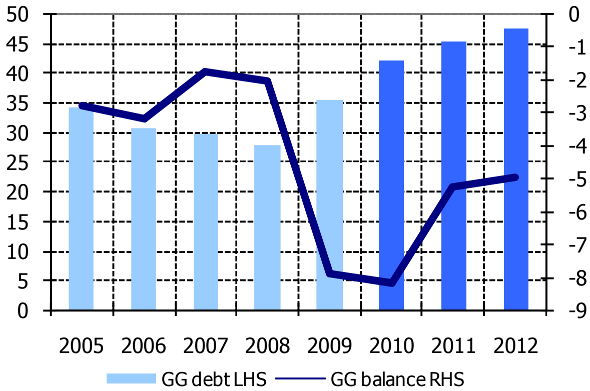
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVENIA

Economic growth

After a severe decline in economic activity in 2009, the recovery in Slovene economy has been very slow. Positive GDP growth, achieved in the first three quarters of 2010 (1.3% y/y) was mainly the result of increased demand from the Slovenia's major trade partners. Domestic demand, on the other hand, continued to decrease, although the scale of decline was smaller than in 2009.

Table 10.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**3.5**	**-7.8**	**-0.2**	**1.4**	**1.3**
Private consumption	2.2	-1.4	-0.7	-0.3	-0.4
Public consumption	3.7	3.1	0.9	0.7	0.1
Fixed capital formation	6.2	-21.6	-6.9	-6.2	-8.9
Exports	3.3	-15.6	5.7	10.0	10.5
Imports	3.5	-17.9	4.1	9.1	4.7

source: Eurostat

2010 was likely the second year in a row to have observed lowered household expenditure as compared to the preceding year, which resulted mainly from adverse labour market conditions as well as maintaining restricted access to loans. This, in turn, was reflected in particular in the clear decline in demand for durable goods. However, the increase in private consumption in Q3 2010 (on quarterly basis) may indicate the reversal of the downward trend in consumption.

Severe declines in fixed capital formation, in turn, are still observed due to deteriorating housing market and considerable drops in infrastructural investments. Given this situation, value added in construction in Q3 2010 decreased below the level from 2005, i.e. from before the beginning of the construction boom. Supply in the real estate market still exceeds demand (in spite of a clear increase in mortgage loans) and according to the Bank of Slovenia, prices of apartments have decreased by c.a. 15% since 2008. Q2 and Q3 2010, in turn, saw an increase in enterprise expenditure on machinery and equipment, which resulted to a large extent from the low base effect last year (when these spending experienced a particularly severe drop). On the other hand, this growth also reflects improved expectations of Slovene and foreign entrepreneurs.

Due to increased foreign demand, accompanied by further decline in domestic demand, exports growth in 2010 remained higher than growth in imports. Exports, which in the second half of 2009 experienced a clear upward trend, continued high growth in the first half of 2010. However, Q3 saw a decrease in exports growth on quarterly basis, which was attributable to a certain decline in foreign demand during this period, in particular in the countries of the euro area. Although imports have maintained upward trend since early 2010 due to increased import of capital and intermediate goods (caused by higher demand in the exports sector as well as by rebuilding of inventories). An upward trend in inventories was halted in Q3 2010. Because of weak internal demand, inventories played a smaller role in the recovery of economic activity in Slovenia as compared to the majority of other CEE countries.

A n increase in industrial output, observed since early 2010, resulted from higher output in export-oriented sectors. This growth was high enough to compensate for continuing declines in domestic market oriented sectors. It was also reflected in the increased production capacity. However, Q3 2010 saw weakening of the upward trend in industrial output. The most severe decline was observed in production of cars due to expiry of subsidies for purchase of new vehicles, applied in many countries of Western Europe in 2009 and 2010. The highest growth, on the other hand, concerned the production of intermediate goods, related to reconstruction of production networks in the CEE region. Lower inflow of new orders to Slovene industry indicates that deceleration of the pace of output growth was also experienced in Q4 2010. Orders from the euro area tended to stagnate, while domestic orders continued to decline. An increase was noted in orders from outside the euro area (with the strongest increase observed from other former Yugoslavian states).

In late 2010, entrepreneurs showed moderate optimism. After a period of stagnation, they expect inflow of new orders to increase in 2011, which in turn will impact the growth of investments. As a consequence, they also expect the level of employment to stabilise.

2010 did not bring any improvement in consumer sentiment. While its indicators slowly grew in the first half of the last year, they dropped again in the following months. The estimation of the current situation slightly improved, both for households and with respect to the country's general economic conditions. The situation on the labour market, however, is assessed extremely negatively. Increasing concerns of Slovenes were expressed in lower sub-indices of expectations. Consumer sentiment was reflected in the value of retail sale, which stabilised at a low level after its considerable drop in early 2009.

Labour market

Labour market conditions deteriorated throughout 2010. According to Eurostat, unemployment rate in October 2010 reached 7.6% (the highest level since at least 1996) as compared to 6.4% in late 2009. However, in Q3 2010, unemployment growth was significantly dampened due to an increase in the number of part-time employees. Another indication of slow stabilisation in the labour market is an increase in temporary employment.

The number of employed in the economy fell in the first three quarters of 2010 by 2.3% as compared to the preceding year (1.9% drop in 2009). However, in Q2, the decrease in employment on quarterly basis was halted as a result of increased number of jobs in the manufacturing sector. At the same time, Slovene government continued measures aimed at alleviating the decline in employment. Yet, the scale of these measures was smaller than in 2009 (they covered 1.7% of all jobs in 2010 as compared to 4.6% in 2009). As a result of the state's intervention, the drop in labour activity in Slovenia was less severe than in other CEE countries.

Wage growth remained at a level similar to 2009. According to preliminary estimations, nominal wages in Slovene economy increased by 3.5% between November 2009 and October 2010. In the first half of 2010, the increase in wages in the private sector was influenced by higher minimum wage. In spite of expectations that enterprises would gradually increase minimum wages, the increase covered 70% of employees receiving minimum wage already in the first half of 2010. In the same period, mean wage in the private sector rose by 4.5% on nominal basis. However, wage growth rate decreased significantly in the public sector (to 0.0% as compared to 6.6% in 2009) due to temporary freezing of some of its components.

Inflation and labour costs

In 2010, average annual inflation, measured with harmonised index of consumer prices (HICP) fell to 1.8% (as compared to 2.3% in 2009). Prices of energy were decisive when it comes to the level of inflation. In Slovenia, they grew due to both increased fuel prices on global markets and increased excise tax. Core inflation, in turn, remained negative practically throughout 2010, with the scale of its decline deepening during the second half of the year. The main causes of a decline in core inflation include weak economic activity, low consumption and decreased growth of labour costs in some sectors. Lower core inflation was primarily due to decreased prices of durable goods (in November 2010, they were more than 5% lower than in November 2009). Increased prices of food and other commodities as well as increases in excise duty did not have significant effect on growth of retail prices, which can be explained by low consumer demand.

Table 10.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**1.4**	**1.7**	**2.4**	**2.3**	**1.6**
Contribution to HICP growth rate (in pp)					
Housing	0.2	0.9	1.2	1.2	0.8
Alcoholic beverages and tobacco products	0.4	0.4	0.4	0.4	0.4
Food and beverages	-0.2	-0.2	0.1	0.4	0.3
Health	0.0	-0.1	0.0	0.1	0.2
Transport	0.3	0.6	0.4	0.0	0.1

source: Eurostat

Balance of payments

In 2010, the current account deficit continued to narrow. After Q3 2010, it diminished to mere 0.4% of GDP (as compared to 3.5% after Q3 2009). Decrease in current account deficit was primarily affected by diminishing deficit in goods, mainly due to low level of domestic demand[45]. Other categories of the current account also worked towards the lowering of the deficit. Income account improved significantly primarily due to a drop in reinvested income and remittances outflow. On the other hand, income of non-residents on investments in government bonds increased. Lower current transfers deficit resulted primarily from decreased transfers in the government sector. The relatively smallest change took place in services, which was related to similar exports and imports growth. Deep declines continued in construction services.

Table 10.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-3.4**	**-1.5**	**-0.9**	**-1.2**	**-0.4**
Goods	-3.2	-2.0	-1.9	-2.3	-2.1
Services	3.2	3.1	3.1	3.1	3.3
Income	-2.5	-2.2	-2.0	-1.8	-1.6
Current transfers	-0.9	-0.4	-0.2	-0.2	0.0
Capital account	**0.0**	**0.0**	**0.1**	**0.0**	**0.1**
Financial account	**2.1**	**0.6**	**0.8**	**1.7**	**1.6**
FDIs	-0.4	-1.5	-1.6	-0.3	0.0
Portfolio investments	15.6	13.1	13.7	11.8	5.1
Other investments	-3.4	-1.5	-0.9	-1.2	-0.4

source: Eurostat

At the same time, financial account surplus decreased, primarily due to reduced inflow of portfolio investments. Balance of direct investment. On the other hand, FDI balance improved (since early 2010, the decrease in FDI inflow has been halted, while the decline of Slovene investments abroad was continued). Moreover, after a strong drop in 2009, deposits of non-residents in Slovene banks stabilised and increased exports caused outflow of capital in the form of trade credits.

Fiscal policy

In mid 2010, due to lower than anticipated execution of tax revenues (especially on CIT), Slovenia revised the budget act. Forecast regarding state budget revenue was decreased by approx. 1.5% of GDP and was followed by the expenditure cuts on a similar scale (among others, related to wage reductions and postponement of investment expenditure). Slovene authorities anticipate that general government deficit in 2010 will amount to approx. 5.6% of GDP, i.e. level similar to 2009. The end of 2010 saw the adoption of a pension reform, providing

[45] In the first three quarters of 2010, exports grew faster to EU states, whereas imports increased at a higher rate from other countries. As a result, negative balance of turnover with other EU states diminished, while positive balance in exchange with third countries decreased.

for the gradual increase in retirement age and its equalisation for men and women, abolishment of early retirement and change of pension benefits formula.

Slovene government expects the fiscal deficit to reach 4.5% of GDP in 2011 and 3.6% of GDP in 2012. Adopted measures include, among others, reduced indexation of pension, disability and social benefits as well as a wage cuts in state administration by 5%. Expiration of the anti-crisis package also contributes to expenditure decrease.

The EC forecasts that the scale of general government deficit reduction in Slovenia in 2011 and 2012 will be smaller than estimated by the government (approx. 1.1 pp of GDP as compared to 2 pp of GDP). Measures taken by Slovenia will therefore be insufficient to reduce the fiscal imbalance below 3% ceiling in 2013.

Forecasts

In 2011 and 2012, the moderate acceleration of economic growth in Slovenia will continue. In October 2010, the Bank of Slovenia (BS) expected GDP to grow by 1.9% in 2011 and by 2.9% in 2012. Unlike in other CEE countries, which forecasts regarding economic growth rose in the second half of 2010, these remained practically unchanged. Moreover, according to the European Commission, during two upcoming years, Slovenia will be the slowest growing economy in the region.

Low GDP growth will primarily result from low households expenditure, due to further decrease in employment. BS expects that employment in 2011 will drop by 0.3% (and therefore it will be the third year of decline in a row). Conditions on the labour market will be adversely affected by the end of governmental programme for jobs protection. Additionally, consumption growth will be deteriorated by fiscal policy consolidation (however, to reduce its consequences on demand, the government has spread the measures until 2013). Nevertheless, the expected wage growth should slightly alleviate the impact of decreased unemployment on consumption. It is expected that investments — in particular, in machinery and equipment — will rise slightly faster than household expenditure. On the other hand, further decline in the construction sector is expected at least until mid 2011.

In the conditions of weak domestic demand, net exports will probably remain the main factor contributing to economic growth (+0.9 pp in 2011). However, exports growth will probably decrease due to low economic growth in the Slovenia's major trade partners (caused, on the one hand, by expiry of stimulation effects and on the other hand — by fiscal consolidation in these countries). Lower exports growth will, at the same time, contribute to weaker demand for imported intermediate goods which played the biggest role in imports growth in 2010. Slightly lighter deceleration of imports growth will affect the minor deterioration of the current account deficit.

In spite of the expected further increase in the prices of food (which will be due to, among others, higher excise duty on tobacco) and energy, the level of inflation will be relatively stable during two upcoming years. Core inflation will reflect low growth of consumer demand.

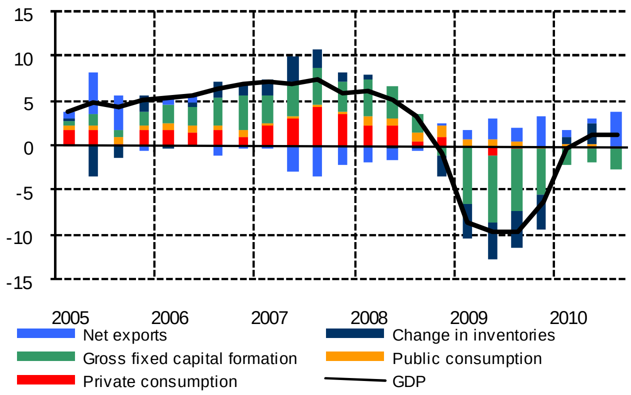
Table 10.4

Forecasts of main macroeconomic indicators

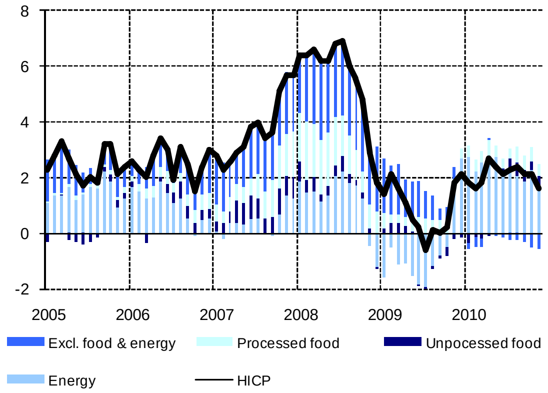
	BS	EC	OECD	IMF
	10.2010 (04.2010)	11.2010 (05.2010)	11.2010 (05.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	1.1 (1.3)	1.1 (1.1)	1.1 (1.4)	0.8 (1.1)
2011	1.9 (1.8)	1.9 (1.8)	2.0 (2.4)	2.4 (2.0)
2012	2.9 (2.9)	2.6	2.7	3.0 (2.8)
Inflation, in %, y/y				
2010	2.3 (1.6)	2.1 (1.8)	2.1 (1.9)	1.5 (1.5)
2011	2.1 (1.4)	2.0 (2.0)	1.9 (1.3)	2.3 (2.3)
2012	2.0 (2.0)	2.2	2.2	2.5 (2.5)
Current account balance, in % of GDP				
2010	-1.1 (-0.5)	-0.7 (-1.4)	-2.8	-0.7 (-1.5)
2011	-1.7 (-1.4)	-0.6 (-1.6)	-3.9	-0.7 (-1.2)
2012	-2.2 (-2.3)	-0.8	-4.5	-0.9 (-0.6)

BS - Price Stability Report, Banka Slovenije.

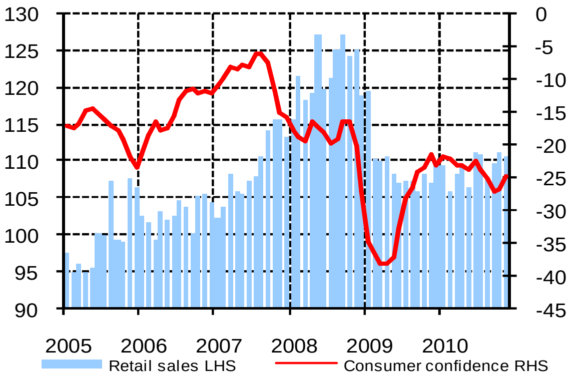
Contribution to GDP growth (in pp, y/y)



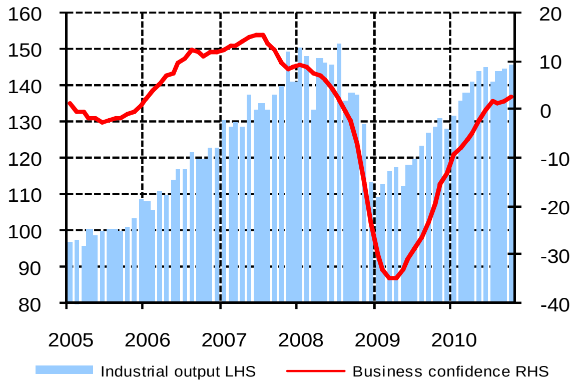
HICP and its components (in %, y/y)



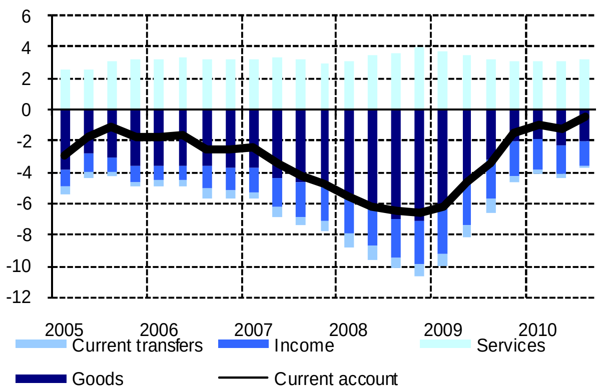
Retail sales (in %, y/y) and consumer sentiment index



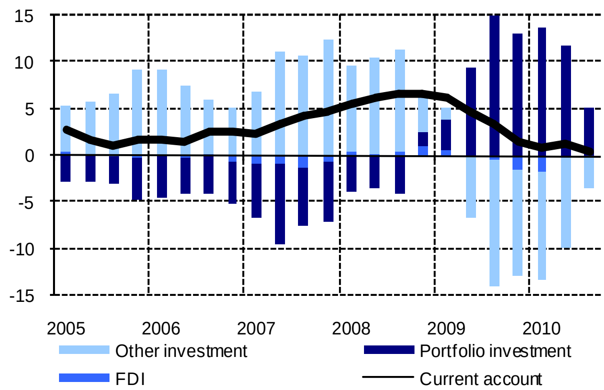
Industrial production (in %, y/y) and business sentiment index



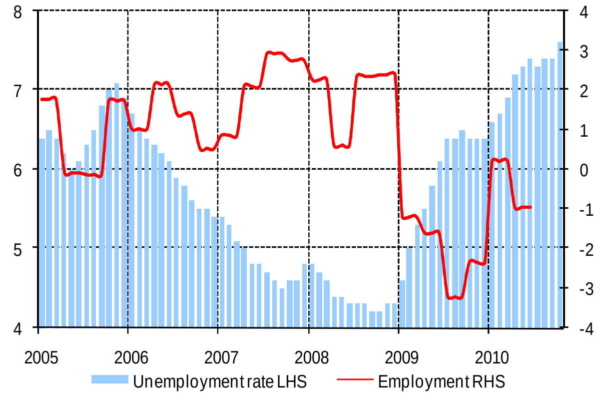
Current account and its components (in % of GDP, 4-quarter moving average)



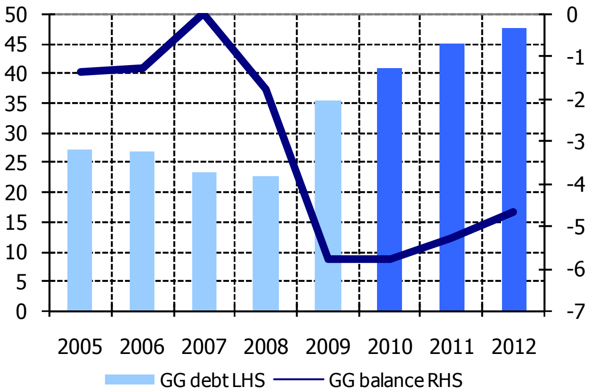
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

HUNGARY

Economic growth

After six quarters of decline, Hungary only recorded positive economic growth (0.6% y/y) in Q2 2010; in the following quarter, GDP growth accelerated even more (2.2% y/y). Increased economic activity resulted from growing foreign demand, connected with the ongoing gradual recovery in Hungary's major trade partners, i.e. EU countries[46], mainly Germany. This was reflected in two-digit growth rate of export volume of goods and services in the first three quarters last year, which additionally increased faster than imports. As a consequence, net exports had positive contribution to GDP growth in Hungary between January and September 2010.

The observed high growth of Hungarian exports resulted to a large extent from improved economic activity in EU member states, although it should be noted that this was partially due to dynamic development of third countries, including Asian emerging markets[47]. The above statement is supported by data concerning Hungary's foreign trade with euro area countries, which show that between January and October 2010, the fastest growth of export volume was observed for both intermediate and investment goods, which may be interpreted as increased intermediate and investment import of euro area, related to high demand from Asian developing economies.

Table 11.1

Contribution to GDP growth (in %, y/y)

	2008	2009	Q1 2010	Q2 2010	Q3 2010
GDP	**0.6**	**-6.3**	**-1.1**	**0.6**	**2.2**
Private consumption	-0.5	-7.6	-4.1	-4.0	0.2
Public consumption	0.7	-1.1	-0.6	-0.7	1.1
Fixed capital formation	-2.6	-6.5	-5.2	-4.8	-3.3
Exports	4.8	-9.1	15.2	15.7	13.8
Imports	4.7	-15.4	10.3	14.3	12.9

source: Eurostat

Domestic demand, including mainly investment demand, remained low. Fixed capital formation continued a downward trend in the first three quarters 2010. Although the scale of its decline decreased by nearly a half, as compared to the corresponding period in 2009, there are still no visible signs of improvement. Similarly, the analysis of quarterly changes in fixed capital formation indicates continuation of declines. Additionally, the results of surveys conducted among Hungarian enterprises show that the capital utilization in Q3 last year was still below long-term average, which may indicate that in the nearest future there will still be no need to increase expenditure on the expansion of the existing production capacity.

Consumer demand so far also does not show signs of permanent improvement, although in this case it is possible that recovery will be observed sooner. Although annual growth of private consumption was negative between January and October last year, on quarterly basis, Hungarian households spent more and more on consumption (with the exception of Q2 last year, when private consumption decreased). Moreover, data concerning retail sales indicate that the upward trend is continuing, which may mean that consumer demand is gradually stabilising. Improved consumer sentiment, observed since early 2010, was halted at the end of the year due to increased expectations of deterioration on domestic labour market as well as of future economic situation in Hungary.

Forecast of the National Bank of Hungary (MNB), published at the beginning of December 2010 and prepared on the basis of data available until the end of November last year, indicates that throughout 2010, GDP growth will have amounted to 1.1%, which would mean that in Q4 last year, the country's economy developed at a pace similar to the previous quarter.

Labour market

In the first half of 2010, unemployment rate in Hungary reached its maximum level (11.3%), after which it dropped to 10.9% in Q3. Available monthly data indicate that in October and November last year, the unemployment rate decreased even more, which may suggest its gradual stabilisation, albeit at a high level.

It also indicates that the decline in employment decelerated in the first two quarters of 2010, especially in the industry sector. On the other hand, in the services sector, the number of new jobs has been gradually growing since the beginning of last year.

Inflation and labour costs

Since early 2010, HICP inflation remained clearly above the medium-term inflation objective of MNB, set at 3.0% y/y. It was mainly the result of fast-growing global energy prices, which, accompanied by simultaneous weakening of the forint's exchange rate against the US dollar, translated into two-digit increase in energy carriers prices in the first half of last year (13.3%). Although July last year saw a decrease in inflation to 3.6% (as compared to 6.2% in January last year)[48], in subsequent months, it rose again due to soaring food prices. Growth in energy prices remained at a high level,

[46] EU Member States make up for approx. 80% of Hungarian exports, whereas euro area states on their own — for as much as 60%.

[47] Although the value of exports to Asian countries increased considerably between January and October 2010 (42%), taking into account their relatively low share in Hungary's foreign trade (below 5%), it did not translate visibly into the general growth of exports in Hungarian economy.

[48] It resulted from the expiry of base effect, related to an increase in intermediate taxes in July 2009.

although it slightly decelerated as compared to the first six months of 2010. Additionally, growth in food prices accelerated rapidly, particularly in the case of non-processed food. The central bank estimates that throughout 2010, HICP inflation in Hungary amounted to 4.9%.

Core inflation (after excluding the prices of energy, food, alcoholic beverages and tobacco products) also remained at a high level in the first half of last year due to persisting base effect, connected with the increase in intermediate taxes in mid 2009, after which it clearly decreased in the subsequent months.

Table 11.2

HICP and its components (in %, y/y)

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Nov 2010
HICP	**4.9**	**5.8**	**5.2**	**3.6**	**4.0**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.4	0.3	-0.1	0.7	1.3
Transport	1.0	2.1	2.0	1.2	1.1
Housing	0.8	0.7	1.1	0.7	0.7
Alcoholic beverages and tobacco products	0.8	1.0	0.9	0.6	0.4
Health	0.3	0.3	0.3	0.2	0.1

source: Eurostat

In spite of adverse conditions in the labour market, wages grew at a moderate pace in 2010. Monthly data indicate that between January and October last year, average wages of Hungarian employees increased by 2.3% y/y. Their growth was the highest in Q1 last year, after which it decelerated slightly in the following two quarters. The biggest increase in wages was observed in wholesale and retail trade (6.5% y/y), industry (5.7% y/y) and the financial services sector (3.9% y/y).

Balance of payments

After three quarters of 2010, a surplus of 1.3% of GDP appeared on the current account in Hungary, as compared to the deficit recorded at the end of 2009 (-0.5% of GDP). It resulted from increased positive balance of trade in goods and services. Balances of income and current transfers, on the other hand, remained at levels seen so far.

Between January and September last year, foreign capital inflow to Hungary continued, although its scale diminished significantly as compared to the levels from 2009. The decline was to a large extent due to withholding of subsequent tranches of financial aid, granted to Hungary in 2008 by the International Monetary Fund, World Bank, European Commission and governments of some EU member states. The decision to stop granting subsequent tranches of aid was caused by termination of negotiations with the IMF by the new Hungarian government, who did not want to agree to further cuts in budget expenditure, taking into account the already difficult economic situation of the country[49].

Table 11.3

Balance of payments, net balance (in % of GDP, 4q moving average)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Current account	**-2.7**	**-0.5**	**0.8**	**1.2**	**1.3**
Goods	2.2	3.6	4.3	4.4	4.6
Services	1.2	1.5	1.9	2.2	2.3
Income	-6.1	-5.9	-5.9	-5.9	-6.0
Current transfers	0.0	0.4	0.4	0.5	0.4
Capital account	**1.9**	**1.3**	**1.4**	**1.4**	**1.5**
Financial account	**14.0**	**5.2**	**3.6**	**5.6**	**1.6**
FDIs	0.4	-0.2	-1.2	-0.3	0.6
Portfolio investments	-6.6	-2.8	2.9	2.7	-1.3
Other investments	20.1	8.2	1.9	3.2	2.3

source: Eurostat

Interest rates and exchange rate

In the first four months of 2010, the National Bank of Hungary continued to cut its main interest rate, commenced in November 2008, eventually bringing it down to 5.25% in April last year. This interest rate remained unchanged until October; in November and December, the Hungarian Monetary Policy Council resolved to increase the main rate, in both cases, by 25 bp. This was dictated, on the one hand, by fast increase in consumer goods prices in Hungary in 2010, while on the other hand — by expectations that inflation will remain above the medium-term objective of the central bank over the forecast horizon, especially in 2011.[50]

Nominal rates in the interbank market remained nearly throughout 2010 above the main rate of the bank of Hungary, reflecting yields of two-week bills issued by the bank. The exceptions were May and June, when monetary authorities concluded the cycle of cuts, and November and December, when the phase of hikes begun. They fell in the first months of last year and started to grow gradually from June, eventually reaching the level of 5.70% at the end of the year.

In the wake of new information concerning fiscal problems of the so-called peripheral countries of the euro area (Greece, Ireland, Portugal and Spain), first months of 2010 saw, on the one hand, strengthening of CEE countries' currencies — including the forint — against the euro and weakening against the U.S. dollar on the other hand. It was due to the fact that investors, withdrawing

[49] The new Hungarian government, elected in 2010, decided in July not to continue the negotiations concerning prolonging of financial aid from international institutions under the leadership of the IMF. The main reason for terminating these negotiations were discrepant positions when it came to the manner of reducing the public finance sector deficit. According to the IMF, the temporary adjustments on the income side, proposed by Hungary, did not ensure stabilisation of the deficit at a low level, whereas the Hungarian government did not want to agree to further cuts in public expenditure. The factor enabling Hungary to resign from the help of financial institutions was also stabilisation in the financial markets, which after the crisis allowed for renewing the financing of expenditure with issue of bonds.

[50] Due to the conflict which had arisen between the new Hungarian government and the National Bank of Hungary, it cannot be ruled out that decisions concerning the increases in interest rates had also political basis.

capital from endangered euro area countries, invested it mainly in assets denominated in USD, but also — albeit on a far smaller scale — in the European emerging markets. The appreciation of the forint, however, did not last long since already May last year saw, along with subsequent signals indicating the deterioration of fiscal conditions in the peripheral countries, flight into U.S. assets and simultaneous sale of emerging markets currencies. This, in turn, was accompanied by internal problems in Hungary (including termination of negotiations concerning prolonged aid from IMF and introduction of solutions unsupported by international institutions). Since that moment, the Hungarian currency started to weaken substantially against the euro. Only in October last year did the declines of the forint decelerate, after which the Hungarian currency began to stabilise until the end of 2010.

Fiscal policy

Under conditions of the EU and IMF financial assistance package, Hungary pledged to reduce the general government deficit in 2010 to 3.8% of GDP as compared to 4.4% of GDP in 2009. Statements made by the representatives of the new government, concerning significant deepening of fiscal imbalance in 2010, as well as critical assessment of the conditions of Hungarian economy sparked negative reactions on financial markets. In response, the Hungarian government presented at the beginning of June last year details of plan aimed at keeping fiscal deficit below 3.8% of GDP. It contained, among others, special levies on financial institutions and gradual income taxes[51] rate reductions, as well as expenditure cuts (cap on amount of wages and severance payments in public administration and state enterprises and a 15-% wage cuts in public sector). Certain laws related to above mentioned proposals were enacted in subsequent months of last year. Additional measures taken included freezing of budget reserves (approx. 0.4% of GDP) and spending items of individual ministries and state agencies (approx. 0.2% of GDP).

The cornerstone of budget deficit reduction in 2011 and 2012 are the changes to pension scheme adopted at the end of 2010 and resulting in actual abolishment of the private pension funds (suspension of contributions transferred to second pillar of pension scheme[52] since November last year — approx. 0.2% of GDP in 2010 and 1.3% of GDP in 2011, lack of entitlement to pension from the PAYG scheme in the case of decision to continue membership in funded pension scheme). The value of private pension funds' assets is estimated at approx. 10% of GDP[53]. Moreover, late 2010 saw the introduction of special temporary taxes imposed on the energy, banking and telecommunications sectors and retail chains (from November 2010 until the end of 2012; approx. 0.6% of GDP per annum). These measures, together with other actions taken by Hungarian authorities (including the limiting independence of the central bank, the Hungarian Budget Council, elimination of the option to appeal to the Constitutional Court against laws affecting budget revenue) sparked a negative reaction of financial markets and concern of the EC.

The EC forecast from November last year indicates that fiscal imbalance in Hungary will increase from 3.8% of GDP in 2010 to 6.2% of GDP in 2011, although it does not take into account full effects of changes related to the funded pension pillar. Due to temporary positive impact of changes in the pension scheme on the general government balance and adopted tax reductions (including introduction of flat PIT rate and reduction of CIT rate), in subsequent years it will be necessary to take additional consolidation measures. The Hungarian government announced that at the end of February this year, it would present a package including approx. 100 proposals reducing the level of expenditure (e.g. in the healthcare sector, Labour Fund, and on public transport). Savings related to their implementation are estimated at approx. 2.0%-2.7% of GDP in 2012 conditions.

Forecasts

The Bank of Hungary, in its forecast from December 2010, anticipates that in 2011 and 2012, the country's economy will clearly accelerate as compared to 2010. GDP growth, according to the latest forecast, will amount to 3.1% and 4.0%, respectively. The main factor for economic growth within the time horizon of the forecast will be domestic demand, whereas contribution of net exports will be neutral. The expected increase in private consumption will result from continuing positive growth of wages and slight increase in employment. Moreover, the planned decrease of income tax in 2011 should provide an additional stimulus increasing the consumption of Hungarian households. Increased fixed capital formation, on the other hand, should impact the recovery of consumer demand and decreasing production capacity in Hungarian companies (especially in the industrial manufacturing sector). The biggest unknown, when it comes to realisation of the GDP forecast, remains the influence of planned government reforms, aimed at reduction of the deficit and debt of the public finance sector on real Hungarian economy.

Although HICP inflation will fall within the time horizon of the forecast, it will still be above the medium-term inflation objective of the Hungarian central bank, albeit it will approach this objective in 2012 (3.3% y/y). Due to the expected increase in consumer demand, it is anticipated that core inflation will also grow.

[51] Introduction of flat PIT rate of 16%, as compared to the current 17% and 32%, cancelation of tax reliefs (apart from family relief) and provisions related to amount of income exempted from tax (introduced gradually – from 2011); reduction of CIT rate from 19% to 10% for enterprises whose annual revenue does not exceed HUF 0.5 billion, introduction of an additional tax paid by banks, insurance companies and entities involved in financial lease for a period of three years; abolishment of 10 tax titles generating low budget income; discontinuance of tax on inheritances and donations in the case of the closest family.

[52] 8% of the basis.

[53] Of which approx. a half is treasury securities.

The current account in 2011 and 2012 is expected to record a lower surplus than in 2010, which will result from anticipated growth of income of non-residents on investments in Hungary, which will increase the income deficit.

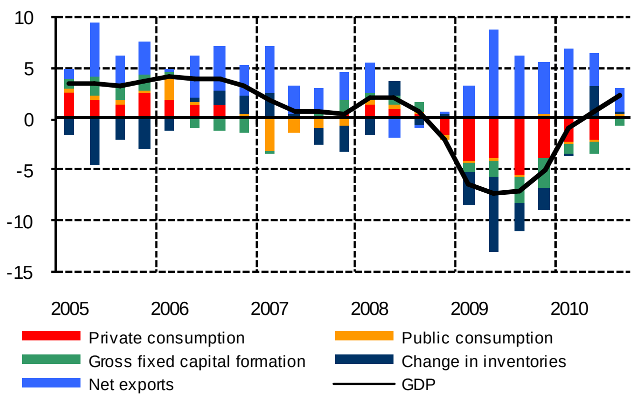
Table 10.4

Forecasts of main macroeconomic indicators

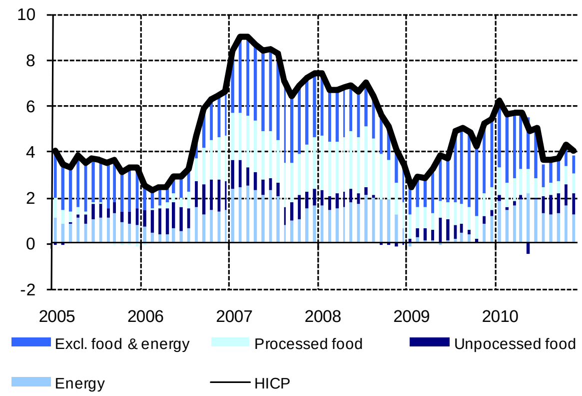
	MNB	EC	OECD	IMF
	11.2010 (05.2010)	11.2010 (05.2010)	11.2010 (10.2010)	10.2010 (04.2010)
GDP, in %, y/y				
2010	1.1 (0.9)	1.1 (0.0)	1.1 (1.2)	0.6 (-0.2)
2011	3.1 (3.2)	2.8 (2.8)	2.5 (3.1)	2.0 (3.2)
2012	4.0 (3.9)	3.2	3.1	3.0 (4.5)
Inflation, in %, y/y				
2010	4.9 (4.9)	4.7 (4.6)	4.9 (4.5)	4.7 (4.3)
2011	4.0 (3.0)	3.9 (2.8)	2.9 (2.3)	3.3 (2.5)
2012	3.3 (2.9)	3.7	3.1	3.0 (2.6)
Current account balance, in % of GDP				
2010		0.8 (-0.2)	-0.3 (0.8)	0.5 (-0.4)
2011		0.4 (-0.3)	-1.1 (-0.4)	0.7 (-1.0)
2012		-0.4	-1.3	-0.7 (-2.1)

MNB – Report on Inflation, National Bank of Hungary

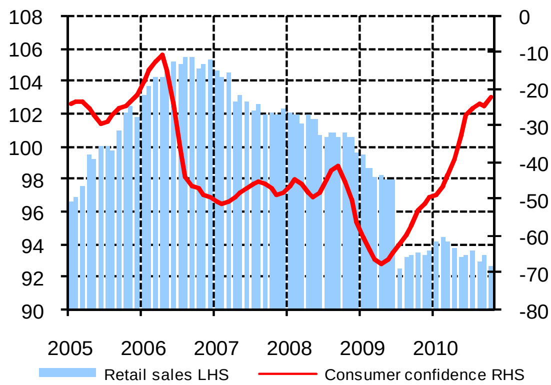
Contribution to GDP growth (in pp, y/y)



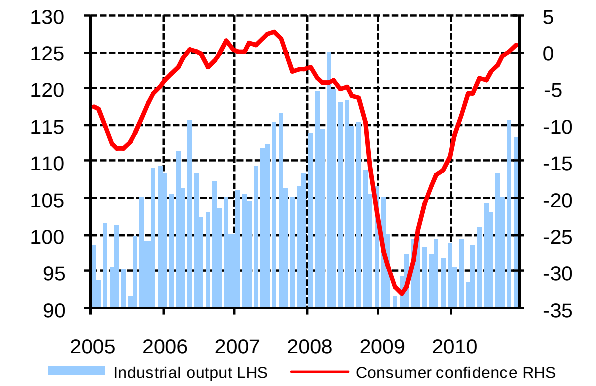
HICP and its components (in %, y/y)



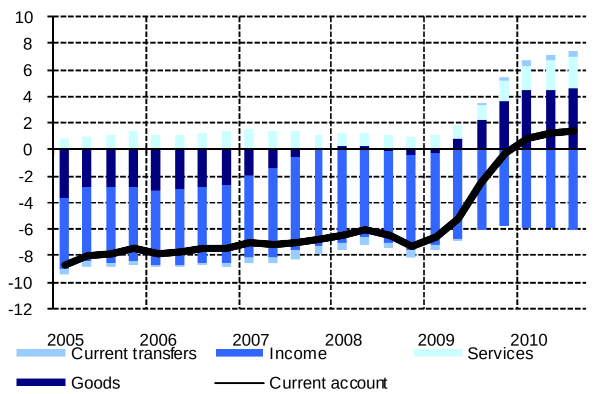
Retail sales (in %, y/y) and consumer sentiment index



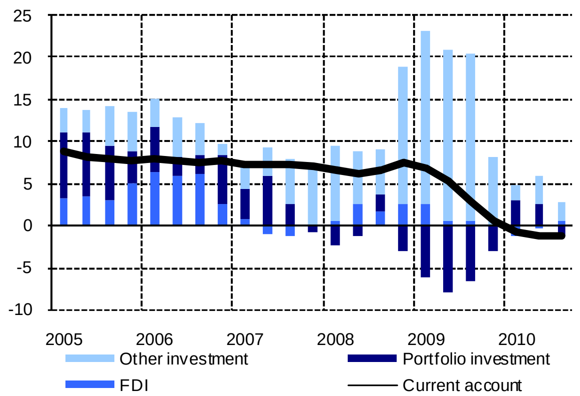
Industrial production (in %, y/y) and business sentiment index



Current account and its components (in % of GDP, 4-quarter moving average)

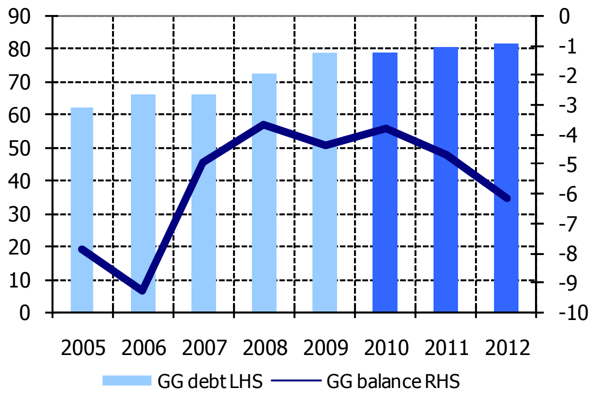


Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (in %, y/y)

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

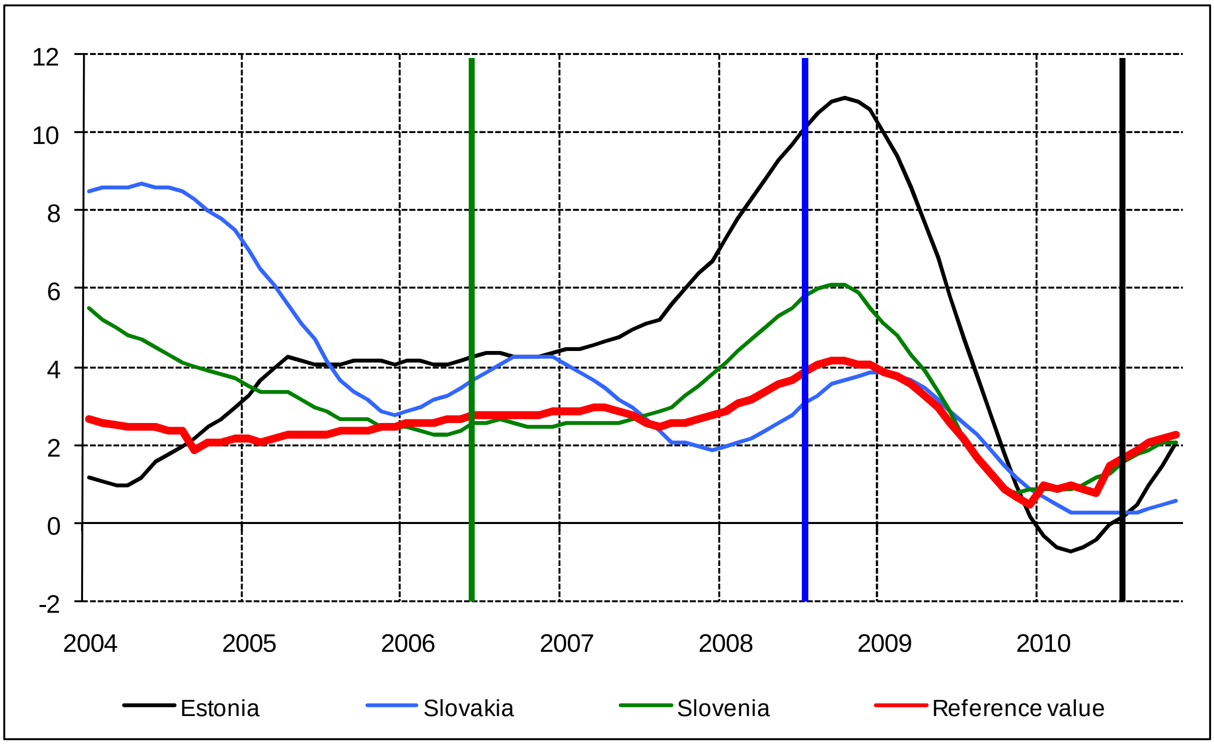
Annex 1

New members of the euro area – experiences and challenges for the other CEE countries

On January 1, 2011 Estonia became the third Central and Eastern European country to join the Economic and Monetary Union (EMU). The common European currency was earlier introduced in Slovenia (2007) and Slovakia (2009). Strategies and circumstances for joining the euro area were different for each of these countries, both with respect to both domestic and the situation in the global economy. Experiences gained from the currency integration process in the three abovementioned countries are a specific lesson for other CEE states on their path to adopt the common European currency.

Slovenia, which was the first one to introduce the euro, joined the European Exchange Rate Mechanism (ERM II) already in June 2004.[54] Central parity (EUR/SIT 239.64) was set at the level approximate to then-current market exchange rate and, according to the Slovene government, it was close to the equilibrium exchange rate. Throughout the entire period within ERM II (until December 2006), the EUR/SIT exchange rate practically did not deviate from the central parity, which resulted from active policy of the Bank of Slovenia (BS), which during this entire period endeavored to retain a constant difference in the levels of exchange rates between Slovenia and the euro area and actively cooperated with commercial banks in the scope of liquidity management on financial markets (e.g. through currency swaps).

Figure 1. Twelve-month average HICP inflation and reference value of the inflation criterion.



Vertical lines indicate the moment of decision to accept a given country membership to the euro area
Source: Eurostat, own calculations

However, there were certain difficulties with stabilising inflation at a low level. When Slovenia joined ERM II, the 12-month average HICP inflation was more than 3 pp. higher than the reference rate. In order to reduce inflation, the government, in agreement with labour unions, took measures to stabilise administered prices as well as wages. Between 2003 and 2005, excise duty for fuel was lowered (to the lowest possible level in the EU) in order to prevent the translation of growing global fuel prices into domestic prices. Reductions were also applied to other administered prices so as to continue the

[54] Slovenia joined ERM II already on 28 June 2004, i.e. in the possibly shortest time after obtaining membership in the EU (1 May 2004). Together with the Slovene tolar, ERM II was joined by the Estonian kroon and Lithuanian lita.

process of reducing inflation, commenced in 2002. Additional factor for limiting inflation was the control of wages. Pursuant to an agreement between the government and social partners, real wages in Slovenia between 2001 and 2006 rose by 1 pp. slower than labour productivity. Moreover, the government delayed the increase in the public sector wages as compared to the private sector. These measures prevented excessive increase of domestic demand and thus of inflationary pressure. Thanks to these measures, Slovenia managed to lower its inflation rate from over 9% in 2001 to c.a. 2% in 2006, which in turn allowed for fulfilling the inflation criterion and accession to the euro area at the beginning of 2007.

After introducing the euro, inflation in Slovenia grew rapidly. On the one hand, it was due to increased prices of energy commodities and food in the world, and on the other, of accelerated activity in Slovene economy. The euro introduction contributed to lowering of real interest rates, causing a boom on the consumer and investment loans market. Rapid growth of bank lending activity, in turn, caused an increase in labour costs and amplified inflationary pressure. At the same time, the control of administered prices and wages was loosened. Procyclical fiscal policy in this period also contributed to overheating of the economy. As a result, inflation in Slovenia increased to c.a. 6% at the end of 2007.

Post-accession inflation growth in Slovenia — like the earlier ones in Spain, Ireland and Italy — caused the European Commission to pay more attention to stability and sustainability of low inflation in its assessment of the potential euro area members. Both Slovakia and Estonia, which joined the euro area in later years, received relatively critical assessments of compliance with the inflation criterion in spite of the fact that their 12-month average HICP inflation was lower than the value of the Maastricht criterion.

Figure 2. EUR/SIT exchange rate and central parity

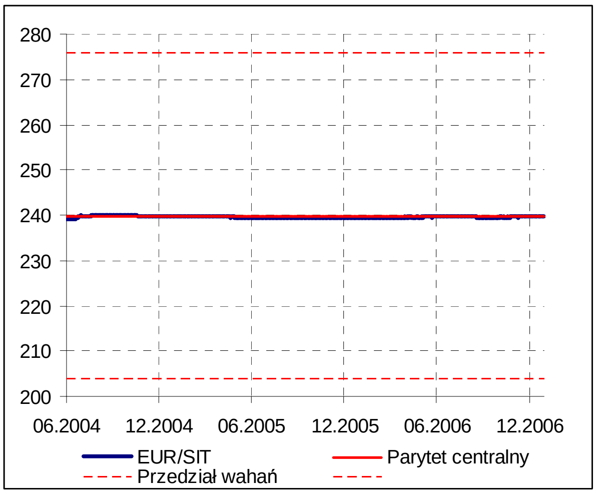


Figure 2. EUR/SKK exchange rate and central parity

Source: EcoWin Financial

In Slovakia, compliance with the exchange rate criterion proved much more difficult than in Slovenia. The National Bank of Slovakia (NBS) did not try at all costs to maintain the stability of the currency exchange rate at the level of central parity, adopted in November 2005 at EUR/SKK 38.4550. Due to increasing inflationary pressure, in 2006, Slovakia experienced a series of increases in NBS interest rates, by 175 bp in total. Moreover, at the end of 2006, Slovakian economy began to develop at a record fast pace. High interest rates, dynamic economic growth as well as expectations of Slovakia joining the euro area resulted in increased inflow of foreign capital, which in turn caused fast appreciation of the koruna. When, in December 2006, EUR/SKK exchange rate approached the upper fluctuation band of ERM II +/-15%, NBS commenced a series of measures aimed at weakening the koruna. However, this was without effect and in March 2007, upon agreement of EU states, central parity for EUR/SKK inside ERM II was revaluated by 8.5%. Pressure on appreciation of the Slovak currency returned in early 2008, when the Slovak government negotiated the final EUR/SKK exchange rate. This led to yet another revaluation of central parity for the koruna. As a result, the final EUR/SKK exchange rate was 22% stronger than when Slovakia joined ERM II. According to the EC, strong appreciation of the koruna in 2007 and 2008, which led to double revaluation of the central parity within ERM II, was one of the main causes for decreasing inflation below the reference value of the inflation criterion. At the same time, the European Commission expressed its concern regarding future inflation developments in Slovakia by claiming that in case of lack of appreciation, maintaining low level of inflation will be difficult[55]. The final — and not very favourable — assessment of revaluation of the exchange rate in Slovakia may suggest that in the future, the EC will be far more reserved with respect to changing central parity by other euro area candidates.

Like in Slovenia, compliance with the inflation criterion in Slovakia involved strict control of regulated prices. After significant increases in administered prices, especially those of energy between 2003 and 2005, these prices did not change during the later period. It was one of the main factors contributing to bringing inflation below the inflation criterion in 2008. Additionally, appreciation of the koruna prevented growth of inflation in 2007 and 2008. Unlike in Slovenia, the government did not have so much impact when it came to controlling wages. The only instruments were the minimum wage and indexation of wages in the public sector, which before the accession had been determined on the basis of inflation forecasts.

Estonia, like Slovenia, joined ERM II in June 2004. Estonian authorities unilaterally committed themselves to maintain fixed exchange rate against the euro (EUR/EKK 15.6466). Fixed exchange rate regime was nothing new to Estonia. It had been followed since gaining the independence.

For Estonia, the biggest challenge related to adopting the new currency was to lower the country's inflation. Between 2004 and 2008, the Estonian economy developed at an extremely fast pace, driven by increased private consumption, which in turn led to fast growth of inflation. 12-month average HICP inflation in those years continuously and clearly exceeded the the inflation criterion reference value. In the second half of 2008, its value was nearly 7 pp. higher than the criterion. The main factor which "helped" to decrease inflation in Estonia was the economic crisis. It resulted from overheating of the economy and additionally was intensified by the outbreak of global financial crisis, which was particularly severe in the Baltic states, including Estonia. Halting of lending activity, deteriorated conditions on the labour market due to a drop in global demand and decelerated inflow of capital resulted in a considerable decline in Estonia's domestic demand. As a consequence, it influenced a decrease in inflation by more than 13 pp. by mid 2010. Fiscal consolidation also played a major role in the disinflation process. One of the main steps aimed at decreasing public expenditure was lowering of wages and cutting down on employment in the public sector. This, in turn, served as an indicator for the private sector, where employment and wages also dropped during the crisis, contributing to lower inflationary pressure. It seems, however, that such a considerable decrease in Estonia's inflation will not be permanent. The EC pointed this out and mentioned the possibility of return of high inflation once Estonia has observed economic recovery.[56.]

The experiences of CEE countries which have hitherto joined the EMU indicate flaws in the convergence criteria, especially the inconsistency between the inflation and exchange rate criteria[57]. In the case of Slovenia, it was possible to retain a stable exchange rate and, at the same time, to lower inflation through strict monetary policy, administrative decisions and labour market control. However, it caused deterioration of domestic demand growth, in particular of consumption. For Slovakia, the discrepancy between these criteria was more visible, resulting in strong depreciation of the koruna and the necessity to revaluate the central parity during the period within ERM II. In the case of Estonia, maintaining a fixed exchange rate against the euro resulted in a credit boom after accession to the EU, which led to overheating of the economy and excessive growth in inflation. These experiences seem important not only for other candidates to the euro area, but also for the ECB and the EC. They made it clear that candidate countries do not treat the period within ERM II as time for preparation for membership in the euro area, but rather as "compulsory waiting room", which they should leave as soon as possible.

CEE states may, in turn, learn that they should not rush with abandoning the floating exchange rate regime during the period when other convergence criteria have not been fulfilled, since long-term stay within ERM II may slow down their real convergence process. Before giving up on floating exchange rate, it is also recommended to make all necessary adjustments in indirect taxes. As the experiences

[55] Convergence Report 2008, European Economy 3/2008, EC, 2008
[56] Convergence Report 2010, European Economy 3/2010, EC, 2010
[57] The real convergence process is related to fast increase in prices (the Balassa-Samuelson effect). Application of rigid monetary and fiscal policies, aimed at reducing inflation, may lead to appreciation of the domestic currency. Therefore, simultaneous compliance with both the exchange rate and the inflation convergence criteria may prove difficult.

of current euro area members have shown, lack of increases in administered prices during the period spent within ERM II allows for eliminating additional stimuli working towards growth of inflation and thus facilitates compliance with the inflation criterion.

Conclusions drawn from the analysis of the euro area accession process of CEE states, in particular of Estonia, indicate that it is not only necessary to comply with fiscal convergence criteria, but also to construct a "safety buffer", in particular during the period of economic upturn. This would allow for taking anticyclical measures and, at the same time, for avoiding the exceeding of the acceptable general government deficit threshold.

Outbreak of the financial and economic crisis in 2008 altered the state of fulfillment of the Maastricht convergence criteria (also for countries which already were members of the euro area). On the one hand, the drop in inflation in the majority of Central and Eastern European countries, especially in Baltic states, was stronger than in EU-15 countries, which allowed for compliance with the inflation criterion[58]. On the other, the economic crisis also impacted the general government sector. Deficit increased considerably and although in 2007 it was still lower than 3% of GDP in the whole region (apart from Hungary), in 2009 the general government deficit criterion was only fulfilled by Estonia.

Current economic and political developments indicate the slowdown in the European currency integration process. Among the seven CEE countries which are not members of the euro area, only Lithuania and Latvia are currently within the ERM II. Although the authorities in both Baltic states express their interest in introducing the euro in 2014, their current fiscal stance (in 2010, general government deficit considerably exceeded 3% of GDP in spite of wide-range savings measures) indicates that these declarations may prove unrealistic. The remaining countries in the region do not fulfill the exchange rate criterion (membership in ERM II), general government and — apart from the Czech Republic — also the inflation criteria. This means that it will be at least another several years before subsequent countries of Central and Eastern Europe join the euro area. According to the Reuters survey from May 2010, the euro area will expand no sooner than in 2014 (Lithuania) and the majority of countries in the region should adopt the common currency in 2015 at the soonest.

Table 1. Reuters survey concerning CEE states' anticipated date of accession to the euro area

	Median	**Mean**	**Mode**	**Minimum**	**Maximum**
Bulgaria	2015	2015	2015	2012	2022
Czech Republic	2016	2016	2016	2013	2020
Lithuania	2014	2014	2014	2012	2020
Latvia	2015	2015	2015	2013	2019
Poland	2015	2015	2015	2014	2019
Romania	2015	2016	2015	2014	2024
Hungary	2015	2015	2015	2013	2019

Source: Reuters

[58] At the end of 2008, only in Slovakia was the 12-month average HICP inflation lower than the reference value of the inflation criterion. In mid 2010, this criterion was not fulfilled only by three countries – Poland, Romania and Hungary.

Annex 2

Changes in the functioning of mandatory funded pension schemes in the CEE-Countries

All countries in the region with mandatory pension funds adopted changes in the functioning of these schemes, as a result of deterioration of public finances caused by the economic crisis and disadvantageous Eurostat regulations[59]. Pursuant to them, funded pension schemes are not treated as a the general government unit and thus contributions transferred to pension funds increase the fiscal deficit.

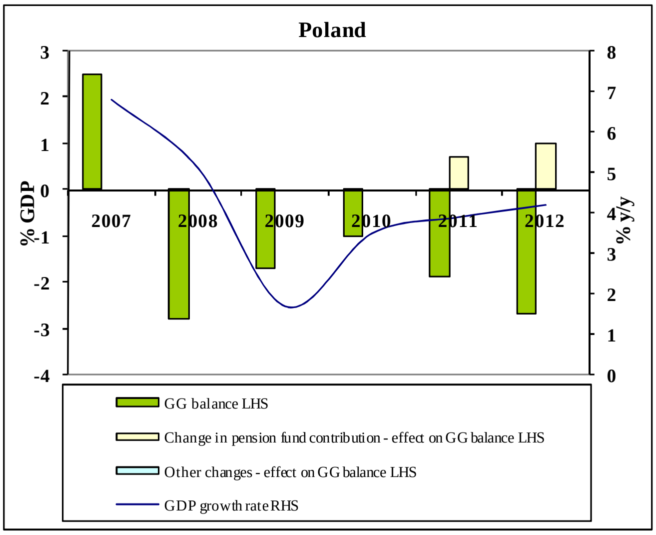
Changes introduced in the countries of the region (see table on the following page) into the second pillar of the pension schemes involved primarily:

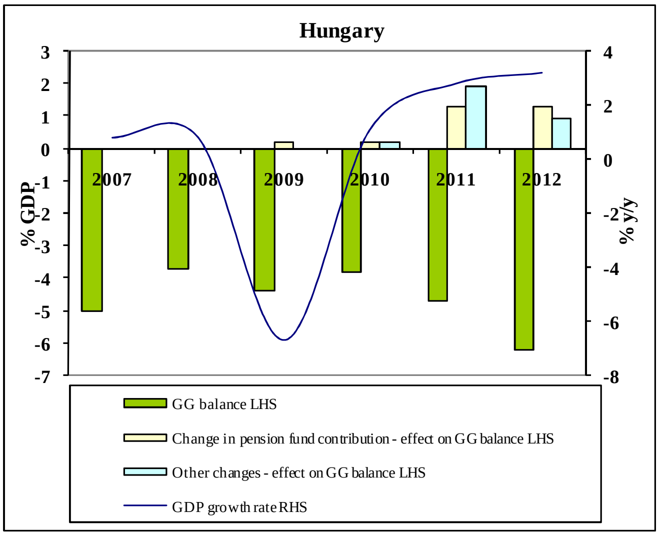
- temporary reduction of contributions transferred to pension funds (Lithuania, Latvia, Hungary, Romania) or suspension of their transfer (Estonia);
- the option for the insured to leave the second pillar (e.g. Slovakia, Hungary).

In Estonia and Lithuania, a temporary increase in contributions was anticipated in subsequent years in order to restore assets in pension funds.

At the end of 2010, budget-related difficulties in Lithuania and Latvia led to a decision to prolong the temporary decreases in contributions transferred to the second pillar. Bulgaria adopted a solution providing for transfer of funds collected in occupational pension funds to the public finance sector for people who will take early retirement in the period between 2011 and 2014. Poland, in turn, announced a reduction of the contribution to pension funds from April 2011 (from 7.3% to 2.3%).

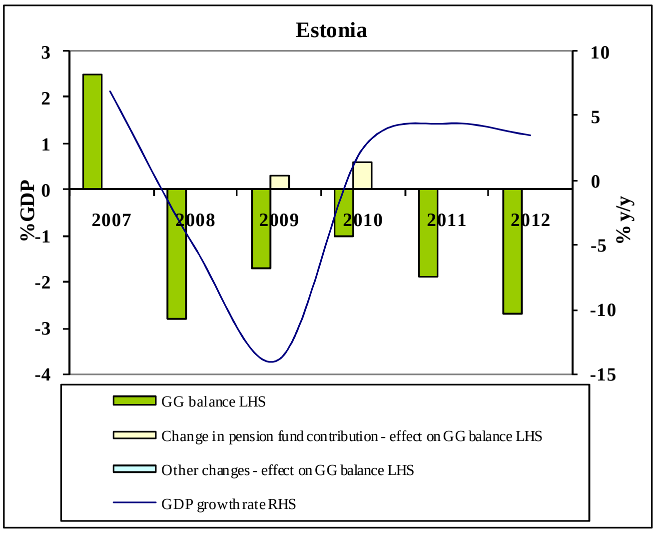
Changes adopted in Hungary in functioning of the funded pension scheme are far-reaching and mean its actual abolishment. During the last months of 2010, the Hungarian parliament passed law providing for temporary suspension (from November 2010 until the end of 2011) of transfers of contributions to pension funds (8% of the salary) as well as cancellation of obligatory membership in the second pillar for persons entering the labour market. Moreover, the insured must make a decision concerning further membership in the pension fund until the end of February 2011. A decision to continue participation in the funded pillar will involve loss of entitlements to pension from the first pillar and lack of the state's guarantee for payment of benefits from the funded part of the pension scheme. The opting-out of private pension fund will enable the insured to receive the income earned by pension funds and in case of negative rate of return, the state will adjust the balance on the insured person's account. Assets transferred from the second pillar (approx. 9.8% of GDP) are to be managed by the established special state fund. As a result, the general government deficit and debt will experience a one-off decrease (approx. half of assets of pension funds are treasury securities).

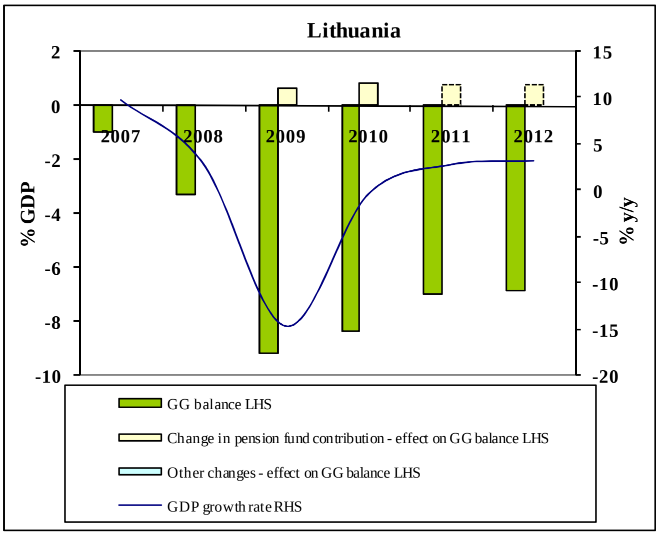


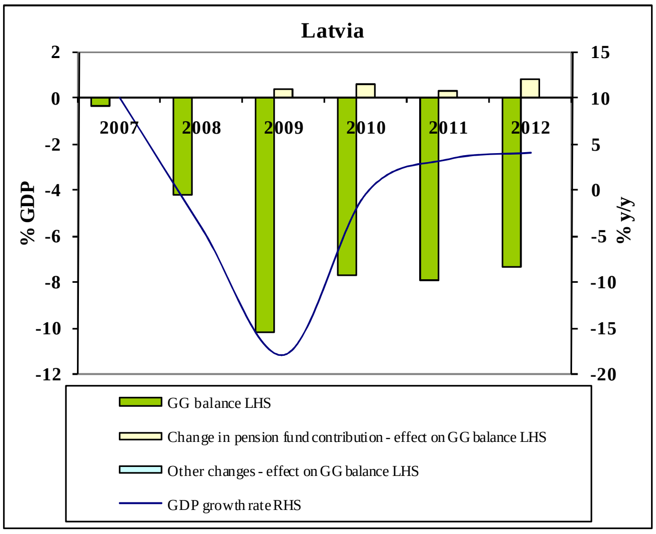


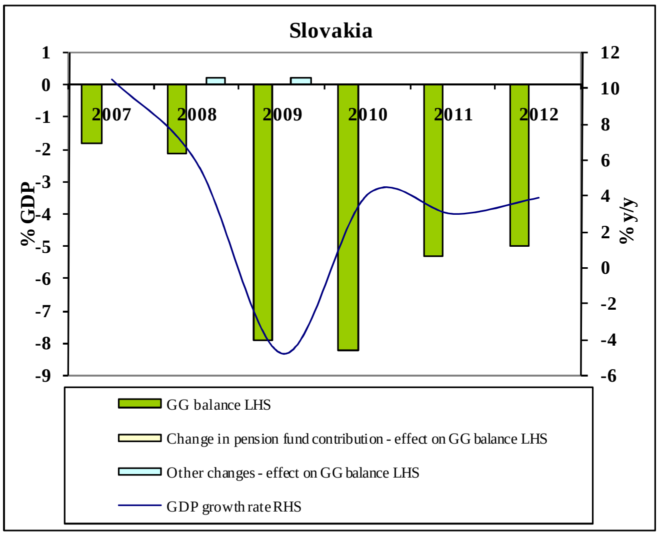
[59] See *New decision of Eurostat on deficit and debt. Classification of funded pension schemes in case of government responsibility or guarantee*, Eurostat, 2 March 2004.

Changes in the functioning of mandatory funded pension schemes in the CEE-Countries









Source: Autumn EC forecast, CEE-10 states Stability and Convergence Programmes, press

Changes in the functioning of compulsory pension funds in the countries of Central and Eastern Europe

Country	Date of introduction of pension funds	Changes in the capital pillar of the pension system			Impact on decreasing the general government r deficit (% of GDP)				Net assets of pension funds (% of GDP)
		the amount of contribution (% of the basis)	opting-out	other	2009	2010	2011	2012	
Poland	1999	Reduction of the contribution from April 2010 (from 7.3% to 2.3%). From 2013 until 2017, it is to be increased to 3.8%. From 2012, an supplementary contribution to the third pillar of pension scheme is to be introduced; it will be paid by the insured (exempt from tax) at 2%, between 2015 and 2016 — at 3%, and starting from 2017 — at 4%.	Women who have reached retirement age in 2009 may leave pension funds.	-	-	-	0.7	1.0	15.7 (December 2010)
Bulgaria	2000	-	-	Transfer of funds collected by occupational pension funds (professions entitled to early retirement) to budget income in the case of early retirement of the insured between 2011 and 2014.	-	-	approx. 0.1 (2011-2014)		4.2 (June 2010)
Estonia	2002	Suspended transfer of contributions between June 2009 and December 2010 (4%). From June 2011, it is expected to amount to 2%, and from June 2012 — once again to 4%. To supplement the funds in pension fund, due to their reduction, the rate is to be raised to 6% between 2014 and 2017.	-	-	0.3	0.6	-	-	7.5 (December 2010)
Lithuania	2004	In 2009, the contribution was reduced from 5.5% to 2%. Initially, it was to increase to 5.5% in 2011 and to 6% between 2012 and 2014 in order to supplement funds in pension funds as a result of reduction of contributions. At the end of last year, the reduction was maintained. An increase will depend on the improvement in conditions of public finance.	-	-	0.6	0.8	NDA	NDA	3.5 (2009)

Changes in the functioning of compulsory pension funds in the countries of Central and Eastern Europe

Country	Date of introduction of pension funds	Changes in the capital pillar of the pension system			Impact on decreasing the general government r deficit (% of GDP)				Net assets of pension funds (% of GDP)
		the amount of contribution (% of the basis)	opting-out	other	2009	2010	2011	2012	
Latvia	2001	Contribution reduced from 8% to 2% from May 2009 until December 2010. From 2011, it was to increase to 4% and from 2012 — to 6%; however, in December 2010 a decision was made to postpone the increases in contributions. From 2013, the rate is to rise from 2% to 6%. In Latvia, it was originally assumed that the contribution would amount to 9% in 2009 and to 10% in 2010.	-	-	0.4	0.6	0.3	0.8	6.0 (June 2010)
Romania	2008	Originally, the contribution was expected to rise by 0.5 pp per annum, starting from 2009, until reaching 6% in 2016. In 2009, however, the increase from 2% to 2.5% was suspended. In 2010 and 2011, it amounted to 2.5%.	-	-	0.1	0.1	NDA	NDA	0.8 (December 2010)
Slovakia	2005	-	It was possible to leave the second pillar between January and June 2008 and between mid November 2008 and June 2009.	From January 2008, pension fund membership is not compulsory for persons starting their careers. The new Slovak government intends to reverse this change.	0.2 (in 2008: 0.2)	-	-	-	5.6 (December 2010)
Hungary	1998	Temporarily suspended transfer of contributions (8%) between November 2010 and December 2011.	Insured who were over 52 years of age before 2009 could leave pension funds until the end of December 2009; the insured are to make a decision on remaining within the second pillar until the end of February 2011 (it involves loss of rights to pension from the PAYG pension scheme).	End of June 2010 saw the adoption of a resolution introducing optional membership in pension funds for persons starting their careers.	0.2	0.4	3.2	2.2*)	9.8 (second half of 2010)

*) Lack of contributions to pension funds, due to actual abolishment of the funded pension scheme, has been taken into account.
Source: Own study and calculations on the basis of CEE-10 states Stability and Convergence Programmes, data of: central banks, finance system supervisors and pension fund organisations, press

Annex 3

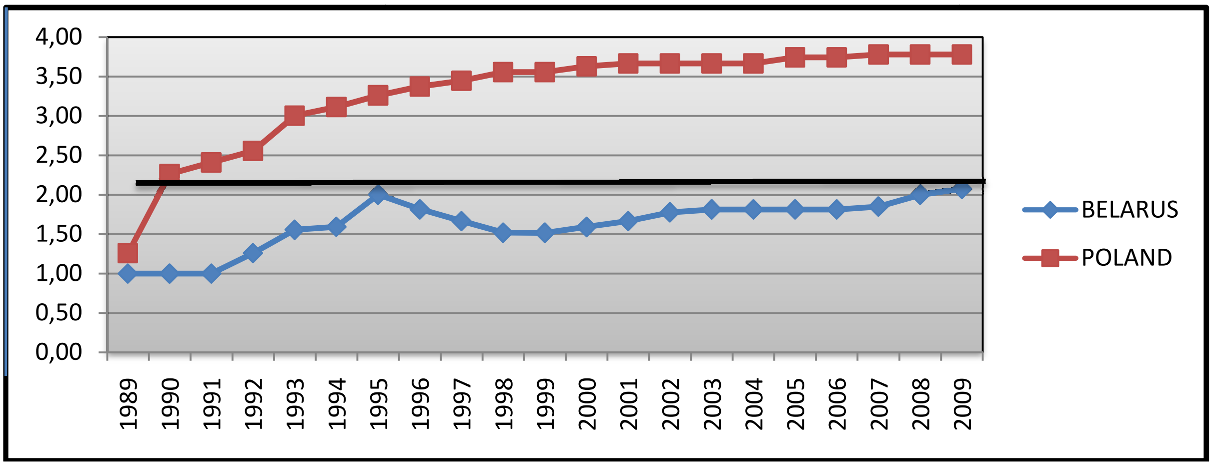
The economy of Belarus between 1991 and 2010

Economical transformations between 1991 and 2010

Since the collapse of the USSR, Belarusian economy was characterised by relatively high economic growth, stable level of prices, positive fiscal and foreign trade balances as well as complete lack of indebtedness. Both the level and high growth of national income and real wages[60] indicated improved prosperity of the entire society and this is probably why centrally planned economy in Belarus had far fewer opponents than in the countries of Central and Eastern Europe or in some of the former USSR states.

It may be stated that Belarus did not undergo market transformation. From proclamation of independence in 1990 until presidential elections in 1994, the government conducted a policy of very slow liberalisation and privatisation while being completely unable to handle economic imbalances — production had been decreasing until 1994, while inflation rate in this year reached approx. 2000% on annual basis. Concentration of production resources in the hands of the state as well as lack of legal and institutional regulations led to corruption and development of the black market, which in consequence supported the process of social stratification. Belarusian authorities therefore lost the people confidence in reforms and Belarusians started to associate the term "market economy" with poor economic situation and total chaos. It was in these conditions that the 1994 presidential elections resulted in victory of Alexander Lukashenko, who promised the nation an improvement of discipline and return to the times of "socialist prosperity". Since the very beginning, Lukashenko had been determined to seize unlimited power in the country. Taking advantage of his initial popularity, he held two referenda in 1995 and 1996, which extended the presidential powers — separation of powers in Belarus practically ceased to exist. The second referendum is not recognised by the international community since its announcement was contradictory to then-applicable constitution of Belarus and its results were deemed counterfeited. After coming to power, Lukashenko halted any further market reforms and started to endeavour to increase state control, also over the economy. In 2004, Lukashenko held another referendum, which removed constitutional limit for holding presidential powers for two terms. In December 2010, Belarus held fourth presidential elections which once again were won by Alexander Lukashenko.

Figure1. Arithmetic mean of all EBRD indices of transformation progress for Belarus and Poland between 1989 and 2009 (with 1 meaning centrally planned economy and 4+ — market economy).



Source: own study on the basis of *Transition Report (1995-2009)*, EBRD

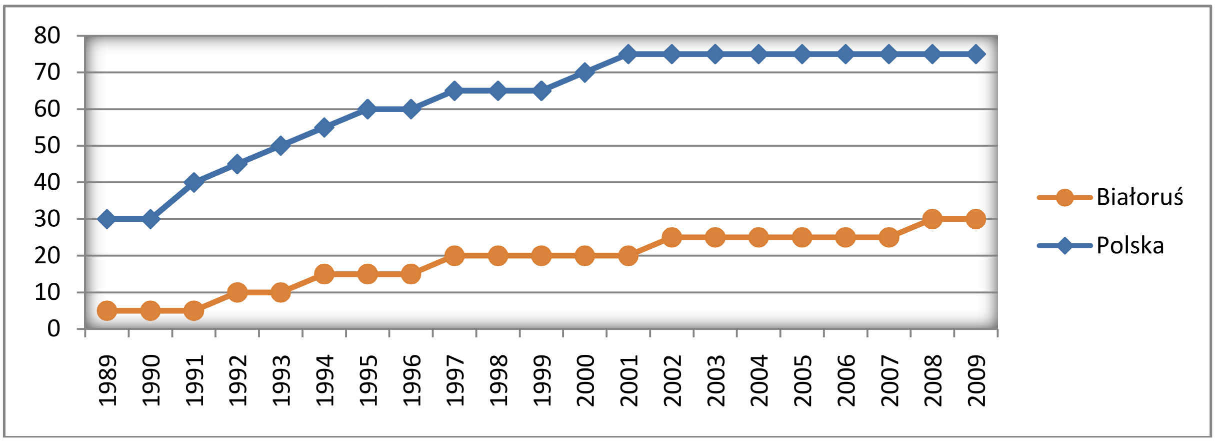
As a result of its economic policy, even 19 years after the beginning of economic transformation, Belarus has introduced fewer structural reforms than Poland during the first year of transformation, in

[60] For example, in Belarus, gross national income per capita in 1990 and real wages in 1991 were exactly by half higher than in 1980, whereas in Poland in 1989, these indicators remained at the level from 1980 – the year which saw an outbreak of nationwide worker strikes and creation of "Solidarity" (data based on Richard Kaufman and John Hardt (1993), *The Former Soviet Union in Transition*, Joint Economic Committee, Congress of the U.S. and *GUS Statistical Yearbook* (1992))

1990 (see Figure 1). It should be noted that the indices evaluating the "transformation progress" in Belarus in 2009 were minimally higher than in 1995 — at the beginning of Lukashenko's rule (see Figure 1).

According to international institutions, such as the World Bank, European Bank for Reconstruction and Development and International Monetary Fund, progress in the scope of economic transformation in Belarus is considered to be the weakest among transition countries. According to the European Bank for Reconstruction and Development (EBRD),[61] among 29 post-socialist countries of Central and Eastern Europe and Central Asia, only Turkmenistan conducted fewer structural reforms than Belarus. Belarusian authorities endeavour to retain the status quo and control the economy for as long as possible. The state's involvement in the economy is measured with the public sector's contribution to GDP, which currently amounts to approx. 70%, and the economic system is still considered by the Heritage Foundation[62] to be "repressed". It should be noted that according to EBRD's estimations, the share of the private sector in Belarusian economy in 2009 (30% of GDP) is exactly the same as in Poland in 1989 (see Figure 2). The assessment of changes in the political system of Belarus, in turn, is very similar to the assessment of economic changes. According to Freedom House,[63] in the scope of progress in democracy, Belarus is in the 27th place among 29 post-socialist countries, preceding only Uzbekistan and Turkmenistan.

Figure 2. Share of the private sector in the economies of Belarus (yellow) and Poland (blue) between 1989 and 2009 (%)



Source: own study on the basis of Transition Report, EBRD

Russian subsidies between 1995 and 2009

Effective economic policy aimed at preservation of the old economic system, practiced by Lukashenko between 1995 and 2009, was made possible only thanks to enormous and unprecedented economic support received from Russia in return for political promises concerning acceleration of the integration processes of these countries. Russian economic support may be viewed at 4 levels:

- import of cheap Russian oil and gas for the domestic use;
- export of oil products manufactured from cheap Russian oil to the West at market prices;
- duty-free trade with Russia, opening access to markets with population of 140 million (Russia's share in Belarusian imports in 2009: 58%; in exports: 32%);
- Russian loans for Belarus, extended on preferential terms (USD 3 billion between 2007 and 2009).

Only due to cheap oil and gas deliveries (as compared to market prices) did Russian "subsidies" for Belarus over the last 15 years amount on average to 16.8% of Belarusian GDP a year. Such huge external subsidies were the only thing that made it possible for Belarus to maintain fast economic growth without reforming the economy.

However, from 2007, Russia commenced the process of gradually changing its relations with Belarus to ones of a more market-oriented character, thus enforcing stronger economic integration with Russia and preference for Russian capital during privatisation of Belarusian enterprises. Since 2007,

[61] See *Transition report (2009)*, EBRD
[62] See *Index of Economic Freedom 2010*, Heritage Foundation
[63] See *Nations in Transit* (2009), Freedom House

gas and oil conflicts, which break out at the end of every year, when the agreement between Belarus and Russia is executed, have been exposing the weakness of Belarusian economy. Belarus is incapable of paying for energy commodities at market prices and each increase in prices is treated as an attack on the country's independence.

In spite of gradual deterioration of relations between Belarus and Russia, "annual subsidy of Belarusian economy from Russia", according to Vladimir Putin,[64] "amounted to USD 4.2 billion in 2010, including USD 1.6 billion for oil and USD 2.6 billion for gas". It constituted approx. 8% of Belarus' GDP. Nevertheless, competitiveness of Belarusian enterprises against the region decreases with every year[65].

Belarusian economy in 2010

According to official data of the Belarusian Statistical Committee, in the last ten years, the economy of Belarus has been reducing the distance to developed countries thanks to mean annual economic growth at 8%. However, GDP per capita in Belarus, measured with purchasing power parity in 2009, constituted only 2/3 of its Polish counterpart[66]. On the other hand, average wage in Belarus in 2009 was three times lower than in Poland and 30% lower than Polish minimum wage. Relative difference between the measure of output and average wage is peculiar and may support the hypothesis about overvaluation of Belarusian GDP.

According to the International Labour Organisation,[67] labour productivity, measured with GDP per employed person, was only 3% higher in Belarus in 2000 than in 1990. Dynamic growth of Belarusian economy in subsequent years, thanks to huge Russian subsidies, caused equally dynamic increase in productivity, which in 2005 was already 51% higher than in 1990. However, this labour productivity growth is still by half lower than in Poland, where it increased by approx. 101% in the corresponding period.

Table 1. The latest international economic indices for Belarus, Lithuania and Poland

Measure	Belarus	Poland	Russia	Ukraine	Lithuania	Latvia
GDP per capita according to National Statistical Programme (2009, USD), IMF	12 737	18 072	14 920	6 339	16 542	14 255
Average wage (December 2009, PLN)	**1 003**	**3 652**	**2 410**	**848**	**3 480**	**3 756**
Minimum wage (2009, EUR), FedEE	57	338	109	89	232	255
Human Development Index (2009), UNDP	**68.**	**41.**	**71.**	**85.**	**46.**	**48.**

Source: own study on the basis of World Economic Outlook (2010), World Bank; Review of minimum wage rates (2010), Federation of European Employment; Human Development Report (2009), UNDP

High inflation, high current account deficit and general government deficits indicate that Belarusian economy still exhibits considerable imbalance, both internal and external. The National Bank of Belarus does not apply rigid monetary policy. Depending on political needs, NBB is forced to lower interest rates and excessively increase money supply in order to stimulate the economy with cheap loans. For example, over the last ten years, the basic basket of goods and services in Poland became approx. 40% more expensive, while in Belarus, the price of corresponding basket increased nearly 9.5 times[68].

Being highly dependent on foreign trade,[69] Belarus suffered as a result of deteriorated terms of trade due to the crisis and strained relations with Russia – import prices of oil and gas from Russia increased, while the prices of the main Belarusian product exported to the West — potassium salt —

[64] Statement from the press conference after the meeting of the government of the Union State of Russia and Belarus, 18.03.2010
[65] In Q3 2010, the price of gas for Belarus, as compared to Ukraine and Poland, was lower by 20% and 40%, respectively, while in 2006, gas for Belarus, as compared to Ukraine and Poland, was lower by 100% and 550%, respectively.
[66] See *World Economic Outlook (2010)*, IMF
[67] See *Key Indicators of the Labour Market (2008)*, ILO
[68] See *Statisticzeskij Jeżegodnik* (2009), Belstat; Statistical Yearbook (2009), GUS
[69] Foreign trade in Belarus in 2008 amounted to 119% of GDP

dropped. Since the beginning of 2007, current account deficit has been deteriorating (see Table 4). Belarus cannot cover this foreign exchange gap from its own foreign exchange reserves as they are extremely meagre. On the other hand, foreign direct investments in Belarus remain relatively small and insufficient for financing this trade deficit. Therefore, to stabilise the economic situation — by preventing the increase of trade deficit and sustaining the exchange rate of the Belarusian ruble — the government decided to take foreign loans. In 2009, Belarusian FDI financed less than 40% of the current account deficit, while the remaining 60% (i.e. USD 4 billion) was financed from foreign loans. Therefore, foreign indebtedness of Belarus increased more than three times over the last 3 years (from USD 6.8 billion in early 2007 to USD 22 billion in early 2010) and, according to the government's forecast, it will continue to grow in the nearest future, posing a significant threat to future stability of the economy.

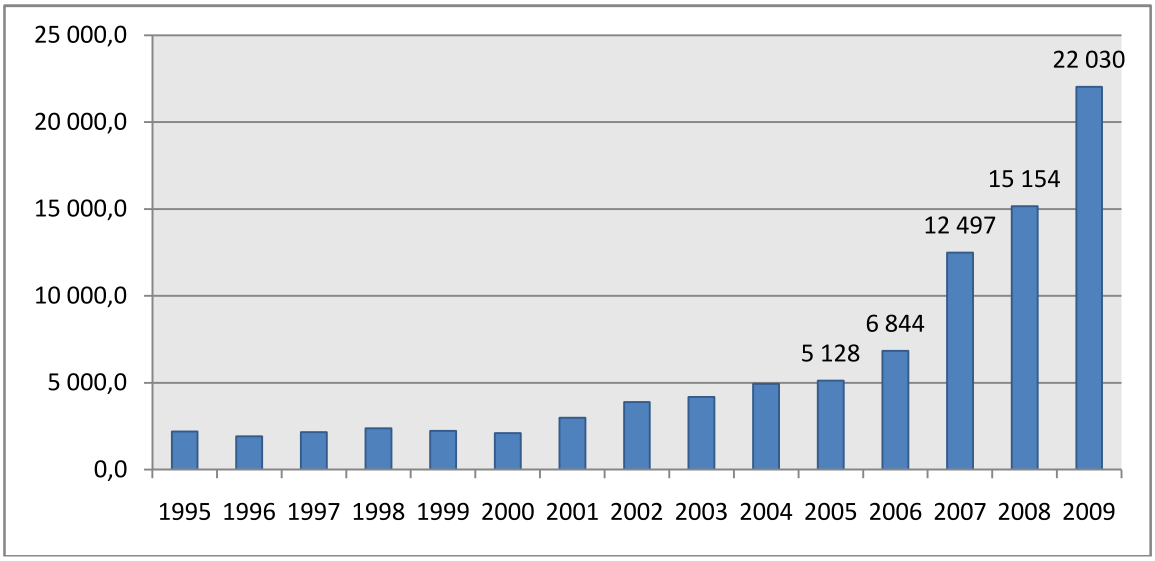
Maintaining macroeconomic stability in Belarus will require acceleration of structural reforms. Due to increased prices of natural resources, in the medium term, competitiveness of Belarusian economy will depend on restructuring and modernisation of the industrial base. The success of these processes depends on the inflow and efficient allocation of capital, which in turn is affected by the following reforms: liberalisation of prices, reforms of the banking sector, simplification of taxes and other improvements in business climate.

Table 2. Trade deficit and FDI of Belarus between 2006 and 2009 (% of GDP)

Year	2006	2007	2008	2009
Current account balance, Belarus	-3.9%	-6.7%	-8.6%	-12.9%
FDI, Belarus (% of GDP)	2.0%	2.9%	3.8%	5.0%

Source: own study on the basis of *Word Economic Outlook (2010)*, IMF and *Statisticzeskij Jeżegodnik (*2009), Belstat; data for 2009, provided by NBB at http://nbrb.by/statistics/BalPay/

Figure 3. Foreign indebtedness of Belarus between 1995 and 2009 (USD billion)



Source: own study on the basis of *Wniesznij dolg*, NBB, http://nbrb.by/statistics/ExternalDebt/Quaterly/

STATISTICAL ANNEX

1. National accounts

Table 1. Gross domestic product (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	5.0	1.7	1.0	2.8	3.1	3.8	4.7
Czech Republic	2.5	-4.1	-4.4	-3.2	1.0	2.3	2.8
Slovakia	6.2	-4.7	-4.9	-4.2	4.6	4.4	4.2
Slovenia	3.5	-7.8	-9.4	-6.1	-0.2	1.4	1.3
Hungary	0.6	-6.3	-7.2	-5.2	-1.1	0.6	2.2
Estonia	-3.6	-14.1	-15.4	-9.0	-2.7	3.0	5.1
Lithuania	2.8	-14.8	-14.8	-14.0	-0.6	-0.3	0.8
Latvia	-4.2	-18.0	-19.5	-16.7	-5.1	-2.6	2.5
Bulgaria	6.0	-5.0	-6.0	-6.7	-0.8	-0.3	0.5
Romania	7.3	-7.1	-7.6	-6.9	-3.2	-1.5	-2.2
EU-15	0.5	-4.3	-4.3	-2.1	0.6	2.0	2.2

Source: CSOs

Table 2. Private consumption (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	5.9	2.3	2.0	1.4	2.1	3.0	3.6
Czech Republic	3.6	-0.2	-0.3	-0.7	0.0	0.8	1.2
Slovakia	6.0	-0.7	0.5	-2.1	0.0	-1.1	-0.5
Slovenia	2.0	-1.4	-0.3	-0.7	-0.7	-0.3	-0.4
Hungary	-0.5	-7.5	-9.9	-7.2	-4.1	-4.0	0.2
Estonia	-4.7	-18.5	-19.7	-16.3	-7.8	-3.4	0.9
Lithuania	3.6	-16.8	-18.1	-18.8	-7.9	-8.2	-1.6
Latvia	-5.2	-24.0	-27.1	-19.4	-6.1	-1.3	2.7
Bulgaria	4.8	-6.3	-2.7	-4.1	-4.2	-4.3	-6.4
Romania	9.5	-10.5	-11.2	-5.0	-2.7	0.3	-1.2
EU-15	0.4	-1.6	-1.6	-0.4	0.5	0.8	1.2

Source: CSOs

Table 3. Gross fixed capital formation (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	8.2	-0.3	-0.6	-1.4	-12.3	-0.7	0.2
Czech Republic	-1.5	-9.2	-10.2	-5.1	-5.6	-3.7	1.7
Slovakia	1.8	-10.5	-22.8	-15.7	-5.5	3.4	5.8
Slovenia	7.7	-21.6	-23.6	-17.7	-6.9	-6.2	-8.9
Hungary	0.4	-6.5	-9.5	-9.3	-5.2	-4.8	-3.3
Estonia	-12.1	-34.4	-35.8	-30.2	-20.4	-16.6	-9.8
Lithuania	-6.5	-39.1	-40.9	-36.0	-31.6	-4.7	15.9
Latvia	-13.6	-37.3	-40.3	-41.0	-34.6	-30.0	-11.9
Bulgaria	20.4	-26.9	-31.1	-33.7	-19.9	-15.6	-5.3
Romania	16.2	-25.3	-29.4	-30.9	-30.0	-1.2	-11.0
EU-15	-1.1	-11.5	-12.4	-10.3	-4.8	-0.2	1.0

Source: CSOs

Table 4. Exports of goods and services (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	7.1	-9.1	-7.0	2.3	9.7	14.9	9.5
Czech Republic	6.0	-10.8	-8.0	2.4	14.0	13.7	14.1
Slovakia	3.2	-16.5	-14.4	-3.3	18.6	16.2	15.0
Slovenia	2.9	-15.6	-19.1	-9.2	5.7	10.0	10.5
Hungary	5.6	-9.1	-7.9	2.7	15.2	15.7	13.8
Estonia	-0.7	-11.2	-17.8	-13.2	6.2	18.0	24.0
Lithuania	12.2	-14.3	-13.9	-6.6	3.5	19.3	16.9
Latvia	2.0	-15.5	-13.9	-4.2	3.0	7.9	15.7
Bulgaria	2.9	-9.8	-10.2	-1.7	5.5	12.6	18.5
Romania	8.7	-5.5	-4.2	4.0	15.7	19.6	16.5
EU-15	1.0	-12.9	-13.4	-5.5	4.9	11.0	10.8

Source: CSOs

Table 5. Imports of goods and services (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	8.0	-14.3	-14.7	-6.4	7.9	15.9	9.7
Czech Republic	4.7	-10.6	-6.6	-2.4	11.1	14.7	16.6
Slovakia	3.1	-17.6	-16.8	-9.3	10.9	16.1	16.5
Slovenia	2.9	-17.9	-20.2	-12.8	4.1	9.1	4.7
Hungary	5.7	-15.4	-13.2	-1.8	10.3	14.3	12.9
Estonia	-8.7	-26.8	-35.5	-24.2	1.8	23.1	29.0
Lithuania	10.5	-29.4	-28.4	-17.7	3.0	15.5	20.2
Latvia	-11.2	-35.5	-34.0	-26.1	-4.9	10.0	13.1
Bulgaria	4.9	-22.3	-20.3	-18.9	-2.8	0.3	3.0
Romania	7.8	-20.6	-21.8	-13.3	0.7	10.5	18.1
EU-15	0.9	-12.0	-12.4	-6.8	4.5	11.9	11.3

Source: CSOs

2. Indices of business cycle and economic activity

Table 6. Industrial production (in %, y/y)

	2008	2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010
Poland	2.3	-3.5	12.5	11.6	13.3	12.0	10.4	6.9
Czech Republic	-2.2	-12.8	9.0	11.4	11.3	12.5	9.6	13.0
Slovakia	3.7	-13.1	24.2	16.9	16.2	13.3	13.3	
Slovenia	1.6	-17.1	10.2	9.4	11.0	5.0	8.2	5.3
Hungary	-0.5	-17.3	12.6	11.6	15.1	11.0	8.3	
Estonia	-4.5	-25.6	21.1	24.8	22.1	31.0	37.5	35.0
Lithuania	5.7	-14.4	5.0	4.3	11.0	8.3	17.4	17.2
Latvia	-3.8	-15.7	12.9	18.6	20.6	19.2	21.6	11.4
Bulgaria	0.7	-18.2	4.3	2.4	4.0	8.9	4.0	5.6
Romania	2.7	-5.7	7.9	3.8	4.6	5.0		

Source: CSOs

Table 7. Retail sales (in %. y/y)

	2008	2009	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	5.4	3.0	6.7	8.4	10.0	12.1	12.8	11.8
Czech Republic	4.1	-1.5	1.5	-0.1	-1.2	1.6	-1.0	
Slovakia	9.5	-10.2	1.0	-1.7	-1.8	-1.8	-3.7	-3.1
Slovenia	11.7	-10.3	3.9	3.3	0.4	3.5	2.8	3.5
Hungary	-1.8	-5.1	-4.7	1.7	0.0	0.8	-0.7	
Estonia	-4.2	-18.3	-3.6	2.1	2.9	4.9	3.6	7.5
Lithuania	4.3	-21.3	-8.1	-8.9	-6.7	-0.2	-0.2	4.0
Latvia	-7.0	-27.2	-2.6	-2.1	2.9	6.3	5.5	8.1
Bulgaria	9.1	-8.6	-6.8	-4.7	-4.3	-4.7	-4.8	-5.2
Romania	22.1	-10.0	4.1	-7.7	-2.5	-1.7	-7.1	-8.9

Source: CSOs

Table 8. DG ECFIN consumer sentiment index

	2009	2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	-26.2	-18.8	-14.0	-19.1	-21.4	-20.6	-21.2	-23.0
Czech Republic	-16.6	-10.5	-6.5	-12.1	-12.8	-15.9	-13.2	-11.1
Slovakia	-35.4	-20.4	-18.5	-21.3	-22.6	-26.8	-18.6	-23.0
Slovenia	-29.6	-24.1	-27.2	-27.4	-27.5	-25.8	-21.2	-23.2
Hungary	-59.3	-29.4	-27.2	-22.5	-24.0	-20.4	-22.2	-25.2
Estonia	-26.3	-6.7	-2.7	-0.7	-1.6	-4.5	-6.2	-3.7
Lithuania	-49.1	-32.4	-31.0	-25.7	-27.3	-23.5	-22.0	-21.8
Latvia	-50.1	-29.7	-29.3	-26.6	-27.5	-23.1	-24.0	-26.4
Bulgaria	-44.6	-40.6	-42.1	-37.4	-40.1	-36.7	-33.8	-30.0
Romania	-44.8	-54.6	-62.1	-58.8	-57.8	-56.7	-54.5	-55.4

Source: EC

Table 9. DG ECFIN business sentiment index

	2009	2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	-24.1	-13.0	-12.9	-12.6	-12.3	-12.5	-12.4	-10.1
Czech Republic	-22.8	3.5	6.4	6.5	6.0	7.4	10.9	17.8
Slovakia	-17.9	1.9	6.3	2.6	-0.9	2.8	1.0	11.2
Slovenia	-25.6	0.0	3.9	0.2	0.9	6.7	3.6	4.3
Hungary	-23.3	-1.9	-2.7	0.9	-0.3	-0.6	3.8	5.8
Estonia	-28.0	0.5	1.4	4.3	2.7	11.7	8.3	12.6
Lithuania	-33.5	-13.1	-17.3	-14.3	-13.5	-10.0	-6.5	-3.3
Latvia	-27.9	-7.5	-4.8	-5.3	-5.5	-4.4	-4.7	-4.4
Bulgaria	-10.8	-9.1	-9.1	-9.2	-9.5	-9.7	-7.0	-5.0
Romania	-13.9	-8.3	-9.3	-9.2	-7.7	-5.7	-5.4	-4.5

Source: EC

Table 10. PMI manufacturing index

	2009	2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	45.6	53.5	52.1	53.8	54.7	55.6	55.9	56.3
Czech Republic	42.5	56.8	56.8	57.3	58.0	57.2	57.3	58.4
Hungary	45.3	52.8	53.8	52.1	50.4	51.5	54.8	52.9

Source: EcoWin Economic

3. Prices

Table 11. CPI (in %, y/y)

	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	2.2	2.3	2.0	2.0	2.5	2.8	2.7	3.1
Czech Republic	1.2	1.2	1.9	1.9	2.0	2.0	2.0	2.3
Slovakia	1.2	1.0	1.1	1.0	1.1	1.0	1.0	
Slovenia	2.1	1.9	2.1	2.3	2.0	1.9	1.4	1.9
Hungary	5.1	5.3	4.0	3.7	3.8	4.2	4.2	
Estonia	3.0	3.5	2.9	2.9	4.0	4.7	5.3	5.7
Lithuania	0.7	1.0	1.9	1.8	1.8	2.7	2.7	3.8
Latvia	-2.3	-1.3	-0.6	-0.2	0.5	1.0	1.9	2.5
Bulgaria	1.9	1.4	2.4	2.7	3.5	3.9	4.6	
Romania	4.4	4.4	7.1	7.6	7.8	7.9	7.7	6.1

Source: CSOs

Table 12. PPI (in %. y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	1.7	3.0	3.3	4.8	5.0	5.7	5.8	6.1
Czech Republic	0.4	1.5	2.0	2.4	1.8	2.5	2.6	2.7
Slovakia	-4.5	-3.1	-1.9	-0.8	-0.4	-0.8	-1.1	-1.1
Slovenia	0.7	2.7	2.6	2.7	2.9	2.8	3.1	3.2
Hungary	5.2	9.1	9.1	9.9	10.4	9.7	10.0	10.7
Estonia	0.3	1.9	2.4	2.1	3.1	3.4	3.5	4.5
Lithuania	2.5	3.5	3.8	5.7	6.5	7.6	8.6	8.6
Latvia	-4.3	-1.2	2.5	3.8	4.2	4.6	4.4	6.3
Bulgaria	5.6	5.8	5.6	9.0	10.0	9.6	10.1	11.1
Romania	5.1	5.6	5.3	6.2	6.1	7.2	6.9	7.3

Source: CSOs

Table 13. HICP (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	2.7	2.3	2.4	1.9	1.9	2.5	2.6	2.6
Czech Republic	0.9	1.0	1.0	1.6	1.5	1.8	1.8	1.9
Slovakia	0.7	0.7	0.7	1.0	1.1	1.1	1.0	1.0
Slovenia	2.7	2.4	2.1	2.3	2.4	2.1	2.1	1.6
Hungary	5.7	4.9	5.0	3.6	3.6	3.7	4.3	4.0
Estonia	2.5	2.8	3.4	2.8	2.8	3.8	4.5	5.0
Lithuania	0.2	0.5	0.9	1.7	1.8	1.8	2.6	2.5
Latvia	-2.8	-2.4	-1.6	-0.7	-0.4	0.3	0.9	1.7
Bulgaria	3.0	3.0	2.5	3.2	3.2	3.6	3.6	4.0
Romania	4.2	4.4	4.3	7.1	7.6	7.7	7.9	7.7
EU-15	1.9	1.9	1.7	1.9	1.8	2.0	2.1	2.1

Source: Eurostat

Table 14. HICP - unprocessed food (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	-0.7	-0.4	3.0	3.4	2.8	5.3	6.2	5.4
Czech Republic	1.7	1.1	1.7	5.7	5.9	6.3	5.5	7.5
Slovakia	2.4	1.5	1.8	6.1	7.0	7.0	6.9	7.7
Slovenia	-1.2	-0.5	2.6	5.7	6.0	4.9	4.1	5.0
Hungary	2.8	-6.5	1.3	9.8	11.9	11.3	11.9	11.8
Estonia	4.6	1.6	2.6	2.9	4.5	8.2	7.4	11.0
Lithuania	-5.2	-4.2	-2.6	-1.5	-0.6	1.1	1.9	3.0
Latvia	-1.5	-1.2	-0.2	1.3	1.6	4.2	3.9	6.2
Bulgaria	-5.0	-3.9	-3.5	-0.6	0.8	0.6	2.7	3.3
Romania	-0.7	-0.6	-0.5	2.2	5.4	6.6	7.5	8.1

Source: Eurostat

Table 15. HICP - processed food (including alcoholic beverages and tobacco products) (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	4.5	4.3	3.9	2.5	2.7	3.6	3.9	4.2
Czech Republic	0.7	1.5	1.6	3.0	3.0	3.3	3.1	3.7
Slovakia	2.4	2.6	3.0	3.1	3.4	3.6	3.2	2.6
Slovenia	4.0	2.5	2.4	2.4	3.6	3.4	3.2	2.8
Hungary	5.2	4.9	4.1	1.8	2.3	2.6	3.8	4.1
Estonia	0.2	1.8	3.5	3.1	4.0	6.3	8.7	9.6
Lithuania	4.3	4.3	5.5	5.8	6.3	6.0	5.6	4.3
Latvia	-0.7	-0.8	-0.4	-0.6	0.3	1.8	3.5	5.3
Bulgaria	7.1	7.0	6.5	6.8	7.7	10.0	11.1	12.0
Romania	8.5	8.3	8.4	12.3	12.4	11.7	11.8	10.8

Source: Eurostat

Table 16. HICP - energy (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	6.9	7.0	5.7	4.6	4.6	5.0	6.2	5.7
Czech Republic	4.4	4.4	3.0	5.1	4.2	4.4	5.4	4.7
Slovakia	-0.6	-0.5	-1.3	-1.5	-1.7	-1.8	-1.7	-1.8
Slovenia	16.7	17.0	13.1	13.8	12.7	11.6	14.0	10.3
Hungary	14.0	16.1	13.8	9.7	9.0	9.8	12.1	9.3
Estonia	15.9	17.0	14.3	10.8	9.2	9.6	10.3	10.7
Lithuania	8.6	8.2	6.6	11.8	10.5	11.0	16.9	16.1
Latvia	1.5	3.7	6.4	10.9	10.0	9.2	10.1	10.3
Bulgaria	10.3	10.3	6.3	9.4	7.8	10.4	10.3	11.2
Romania	5.8	6.3	5.6	9.5	8.5	9.4	9.5	9.6

Source: Eurostat

Table 17. HICP - excluding energy, food, alcoholic beverages and tobacco products (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	1.5	1.0	0.9	0.8	0.9	0.9	0.9	0.7
Czech Republic	-0.1	0.0	0.0	0.0	0.0	0.2	0.1	-0.1
Slovakia	0.3	0.3	0.4	0.3	0.4	0.4	0.3	0.4
Slovenia	0.1	-0.1	-0.2	-0.4	-0.4	-0.5	-0.8	-0.9
Hungary	4.3	3.9	3.7	1.7	1.6	1.6	1.5	1.4
Estonia	0.1	0.3	1.1	0.8	0.7	0.9	1.2	1.2
Lithuania	-2.6	-2.1	-1.8	-2.0	-2.0	-2.3	-2.1	-1.9
Latvia	-5.1	-5.0	-4.5	-4.2	-3.8	-3.3	-3.0	-2.5
Bulgaria	1.6	1.4	1.3	1.2	1.1	0.6	0.0	0.1
Romania	2.8	3.0	3.1	4.7	4.8	4.8	4.7	4.7

Source: Eurostat

4. Balance of payments

Table 18. Current account balance (in % of GDP, 4q moving average)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	-4.8	-4.0	-3.2	-2.7	-2.2	-2.2	-2.2	-2.8
Czech Republic	-0.6	-1.5	-1.4	-1.9	-1.1	-1.2	-1.2	-2.7
Slovakia	-5.8	-6.4	-5.1	-3.8	-2.9	-2.3	-2.4	-2.7
Slovenia	-6.7	-6.2	-4.7	-3.4	-1.5	-0.9	-1.2	-0.4
Hungary	-7.3	-6.7	-5.2	-2.7	-0.5	0.8	1.2	1.3
Estonia	-9.7	-5.8	-2.1	1.7	4.5	4.8	4.1	3.7
Lithuania	-13.1	-9.0	-4.4	-0.3	4.3	4.6	5.5	3.9
Latvia	-13.1	-9.2	-2.4	3.3	8.6	10.6	8.6	6.5
Bulgaria	-23.1	-21.6	-18.3	-15.1	-9.9	-7.5	-4.7	-1.4
Romania	-11.6	-10.0	-7.3	-5.3	-4.4	-5.0	-5.5	-5.0

Source: Eurostat, central banks, own calculations

Table 19. Poland: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-4598	-861	-1460	-1486	-3024	-1135	-1854	-3640
Goods	-4983	-771	-515	-821	-1011	-682	-1076	-1581
Services	3,756	768	875	726	1052	589	776	519
Income	-1790	-2322	-3478	-2688	-3375	-2738	-3225	-3422
Current transfers	788	1464	1658	1297	310	1696	1671	844
Capital account	538	1818	1022	446	1729	1265	1074	1290
Financial account	2292	2722	4996	11052	6956	9173	6653	12650
FDIs	1818	1431	508	2870	1426	3159	158	460
Portfolio investments	-3143	-759	3904	4951	3061	6487	4351	7182
Other investments	4269	3288	737	3122	2501	-363	2169	4900

Source: Eurostat, central banks, own calculations

Table 20. Czech Republic: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-1491	904	-1152	-927	-290	738	-1262	-3116
Goods	-259	1511	1966	1727	1629	2482	2054	1425
Services	499	534	351	104	8	-280	-262	-460
Income	-1409	-1299	-3436	-2330	-1688	-1467	-3185	-3869
Current transfers	-322	158	-34	-428	-239	4	131	-211
Capital account	366	559	170	214	598	84	378	582
Financial account	1206	-316	989	1051	1950	-1116	1175	5148
FDIs	424	533	-12	-701	1156	1311	786	1801
Portfolio investments	-1732	-38	2782	936	645	527	2254	3117
Other investments	2725	-676	-1641	843	133	-2929	-1847	261

Source: Eurostat, central banks, own calculations

Table 21. Slovakia: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-1058	-582	-269	-523	-480	-215	-292	-805
Goods	-169	-263	385	255	570	146	389	-139
Services	-208	-242	-369	-222	-282	-172	-255	-188
Income	-415	-21	-196	-396	-502	-237	-354	-243
Current transfers	-266	-55	-89	-161	-266	49	-72	-235
Capital account	528	168	225	176	282	215	177	479
Financial account	1331	176	856	237	1215	-213	-891	445
FDIs	765	161	-487	-437	392	235	252	-357
Portfolio investments	376	241	-814	-791	452	-972	-963	-339
Other investments	190	-225	2157	1465	371	524	-181	1146

Source: Eurostat, central banks, own calculations

Table 22. Slovenia: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-757	-304	64	-235	-51	-113	-40	60
Goods	-743	-156	-29	-228	-286	-128	-190	-140
Services	304	239	311	296	269	226	327	354
Income	-231	-230	-200	-241	-112	-157	-135	-163
Current transfers	-87	-158	-18	-62	79	-54	-43	8
Capital account	-26	-4	41	-4	-42	46	2	15
Financial account	729	-20	-98	134	214	49	225	94
FDIs	299	3	-415	-46	-81	-39	60	50
Portfolio investments	1258	874	1151	2293	307	1102	500	-59
Other investments	-855	-988	-891	-2112	-29	-1054	-220	85

Source: Eurostat, central banks, own calculations

Table 23. Hungary: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-2514	-582	161	393	-401	566	584	477
Goods	-197	438	1006	823	1085	1234	1193	966
Services	33	97	351	621	297	596	611	744
Income	-2111	-1062	-1318	-1228	-1892	-1217	-1457	-1352
Current transfers	-238	-55	122	178	109	-47	237	119
Capital account	786	278	396	325	183	452	389	439
Financial account	8449	3994	-2033	2743	187	2576	-73	-1138
FDIs	1732	349	-1413	-256	1162	-668	-544	604
Portfolio investments	-5659	-2940	-542	2907	-2084	2513	-742	-926
Other investments	12376	6585	-78	92	1109	732	1213	-816

Source: Eurostat, central banks, own calculations

Table 24. Estonia: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-204	10	177	257	184	43	86	209
Goods	-511	-199	-81	-111	-170	-107	-105	-48
Services	315	242	390	397	317	236	341	437
Income	-114	-55	-174	-76	-76	-120	-199	-202
Current transfers	107	21	42	47	113	34	49	23
Capital account	69	40	52	125	167	137	85	105
Financial account	442	-192	-42	-622	-54	-395	25	-841
FDIs	90	-18	-195	-157	470	140	314	156
Portfolio investments	380	-17	-376	-150	-900	27	-290	-221
Other investments	-68	-166	508	-333	410	-565	-11	-793

Source: Eurostat, central banks, own calculations

Table 25. Lithuania: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-409	-29	98	254	806	55	340	-158
Goods	-782	-188	-263	-253	-129	-257	-250	-363
Services	241	122	86	135	174	212	225	48
Income	3	-184	-23	52	422	-76	-104	-96
Current transfers	128	221	297	320	338	176	469	252
Capital account	78	258	178	265	206	177	202	82
Financial account	436	-150	-353	-467	-1068	-242	-526	-21
FDIs	277	170	16	-95	-124	-21	-111	37
Portfolio investments	331	63	6	65	642	1382	-26	429
Other investments	-163	-657	-212	-445	-1559	-1488	-529	-119

Source: Eurostat, central banks, own calculations

Table 26. Latvia: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-458	53	651	412	486	348	260	52
Goods	-927	-487	-300	-323	-212	-272	-245	-333
Services	239	290	281	274	277	257	296	291
Income	164	163	434	323	253	204	48	-31
Current transfers	66	86	236	137	169	160	161	126
Capital account	73	140	128	80	103	137	63	96
Financial account	544	-197	-905	-531	-563	-512	-258	-218
FDIs	-158	46	-98	137	27	-147	71	108
Portfolio investments	27	47	56	-40	61	60	39	-65
Other investments	61	-991	-1356	1008	-458	301	-471	116

Source: Eurostat, central banks, own calculations

Table 27. Bulgaria: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-2829	-1416	-1235	112	-938	-557	-262	1278
Goods	-2341	-1156	-1257	-856	-905	-566	-783	-119
Services	-15	-44	212	1139	-10	7	427	1376
Income	-515	-428	-505	-369	-229	-383	-349	-392
Current transfers	42	213	315	198	206	385	444	412
Capital account	41	183	121	76	97	62	-110	174
Financial account	3499	874	748	409	813	93	520	-814
FDIs	1505	893	658	591	1229	16	405	341
Portfolio investments	-140	-503	-114	39	7	-137	-316	-51
Other investments	47	-537	331	-390	7	-564	52	-372

Source: Eurostat, central banks, own calculations

Table 28. Romania: balance of payments and its components (EUR mn)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Current account	-3114	-910	-1520	-946	-1722	-1629	-2205	-400
Goods	-4511	-1547	-1725	-1693	-1907	-1284	-1898	-1120
Services	289	-64	-26	-154	-158	-283	-219	-27
Income	-238	-518	-677	-261	-479	-495	-690	-544
Current transfers	252	9	44	223	351	50	28	65
Capital account	1345	1217	908	1162	822	433	602	1291
Financial account	3584	454	1390	1728	1159	971	2832	15
FDIs	2395	1471	1122	743	79	542	810	562
Portfolio investments	-826	-296	138	324	268	1321	-109	-494
Other investments	1934	-2404	1952	1886	607	2273	764	1979

Source: Eurostat, central banks, own calculations

Table 29. Official reserve assets to foreign debt ratio (in %, end of period)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	23.7	26.5	26.1	27.5	29.0	32.1	34.8	23.7
Czech Republic	44.5	48.8	46.4	48.2	48.1	48.2	47.0	44.5
Slovakia	43.3	2.2	1.7	2.5	2.8	2.9	3.3	43.3
Slovenia	1.8	1.6	1.4	1.9	1.9	1.8	2.0	1.8
Hungary	19.5	21.6	20.6	23.2	22.6	24.0	24.9	19.5
Estonia	14.8	14.3	14.9	13.6	15.4	15.1	15.9	14.8
Lithuania	20.7	19.3	19.3	19.8	19.8	19.8	19.6	20.7
Latvia	13.1	11.7	10.0	15.7	16.4	19.1	19.4	13.1
Bulgaria	34.3	32.1	32.1	33.5	34.2	32.9	32.5	34.3
Romania	39.1	37.5	37.4	37.8	38.0	40.0	39.8	39.1

Source: Eurostat, central banks, own calculations

Table 30. FITCH rating for sovereign debt denominated in foreign currency

	2005	2006	2007	2008	2009	12.2010
Poland	BBB+	BBB+	A-	A-	A-	A-
Czech Republic	A	A	A	A+	A+	A+
Slovakia	A	A	A	A+	A+	A+
Slovenia	AA-	AA	AA	AA	AA	AA
Hungary	BBB+	BBB+	BBB+	BBB	BBB	BBB-
Estonia	A	A	A	A-	BBB+	A
Lithuania	A-	A	A	BBB+	BBB	BBB
Latvia	A-	A-	BBB+	BBB-	BB+	BB+
Bulgaria	BBB	BBB	BBB	BBB-	BBB-	BBB-
Romania	BBB-	BBB	BBB	BB+	BB+	BB+

Source: FitchRatings

Table 31. FITCH rating for sovereign debt denominated in local currency

	2005	2006	2007	2008	2009	12.2010
Poland	A	A	A	A	A	A
Czech Republic	A+	A+	A+	AA-	AA-	AA-
Slovakia	A+	A+	A+	A+	A+	A+
Slovenia	AA	AA	AA	AA	AA	AA
Hungary	A-	A-	A-	BBB+	BBB+	BBB
Estonia	A+	A+	A+	A	A-	A
Lithuania	A	A+	A+	A-	BBB+	BBB+
Latvia	A	A	A-	BBB	BBB-	BBB-
Bulgaria	BBB+	BBB+	BBB+	BBB	BBB	BBB
Romania	BBB	BBB+	BBB+	BBB-	BBB-	BBB-

Source: FitchRatings

5. Interest rates and exchange rates

Table 32. Central banks main policy rates (end of period)

	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	3.50	3.5	3.5	3.50	3.50	3.50	3.50	3.50
Czech Republic	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Hungary	5.25	5.25	5.25	5.25	5.25	5.25	5.50	5.75
Romania	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Euro area	3.50	3.5	3.5	3.50	3.50	3.50	3.50	3.50

Source: Central Banks, EcoWin Financial

Table 33. 3m interbank rates (average)

	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	3.9	3.9	3.8	3.8	3.8	3.8	3.9	3.9
Czech Republic	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Slovakia	0.7	0.8	0.9	0.9	0.9	1.0	1.0	1.0
Slovenia	0.7	0.7	0.8	0.9	0.9	1.0	1.0	1.0
Hungary	5.2	5.2	5.3	5.3	5.4	5.4	5.4	5.7
Estonia	1.7	1.5	1.4	1.3	1.2	1.1	1.1	1.1
Lithuania	1.5	1.6	1.7	1.7	1.6	1.6	1.6	1.6
Latvia	2.3	2.1	1.7	1.3	1.2	1.2	1.0	0.8
Bulgaria	4.2	4.2	4.1	4.0	3.9	4.0	4.0	3.9
Romania	6.6	6.9	7.2	6.7	6.7	6.7	6.6	6.3

Source: EcoWin Financial

Table 34. Exchange rates against EUR (average)

	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	4.06	4.10	4.07	3.98	3.95	3.95	3.95	3.99
Czech Republic	25.62	25.75	25.27	24.77	24.63	24.51	24.62	25.13
Hungary	276.73	281.49	283.32	280.96	281.51	273.72	275.52	277.24
Estonia	15.64	15.64	15.64	15.64	15.64	15.64	15.64	15.64
Lithuania	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Latvia	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71
Bulgaria	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Romania	4.18	4.24	4.26	4.24	4.26	4.28	4.29	4.29

Source: Eurostat

Table 35. Exchange rates against EUR (in %, y/y)

	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010	12.2010
Poland	-7.8	-8.9	-5.0	-3.4	-5.0	-6.3	-5.0	-3.7
Czech Republic	-4.1	-2.8	-2.0	-3.3	-2.8	-5.3	-4.6	-3.6
Hungary	-1.8	0.4	4.2	4.3	3.7	2.0	1.7	1.5
Romania	0.3	0.7	0.9	0.6	0.5	-0.1	0.2	1.5

Source: Eurostat, own calculations

Table 36. NEER (in %, y/y)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	11.8	5.0	4.9	1.4	-0.4	0.9	3.4	1.7
Czech Republic	3.4	0.6	-1.8	-1.9	-0.6	-1.4	2.1	1.0
Slovakia	-3.0	-3.5	-4.3	-3.3	-3.5	-3.7	-3.2	-3.5
Slovenia	-1.9	-2.3	-3.0	-2.4	-2.4	-2.6	-2.0	-2.2
Hungary	8.7	-1.9	-5.3	-7.9	-8.1	-7.9	-5.4	-5.5
Estonia	-3.2	-4.0	-5.1	-4.3	-4.2	-4.4	-3.4	-3.6
Lithuania	-3.5	-3.9	-4.8	-3.8	-3.7	-3.9	-3.0	-3.1
Latvia	-3.0	-3.2	-5.2	-4.7	-4.4	-4.2	-2.8	-2.9
Bulgaria	-2.4	-3.5	-4.5	-3.5	-3.7	-4.0	-3.2	-3.7
Romania	-0.6	-3.4	-4.8	-4.3	-3.7	-4.4	-2.8	-3.5

Source: BIS, own calculations

Table 37. REER (in %, y/y)

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	12.1	5.1	5.3	1.3	-0.5	1.2	4.0	2.0
Czech Republic	2.4	-0.4	-2.6	-2.1	-0.8	-1.7	1.5	0.4
Slovakia	-3.7	-4.2	-5.2	-4.2	-4.3	-4.7	-4.5	-4.8
Slovenia	-1.5	-2.2	-2.8	-2.2	-2.0	-2.6	-2.2	-3.0
Hungary	12.6	1.1	-2.0	-6.3	-6.6	-6.6	-3.8	-3.7
Estonia	-2.2	-2.9	-3.4	-3.5	-3.2	-2.7	-1.3	-1.1
Lithuania	-5.2	-5.3	-5.7	-4.1	-4.0	-4.5	-2.9	-3.2
Latvia	-7.6	-7.5	-8.3	-7.3	-6.7	-6.1	-4.5	-3.8
Bulgaria	-3.3	-4.2	-5.5	-3.8	-3.7	-3.5	-2.3	-2.1
Romania	1.2	-1.5	-2.8	0.2	1.3	0.5	2.1	1.3

Source: BIS, own calculations

6. Labour market

Table 38. Employment (in %, y/y)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	3.0	1.3	1.0	0.2	-0.7	-0.9	0.9	1.1
Czech Republic	1.3	-0.2	-1.3	-1.9	-0.9	0.1	0.3	0.8
Slovakia	2.8	-0.1	-1.1	-4.3	-5.5	-4.4	-2.8	-1.3
Slovenia	2.3	-0.2	-2.1	-3.1	-4.1	-3.8	-2.5	-2.2
Hungary	-0.7	-2.1	-1.8	-3.6	-2.5	-1.2	-0.5	1.0
Estonia	-0.2	-6.8	-9.7	-9.4	-11.0	-9.6	-5.7	-3.3
Lithuania	-1.2	-5.1	-6.7	-7.4	-8.2	-7.3	-6.6	-5.1
Latvia	-5.5	-8.0	-12.5	-15.8	-14.1	-12.4	-6.3	0.7
Bulgaria	1.7	-0.8	-2.1	-4.0	-5.7	-7.7	-6.9	-5.4
Romania	1.1	-0.3	-3.5	-6.0	-7.7	-9.4	-8.1	-7.0

Source: CSOs, own calculations

Table 39. Unemployment rate (in %)

	04.2010	05.2010	06.2010	07.2010	08.2010	09.2010	10.2010	11.2010
Poland	9.7	9.6	9.6	9.6	9.6	9.7	9.8	9.8
Czech Republic	7.5	7.3	7.2	7.1	7.1	7.1	7.2	7.3
Slovakia	14.5	14.5	14.5	14.4	14.4	14.5	14.5	14.5
Slovenia	7.2	7.3	7.4	7.2	7.3	7.3	7.5	7.5
Hungary	11.4	11.2	11.3	11.1	11.0	11.0	11.2	11.3
Estonia	18.5	18.5	18.5	16.2	16.2	16.2		
Lithuania	18.2	18.2	18.2	18.3	18.3	18.3		
Latvia	19.4	19.4	19.4	18.2	18.2	18.2		
Bulgaria	7.1	7.1	7.1	7.3	7.3	7.3		
Romania	9.9	10.0	10.0	10.0	10.0	10.1	10.1	10.2
EU-15	9.5	9.5	9.5	9.5	9.5	9.5	9.6	9.6

Source: Eurostat

Table 40. Nominal wages (in %, y/y)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	6.1	-14.4	-18.3	-17.4	-6.2	16.4	14.3	
Czech Republic	15.0	-1.3	-2.7	0.2	3.1	2.2	2.4	2.0
Slovakia	5.4	8.7	5.3	2.7	0.4	0.3	0.2	4.0
Slovenia	11.8	9.2	9.8	4.4	-1.0	3.7	-0.4	-1.0
Hungary	3.8	-10.9	-10.3	-11.7	-5.5	13.2	4.5	-2.2
Estonia	8.7	2.4	-1.2	-5.0	-7.6	-4.9	-2.4	0.0
Lithuania	13.4	1.9	-3.7	-7.6	-11.1	-9.4	-6.1	-2.3
Latvia	12.7	2.5	-0.4	-6.9	-12.7	-9.4	-7.9	-2.6
Bulgaria	1.0	19.5	16.2	11.7	9.4	10.4	10.7	11.8
Romania	10.4	2.9	-3.3	-8.8	-8.9	8.4	3.0	-1.8

Source: CSOs, own calculations

Table 41. ULC (in %, y/y)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Poland	6.6	-14.7	-18.7	-18.2	-9.7	12.4	11.4	
Czech Republic	15.9	2.1	0.8	2.7	5.4	1.3	0.4	0.0
Slovakia	6.9	13.7	9.1	3.3	-1.0	-8.7	-7.0	-1.6
Slovenia	14.9	17.4	17.2	10.7	1.0	0.1	-4.3	-4.6
Hungary	5.2	-6.6	-4.8	-8.1	-2.8	13.1	3.4	-3.3
Estonia	19.7	9.8	5.6	0.9	-9.7	-11.8	-11.1	-8.4
Lithuania	21.7	15.3	10.3	5.3	-4.2	-11.6	-11.9	-10.2
Latvia	9.3	9.5	-1.8	-8.5	-11.2	-21.2	-12.1	-2.4
Bulgaria	-2.1	22.0	18.7	13.7	10.4	3.5	4.1	5.9
Romania	8.9	7.8	1.2	-7.2	-9.7	2.2	-3.7	-6.6

Source: Eurostat, CSOs, own calculations

7. Public finance

Table 42. General government deficit according to ESA'95 (in % of GDP)

	2005	2006	2007	2008	2009	2010f	2011f	2012f
Poland	-4.1	-3.6	-1.9	-3.7	-7.2	-7.9	-6.6	-6.0
Czech Republic	-3.6	-2.6	-0.7	-2.7	-5.8	-5.2	-4.6	-4.2
Slovakia	-2.8	-3.2	-1.8	-2.1	-7.9	-8.2	-5.3	-5.0
Slovenia	-1.4	-1.3	0.0	-1.8	-5.8	-5.8	-5.3	-4.7
Hungary	-7.9	-9.3	-5.0	-3.7	-4.4	-3.8	-4.7	-6.2
Estonia	1.6	2.4	2.5	-2.8	-1.7	-1.0	-1.9	-2.7
Lithuania	-0.5	-0.4	-1.0	-3.3	-9.2	-8.4	-7.0	-6.9
Latvia	-0.4	-0.5	-0.3	-4.2	-10.2	-7.7	-7.9	-7.3
Bulgaria	1.0	1.9	1.1	1.7	-4.7	-3.8	-2.9	-1.8
Romania	-1.2	-2.2	-2.6	-5.7	-8.6	-7.3	-4.9	-3.5
EU-15	-2.4	-1.4	-0.8	-2.3	-6.8	-6.8	-5.1	-4.1

f — Autumn 2010 forecast of the European Commission
Source: Eurostat, EC

Table 43. Public debt according to ESA'95 (in % of GDP)

	2005	2006	2007	2008	2009	2010f	2011f	2012f
Poland	47.1	47.7	45.0	47.1	50.9	55.5	57.2	59.6
Czech Republic	29.7	29.4	29.0	30.0	35.3	40.0	43.1	45.2
Slovakia	34.2	30.5	29.6	27.8	35.4	42.1	45.1	47.4
Slovenia	27.0	26.7	23.4	22.5	35.4	40.7	44.8	47.6
Hungary	61.8	65.7	66.1	72.3	78.4	78.5	80.1	81.6
Estonia	4.6	4.4	3.7	4.6	7.2	8.0	9.5	11.7
Lithuania	18.4	18.0	16.9	15.6	29.5	37.4	42.8	48.3
Latvia	12.4	10.7	9.0	19.7	36.7	45.7	51.9	56.6
Bulgaria	27.5	21.6	17.2	13.7	14.7	18.2	20.2	20.8
Romania	15.8	12.4	12.6	13.4	23.9	30.4	33.4	34.1
EU-15	64.2	63.1	60.5	64.3	76.3	81.6	84.3	85.8

f — Autumn 2010 forecast of the European Commission
Source: Eurostat, EC