National Bank of Poland
Economic Institute
Bureau of World Economy

Analysis of the Economic Situation in the Countries of Central and Eastern Europe

JANUARY 2013

The report *Analysis of the Economic Situation in the Countries of Central and Eastern Europe* is prepared twice a year by economists of the Bureau of World Economy in cooperation with the Bureau of Public Finance at the Economic Institute of the National Bank of Poland. This report presents an analysis of the current economic situation in the region of Central and Eastern Europe and the key macroeconomic issues in individual countries in this region.

Table of Contents:

Prepared by:
Marcin Grela (coordination)
Marcin Humanicki
Marcin Kitala (*Bureau of Public Finance, EI, NBP*)
Tomasz Michałek
Wojciech Mroczek
Agnieszka Rybaczyk (*Bureau of Public Finance, EI, NBP*)

Approved by:
Ewa Rzeszutek
Małgorzata Golik (*Bureau of Public Finance, EI, NBP*)
Jarosław Jakubik

This Report has been prepared for information purposes based on various research sources independent from the National Bank of Poland. The Report is based on data published before 31 December 2012

General information on the CEE countries in 2011

	Area (km2)	Population		GDP (EUR bn)	GDP per capita (EUR)	
		thousand of inhabitants	inhabitants per 1 km2		current prices	PPP adjusted
Bulgaria	110 879	7 505	67.7	38 483	4 800*	10 700*
Czech Republic	78 867	10 533	133.6	154 913	14 700	20 000
Estonia	45 227	1 340	29.6	15 973	11 900	16 800
Lithuania	65 300	3 245	49.7	30 705	9 500	15 500
Latvia	64 559	2 230	34.5	20 050	9 700	14 600
Poland	312 685	38 200	122.2	370 014	9 600	16 200
Romania	238 391	21 414	89.8	136 480	5 800*	11 400*
Slovakia	49 035	5 435	110.8	69 058	12 700	18 400
Slovenia	20 273	2 050	101.1	35 639	17 400	21 000
Hungary	93 028	9 986	107.3	100 513	10 100	16 500

*2010
Source: Eurostat.

Gross domestic product growth rate (seasonally adjusted constant prices)

	2011	2012			2011	2012		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	q/q				y/y			
Bulgaria	0.1	0.0	0.3	0.1	0.9	0.5	0.5	0.5
Czech Republic	-0.2	-0.6	-0.2	-0.3	0.6	-0.5	-1.0	-1.5
Estonia	0.7	0.2	0.5	1.7	6.1	3.7	2.7	3.4
Lithuania	1.0	0.3	0.6	1.3	5.6	4.2	3.2	3.3
Latvia	0.8	1.1	1.2	1.7	5.9	5.5	4.6	5.3
Poland	0.8	0.5	0.2	0.4	4.2	3.5	2.3	1.9
Romania	-0.1	0.1	0.5	-0.5	2.2	1.1	1.6	-0.8
Slovakia	0.8	0.5	0.6	0.6	3.2	2.9	2.6	2.5
Slovenia	-1.2	0.0	-1.1	-0.6	-1.0	-0.8	-2.3	-2.9
Hungary	0.1	-1.0	-0.2	-0.2	1.2	-1.2	-1.1	-1.6

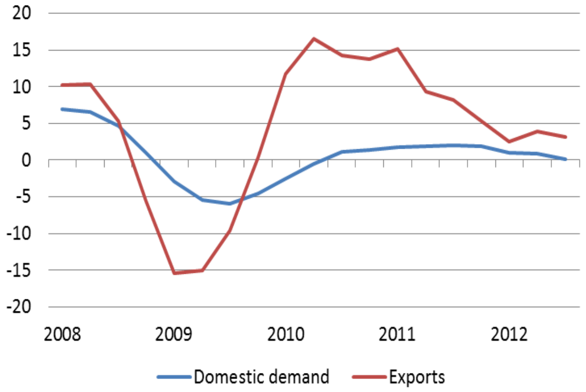
Source: Eurostat.

Summary

As of mid-2011, external conditions of the Central and Eastern European (CEE) economies were gradually deteriorating. The euro area crisis affected both the real economy (the annual GDP growth in the euro area in the third quarter of 2012 dropped to -0.6%) and the financial sector, especially banks. Ongoing fiscal consolidation was another major contributor to a weaker economic performance of the CEE countries in 2012. Consequently, economic growth in the CEE region in the first three quarters of 2012 slowed down noticeably. In the course of that period, it amounted to 1.1% compared to 3.2% in 2011. In 2012 Q3 it declined further to 0.6% y/y.

The observed economic slowdown results from both weaker external demand and persistently low domestic demand.

Domestic demand and exports in the CEE countries (in %, y/y)

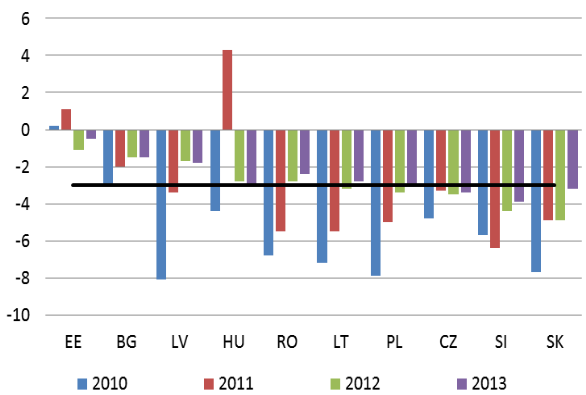


Source: Eurostat

Exports, the main engine of GDP growth in the two previous years, decelerated markedly in 2012. The biggest dip in its growth took place at the beginning of 2012. In the subsequent quarters of the year, exports went up slightly. However, its pace of growth was much slower than in 2010-2011. The scale of this slowdown differed across the CEE economies. Exports in Slovakia and the Baltic states showed a relatively slower response to weaker euro area demand. In Slovakia, this resulted from a large share of exports to countries outside the euro area, where economic slowdown in the last quarters was less pronounced, and from prompt adjustment of the export offer to meet market needs (car exports to emerging economies and to the United States). In the Baltic states, it resulted from sustained high competitiveness (the effect of "internal devaluation" in 2008-2009). In other CEE countries, export growth was noticeably slower and Romania even recorded a decline in exports on annual basis in each of the first three quarters of 2012.

Domestic demand in the CEE countries also decreased. It concerned both consumption and fixed investment and was brought about by a number of factors: further deceleration in bank lending, ongoing fiscal consolidation and a slowdown in industrial production. Similarly to 2009, most CEE countries recorded increasingly slower growth in lending to the private sector. This resulted from both weakening household and corporate demand for credit and its limited supply. Low supply of loans was attributable to the outflow of capital from the banking sector and insufficient supply of resident deposits, increasingly restrictive lending policy and deteriorating portfolio of existing loans. However, in the Baltic states, where intensive deleveraging of the banking sector had taken place in previous years, in the first half of 2012 the trend slackened markedly. Restrictive fiscal policy continues to be another factor hindering the growth of domestic demand. Previous and planned consolidation measures in many CEE countries have strongly affected consumers' confidence and curbed their spending. Fiscal consolidation was, among others, a significant reason for the slump in domestic demand in the Czech Republic. Its adverse impact on consumption growth and investment outlays was also noticeable in other economies of the region, among others in Slovakia and Slovenia. In the case of Slovenia, the most severe effects of measures associated with the fiscal tightening are to materialise in 2013.

General Government balance in the CEE countries (in % of GDP)

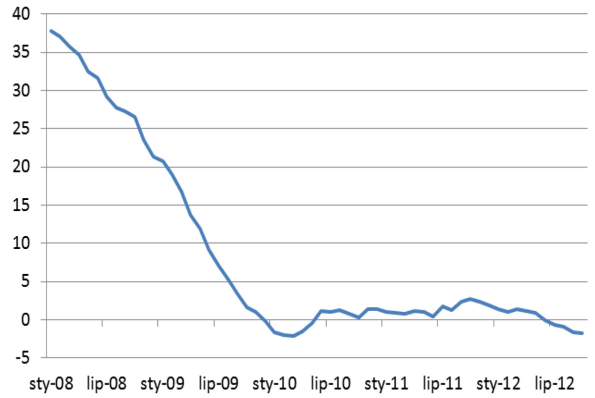


Source: Eurostat

Additionally, weakening external demand led to a drop in the industrial sector activity and contributed to stagnation in the region's labour markets (although a rise in activity in industry in the years 2010-2011 had not resulted in any significant increase in employment in the CEE countries). In most CEE countries, except for the Baltic states, the situation in the labour markets in 2012 did not show any substantial improvement and in the Czech Republic and Bulgaria it even worsened (Bulgaria has noted persistent drop in employment since 2009).

In 2012, in spite of the marked slowdown, the CEE region still recorded strongly diverse trends in domestic demand. The fastest growth took place in the Baltic states (5.3% in the first three quarters of 2012 compared to 0.3% in the remaining CEE countries). However, it should be mentioned that in spite of a rapid growth in the last quarters, domestic demand in the Baltic states persisted at approx. 20% below its 2008 level. Also Romania recorded relatively fast domestic demand growth rate, especially with respect to fixed investment, which took on the role of the primary driver of the country's economic growth. Fixed capital formation growth in Romania was mainly attributable to rising public investment, which was necessitated by prompt use of European funds.

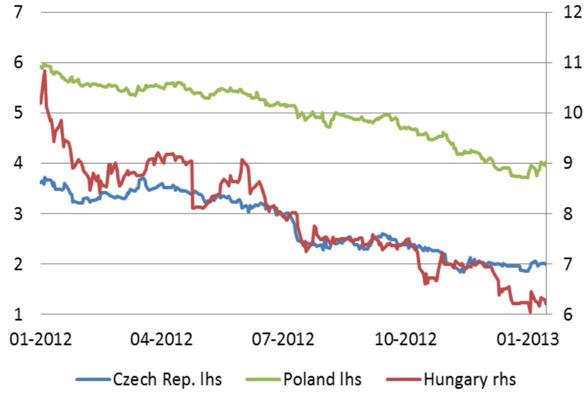
Private sector loans in the CEE countries, average, in % y/y



Source: Central Banks

The stabilisation in the European financial markets in the second half of 2012, following the activities of the European Central Bank and other central banks (liquidity provision to the banking sector) and the easing of political tension relating to the situation in the euro area peripheral countries had a considerable influence on developments in the financial markets in the CEE countries. Declining global risk aversion and excess liquidity in the banking system contributed to the increased interest of foreign investors in Central and Eastern European markets. It affected, among others, yields on Treasury bonds in the observed countries (in Czech Republic and in Poland they reached all-time lows in December 2012), caused an appreciation of the CEE countries' currencies and stock market indices increase.

Yields on 10-year Treasury bonds in %



Source: Reuters

According to forecasts published in the 2012 Q4, the most severe slowdown took place in 2012. GDP in the whole region expanded (according to the forecasts of the European Commission - EC) by a mere 1.0%. According to the projections, the coming years will bring a modest recovery, although Poland and the Baltic states can expect a slight slowdown. According to EC forecasts, in 2013 growth in all CEE countries will accelerate to 1.5% and in 2014, to 2.4%. This modest GDP growth acceleration will mainly be supported by rising domestic demand, anticipated virtually throughout the region. A minor slowdown will only be observed in the Baltic states (especially in Estonia, where two-digit fixed capital formation growth rate shows clear signs of weakening) and in Poland. Net exports contribution, in turn, is to decline gradually. Although exports are expected to recover, among others, due to economic recovery in the euro area, imports should grow at an even faster pace.

COUNTRIES OF CENTRAL AND EASTERN EUROPE

Further slowdown in the CEE economies in 2012

From the beginning of 2012, real GDP growth in most CEE countries slowed down. In 2011 Q4, these economies were growing at an average pace of 2.8%, y/y (3.2% y/y in the whole 2011) whilst in 2012 Q3, growth dropped to 0.6%. The Czech Republic, Romania, Slovenia and Hungary recorded a GDP decrease (in the Czech Republic, Slovenia and Hungary, output declined already at the beginning of 2012). The slowdown was relatively mildest in the Baltic states, especially in Latvia, where the annual GDP growth exceeded 5% in all of the three quarters of 2012. At the same time, only the Baltic states, Poland and Slovakia recorded GDP growth in quarter-on-quarters terms in all three quarters of 2012.

Ongoing euro area crisis had an impact on economic situation in the region

The exacerbating crisis in the euro area was the main reason for the economic slowdown in the CEE countries. Foreign trade was one of key channels of transmission. Taking into consideration the structure of most the CEE economies (small open economies with strong ties to the euro area), subdued demand from its major trade partners has contributed, directly and indirectly, to the contraction in economic activity.

Deleveraging in the European banking sector had a similar effect. It led to an outflow of capital from CEE countries (withdrawal of foreign deposits and loans repayment by the CEE located banks), which impeded consumption growth and reduced fixed investment outlays.

Noticeable slowdown in domestic demand

Annual consumption growth, both private and public, as well as investment, was increasingly subdued in each subsequent quarter of 2012. In the third quarter of the previous year, the contribution of all three categories to annual GDP growth in the CEE region was reduced to zero. At the same time, from the beginning of 2012, the cycle of inventories reversed. A rise in inventories observed in 2011 in the economies of the region was one of the driving forces of economic growth, yet each of the first three quarters of 2012 saw a downfall. In 2012 Q3, inventories detracted 1.3 pp. from the region's growth.

Diversified domestic demand growth

Subdued growth of domestic demand observed in the first three quarters of 2012 did not affect all of the region's economies to the same degree. Robust consumption and investment expansion continued in the Baltic states[1], especially in Estonia, where annual growth in both categories had gone further up on its 2011 level. The pick-up in domestic demand was also noted in Bulgaria and Romania, where it replaced net exports as the main growth contributor.

In the remaining countries of the region, domestic demand growth, which already in 2011 was slower than in the Baltic states, continued on a gradual downward trend. It was especially noticeable in Czech Republic, Slovenia and Hungary, where the annual private consumption and investment growth dropped below zero, contributing heavily to the recession in these countries. Poland and Slovakia, countries characterised by relatively strong domestic demand growth in 2011 (in Slovakia it applied only to fixed capital formation), recorded a marked downward shift in the growth rate in each of the first three quarters of 2012.

Deleveraging of the banking sector continued to subdue domestic demand growth

One of the main factors dampening economic growth in the region, mainly domestic demand growth, was the ongoing private sector deleveraging. Growth in bank lending to the private sector in the CEE countries continued to slacken 2012. It was especially clear in the Baltic states, Slovenia and Hungary.

Private sector deleveraging in the CEE countries resulted from both demand (worsening growth prospects limited the propensity to incur further debt) and to supply factors. The latter was especially visible in the countries where lending in previous years was not based on resident deposits but on foreign capital (mainly loans and deposits of European financial institutions at local branches and subsidiaries). In the first half of 2012, similarly to the second half of 2008, foreign claims on the CEE economies were reduced, albeit the reduction resulted from smaller capital needs of the CEE banks relating to weaker demand for lending. Foreign claims went down by 1.3% in 2012 Q2 compared to 2011 Q4 throughout the entire region (by 1.8% vis-a-vis the European banks)[2]. This, however, meant a significant slowdown in the deleveraging process compared to the second half of 2011. The outflow of capital at that time amounted to almost 15%. In the first half of 2012, Poland, Estonia and Slovakia even recorded an increase of foreign claims.

Net exports the only positive contributor to GDP growth

Export growth in the group of 10 CEE countries dropped from 9.4% in 2011 to 3.2% in the first three quarters of 2012, with Romania recording a decline in that period. Relatively high exports were observed only in Slovakia and the Baltic states. This was mainly driven by strong demand from the countries outside EU-15 (in the case of the Baltic states, it was mainly exports to Russia).

[1] Marked decline in fixed investment was recorded only in Lithuania but the private consumption grew at a pace of 5% y/y.

[2] Based on data of the Bank for International Settlements, *International bank claims, consolidated.*

However, as domestic demand in the CEE countries remained weak, even in the face of a considerable slowdown, the contribution of external trade to GDP growth in the entire region rose from 0.9 pp. in 2011 to 1.9 pp. across the region in the first three quarters of 2012. It meant that it was the only item on the national accounts with a boosting effect on growth. The rising contribution of net exports amidst slower exports stemmed basically from a slower imports growth. Imports of goods and services, which in 2011 had gone up by 7.8%, in the first three quarters of 2012 remained practically unchanged (posting an increase of a mere 0.3% y/y across the region) while Poland, Romania and Slovenia even registered a decrease. Still, not all the countries saw net exports' positive contribution to GDP growth. In Estonia, Bulgaria and Romania it stayed negative. In the case of Estonia, it was largely driven by fast imports growth on the back of over 20% growth in fixed investment. The Balkan countries, recorded a sharp drop in exports, which was attributable to close ties of these countries with the periphery of the euro area, the demand of which was trending downwards at the fastest pace.

Deteriorating consumer and business sentiment

Retail sales figures in 2012 indicated further weakness of consumption in the majority of the region's countries. From January to October 2012, retail sales across the region dropped by 2.5%. Only the Baltic states saw an increase of over 5%, with Latvia posting almost 10%. Other countries recorded a marked drop in retail sales, which, in Slovenia, amounted to 5.7%. Similar conclusions follow from the analysis of consumer confidence indices published by the European Commission. As of the beginning of 2012, they remained at a low levels, similar to those seen in 2009. However, the Baltic states, Hungary and Slovakia observed the improvement in consumer confidence even though the trend was not reflected in consumption and retail sales figures in those countries. The persistently downbeat consumer sentiment was basically attributable to household concerns about the future financial situation combined with the stagnation in labour markets, ongoing financial consolidation and dim outlook for economic growth.

The decline in external demand and exports in 2012 combined with a domestic demand crisis, contributed heavily to the decline in the industrial sector activity, which was the main driving force of economic recovery in 2011. The annual industrial production growth rate amounted to a mere 1.9% in October 2012, significantly decelerating as compared to the beginning of 2011. In 2012, the majority of the countries noted a decline in industrial production growth. The most severe one was recorded in Bulgaria, the Czech Republic, and Romania (in October 2012, the slowdown in production was noted on an annual basis). Industrial production growth rate also went down markedly in Slovakia (yet, except Lithuania, it was still the highest in the region), although at the beginning of 2012 it was far the highest in the region (due to strong US and Asia's demand for cars manufactured in Slovakia).

The persisting euro area crisis seems to be the main reason for the weakening industrial output growth in the region. Indices describing sentiment in industry also point to the fact. Indices published by the European Commission in 2012 continued on a downward trend. The most severe drop was recorded in the Czech Republic and Slovakia, that is in the countries, in which industry was of major importance to economic growth in previous years. PMI indices for Poland, the Czech Republic and Hungary were also running below the threshold of 50 points[3] already in the 2012 Q2 and until the end of the year they continued to indicate recession in industry. Economic slump among major trading partners (euro area countries) resulting in falling export orders and the need to limit current production were the main reasons for declining sentiment.

Still no improvement in the labour market

Stagnation in the labour markets was one of key reasons why private consumption remained sluggish in the first three quarters of 2012 in the CEE countries. A marked drop in the harmonised unemployment rate compared to end-2011 took place only in the Baltic states (on average by 1.4 pp.[4]). A minor decline in the unemployment rate was also observed in Romania and Hungary. In Bulgaria, the Czech Republic, Poland, and Slovakia the unemployment rate went up in course of the same period. The Baltic states and Slovakia were marked by the highest unemployment in the region, exceeding 10% in the 2012 Q3. The lowest unemployment rate in October 2012 was recorded in Romania (6.9%) and the Czech Republic (7.3%). The first half of 2012 also saw a growing number of the long-term unemployed. In Latvia and Slovakia, it accounted for 9% of the entire economically active population.

The number of employed in the CEE countries in the first half of 2012 practically did not change compared to 2011 Q4 (posting an increase of 0.1% across the region). It meant, that the number of employed in the region's economies was over 3% lower than in the second half of 2008. Similarly to the unemployment rate, the highest rise in employment was recorded in Estonia, Lithuania[5], Hungary and, above all, in Romania, where the number of jobs went up by 3.5% in the first half of 2012. At the opposite end were Bulgaria, the Czech Republic, Slovenia

[3] Only PMI index for Hungary in single months 2012 was above 50 points; however throughout the whole of 2012 its values were subject to sharp fluctuations.

[4] The data take into consideration the methodology changes introduced in Latvia in the 2012 Q1. Due to the census carried out in Latvia the number of people employed in the economy and the number of unemployed was verified, which contributed to one-off drop in the number of the employed in economy and a rise in the unemployment rate. Barring those changes, the unemployment rate in Latvia would have been lower by 1.5 pp.

[5] According to statistics, employment in Latvia in the Q1 dropped by 110 000 persons compared with the 2011 Q4; still, it resulted from the above-mentioned correction of data and caused that data on activity rate in 2011 and 2012 were not comparable.

and Slovakia, where the number of the employed declined in the first half of 2012.

Deceleration of activity in industry in 2012 had effect on the reduction of employment in this sector. In the first three quarters of 2012, it dropped by 2.8% throughout the region. Lower employment in industry was recorded in almost all economies of the region except the Czech Republic and Latvia. Employment in construction also continued its downward trend. Only some services sectors such as information technology and telecommunication or financial intermediation saw significant improvement in employment.

EC forecasts from October 2012 indicate that stagnation in labour markets in the CEE countries registered in 2012 will continue in 2013 or even in 2014. Additionally, the number of employed in the region's economies will rise only very slowly, particularly in 2013. EC does not expect any sizeable drop in the unemployment rate either. In the Baltic states, where the greatest labour market improvement has been observed so far, the pace of employment growth and the fall in unemployment will be the highest in the region but definitely lower than in 2011-2012. The prospects for Bulgaria, the Czech Republic and Slovenia are the bleakest. These countries can expect a further reduction in employment and a rising unemployment rate in 2013 (in Slovenia also in 2014), which will be affected by limiting employment in the public sector in the years to come.

Further increase in unit labour costs despite slower wage growth

The entire CEE region recorded slower nominal wage growth in the first half of 2012 (its rate amounted, on average, to 3.8% y/y compared to 5.1% in the second half of 2011). Slower wage growth was recorded in almost all countries except Slovenia and Latvia and concerned both the private and the public sector. Weaker wage growth amidst relatively high inflation persisting in the first half of 2012 resulted in shrinking real income in some countries of the region (the Czech Republic, Hungary, Poland, Slovenia).

In spite of slower wage growth, the region's economies recorded faster growth in unit labour costs (ULC)[6]. The increasing ULC growth rate was driven by slowing economic activity, while the number of employed remained practically unchanged in the first half of 2012. A fall in ULC growth rate was only recorded in Bulgaria and Slovakia. In Bulgaria, it was mainly associated with weaker wage growth (which was still the highest one amongst the region's countries), while in Slovakia it stemmed from a relatively minor deceleration in GDP growth.

According to EC projections, wage growth in the majority of the CEE countries in 2013 is set to decline. Productivity in turn, is anticipated to rise slightly, mainly in result of the expected economic recovery. After taking into consideration both factors, the EC anticipates the decline in ULC growth in 2013 compared to 2012.

Inflation determined by food and energy prices

Inflation in the CEE countries in 2012 was primarily affected by supply factors, mainly food prices, and in the first half of 2012 by prices of energy products and raw materials. Deteriorated consumer sentiment observed at the beginning of 2012, resulting from stagnation in the labour market, low supply of consumer loans as well as fears of future financial situation, curbed the inflation pressure. The fact was reflected in a fall in core inflation (HICP excluding energy and food prices) in the region in the course of the entire 2012.

In the first months of 2012, inflation declined. In January, it amounted to 3.8%, subsequently peaking in February at 4.0%, to gradually drop off in the following months (to 3.3% in May). The decline in inflation stemmed mainly from slower food (non-processed and processed) and energy prices growth. From February to May 2012, food prices growth rate fell from 4.3% y/y to 3.1% y/y. Energy price growth rate decreased from 9.6% to 8.6%. These two groups of prices were responsible for the entire inflation decline in in the region in that period.

The downward trend was reversed in 2012 Q3. Annual HICP growth rate accelerated from 3.3% in May to 4.2% in September 2012. Inflation picked up almost entirely on the back of rising unprocessed food prices. Due to poor harvests, food prices (particularly those of vegetables) accelerated from -0.1% to 9.2% in the period under review. In October and November 2012 inflation fell back to lower levels (3.2% across the region in November 2012). Unprocessed food prices growth slowed down (to 7.2%) as the effects of the supply shock in the agriculture market have begun to wane. At the same time, in November 2012, the energy prices growth rate also fell off markedly. Still, many countries of the region (Latvia, Romania, Slovakia) saw a pass-through effect of higher unprocessed food prices to other price categories (resulting, above all, in an increasingly faster growth of processed food prices).

Similarly to previous years, in 2012 inflation levels were diversified among the individual CEE economies. The lowest average inflation from January to November 2012 was recorded in Bulgaria (2.3%) and in Latvia (2.4%). The highest was observed in Hungary (5.7%), which was driven up by the VAT rate increase of 1 pp. at the beginning of 2012.

In the first half of 2012 core inflation stabilised in the countries of the region (2.4-2.6% for the entire CEE region), after a period of growth in the second half of 2011. However, it was the highest level observed since 2009 Q4. In the following months, core inflation was seen to decline steadily. In November 2012, it amounted to 1.9% across the region.

[6] Nominal unit labour costs for the entire economy

Expected further decline in inflation

According to the European Commission forecasts, the increase in inflation recorded in 2012 Q3 should not be lasting. In 2013, the majority of the CEE countries can expect slower consumer price growth, especially in the second half of the year as base-effects associated with high growth in food prices will fade away. Only Bulgaria and Romania expect a slight rise in inflation, which will mainly originate from the effects of rises in energy prices prevailing until September 2013. In some CEE countries, the continuation of fiscal tightening will lead to higher indirect taxes (in the Czech Republic and Hungary the VAT rate is expected to rise) still, its impact on inflation will be smaller than in 2012. Forecasted stabilisation on the food and energy commodities markets in 2014 is set to hold the inflation down. On the other hand, the expected gradual economic recovery and growing consumption will contribute to a rise in core inflation.

Monetary policy easing

The ongoing economic slowdown and the fall in inflation observed in the fourth quarter of 2012 as well as expected continuation of this trend in 2013 encouraged the monetary authorities to ease their policies in the second half of 2012. Central Banks of Poland, the Czech Republic, and Hungary[7] decided to lower their interest rates. The National Bank of Poland (NBP) reduced the reference rate by 50 bp. to 4.25%, the Czech National Bank (CNB) by 70 bp. to 0.05%[8], and the Hungarian National Bank (MNB) by 125 bp. to 5.75%. Only the National Bank of Romania (BNR) did not decide to lower interest rates in that period. In Romania such measures were taken in the first half of 2012, when the main policy rate was reduced by 75 bp., down to 5.25%.

Interest rate cuts introduced by central banks were accompanied by a decline in interbank interest rates. In the second half of 2012, the three-month interest rates in Poland, the Czech Republic and Hungary declined by even more than the central banks' policy rates, which was additionally fuelled by falling risk aversion and an increase in liquidity in the European banking sector. Other countries of the region demonstrated similar tendencies. The decline was induced by easing of the monetary policy by the European Central Bank[9] (liquidity injections). Only in Romania interest rates in the interbank market increased in that period.

Further improvement in fiscal stance

According to EC forecasts of November 2012, the general government balance in 2012 in the majority of the CEE countries improved compared to the previous year, as a result of the adopted consolidation measures. Their extent, as measured by the primary structural balance amounted to approximately 1.6 pp. of GDP in the region (compared to 1.8 pp. of GDP in 2011). The largest consolidation effects were observed in Romania (2.5 pp. of GDP), Hungary (2.4 pp. of GDP), Lithuania (2.3 pp. of GDP), Slovenia (2.2 pp. of GDP), and Poland (2.1 pp. of GDP). The general government deficit in 2012 is to decrease significantly in Romania (by 2.7 pp. of GDP), Lithuania (by 2.3 pp. of GDP) and Slovenia (by 2.0 pp. of GDP). The Czech Republic, Estonia and Hungary, in turn, are expected to increase their deficit. The deterioration in the general government balance in 2012 in these countries will result from one-off factors[10].

In most of the region's countries, economic situation in 2012 deteriorated, which hindered the achievement of budgetary targets provided for in the Stability/Convergence Programmes updates for 2012. In order to hold the deficit down, the Czech Republic, Slovakia, Romania, and Slovenia undertook additional adjustment measures consisting in curbing the spending (in Slovakia – increasing the revenues[11]). Current EC forecasts indicate that half of the CEE countries will not meet the assumed budgetary targets for 2012. Only in Estonia and Latvia, general government balance in 2012 will be higher than previously assumed, which is attributable to better economic situation.

The deadline for curbing budget deficit imposed on Poland, Hungary, Romania, Lithuania and Latvia under the excessive deficit procedure (EDP) passed in 2012. According to EC estimates, in 2012 only Romania, Latvia and Hungary will decrease the scale of fiscal imbalance below the reference value (3% of GDP). A long-lasting reduction in Hungary's general government deficit will

[7] The central Banks of these countries and Romania were the only ones in the CEE region to pursue the policy of Explicit Inflation Targeting.

[8] According to CNB it is the level of "technical zero".

[9] Other CEE countries are either euro area member states (Estonia, Slovakia, Slovenia) or their currencies are pegged to the euro (Bulgaria, Lithuania, Latvia).

[10] Budget surplus in Hungary in 2011 (4.3% of GDP) was achieved as a result of nationalisation of the funded pension system (transfer of assets amounting to 10% of GDP). After eliminating this factor, Hungary will be the country that has reduced the negative public finance balance by the most in 2012 (by approx. 2.9% of GDP). The increase in the general government deficit in the Czech Republic (from 3.3% of GDP in 2011 to approx. 5.0% of GDP in 2012) is related, apart from the deterioration of economic situation, to the restitution of church property (approx. 1.5% of GDP). In Estonia, the budget surplus (1.1% of GDP) in 2011 resulted from, inter alia, high revenue from the sale of rights to CO2 emission (approx. 1% of GDP). In 2012, part of these resources will be allocated to environmental investment, which with the end of consolidation measures undertaken in 2009 will contribute to the deterioration of the general government sector balance of Estonia (deficit at the level of 1.1% of GDP).

[11] Extension of the bank tax base (since September 2012), one-off special bank tax in 2012, a special fee paid be enterprises operating in regulated industries, earlier increase in excise tax on tobacco products (moving from March 2013 to October 2012). These operations are an element of the consolidation package adopted in Slovakia in mid-2012 and the impact of such measures will account for approx. 0.2% of GDP. Additionally, in August 2012, a pension system reform was adopted, which provides for, among other things, a reduction in the contribution transferred to pension funds from 9% to 4% from September 2012 with an option of withdrawal from open pension fund (collected contributions will be transferred to the state pension fund (improvement in the result of 2012 by approx. 0.3% of GDP).

require additional consolidation measures. The deficit in Poland and Lithuania will exceed 3% of GDP (3.4% and 3.2% of GDP, respectively). According to the provisions of the so-called 'six-pack' package, a decision on lifting EDP will take into consideration the costs of pension scheme reform introducing the capital-funded pillar to the pension scheme.

Slower pace of fiscal consolidation in 2013-2014

A significant reduction in the budget deficits of the CEE countries in previous years and forecasted economic rebound in the majority of countries make the necessary scale of fiscal adjustments smaller. According to the EC forecasts, the pace of fiscal consolidation (as measured by the change in primary structural balance) will fall from approx. 1.6-1.8 pp. of GDP in the years 2011-2012 to 0.6 pp. of GDP in 2013 and approx. 0.2 pp. of GDP in 2014. Only in Slovenia, in spite of the adjustment measures launched, the negative balance of the general government sector will significantly exceed 3% of GDP (4.1% GDP in 2014). The path of the deficit reduction in the CEE countries will be less ambitious than provided for in the latest Stability/Convergence Programmes updates, which is due to the fact that the economic growth forecasts remain dim.

In the Czech Republic, Slovenia and Slovakia, adjustment measures will continue in line with the deadline set under EDP (2013), due to the need to stem the general government deficit below 3% of GDP. The Czech Republic and Slovakia are planning to increase taxes while Slovenia will restrain the public spending. According to EC forecasts, the country will need further measures reducing the fiscal imbalance[12]. Fiscal tightening[13] in 2013-2014 is set to take place in Romania (1.4 pp. of GDP), Poland (1.2 pp. of GDP) and Lithuania (1.0 pp. of GDP). However, its scale will be narrower compared to 2011-2012[14]. In 2012, Hungary adopted a package of additional adjustment changes (1.3% of GDP in 2013). However, according to the EC, these will not be sufficient to reduce the general government deficit permanently below 3% of GDP. In other countries the process of fiscal consolidation will be milder and the budget deficit in the years 2013-2014 will be kept below 3% of GDP. In Estonia, Bulgaria and Latvia[15] freezes or reductions in expenditure on the government sector wages or social benefits will cease[16]. Latvia is expected to increase the contribution to pension funds[17] and reduce VAT and PIT[18] rates. Budgetary targets in the CEE countries will be at risk in subsequent years due to poorer-than-expected macroeconomic conditions.

Moderate pace of the public debt increase

According to EC forecasts (of November 2012), the increase in the public debt in the majority of the CEE countries in 2013-2014 will remain moderate (except Slovenia[19]), thanks to an improvement in the fiscal stance. In the case of Bulgaria, Lithuania and Hungary, the debt-to-GDP ratio is projected to drop (by approx. 1.1-1.6 pp.). The level of the general government debt in Hungary will remain considerably above the reference value (77.1% of GDP in 2013, 76.8% in 2014). Hungary will be the only country of the region where Treasury bonds are given junk status by all the three rating agencies. In Estonia, Slovenia and Slovakia, being the euro area members, the sovereign debt increase will be fuelled by the transfer of funds under European Financial Stability Facility (EFSF). In the case of Slovenia, further support to the banking system planned for 2013 is a risk factor to the forecast[20].

Further reduction in external imbalances

In the first half of 2012, the current account deficit in the CEE region continued to decrease. In 2012 Q2, it amounted to 2.7% of GDP (4q moving average) as compared to 3.1% of GDP in 2011. This decrease resulted primarily from an improved foreign trade balance. In spite of a markedly slower export growth in the first half of 2012, weak domestic demand contributed to an even slower imports growth. A deterioration in the foreign trade balance was recorded only in Estonia and Latvia, where strong domestic demand resulted in robust imports growth, and in Romania, which recorded a noticeable fall in exports. The reduction of external imbalances in the region in the first half of 2012 also resulted from lower deficits in income and a higher surplus in services. The surplus in current transfers showed a mild downward trend.

---

[12] According to the EC Autumn forecast (of November 2012), the deficit of the public finance sector in 2013 will exceed 3% of GDP also in the Czech Republic and in Slovakia, possibly going slightly above the expected forecasts (0.4 pp. of GDP and 0.2 pp of GDP, respectively). In the case of these countries, it would be possible to take into consideration the costs of pension system reform while taking decision on abrogating the EDP.

[13] Measured by the change in the primary structural balance.

[14] According to EC estimates, the primary structural balance in 2011-2012 was reduced in Romania by 5.8 pp. of GDP, in Poland by 5.1 pp. of GDP. and in Lithuania – by 2.4 pp. of GDP.

[15] Minor wage increase in the civil service. In Latvia, expenditure on social transfers will remain frozen.

[16] Wages in civil service were increased also in Romania as a result of a verdict pronounced by the Constitutional Court of Romania. In other CEE countries, these activities have been continued.

[17] Contribution to pension funds was reduced in Latvia as of May 2009 from 8% to 2% of the base amount. Since 2013, the contribution rate is set to increase to 6% of the base. Also in other countries of the region, which in 2009 (Poland – 2011) reduced or suspended the transfer of contributions to open pension funds, in 2013 and in subsequent years the contribution will be increased (Poland, Romania, Estonia, Lithuania).

[18] Since July 2012, VAT rate has been reduced in Latvia by 1 pp. Also, a gradual reduction in the PIT rate from 25% to 20% (by 1 pp. has been adopted since 2013 and by 2 pp. in 2014 and 2015).

[19] According to EC's autumn forecasts, public debt in Slovenia in 2013-2014 will increase by 8.3 pp. of GDP (to 62.3% of GDP). In other countries, the growth of debt will not exceed 4.2 pp. of GDP (Slovakia; Poland, Estonia – approx. 0.6-0.7 pp. of GDP, Latvia and the Czech Republic – 3.0 pp. of GDP).

[20] According to IMF estimates, at 2013 year-end sovereign debt in Slovenia would thus amount to approx. 67.3% of GDP (EC – 59.0% of GDP) and in 2014 – 69.0 % of GDP (62.3% of GDP).

The acceleration in foreign trade anticipated in the CEE countries in 2013 will apply to exports rather than imports, which will contribute to a further, however smaller than in 2012, improvement in the foreign trade balance in the majority of the countries. Only in Bulgaria, Romania (economies tied to the southern euro area periphery) and Lithuania, the deficit in foreign trade will go up. In 2014, the expected boost in the economy will be accompanied by a rise in imports, which will involve a slight drop in the goods balance. The situation in foreign trade in the coming years will be the main determinant of the current account balance. In 2013, the EC expects the deficit to be on a downward path in the entire region, which may be additionally boosted by the reduction in the deficit in income (lower profits transfer by enterprises with foreign capital). The year 2014 will see slight reduction in the current account balance.

Lower inflow of foreign investment as a result of capital outflow from the banking sector

In the first half of 2012, the inflow of foreign capital to the CEE countries was distinctly lower. At the end of 2011, it amounted to 3.2% of GDP and in 2012 Q2 (4q moving average) it dropped to 1.1% of GDP. Such a big drop resulted almost entirely from rapidly rising outflow of capital under "other investment", mainly deposits and loans granted by foreign banks to banks in the CEE countries. In 2011 Q4, the outflow amounted to 0.7% of GDP, and in 2012 Q2, it grew up to 3.0% of GDP. Yet, not in all countries the process of deleveraging of the banking sector proceeded at an equal pace. In Bulgaria, Estonia and Lithuania, that is in the countries where intensive outflow of other investment started in 2009, in the first half of 2012 the outflow began to slow down.

Inflow of foreign direct investment in the first half of 2012 was kept at a similar level as in 2011 while in the Czech Republic, Slovakia, Hungary, and Bulgaria, it was even distinctly trending upwards. However, the structure of foreign direct investment changed. In the first half of 2012, inflow of equity capital was replaced by intra-company loans. At that time, inflow of portfolio investment, driven by growing interest of foreign investors in the Polish, Czech and Slovak Treasury bonds, remained high.

Improved confidence boosts CEE financial markets

Bringing situation in the European financial markets under control in the second half of 2012 owing to the activities of the European Central Bank and other central banks (liquidity injection to strengthen the banking sector) as well as easing of political tension resulting from the situation in the euro area peripheral countries, had a great influence on the developments in the financial markets of the CEE countries. The decline in risk aversion and excess liquidity in the global banking system boosted the interest of foreign investors in the CEE markets. It resulted in narrower spreads on Credit Default Swaps (CDS) and an increase in the value of financial instruments.

From June to December of 2012, CDS quotes in all countries of the region declined markedly. The greatest drop (of over 300 bp.) took place in Hungary in spite of prolonged negotiations of the Hungarian government with the IMF and EC over granting new loan. Hungary remained the lowest-rated economy of the region (CDS for 5-year Treasury bonds amounted in mid-December 2012 to almost 290 bp.). The Czech Republic, Estonia and Poland (CDS approx. 70 bp.) were considered as the safest countries.

The drop in risk aversion was also noticeable in the appreciation of the region's currencies. From the beginning of June until the end of 2012, the Polish zloty strengthened by 7.5% against the euro, Hungary forint by 4.5%[21], and the Czech koruna by almost 3%[22]. Only the Romanian leu continued to weaken slowly in the second half of 2012. Only in December last year it strengthened against euro.

Bond yields responded distinctly to the increased demand of foreign investors. All the countries of the region, except Slovenia[23], recorded a sharp decline in 10-year Treasury bond yields. A significant decline in yields was noted in Poland (a fall to below 4% in December 2012), the Czech Republic (below 2%), and Bulgaria (approx. 3.5%). In all these countries, they hit their all-time lows.

Major stock markets also followed an upward trend in the second half of 2012. Stock exchange indices picked up substantially. From mid-May to mid-December 2012, the Hungarian BUX recorded an increase of almost 10%, the Czech PX of over 15%, and the Polish WIG of over 25%.

Slow recovery in 2013-2014

The euro area crisis seems to be a major threat to economic growth in the CEE countries not only in 2012 but also in the years to come. Apart from directly impacting on the region's economies by curbing external demand, the crisis in the euro area may affect the CEE countries also through other, indirect, transmission channels. Among them are further restrictions in lending activity introduced by local branches of the European banks or a cut-back in capital inflows from the Western European countries.

Additional factors dragging on domestic demand growth may include: continued fiscal consolidation, although its impact should be smaller than in 2011-2012, and persistent stagnation in the labour market. In spite of stabilisation in financial markets observed in the second half of 2012, a threat of the return of high risk aversion (caused, among others, by new problems that may

[21] The Hungarian forint depreciated markedly against the euro in the second half of December 2012 in response to further interest rate cuts.
[22] However, it should be noted that the Czech koruna in recent years, has definitely been the most stable currency in the region and the scale of its depreciation in the early months of 2012 was definitely smaller than in the case of PLN and HUF.
[23] It resulted, among others, from the downward revision of Slovenian Treasury bond rating by all the three major rating agencies in August and September 2012.

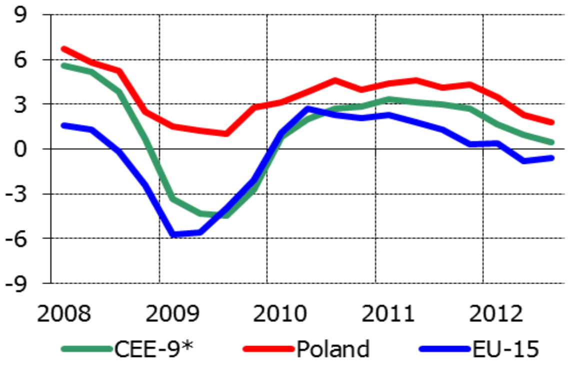
emerge in peripheral euro area countries) is prevailing at all times, which would result in a depreciation of the region's currencies and an increase in the Treasury bonds yields, similarly as at the end of 2011 and the beginning of 2012. It would result not only in higher costs of foreign currency loans service (especially in the case of the public sector) but would also affect disposable income of foreign currency indebted households (particularly in Romania and Hungary, where these accounted for the largest share of all households among CEE countries).

The anticipated gradual acceleration of economic growth should first of all result from expansion in domestic demand, which is expected almost in the entire region. Domestic demand growth is only expected to slow down somewhat in the Baltic states (especially in Estonia, where high, investment growth - over 20% - recorded in 2011 and 2012 seems unlikely to be upheld) and in Poland. The contribution of net exports, in turn, should gradually decrease. Indeed, the forecasts point at a slow recovery in the euro area countries, which should result in rising exports from the region's countries. Yet imports are expected to rise even faster.

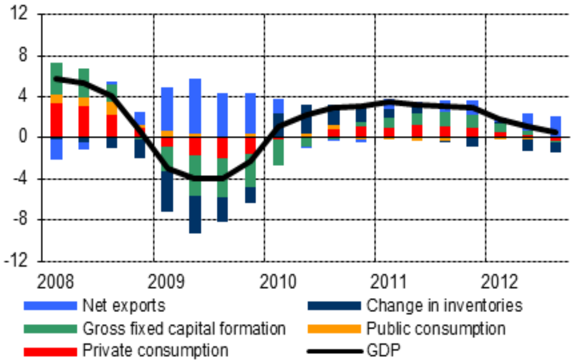
This opinion seems to be confirmed by the EC forecasts published in November 2012. They suggest that the most severe fall in GDP growth took place in 2012, when economy of the entire the region grew by only 1.0%. In the following years, the EC expects a gradual acceleration of growth, although not in Poland or in the Baltic states. In all CEE countries in 2013, the GDP growth rate is set to reach 1.5%, and in 2014 - 2.4%. Still, it indicates slight downward correction against spring forecasts, when the EC expected economic growth at the level of 1.5% in 2012 and 2.3% in 2013.

GDP growth is projected to be the highest in the Baltic states in 2013 and 2014, similarly to 2011-2012, and it should continue to exceed 3% in the course of these years. At the opposite end is Slovenia, where the slump will continue into 2013.

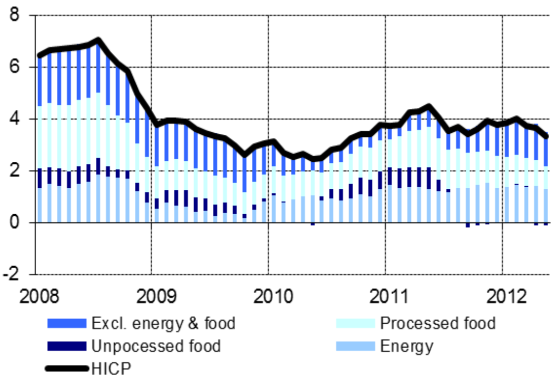
Growth of GDP (%, y/y)



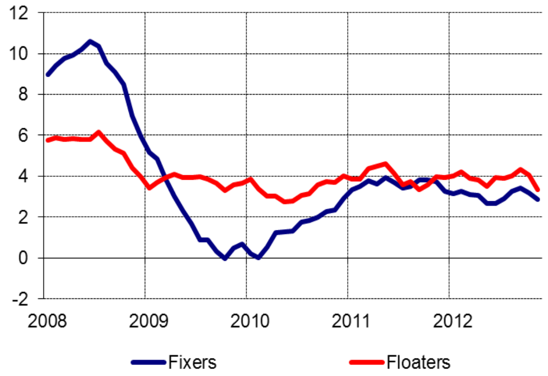
Contribution to GDP growth (pp., y/y) in the CEE countries



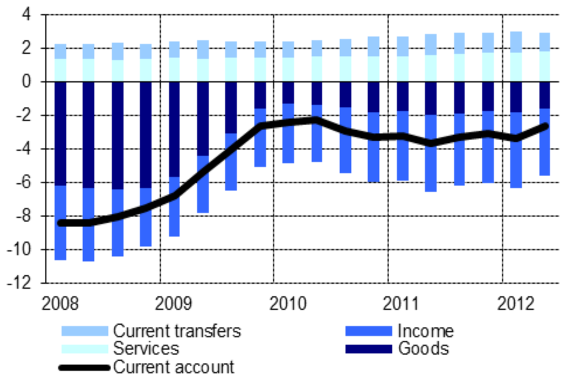
HICP inflation and its components (%, y/y)



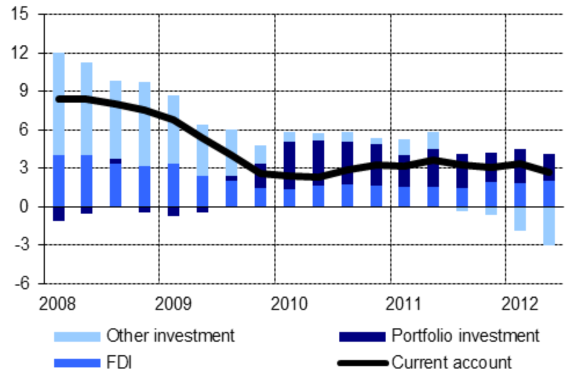
HICP inflation (%, y/y)



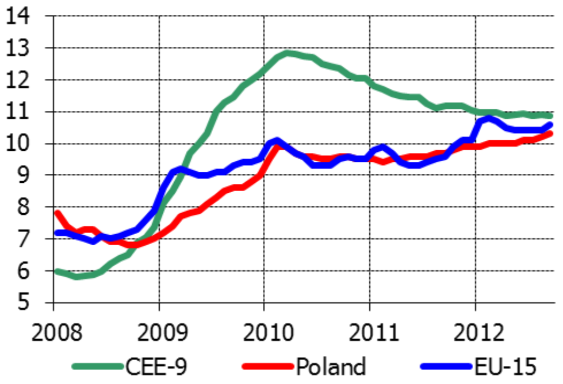
Current account and its components (in % of GDP, 4-quarter moving average)



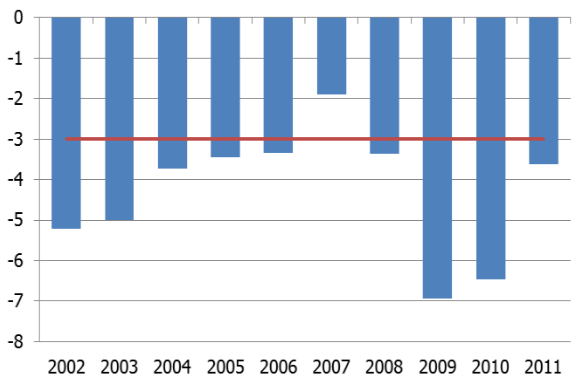
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%)



General government balance (% of GDP)



Source: Eurostat, CSOs

BULGARIA

Consumption expands in spite of tight labour market

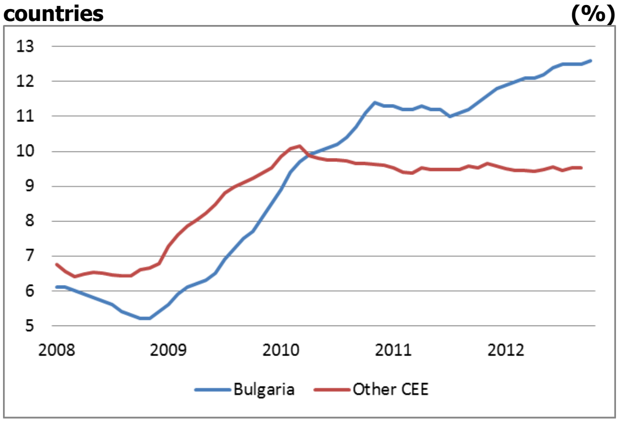
During the first three quarters of 2012, economic activity in Bulgaria slowed down, barely exceeding 0.5% in annual terms (compared to 1.7% y/y in 2011). While in the years 2010–2011 economic revival was mainly driven by net exports, in the first three quarters of 2012, domestic demand became a substantial driving force behind positive economic growth. The main factor contributing to it was a rising consumption by Bulgarian households (an increase of 3.1% y/y in Q1-Q3 2012 compared to -0.6% y/y in 2011). Hence the sustainability households consumption growth seems to be a major issue as regards the Bulgarian economy, particularly taking into consideration the deterioration of external conditions. The increase in private consumption in the first three quarters of 2012 in Bulgaria resulted mainly from a declining savings rate of households in 2012. The savings rate in the Bulgarian economy dropped from 25% in mid-2011 to 22% in 2012 Q3. It seems to imply that the current increase of household consumption was financed by savings. Simultaneously, the deteriorating situation in the Bulgarian labour market in the mentioned period definitely did not inspire consumers with optimism.

Contrary to the majority of the countries in the region, the adjustment in the Bulgarian labour market was mainly achieved through workforce downsizing and to a lesser extend through wage cuts. From the beginning of the economic slump until 2012 Q4, the unemployment rate more than doubled (from 5.2% in October 2008 to 12.6% in October 2012) while the employment rate went down by over 10 pp. Excepted the Baltic States[24], this was the biggest labour market adjustment in the CEE countries. Other indices of the labour market worsened similarly. In the years 2010-2012, the long-term unemployment rate doubled. The percentage of discouraged workers also went up, which was evidenced, inter alia, by falling number of candidates per vacancy. In the same time, contrary to other countries of the region, negative trends were not mitigated even during economic recovery after the first stage of the crisis in the years 2010-2011, when the number of unemployed kept growing.

Rising unemployment and shrinking employment in Bulgaria were not reflected in wage dynamics, which since 2008 was the highest among CEE countries (almost 7% in 2012 Q3). Due to a freeze in the public sector wages, the private sector accounted for the bulk of the wage increase in the economy.

The specific developments in the Bulgarian labour market, i.e. a pronounced fall in employment amidst a sustained relatively strong wage growth resulted from a number of factors. Above all, the strongest adjustment in employment in the last quarters took place in sectors characterized by a relatively low productivity and requiring low-skilled labour force, hence a lower average wage (among others, in the construction sector or retail sales). Large differences in employment and wages trends among particular regions of the country were yet another factor. A relatively steeper decline in employment was observed in the poorest regions of Bulgaria characterised by the lowest average wages. Ultimately, the fact that the majority of people that have lost their jobs in Bulgaria in recent years was earning below the country average, has contributed to an increase in the average wage in the entire economy.

The unemployment rate in Bulgaria and other CEE countries (%)



Source: Eurostat

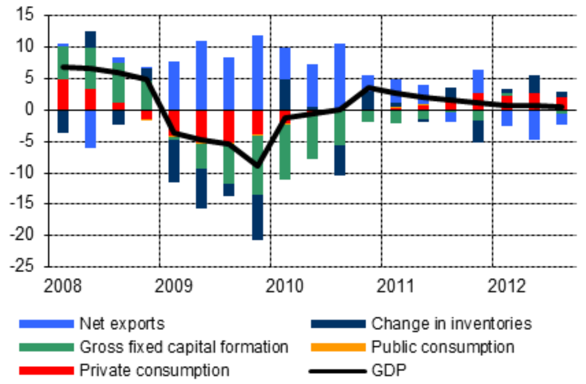
Another factor is the fact that the level of wages in the Bulgarian economy is still the lowest in the whole EU. With a good export performance observed in 2009-2011, one could observe a pressure for wages convergence towards EU levels in the sectors oriented to the sale of goods and services abroad.

Maintaining consumption growth in Bulgaria in 2012 seems to be very difficult without a significant improvement on labour market. The structural specificity of this market in time of external demand slowdown will significantly hinder the process of recovery on the labour market.

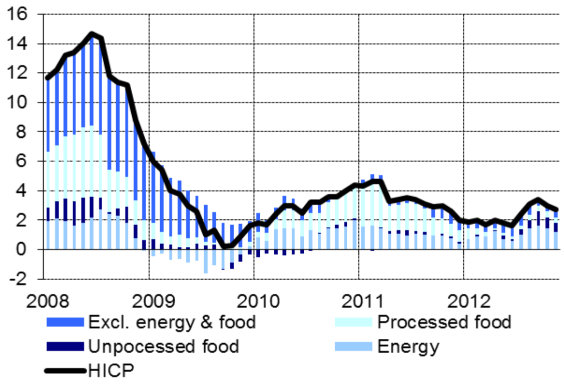
These fears are also reflected in the unemployment rate forecasts that generally do not expect its significant reduction before 2014. The relatively optimistic IMF forecasts set the unemployment rate at 10.2% in 2014. On the other hand, according to the European Commission, the unemployment rate, accompanied by the increase of wages in the economy exceeding 5% per annum, is expected to remain at the level above 12.5% until 2014.

[24] However, in the Baltic States already in 2011, the situation in the labour market began to improve.

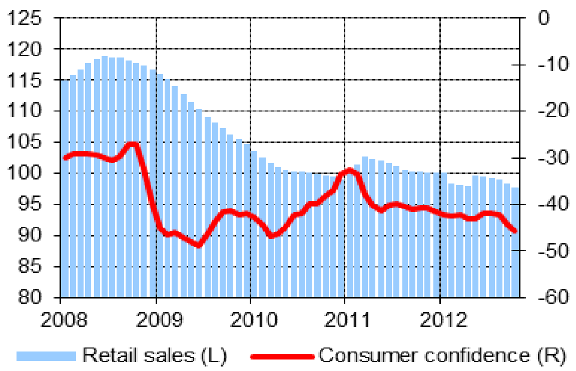
Contribution to GDP growth (in pp., y/y)



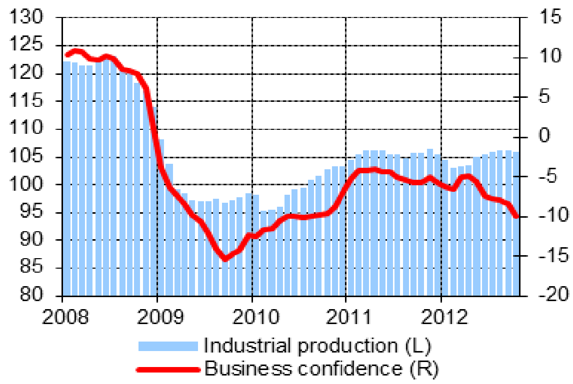
HICP inflation and its components (%, y/y)



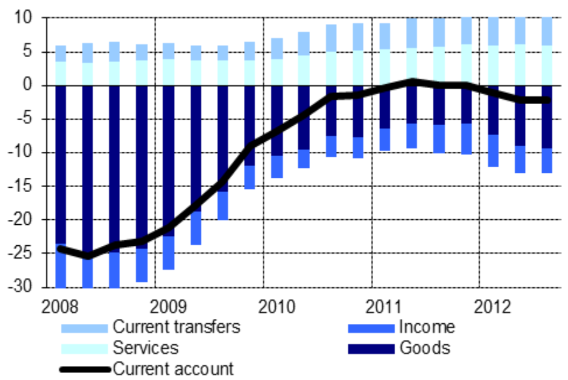
Retail sales (%, y/y) and consumer sentiment index



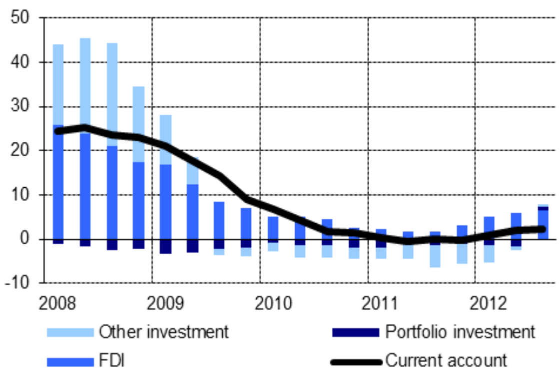
Industrial production (%, y/y) and business sentiment index



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

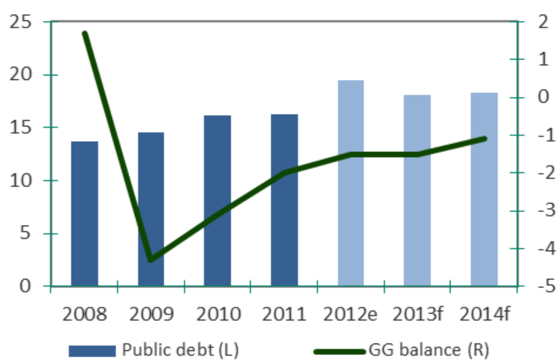


Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and growth of employment (%. y/y)

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

CZECH REPUBLIC
Fiscal tightening deepens recession

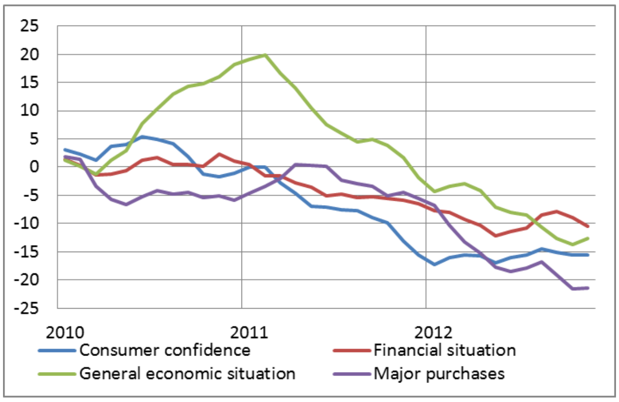
The slump in the Czech economy lasting since the second half of 2011 deepened gradually in 2012. As of 2011 Q3, the GDP of the Czech Republic declined in every subsequent quarter, with a decline of 1.3% y/y recorded in 2012 Q3. It means, that after a period of a rebound that took place after the first stage of a global financial crisis, the country slipped again into a technical recession.

Weakening domestic demand, consumption on particular, was standing behind the GDP decline in the Czech Republic. Both private and public consumption had been on a steady downward path since mid-2010. In the course of the first three quarters of 2012, consumption spending was severely cut. Private consumption dropped by 2.7% y/y (the sharpest drop since 1996 r.)[25] and public consumption by 0.7%. The drop was particularly visible with respect to durable goods (which was rising in 2011).

The main factor that impacted consumption growth in the Czech Republic was the ongoing fiscal consolidation. In 2012 the reduced VAT rate was increased by 4 pp. (up to 14%), the tax on betting and gambling was introduced and wages in the civil service[26] were maintained at the level of the previous year, which, considering inflation growth, reduced households' real disposable income. Facing poorer-than-anticipated macroeconomic situation, the Czech Republic adopted additional cuts in budgetary units spending (approx. 0.6% of GDP)[27] in order to achieve the budgetary target for 2012. According to the estimates by Czech authorities, as a result of suspending part of reimbursement under the European Union funds[28] (0.3% of GDP) and a decision on the payment of compensation for the church property repossessed after World War Two (approx. 1.5% of GDP[29]), the budget deficit in 2012 may amount to approx. 5.0% of GDP. Effectively, in Czech Republic, Hungary, and Estonia, fiscal imbalance increased in 2012 compared to the previous year.

The aggravated situation in the labour market as well as the hike in inflation that took place at the beginning of 2012[30] were the main contributors to the weakening of consumer sentiment. DG ECFIN indices of consumer confidence at that time, similarly to 2011, went down. In effect, retail trade turnover contracted. Expectations of a further deterioration of economic situation in the Czech Republic and the financial situation of households led to an increase in the saving rate (from 9.5% in mid-2011 to 10.2% in mid-2012). It is worth stressing this took place amidst stagnation prevailing in the labour market and a decline in households' real disposable income. The unemployment rate, although the lowest amongst the CEE countries in 2012, was on a steady upward trend (from 6.7% in December 2011 to 7.3% in October 2012). At the same time, employment had been gradually contracting. In the first half of 2012, it was on average 0.5% lower than a year before. Households' disposable income grew by only 0.7% in nominal terms in 2012 Q2, a level which, adjusted for inflation (in the second quarter, it amounted, on average to 3.8%), points to a drop in households' real income[31].

Consumer confidence index in the Czech Republic



Source: European Commission

Investment activity (especially investment in buildings) of households in 2012 also slowed down, which contributed to a fall in gross fixed capital formation in the whole economy. Considering the fact that the economic downturn in industry also brought corporate investment to a standstill, the annual growth of fixed investment throughout the Czech economy in the 2012 Q3 was in negative.

In the first three quarters of 2012, net exports, as the only category, made a positive contribution to annual GDP growth. In the first quarter of 2012, this resulted

[25] In the second half of 2009, private consumption in the Czech Republic dropped by "only" 1.5%.
[26] Except teachers, physicians, judges and prosecutors.
[27] Depending on the amount provided for in a given budget section, it was reduced by 1.5% (for smaller units) or 3.95%. Except budgetary spending on education. In this case, plan reduction was of minor importance.
[28] As a result of objections of the European Commission regarding the audit system of projects with EU funding, the Czech Republic temporarily withheld the submission of applications for the reimbursement of expenditure under operational programmes (Transport OP and Environment OP) until June 2012. Thereby, these projects were in whole financed from national means.
[29] Although payments are spread over 30 years, according to ESA '95 system, the entire expenditure will be charged to 2012 budget result.

[30] In January 2012, due to increased VAT reduced rate inflation went up by 1.1 pp. to 3.8% and was maintained on the increased level throughout 2012.
[31] Low growth of nominal disposable income resulted, first of all, from the fall of social transfers and other income not related with remuneration payable for work.

from relatively high exports growth rate (6.9% y/y). However in the following two quarters, external demand weakened markedly as euro area plunged into a deepening crisis. Annual exports growth rate dropped to 4.7% in 2012 Q3. However, contribution of net exports to economic growth remained positive and even increased. It resulted from a sharp decline in demand for imported goods and services and was an outcome of poor households and enterprises demand.

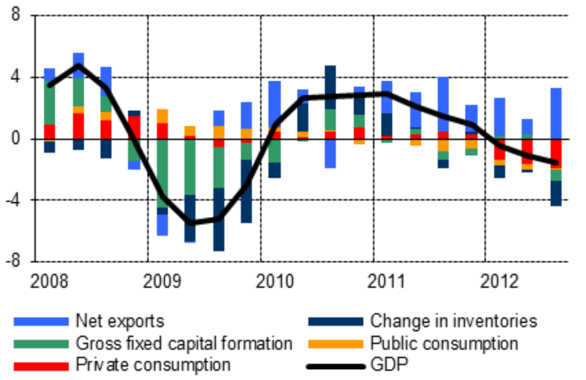
Growth forecasts published in 2012 Q4 by EC and the Czech National Bank (CNB) show the continuation of the recession until at least mid-2013. In the following quarters, the Czech economy is projected to gradually recover. However, the slow recovery will mainly be driven by exports, which will relate to the improvement in the euro area situation. Domestic demand will continue along a downward trend, both in terms of consumption and investment. Czech households and enterprises can no longer rely on the economy being stimulated by monetary policy. The capacity for such measures was severely limited in the second half of 2012, when the CNB main policy rate (2W Repo rate) was reduced to 0.05% ("the technical zero"), mainly as a response to restrictive fiscal policy. Yet, it is the continued consolidation of the public finance sector which, in similarity to 2012, will be the main reason for domestic demand remaining weak.

The process of fiscal consolidation in the Czech Republic is to continue in 2013-2014, in order to reduce the fiscal imbalance in time to meet the deadline set under the EDP (2013). According to the November 2012 forecasts by the Czech Ministry of Finance, the scale of the tightening[32] will be smaller in 2013 than in the previous years (approx. 0.6% of GDP[33] compared to 1.0-1.4% of GDP in 2011-2012) and will decelerate in 2014 (0.2% of GDP). Adjustment measures adopted at the end of 2012 provide for a temporary (2013-2015) increase in the rates of: VAT (by 1 pp. to 15% and 21%)[34] and PIT (solidarity tax – 7% until the end of 2015) for top earners and also temporary lifting of ceiling for health insurance contribution for (2013-2015). As of 2013, the tax on the sale of real estate will be raised (by 1 pp.), whereas the lump-sum tax-deductible costs for the self-employed will be reduced and excise duty refunds for farmers (fuel used for agricultural production) will phase out. Additionally, in 2013 the freeze on wages in civil service will be maintained, while old age and disability pension benefit will be only slightly increased. The year 2013 will see a voluntary capital-funded tier introduced into the pension scheme. The reduction in the general government revenue on this account is estimated to be at approx. 0.5% of GDP.

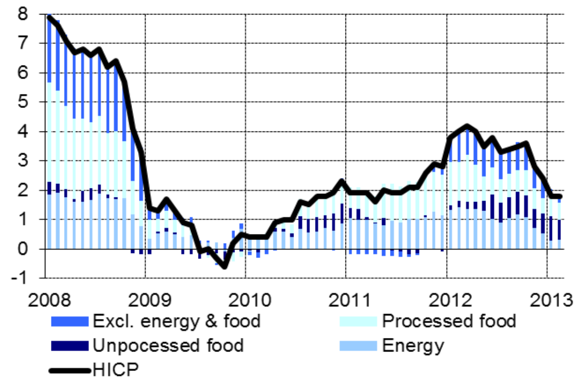
The EC forecasts of the general government deficit in the Czech Republic for 2013 (3.4% of GDP) differ from the targeted figures included in the 2013 Budget Act (2.9% of GDP). In its forecasts, the EC did not take into consideration corrections in the income position assumed for 2013. Within the forecast horizon for sovereign debt in the Czech Republic will see a small increase (from 45.1% of GDP to 48.1% of GDP).

[32] Measured with the primary change in the structural balance.
[33] From IMF forecasts was deducted the decrease in state budget revenues resulting from a voluntary capital-funded tier within the pension system introduced in 2013 (approx. 0.5% of GDP).
[34] The date for their equalisation (17.5%) was postponed from 2013 to 2016.

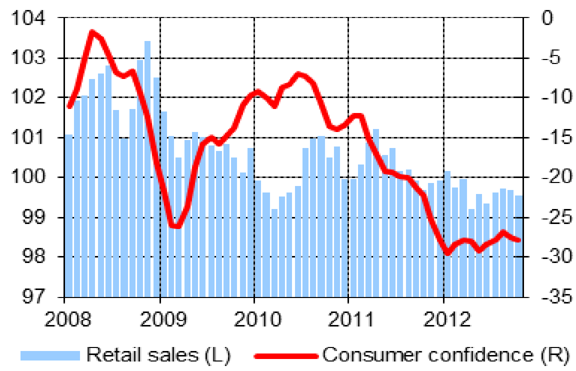
Contribution to GDP growth (in pp., y/y)



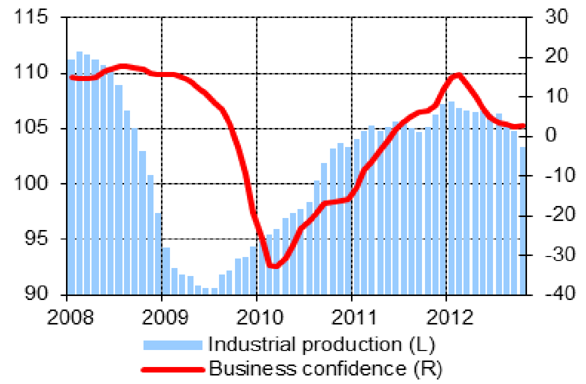
HICP inflation and its components (%, y/y)



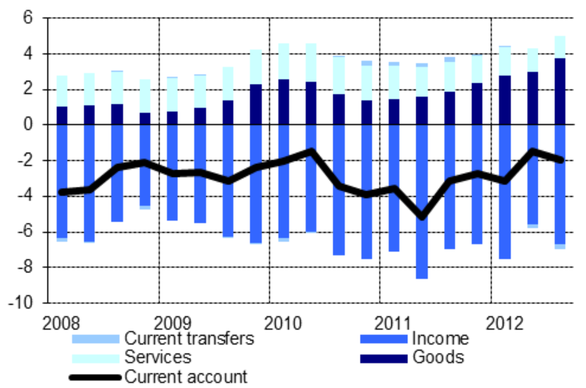
Retail sales (in %, y/y) and consumer sentiment index



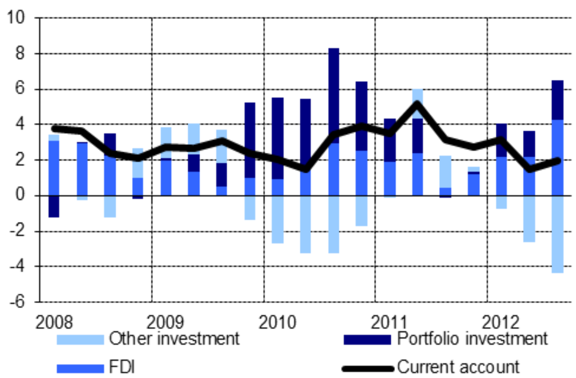
Industrial production (in %, y/y) and business sentiment index



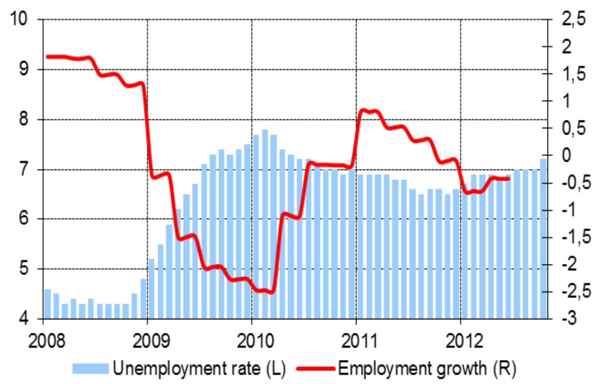
Current account and its components (% GDP, 4-quarter moving average



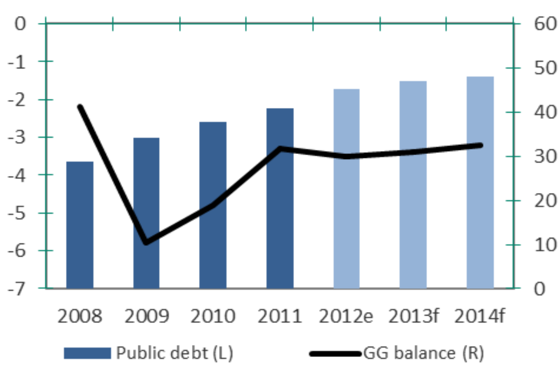
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ESTONIA LITHUANIA LATVIA

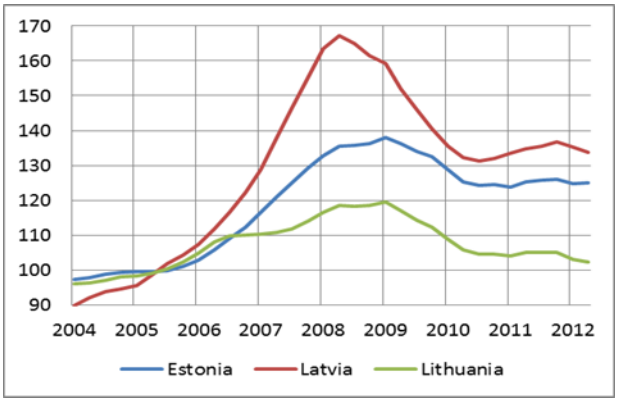
Regained competitiveness boosts the export sector

The economic situation in the Baltic states in 2012 differed from that observed in other CEE countries. Similarly to 2011, in the first three quarters of 2012 Estonia, Latvia and Lithuania were the most rapidly developing economies, not only amongst the CEE countries, but also in the entire EU. Annual GDP growth rate in this period amounted to 3.3% in Estonia, 3.6% in Lithuania and 5.2% in Latvia. It shows, however, that except for Latvia, the GDP growth rate in 2012 fell compared to 2011. Still, in contrast to most CEE countries, GDP on quarterly basis kept rising, accelerating markedly in 2012 Q3. It should be borne in mind, however, that despite relatively fast growth in recent years, Estonia, Lithuania and Latvia have not managed to make up for the losses they suffered in 2008 and 2009. In 2012 Q3, real GDP in these countries was at the level close to the second half of 2006 and was approx. 7% lower from that recorded at 2007 year-end.

Economic growth in the Baltic states is crucially supported by relatively rapid exports growth. Except for Slovakia, Baltics' exports expanded most rapidly in the region. High exports growth resulted in an increased share of the Baltic states in the whole EU exports. It applied both to the EU internal markets but mainly to countries outside the EU. In the case of exports to the EU, this share increased from 1.29% in 2009 to 1.76% in 2012 Q3, that is, by over 1/3. An even higher growth was recorded in exports to countries outside the EU. In the corresponding period, the total share of exports from Estonia, Latvia and Lithuania increased by almost 60% (from 0.65% to 1.03%). It was particularly noticeable in the case of exports to Russia, which is one of the major trading partners of all three Baltic states (its share in exports in the first three quarters of 2012 ranged from 12% in Estonia to 18% in Lithuania). Exports to Russia increased on a comparable scale in all three countries (on average, by almost 26% y/y in nominal terms). The highest growth could be observed in durable goods (electrical devices, machines, mechanical vehicles and in Latvia also clothing).

Relatively good performance of the export sector, compared the rest of the region, results from "internal devaluation" carried out in 2008-2010. Through labour cost cuts in the Baltic states increased their international competitiveness. The unit labour costs deflated real effective exchange (REER ULC) dropped distinctly in that period in all the three countries (the most significant drop – of almost 30% - was seen in Latvia) despite their currencies were pegged to the euro and the exchange rate parity remaining unchanged. In 2011-2012, the Baltic states were back on the fast-growth track, recording growth rates close to those observed in the post-accession period[35]. However, in contrast to the 2004-2007 period, when economic expansion was accompanied by rapid wage growth resulting in higher labour costs, in 2011-2012 labour costs rose only slightly. Thus, the competitiveness was preserved. From the beginning of 2011, REER ULC strengthened only in Latvia (while still remaining over 25% weaker than in 2008). Estonia and Lithuania, on the other hand, recorded a permanent depreciation of real exchange rate.

ULC deflated real effective exchange rate (2005=100)



Source: Eurostat

EC forecasts indicate that exports growth will remain strong in 2013 (Estonia and Lithuania even expect a slight acceleration) and is to even speed up in 2014. This means that the Baltic states will post the highest export growth rates among all of the EU countries. Thus, it seems that the impact of the reforms implemented in these countries, resulting in restored competitiveness should continue to be felt in the coming years. High competitiveness of the Baltic economies on the international arena may therefore provide the foundation for the countries' return on the track of sustained rapid economic growth and a recovery the "Tigers of Europe" name.

The increase in wages expected in the following quarters poses the greatest threat to upholding the present level of competitiveness. After a period of severe decline in 2009 followed by stagnation until mid-2011, wages have been on a mild upward trend since the second half of 2011. So far, fast productivity growth has not translated into higher unit labour cost. Yet, further wage growth amidst the expected slowdown in export production might result in the countries losing the hard-won position in international markets.

Like in 2011, 2012 saw relatively high GDP growth, supported not only by robust exports growth but also by persistently strong domestic demand. The latter involved

[35] In 2011, GDP in Estonia grew up by 8.3%, in Lithuania by 6.0% and in Latvia by 5.2%. It was by far the fastest growth recorded among EU countries.

in particular households consumption, which continued to grow fast in all the three countries. In the first three quarters of 2012, in turn, the Baltic states recorded differences in the fixed investment trends. Estonia maintained high investment growth rate (of over 20% y/y) while Latvia, and especially Lithuania, registered a drop, particularly in 2012 Q3. However, a decline in inventories was the main reason for slowing economic growth in the Baltic states in 2012 compared to 2011. The projections of GDP growth, both published by national and international institutions, assume that the period of fast recovery will continue in 2013. Output growth is only to drop somewhat in Latvia, but Estonia and Lithuania can expect a slight increase. In 2014, in turn, the EC expects a further acceleration in GDP growth, up to approx. 4% (average for the three Baltic states). A relative expansion in domestic demand is also expected to continue. It is to result from, inter alia, measures taken by the governments (in Estonia and Latvia) towards further stimulation of consumption and investment[36].

A less steep decline in lending observed since mid-2012 can contribute to domestic demand growth in Estonia, Latvia and Lithuania. In all these countries, the amount of loans granted to enterprises and households in 2012 Q3 was even lower than a year before. Still, a slight upward trend has been recorded since 2012 Q2, especially with respect to corporate loans. At the same time, 2012 saw the scale of the foreign capital outflow from the banking sector diminish. Yet, according to Bank for International Settlements data, from the 2011 Q4 to 2012 Q2, foreign claims of the Baltic banks towards European banks were seen to go down only in Lithuania, while Estonia and Latvia saw this trend, observed since mid-2008, halt.

Current economic situation indicators also do not point to domestic demand slowdown. Retail sales in 2012, contrary to the majority of other CEE countries, kept growing. A small increase was also noted in consumer sentiment indices. Business confidence indicators, in turn, went down slightly. The lack of new orders from abroad (the effect of the euro area) was mainly responsible for this trend. However, the decline in business sentiment was not confirmed in the industrial production volume. In Estonia, Latvia and Lithuania, in the first three quarters of 2012 it increased on average by over 8%[37].

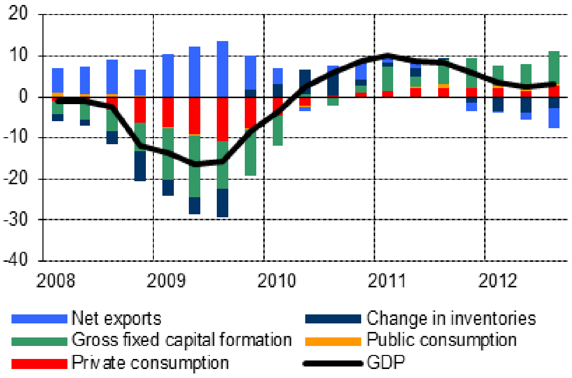
Quite optimistic data are also coming from the Baltic states' labour markets, which stand for another premise for further household consumption growth. Apart from the above-described increase in wages, also employment in the Baltic states has gone up. Both in Estonia and Lithuania, in the first half of 2012, the number of the employed in the economy grew (by 3.6% and 1.5% y /y, respectively) and the unemployment rate demonstrated downward tendencies in the first three quarters of 2012 (drop by 1.6 pp. in Estonia and 1.2 pp. in Lithuania)[38].

[36] Among others, Estonia plans to unfreeze and increase the pensions and wages in the public sector, in Latvia, except the reduction of VAT rates introduced in mid-2012, the reduction of personal income tax has been scheduled for 2013.

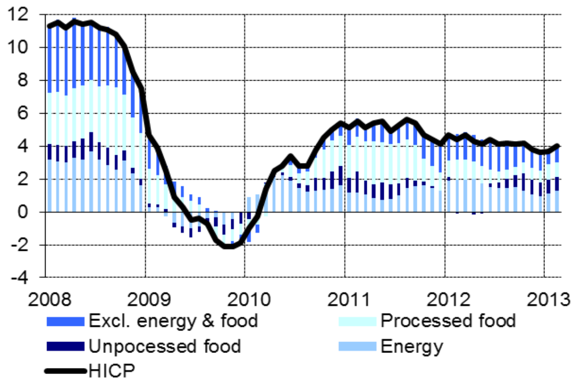
[37] The biggest industrial production increase was recorded in Lithuania (by 10%) at that time, in spite of Orlen Lietuva AB curbing its output of in May 2012.

[38] Data from the Latvian labour market from the 1st half of 2012 are not fully comparable with the data from the previous years due to the census taken in the meantime. Based on the census results, the number of employed in economy was reduced by 110 000 people. This was the reason for higher unemployment rate estimates, which in 2012 Q3 amounted to 14.2%. Still, before the adjustment it would have been lower by 1.5 pp. from an official value, that is, 2,8 pp. lower than in 2011 Q4.

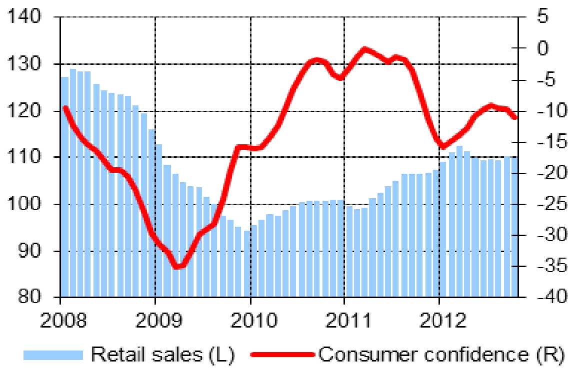
Contribution to GDP growth (in pp., y/y)



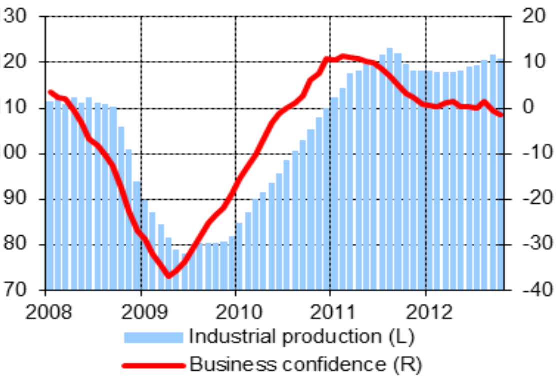
HICP Inflation and its components (%, y/y)



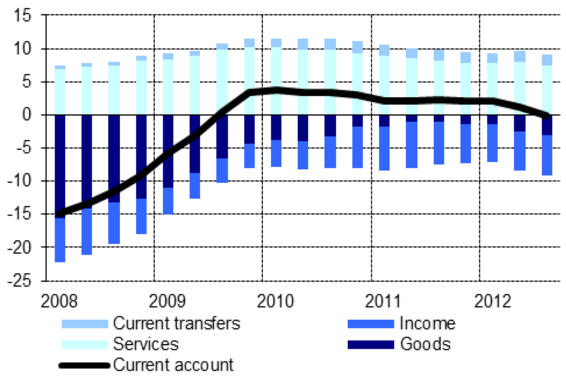
Retail sales (in %, y/y) and consumer sentiment index



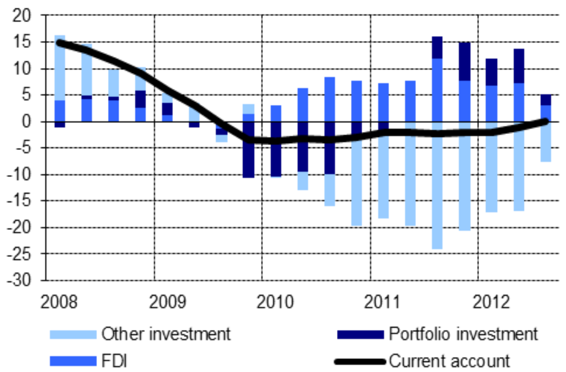
Industrial production (in %, y/y) and business sentiment index



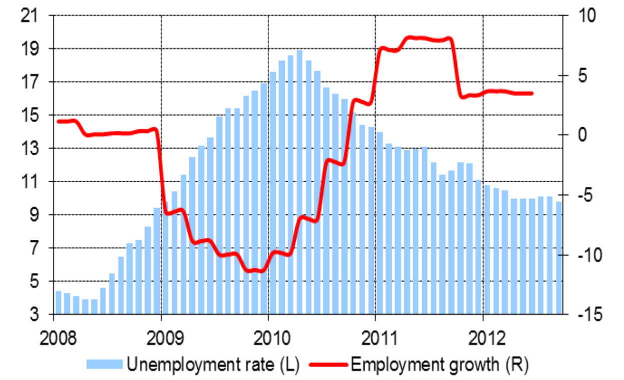
Current account and its components (in % of GDP, 4-quarter moving average



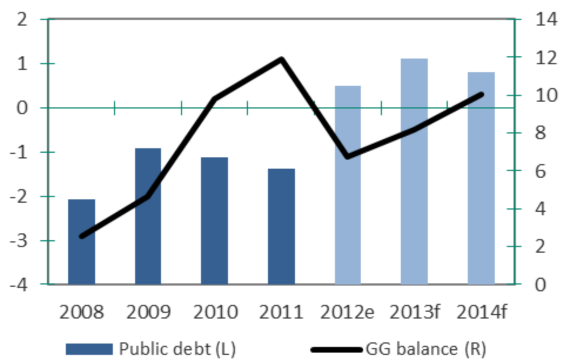
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

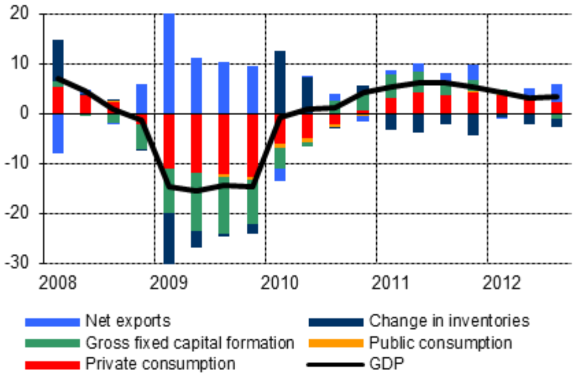


General government debt and deficit (in % of GDP)

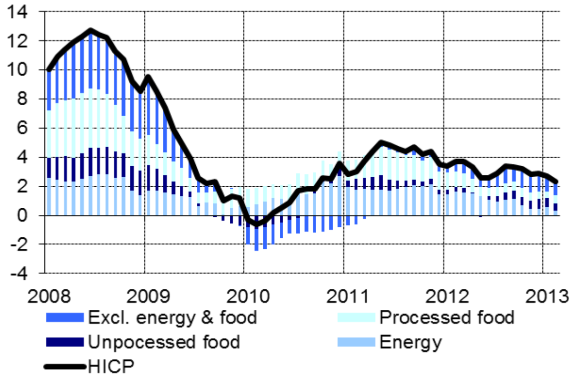


Source: Eurostat, CSOs

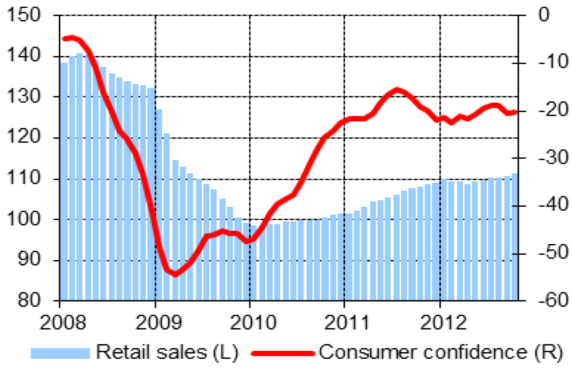
Contribution to GDP growth (in pp., y/y)



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

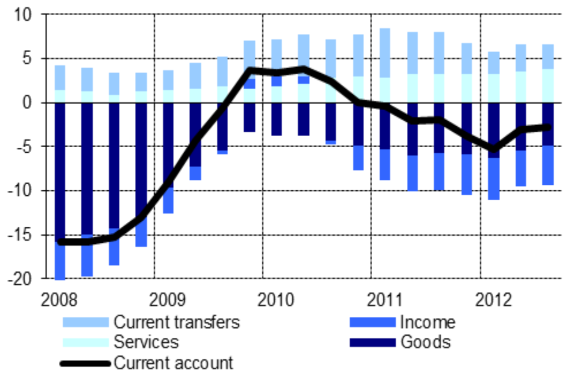


Retail sales (in %, y/y) and consumer sentiment index

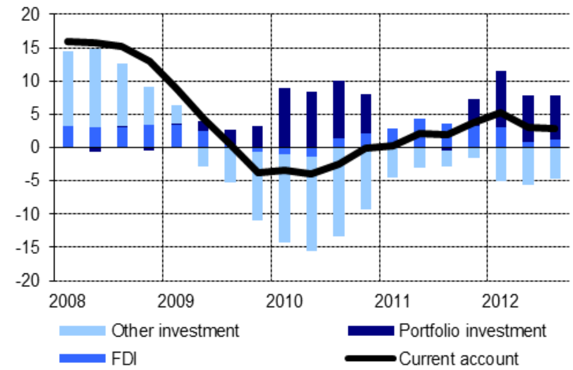


Industrial production (in %, y/y) and business sentiment index

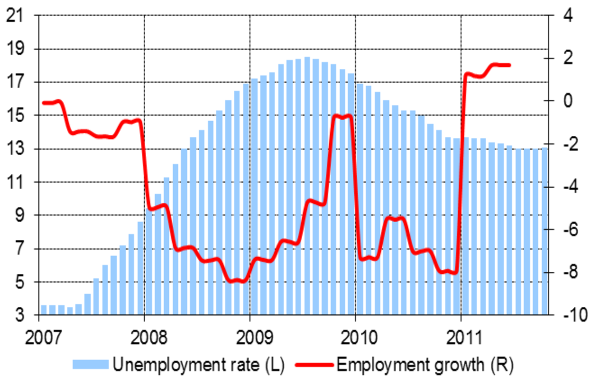
Current account and its components (in % of GDP, 4-quarter moving average)



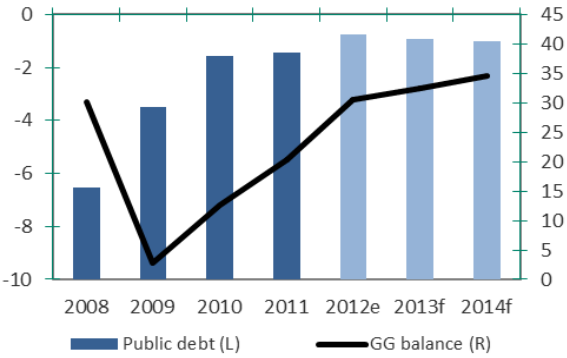
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (%. y/y)

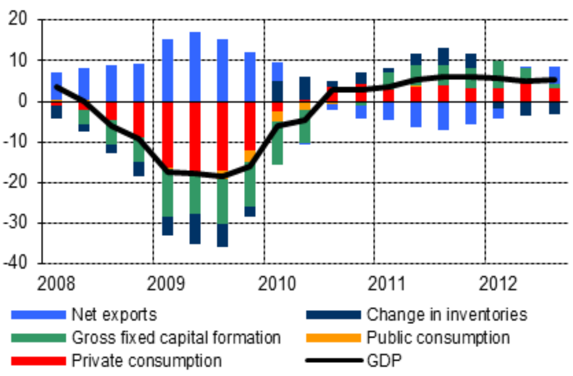


General government debt and deficit (in % of GDP)

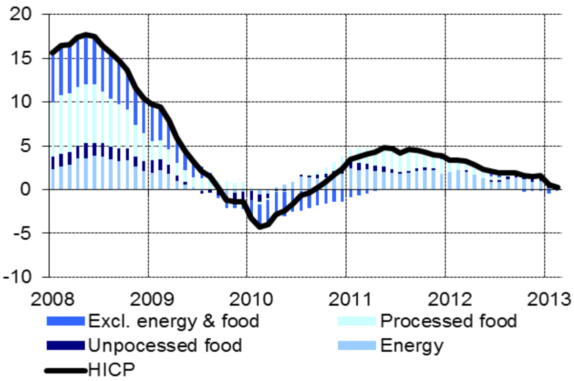


Source: Eurostat, CSOs

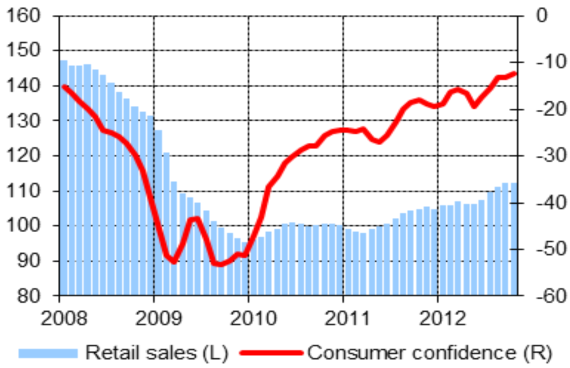
Contribution to GDP growth (in pp., y/y)



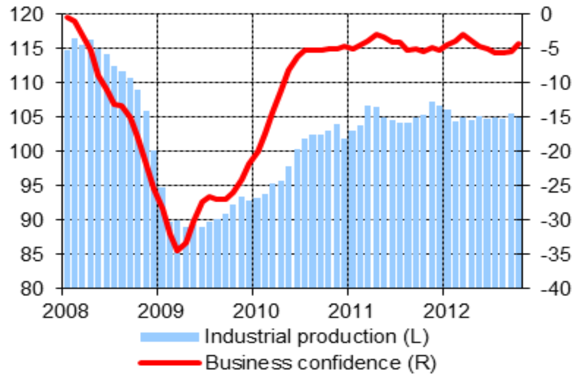
HICP inflation and its components (%, y/y)



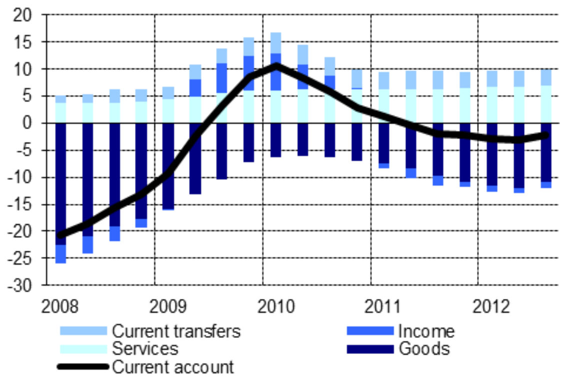
Retail sales (in %, y/y) and consumer sentiment index



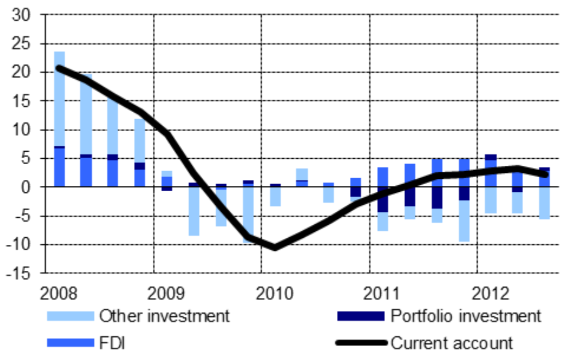
Industrial production (in %, y/y) and business sentiment index



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

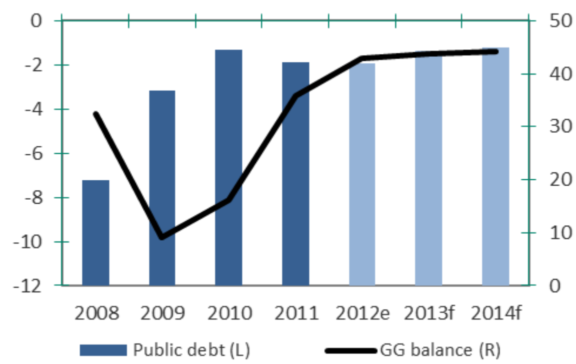


Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (%. y/y)

General government debt and deficit (in % of GDP)

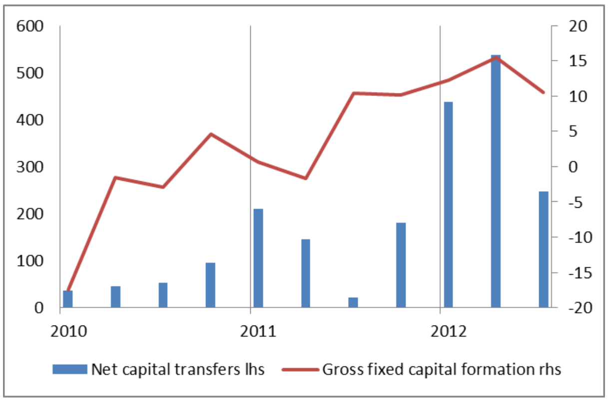


Source: Eurostat, CSOs

ROMANIA
Rising investment paves the way back to growth

In 2012, the Romanian economy slowed down markedly, in the first three quarters of 2012, GDP growth in Romania slowed down to 0.4% y/y (compared to 2.5% y/y in 2011). The main factor that contributed to the slowdown was an increase in the negative contribution of net exports resulting from a slump in exports. The decline in GDP growth was also driven by a further fall in public consumption and a reversal of the inventory cycle. Contrary to the majority of other region's countries, investment and consumption appeared as significant drivers of GDP growth in Romania. However, taking into account the poor performance of the agricultural sector in 2012 (having a potentially significant impact on consumption in Romania) and a worsening economic situation of main trading partners, the sustainability of the investment recovery will be decisive for GDP growth in the coming quarters. Robust investment growth started already in the second half of 2011; it reached 10.2% and 12.7 % y/y in the second half of 2011 and in the first three quarters of 2012 respectively. Except Latvia and Estonia, it was the strongest investment growth among all countries of the region.

Net capital transfers (EUR m) and gross fixed capital formation (%, y/y)



Source: Eurostat

The acceleration in investment in the second half of 2011 and 2012 reflected mainly a substantial increase in spending on road infrastructure from the National Road Fund. Additionally, a part of investment from 2011, especially at the local level, was shifted to the beginning of 2012 in order to avoid a sudden hike in expenditure at the end of year. This contributed to an accelerated investment growth in the first half of the last year. Moreover, a better use of the EU funds was another important factor shaping investment; EU funds absorption exceeded 21% in December 2012 (compared to 14% at the 2011 year-end)[39]. Finally some infrastructural expenditure could have been accelerated in connection with parliamentary elections that were held at the beginning of 2012 Q4. Nevertheless, slowdown in investment spending by the general and local government is expected in the last quarter due to the use of most of budgetary means allocated for 2012 in the first half of 2012.

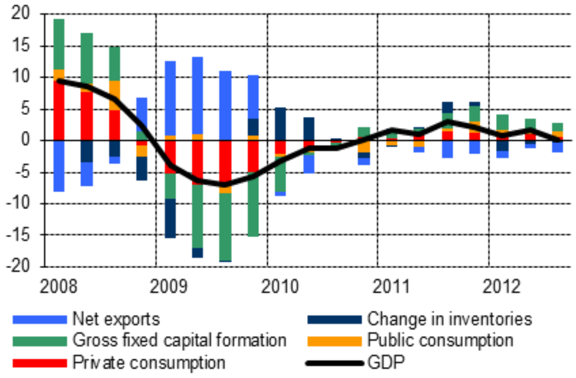
Although investment growth relied at the beginning of 2012 mainly on one-off factors, the aggregated data for 2012 Q3 indicate that growth of investment has been maintained. The annual growth of fixed capital formation in 2012 Q3 was kept at a high level and amounted to 10.5% y/y. The slowdown in infrastructural as well as households housing investment pointed to a growing role of investment in equipment, including machinery and equipment as well as means of transport, whose impact on investment dynamics has been gaining in importance. Hence, from the point of view of investment structure the share of industry in total investment grew at the expense of the construction sector . The shares of services and agriculture in total investment have remained almost unchanged. The changes observed in 2012 Q3 also reveal an increase in investment by the private sector. It was possible due to loans availability that was better than in many countries of the region (the value of investment loans grew by 6% in 2012 Q2) and inflow of foreign direct investment that was directed mainly to the non-financial sector.

The sustained high growth of investment expenditure in Romania, including the rising role of private investments may therefore contribute to the strengthening of the Romanian economy potential in the long run. It also points towards relatively optimistic expectations concerning its development in the nearest future.

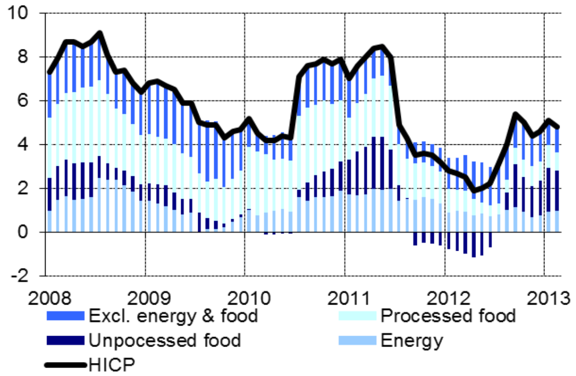
Hence, in spite of a considerable role of one-off factors in the investments increase in the second half of 2011 and first half of 2012, investment can be expected to continue to rise at a pace comparable with this observed in 2011. The European Union forecasts expect investment growth of 6.7%, 5.1% and 5.5% in 2012, 2013 and 2014 respectively, which, taking apart Latvia and Lithuania, would be the best outcome in the region. Market consensus for investment dynamics also places Romania among the leaders of the region with a growth of 5.8% and 5.4% in 2012 and 2013 respectively.

[39] In spite of a considerable acceleration of EU funds absorption in 2012, Romania is still lagging behind in the use of EU funds; in 2012 Q3 the average absorption in the CEE countries exceeded 40%. Poor civil service experience in this area, corruption practices and restrictions associated with co-financing are the main reason of poor absorption.

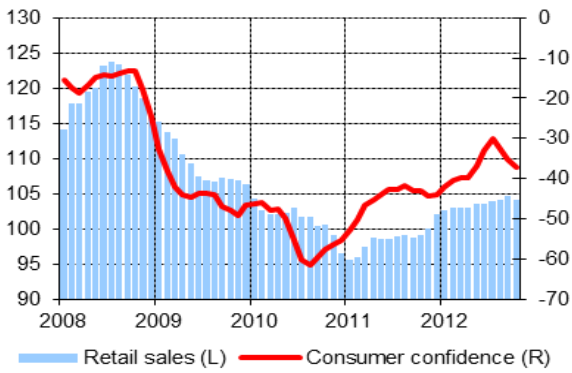
Contribution to GDP growth (in pp., y/y)



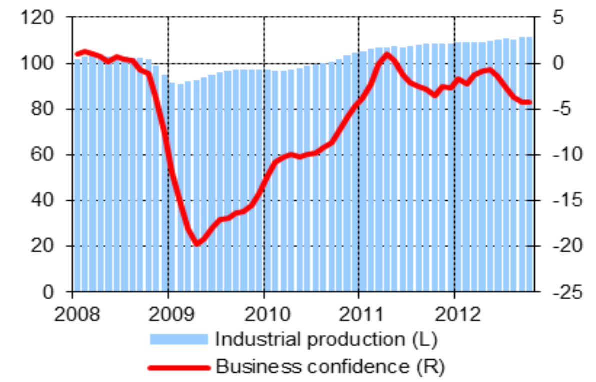
HICP inflation and its components (%, y/y)



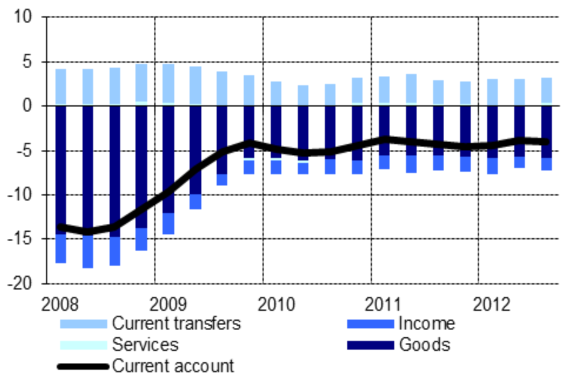
Retail sales (in %, y/y) and consumer sentiment index



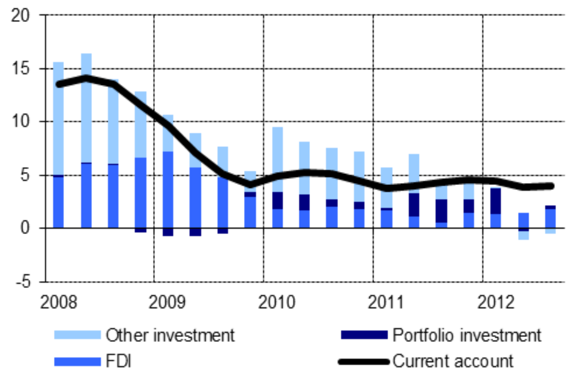
Industrial production (in %, y/y) and business sentiment index



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

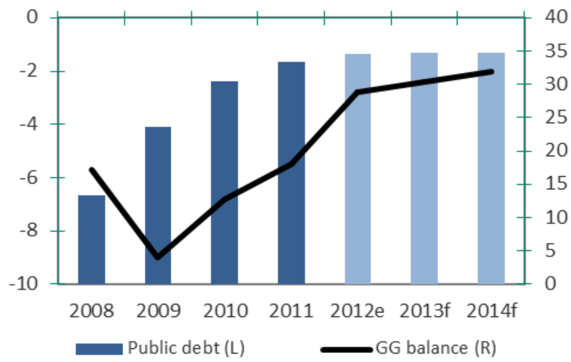


Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (%. y/y)

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

Slovakia

Further export-driven recovery

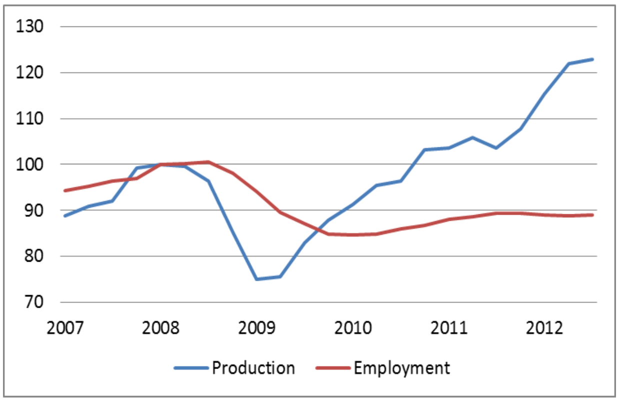
In the first three quarters of 2012, Slovakia was one of the fastest growing economy among the CEE countries. The annual GDP growth rate in that period amounted to 2.7%. In this respect only the Baltic states were ahead of Slovakia. It meant that after Estonia, the Slovak economy in 2012 was the second fastest-growing in the euro area. On the other hand, in each of the subsequent quarters of 2012, a gradual flattening of GDP growth could be noted (from 2.9% y/y in the Q1 to 2.5% y/y in 2012 Q3). However, the scale of the decline was definitely smaller than in the majority of other CEE economies.

In similarity to most of the region's countries, net exports was the driving force of the economy. Its contribution to GDP growth in the first three quarters of 2012 amounted to 6.5 pp. However, contrary to other CEE countries, it was not weak imports but a steady and robust exports (in the first three quarters of 2012, its growth rate amounted to 9.3% y/y) that was responsible for the fact. In spite of a marked decline in demand in countries being major consumers of Slovak goods, i.e. mainly Western European states, Slovakia still managed to record high exports growth. Shrinking demand on part of traditional major trading partners was compensated by increased exports to countries outside the European Union.

High exports growth in Slovakia in 2012 entailed steeply rising industrial output. In the first three quarters of 2012, industrial production annual growth rate in Slovakia amounted to 12.7% while in other CEE countries it was considerably lower (the weighted average for other CEE countries amounted only to 1.5% in that period while Estonia, Bulgaria and Hungary even recorded a drop). The most rapid, in terms of the region, increase in industrial output and exports was mainly attributable to good performance of the automotive industry. Car manufacturing in Slovakia from January to September in 2012 grew by 53% y/y and was responsible for almost the entire industrial output increase. Since Slovakia is a small open economy, a hefty part of the production was aimed for exports. Exports of Slovakia-manufactured cars rose over 26% in the first three quarters of 2012.

Strong performance of the automotive sector recorded in Slovakia in 2011-2012, particularly compared to other European countries, results from the strategy of big manufacturers (mostly Volkswagen and Kia). They have decided to expand their car portfolio, introducing new, tailored to customers'[40] needs car models. Additionally, these companies, due to declining demand from the euro area customers, have been looking for new sales markets. In effect, the sales of cars in Asian markets went up distinctly (among others, exports of passenger cars manufactured in Slovakia to China increased by over 50% y/y between January and August 2012). Sales to Russia and the United States also grew in 2012.

Production and employment in manufacturing (Q1 2008=100)



Source: Eurostat

However, similarly to 2011, strong performance of the Slovak export sector failed to give any significant boost to the domestic economy. In the first three quarters of 2012, domestic demand was in recession. Household consumption expenses went down in annual terms in all three quarters of 2012. Similar developments took place in public consumption.

Gross capital formation also shrank in that period, which basically resulted from the fall in inventories. Additionally, favourable economic conditions in industry did not translate into increased fixed investment outlays, except investment in the automotive industry. Indeed, in the 2012 Q1, their annual growth rate remained positive but noticeable deterioration of manufacturers' sentiments and more difficult access to credit facility for enterprises hindered investment processes in Slovakia in the subsequent quarters of 2012.

Increase in industrial production mostly resulted from increased productivity and higher capacity utilisation, not from employment growth. Since mid-2009 (peak of the crisis), until 2012 Q3, the production volume increased by almost 75%. At the same time, employment in industry grew up by merely 5%. In 2012 Q2 employment in industry decreased (by almost 1% y/y). Similar situation took place in other sectors. The number of employed in the whole economy fell in annual terms in 2012 Q2 to a similar degree. At the same time, nominal wages went up by 2.1% y/y, which means that in real terms, wages in Slovakia also decreased (average inflation in 2012 Q2 amounted to 3.6%). Both factors, together with ongoing fiscal consolidation, were the main

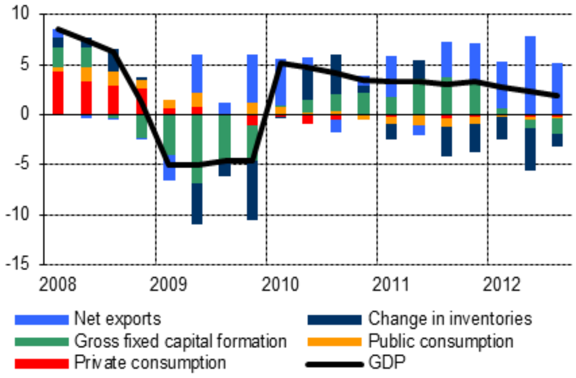
[40] Among others, Volkswagen Group decided to increase the production of SUV cars' for which the demand in emerging markets has kept growing.

reasons of deteriorating consumers' sentiment and thereby impeded the consumption. On the other hand, influence of the deleveraging in the European as well as Slovakian banking systems did not translate into more difficult access to loans for households. In the first three quarters 2012, they scored a noticeable pick-up at an almost two-digit rate, which slowed down in the following quarters of 2012. The drop in growth rate was observed specifically in consumer loans (they grew was almost twice slower than housing loans) and resulted mainly from weak demand resulting from growing fears about the future financial situation of households.

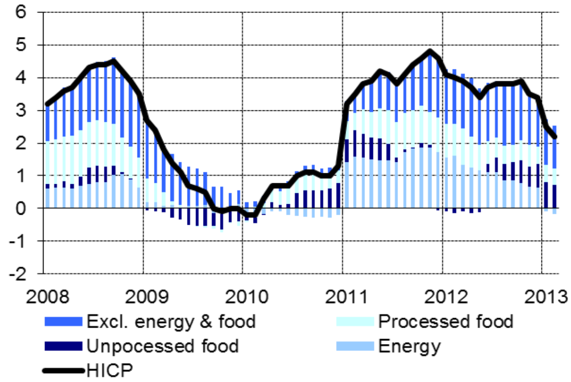
According to the projections of the National Bank of Slovakia (NBS), GDP growth rate in Slovakia in 2013, will slow down to 2% from 2.7% recorded in 2012. The reduction will be mainly affected by a slowdown in exports growth, as the supply shock in the automotive industry is expected to vain. Another factor hampering economic growth in 2013 will be the continuation of fiscal consolidation in Slovakia. According to NBS estimates, its direct impact on the GDP growth rate will be c.a. -0.4 pp.[41] Fiscal austerity measures will also translate into private consumption, inter alia, through further drop of households' real disposable income. In spite of that, NBS expects for slight increase in private consumption. Fixed investment are also to increase. This will be a result of investment process in the automotive industry initiated in previous years.

[41] NBS assumed that from the beginning of 2013 the following measures would be introduced: changes in the second pension system tier, increase in social insurance contributions , increase in the CIT rate (to 23%), changes in personal income tax, freeze on wages in the public sector and cuts in government consumption expenditure.

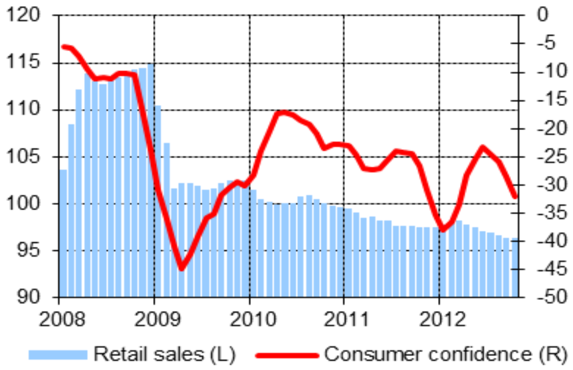
Contribution to GDP growth (in pp., y/y)



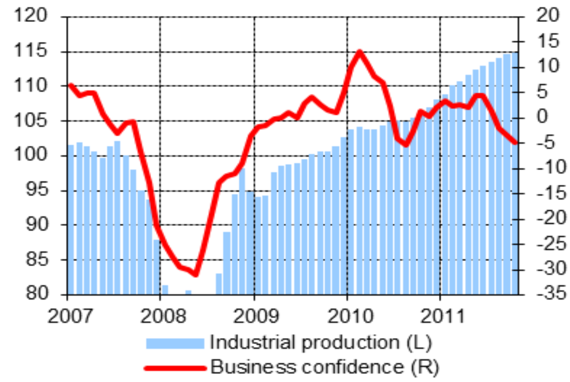
HICP inflation and its components (%, y/y)



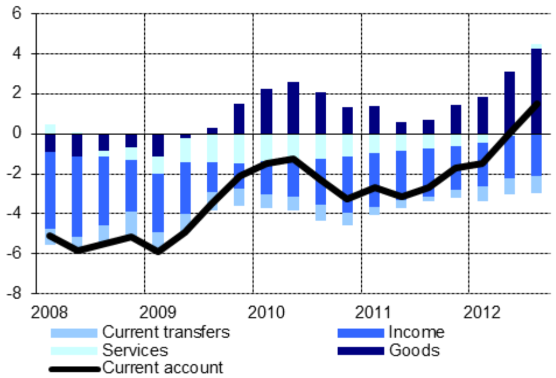
Retail sales (in %, y/y) and consumer sentiment index



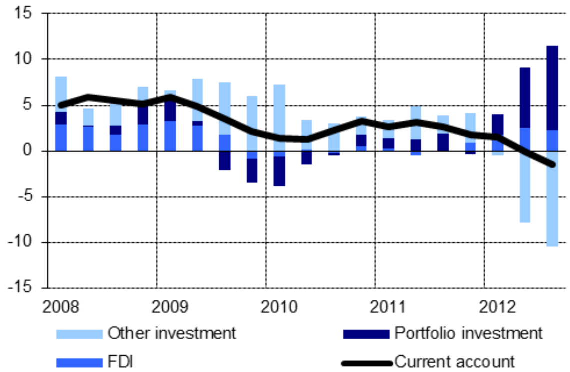
Industrial production (in %, y/y) and business sentiment index



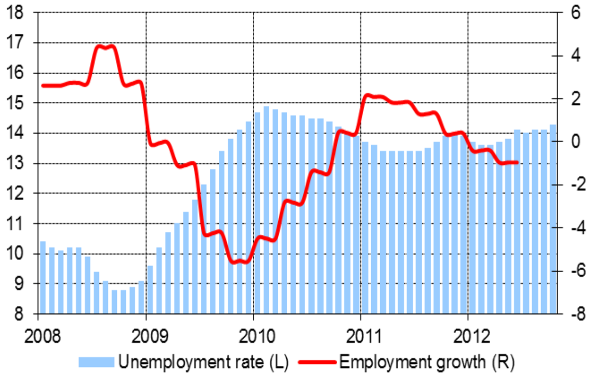
Current account and its components (in % of GDP, 4-quarter moving average)



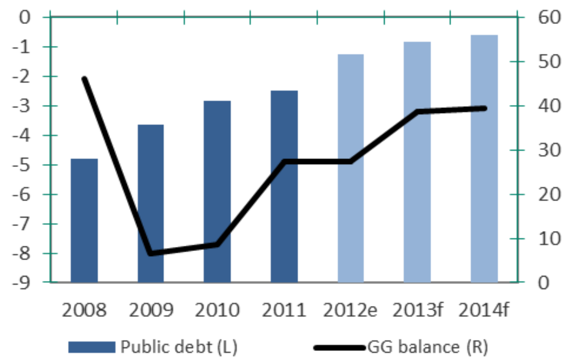
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (%. y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVENIA

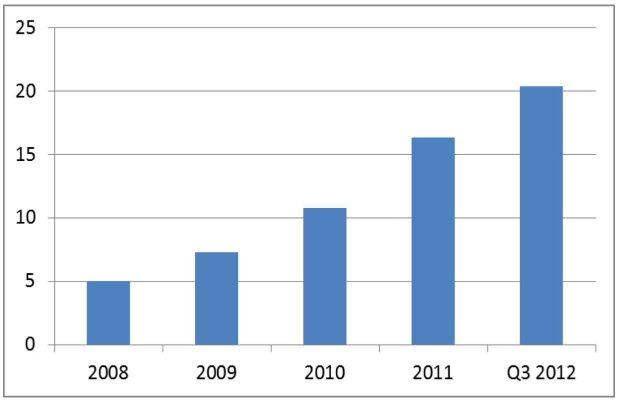
Fiscal consolidation and poor position of the banking sector – reasons for mounting recession

In the first three quarters of 2012, the Slovenian economy was experiencing the deepest recession among all CEE countries. Real GDP dropped by 2.0% y/y in that period[42]. A particularly sharp slowdown was recorded in Slovenia in the second and third quarters of 2012. In that time, real GDP went down by altogether 1.7%.

GDP decline resulted mainly from the persistent domestic demand crisis, which had been falling almost uninterruptedly since mid-2008. The weakness of domestic demand in Slovenia in 2012 was driven by both contracting consumption (private and public) and fixed capital formation. The decrease in fixed investment expenditure in the first three quarters of 2012 amounted to 9% y/y. The greatest decline (by 17% y/y) concerned investment in buildings and was caused by the sever Slovenia's real estate crisis observed since mid-2008[43].

Fall in corporate investment outlays resulted from, weak domestic and foreign demand as well as limited access acquiring necessary funds. Constrained access to credit for Slovenian enterprises is attributable to both demand and supply-related factors. The Slovenian banking system, contrary to other CEE countries, is not dominated by foreign-owned banks. Until the end of 2011, domestically owned banks accounted for over 60% of banking sector assets. Still, it did not protect the banking sector from the crisis. Domestic banks in Slovenia also experienced a liquidity crisis. Increased capital requirements and deteriorating asset portfolio, forced the Slovenian government to recapitalise – twice – the biggest state-owned bank (*Nova Ljubljanska banka d.d.* – NLB). Low liquidity and deteriorating assets curbed new lending, especially to non-financial corporations. Additionally, Slovenian companies are one of the most heavily indebted in the CEE region. At the end of 2011, the value of loans to non-financial enterprises amounted to over 83% of GDP. Due to the recession both in Slovenia and in the euro area[44], as well as weak prospects for strengthening of domestic and foreign demand, Slovenian companies were not interested in applying for further loans. The annual growth in corporate lending in Slovenia has been falling since the beginning of 2008. In 2011 Q3 it ran into negative territory and continued to decline (to -5.2% in 2012 Q3)[45]. At the same time, Slovenia's credit rating downgrades (in August 2012 three major rating agencies downgraded the country's rating, as well as its major financial institutions), resulted in a more difficult and more expensive access to international funding, especially at the time of heightened global risk aversion.

Non-performing loans as percentage of total loans in Slovenia



Source: FitchRatings

The process of fiscal consolidation, which started with a lag compared with other CEE countries, was an additional factor of Slovenia's deepening recession. Until 2012, Slovenia was the only country in the region which not only failed to record an improvement in the general government balance but which also registered an increase in the deficit from 5.7% of GDP in 2010 to 6.4% of GDP in 2011. The increase, however, stemmed from one-off factors, i.e. the recapitalisation of state-owned enterprises and NLB (1.3% of GDP)[46]. It means, that the consolidation burden is still hanging over Slovenia's economy.

Weaker-than-expected general economic performance[47] led to the need to amend the 2012 Finance Act (in May 2012). Revenue forecasts were revised downward by 2.1% of GDP while the spending limit, by 3.1% of GDP (resulting in, among others, cuts in social, administrative and capital expenditure, as well as transfers to local authorities). The amendment of the Finance Act was

[42] The fall in real GDP in that period was also noted in the Czech Republic and Hungary; however, its scale was narrower (0.8% and 1.2%, respectively).

[43] In 2012 Q2, the value of commenced new constructions dropped by 43% against 2008 Q3. In the case of housing, the decline amounted to 71%.

[44] Relatively better economic situation was recorded in 2012 in exporting enterprises, however, taking into consideration structural conditions of Slovenian manufacturing (small share of innovative goods in the product range and relatively low competitiveness, particularly against other CEE countries), even that part of enterprises did not record results comparable with exporters from other countries of the region.

[45] A drop was also observed in lending to households, but on a milder scale. In 2012 Q3, its level sank by 1.5% y/y.

[46] Except the recapitalisation of NLB (EUR 243m, 0.7% of GDP), the government has also allocated, among others, EUR 119m (0.3% of GDP) for support of the railway and EUR 49 m (0.1% of GDP) for the national airline Adria Airways. Total expenditure in 2011 on account of transfers to state enterprises and NLB amounted to EUR 459m (approx. 1.3% of GDP).

[47] GDP growth rate forecast in 2012 was reduced from 4.9% to 0.0%.

accompanied by the adoption of a package of consolidation measures (the Public Finance Balance Act – ZUJF[48]) that were set to maintain the budgetary targets in 2012 and to hold fiscal imbalance below 3% of GDP in the coming years. Through additional activities in 2012, old age and disability pensions were frozen, wages in the public sector reduced by 8%[49] (as of June 2012, and in 2013 by further 5%), some supplementary entitlements and allowances were reduced or suspended (until the end of 2013). Cutbacks are also to concern, inter alia, welfare spending (pensions, sickness benefits, family allowances and unemployment benefits – on average by 10%). According to estimates, the above changes should produce savings of approx. 1.1% of GDP in 2012 and of 1.9% of GDP in 2013. As of mid-2012, under the ZUJF Act, tax revenue has been increased by taxes on contracts concluded with students and new taxes (on the acquisition of new transport vehicles, sale of building plots or real estate of great value that are to be abolished by the end of 2014). From 2013 onwards, the upper threshold for the second PIT bracket (27%) will be raised and for two years, an additional (fourth) rate for top earners (50%) will be introduced. The tax on dividend and capital gains will also be increased (to 25% compared to 20%). Additionally, the ZUJF Act includes a provision regarding a conditional increase in the standard VAT rate in 2014 from 20% to 23%, triggered by the 2013 public finance sector deficit exceeding 3% of GDP.

Adjustment measures will be coupled with the adoption in 2012 by the Slovenian government of three packages of activities aimed at stimulating economic growth by constraining administrative and tax burdens (a gradual reduction in the CIT[50] rate, increasing tax relief relating to investment and R&D activity).

Apart from changes arising under ZUJF, the Finance Bill for the years 2013-2014 takes into consideration financial consequences of the adoption of a new pension scheme (including, among others, the increase in pension ages[51]) increase of flexibility of the labour market, VAT for some products and services[52] and of excise duty[53] rise. Slovenian authorities provide for hold back the deficit of the general government to below 3% of GDP in 2013, i.e. within the deadline set by EDP. The fiscal strategy also assumes the achievement of balanced structural position by 2015.

EC autumn forecasts indicate lower general government deficit in 2012 but in the years to come it will remain at over 3% of GDP (4.4% of GDP in 2012 and close to 4% of GDP in the years 2013-2014). An increase in public debt in 2013-2014 is also expected (by 8.3 pp. to 62.3% of GDP). Differences between the government and the EC in the assessment of the fiscal situation arise from, inter alia, a more pessimistic assessment of the growth prospects. The forecast is subject to risk relating to the difficult situation of the banking system and its planned support[54]. To this end, the government prepared a project in 2012 (supported by the IMF and ECB) providing for the establishment of the so-called "Bad Bank"[55]. According to the prime minister of Slovenia, the adoption of the package of consolidation activities and help to the banking system are to protect the country from the need to request assistance of international institutions. The implementation of such activities is risky. Leaders of trade unions and opposition have filed a petition for a referendum on setting up the so-called "Bad Bank". It is to be held in January 2013.

[48] *Zakon za uravnoteženje javnih financ* (ZUJF).

[49] Initially, the government of Slovenia planned to reduce wages by 15%. As a result of negotiations with trade unions, the reduction was smaller.

[50] From 20% to 18% this year and in subsequent years by 1 pp. per year until 15% from 2014.

[51] The reform is almost identical with the proposed changes rejected in the referendum held in mid-2011. The standard retirement age should be gradually increased (until 2019) to 65 for women (presently 61) and for men (63) with an option of earlier retirement after completing 40 years of service (and being at least 60 years of age). Additionally, the period taken into consideration for the calculation of the benefits will be extended (from 18 to 28 years). The reform assumes less favourable principles for indexation of benefits and wages taken into consideration in the calculation of pensions.

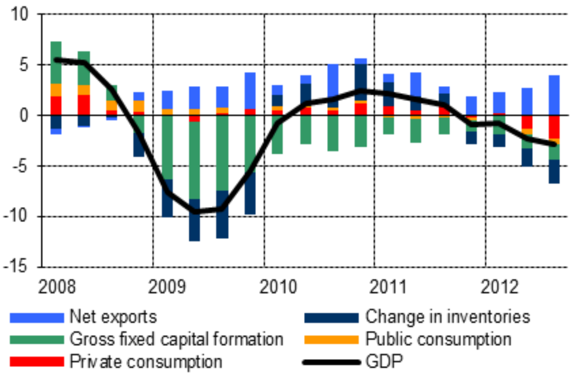
[52] From 8.5% (reduced rate) to 20% (standard rate). VAT increase will apply to magazines, animal feeds, hairdressing, personal grooming, sports-related services, cleaning, cut flower and plant delivery.

[53] Adjusting the minimum taxation level to that required by EU law.

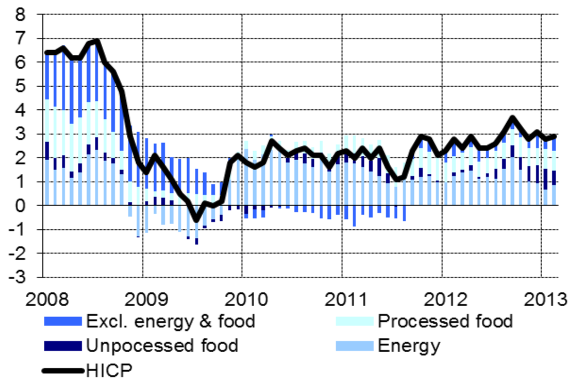
[54] IMF estimates that as at 2013 year-end sovereign debt in Slovenia will amount to 67.3% of GDP and in 2014 – 69.0 % of GDP. See: *Republic of Slovenia: 2012 Article IV Consultation—Staff Report*, IMF, and 29 November 2012.

[55] A special agency is to take over non-performing loans (of approx. 4 EUR bn. that is approx. 11% of GDP). According to Banka Slovenije, the value of loans with repayment lags of more than 90 days, amounted at the end of the first half of 2012 to approx. EUR 6.3 bn. that is, approx. 18% of GDP). In return, the agency will transfer to banks bonds guaranteed by the state, which can be used for operations with the European Central Bank. Such activity would provide support for the distressed banking sector and boost lending activity. On the other hand, the operation would increase the sovereign debt. The Slovenian Finance Minister said that the government also planned to recapitalise the banking system with approx. EUR 1bn (that is, approx. 3% of GDP). At a further stage, Slovenia authorities plan to decrease the state shares (to 25% of capital) at commercial banks.

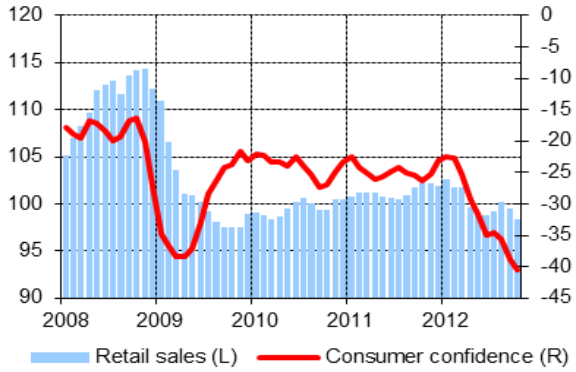
Contribution to GDP growth (in pp., y/y)



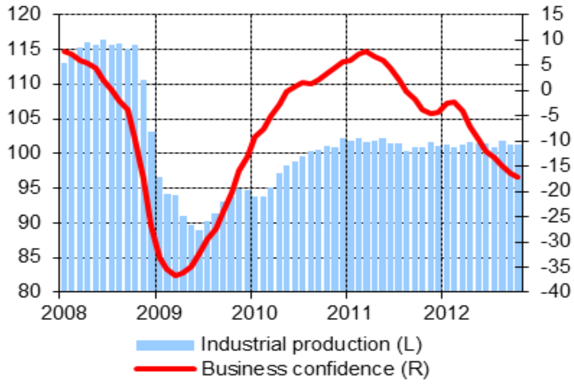
HICP inflation and its components (%, y/y)



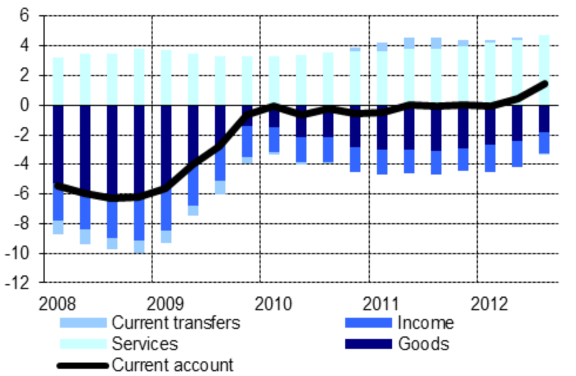
Retail sales (in %, y/y) and consumer sentiment index



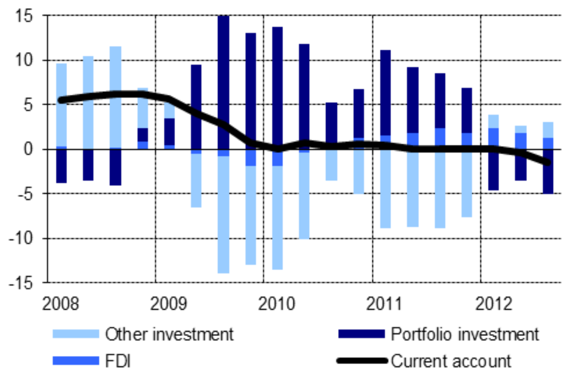
Industrial production (in %, y/y) and business sentiment index



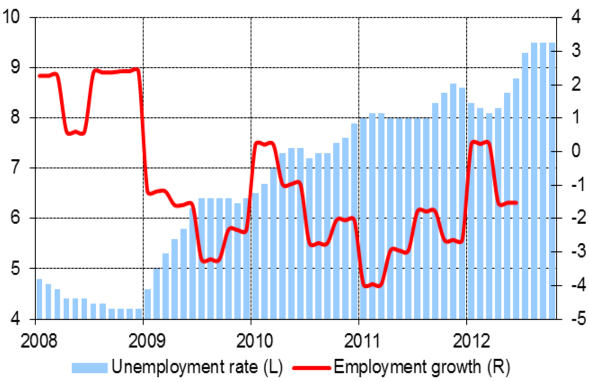
Current account and its components (in % of GDP, 4-quarter moving average)



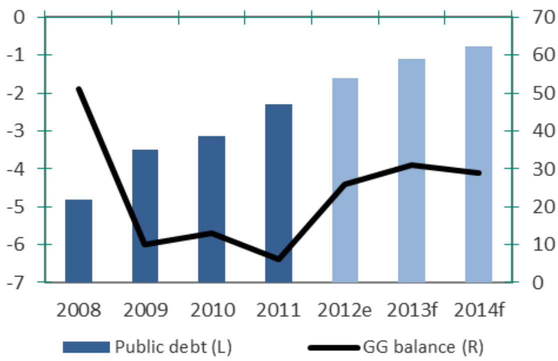
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and growth of employment (%. y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

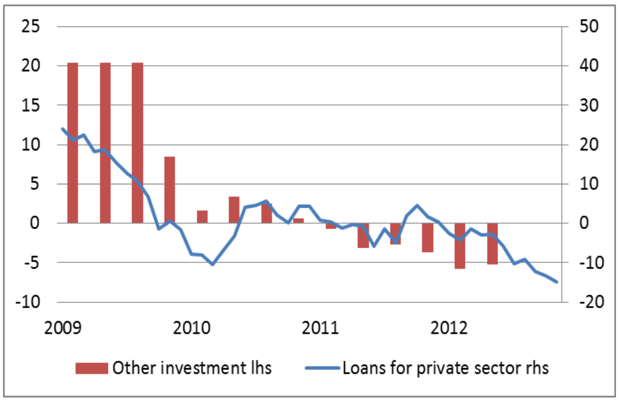
HUNGARY
Poor business confidence hinders recovery

After growing by 1.7% y/y in 2011, the Hungarian economy entered a recession in the first half of 2012, and according to preliminary figures for the third quarter, it still remains in it. GDP drop in the first three quarters of 2012 (by 1.3%, 1.4% and 1.6% y/y, respectively) stemmed from a decline in domestic demand which had been observed for a long time. Corporate investment outlays fell for the fourth year in a row due to uncertain economic prospects both at home and in the euro area. Apart from the above-mentioned factors, the structural character of the slump in investment activity in Hungary was determined by falling supply of corporate loans, which primarily affected small and medium-sized enterprises, and by unfavourable business climate related to unstable laws, including tax regulations. It was reflected in low rate of private investment. In the first two quarters of 2012, gross fixed capital formation (in relation to GDP) dropped to a record low of 17.7% (compared to almost 22% on average in the years 2000-2011). The slump in Hungary was also driven by weak private consumption which was being dragged by falling real disposable income, the ongoing process of household deleveraging and stringent lending conditions imposed by banks[56].

For the time being, exports are the only factor mitigating the decline in the Hungarian economy, although their potential for further growth has diminished markedly in the last quarters. As recently as 2011, annual growth rate of exports was at approx. 6.4%; however, in the third quarter of 2012, it slowed down substantially, to approx. 2.0%. The observed slump in exports resulted largely from demand-side factors such as the economic downturn in Hungary's main trading partners (among others, Germany). Nevertheless, supply-side factors, i.e., available production capacity in Hungarian manufacturing and especially in the automotive industry[57], which is of key importance to the economy, do not pose any considerable barrier for exports growth.

The decline in corporate investment outlays, which has been observed for a long time now, coupled with poor private consumption severely curbed demand for bank loans in Hungary. This was seen in the growth rate of lending, which has continued to flatten in the first three quarters of 2012, although the corporate loans have stopped to fall. Restricted access to credit to private sector in Hungary also stems from shrinking funding sources. On the one hand, the parent banks have significantly reduced the volume of loans to their Hungarian subsidiaries, amidst constrained interbank market refinancing of loans due to persistently low confidence. On the other hand, the inflow of deposits from Hungarian households and enterprises is insufficient to offset the loss of capital from foreign sources.

Loans to the private sector (in %, y/y) and capital outflow from the banking sector (other investment, in % of GDP)



Source: MNB

The Hungarian economy is expected to pick up slightly in 2013, mainly thanks to a considerable improvement in business conditions worldwide, including major export markets. Falling central bank rates[58] can also fuel GDP growth in Hungary this and next year. It is believed that domestic demand will continue to drag on economic activity in Hungary due to the expected further drop in corporate investment and sluggish private consumption. Inflation in Hungary should begin to recede in 2013, dropping to approx. 3.5% from the 5.7% anticipated in 2012 thanks to the cuts in regulated energy prices (gas, energy, heating) announced by the government, lower-than-expected increase in excise duty on tobacco products and the fading out of the base effect associated with the VAT rate hike implemented at the beginning of 2012.

The fiscal measures approved by the Hungarian government to date with the aim to improve the situation in the public finance sector[59] also had an adverse impact on economic growth. A number of adjustments both on the expenditure side (e.g. smaller drug refunds, and city transport and education subsidies) and on the revenue

[56] According to the latest survey carried out in October 2012, (*Senior Loan Officer Survey on Bank Lending Practices*), in the third quarter, banks operating in Hungary introduced more stringent lending terms for the corporate sector, but slightly mitigated terms for households.

[57] At the end of March 2012, the Daimler concern launched a Mercedes car factory in Hungary, which increased considerably the production capacity of the sector. Moreover, in 2013 further car manufacturers (Opel and Audi) are planning new investments that will provide additional stimulus for export growth.

[58] In 2012, the central bank of Hungary (MNB) started a cycle of interest rate reductions (by altogether 1.25 pp.), which eventually led to a fall in the reference rate to 5.75%.

[59] The European Commission expects that in 2012 budget deficit in Hungary will amount to 2.5% of GDP while in 2010 it was at the level of 4.4% of GDP (exceptionally, 2011 saw a surplus which resulted from the nationalisation of the second pillar of the pension scheme).

side - mainly tax revenue (the so-called anti-crisis taxes imposed on financial institutions, telecommunication, energy and retail trade companies) - have been introduced as a part of fiscal consolidation. The 2013 Finance Act provides for further cuts in spending and for increase taxation (among others, new tax on financial transactions imposed on the central bank, more efficient tax collection, new road toll system), which will ensure the level of budget deficit below 3% of GDP. Otherwise, Hungary will still remain under so-called excessive deficit procedure that will limit its access to funds from the Cohesion Fund.

In spite of the announced series of additional activities[60], including the withdrawal from the idea to tax financial transactions carried out by the central bank, the economic policy of the Hungarian government is negatively perceived by foreign investors (which is reflected in continuously high interest rate of Treasury bonds[61]) and by rating agencies, who have downgraded the credibility of Hungary to the junk status[62]. In order to improve the image of the country outside and due to the growing number of structural problems in the economy, the new government has decided to apply to the International Monetary Fund and European Commission for financial assistance. It implies a turn in the strategy of Hungarian authorities, which in mid-2010 terminated the cooperation with the above-mentioned institutions to underline their independence in economic decision-making process.

A possible loan from IMF and EC will certainly not remove the structural sources of the persistently low investment activity and weak private consumption in Hungary. Nevertheless, it may improve the country's image in the eyes of foreign investors, which, in turn, should translate into lower costs of capital raised in financial markets. Additionally, financial aid from international institutions will involve the need to carry out a number of structural reforms in the economy. It inspires hope for a change in the Hungarian authorities' policy in relation to foreign investors, which should be reflected in more favourable business sentiment.

What's more, loan granted by IMF and EC may prove necessary from the point of view of financing the borrowing needs of the Hungarian budget in 2013. According to debt (both domestic and foreign) service schedule, prepared by the Public Debt Management Agency (AKK) at the end of September 2012, in 2013, the Hungarian government will have to redeem debt of approx. HUF 3.9 trillion (EUR 13.3 billion) with over half of liabilities coming due in the first two quarters of this year. Additionally, the value of foreign debt resulting from bonds issued abroad and on the domestic market (purchased by non-residents) and loans taken out from international institutions is estimated at HUF 1.5 trillion (EUR 5.1 billion). Available financial resources deposited by the government on account at the central bank of Hungary amounted to HUF 1.8 trillion at the end of 2012. It implies that Hungary is able to finance less than half of its 2013 borrowing needs without asking for a financial assistance from international institutions and funds raised from the issuance of T-bonds.

If the negotiations between the Hungarian government, EC, and IMF on a possible loan end in a failure, the authorities will have to issue bonds in international markets in order to meet its foreign financial liabilities. The cost of financing could prove higher than in the case of loans from the above-mentioned institutions. In spite of the marked decline in Hungarian bond yields in the second half of 2012, they are still record high in the region, due to, inter alia, persistently high risk premium. Nevertheless, the very fact of the Hungarian government returning to negotiations can be perceived positively by foreign investors, which should be reflected in a further drop in Hungarian T-bond yields. Thus, it may turn out that in spite of lack of agreement with EC and IMF on the terms of financial assistance, Hungary will manage to improve its image among foreign investors and thereby raise funds to service foreign debt coming due in 2013.

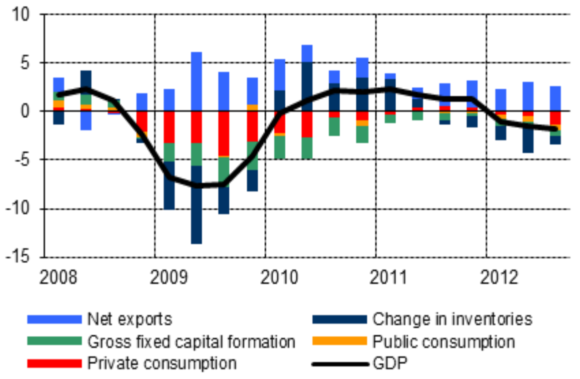
---

[60] In October 2012, the Hungarian authorities announced two saving packages that are set to keep the deficit down. They provide for, among other things, reducing the scale of co-financing of EU projects from current 15% to 5%, freeze of ministerial expenditure, reduction of pensions and wages of civil servants.

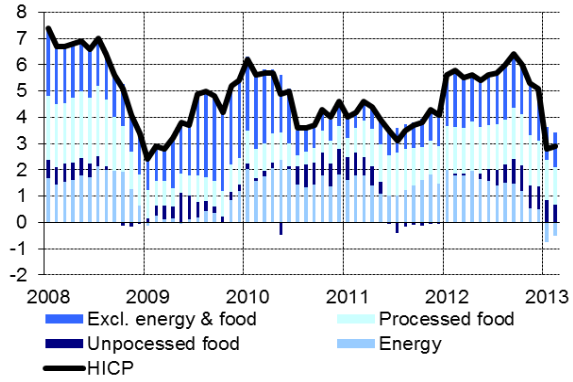
[61] Indeed, the interest on 10-year Treasury bonds fell in November 2012 to approx. 7% (from initial 11% in the previous year), but it derived largely, from non-standard activities of major central banks that led to increase in liquidity in global financial system. In spite of the observed fall, yields of Hungarian bonds are still much higher than that of the Polish (currently approx. 4.2%) or Czech (currently approx. 2%) debt securities.

[62] Moody's was the first rating agency to downgraded country's debt rating in November 2011. While in January 2012, a similar step was taken by Standard & Poor's and Fitch.

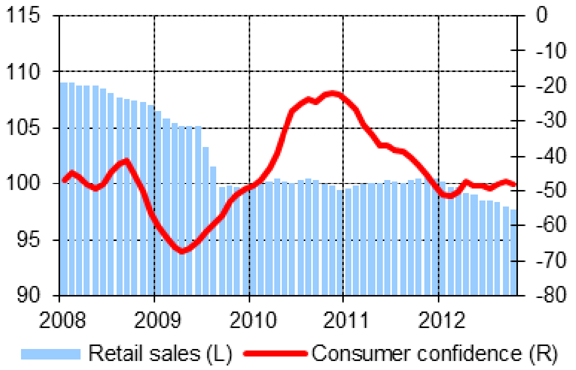
Contribution to GDP growth (in pp., y/y)



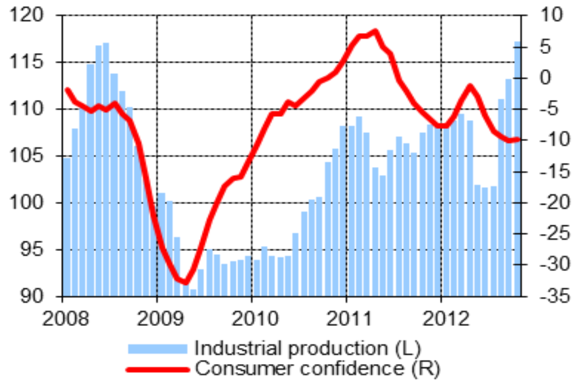
HICP inflation and its components (%, y/y)



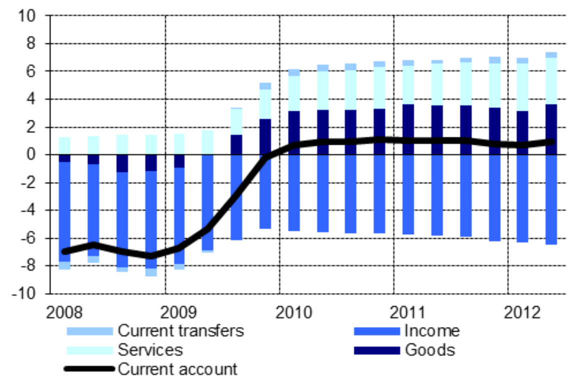
Retail sales (in %, y/y) and consumer sentiment index



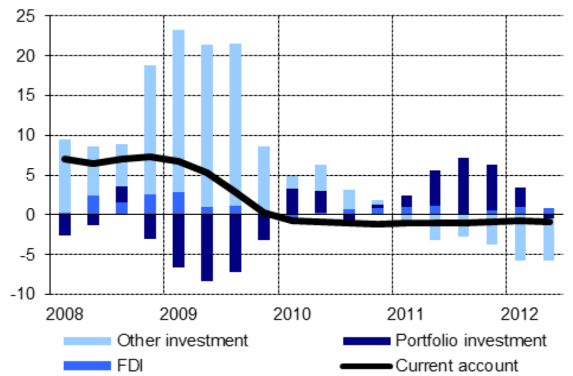
Industrial production (in %, y/y) and business sentiment index



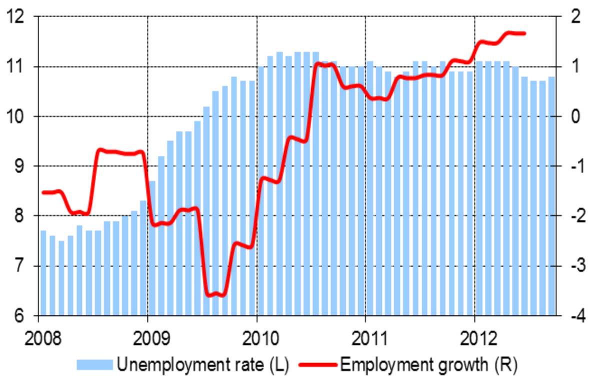
Current account and its components (in % of GDP, 4-quarter moving average)



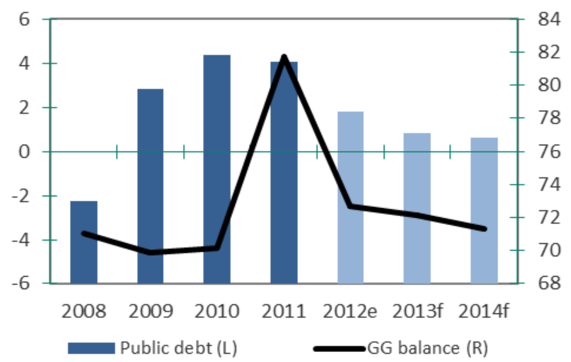
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%) and employment growth rate (%. y/y)



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

Article

Reasons for minor role of BRIC economies as CEE export markets

Conclusions

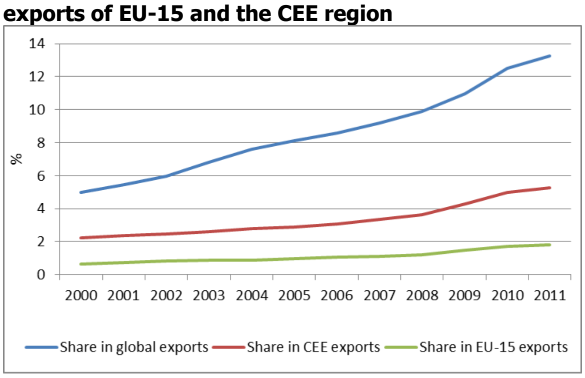
- The profound changes that have taken place in recent years in the exports goods structure of the CEE countries as a result of foreign direct investment have not been accompanied by corresponding changes in the geographic structure in spite of major shifts in the global economy. The key emerging economies, whose rapid demand expansion in the last decade has been instrumental in boosting international trade, are still of marginal significance in the exports of the CEE countries.
- The analysis of changes in the geographical structure of CEE exports that has been performed in recent years shows that the relocation of production to the CEE region by Western European companies was aimed at boosting exports (by increasing price competitiveness) to the closest geographical markets, mainly to EU-15, Russia and to other countries of the former Soviet Union, therefore strengthening the existing geographical structure of exports.
- The geographical concentration of exports on the closest geographical markets. It arises from the fact that most subsidiaries of foreign enterprises in Central and Eastern Europe specialise in manufacturing and exports of products with few distinguishing features, targeted at lower market segments. While previously exports were geared to geographical market proximity, over the last decade they were shifted towards lower manufacturing costs.
- Production and exports of goods with low unit values (prevailing in in CEE exports) reflect low value added of the exported goods. Thus, goods from the CEE countries have little chance to establish a presence in geographically remote markets. It is associated with low innovativeness of offered products and fierce competition from exporters from emerging markets.

Distinct changes in global economic geography that took place in the first decade of the 21st century, driven by the spectacular rise in importance of the BRIC countries, were only marginally reflected in the exports of Central and Eastern Europe. Apart from Russia, major emerging economies continued to be regarded as exotic markets by exporters from the CEE countries. There was, in principle, no major improvement in the situation even following the great shift in the region's export structure towards more processed goods associated with the expansion of the European Union and inflow of foreign direct investment. For this reason, the significance of such countries as China, India or Brazil in the region's exports remains markedly smaller not only in terms of general tendencies in global trade but also when compared to Western Europe. Furthermore, it is obvious that in spite of a robust growth of exports in the CEE countries in the course of the last ten years, these unfavourable proportions have not improved.

CEE exports to BRIC countries accounted for 6.3% of total exports in 2011 (compared to 15% share of these countries in the global imports and 7.5% in the EU-15 exports). Russia is by far the most important destination among the BRIC countries, accounting for over 70% of exports directed to those countries in 2011 (and in the case of the Baltic states, even exceeding 90%). CEE exports to Russia differ considerably from the exports to other BRIC countries. These profound structural differences are determined mainly by the geographical and cultural proximity and the historical links. These factors have contributed to an increase in the comparative advantage of most CEE countries on the Russian market over other exporters (although their importance in the following years has been falling in line with the changes in the structures of the economies of both the CEE countries and Russia). In contrast, the factors determining exports to geographically remote markets are of a more global nature. This is the reason why the next section of the article will highlight exports from the CEE region to China, India, and Brazil.

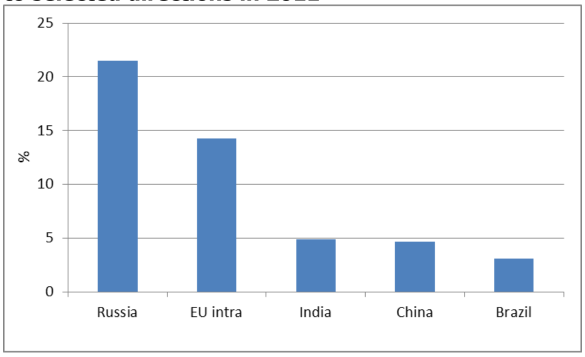
The above-mentioned countries are of marginal importance to the exports of Central and East Europe. The share of China, India, and Brazil in the region's export in 2011 accounted for only 1.8%. True, it had gone up compared to the 2000 figure (at that time, it amounted to 0.6%). Yet, it is much less not only compared with the share of these three countries in global imports (13.2% in 2011) but also with the exports of EU-15 (5.3% - increase from 2.2% in 2000).

Figure 1
China, India and Brazil's share in global imports and exports of EU-15 and the CEE region



Source: Calculations based on WTO and Eurostat data.

Figure 2
Share of the CEE countries in European Union exports to selected directions in 2011



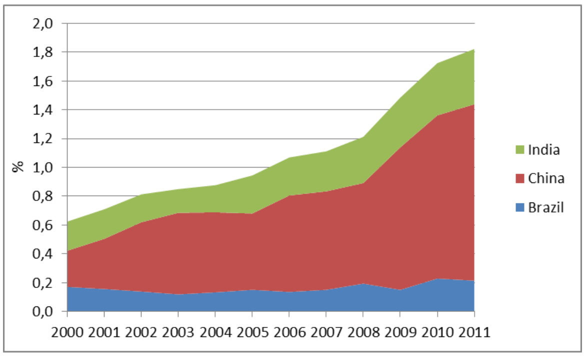
Source: Calculations based on Eurostat data.

A vital export destination for the CEE countries amongst the most rapidly emerging global economies is China. However, China accounted for only 1.2% of total exports from the CEE countries (while it accounted, in 2011, for 3.4% of the total EU-15 exports and for 9.5% of the global imports). In 2011, China ranked as low as 19th as a CEE export market (taking into consideration the value of the exports); while the Chinese economy is the second biggest global importer[63] after the United States.

The share of India and Brazil in the region's exports is definitely smaller. In 2011, India accounted for some 0.4% of the CEE country exports (compared with 1.0% of EU-15 exports and a 2.5% share in global imports). As far as the value of exports of the CEE countries is concerned, in 2011 India was ranking 34th. Brazil, in 2011, accounted for only 0.2% of the value of the region's exports (compared to 0.9% of EU-15 exports and 1.3% of share in the global imports).

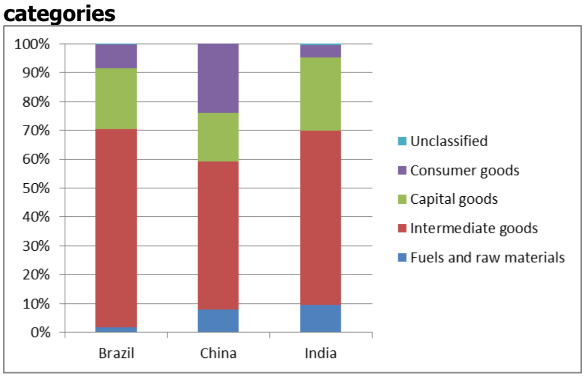
Comparing the significance of the three biggest emerging economies in CEE exports and in the global imports (as well as EU-15 exports), it can be seen that in 2000-2011, the scale of despecialisation[64] (the values of specialisation indices below unity) of exporters from the countries of CEE region in these markets has not changed. Slovakia is practically the only country observing a noticeable fall in the degree of despecialization. As far as other countries are concerned, including Poland, despecialisation has deepened.

Figure 3
The share of major emerging markets in the CEE countries' exports



Source: Calculations based on Eurostat data.

Figure 4
Structure of the exports in the CEE countries to major emerging markets in 2011 by main economic categories



Source: Calculations based on Eurostat data.

It seems that in spite of similar conditions (distance) and the increasing convergence of export structures of the CEE and EU-15 countries (which is evidenced by general foreign trade statistics, for instance, according to SITC classification)[65], the differences in the importance of new, dynamically emerging markets in the exports of Central

[63] Only in the case of Slovakia, China is among ten major export markets (ranking 10). At the same time, to the Chinese market in 2011 found the way 2.7% of Slovakian exports value (the record achievement among all CEE countries).

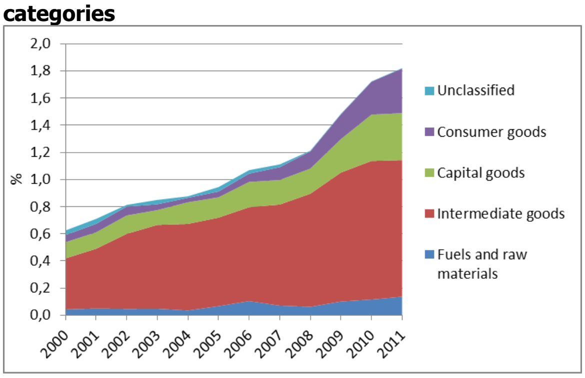
[64] Specialisation of *x* country in a market of *y* country takes place if the share of *y* country in the *x* country exports is higher than the share of *y* country in the world imports (that is, if such relation adopts higher values from the unity (=1)). If the value of so calculated index is lower from unity, then it is a reversal situation (the so-called despecialisation).

[65] In the years 2000-2011, primary changes in the structure of exports from CEE countries to China, India and Brazil towards the increase of share of more processed products had taken place. At the beginning of the decade, products classified as plants and machines (SITC 7) accounted for hardly over 40%, after eleven years their share went up to almost 60% (in EU-15

and Eastern Europe and in the Western European countries is determined by strategies pursued by multinational corporations.

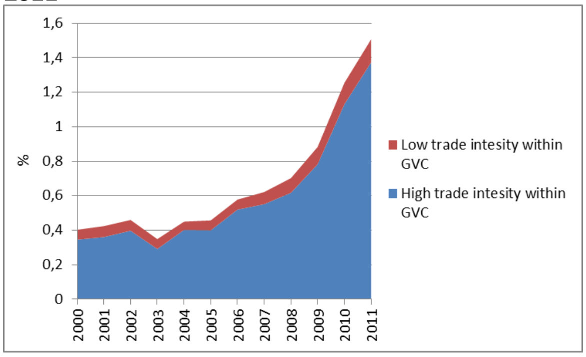
As a result of production outsourcing after CEE countries EU accession, international corporations exert strong influence on the export structure in the region. The analysis of changes in the geographical structure of CEE exports that has been performed in recent years shows that the main purpose of the outsourcing has been to increase exports (by stimulating price competitiveness) to the closest geographical markets, mainly to EU-15, Russia and other countries of the former Soviet Union. Such geographical structure results from the fact, that the majority of subsidiaries of foreign enterprises in Central and Eastern Europe specialise in manufacturing and exports of products characterised with few distinguishing features, targeted at lower market segments. At the same time the production of varieties of goods characterised by higher quality (reflected in their higher prices) is carried out in home countries, with R&D centres located there.

Figure 5
The share of major emerging markets in the exports of CEE countries in the years 2000-2011 by main goods categories



rce: Calculations based on Eurostat data.

Figure 6
The share of major emerging markets in the exports of finished goods from CEE countries in the years 2000-2011



Source: Calculations based on Eurostat data.

In parallel, Western European corporation (following the example of Japanese and American enterprises) have been outsourcing entire production processes to remote emerging markets, including China, Brazil and India. On the one hand, it was aimed at a reduction of costs associated with transportation (which is more important in the case of less expensive goods), on the other– at evading of high duty tariffs imposed in these countries on finished goods. It should also be taken into consideration a powerful potential of the discussed emerging markets and a fact that they are self-sufficient in terms of a wide range of products from lower market segments. It means, that import demand in these countries, particularly for finished products, basically concerns high-end segments. Thus, such countries as China, India or Brazil have not created demand for products featuring in the export offer of the CEE countries. Simultaneous changes taking place in the CEE and BRIC economies have even made them competitors on the global market.

Consequently, European Union exports to geographically remote countries, such as China, India and Brazil, are dominated by finished goods targeted at higher market segments, which is reflected in their higher unit values. The average unit value of finished goods traded within global value chains category (GVC – i.e. BEC 410, BEC 510, and BEC 610, and thus largely associated with intra-company trade) exported by the CEE countries to China, India and Brazil amounted to 59% of the EU-27 export unit value to those countries[66]. At the same time, the unit value of EU-15 exports amounted to 104% of EU-27 (and in the case of the greatest EU exporter, Germany, the export unit value accounted for 116% of the European Union export unit value).

The production and exports of goods with high unit values, which may reflect high value added, is principally concentrated in the EU-15 countries, hence their share in total EU exports to China, India and Brazil is substantially higher than the share in the exports inside the European Union. At the same time, the importance of

countries, it was at the level of approx. the same 55% in course of that period). At the same time, the importance of products classified by raw materials (SITC 6) and raw materials other than fuels (SITC 2) has changed. Compared to UE-15 countries, chemical products play less important role in the CEE countries (their share in EU-15 exports amounted to 13% in 2011 against 8% in the CEE countries).

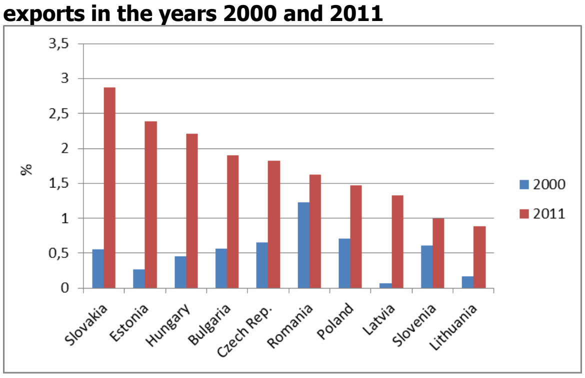
[66] Unit value was calculated in this case based on the export value and exports expressed in physical units (kilograms) based on Eurostat-Comext database. The index calculated with use of this method does not fully reflect the complexity of issues relating to the value added in foreign trade. However, in comparison with other indices associated with changes in goods' and geographic structure shows general processes taking place in this field.

CEE exporters countries diminishes along with the distance of the markets, which suggests that cheaper products from the CEE region are rather a supplement to the export offer of Western European enterprises[67].

Goods originating from the CEE region have little chance to compete in geographically distant markets. This stems from their substantially lower innovativeness in comparison not only with the EU-15 products but also Japanese, American etc. Another reason is fierce competition from other emerging markets in Asia (in the case of China and India) and in South America (in the case of the Brazilian market). The automotive industry can serve as an example here. Although there are thirteen car plants operating in the CEE region that are subsidiaries of Western European manufacturers (belonging to the ACEA European Automobile Manufacturers' Association), only one of them exports cars to China, i.e. the most rapidly growing automotive market worldwide.

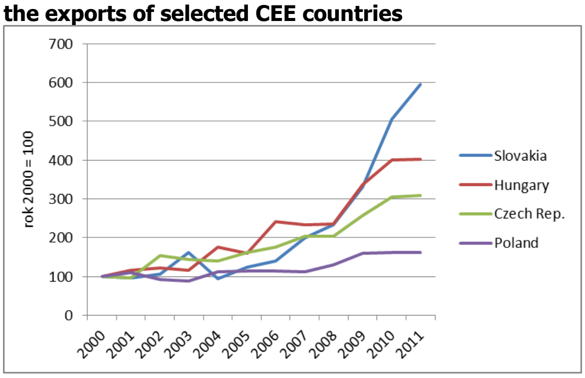
Thus, we may say that the CEE countries export structure does not fit in well with the structure of import demand of the major emerging markets. On the one hand, technologically advanced products constitute only a relatively small share of these exports, as these products tend to be manufactured in countries with strong R&D capacity. On the other, the CEE countries generally are not raw materials exporters, for which China specifically has an almost unlimited demand. Products offered by the CEE countries are easily substituted with ones either manufactured in these countries or in their direct neighbourhood.

Figure 7
The share of major emerging markets in the CEE exports in the years 2000 and 2011



Source: Calculations based on Eurostat data.

Figure 8
Changes in the share of major emerging markets in the exports of selected CEE countries



Source: Calculations based on Eurostat data.

This seems to be the reason why China, India or Brazil are not the major trading partners of the CEE region. Exports from the CEE countries to China accounted for only 0.7% of the country's total imports in 2011 (in this case, a noticeable difference can be seen comparing with the beginning of the previous decade when imports from the region's countries accounted for 0.3% of Chinese imports). In India the figure is even less meaningful – only just 0.6% (data from 2010) against 0.4% in 2001. In Brazil, in turn, imports from the CEE countries have slightly declined in recent years (from 1.0% in 2001 to 0.9% in 2011).

The above-presented conditions are the reason why not finished but intermediate goods made up for the most imprtant CEE exports to the major emerging markets. Until 2008, they accounted for approx. 70% of the combined value of exports to China, India and Brazil. In the following years this share declined (mainly due to the increase in exports of cars from Slovakia). In 2011, intermediate goods accounted for 55% of export sales from CEE countries destined for the major emerging markets. The biggest share of intermediate goods has been observed in exports to Brazil (70% of the export value) and India (60%), slightly smaller in the exports to China (slightly over 50%).

Exports of intermediate goods from CEE countries is associated with the demand of the industrial sector of the major emerging markets on one hand, and international supply chains set up by multinational corporations on the other. Statistics regarding foreign trade enable us to distinguish between these two forms of demand only to a very limited degree. In the first case it is strongly related to domestic demand, in the second, to both domestic and global demand (especially in exports to China).

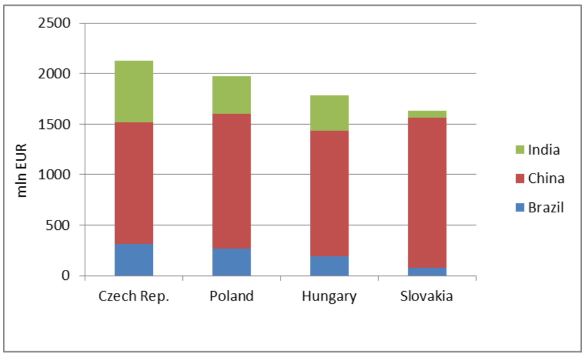
Demand of the industrial sector of emerging markets is basically expressed in the changes in the processed industrial supplies (BEC 220). Whereas the activity of multinational supply chains, part of which are plants located in the CEE countries on one hand and subsidiaries in the BRIC countries on the other, reflect major changes in capital goods (BEC 420) and parts and accessories of transport equipment (BEC 530). Currently, parts and accessories (accounting for almost 30% of the total CEE exports to these countries) play a more important role in

[67] In 2011, CEE countries accounted for 4% of exports of all European Union to China, India and Brazil while in the case of exports within the EU, their share amounted to 14% and in the case of exports to Russia – 22%.

the exports to the major emerging markets, which is associated with faster export growth of this category (on average by 27% per annum) in 2000-2011. High growth in exports of parts and accessories has reflected the general tendency to consolidate the role of multinational corporations in the global trade. Ties of this kind (between subsidiaries of such corporations) are of vital importance to Hungarian exports (2011 saw 53% of export sales of parts and accessories going from Hungary to Brazil, China and India) and the Czech Republic (43%).

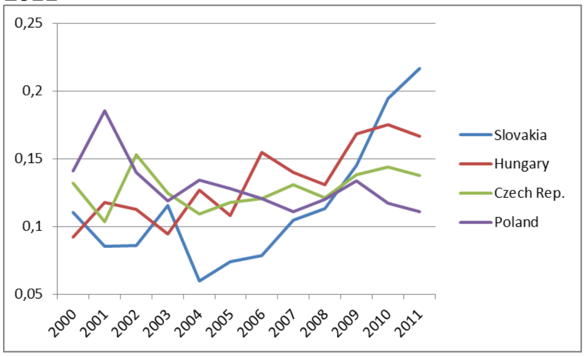
The above-described conditions cause finished goods to play a relatively minor role in the region's exports to BRIC countries (excluding Russia). In 2011, finished goods accounted for slightly more than 40% of exports (of which more than 90% of value constituted exports in categories relating to high-volume trade within GVC)[68].

Figure 9
The value of exports from selected CEE countries to major emerging markets in 2011



Source: Calculations based on Eurostat data.

Figure 10
Indices of specialisation of selected CEE countries' exports to major emerging markets in the years 2000-2011



Source: Calculations based on Eurostat data.

Consumer goods account for a relatively small share in the exports to major emerging markets (as little as 18%). It should also be noted that almost ¾ of the export value of consumer goods exports to three BRIC countries was constituted by cars from Slovakia to China in 2011. As a result of exports of the VW Touareg cars from the Bratislava Volkswagen plant, Slovakia has become the third biggest, in terms of value, car exporter to China amongst European Union countries (after Germany and the United Kingdom). At the same time, passenger cars accounted for 85% of export sales from Slovakia to China[69]. The Volkswagen subsidiary in Slovakia is also the region's biggest exporter of cars to India and Brazil. In total, over 15% of Slovak car exports, in terms of value, went to three major emerging markets in 2011. Without car exports from Slovakia to China, the share of consumer goods in CEE exports to major emerging markets would account for less than 5%.

Capital goods are slightly more important in the region's exports to three BRIC countries. In 2011 they accounted for 19% of the value of total CEE export to these countries. A vast majority of capital goods exports originates in the Czech Republic (where this category accounted for 29% of the export value) and Hungary (32%). In the case of Poland, capital goods accounted for less than 10% of the export value to China, India and Brazil.

The third major item of exports from the CEE countries to major emerging markets are parts and accessories supplied by the region to other European Union countries, subsequently becoming elements of finished products (or sub-assemblies) exported to China, India or Brazil. This form of export sales is also carried out within regional or multinational production networks. The German export sector is the greatest intermediary of this kind. This is related, firstly, to high activity of German enterprises in exports to the above-mentioned countries (in 2011, China, India and Brazil accounted for 8.2% of the entire German exports while the remaining EU-15 - on average for 4.2%). Secondly, it stems from the dominant position of Germany as a intermediate goods exporter, basically parts and accessories (BEC 420 and BEC 530), to Central and Eastern Europe[70]. The scale of this phenomenon, described occasionally as indirect exporting, is very difficult to assess, as it is not reflected in any foreign trade

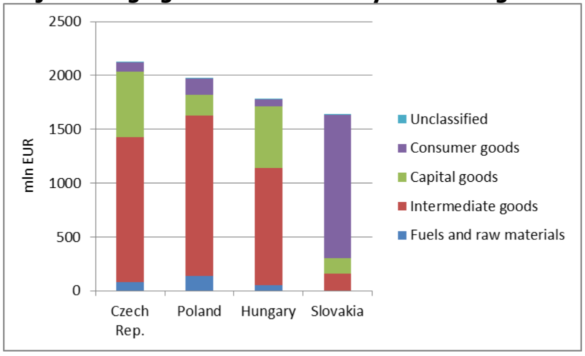
[68] The total share of China, India and Brazil in general exports of finished products of CEE countries. In 2011, it only amounted to 1.5% so it was lower compared to the total share of the three economies in the exports of the CEE countries.

[69] At the same time, car export from Slovakia to China accounted for almost 20% of CEE countries exports value to China in 2011.

[70] In 2011, almost 1/4 of the German imports of parts and accessories (BEC 420 i 530) was coming from CEE countries while the share of the countries of the region in German imports accounted for 13.0%. At the same time, parts and accessories accounted for almost 30% of German imports with CEE countries. Some 11.7% of German export sales of high-volume of finished goods go to Brazil, India and China, and 11.4% of German export sales of high-volume parts and accessories go to Brazil, India and China. At the same time, high volume finished goods within GVC and parts, i.e. goods that are object of intra-firm trade account for ¾ of the entire German exports to the three biggest emerging markets.

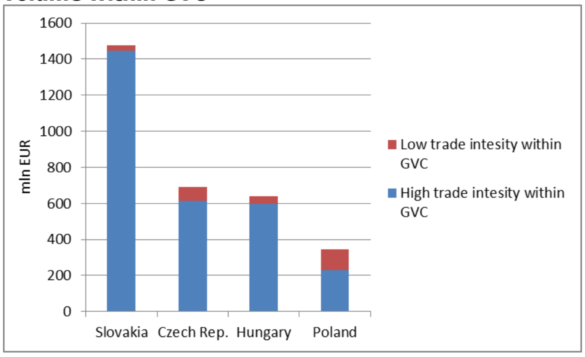
statistics. However, taking into consideration the simple correlation between the changes of the German exports of finished goods to major emerging markets and exports of parts and accessories from the CEE countries, the size of this category does not seem large. Most likely, the demand of the export sector in Germany and in other EU-15 countries for intermediate goods from Central and Eastern Europe countries is more connected with trade within the European Union and countries of the former Soviet Union.

Figure 11
The value of exports of selected CEE countries to major emerging markets in 2011 by main categories



Source: Calculations based on Eurostat data.

Figure 12
The value of exports of finished commodities of CEE countries to major emerging markets in 2011 by trade volume within GVC



Source: Calculations based on Eurostat data.

Differences in the shares in the exports to major emerging markets are observed not only between EU-15 and CEE countries but also across the CEE region. The greatest significance of exports to China, India or Brazil is seen in Slovakia. In 2011, exports to these countries accounted for 2.9% of total Slovak exports. Since 2000, Slovakia has also seen the most rapidly growing share of exports to China, India and Brazil[71]. Besides that, only in Estonia and Hungary the export value to the above-mentioned countries accounted for over 2.0%. In Lithuania, in turn, its share did not exceed 1%. The total share of China, India and Brazil in Poland's export sales is lower than the average for the remaining CEE countries (1.5% compared to 1.9%). A smaller share in Poland may result from the fact that the importance of multinational corporations in the structure of the Polish exports is smaller than in the remaining countries while exports to distant countries is basically covered by large multinational companies.

In 2011, in other CEE countries (except Poland) over 90% of the value of finished goods exports to major emerging markets focused in the categories of high-volume trade within GVC. Poland recorded slightly over 2/3 of the value. Poland's share in the exports of these categories accounted for 7% (that is, three times less than the entire exports of CEE countries to China, India and Brazil). Minor importance of products associated with intra-company trade in the Polish exports compared to other CEE countries may prove that multinational corporations have selected other countries rather than Poland for their production.

[71] In 2000, Slovakia's exports to China, India and Brazil in total, accounted for 0.6%, while in Poland – such exports amounted to 1.2%.

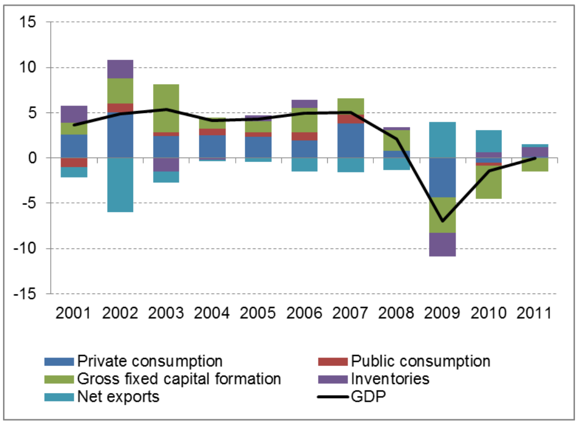
Annex 1

Croatia – the new European Union Member State

On 1 July 2013, Croatia will become a fully-fledged member of the European Union, thereby joining, after six years of negotiations, its 27 Member States. Next to Slovenia, Croatia will be the second country of the former Yugoslavia to become part of the EU structures. In terms of national wealth measured on Purchasing Power Parity basis, GDP *per capita* of the country, with a population of less than 4.5 million, amounted to USD 20 000 in 2011. This constitutes 61% of the EU average (USD 33 000 at PPP), while as recently as 2000 the figure was 50% (USD 22 000 at PPP). The Croatian economy is based on services (mainly tourism) and industry (including construction), which accounted for 68% and 27% of the country's total GDP in 2011.

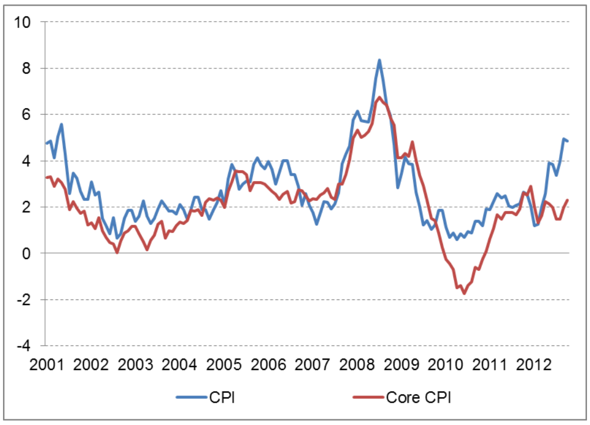
In the first years after the declaration of independence by Croatia (1991) and the launch of reforms that would pave the way to the free market, the country's economy suffered badly due to deindustrialisation (the removal of heavy industry) and considerable civil war damage during the years 1991-1995. The improvement in the economic activity took place in 2000 thanks to a boost in the tourism industry, which was stimulated by the reconstruction of the destroyed road and transport infrastructure, and the catering and accommodation base. Another driver of economic growth was the robust expansion in private consumption, financed by easy access to credit from newly privatised state-owned banks. As a result, the average annual real GDP growth in Croatia was relatively high during the years 2000-2007, i.e. within the range of 4-6%.

Figure 1. Decomposition of GDP in pp. y/y



Source: Eurostat

Figure 2. Inflation in %, y/y



Source: Eurostat

Inflation did not pose any risk for macroeconomic stability in Croatia. The years 2002-2003 saw a sharp decline in prices of consumer goods and services (to below 2% y/y from over 4% in 1999-2001), which resulted from a fall in crude oil and raw material prices worldwide. In the following years inflation was gradually driven upwards, yet it did not return to the high level observed in 2000 (over 5%). A factor that abated inflationary pressure at that time was, among other things, the nominal exchange rate of the kuna (HRK), which, after the initial stabilisation, began to appreciate markedly. During the years 2000-2007, the Croatian currency strengthened against the US dollar by 51%. The scale of the appreciation of the kuna would have even been larger if the Croatian National Bank hadn't intervened on foreign exchange market[72]. The strengthening of the kuna exchange rate was on the one hand stimulated by the boost in the tourism industry, reflected, among others, in the number of tourists coming to Croatia, while on the other, by the inflow of foreign capital related to the takeover of privatised state-owned companies. During the years 2000-2007, the total value of foreign investment accounted for 14% of Croatia's GDP and took mainly the form of direct investment and external loans for the country's banking sector.

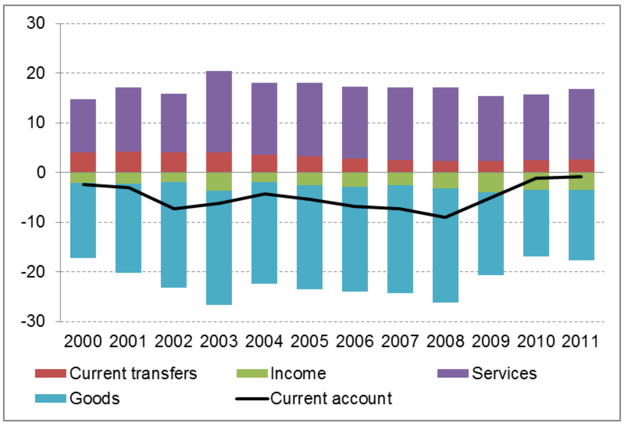
The onset of the financial crisis led to a marked decline in the growth rate of the Croatian economy. In 2008, real GDP growth amounted to a mere 2.1% y/y. The factor that mitigated the impact of the turmoil in international financial markets on the country's economy proved to be the tourism industry, which responded to global slump with some delay. The escalation of the crisis was accompanied by a collapse in economic activity. In 2009, Croatia entered a recession, which was reflected in a GDP decline by 6.9%. In 2010 the country remained still in

[72] Managed floating regime is applicable in Croatia, which means that although the kuna nominal rate is determined by market forces, still, the central bank has right to intervene (buy or sell foreign currency) when the fluctuations in the exchange rates pose threat to price stability in the economy.

recession, but somewhat less intensive (-1.4%). GDP drop was halted in 2011, when the Croatian economy stagnated.

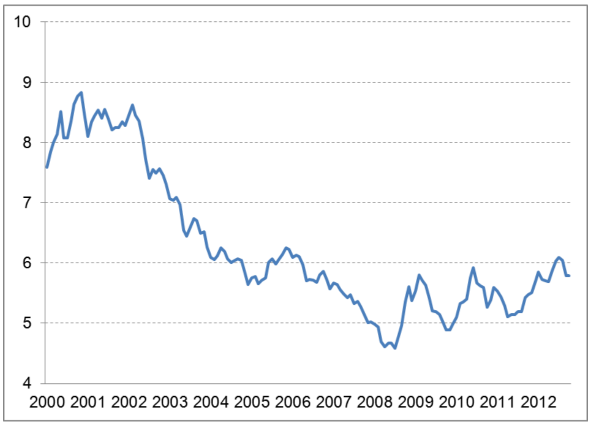
As a result of the global financial crisis, inflation in Croatia went rapidly up at first, due to an increase in the prices of food and energy commodities (including crude oil) globally. Subsequently, it went sharply down and remained relatively stable until the end of 2011. The turmoil in the international financial markets also hindered the appreciation trend in the kuna exchange rate against the US dollar, which began to weaken as of mid-2008. Activity of the Croatian National Bank, including its frequent interventions aimed at curbing the appreciation trend of the national currency, had also contributed to the depreciation of the kuna exchange rate.

Figure 3. Current account balance in % of GDP



Source: COS

Figure 4. Nominal exchange rate USD/HRK



Source: Croatia National Bank

The financial crisis also brought about a significant reduction in external imbalance of the Croatian economy. The deterioration in the country's economic activity and its external environment led to a drop in exports and imports, a more pronounced one in the case of the latter. As a result, the trade deficit shrank while the services surplus was maintained at the same level, thanks to, among other things, sustained high revenues from the tourism industry. In effect, the current account deficit in Croatia dropped from 9.0% of GDP in 2008 to 1.1% of GDP in 2010. It was still covered by foreign direct investment considered as a safe and stable form of foreign capital inflow.

After two years of recession and a year of stabilisation, the economy of Croatia experienced another slump in 2012. It is reflected in quarterly figures showing the country's GDP decrease in the first three quarters of 2012 (by 1.2%, 2.2% and 1.9% y/y, respectively) and monthly figures regarding retail sales, construction and industrial production as well as the level of unemployment, suggesting that the economy stalled in the 2012 Q4. The European Commission anticipates that this time the tourism industry, while posting a further rise in revenues, will not manage to compensate for worse results of other economy sectors. According to the European Commission forecasts, in 2012 the Croatian GDP will contract by 1.9% y/y. Apart from domestic factors, recession in the EU countries, with which Croatia is strongly integrated in terms of trade and finance, will also contribute to the economic slump. This arises from, among other things, the fact that approx. 60% of exports from this country go to the EU, particularly Germany, Italy, Austria and Slovenia. Moreover, 75% of foreign direct investment inflows come from the euro area. It implies that the economic prospect of Croatia in the foreseeable future will largely depend on the developments in its external environment.

After the relative stability of 2011, the year 2012 saw a rapid increase in the prices of consumer goods and services in Croatia. In October 2012, CPI inflation amounted to 4.8% y/y, while as recently as at the beginning of the year it amounted to 1.2% y/y. It resulted from rising food and energy prices, adverse weather conditions and VAT rate hike. Core inflation was quite stable in that period. The nominal kuna exchange rate against the US dollar weakened slightly in the first months of 2012. However, it stabilised in the second half of 2012.

The gap on the Croatian balance of payment shrank again in 2012, which means that it did not pose any threat from the point of view of the country's macroeconomic stability. Current account deficit-to-GDP ratio decreased in the second quarter of 2011 (moving average for 4 quarters) from 1.0% to 0.5%. This resulted from, among others, a higher surplus on services compared to 2011 Q2. On the other hand, the balance on goods was persistently negative. Exports and imports continued to go down with the former falling faster.

The European Commission expects that after the decline in 2012, the Croatian economy will enter the phase of stagnation in 2013, but in 2014 it will post moderate growth (1.4% y/y). The expected gradual improvement in Croatia's economic situation will mainly origin from a rebound in investment demand, especially in the public sector. It will basically stem from the increase in investment outlays by the state-owned companies operating in the power industry and in transport. Private investment will begin to rise in the second half of 2013 and throughout 2014, which should be inspired by Croatia's accession to the European Union. At first, private consumption will have a negative impact on the country's economy due to the expected lack of visible improvement in the domestic labour market. However, as exports pick up, stimulated by better economic activity in major trading partners, Croatia is set to see a rise in employment and wages, which will boost the country's GDP growth.

In 2013, inflation will remain close to the level of 2012, i.e., 3.2%, mainly due to persistently high global food prices and both VAT rate and administrative prices hikes introduced in 2012. According to the forecasts, the annual growth rate of consumer prices in 2014 will drop to approx. 2.0% due to, among others, the fading out of the abovementioned effects.

STATISTICAL ANNEX

1. National accounts

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

	2010	2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	3.8	4.3	4.1	4.2	3.5	2.3	1.9
Czech Republic	2.3	1.7	1.5	0.9	-0.5	-1.0	-1.3
Slovakia	4.0	3.3	3.1	3.2	2.9	2.6	2.5
Slovenia	1.0	-0.2	1.1	-1.0	-0.8	-2.3	-2.9
Hungary	1.2	1.7	1.3	1.2	-1.3	-1.4	-1.6
Estonia	3.1	7.6	8.3	6.2	4.0	3.1	3.7
Lithuania	-0.3	6.0	6.6	5.6	4.2	3.2	3.3
Latvia	1.3	5.0	6.0	5.9	5.6	4.8	5.2
Bulgaria	0.2	1.8	1.4	0.9	0.5	0.5	0.5
Romania	-1.3	2.1	3.4	2.3	0.9	1.1	-0.8

Source: Eurostat

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

	2010	2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	3.2	3.1	2.4	1.8	1.6	0.9	0.1
Czech Republic	0.2	0.7	1.0	0.6	-3.0	-2.8	-2.4
Slovakia	-0.3	-0.4	-0.8	-0.5	-0.3	-0.3	-0.4
Slovenia	0.7	-0.2	2.0	-0.6	0.5	-2.2	-3.0
Hungary	-2.1	0.0	0.9	1.0	-0.3	-1.1	-3.1
Estonia	-1.9	4.2	3.8	3.8	4.1	2.8	5.9
Lithuania	-0.1	6.1	5.9	7.1	6.4	5.0	3.7
Latvia	-4.5	4.4	5.6	4.3	4.9	6.6	4.8
Bulgaria	-1.2	0.2	0.5	0.8	0.7	4.4	4.5
Romania	-1.7	1.3	2.0	1.8	1.7	2.2	2.0

Source: Eurostat

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

	2010	2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	-2.0	8.1	9.0	8.7	3.4	1.1	-1.5
Czech Republic	-3.1	-0.9	-1.9	-1.7	1.2	1.9	-2.3
Slovakia	3.6	5.7	17.4	16.1	4.5	-1.7	-4.4
Slovenia	-7.1	-10.4	-7.8	-5.9	-9.7	-7.2	-8.6
Hungary	-5.6	-5.5	-3.7	-2.5	-5.5	-4.5	-4.5
Estonia	-9.2	26.8	29.5	33.3	19.9	25.4	32.6
Lithuania	-19.5	17.2	10.0	12.0	3.6	-0.7	-3.7
Latvia	0.0	28.6	25.3	27.1	22.4	17.4	4.9
Bulgaria	-16.5	-7.9	-7.4	-10.5	-5.4	-2.1	1.0
Romania	-13.1	4.4	10.4	10.1	12.3	15.5	10.5

Source: Eurostat

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

	2010	2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	10.2	7.6	9.2	5.7	0.0	2.2	1.4
Czech Republic	18.0	11.1	6.9	4.0	6.5	4.9	4.7
Slovakia	16.4	10.8	9.0	7.1	5.2	10.8	12.0
Slovenia	7.7	7.8	6.3	6.7	2.7	1.9	0.5
Hungary	14.1	8.4	4.8	3.1	1.8	4.1	2.0
Estonia	21.7	24.9	25.8	9.3	8.1	4.4	2.9
Lithuania	10.3	14.6	15.3	7.0	5.7	3.0	7.9
Latvia	17.4	13.1	11.6	10.0	9.0	5.8	6.6
Bulgaria	16.2	12.8	5.3	11.9	-0.1	3.9	3.3
Romania	13.1	10.5	9.7	4.0	-2.9	-0.4	-4.1

Source: Eurostat

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

	2010	2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	10.7	5.8	5.7	1.7	-3.3	-2.7	-3.6
Czech Republic	18.0	7.5	2.5	1.9	4.0	4.0	1.6
Slovakia	14.9	4.5	5.2	2.6	-0.3	1.6	5.8
Slovenia	6.7	5.6	5.5	4.0	-0.2	-1.8	-4.1
Hungary	12.0	6.3	2.5	0.5	-0.4	1.5	-0.6
Estonia	21.0	27.0	28.1	12.0	9.1	6.2	8.8
Lithuania	8.6	13.6	9.0	3.2	-0.8	-1.2	8.4
Latvia	17.9	20.6	22.5	18.5	11.7	3.9	-0.3
Bulgaria	4.5	9.0	8.9	5.2	0.0	8.6	4.0
Romania	11.6	11.5	13.0	6.9	-1.5	0.1	-0.3

Source: Eurostat

2. Business cycle and economic activity indicators

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

	2010	2011	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	10.7	7.3	1.0	4.6	1.7	-2.2	1.1	-1.8
Czech Republic	9.8	6.7	-0.3	1.6	-2.6	-2.1	-3.3	-6.2
Slovakia	18.9	7.4	13.0	18.5	17.1	13.0	8.1	
Slovenia	6.4	2.8	2.9	1.8	4.3	-0.7	2.1	
Hungary	6.5	7.9	0.4	-2.0	1.8	0.6	-3.8	
Estonia	20.0	17.6	-3.4	-7.1	-3.1	8.6	0.4	6.5
Lithuania	13.9	9.0	0.5	4.3	10.6	8.0	10.4	8.9
Latvia	10.2	5.7	5.4	5.3	9.4	3.1	3.1	3.9
Bulgaria	2.0	6.1	2.3	-0.5	2.6	-3.0	-4.4	-2.1
Romania	5.6	6.1	0.4	2.2	-1.2	0.1	0.3	

Source: Eurostat

Table 7. Retail trade turnover (in %, y/y)

	2010	2011	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	6.2	0.1	-0.1	1.9	-0.9	-2.6	-4.4	-2.8
Czech Republic	-1.1	0.4	-0.4	-0.3	0.2	0.3	-1.0	
Slovakia	-2.2	-2.3	-0.9	-1.4	-0.8	-1.3	-1.4	-1.7
Slovenia	-0.3	1.8	0.6	-1.7	-1.0	-4.5	-6.1	-6.1
Hungary	-2.3	0.2	-1.2	-2.0	-2.5	-3.0	-3.3	
Estonia	-0.5	4.3	8.7	6.9	7.1	9.8	6.8	4.6
Lithuania	-6.7	8.3	3.9	5.5	2.8	2.3	3.0	0.9
Latvia	-2.2	4.3	8.9	10.5	9.6	8.3	9.1	9.0
Bulgaria	-7.0	-1.8	-0.2	0.1	-1.1	-2.0	-2.0	-2.1
Romania	-5.8	-2.3	3.8	3.6	5.0	4.8	1.0	3.0

Source: Eurostat

Table 8. DG ECFIN consumers' confidence indicator

	2011	2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	-23.7	-29.3	-27.5	-29.1	-31.9	-32.6	-29.9	-31.6
Czech Republic	-20.9	-27.7	-26.5	-26.9	-29.0	-27.5	-27.0	-27.3
Slovakia	-28.1	-29.9	-25.4	-27.3	-32.6	-36.1	-31.1	-36.3
Slovenia	-24.6	-34.2	-34.8	-35.4	-46.1	-39.7	-37.7	-35.9
Hungary	-39.2	-48.8	-48.1	-48.2	-45.6	-50.1	-48.9	-47.9
Estonia	-4.9	-11.3	-9.8	-9.2	-10.4	-13.5	-14.6	-8.0
Lithuania	-19.3	-19.1	-20.1	-19.4	-22.2	-18.9	-13.9	-13.0
Latvia	-22.0	-14.1	-14.3	-12.7	-12.8	-11.7	-11.5	-7.6
Bulgaria	-40.2	-43.3	-43.0	-43.3	-46.6	-47.1	-43.7	-43.1
Romania	-44.1	-35.8	-30.7	-37.4	-37.6	-37.1	-35.8	-32.2

Source: European Commission

Table 9. DG ECFIN business confidence indicator

	2011	2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	-12.6	-16.9	-16.3	-18.5	-19.7	-21.6	-19.5	-19.5
Czech Republic	5.6	-5.6	-9.7	-9.9	-9.5	-9.5	-12.6	-7.7
Slovakia	3.2	-2.2	-5.3	-4.8	0.4	-9.7	-18.5	-9.4
Slovenia	1.5	-11.4	-14.7	-16.1	-18.0	-17.0	-13.9	-9.7
Hungary	-0.3	-7.0	-7.9	-10.9	-11.5	-7.3	-8.6	-8.7
Estonia	6.9	-1.2	-1.3	2.0	-2.2	-4.1	-6.0	-6.9
Lithuania	-4.8	-12.6	-10.9	-16.6	-12.2	-13.8	-16.4	-11.4
Latvia	-4.5	-4.3	-7.3	-5.3	-3.7	-3.9	-3.9	-3.4
Bulgaria	-5.0	-7.7	-7.0	-8.6	-9.8	-11.6	-10.5	-7.6
Romania	-1.7	-2.8	-4.5	-3.8	-4.4	-4.5	-3.5	-4.1

Source: European Commission

Table 10. PMI manufacturing

	2011	2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	52.3	48.9	49.7	48.3	47.0	47.3	48.2	48.5
Czech Republic	54.9	48.8	49.5	48.7	48.0	47.2	48.2	46.0
Hungary	52.1	51.2	51.8	49.5	52.4	49.8	52.1	48.9

Source: Markit Economics

3. Prices

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

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	4.0	3.6	4.3	4.0	3.8	3.8	3.4	2.8
Czech Republic	3.5	3.2	3.5	3.1	3.3	3.4	3.4	2.7
Slovakia	3.6	3.4	3.6	3.7	3.7	3.6	3.8	3.4
Slovenia	2.6	2.4	2.3	2.4	2.9	3.3	2.7	2.3
Hungary	5.7	5.3	5.6	5.8	6.0	6.6	6.0	5.2
Estonia	4.0	3.8	3.9	3.6	3.8	3.8	4.1	3.6
Lithuania	3.2	2.5	2.5	2.8	3.3	3.4	3.1	2.8
Latvia	2.8	2.2	1.9	1.7	1.7	1.9	1.6	1.5
Bulgaria	1.7	1.7	1.6	3.1	3.9	4.9	4.4	3.9
Romania	1.8	1.8	2.0	3.0	3.9	5.3	5.0	4.6

Source: CSOs

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

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	4.2	4.6	3.9	3.3	3.3	3.0	2.1	1.2
Czech Republic	2.2	1.7	1.5	1.3	1.9	1.7	1.9	1.6
Slovakia	3.9	4.1	3.9	3.7	4.2	4.2	4.0	3.8
Slovenia	0.7	1.3	0.8	0.9	0.8	0.9	1.2	1.3
Hungary	7.0	7.4	6.9	6.1	5.7	4.3	2.8	0.6
Estonia	3.5	3.3	2.8	2.8	3.2	3.1	3.1	3.1
Lithuania	6.9	5.4	4.7	4.7	5.5	5.3	4.0	3.2
Latvia	5.7	3.9	2.9	3.3	2.9	3.1	3.6	4.2
Bulgaria	5.0	4.3	3.3	4.5	7.1	6.6	6.9	6.4
Romania	5.3	5.1	4.3	4.5	6.3	6.1	6.5	5.3

Source: CSOs

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

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	4.0	3.6	4.2	4.0	3.8	3.8	3.4	2.7
Czech Republic	4.0	3.5	3.8	3.3	3.4	3.5	3.6	2.8
Slovakia	3.7	3.4	3.7	3.8	3.8	3.8	3.9	3.5
Slovenia	2.9	2.4	2.4	2.6	3.1	3.7	3.2	2.8
Hungary	5.6	5.4	5.6	5.7	6.0	6.4	6.0	5.3
Estonia	4.3	4.1	4.4	4.1	4.2	4.1	4.2	3.8
Lithuania	3.3	2.6	2.6	2.9	3.4	3.3	3.2	2.8
Latvia	2.8	2.3	2.1	1.9	1.9	1.9	1.6	1.5
Bulgaria	2.0	1.8	1.6	2.4	3.1	3.4	3.0	2.7
Romania	1.9	2.0	2.2	3.1	4.0	5.4	5.0	4.4

Source: Eurostat

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

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	0.5	0.1	6.4	6.3	7.4	7.5	6.6	5.1
Czech Republic	3.6	5.1	12.6	9.8	10.6	11.4	11.0	9.6
Slovakia	-2.1	-1.4	3.3	6.1	6.7	8.0	9.7	8.7
Slovenia	3.1	0.9	2.4	5.7	5.8	6.8	7.0	8.4
Hungary	0.0	2.8	6.0	8.2	9.1	13.1	13.3	11.8
Estonia	-1.9	-1.4	3.1	3.7	6.5	8.5	12.4	10.6
Lithuania	1.1	-1.0	1.9	3.3	4.5	4.8	5.0	5.1
Latvia	-0.5	-0.4	2.1	2.3	3.6	2.9	5.0	4.0
Bulgaria	0.6	2.5	1.4	4.2	6.6	11.7	8.8	7.1
Romania	-7.3	-6.7	-4.4	0.2	5.0	12.6	10.0	8.9

Source: Eurostat

Table 15. HICP – processed food (including alcohol and tobacco) (in %, y/y)

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	5.2	4.8	4.4	4.1	3.8	3.8	3.7	3.5
Czech Republic	6.5	4.3	4.7	4.2	4.1	3.8	4.5	3.6
Slovakia	5.8	4.8	4.3	3.8	3.5	3.1	3.7	4.1
Slovenia	4.9	4.3	4.2	5.0	4.4	4.4	5.5	4.9
Hungary	9.4	8.9	8.5	8.7	8.7	9.7	9.8	9.6
Estonia	4.9	4.9	3.8	3.1	2.5	2.4	3.1	3.3
Lithuania	3.8	2.7	2.4	2.6	2.8	2.8	2.7	2.5
Latvia	4.3	3.2	1.6	1.4	1.0	0.7	0.5	1.9
Bulgaria	0.6	0.8	0.9	1.1	1.5	1.6	1.8	1.7
Romania	3.4	2.4	2.4	2.2	2.6	3.3	3.7	4.1

Source: Eurostat

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

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	9.8	9.4	9.5	8.2	7.7	8.5	6.7	4.5
Czech Republic	9.6	9.1	7.1	6.4	7.3	8.2	7.6	5.1
Slovakia	6.6	6.1	5.9	5.9	4.6	4.5	4.1	3.5
Slovenia	10.1	7.8	8.2	7.8	10.6	14.0	10.4	7.1
Hungary	11.7	9.9	9.4	8.4	9.1	8.7	7.1	3.3
Estonia	13.7	11.8	10.1	10.0	9.9	10.2	8.6	7.2
Lithuania	9.0	8.1	6.6	5.9	6.4	6.9	4.3	2.7
Latvia	10.5	8.5	5.7	5.5	7.2	8.6	7.5	5.6
Bulgaria	9.4	5.3	4.4	7.5	10.6	12.1	10.7	8.7
Romania	6.0	6.6	5.6	6.3	8.1	9.0	7.4	5.5

Source: Eurostat

Table 17. HICP – excluding food, alcohol and tobacco (in %, y/y)

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	2.7	2.4	2.5	2.5	2.2	2.0	2.0	1.5
Czech Republic	1.9	1.9	1.7	1.6	1.5	1.6	1.5	1.3
Slovakia	3.1	3.0	3.1	3.0	3.2	3.1	3.2	2.7
Slovenia	0.7	0.8	0.6	0.5	0.8	0.8	0.5	0.7
Hungary	3.3	3.1	3.4	3.5	3.7	3.7	3.4	3.5
Estonia	2.9	2.9	3.5	3.3	3.0	2.4	2.2	2.0
Lithuania	1.7	1.7	1.7	2.0	2.5	2.1	2.7	2.5
Latvia	0.5	0.7	1.2	0.9	0.3	0.3	-0.4	-0.3
Bulgaria	1.1	1.3	1.3	1.4	1.3	0.8	0.7	0.9
Romania	3.5	3.7	3.5	3.6	3.2	3.0	3.3	2.9

Source: Eurostat

4. Balance of payments

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

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	-5.1	-5.3	-5.5	-5.2	-4.9	-5.1	-4.6	-4.1
Czech Republic	-3.9	-3.8	-4.5	-3.3	-2.8	-2.9	-1.9	-1.7
Slovakia	-3.3	0.5	0.0	0.4	1.3	0.1	1.7	2.7
Slovenia	2.9	2.1	2.0	2.3	2.1	2.2	1.2	-0.3
Hungary	1.1	1.0	1.1	1.1	0.9	0.7	0.8	
Estonia	0.1	-0.3	-2.1	-1.9	-3.7	-5.2	-3.0	-2.7
Lithuania	2.9	1.2	-0.4	-2.0	-2.1	-2.9	-3.2	-2.1
Latvia	-1.5	-0.5	0.6	0.1	0.3	-0.7	-1.8	-1.8
Bulgaria	-4.4	-3.7	-3.9	-4.2	-4.4	-4.2	-3.6	-3.7
Romania	-0.6	-0.5	0.0	-0.1	0.0	-0.2	0.3	1.1

Source: Eurostat. Central banks, NBP IE calculations

Table 19. Poland: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-6701	-3609	-4087	-5117	-5183	-4488	-2201	-3363
Goods	-3347	-1949	-3157	-2380	-2606	-2114	-1638	-421
Services	600	919	1400	1052	680	1086	1540	1148
Income	-3861	-3328	-4747	-4520	-3789	-3908	-3948	-4891
Transfers	-93	749	2417	731	532	448	1845	801
Capital account	2837	828	1409	1457	3557	1351	2273	2481
Financial account	3932	13284	4464	1027	3147	5265	3347	4429
FDI	-115	3031	-133	3411	1987	-776	2037	821
Portfolio investment	2163	2212	4437	4304	985	4322	3477	4194
Other investment	1355	8055	220	-6398	205	1245	-2870	-1234

Source: Eurostat, central banks, NBP IE calculations

Table 20. Czech Republic: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-1392	932	-2337	-2360	-688	913	-794	-2025
Goods	179	1382	1204	322	917	2146	1482	1205
Services	682	582	836	769	516	568	523	521
Income	-2337	-1167	-4595	-3351	-1977	-1847	-2626	-3564
Transfers	85	135	218	-102	-144	47	-174	-186
Capital account	243	28	-4	114	448	22	4	0
Financial account	1891	-1022	3428	387	789	826	33	1553
FDI	535	539	1418	-177	1264	1252	1939	1765
Portfolio investment	367	-1637	1208	-76	718	1008	592	1132
Other investment	1079	-52	597	744	-855	-1629	-2402	-1509

Source: Eurostat, central banks, NBP IE calculations

Table 21. Slovakia: balance of payments (EUR m**)**

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-734	2271	-583	-681	-99	1458	549	371
Goods	80	-599	48	37	612	-452	970	910
Services	-124	666	-165	-135	-40	444	61	94
Income	-542	1605	-398	-425	-431	1263	-382	-420
Transfers	-148	600	-68	-158	-240	203	-101	-213
Capital account	346	-341	664	-155	873	-866	1261	-587
Financial account	878	-1992	851	487	792	-2259	-697	289
FDI	-43	-141	-161	69	570	125	305	-30
Portfolio investment	1219	-1059	9	179	-256	1846	3191	2029
Other investment	-298	-792	1002	238	478	-4231	-4193	-1710

Source: Eurostat, central banks, NBP IE calculations

Table 22. Slovenia: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-62	56	73	-91	-36	-27	261	179
Goods	-447	-227	-219	-214	-383	-227	-98	14
Services	314	316	399	358	370	405	451	386
Income	-116	-85	-143	-238	-84	-175	-119	-177
Transfers	188	52	36	3	61	-30	27	-44
Capital account	-37	-7	-6	-8	-82	6	27	1
Financial account	35	55	-239	-77	-89	130	-202	-423
FDI	358	-9	240	246	161	221	55	57
Portfolio investment	392	2592	-300	-440	-15	-935	213	-1006
Other investment	-689	-2457	-177	108	-236	826	-447	548

Source: Eurostat, central banks, NBP IE calculations

Table 23. Hungary: balance of payments (EUR m**)**

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	205	157	398	328	27	-16	478	
Goods	886	1176	865	672	648	995	1308	
Services	593	455	1091	989	689	586	857	
Income	-1304	-1437	-1658	-1533	-1526	-1411	-1720	
Transfers	30	-37	101	200	216	-186	33	
Capital account	198	469	390	747	742	386	482	
Financial account	194	2410	806	910	-1930	-2441	-1446	
FDI	999	-54	-470	-570	1211	469	-530	
Portfolio investment	-262	3522	2119	1697	-1554	165	-793	
Other investment	-544	-1058	-844	-218	-1588	-3075	-122	

Source: Eurostat, central banks, NBP IE calculations

Table 24. Estonia: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	153	-118	36	292	131	-108	-111	40
Goods	35	-129	-43	-37	-12	-148	-227	-151
Services	293	211	336	430	263	228	405	353
Income	-321	-225	-289	-168	-251	-197	-347	-239
Transfers	146	25	31	67	131	9	58	77
Capital account	276	187	114	160	209	87	110	212
Financial account	-740	-105	-170	-285	-392	14	157	-108
FDI	427	186	391	850	-194	56	481	144
Portfolio investment	22	213	-38	435	542	-116	194	-232
Other investment	-1190	-474	-510	-1583	-732	48	-530	-41

Source: Eurostat, central banks, NBP IE calculations

Table 25. Lithuania: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	126	-290	-281	-138	-443	-750	386	-69
Goods	-324	-494	-507	-405	-403	-609	-215	-252
Services	203	157	333	278	228	176	464	254
Income	-220	-341	-386	-326	-360	-438	-272	-376
Transfers	468	388	278	315	92	121	409	306
Capital account	271	184	85	325	173	42	228	319
Financial account	-433	66	247	-214	288	620	-523	-263
FDI	238	265	264	324	149	213	-230	369
Portfolio investment	-178	-100	-53	212	1160	1302	-451	72
Other investment	-364	-124	12	-283	-71	-1261	-347	144

Source: Eurostat, central banks, NBP IE calculations

Table 26. Latvia: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-14	11	-61	-322	-62	-149	-148	-107
Goods	-342	-386	-483	-694	-626	-585	-628	-520
Services	278	278	341	322	374	363	392	374
Income	-153	-17	-118	-74	29	-75	-98	-131
Transfers	202	136	199	124	161	148	186	170
Capital account	55	5	21	320	80	1	89	388
Financial account	-92	-85	58	85	21	247	-76	-195
FDI	161	274	234	288	200	227	14	194
Portfolio investment	-232	-504	219	-236	66	186	-221	82
Other investment	-115	-244	-262	171	-1124	249	-54	-301

Source: Eurostat, central banks, NBP IE calculations

Table 27. Bulgaria: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-862	-169	73	992	-792	-553	-328	964
Goods	-1040	-285	-623	-358	-890	-939	-1266	-548
Services	98	144	499	1510	162	104	611	1548
Income	-214	-368	-470	-497	-405	-319	-258	-419
Transfers	293	339	666	337	342	601	585	382
Capital account	140	18	47	126	306	21	44	150
Financial account	71	-27	-216	-1309	606	131	289	-772
FDI	424	8	202	362	1004	470	399	397
Portfolio investment	-135	-175	-14	-236	72	-371	-57	735
Other investment	-153	-514	-306	-936	-190	-138	592	-415

Source: Eurostat, central banks, NBP IE calculations

Table 28. Romania: balance of payments (EUR m)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Current account	-803	-594	-2754	-1432	-1157	-433	-1861	-1547
Goods	-2034	-966	-2448	-1812	-2183	-1192	-2267	-2018
Services	228	40	57	-45	289	-14	88	217
Income	-261	-248	-1221	-333	-406	-376	-538	-326
Transfers	91	271	161	48	240	451	549	271
Capital account	1264	580	858	758	1142	1149	855	580
Financial account	855	1486	1530	682	1079	-480	1216	1001
FDI	-215	160	346	404	927	97	384	763
Portfolio investment	246	822	2257	-536	-867	2032	-1345	300
Other investment	476	1644	844	-631	374	-815	212	-296

Source: Eurostat, central banks, NBP IE calculations

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

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	29.9	29.2	29.4	31.1	31.8	28.1	31.1	29.0
Czech Republic	45.1	42.7	41.6	40.8	42.9	41.6	41.7	41.5
Slovakia	3.3	3.1	3.1	3.5	3.6	3.5	3.6	3.9
Slovenia	2.0	1.8	1.8	1.8	1.8	1.7	1.8	1.9
Hungary	24.4	25.5	26.2	27.8	28.6	26.5	27.1	27.1
Estonia	11.2	1.0	0.9	1.0	1.0	1.3	1.3	1.4
Lithuania	20.7	21.5	20.4	22.6	26.1	23.9	22.2	25.0
Latvia	19.4	18.3	18.8	19.4	16.4	17.9	16.9	17.7
Bulgaria	35.1	33.4	33.9	35.9	37.2	36.7	38.1	42.1
Romania	38.9	38.0	38.4	38.1	37.7	38.9	37.2	37.4

Source: Eurostat, central banks, NBP IE calculations5. Interest and exchange rates

Table 30. Central banks' policy rates (end of period)

	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	4.75	4.75	4.75	4.75	4.75	4.75	4.50	4.25
Czech Republic	0.75	0.50	0.50	0.50	0.50	0.25	0.05	0.05
Hungary	7.00	7.00	7.00	6.75	6.50	6.25	6.00	5.75
Romania	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Euro area	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75

Source: Central banks, EcoWin Financial

Table 31. 3m interbank rates (average)

	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	4.80	4.94	4.98	4.99	4.97	4.95	4.94	5.05
Czech Republic	1.17	1.15	1.16	1.17	1.20	1.23	1.24	1.24
Slovakia	1.59	1.47	1.36	1.13	0.98	0.78	0.71	0.67
Slovenia	1.58	1.48	1.43	1.23	1.05	0.86	0.74	0.68
Hungary	6.12	6.41	7.07	7.54	7.42	7.29	7.24	7.21
Estonia	1.59	1.47	1.36	1.13	0.98	0.78	0.71	0.67
Lithuania	1.87	1.87	1.78	1.48	1.43	1.31	1.28	1.24
Latvia	0.99	1.27	1.86	1.79	1.31	1.19	1.00	0.94
Bulgaria	3.68	3.64	3.64	3.34	3.19	2.91	2.71	2.59
Romania	6.21	6.26	6.30	5.51	5.04	4.50	4.37	4.94

Source: EcoWin Financial

Table 32. Exchanage rates vis-à-vis EUR (average)

	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	4.29	4.29	4.18	4.09	4.13	4.11	4.13	4.09
Czech Republic	25.30	25.61	25.41	24.98	24.74	24.93	25.34	25.17
Hungary	293.43	292.83	285.86	278.52	283.42	281.80	282.21	286.31
Lithuania	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Latvia	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
Bulgaria	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Romania	4.44	4.46	4.55	4.51	4.50	4.56	4.52	4.48

Source: Eurostat

Table 33. Changes in exchange rates vis-à-vis EUR (in %, y/y – fall means appreciation)

	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012	12.2012
Poland	9.1	8.2	4.8	-0.8	-4.8	-5.6	-6.9	-8.5
Czech Republic	3.9	5.6	4.6	3.1	0.9	0.5	-0.5	-1.3
Hungary	9.9	9.9	6.9	2.4	-0.5	-5.0	-8.6	-6.0
Lithuania	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Latvia	-1.6	-1.7	-1.8	-1.8	-1.8	-1.4	-0.7	-0.1
Bulgaria	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Romania	7.9	6.4	7.4	6.2	5.1	5.4	3.9	3.6

Source: Eurostat, NBP IE calculations

Table 34. NEER (in %, y/y – growth means appreciation)

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	-7.2	-10.6	-10.3	-7.7	-3.0	2.6	3.6	4.8
Czech Republic	-4.2	-6.0	-7.9	-7.6	-6.5	-3.2	-2.8	-2.2
Slovakia	-1.3	-1.2	-1.4	-2.1	-2.8	-2.1	-2.4	-2.7
Slovenia	-1.2	-1.2	-1.5	-1.9	-2.3	-1.6	-1.7	-1.8
Hungary	-12.0	-11.2	-11.6	-9.5	-5.8	-2.0	2.8	7.0
Estonia	-2.1	-1.9	-2.3	-3.2	-4.0	-2.8	-2.7	-2.6
Lithuania	-1.4	-1.0	-1.2	-2.0	-3.1	-2.5	-2.6	-2.6
Latvia	0.1	0.7	0.8	0.2	-0.7	-0.3	-0.9	-1.6
Bulgaria	-0.9	-1.2	-1.7	-2.4	-3.1	-2.0	-2.1	-2.2
Romania	-7.2	-8.3	-7.2	-9.1	-8.7	-6.7	-7.3	-6.3

Source: BIS, NBP IE calculations

Table 35. REER (in %, y/y – growth means appreciation)

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	-6.1	-9.7	-8.7	-6.3	-1.9	3.7	4.5	5.4
Czech Republic	-3.6	-5.4	-7.0	-7.0	-5.9	-2.5	-2.0	-1.8
Slovakia	-0.6	-0.6	-0.5	-1.0	-1.9	-1.3	-1.4	-1.8
Slovenia	-1.4	-1.4	-1.7	-2.0	-2.2	-1.2	-1.7	-1.9
Hungary	-9.5	-8.9	-8.9	-6.6	-2.7	1.7	6.2	10.0
Estonia	-0.9	-0.6	-0.9	-2.0	-2.8	-1.7	-1.2	-1.3
Lithuania	-1.1	-1.2	-1.3	-2.0	-2.6	-2.1	-2.3	-2.4
Latvia	0.0	0.3	0.0	-0.9	-1.9	-1.4	-2.1	-2.6
Bulgaria	-2.5	-2.5	-3.0	-2.3	-2.5	-0.4	-0.9	-1.1
Romania	-8.5	-9.3	-8.0	-9.0	-7.9	-4.8	-5.5	-4.6

Source: BIS. NBP IE calculations

6. Labour market

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

	III 2010	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012
Poland	1.1	1.1	1.9	1.0	0.5	0.7	0.6	0.3
Czech Republic	-0.2	-0.2	0.8	0.5	0.3	-0.1	-0.6	-0.4
Slovakia	-1.4	0.4	2.1	1.8	1.3	0.4	-0.4	-1.0
Slovenia	-2.7	-2.0	-4.0	-3.0	-1.8	-2.6	0.2	-1.5
Hungary	1.0	0.6	0.4	0.8	0.8	1.1	1.5	1.7
Estonia	-2.2	2.8	7.1	8.1	7.9	3.4	3.7	3.5
Lithuania	-4.7	-0.8	0.8	3.7	1.7	0.7	1.7	1.4
Latvia	0.6	2.2	3.5	3.3	2.6	3.9	-9.7	-9.6
Bulgaria	-5.3	-4.7	-4.0	-4.5	-2.8	-2.2	-1.2	-0.7
Romania	-0.3	0.7	1.7	-2.4	-2.2	-0.2	-0.4	1.7

Source: Eurostat

Table 37. Unemployment rate (in %, of labour force)

	04.2012	05.2012	06.2012	07.2012	08.2012	09.2012	10.2012	11.2012
Poland	9.9	10.0	10.1	10.2	10.3	10.3	10.5	10.6
Czech Republic	6.8	6.8	6.9	6.9	7.0	7.1	7.3	7.4
Slovakia	13.8	13.9	14.0	14.1	14.1	14.1	14.2	14.5
Slovenia	8.4	8.7	8.9	9.2	9.4	9.5	9.7	9.6
Hungary	11.1	11.0	10.8	10.7	10.7	10.8	10.9	
Estonia	10.0	10.0	9.9	10.1	10.0	9.6	9.5	
Lithuania	13.2	13.0	12.9	12.7	12.6	12.5	12.4	12.5
Latvia	15.7	15.7	15.7	14.1	14.1	14.1		
Bulgaria	12.2	12.2	12.3	12.4	12.3	12.3	12.4	12.4
Romania	7.1	7.1	7.3	7.1	7.0	7.0	6.9	6.7

Source: Eurostat

Table 38. Nominal wages (in %, y/y)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	0.7	3.8	4.5	5.2	4.2	2.8	3.5	4.2
Czech Republic	0.7	2.4	2.4	2.4	2.4	3.4	2.3	1.4
Slovakia	3.4	3.0	4.2	5.5	2.4	2.3	2.7	0.9
Slovenia	2.7	2.5	2.9	2.5	0.4	-0.6	3.6	-0.7
Hungary	-0.5	1.7	4.8	5.1	7.5	2.4	5.0	5.3
Estonia	1.3	1.9	3.8	4.0	6.5	5.7	3.5	7.7
Lithuania	1.4	1.7	2.9	2.8	4.1	3.9	2.7	4.9
Latvia	2.2	3.9	5.3	5.7	5.2	3.8	4.5	3.8
Bulgaria	9.6	7.3	9.4	7.6	9.1	6.9	5.8	6.7
Romania	-1.3	-2.1	2.4	10.1	9.7	4.5	7.0	7.2

Source: Eurostat

Table 39. ULC (in %, y/y)

	IV 2010	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012
Poland	0.9	-1.8	-1.6	-1.6	-3.7	-3.9	1.3	-2.5
Czech Republic	-0.8	-0.6	0.3	0.9	1.5	3.9	3.3	2.8
Slovakia	0.4	-0.3	0.8	2.3	-0.7	-0.6	0.1	-1.5
Slovenia	-3.9	1.7	2.9	4.0	5.2	3.7	5.9	7.3
Hungary	-2.0	-0.7	3.2	3.8	6.2	3.7	6.5	7.0
Estonia	-4.8	-7.1	-4.8	-4.0	0.3	1.7	0.4	3.9
Lithuania	-3.2	-1.5	-0.8	-0.8	-0.4	-0.4	1.3	0.4
Latvia	0.4	-1.9	-2.3	-3.1	-1.7	-1.6	-2.0	-0.3
Bulgaria	0.9	4.4	7.2	6.1	8.1	6.4	5.3	6.1
Romania	-7.2	-3.8	1.1	6.5	7.1	3.6	5.9	7.9

Source: Eurostat. NBP IE calculations

7. Public finance

Table 42. General government balance (ESA'95) (in %, of GDP)

	2008	2009	2010	2011	2012p	2013p	2014p
Poland	-3.7	-7.4	-7.9	-5.0	-3.4	-3.1	-3.0
Czech Republic	-2.2	-5.8	-4.8	-3.3	-3.5	-3.4	-3.2
Slovakia	-2.1	-8.0	-7.7	-4.9	-4.9	-3.2	-3.1
Slovenia	-1.9	-6.0	-5.7	-6.4	-4.4	-3.9	-4.1
Hungary	-3.7	-4.6	-4.4	4.3	-2.5	-2.9	-3.5
Estonia	-2.9	-2.0	0.2	1.1	-1.1	-0.5	0.3
Lithuania	-3.3	-9.4	-7.2	-5.5	-3.2	-2.8	-2.3
Latvia	-4.2	-9.8	-8.1	-3.4	-1.7	-1.5	-1.4
Bulgaria	1.7	-4.3	-3.1	-2.0	-1.5	-1.5	-1.1
Romania	-5.7	-9.0	-6.8	-5.5	-2.8	-2.4	-2.0

p – European Commission autumn forecast of November 2012
Source: Eurostat (autumn fiscal notification of October 2012), European Commission

Table 43. Sovereign debt (ESA'95) (in % of GDP)

	2008	2009	2010	2011	2012p	2013p	2014p
Poland	47.1	50.9	54.8	56.4	55.5	55.8	56.1
Czech Republic	28.7	34.2	37.8	40.8	45.1	46.9	48.1
Slovakia	27.9	35.6	41.0	43.3	51.7	54.3	55.9
Slovenia	22.0	35.0	38.6	46.9	54.0	59.0	62.3
Hungary	73.0	79.8	81.8	81.4	78.4	77.1	76.8
Estonia	4.5	7.2	6.7	6.1	10.5	11.9	11.2
Lithuania	15.5	29.3	37.9	38.5	41.6	40.8	40.5
Latvia	19.8	36.7	44.5	42.2	41.9	44.3	44.9
Bulgaria	13.7	14.6	16.2	16.3	19.5	18.1	18.3
Romania	13.4	23.6	30.5	33.4	34.6	34.8	34.8

European Commission autumn forecast of November 2012
Source: Eurostat (autumn fiscal notification of October 2012), European Commission

Table 43. Excessive deficit correction period (EDP)

	Year
Poland	2012
Czech Republic	2013
Slovakia	2013
Slovenia	2013
Hungary	2012
Estonia	not included by EDP
Lithuania	2012
Latvia	2012
Bulgaria	not included by EDP
Romania	2012

Source: European Commission

8. Forecasts

Table 45. Forecasts regarding economic growth rate (in %, y/y)

	2011	European Commission			IMF			Domestic sources		
		2012	2013	2014	2012	2013	2014	2012	2013	2014
Poland	4.3	2.4	1.8	2.6	2.4	2.1	2.7	2.3	1.5	2.3
Czech Republic	1.9	-1.3	0.8	2.0	-1.0	0.8	2.8	-0.9	0.2	1.9
Slovakia	3.2	2.6	2.0	3.0	2.6	2.8	3.6	2.4	1.6	3.5
Slovenia	0.6	-2.3	-1.6	0.9	-2.2	-0.4	1.7	-1.8	-0.7	0.8
Hungary	1.6	-1.2	0.3	1.3	-1.0	0.8	1.6	-1.4	0.5	1.5
Estonia	8.3	2.5	3.1	4.0	2.4	3.5	3.5	2.9	3.0	4.0
Lithuania	5.9	2.9	3.1	3.6	2.7	3.0	3.5	3.0	3.1	
Latvia	5.5	4.3	3.6	3.9	4.5	3.5	4.2	3.8	2.7	
Bulgaria	1.7	0.8	1.4	2.0	1.0	1.5	2.5			
Romania	2.5	0.8	2.2	2.7	0.9	2.5	3.0	0.7	2.0	2.5

Table 46. Inflation Forecasts (in %, y/y)

	2011	European Commission			IMF			Domestic sources		
		2012	2013	2014	2012	2013	2014	2012	2013	2014
Poland	3.9	3.8	2.6	2.4	3.9	2.7	2.5	3.8	2.5	1.5
Czech Republic	2.1	3.6	1.1	1.1	3.4	2.1	2.0	3.3	2.3	1.6
Slovakia	4.1	3.7	1.9	2.0	3.6	2.3	2.3	3.8	2.3	1.9
Slovenia	2.1	2.8	2.2	1.6	2.2	1.5	1.9	2.9	2.3	1.3
Hungary	3.9	5.6	5.3	3.9	5.6	3.5	3.0	5.7	3.5	3.2
Estonia	5.1	4.3	4.1	3.3	4.4	3.2	2.8	4.3	3.6	2.4
Lithuania	4.1	3.4	3.1	3.0	3.2	2.4	2.4	3.2	2.8	
Latvia	4.2	2.4	2.1	2.3	2.4	2.2	2.2	2.4	2.3	
Bulgaria	3.4	2.5	2.6	2.7	1.9	2.3	2.8			
Romania	5.8	3.5	4.9	3.3	2.9	3.2	3.0	3.4	4.9	3.3

Table 47. Forecasts of current account balance (in %, of GDP)

	2011	European Commission			IMF			Domestic sources		
		2012	2013	2014	2012	2013	2014	2012	2013	2014
Poland	-4.5	-3.9	-3.3	-3.7	-3.7	-3.8	-3.7	-1.4*	-0.9*	-0.6*
Czech Republic	-3.9	-2.9	-2.1	-1.3	-2.4	-2.2	-2.0	-1.4	-1.4	-1.0
Slovakia	-2.5	1.4	1.4	2.2	0.8	0.3	0.3	2.5	1.5	3.2
Slovenia	0.1	2.0	2.7	2.3	1.1	1.0	1.0	1.1	3.3	4.3
Hungary	1.0	1.6	2.6	2.6	2.6	2.7	0.7	2.0	3.7	4.3
Estonia	0.3	-0.9	0.1	0.4	0.7	-0.1	-1.8	-1.1	-2.1	-2.5
Lithuania	-3.7	-2.9	-3.0	-3.6	-1.1	-1.4	-2.3	-2.4	-2.9	
Latvia	-2.4	-2.9	-3.1	-3.5	-1.6	-2.8	-3.4			
Bulgaria	1.7	-1.6	-2.1	-2.5	-0.3	-1.5	-2.1			
Romania	-4.1	-4.1	-4.2	-4.4	-4-3.7	--3.8	-3.9	--3.6	-4.2	-4.3

* - balance on current and capital account

Sources for tables 45-47: European Commission (11.2012), IMF (10.1012), Narodowy Bank Polski (07.2012), Ceska Narodni Banka (11.2012), Narodna Banka Slovenska (12.2012), Magyar Nemzeti Bank (12.2012), Comisia Naţională de Prognoză (11.2012), Banka Slovenije (10.2012), EestiPank (12.2012), Latvijas Banka (10.2012), Lietuvos Bankas (11.2012)