NBP Narodowy Bank Polski

No. 1/15 January 2015

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

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Warsaw 2015

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Summary

In 2014, economic recovery in the majority of the countries of Central and Eastern Europe (CEE) continued. Annual GDP growth in the first three quarters of 2014 amounted to 2.9% against 1.3% in 2013. In this period, Poland and Hungary were the fastest-growing EU economies.

GDP growth, persistently staying at a relatively high level, is the consequence of increasing domestic demand, both consumption and investment. In 2014 Q2 and Q3, only domestic demand contributed positively to GDP growth. The weakening economic situation in the external environment of the region (slowdown in the euro area, crisis in Russia and in Ukraine) had a negative impact on the contribution of net exports to GDP growth.

Private consumption has demonstrated the most dynamic increase since the first half of 2011 (2.7% y/y in 2014 Q3). **Its growth resulted from the improving situation in the labour markets** (decline in unemployment rates, growth in employment and wages), **as well as a historically low level of inflation.** These factors resulted in the increase in households' real disposable income and improvement in consumer confidence indicators. Most evident increase in consumption was noticeable in Hungary (the effect of employment growth as a result of public works programme), Romania and the Baltic states (the highest wage growth in the region).

Gross fixed capital formation growth rate went up sharply. It amounted to 7.5% y/y in 2014 Q3. However, in the case of investment, situation in the countries of the CEE region was very diversified. The dynamic growth took place in Poland, Slovakia and in Hungary (the effect of, inter alia, the *Funding for Growth Scheme*, aimed at supporting investment of small and medium-sized enterprises). On the other hand, in the Baltic states and in the Czech Republic, the growth in fixed investment was weaker. The improvement of investment activity throughout the region, was mainly connected with the growth in public investment, co-funded by the EU funds, focused mainly on infrastructure projects.

Domestic demand growth in the CEE countries was supported by the accommodative monetary policy stance. In the second half of 2014, central banks of Poland, Romania and Hungary further lowered their policy rates. The Czech National Bank maintained its decision to use the exchange rate as an additional instrument for easing the monetary conditions.

Fiscal policy ceased to hamper economic growth in 2014. In the majority of the CEE countries, the general government balance in 2014 was kept at a level close to that recorded in 2013. In 2015-2016 Croatia will face the biggest fiscal challenges. Meanwhile, Hungary and Bulgaria, where deteriorating fiscal position led to the downgrade of the Bulgarian sovereign credit rating to "junk" level by S&P in December 2014, might be placed under the excessive deficit procedure. Switch to fiscal consolidation is planned in Slovakia, while no significant change of fiscal stance is expected in other countries of the region.

Growth in the domestic demand was hampered by the private sector deleveraging. However, in the second half of 2014 lending conditions slightly eased, especially in the case of loans to households. It signals a possibility of credit recovery in the CEE region in the forthcoming years.

Since the beginning of 2014, the contribution of net exports to economic growth in the CEE countries has decreased. It has been a result of the weakening external demand, both from the euro

area and from non-EU economies. Whereas in 2014 Q1 contribution of net exports was still positive, it turned negative in the subsequent quarters. The decrease in its contribution to the GDP growth took place almost in the whole CEE region (besides Estonia and Slovenia). It had the strongest effect on GDP decline in Poland and in Hungary.

The negative contribution of net exports resulted mainly from weakening exports growth. Exports to the euro area, Russia and Ukraine were the most affected. CEE countries' mutual links within the euro area based global supply chains have also influenced the slowdown in trade turnover growth inside the region. At the same time, strong domestic demand resulted in a lower decline in imports growth in this period.

Unfavourable trends in foreign trade were mitigated in 2014 Q3 through the improvement in the terms of trade. The decline in prices of energy commodities influenced the reduction in import prices, enabling a slight surplus on the current account.

The first half of 2014 was marked by a foreign capital outflow from the CEE region. It was the consequence of the permanent withdrawal of funds from the banking sector coupled by a reduction in portfolio investment inflow.

The GDP growth in 2014 was accompanied by a further fall in inflation. Decelerating inflation resulted mainly from supply side factors, i.e. the decline in energy (mainly fuels) and unprocessed food prices. Low energy and food prices translated into other price categories, which, together with a relatively low demand pressure, resulted in historically low levels of core inflation.

The decline in inflation occurred in almost all countries of the region. It turned negative in Bulgaria and Poland, and temporarily also in Croatia, Estonia, Slovenia, Slovakia and Hungary.

In the second half of 2014, the situation in currency markets of the CEE countries was relatively stable. Temporary weakening of the CEE currency exchange rates occurred at the turn of July and August 2014 (the consequence of the Russian embargo) and in October 2014 (FED announcement of QE tapering). Larger exchange rate volatility was recorded in December 2014 when turbulences on the Russian market were partly transferred to the CEE countries and resulted in the weakening of their currencies, in particular, the Polish zloty and the Hungarian forint.

It is expected that the pace of economic recovery observed in 2014 will be continued until mid-2015. Starting from the second half of 2015 the GDP growth should slightly accelerate. In 2015-2016 domestic demand will remain the major growth factor, whereas the role of foreign demand will be still limited.

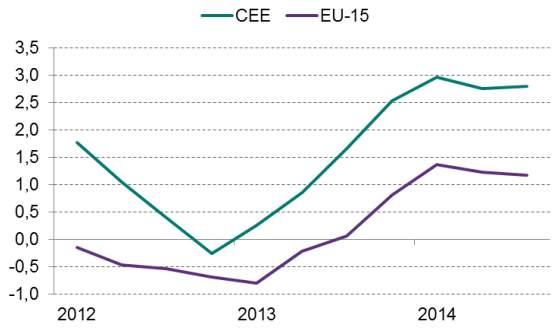
Following the period of historically low inflation in the second half of 2014, it should increase starting from the second half of 2015. However, in 2015-2016 HICP inflation will remain at a relatively low level. The slight increase in inflation will mainly result from the expected strengthening of private consumption and core inflation growth. In view of the recent forecasts of commodities prices on international markets, prices of energy and unprocessed food may have a smaller impact on the growth in consumer prices, in particular in 2016.

Countries of Central and Eastern Europe - macroeconomic outlook

Ongoing economic recovery

In 2014, economic recovery in the majority of the countries of Central and Eastern Europe continued. The annual GDP growth rate in the whole region[1] in the first three quarters amounted to 2.9%, against 1.3%[2] in 2013. It was almost two-fold higher than in the EU-15 countries[3], where GDP growth amounted to 1.2% y/y in that period.

Figure 1.1. GDP growth rate in CEE and EU-15 (in %)



Source: Eurostat.

Diversified GDP growth rate in individual countries

The diversification in the growth rate between individual economies of the CEE was maintained. In 2014 Q3 the highest GDP growth was recorded in Poland (3.4% y/y). High growth rate was still observed in Hungary, irrespective of the slowdown against the preceding quarter (3.6% and 3.1% in Q2 and Q3, respectively). GDP grew at a pace close to 3% y/y also in Romania (acceleration in relation to Q2) and Slovenia, where economic recovery was observable from the beginning of 2014[4]. Poland and Hungary, where the GDP growth in the first three quarters of 2014 clearly exceeded 3% y/y, were the fastest growing economies in the entire EU.

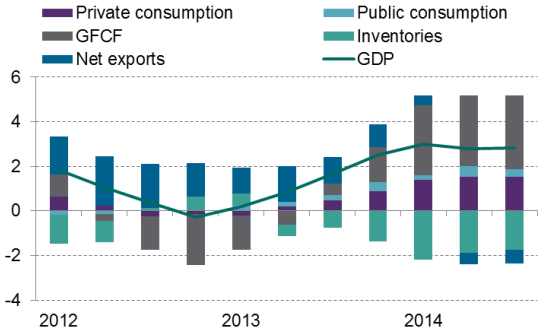
In the Czech Republic and in Slovakia, GDP growth in first three quarters of 2014 amounted to approx. 2.5% y/y. GDP growth in the Baltic states weakened at that period. In 2014 Q3, the weakest growth among the CEE countries, as in the preceding two quarters, was recorded in Bulgaria (1.5% y/y) and recession facing Croatia (-0.5% y/y).

Domestic demand as the main growth factor

The relatively high growth rate of real GDP is the consequence of increasing domestic demand. Growth in consumption and fixed investment could be observed in the CEE countries from the beginning of 2013. In 2014 Q2 and Q3 domestic demand was the only positive contributor to GDP growth in the whole region. The largest increase in domestic demand contribution to the economic growth was recorded in Poland, Slovakia and Hungary. On the other hand, in the Baltic states, in particular, in Estonia and Latvia, this contribution was decreasing, mainly as a result of weakening investment. Croatia was an exception, where both consumption and investment continued to decrease. Since 2013 domestic demand growth in the CEE countries has been supported by the less restrictive fiscal policy and the accommodative monetary policy stance.

[1] In this report, the CEE region comprises eleven countries: Bulgaria, Croatia, Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia and Hungary.
[2] Growth based on price series of 2010, seasonally adjusted, considering the number of working days, according to ESA 2010 methodology.
[3] Member countries in the EU before 2004.
[4] In 2012-2013, the GDP decline on an annual basis was observed in Slovenia.

Figure 1.2. GDP and its components in the CEE region (y/y, pp).



Source: Eurostat.

Growing private consumption

Since mid-2013 households' consumption in the CEE countries has successively increased. In 2014 Q2 and Q3 its growth rate amounted to 2.7% y/y in and reached the highest level since 2008 Q3. Growth in private consumption was observed in the majority of the economies, except Latvia (the strongest response of consumers to the geopolitical risk growth) and Bulgaria (the negative impact of the political crisis and turbulences in the banking sector on consumers' confidence). The highest individual consumption growth rate was recorded in Romania, Estonia and Lithuania, which resulted from the fastest increase in nominal wages in those countries.

The growth in private consumption in the CEE countries resulted from improved labour market conditions, an increase in real disposable income and the eased scope of fiscal consolidation observed amongst the majority of the countries. These factors led to improved consumer sentiment and their propensity to spend. The ongoing process of households' deleveraging still hindered the growth in consumer spending. However, CEE banks survey[5] shows an easing of lending conditions for households in the CEE countries in the second half of 2014. It may indicate that the consumption should rely to a larger extent on bank loans in the following quarters.

[5] *CESEE Bank Lending Survey H2-2014*, EIB, October 2014.

Fast increase in fixed capital formation

As early as in 2013 Q4, fixed capital formation demonstrated the highest contribution to the economic recovery in the CEE region. In 2014 this contribution further increased. In 2014 Q3, investment growth amounted to 7.5% y/y, which indicated the fastest growth since mid-2008.

However, the situation among the CEE countries was diversified. A strong growth in fixed investment occurred in 2014 Q2 and Q3 in Poland, Slovakia and recovering from recession Slovenia. High investment growth was maintained in Hungary, supported by the *Funding for Growth Scheme* - programme aimed at facilitating the access of small and medium-sized companies to bank loans (see *Economic policy of Hungary and its effects*). In Romania, following a period of investment downturn in 2014 Q1[6], the scale of the decline gradually decreased in the following two quarters. A similar situation was observed in Croatia. In other CEE countries (the Baltic states, the Czech Republic), fixed capital formation growth slowed down. In Estonia and Latvia, investment even decreased on an annual basis. It was a result of the decrease in public investment and a deteriorating propensity to invest related to a growing geopolitical uncertainty.

All over the CEE region, growth of investment continued to be spurred by public investment co-funded by the EU. It referred, in particular, to infrastructural investment, mainly in buildings and structures. Private construction investment was still low in the majority of economies in the region.[7]

On the other hand, private investment in machinery and equipment, as well as means of transport increased. It was particularly noticeable in Slovakia

[6] It was the result of high base effect as well as tax changes unfavourable for investors (tax on structures, increased VAT on fuel).

[7] Even in the Baltic states, where the growth of private construction investments has been noticeable since the beginning of 2013, in Q2 and, in particular, in 2014 Q3, clear slowdown of their growth occurred.

and Hungary, where growth in fixed capital formation of automotive manufacturers took place.

Weakening exports curb the recovery

Since the beginning of 2014, the contribution of net exports to the economic growth has been decreasing in the CEE countries. Whereas in 2014 Q1 it was still positive, in the following two quarters it turned negative. Its strongest negative impact on the GDP growth was noted in Poland and Hungary, while positive contribution of net exports were only recorded in Croatia, Estonia and Slovenia.

The declining contribution of net exports resulted mainly from the weakening exports growth in 2014 Q2 and Q3 (4.2% y/y in Q3 against 8.5% y/y in 2014 Q1). In Q3 and in October 2014 exports slowed down in the case of all main trade partners. Since 2014 Q2 growth in exports to the euro area has decelerated. The slowdown in trade turnover within the European supply chains, resulting from both domestic and external demand in the euro area, affected negatively the trade turnover within the CEE countries. Exports outside the EU continued to decrease, which mainly resulted from the decline in exports to Russia and Ukraine. In the case of some CEE countries (the Czech Republic, Romania and Hungary) a fall in external demand resulted in temporary downturns in industrial production at the beginning of 2014 Q3. It referred to plants belonging to foreign, mainly German, automotive corporations.

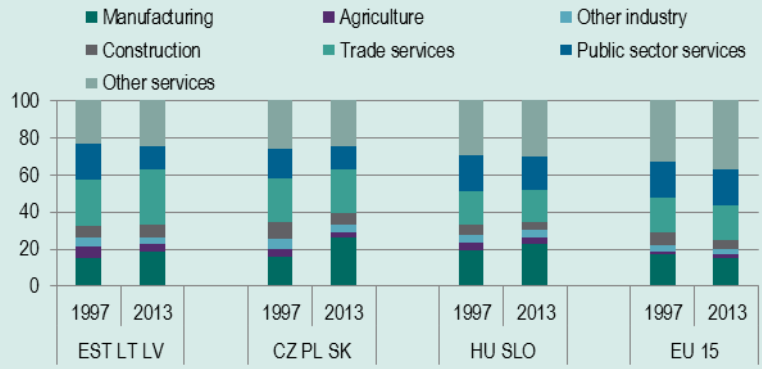
High import intensity of exports, in particular, within global supply chains (GSC), affected the decline in imports growth. It was particularly noticeable in case of intermediate goods whose both exports and imports clearly decreased in 2014 Q2 and Q3. However, under the conditions of the relatively high domestic demand growth, imports grew faster than exports.

Changes in the structure of value added in the countries of Central and Eastern Europe

In 2000-2013 GDP *per capita* in the CEE countries, expressed in PPS, increased faster than in the EU-15 countries. Consequently, income convergence[8] of the CEE and EU-15 countries was noticeable. However, it was not followed by economic structure convergence (i.e. the structure of value added) in the CEE countries.

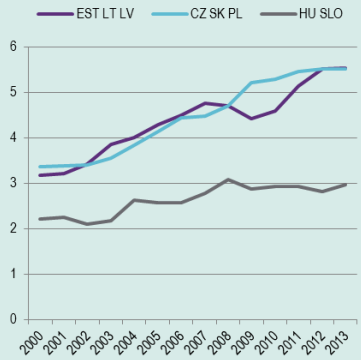
The process of change in the structure of value added (VA) in the CEE countries was different than in the EU-15 countries. In the CEE region, changes mainly occurred as a result of integration with the EU and they were more dynamic than in the EU-15 countries. The process of economic integration with the EU has not resulted in harmonisation of value added in CEE and EU-15 economies. Similar trends between those two regions were noticeable only in the case of agriculture and non-manufacturing industry. In other cases divergence in the value added structure occurred. Its strongest effect was observed in the case of the manufacturing, retail and wholesale trade[9] and other market services[10]. The share of manufacturing in the CEE countries increased by 5.9 percentage points in 2000-2013, to 23.5% of VA (against a decline by 1.4 percentage points to 15.5% of VA in the EU-15 countries). In the case of trade, its share increased by 0.5 percentage points in the CEE, to 22.7% of VA (against a decline by 0.5 percentage points, to 18.7% of VA in the EU-15 countries).

Figure 1. Structure of value added in individual groups of countries in 2000 and 2013.



Source: Eurostat.

Figure 2. Divergence in VA structure against EU-15[11]



Sources: Eurostat, NBP EI calculations.

At the same time, the share of other market services increased only by 0.6 percentage points, to 25.8% of VA (against a growth of 3.8 percentage points to 37.1% of VA in the EU-15 countries), whereas the share of public services[12] decreased by 3.7 percentage points to 12.8% of VA (against a growth of 0.4 percentage points to 19.2% of VA in the EU-15 countries).

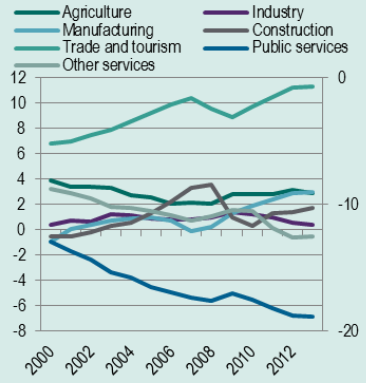
[8] See *Economic situation in the countries of Central and Eastern Europe,* Narodowy Bank Polski, July 2014.
[9] Differences between the CEE countries and the EU-15 countries increased both in the case of wholesale and retail trade, nevertheless, the increase in differences in the case of wholesale trade was higher.
[10] Other market services are understood as market services excluding commercial services.
[11] In order to compare the level of divergence in value added structure of individual groups of countries against the EU-15, a synthetic indicator was presented, constituting the sum of absolute values of differences between percentage shares of individual NACE 2 categories in a given group of countries and the EU-15 countries.
[12] In the case of the EU-15 countries, the share of those sectors in value added was systematically increasing.

Changes in the structure of value added differed significantly between CEE countries. The biggest changes occurred in economies in which the income convergence against the EU-15 was the highest.[13] The characteristics of changes seemed determined by the nature of the integration process with the EU economy.

For example, the process of EU integration in the Baltic states was based on strong capital inflow (relative to the size of those economies) stimulating a credit boom, with a less important role of the GSC in the process. Therefore, as compared to the CEE region, as well as the EU-15 countries, the Baltic states were characterised by an increased role of wholesale trade, construction (particularly sensitive to business cycle) and real estate activities. The share of manufacturing in the value added was relatively smaller.

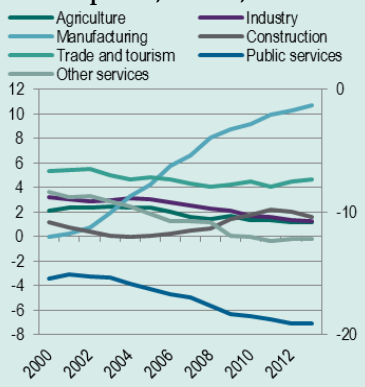
The process of changes in the structure of value added was different in countries where the GSC expansion was of key importance, i.e. in the Czech Republic, Poland and Slovakia. At the beginning of the integration process, those countries, similarly to the Baltic states, were characterized by a high share of trade and construction in the value added relative to the EU-15 countries. However, with the development of the GSCs in the region, the role of manufacturing in those countries strongly increased. At present, manufacturing plays a much more significant role in those countries than in the EU-15 and other CEE countries. The increase in the manufacturing role took place mainly at the expense of other industries, public sector services and retail and wholesale trade.

Figure 3. Differences in the share of NACE sectors in VA against EU-15 - Estonia, Lithuania, Latvia



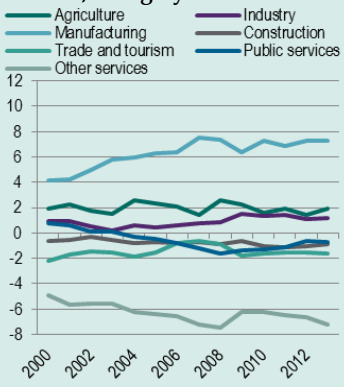
Source: Eurostat.

Figure 4. Differences in the share of NACE sectors in VA against EU-15 - Czech Republic, Poland, Slovakia



Source: Eurostat.

Figure 5. Differences in the share of NACE sectors in VA against EU-15 - Slovenia, Hungary



Source: Eurostat.

Market services had relatively the highest share in the value added in Slovenia and Hungary. Compared to other CEE countries, those countries presented a high share of manufacturing, market services and public sector in value added, with the relatively low share of trade, already at the beginning of the EU integration process. The share of manufacturing exceeded the average of the EU-15 countries and the share of public sector services corresponded, more or less, to that observed in the EU-15 countries. In this group of countries, as in Poland, the Czech Republic and Slovakia, GSC expansion also occurred, increasing the share of manufacturing in value added. Similarly to the Baltic states, the inflow of foreign capital has also stimulated the development of wholesale and retail trade. However, the scale of those changes was much smaller than in the abovementioned groups of countries. Consequently, the role of manufacturing in Slovenia and Hungary decreased to the average in the region, whereas the share of trade remained at a low level. Against the relatively weak growth in the share of manufacturing and trade, the share of public sector services and other market services in value added increased. Relatively small structural changes in those countries have also

[13] *Economic situation in the countries of Central and Eastern Europe*, Narodowy Bank Polski, July 2014.

resulted in a smaller degree of divergence between those countries and the EU-15, comparing to what happened in other CEE countries.

The analysis of changes in the value added structure in the CEE countries in 2000-2013 shows that the convergence of *per capita* income was accompanied by economic structure divergence between the CEE and the EU-15 countries. Contrary to the EU-15, in the CEE countries, manufacturing and wholesale trade play an increasing role in the value added creation. The following factors seemed to play the key role in shaping the structural changes: integration within the GSC, capital inflow to the banking sector and intensity of those phenomena. The most significant changes in the value added structure took place in countries where the highest growth of *per capita* income was recorded in this period.

Private sector deleveraging continued to drag down domestic demand growth

The ongoing deleveraging of the private sector was hampering the growth of domestic demand in the CEE region in 2014. The annual growth rate of credit to private sector remained negative from mid-2012 to October 2014. The fastest growth in the value of granted loans took place, as in the previous years, in Poland (mainly corporate loans) and Slovakia (loans for households). In both those countries, its growth exceeded 6% y/y in 2014 Q4. The growth in the loans value also occurred in the Czech Republic and Estonia, however, its scale was lower (2.5-3.1% y/y in November 2014). In other CEE countries, the value of loans to the private sector was decreasing, as it was the case in the previous years. In Romania and Slovenia[14] the scale of deleveraging of enterprises and households in the second half of 2014 even increased.

It seems that the poor lending to households and enterprises in 2014 was mainly due to supply side factors whereas the demand for loans started to recover slowly.

Figure 1.4. Bank lending to the private sector in the CEE countries (mean, y/y, in %)

Source: Central banks.

The European Investment Bank's report on lending determinants[15] in the CEE countries indicates that in the second half of 2014 the demand for bank loans increased slightly, whereas its supply remained at a low level. However, contrary to the previous years, the trend to tighten lending conditions came to a halt. According to bank representatives, the large number of non-performing loans[16], the local and European regulations in the banking sector, as well as the need of the banks to increase their capital, were the main reasons for maintaining restrictive lending conditions. Corporate lending was the most affected, whereas in the case of loans to households, lending conditions have been slightly eased in the recent months. Representatives of banks from the CEE countries perceive the future in a more favour-

[14] The considerable decline in the value of corporate lending in Slovenia is the result of the takeover of some non-performing loans by the so-called "bad bank". However, even without considering this programme, the poor financial situation of Slovenian banks caused the decline in the value of newly granted loans.

[15] *CESEE Bank Lending Survey H2-2014*, EIB, October 2014.

[16] In 2013, non-performing loans ranged from c.a. 5% of overall loans in the Czech Republic and Slovakia to over 18% in Bulgaria and Croatia and almost 22% in Romania.

able way. Most of them expect growth in demand for lending in 2015 and easing of lending conditions, which should accelerate credit growth in the CEE region.

Deleveraging of the banking sector

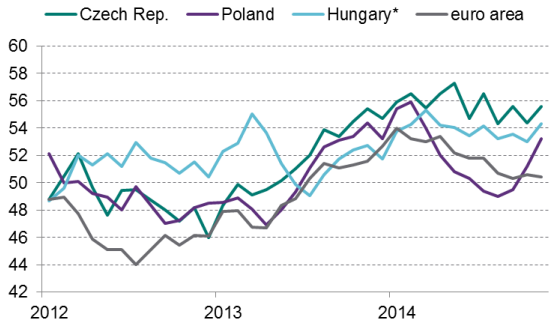
BIS data[17] on foreign claims in 2014 Q3 point to a decrease in liabilities of CEE banks vis-a-vis foreign banks (excluding Estonia). In the whole region, those liabilities decreased by c.a. 4% against 2013. At the same time, a part of the capital withdrawn by foreign financial institutions was replaced by the permanent inflow of domestic deposits, growing at a rate of c.a. 5% y/y since 2011. However, the domestic capital was still unable to fully replace foreign capital.

Improvement in business confidence

The confidence indicators in the CEE manufacturing in the second half of 2014 were influenced mainly by the situation in the external environment of the region. The outbreak of the Russian-Ukrainian conflict in the first half of 2014 had an slowed down the improvement of sentiment in industry. It was particularly noticeable in the Baltic states and Poland. The bilateral economic sanctions imposed by Russia and the EU in August 2014 (comprising the ban on food export to Russia) have already resulted in a clear deterioration of business confidence in the whole region. The decline in entrepreneurs' confidence resulted mainly from a smaller number of new orders, particularly foreign ones. It was the effect of the weakening demand from Russia and Ukraine but, first of all, from the euro area.

[17] Bank for International Settlements, Locational Banking Statistics

Figure 1.5. PMI in manufacturing in the CEE countries and in the euro area (in pp)



*For Hungary, three months moving average
Source: Markit.

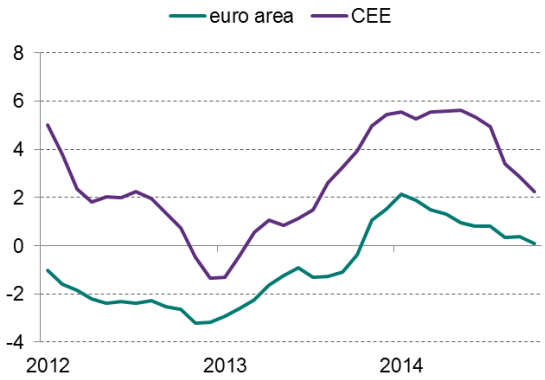
From October 2014, business confidence in the CEE region started to recover. PMI in manufacturing in the largest economies exceeded the threshold of 50 points (indicating the growth in activity in the sector). Following the temporary decline in August and September 2014, BCI indicators of the European Commission increased, reaching the highest levels since mid-2011. The improvement in sentiment should be mainly associated with the weakening of the tensions between the EU and Russia. It resulted in the improvement of future production level assessment in the region, even irrespective of the continued very weak recovery in the euro area.

Slowdown in industrial production growth

In the second half of 2014, a marked slowdown in industrial production growth rate was recorded. The annual production growth in industry decreased to 2%, against almost 6% in 2014 Q2. In some countries (Bulgaria, Lithuania) the volume of production in October 2014 was even lower than a year before. The strong weakening in its growth was also noticeable in the majority of other CEE countries, especially in Romania and Hungary. A slight growth in industrial production occurred in Croatia and Slovenia, which resulted mainly from a low base in those countries, where the industrial sector faced recession from the beginning of 2012 to mid-2014.

The decline in industrial production growth rate resulted from the weakening foreign demand, especially from the euro area. It was confirmed by statistics of exports to the euro area, which clearly slowed down in the second half of 2014. The poor demand from the euro area was also reflected in lower trade between the CEE countries (the effect of strong links within the GSC). The demand from non-EU countries also decreased, mainly due to declining sales to Russia and Ukraine.

Figure 1.6. Industrial production in the CEE region and in the euro area (in %, y/y, average for 3 months)



Source: Eurostat.

The decline in turnover associated with the GSC has caused the highest slowdown in production of intermediate goods. The growth in consumer goods production, in particular, durable consumer goods, was also decreasing. In the second half of 2014, as from 2013, energy production dropped, although the scale of the decline was gradually decreasing. Only the production of capital goods maintained a relatively high growth rate in the second half of 2014.

Economic policy in Hungary and its effects

Following a period of recession in 2012, Hungary entered a path of stable growth, which enabled it to become one of the fastest growing economies of the European Union in 2014 Q2 and Q3. Similar to other countries of the CEE region, Hungary, as a small and open economy was the beneficiary of the recovery in the euro area in 2013. The unorthodox economic policy was an additional factor which has had a significant impact on the economy over the recent few years. The unconventional measures of the authorities referred both to fiscal policy, monetary policy and to regulatory changes in the economy. Measures which had the most significant impact on the economy include:

1. Regulations related to foreign currency loans

Foreign currency loans in Hungary in 2004-2008 demonstrated a significantly higher growth rate than forint-denominated loans. At the beginning of 2009, they amounted to over 60% of all loans, against almost 30% in 2004. The problem of foreign currency loans in Hungary manifested itself after the outbreak of the global financial crisis when strong depreciation of the forint occurred and, consequently, costs of foreign currency loans repayment increased. As a result, it has led to a decline in households' disposable income as well as to the increase of banking system risk (growth in value of non-performing loans).

As early as in 2011 the government of Hungary decided to introduce a plan of conversion of housing foreign currency loans into national currency loans at the preferential exchange rate of EUR, CHF and JPY, lower by approx. 25% than the market exchange rate. The costs of this operation were mostly passed on to banks. Additionally, the regulations practically eliminated the possibility to grant new foreign currency denominated loans. In 2014 the government of Hungary decided to introduce further measures related to foreign currency loans. The act adopted in June 2014 obliged banks to return costs of "unfairly" high interest rate and exchange rate spreads cumulated since 2004, to clients. It is estimated that such a cost will amount to EUR 2-3 billion, i.e. 1/3 of the banks' equity capital. In addition, in October 2014 another conversion programme for foreign currency loans was adopted, which practically eliminated a possibility for households to maintain foreign currency loans. However, this time the conversion rate will be close to the market exchange rate and the central bank has secured access of commercial banks to foreign currency (EUR 3 billion) through open market operations.

2. Sectoral taxes

In the recent years the government of Hungary decided to introduce taxes to affect only companies operating in selected sectors of the economy. It referred mainly to services sectors "dominated by foreign-owned companies. The first "sectoral" taxes were imposed in 2010. They were mainly aimed at compensating the fall in general government revenues, which significantly fell during the crisis. At that time, taxes were imposed on banks, energy, telecommunication and large retail trade companies. Taxes were to take effect till 2012, however, in the following years, those taxes were replaced by consecutive burdens (inter alia, tax on financial transactions, tax on ICT and cable services, tax on "junk" food). In 2014 consecutive tax proposals were introduced: Internet tax (the government of Hungary has withdrawn from this idea following massive protests of citizens), media tax (tax on revenue from advertisements), tax for

tobacco companies, extension of tax on "junk" food on alcoholic beverages (affecting mainly the biggest retail chains) or introduction of environmental fees on sales of detergents.

3. Supporting investors in manufacturing, in particular, in the automotive sector

Attracting foreign investors to manufacturing, in particular, into the automotive industry, has been one of the priorities of the Hungarian government over the recent years. Contrary to other sectors of the economy (financial services, telecommunication, energy, retail trade), no additional taxes were imposed on the industry. On the opposite, many incentives were used in this sector for foreign investors, such as tax exemptions, or even co-financing of production investment (among others, the government of Hungary agreed to participate in the construction of Audi factory in Győr). The focus of the Hungarian government on investment in the automotive sector is demonstrated, besides the aforementioned facilities, by efforts continued in 2014 aimed at reducing the CIT rate for entrepreneurs representing this sector to 10% (from the currently applicable two rates: of 10% - for the turnover below HUF 500 million and of 19% - above this amount).

4. Public works programme

The programme of public works introduced in Hungary in 2011 and extended to the consecutive years (funds for that purpose were included in the budget for 2015) was mainly aimed at reducing the scale of unemployment, especially the long-term unemployment, and increasing the economic activity in the country. According to the act on public works, the unemployed who wants to receive the benefits after the lapse of 180 days following the loss of work, are bound to participate in public works at least four hours per day. The effects of the programme included: a decline in the unemployment rate (to the levels observed in 2008), almost a 10% increase in employment (in 2014 Q3 against 2011 Q3) and an increase in the activity rate (from 55% in 2011 to almost 60% in 2014). The negative aspect of the programme was the increase in public expenditure which was, however, mostly offset by the decrease in social expenses, mainly the unemployment benefits.

5. Unconventional monetary policy

In 2012-2014 the National Bank of Hungary (MNB) decided to ease the monetary policy to support the recovery of the country from the crisis. Besides conventional measures (reduction in interest rates by 490 bps in 2012-2014), MNB also decided to undertake less conventional steps. In order to support investment of small and medium-sized enterprises, MNB decided to introduce the *Funding for Growth Scheme* (FGS) programme. In June 2013, MNB allocated HUF 750 billion for the support of lending for small and medium-sized enterprises. For this purpose MNB granted interest free loans to commercial banks which have undertaken to make these funds available to enterprises in the form of low-interest loans (up to 2.5% on an annual basis). The demand from entrepreneurs for such loans was so high that MNB decided to increase the scope of the programme in September 2013. The pool of available funds was increased to HUF 1 trillion (approx. 3.5% of GDP), and the period of effectiveness of the programme was extended until the end of 2014. It is estimated that until September 2014 approximately 2/3 of the amount allocated to the programme was used (c.a. HUF 1.15 trillion out of the total resources of HUF 1.75 trillion), which was mostly addressed to investment projects of micro and small enterprises (employing up to 50 em-

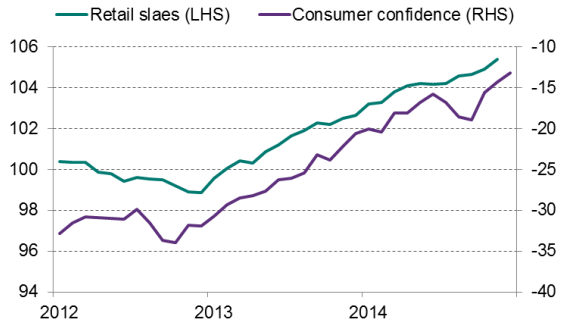
ployees). The programme turned out to be particularly popular among farmers. Over 1/3 of all funds was assigned to entrepreneurs operating in agriculture, which resulted in the increase of capital expenditure in this sector of economy by 36.6% y/y in 2014 Q2. Following the success of the FGS, MNB decided to extend the programme for 2015.

So far, the impact of the unconventional measures of the Hungarian authorities on the economic situation of the country in 2013-2014 was positive. The FGS influenced the acceleration in investment growth, which was the highest in the EU. Growing employment had a positive impact on households' sentiment, which translated into their increased propensity for consumption. However, the impact of the aforementioned measures on the economy of Hungary in 2015 and in the consecutive years does not need to be positive. On the one hand, the programme supporting investment in small and medium-sized enterprises and a growing income of households (the effect of expected further employment growth, as well as reduction of burdens associated with loan repayment) should influence the growth of domestic demand. On the other hand, growing burdens for banks seem to pose risk to growth. Both tax burdens and those arising from costs of foreign currency loan conversion will result in still low supply of loans for the private sector. The stability of the whole financial system in Hungary might even be endangered. The imposed sectoral taxes may have an adverse impact on investment by companies of the services sector. Increased costs and the growing economic instability (as a result of frequent regulatory changes) do not increase propensity of such enterprises to invest, but rather to limit the scope of operations. It cannot be ruled out that the continuation of the unconventional changes will affect the growth of foreign investors' aversion to the Hungarian economy, which could have been observed already in 2013-2014 when the volatility in prices of financial assets was the highest among the CEE countries. The pro-consumption policy of the authorities may also have an impact on the growth of inflation, although forecasts of the second half of 2014 do not indicate a high probability of such a situation.

Improvement in consumer sentiment and retail sales growth

In 2014, consumer sentiment indicators continued to improve. The transitional slowdown in households' optimism in August and September 2014 was most visible in the Baltic states. It resulted from the deteriorating prospects of the labour market' conditions in connection with the expected decline in production and exports onto the eastern markets. However, already in October, as political tensions in the east weakened, consumer sentiment in the CEE countries started to recover. The scale of household sentiment growth was relatively big. In November 2014 the value of the aggregated European Commission indicator for the whole region reached its highest level from April 2011. Only in Lithuania the sentiment decreased, influenced by the deterioration in the assessment of the future consumers' financial situation.

Figure 1.7. Retail sales (2010=100, left-hand axis) and consumer confidence (in points, right-hand axis) in the CEE region



Sources: Eurostat, European Commission.

The improvement in consumer sentiment resulted from the continually decreasing inflation which had an impact on lower inflation expectations and thus on the growth of real disposable income. In addition, the improvement in the labour markets in the majority of CEE economies, observed in 2014, caused that households started to evaluate better the prospects of their financial situation and the economic situation in the country.

The improvement in consumer sentiment translated into the growth in retail trade turnover. From January to October 2014 the volume of retail sales in the CEE countries increased by 2.2%. The temporary slowdown of retail sales occurred only in August and September 2014 in response to the decline of consumer sentiment. However, in the following month, the turnover in retail trade increased again. In 2014 the growth in sales referred equally to all groups of goods: food, non-food goods and fuel (excluding Poland and Romania).

The growth in retail trade turnover was recorded in the majority of the CEE countries, besides Poland and Slovenia, where retail sales have not changed significantly in the analysed period. The fastest growth in retail trade turnover in occurred in the Baltic states, even under the circumstances of the relatively strongest volatility of consumer sentiment in response to the Russian-Ukrainian conflict. Visible acceleration of retail sales was also recorded in Hungary (the effect of clear recovery in the labour markets) and in Romania.

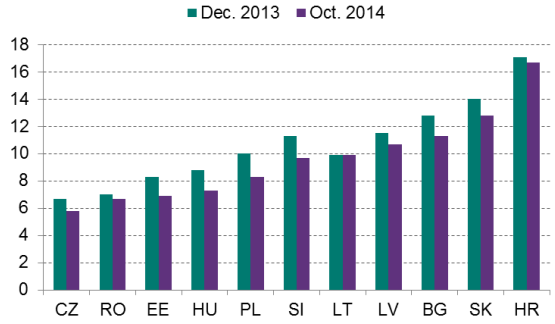
Further recovery in the labour markets

In 2014 the situation in the labour markets of the CEE countries continued to improve. The harmonised unemployment rate in the region was decreasing. Its decline from December 2013 to October 2014 occurred in all economies, although in most of them the unemployment still remained at an elevated level (as compared to the pre-crisis period). The highest decline of unemployment rate was recorded in Bulgaria and in Poland (by 1.7 percentage points in the analysed period). Its significant decline also took place in Hungary, where the harmonised unemployment rate decreased by almost 4 percentage points from the beginning of 2013, approaching the levels observed in 2007. Besides the improvement in the real economy, the decreased number of the unemployed in Hungary resulted from the growth in employment in the public sector due to public works programmes. The decline in the harmonised

unemployment rate in other countries of the region was lower, although noticeable. In the analysed period, it amounted to approx. 1 pp on average.

In October 2014 the lowest unemployment rate was observed in the Czech Republic (5.7%) and Romania (6.7%). However, those values were still higher by 1 pp than in mid-2008. On the other hand, the highest unemployment rate was recorded in Slovakia (12.9%) and Croatia (16.0%).

Figure 1.7. Unemployment rate in the CEE region in 2013 and 2014 (in %)



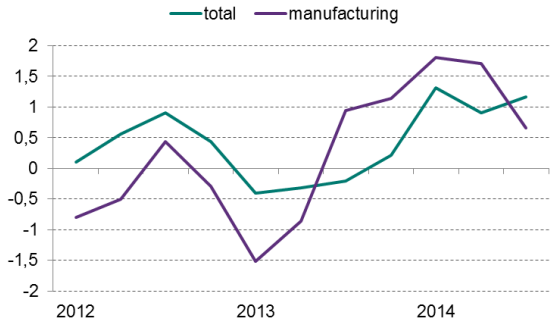
Source: Eurostat.

Improvement in unemployment statistics in 2014 resulted mostly from the decreasing youth unemployment (aged below 25). From January to October 2014 this number decreased by 16%, as compared to the decline by 11% in the case of other age groups. However, this trend has not translated into growth of employment among young people, which may indicate their decreasing activity in the CEE countries.

The improvement of the situation in the labour markets in some countries of the region influenced the decrease in the long-term unemployment (jobless over 1 year). This referred mainly to Croatia, Latvia, Romania and Hungary. In other countries the long-term unemployment rate has not changed, or it has even increased (inter alia in Estonia). In Slovakia, in mid-2014, the long-term unemployed constituted over 70% of the total unemployed. In other countries of the region this percentage ranged from 40-50% and it was close to the average for the EU-15 countries.

Employment statistics[18] of 2014 also indicate the recovery in the labour markets. In the first three quarters of 2014 the employment in the CEE countries increased by 0.9% on an annual basis (1.2% in 2014 Q3). The decline in the number of employed occurred only in Latvia. On the other hand, in Poland, Lithuania and Hungary, the growth in employment was the highest in the region. In this period, it reached 3.3% y/y in Hungary, which mainly resulted from the public works programme.

Figure 1.7. Employment growth (in %, y/y)



Source: Eurostat.

Growth in employment was recorded in the majority of economic sectors, mainly in retail trade. This confirms the information concerning growing consumption demand in the region. The number of employed has also increased in manufacturing (except the Baltic states), even despite the slowdown in production growth. In the majority of market services and in public administration (excluding Latvia) number of employed also grew. The permanent and visible decline in the number of employed was recorded in agriculture. The number of employed decreased in construction, although this decline was definitely lower than in 2013, whereas in Hungary and Romania employment in this sector of economy increased in three first quar-

[18] Data originating from national accounts statistics.

ters of 2014. Employment in financial sector as well as real estate services continued to decrease.

Growth in nominal wages translated into higher labour costs

The improvement in the situation in the labour markets was reflected in the growth in nominal wages. In the whole region, wages in 2014 Q2 increased by 4.5% against 3.5% a year earlier. Strong growth in nominal wages was observed in Slovenia (8.4% y/y), following their decline in 2012-2013. The growth rate of wages increased also in Poland, Latvia and Slovakia. On the other hand, in Bulgaria, Estonia and Romania, the growth of nominal wages slowed down, although in the last two countries it was still the highest in the region.

Decreasing inflation led to an increase in real wages. In connection with higher employment, it has caused an evident growth in real households' disposable income.

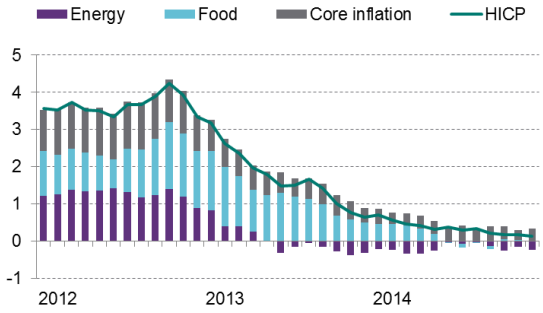
Nominal wages in the first half of 2014 grew faster than productivity in the CEE countries, resulting in the increase of unit labour costs (ULC). As a consequence, the downward trend of ULC growth, observed since the second half of 2012, was stopped. However, it did not happen in all economies. The decline in the growth in wages in Bulgaria, Estonia and Lithuania, with simultaneous acceleration of the economic growth in the first half of 2014 resulted in the decline in ULC growth in those economies.

Inflation at the historically low level

The disinflation process that started in the CEE countries in 2012 Q4 continued throughout 2014. In November 2014 the annual growth rate of HICP in amounted to 0.1%. It meant that inflation in the CEE countries had decreased to the all-time low level.

The decline in inflation in the second half of 2014 took place in the majority of the CEE economies. The sharpest fall was recorded in Slovenia, Poland and Hungary. On the other hand, inflation growth was observed in Romania (base effects associated with the VAT rate decrease) and Latvia (low base and partly, the increase in prices as a result of euro introduction).

Figure 1.8. HICP inflation and its components in the CEE region (in %, y/y)



Source: Eurostat.

In November 2014 the relatively highest inflation was observed in Romania (1.5%). In other CEE economies it did not exceed 1%. In Bulgaria and Poland the annual HICP growth was negative. In earlier months of 2014, deflation was also temporarily recorded in Croatia, Estonia, Slovenia, Slovakia and Hungary.[19]

Whereas in most of the CEE countries the deflation appeared in the second half of 2014, in Bulgaria it could have been observed since mid-2013. It was expected to have only a temporary character and expire after a year. The fall in energy and unprocessed food prices caused the extension of the deflation period in Bulgaria at least until mid-2015.

[19] In November 2014 a very big discrepancy between the annual growth of the HICP index and the domestic CPI in Hungary. The former amounted to 0.1% and the latter - to 0.7%.

The reasons for the decline in inflation were similar in all countries. It was mainly attributed to decrease in prices of energy and unprocessed food.

Sanctions imposed by Russia on imports of the European food, as well as good harvests, resulted in the growth in food supply in the CEE countries in the second half of 2014. The contribution of unprocessed food prices to inflation, which was still positive in 2014 Q1, started to decrease in the following months. In November 2014, it reached -0.2 pp.

The decline in energy prices resulted mainly from the decrease in energy commodities on international markets (price of crude oil at the beginning of December decreased to the lowest level since the first half of 2009). Additionally, in the CEE countries regulated energy prices were reduced (prices of electricity in Romania and Hungary, gas in Lithuania). In general, in November 2014 energy prices contributed to 0.2 pp to the decline of the headline HICP inflation.

Core inflation still at a low level

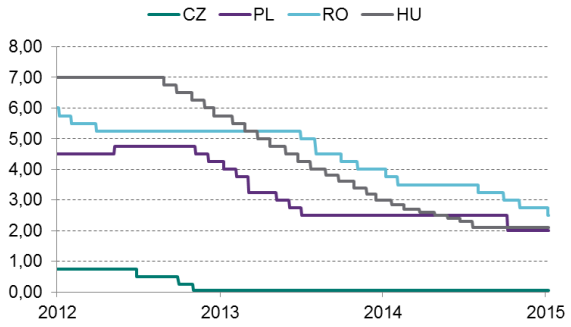
Since the beginning of 2014, core inflation in the CEE region remained at a historically low level, i.e. 0.5%-0.7%. In the majority of the countries, a minor decline in core inflation occurred. Its growth was only observed in the Czech Republic (the effect of growth in import prices in connection with the weakening of the koruna rate), in Lithuania (increase in the prices of communication, restaurants and hotels) and in Hungary (increase in the prices of ICT and healthcare services).

Low core inflation was caused by two basic factors. First of all, the growth in consumer demand in 2014 so far has not been strong enough to influence the growth of inflation pressure. Low inflation in 2013 and 2014 led to a decline in inflation expectations of households, which had an additional impact on lower pressure on price growth. Secondly, low core inflation resulted from the transfer of the decrease in energy and food prices and producers' prices[20] onto prices of other categories of goods and services.

Continued monetary policy easing

The noticeable decline in inflation in 2014 was the reason for further monetary policy easing in the CEE countries applying the direct inflation targeting strategy (i.e. in the Czech Republic, Poland, Romania and Hungary). In December 2014 interest rates in all four countries reached their all-time low levels.

Figure 1.9. Central banks main policy rates in the CEE region (in %)



Source: Reuters.

Inflation in the aforementioned CEE countries in the second half of 2014 fell below the lower band of the inflation target. Consequently, central banks of Poland (NBP), Romania (BNR) and Hungary (MNB) decided to reduce interest rates. NBP decreased the main policy rate in October 2014 by 50 bps to 2.0%. BNR decided to decrease interest rate three times (in August, October and November 2014) by 25 bps, to 2.75%[21]. MNB, which was regularly reducing

[20] Domestic PPI in the period from June to October 2014 was negative in all CEE states, except for Romania where it did not exceed 1% y/y.

[21] Additionally, BNR decreased the rate of reserve requirement for liabilities in national currency (from 12 to 10%) and narrowed the corridor between the deposit rate and credit rate from ±3 pp to ±2.75%.

interest rates from August 2012[22], decided to suspend this process. In the second half of 2014, MNB decreased interest rates only once, in July, from 2.3% to 2.1%, and announced maintaining this status until the end of 2015.

In the second half of 2014 the Czech National Bank (CNB) maintained interest rates at its historically low level of 0.05%. On the other hand, CNB continued to use koruna exchange rate as an additional instrument of monetary policy easing, i.e. preventing strengthening of the EUR/CZK rate above the level of 27. Prevailing low inflation made CNB Management Board decide on extending the intervention period to at least 2016 Q1.

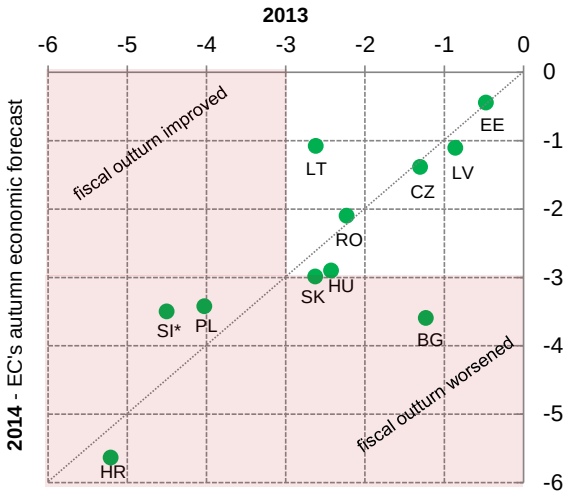
The low inflation, ECB decisions on monetary policy easing (lowering interest rates and introduction of quantitative easing), as well as the expected slowdown in the euro area may announce the continuation of accommodative monetary policy stance in the CEE countries in the nearest quarters. In the case of further decline in inflation as well as currency strengthening, its successive easing cannot be excluded.

The accommodative policy stance of the central banks in the CEE countries was accompanied by the low level of short-term interbank interest rates. In the majority of the countries, three-month interbank interest rates decreased, following the decisions of central banks. This trend was mostly noticeable in Poland and Romania[23], where they decreased by 0.6-0.7 pp in June - December 2014 period.

General government balance broadly unchanged in 2014

In the majority of the countries of the region, the general government balance in 2014 is to remain at a level close to that recorded in 2013 (cf. Figure 1.10). This situation stems from the absence of additional consolidation efforts as well as, among others, the rolling back of austerity measures adopted in the preceding years (mainly on the expenditure side[24]) and the weaker than expected economic conditions[25] (growth, inflation). The headline deficit is to decrease only in Poland, Slovenia and Lithuania. Nevertheless, according to the EC autumn forecast, the general government deficit in the CEE countries will stay below the reference value (3% of GDP), except for Bulgaria and the countries currently under the excessive deficit procedure (EDP), i.e. Croatia, Poland and Slovenia.

Figure 1.10. General government balance in 2013-2014 (ESA 2010; in % of GDP)



* headline deficit of Slovenia excluding expenditure on bank recapitalisations, (10.1% of GDP in 2013 and 0.9% of GDP in 2014).

Sources: AMECO database, European Commission.

[22] In total, MNB decreased interest rates from 7.00% to 2.1% in the period from August 2012 to August 2014.

[23] In the second half of 2014, 3M BUBOR had a value lower than the main BNR interest rate, however, this difference decreased as compared with the first half of 2014, when it was exceptionally big.

[24] They referred mainly to cuts in social security benefits, modifications of pension indexation rules and wage cuts or freezes in the public administration.

[25] Bulgaria, Croatia, Latvia, Romania.

Significant fiscal challenges in Croatia, risk of opening the excessive deficit procedure against Hungary and Bulgaria

In view of the latest EC forecast[26] (2015-2016) and the draft budget acts for 2015, Croatia will face the biggest fiscal challenges among the CEE countries. It will remain the country with the highest headline deficit and public debt (above 80% of GDP), along with the weakest growth outlook in the region. At the end of 2014 the Croatian authorities announced the consolidation package of approx. 1 pp of GDP, mostly expenditure-based. Though its implementation will improve the fiscal position, in 2016 – the EDP deadline – the general government deficit would still exceed 3% of GDP.[27] Moreover, potential tensions in financing of high borrowing needs in 2015 (over 20% of GDP) may prompt Croatia to request for financial assistance from IMF/EU. The source of these tensions could be a failure of the planned sale of the motorway network operation concession (ca. 7% of GDP) and privatisation of selected state-owned enterprises.

Hungary and Bulgaria could be placed under the excessive deficit procedure. In first case, that risk is associated with the headline deficit breaching the 3%-of-GDP threshold, due to the uncertainty concerning the implementation of some austerity measures announced by the government (inter alia, public wage freezes). Moreover, the EC signalled a possible re-launch of EDP due to the slower than required pace of public debt (ca. 75% of GDP) reduction. In the latter case, the general government deficit in 2014 exceeded the reference value, as a consequence of weaker than expected economic growth and deflation. The EDP may be imposed on Bulgaria, provided that in view of the EC (spring economic forecast, May 2015) the budget deficit is to stay above 3% of GDP. For 2015 the Bulgarian government envisages, among others, public administration wage cuts, increase in tax on interest earned on bank deposits and the social contributions hike. These measures are expected to allow for the deficit reduction to 3% of GDP in 2015 and 2% of GDP in 2017. In mid-December 2014 the sovereign debt rating of Bulgaria was cut by Standard&Poor's to the "junk" level. The downgrade was explained by, inter alia, the deterioration of the fiscal position and the risk of continued public support to the financial institutions. Both factors[28] translated into sharp increase in the general government debt in 2014 (by approx. 9 pp of GDP to the level of ca. 28% of GDP).

Expected maintaining of the current fiscal stance in the following years

In other countries of the region, no significant change in fiscal stance is awaited in 2015-2016, except for Slovakia. This is arising from, among other things, weaker economic prospects (less favourable growth outlook for the euro area countries, the Russian embargo) and the fiscal fatigue. Keeping the headline deficit below the 3% of GDP within the horizon of the EC forecast (Poland and Slovenia – expected exit from the EDP) creates room for fiscal policy loosening or halting consolidation efforts. Furthermore, the public debt-to-GDP ratio will not exceed 60% and the conditions of borrowing needs financing will be also favourable (low government bond yields). Only in Slovenia this threshold will be exceeded (80% of GDP). However, the EC expects the decrease in the public debt level of this country, the highest in the region besides Hungary and Croatia, within the horizon of the autumn forecast. The planned privatisation measures may increase the pace of debt reduction. On the other hand, it could

[26] The EC did not take into account some discretionary measures for 2015 announced by Bulgaria, Croatia, Romania, and Hungary, as the draft budget acts for 2015 underpinning them were not available at the cut-off date of autumn forecast.

[27] The Croatian government estimates that the headline deficit will be reduced from 5.6% of GDP in 2014 to 3.8% of GDP in 2015, followed by 3.6% of GDP in 2016.

[28] Including the rollover of Treasury bonds maturing at the beginning of 2015.

be hampered by the execution of the European Court of Human Rights[29] ruling and potential further bank recapitalisations.

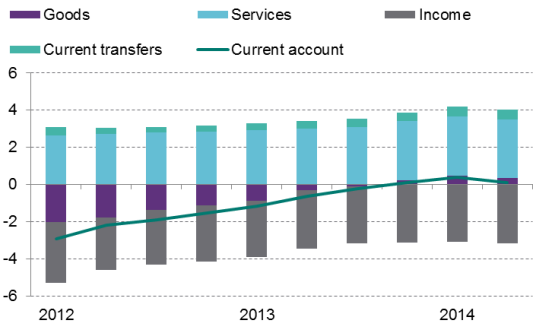
In Slovakia switch in fiscal policy is planned for 2015 to meet the national public debt rule (prudential provisions launched after the breachment of 55%-of-GDP threshold)[30]. Fiscal tightening will be mainly expenditure driven (e.g. the reform of public administration and public procurement). However, the EC assumes that some of these measures might not enter into force, as public debt in the coming years is not to exceed 55% of GDP owing to application of ESA2010 rules, introduced in autumn 2014.[31]

Improvement in the current account balance[32]

In 2013 the current account balance in the CEE region got out of the negative territory for the first time in the 21st century. In the first half of 2014 the situation across the region continued to improve and the current account balance (four-quarter moving average) recorded a minor surplus (0.1% of GDP in 2014 Q2).

The situation in individual CEE countries was not homogenous. The improvement in the current account balance was only noted in the biggest economies (decreasing deficit in the Czech Republic and Poland; increasing surplus in Hungary), whereas it deteriorated in other countries in the first half of 2014.

Figure 1.12. Current account balance in the CEE region (in % of GDP, four-quarter moving average)



Source: Eurostat.

The structure of the current account balance has practically not changed. Goods balance indicated a slight surplus, irrespective of the slowdown in export growth. Foreign trade surplus resulted from the improvement in the terms of trade (the decline in crude oil prices affected the decline in import prices). No significant change was noted in the services, income and current transfers accounts.

Foreign capital outflow

The improvement in the current account balance was accompanied by net outflow of foreign capital from the CEE countries. In 2013 the balance on the financial account decreased to -1.5% of GDP. In 2014 Q2 this balance improved, but it still indicated the net foreign capital outflow (-1.2% of GDP). The

[29] In July 2014 the European Court of Human Rights ruled that, Slovenia should (within one year) reimburse holders of deposits at Ljubljanska Banka (ca. 1.5% of GDP), which were not accessible to owners from the remaining countries emerging after the collapse of former Yugoslavia, following the proclamation of independence by Slovenia.

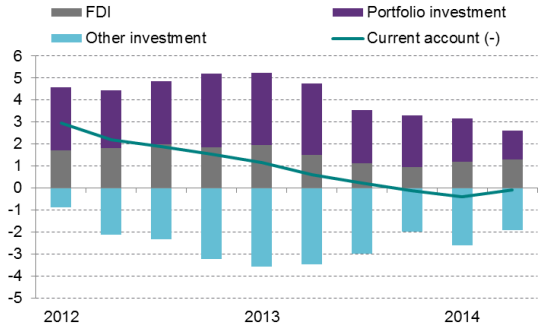
[30] In May 2014, 3% of the planned state budget expenditure were frozen (with the exception of certain items, e.g. interest payments, EU contribution, spending related to projects co-financed by the EU and subsidies to the social security fund) following the announcement of the public debt-to-GDP ratio in 2013 exceeding the threshold of 55% of GDP. Moreover, the statutory provisions bind the government to present the draft budget act which assumes freezing or reduction of the public spending.

[31] Details concerning the revisions of general government accounts related to ESA2010 introduction, as well as the impact of other methodological changes on deficit and debt data (inter alia, estimates of illegal activities included in the GDP figures) were presented in the Eurostat press release, published alongside with the autumn fiscal notification in October 2014 (cf. *Revisions to government deficit and debt of EU Member States for 2010-2013. A special note prepared due to the introduction of ESA 2010, and accompanying the Eurostat Press Release 158/2014,*

[32] Data of the balance of payments presented in the report are compliant with the old methodology (BPM5), since not all the countries covered by the analysis have implemented the new statistical standards (BPM6).

decline in net foreign capital inflow occurred almost in the whole region, excluding Slovakia.

Figure 1.13. Foreign capital net inflow to the CEE region (in % of GDP, four-quarter moving average)



Source: Eurostat.

Inflow of foreign direct investments (FDI) in 2014 Q2 slightly increased. It was a result of its growth in the Czech Republic, due to loans granted within capital groups in the energy sector. This situation became an inherent part of the change in the structure of direct foreign investment observed for several years in the CEE countries, consisting in replacing equity flows by reinvested earnings and debt instruments (intra-corporate loans). At the same time, the decline in the portfolio investment inflow was observed.

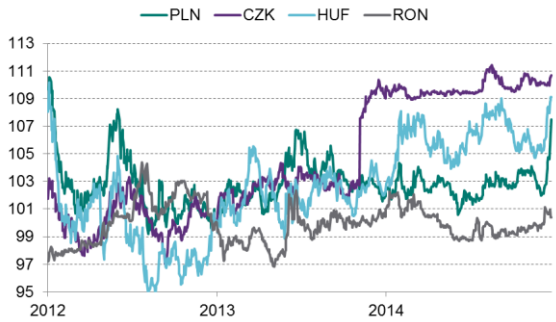
In the first half of 2014 the deleveraging process of the CEE banking systems continued. It was reflected in the net outflow of other investments, which negatively influenced the financial account balance. It resulted both from the withdrawal of deposits by non-residents, as well as from the repayment of loans towards foreign financial institutions. The scale of net outflow of other investment in the first half of 2014 was comparable to that recorded in 2013.

Relatively stable situation in the currency markets throughout most of 2014. In December 2014, depreciation of the CEE currencies as a result of turbulences in the Russian market

The situation in the CEE countries financial markets in the second half of 2014 was affected both by global and domestic factors. The global factors included mainly the consequences of the Russian-Ukrainian conflict (withdrawal of investors from the Russian market and the rapid depreciation of the ruble exchange rate). The developments in prices of financial assets were also influenced by the policy of main central banks, i.e., QE tapering by the FED and monetary policy easing by the ECB. However, it is worth noticing that the impact of those factors on financial assets in the CEE countries was definitely lower than in the previous years.

The exchange rates of the Polish zloty, Czech koruna and Romanian leu practically remained unchanged against euro in Q3 and at the beginning of Q4 2014. Temporary weakening of the currencies occurred at the turn of July and August 2014 (the effect of the Russian embargo) and in October (FED announcement of QE tapering).

Figure 1.14. Exchange rates of currencies of the CEE countries against EUR (01.01.2013=100)

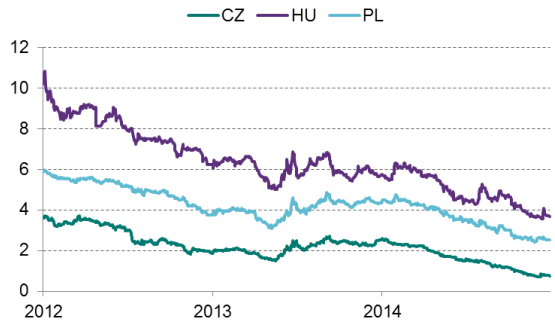


Source: Reuters.

The exchange rate of Hungarian forint demonstrated the highest volatility in this period. Besides external factors, forint also responded strongly to the local factors. Its weakening was observed from June

to September 2014 (by 5% against EUR), which was due to decreasing interest rate disparity in connection with policy rate reduction by MNB, uncertainty concerning the details of the announced programme of FX loans conversion or the ECB statement on the possible renewal of the excessive deficit procedure (EDP) against Hungary. In the consecutive months (September-November 2014) the situation in the Hungarian currency market stabilised. Forint made up for its losses against euro. The detailed FX loans conversion plan was positively received by markets, the relatively high growth rate and the draft budget act for 2015 averted the risk of the EDP resumption and interest rate cutting in Poland and Romania influenced the relative improvement in the attractiveness of the Hungarian assets.

Figure 1.14. 10-year treasury bond yields (in %)



Source: Reuters.

The situation in the currency markets, particularly in the case of zloty and forint, deteriorated explicitly in December 2014. Both those currencies depreciated against EUR (PLN by over 5%, HUF by almost 4%), reaching the lowest level since 2012. The depreciation also affected, to a lesser extent, the Czech koruna and Romanian leu (less than 1% against EUR). The weakening of the CEE currencies originated mainly from the growth in risk aversion caused by the panic in the Russian market. In Poland and Hungary it also arose from the expectations concerning further monetary policy easing.

Since the beginning of the second half of 2014, the CEE currencies significantly depreciated against the US dollar. It mainly resulted from the euro depreciation against the US currency. In the second half of 2014, PLN depreciated vis-à-vis USD by over 16%, HUF and RON - by over 15%, and CZK - by almost 14%. At the same time, almost 13% EUR/USD depreciation took place.

Turbulences in the Russian market did not have a major impact on the change in the downward trend in treasury bond yields. The decline in bond yields to all-time lows occurred in all countries. The sharpest falls were recorded in Poland, Slovenia and Hungary. At the end of December 2014 yields of 10-year Treasury bonds fell to 0.8% in the Czech Republic, 2.5% in Poland, or 3.7% in Hungary. The ECB policy of quantitative stimulation and massive inflow of new funds stood behind this phenomenon. Moreover, QE tapering by the FED, as well as the still present threat of escalation of the crisis in Russia and Ukraine resulted in increased risk aversion among global investors, which encouraged them to invest in safer CEE bond markets rather than in the stock markets.

Forecasts

Recovery to continue

GDP growth forecasts of domestic and international institutions for the CEE countries for 2015-2016 have not changed significantly as compared to spring 2014. Across the whole region it is expected that the pace of growth observed in 2014 will be maintained until mid-2015. Starting from the second half of 2015, GDP growth in the CEE region should slightly accelerate. The Baltic states, in particular, Lithuania and Latvia, next to Poland, will be the fastest growing economies of the region in the forthcoming years (the average growth rate in the 2015-2016 should exceed 3% y/y). The relatively stable growth rate, comparable to that observed in 2014 (approx. 2.5%-2.7% y/y), will be maintained in the Czech Republic and Slovakia. GDP growth in Romania, following a period of a strong decline in 2014, should accelerate again. In Hungary, where the economic growth in 2014 was driven by one-off factors, some slowdown is expected in 2015-2016.

Domestic demand to remain the major growth factor

Domestic demand will remain the major growth factor, whereas the role of the foreign demand will be still limited, especially in 2015.

In the forthcoming two years a faster growth in private consumption is expected, whereas investment, driving the domestic demand growth in 2014 should increase at a slower pace. The expected further improvement in labour markets, as well as the still relatively low inflation translating into the growth in households' real disposable income, will be still standing behind the increase in private consumption.

The situation in the labour markets should still improve in 2015-2016, however, at a slower pace than in 2014. It refers both to the growth in employment and to the decline in unemployment. Relatively weak recovery in the CEE external environment, mainly in the euro area, will translate into slower growth in employment in the export oriented sectors, i.e. mainly manufacturing.

Growth in fixed capital formation, like in 2014, will depend on the still relatively rapidly growing public investment. It seems that private investment will almost stall (except for Romania, where strong rebound is expected following the period of investment crisis in 2014), mainly due to the still continuing uncertainty related to the unstable growth prospects in the main trade partners of the region and the risk of the deepening crisis in Russia and Ukraine.

The growth in the domestic demand will be fostered by the accommodative monetary policy and neutral fiscal policy stance. Major threat to the domestic demand growth seems to be the continued deleveraging of households and enterprises, but its scale should slowly diminish. In addition, the strong slowdown in exports, and the consequent decline in the industrial sector activity may indirectly lead to the weakening of sentiment among consumers and producers (which could have been temporarily observed in 2014 Q3) and negatively influence their consumption and investment propensity. A significant threat for the CEE region also includes persisting deflation, which may also cause the decline in consumption and investment.

The growth in external demand in the forthcoming years will be slower than in domestic demand, which will translate into continued slowdown in export growth, especially in 2015. Assuming that the stable growth in domestic demand will still drive imports, the contribution of net exports to the GDP growth will be close to zero. External demand and thus exports of the CEE countries seem to be most threaten by weak euro area demand (as the effect of secular stagnation in the developed coun-

tries), as well as the recession in Russia and Ukraine.

In 2015-2016 the current account balance is expected to deteriorate across the whole region. It will mainly result from the deterioration in the trade balance due to the aforementioned faster growth in imports than in exports.

Expected low inflation

The fall in consumer prices growth rate in 2014, was reflected in lowering inflation forecasts. Although growth in inflation is still expected in 2015-2016, its scale will be limited and the reversal of the disinflationary trend is postponed. Following the all-time low inflation in the second half of 2014, it should grow slowly starting from the second half of 2015. However, in the forecasted period, the HICP inflation will remain at a relatively low level. The growth of inflation will mainly result from the expected strengthening of consumer demand, which will gradually increase inflationary pressure from households. Consequently, it should lead to the gradual growth in core inflation.

In view of commodities prices forecasts, prices of energy and unprocessed food, which determined the decline in inflation in 2014, may have a lower impact on inflation in the consecutive years. The effect of the low base should be still noticeable in the first half of 2015, when prices of energy and agricultural commodities are not expected to grow. However, their negative contribution to inflation can be cushioned in the case of further weakening of the CEE currencies.

The relatively low headline inflation and inflation expectations are to inhibit the growth in nominal wages and labour costs. In 2015, a minor decline in wage growth is expected, with its acceleration foreseen only in 2016. The expected decline in nominal wage growth in 2015, with simultaneous maintaining of the labour productivity growth rate, will cause the slowdown in the ULC growth rate. In 2016, similar to wages, ULC growth should accelerate.

Foreign direct investment inflow and its impact on the structure of CEE economies

Summary

The growth model of Central and Eastern European countries[33] during the transformation and integration with the European Union was based on foreign capital inflows, foreign direct investment (FDI) in particular. It resulted, on the one hand, from the strategy of international corporations seeking more efficient means of production and, on the other hand, from insufficient domestic capital stocks.

During the last twenty years, the inflow of FDI had a significant impact on changes in the structure of the CEE economies. The role of manufacturing has clearly increased, in particular, those of its branches which are most strongly integrated into global supply chains (GSC). They include production of electrical and electronic devices and the automotive industry. In the same period, different trends were observed in the EU-15 countries, i.e. the deindustrialisation and the increasing role of services in those economies.

Contrary to expectations, growing role of international corporations, which occurred as a result of foreign direct investment inflow, has not made the export structure of countries in the region similar to the structure observed in the EU-15 countries (where international corporations dominated in exports before). One of the most important symptoms is the significantly lower share of services in the CEE exports.

Diversified trends in the role of services in trade observed between the CEE and EU-15 countries confirm that the transfer of production to new member states was, to a large extent, limited to manufacturing production. On the other hand, a considerable part of services associated with the production transferred to the CEE, is provided in the countries of Western Europe.

Changes in the structure of production and exports was associated with the increasing role of foreign enterprises, mainly the branches and subsidiaries of international corporations. They have also played an essential role in the production and exports of the CEE economies already since the end of 1990s, but their role in the consecutive years has even increased.

The growth in the number of foreign enterprises has influenced the growth in labour productivity in the CEE economies. Consequently, the CEE countries still remain an attractive investment destination for European corporations, even despite growing labour costs. The observed decline in FDI inflow to the CEE region after 2008 should be treated rather as a change resulting from the weakening of the economic growth in the global economy, especially in Western European countries, than the permanent retreat of foreign investors from the CEE region.

[33] Unless indicated otherwise, in this part of the report, the group of Central and Eastern European countries includes Poland, Czech Republic, Slovakia and Hungary.

Impact of foreign direct investment on economic growth and the level of trade openness –literature review

Foreign capital inflow, as many empirical studies indicate (inter alia, Borensztein et al., 1998; De Mello, 1999; Quinn and Toyoda, 2008; Kose et al., 2009), **has generally a favourable impact on the economy of the receiving country.** Foreign investment, through transfer of technology and *know-how*, has an impact not only on the increase in the capital stock, but also on the productivity growth (and an increase in the production potential) and trade openness. Foreign capital inflow played a particularly important role in the developing countries which, on the one hand, demonstrated a lower domestic savings rate (with the exception of countries of South-Eastern Asia) and, simultaneously, presented considerable investment needs. Countries of Central and Eastern Europe may be classified in this group.

Apart from obvious benefits associated with foreign capital inflow, some threats for the stability of host countries may also occur (e.g. speculation bubbles, higher vulnerability to external shocks, dependence on short-term capital, risk of currency crisis, etc.). In the literature (inter alia, Prasad et al., 2003; Alfaro et al., 2004; Dell'Ariccia et al., 2008), certain factors are indicated which should be demonstrated by host countries, enabling it to increase the benefits and limit the aforementioned threats. They include mainly a stable macroeconomic situation, a developed financial system and the accumulated human capital.

The empirical studies on the assessment of foreign capital inflow effects on economic growth (in particular, in the export sector) show that among all forms of investment, direct investment has the most beneficial impact. Aizenman and Sushko (2011) analysed the impact of FDI as well as portfolio investment (debt and equity), on the economies of 99 developed and developing countries in 1991-2007. The results of the studies have confirmed that only FDI inflow had a positive impact on the industrial sector in these countries. The portfolio investment inflow, in particular portfolio debt, was negatively correlated with the growth in production in industry. Similar conclusions were drawn by Milewa (2008) who studied implications between foreign capital inflow and domestic investment in 22 transition economies in 1995-2005. Foreign direct investment had a beneficial long-term impact on the growth in investment in these countries, especially in economies characterised by the low level of financial system development. On the other hand, the impact of portfolio investment on the capital expenditure growth was insignificant. The next channel, through which FDI influenced the acceleration of economic growth, was the increased openness of economies, in particular, growth in exports. Liu et al. (2002) found the mutual causality between FDI inflow and the growth of exports in China.

FDI inflow had a positive impact on economic growth and its structure in the CEE countries. For example, Fidrmuc and Martin (2011) confirmed that there exists a strong, positive mutual relation between FDI, industrial production and economic growth in the CEE countries. On the other hand, portfolio investments seem to have a definitely smaller impact on GDP growth in those countries. Similar conclusions may be also drawn from the study by Bogumił (2014). Damijan et al. (2013) studied the impact of FDI on the changes in the level and structure of exports in new EU member states,

with special attention to the impact of global supply chains on this process. The authors have concluded that foreign capital inflow fosters restructuring in manufacturing and exports growth, in particular, exports of technologically advanced goods.

FDI inflow to the non-tradables sectors, i.e. mainly construction and market services, had more influence on the acceleration of economic growth than the inflow to tradables sectors, i.e. mainly manufacturing. However investment in domestic market oriented sectors led to the growth of macroeconomic imbalances and the increase in volatility of business cycles. Mirta (2011), based on the analysis of economies of new EU member states, claims that direct investment inflow to the real estate sector has a much bigger impact on GDP volatility than in the case of other sectors of the economy, irrespective of the adopted currency exchange regime or restrictiveness of fiscal policy in a given country. The study of Kinoshita (2011) on the panel of 15 developing economies of Europe in 2000-2007 confirms that FDI inflow to tradables and non-tradables sectors had a totally different impact on the economies of these countries. Investment in manufacturing resulted in the growth in exports and had a neutral impact on the current account balance. On the other hand, investment in domestic-market oriented sectors fostered the growth in imports and accumulation of external imbalances.

Foreign investment inflow to the CEE countries– general characteristics

The growth model of the CEE countries

The specific feature of the CEE economic growth model in the last two decades was the reliance on foreign capital inflow, mainly originating from Western European countries. This inflow was supported by the ongoing shift of the CEE economies towards the market economy, liberalisation of capital flows and the process of integration within the European Union. The CEE countries provided a very good example of economies, where the growth was boosted by downhill capital flows. This growth model, although consistent with the theory of economics, was markedly different from that observed in other developing countries in the last twenty years[34]. Economies of Latin America and most of all of Eastern and South-Eastern Asia, did not benefit from the foreign investment inflow to that extent They even often acted as net exporters of capital[35].

Figure 2.1. Net foreign capital inflow to selected regions, in % of GDP

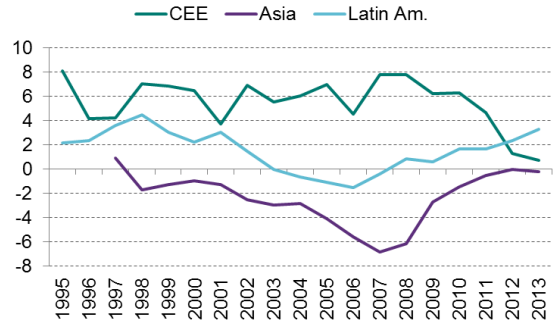
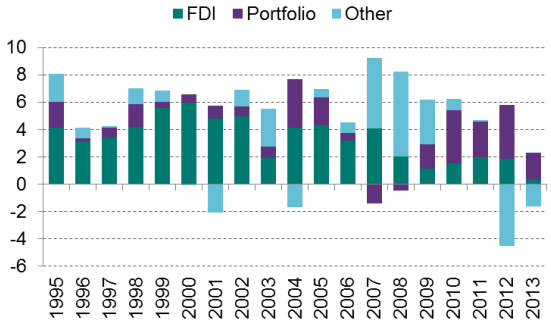


Figure 2.2. Net foreign capital inflow to the CEE countries, according to the type, in % of GDP



Sources: IMF WEO, OECD MEI, EI NBP calculations.

FDI constituted the major part of foreign capital flows into the CEE countries before 2008. In 1995-2007 the value of net inflows to the four analysed countries amounted, on average, to 4% of GDP, which accounted for over 2/3 of the total inflow.

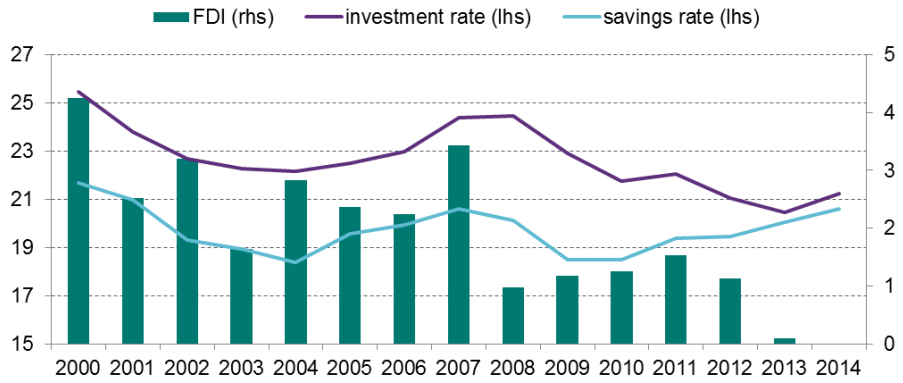
Foreign capital inflow to the CEE countries, FDI in particular, had a big impact on the gross fixed capital formation. The CEE countries in the transition period demonstrated a relatively low savings rate and large investment needs. Thus, the deficit between domestic savings and investment was financed through the inflow of foreign capital. Until 2008, it was mainly capital in the form of FDI. In the following years, as a result of the global financial crisis, the decline in foreign capital inflow oc-

[34] The paradox associated with the capital flow from less developed countries to more developed countries was first signalled as early as in 1990 - cf. Lucas (1990).

[35] In case of the Asian and Latin American countries, this situation resulted from changes following the financial crises in the 1980s and 1990s.

curred, mainly in terms of FDI[36]. This had an influence on the decrease in the region's investment rate, irrespective of the gradual growth in the domestic savings rate.

Figure 2.3. Savings and investment rate and FDI net inflow in the CEE countries, in % of GDP



Sources: AMECO, Eurostat, national statistical offices, EI NBP calculations.

Determinants of FDI flows into the CEE countries

The development of the growth model based on FDI inflow in the CEE countries resulted mainly from the favourable conditions for foreign investors. The main pull factor for foreign investors to invest in the CEE countries was the intention to improve the cost efficiency of production means (*efficiency seeking* FDI[37]). It mainly related to the definitely lower labour costs. At the same time, the CEE countries offered relatively skilled employees, favourable geographical location and the developed logistic, energy and communication infrastructure. A significant part of investors was also driven by the aim to enter local markets (*market seeking* FDI). This fact is confirmed by the relatively high percentage of direct investment directed to the economic sectors clearly focusing on domestic market, i.e. construction or market services (financial, telecommunication services, retail trade). In the CEE countries, it amounted to approx. 60% of all FDI.

The transition to the market economy as well as the ongoing integration with the European Union explicitly fostered the inflow of foreign capital. Gradual liberalisation of capital flows enabled international corporations to enter the CEE markets. Another important aspect was the mass privatisation whose major beneficiaries were foreign companies. Governments in the CEE countries clearly supported foreign investors and used many incentives (e.g. reduction in tax rate or even full exemption, subsidies to investment projects) in order to attract new investments.

[36] Although the inflow of portfolio investment increased in this period, the empirical studies described in the preceding part of the material show that their impact on economic growth is definitely lower than in the case of direct investment.
[37] The most popular classification of factors driving foreign investors was introduced by Dunning (1992), who made a distinction between *resource*, *efficiency*, *market* and *strategic asset-seeking* investment.

Directions of FDI inflow – differences between the CEE group and other new EU member states

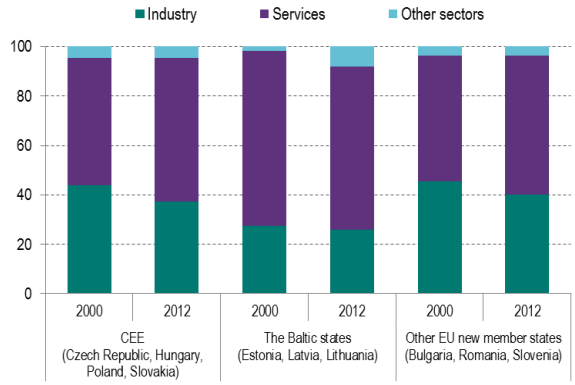
Since the beginning of the transition foreign capital in the form of direct investment has flowed to new EU member states mainly to two sectors of the economy, i.e. industry and services[38]**.** At the end of 2000, the cumulative value of FDI in industry accounted for 43% of all investments in the region, and in services – 53%[39]. In the following decade, the share of industry in the FDI inflow was gradually decreasing, reaching 37% at the end of 2012 (the share of services at that time increased to 58%). FDI distribution in individual countries was not equal, whereas the biggest differences occurred and still occur between the CEE countries (Czech Republic, Poland, Slovakia, Hungary) and the Baltic states (Estonia, Lithuania, Latvia). In the former group of countries, the FDI resources in industry are markedly higher (37%) than in the latter group (26%) – as at the end of 2012. On the other hand, the share of FDI channelled to services sectors in the CEE is smaller (60%) than in the Baltic states (67%). In other new EU member states (Bulgaria, Romania, Slovenia), the distribution of FDI in industry and services is relatively close to that in the CEE.

The diversity of new EU member states, in terms of the FDI sectoral structure, is more evident if more detailed data on industry and services are taken into account. In the case of the industrial sector, foreign investors invested mainly in manufacturing and, to a lesser extent, in mining and quarrying or electricity, gas, steam and air conditioning supply. The detailed analysis of the data shows that at the end of 2012 over 30% of FDI in the CEE countries went to the manufacturing sector (except for Hungary, where the share amounted only to 15%). On the other hand, in the Baltic states this share did not exceed 20% (in Lithuania, the percentage amounted to 27%). In other new EU member states (Bulgaria, Romania and Slovenia) the FDI share in manufacturing reached 25% at the end of 2012.

The inflow of FDI to the services sector was directed mainly to the financial-insurance, real estate, retail trade and transportation sectors. The significant role of the aforementioned sectors in FDI inflow arises from the fact that privatisation of banks, insurance companies and other state enterprises, conducted in the first years of transformation, involved the participation of foreign investors. Considering the distribution of FDI in services, it can be observed that the CEE countries and the Baltic states show a similar share of foreign capital in the financial intermediation sector.

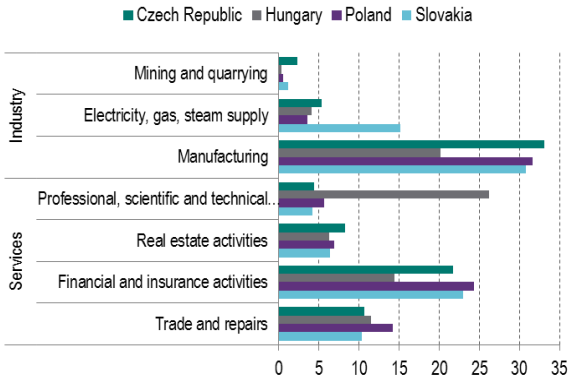
[38] In the majority of the states in the region, the share of agriculture and construction in the FDI inflow does not exceed 5% of the total inflow. Exceptions include Bulgaria (7.3%), Latvia (8.0%), Poland (6.1%) and Romania (6.4%).
[39] All figures provided in this chapter refer to arithmetic means weighted by value added generated in the specified sectors and branches of new EU member states.

Figure 2.4. The structure of FDI stock in the EU new member states



Sources: Eurostat, OECD.

Figure 2.5. FDI distribution in selected sectors of industry and services in the CEE countries (in %, as at the end of 2012)



Note: An exceptionally large FDI stock in Hungary in "Professional, scientific and technical activities" results mainly from statistical changes.

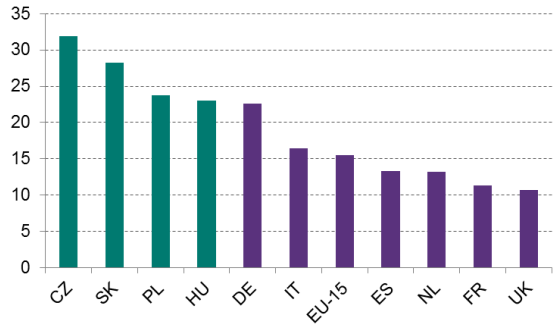
Sources: Eurostat, OECD.

Changes in the structure of the CEE economies – the growing role of manufacturing

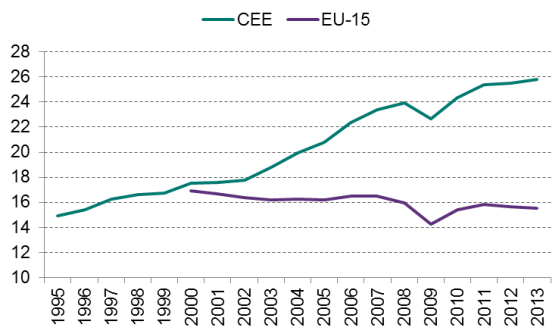
The growth of the manufacturing's share in the value added in the CEE economies could be observed in the last two decades. The opposite trend was seen in the EU-15 countries[40]**.** In 1995, in the CEE countries, the share of value added in manufacturing in the total value added amounted to less than 15%, and in 2013 it increased to over 25%. This growth occurred in all four economies. It was exceptionally high in the Czech Republic and Slovakia, where the share of the value added in manufacturing more than doubled. In Poland and Hungary, the scale of growth was smaller, although still quite significant (60% and 45%, respectively). On the other hand, in the majority of the EU-15 countries, the deindustrialisation of economies took place in 1995-2012. Whereas in the most industrialised countries (Germany, Austria, Sweden) the position of manufacturing remained stable, in France, Italy, the United Kingdom and Spain, the decline in the share of value added in manufacturing in total value added was very pronounced (inter alia, in the United Kingdom it decreased by 1/3).

Figures 2.6. and 2.7. Share of value added in manufacturing in total value added in the CEE countries compared to the EU-15 countries,

in %, 2013



in %, 1995-2013



Source: Eurostat.

Considerable changes also occurred in the structure of value added within the manufacturing sector in the CEE countries. The role of food and textile industries as well as manufacture of coke and refined petroleum product gradually decreased. In mid-1990s, those sectors were the most important ones in in the CEE manufacturing. However, their role was successively decreasing. In 1995-2012 it decreased by over 1/3 from 6.2% to 4.0% of total value added. On the other hand, the role of industries strongly integrated within the GSC increased, i.e. production of machinery, electrical and electronic devices, computers and transport vehicles. Value added in the automotive industry and production of electrical devices increased five-fold and in the case of computers and electronic devices – even ninefold. At the same time, in the EU-15 countries, the reduction of the relative production value in the aforementioned sectors of industry was, to a large extent, responsible for the continued decrease in the share of value added of manufacturing. It was particularly visible in France, Italy (decline in the share

[40] See Box: *Changes in the structure of value added in the countries of Central and Eastern Europe.*

of the automotive industry by ¼), Spain and the United Kingdom (the share of production of electrical and electronic devices decreased by almost a half).

Figure 2.8. Structure of value added in manufacturing in the CEE countries, 1995-2012.

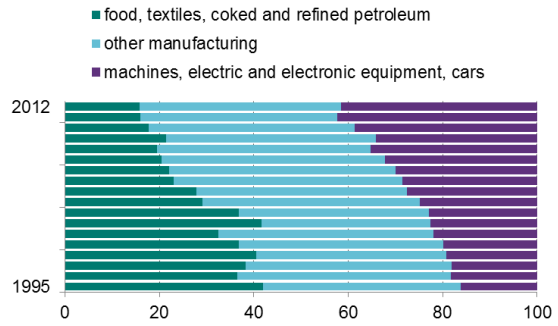
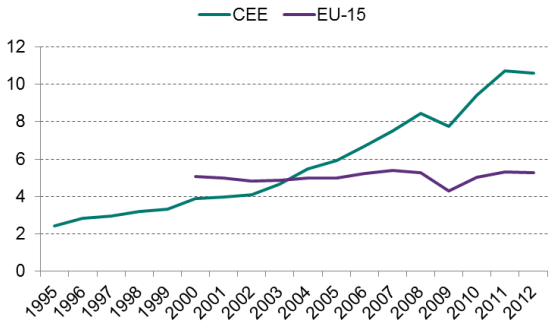


Figure 2.9. Share of GSC related manufacturing value added in the CEE countries as compared to the EU-15 countries, in %



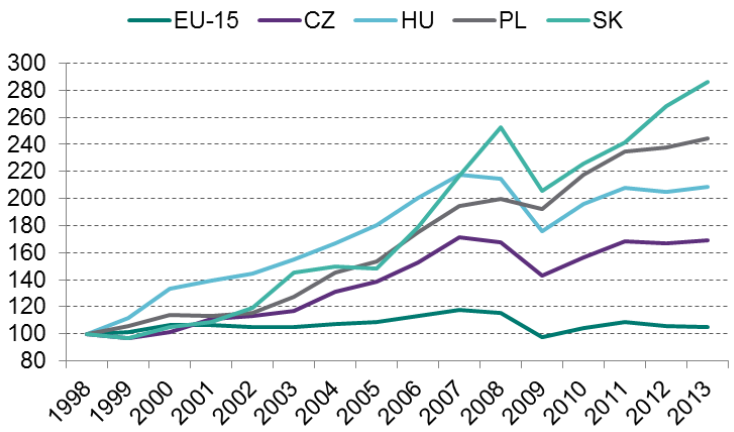
Source: Eurostat.

FDI inflows into the industrial sector in the CEE countries in 1998-2013 resulted in the growth of industrial production, in particular, in manufacturing, whereas in the EU-15 countries the volume of industrial production remained almost unchanged. In the analysed period, the growth in the volume of industrial production ranged from 70% in the Czech Republic to 190% in Slovakia. The relatively highest growth in the CEE countries was demonstrated by the sectors of industry most strongly incorporated into GSC, i.e. production of electrical, electronic and computer equipment as well as the automotive industry. Production in those sectors in the CEE countries at least tripled in the analysed period (production of cars in Slovakia increased almost ten-fold), whereas in the EU-15 countries, this growth was definitely lower, or even the decline in production was recorded (in the case of production of electrical devices).

The particularly high decline in production in the analysed fifteen years was observed in the peripheral countries of the euro area, but also in France and the UK. In Germany and its satellite countries (the Netherlands, Belgium, Austria) industrial production was growing, albeit definitely slower than in the new member states. The growth in production was halted, or even its minor decline was recorded in the peripheral countries of the euro area, the UK and France as early as at the beginning of the 21st century. Disproportion in industrial production growth increased after 2008. In the aforementioned EU-15 countries, the decline of production in manufacturing was relatively strong and sustainable, whereas in the CEE countries the decline trend was quickly reversed. Thus, in the last two decades the CEE countries were the main destinations of expansion of international corporations, particularly, in branches of industry most strongly incorporated in GSC. This is where the majority of new production investments was located, while limiting production in home countries and its with-

drawal from the peripheral countries of the euro area[41], where the growth of industrial production was very high in the 1990s.

Figure 2.10. Industrial production in the CEE countries, 1998=100, volume



Source: Eurostat

Growth in manufacturing share in GDP in the CEE countries, with the simultaneous decline in the EU-15 countries (excluding Germany), confirms a clearly different role of the CEE countries in international production chains. While investing in the CEE countries, international corporations focused on relocating manufacturing plants or units responsible for sales on the local markets, leaving the majority of the activity associated with pre-production and after-sales services in their home countries[42].

[41] In 1998-2013, i.e. in the period of a very dynamic growth of production in the CEE countries, the scale of decline in the production of the electronic equipment and cars in Greece, Spain and Portugal amounted from 30% to even 90%.

[42] This process was described in Antras Yeaple (2013). Companies investing abroad most commonly transfer their production or sales departments (in particular, if they intended to enter the local markets), leaving the majority of the services, inter alia, those associated with research and development, in their home branches.

Role of services in exports of the CEE countries – comparison with the EU-15 countries

Foreign direct investment inflow to the CEE region had an impact on the strong change in the structure of foreign trade of those countries. It was reflected in the relative decrease of the role of services in exports of those economies.

The role of services is one of the main features differing the export structures of the European Union countries[43]**.** In the countries of the "old" EU (EU-15)[44], it is clearly higher than in the new member states. Moreover, whereas in the EU-15 countries the permanent growth of importance of services in exports has been observed since 1995, in the CEE countries the opposite trend prevailed. It was visible especially in the period directly following the enlargement of the European Union. The decline in the share of services in CEE exports is demonstrated both by the traditional foreign trade statistics as well as by the value added in international trade statistics.

Services play a key role in the development of international trade based on global supply chains. Growing share of services in the value added in exports of goods increases the scale of product diversity and determines the quality of goods.

Traditional statistics

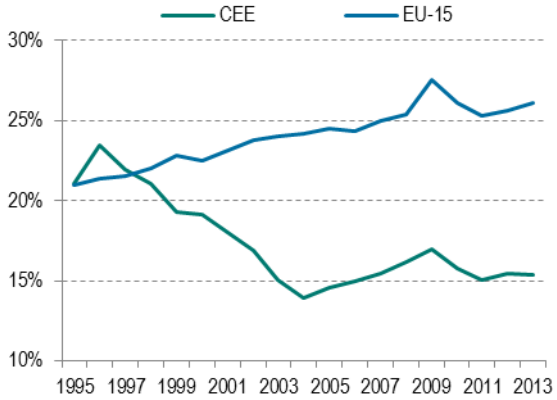
The importance of the services sector in exports of the new member states in the last decade of the 20th century and in the first decade of the 21st century was strongly marginalised. The high growth in exports of goods was not accompanied by the same scale of growth in exports of services (the value of exports of goods in the CEE countries in 1995-2013 increased seven-fold, while the value of exports of services increased 4.5-fold).

According to the Eurostat national accounts statistics, which distinguish exports of goods and services, the services constituted 15% of the CEE export value in 2013, i.e. much less than in 1995 and clearly below the level observed in the EU-15 countries. In 1995-2013 the share of services in CEE exports decreased by 6 pp (from 21% to 15%), whereas in the EU-15 countries the share of services in exports in the same period increased from 21% to 26% (thus, initially, it was close to the level observed in the CEE).

[43] Other significant differences in exports include the share of non-European countries in the export structure and the high diversity of unit prices.

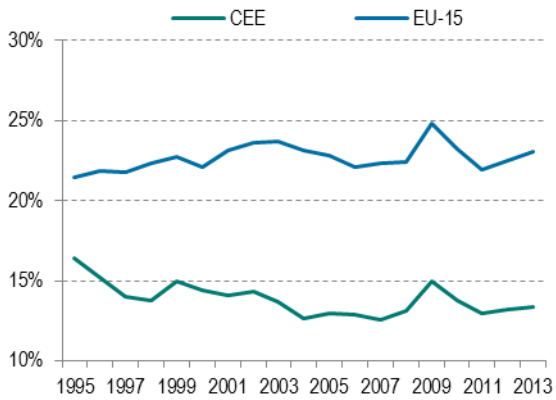
[44] Figures provided in this part for the EU-15 countries refer to the EU member states according to their composition as of 1995, excluding Greece and Luxembourg, participating in global supply chains to a much lesser extent.

Figure 2.11. Share of services in exports of the CEE and EU-15 countries (as % of the total exports of goods and services)



Source: Eurostat.

Figure 2.12. Share of services in imports of the CEE and EU-15 countries (as % of the total imports of goods and services)

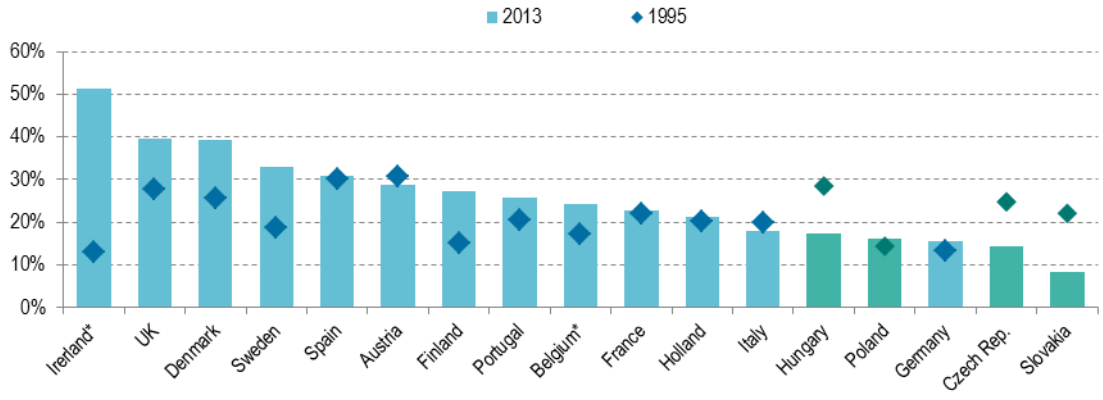


Source: Eurostat.

Among the CEE countries, exports of Hungary demonstrates the highest share of services (18%), and exports of Slovakia – the lowest (only 8%). Between 1995 and 2013, the share of services in exports increased only in Poland (by 2 pp). On the other hand, in Slovakia, Hungary and the Czech Republic, the highest decline in the share of services occurred in the same years (by over 10 pp).

The failure of the services sector development to follow the growth in manufacturing exports in the CEE has not contributed to the growth in the importance of services in imports. Although the share of services in CEE imports in 1995 was much smaller than in CEE exports and in the imports of the EU-15, in 1995-2013 it decreased even more (from 16% to 13%), whereas in the EU-15 countries, it increased from 21% to 23%.

Figure 2.13. Share of services in exports of selected countries of the European Union (as % of the total exports of goods and services)

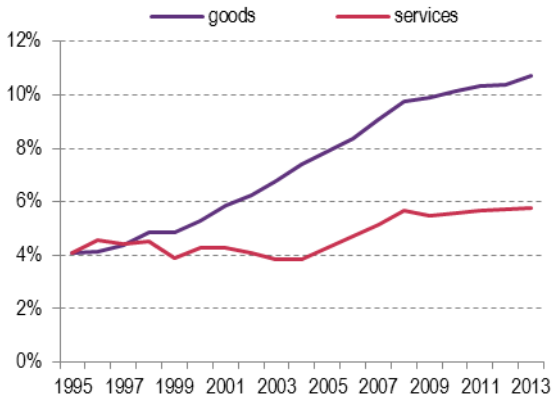


* 2012
Source: Eurostat.

In general, the CEE countries were on the peripheries of the European trade in services. Whereas the share of CEE in the European Union trade in goods amounts to approx. 11%, in the case of services it is almost twice smaller.

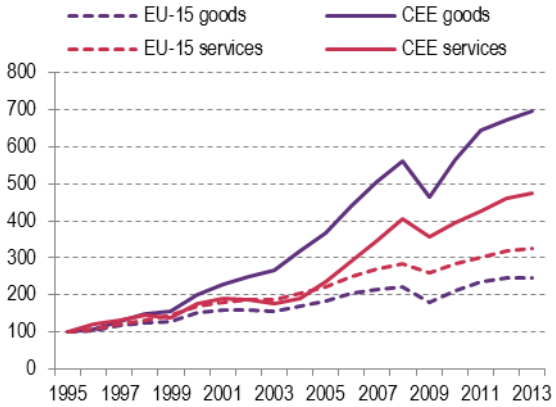
Diverging trends in the role of services in trade observed between the CEE and EU-15 countries indicate that the transfer of production to new EU member states, which was a consequence of GVS expansion, was limited to manufacturing production. On the other hand, services associated with production are still mainly provided by Western European countries (probably some of them were transferred from big EU-15 countries to smaller economies). It generally arises from the fact that the intensification of the production relocation and fragmentation processes resulted in the increased level of separation of services from industrial production.

Figure 2.14. Share of CEE countries in exports of goods and services in EU-27



Source: Eurostat.

Figure 2.15. Dynamics of exports of goods and services in the EU-15 and in the CEE countries (year 1995=100; in current prices in EUR)



Source: Eurostat.

Thus, the allocation of tasks within the GSC is asymmetric at individual stages of production. Whereas tasks implemented in manufacturing are mostly transferred to developing economies (in this case, to the CEE), services associated with the functioning of GSC definitely remain in the domain of developed economies. Taking into account the dynamics of those processes, clear polarisation in specialisation has occurred in recent years. Developed countries focus on services and developing countries on manufacturing.

In the interpretation of changes in the role of services in international trade of the CEE and EU-15 countries, the statistics of the value added have a considerable importance.

Value added statistics

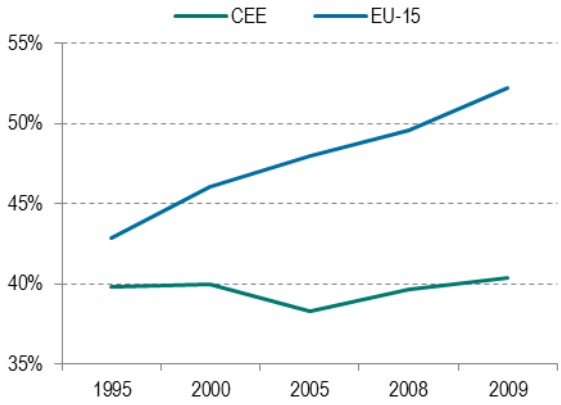
The OECD and WTO statistics of value added (Trade in Value Added – TiVA) **indicate a much higher real share of services in exports of both EU new member states and EU-15 countries**. However, according to the TiVA data, the share of services in the exports of the CEE countries also remains definitely lower as compared to economies of the "old" European Union. In 2009, in the CEE countries, 40% of the gross export value was generated in the services sector, whereas in the EU-15-52%. Both groups of countries differ not only in terms of the share of services in exports but mainly in terms of trends observed in the development of this share. In 1995 (the first year for which data on the value added in international trade are available), the share of services in exports of the CEE and EU-15 was

relatively similar (40% and 43%, respectively). However, while in the EU-15 countries the share of services in exports was systematically increasing in 1995-2009, in the CEE countries it practically remained at an unchanged level.

The statistics of the value added enable to distinguish four main categories of services composing the value added in exports, depending on the origin (domestic and foreign) and destination (value added in exports of goods and in exports of services).

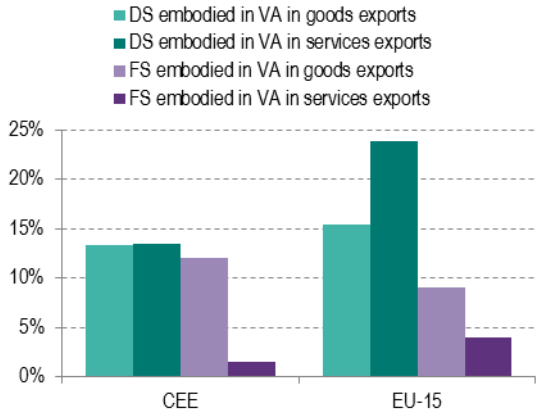
The main category differentiating the share of services in CEE exports, as compared to the EU-15, are the domestic services embodied in the value added in exports of services. In 2009, they contributed to only 13% of gross exports of the CEE whereas in the EU-15 countries, they generated 25% of gross exports. This category is mostly responsible for diverse trends in exports of services in both groups of countries. At the beginning of the period covered by the analysis, the value added of domestic services in exports of services in the CEE countries made 19% of the gross export value (i.e. by 6 pp more than in 2009), whereas in the EU-15 countries they contributed to 18% of the gross export value (i.e. by 6 pp less than in 2009).

Figure 2.16. Share of services in the value added of gross exports



Source: OECD.

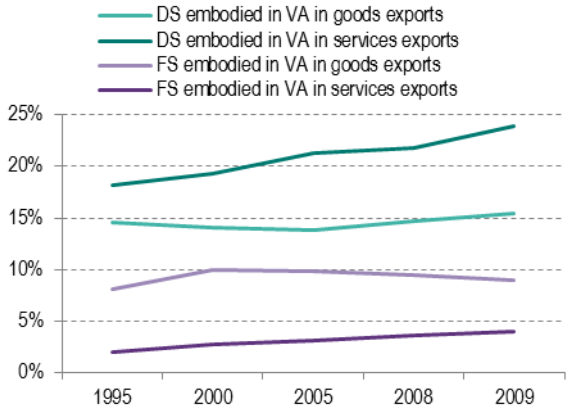
Figure 2.17. Share of services in gross exports in 2009



DS – domestic services, FS - foreign services
Source: OECD.

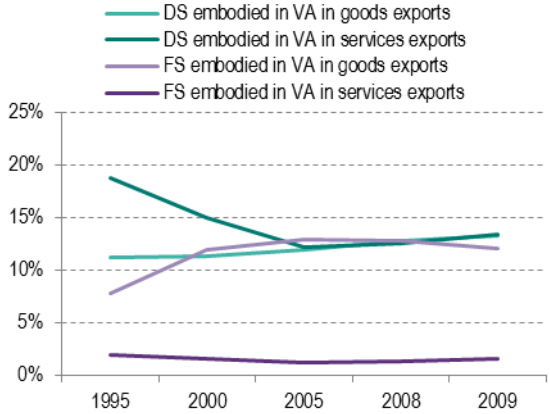
Despite the increasing presence of international corporations in the CEE countries in 1995-2009, the share of foreign services in the value added in exports remained at a very low level (2%), whereas in the EU-15 countries the share of this category increased from 2% to 4% of gross exports in those years.

Figure 2.18. Share of services in gross exports of the EU-15 countries



Source: OECD.

Figure 2.19. Share of services in gross exports of the CEE countries



Source: OECD.

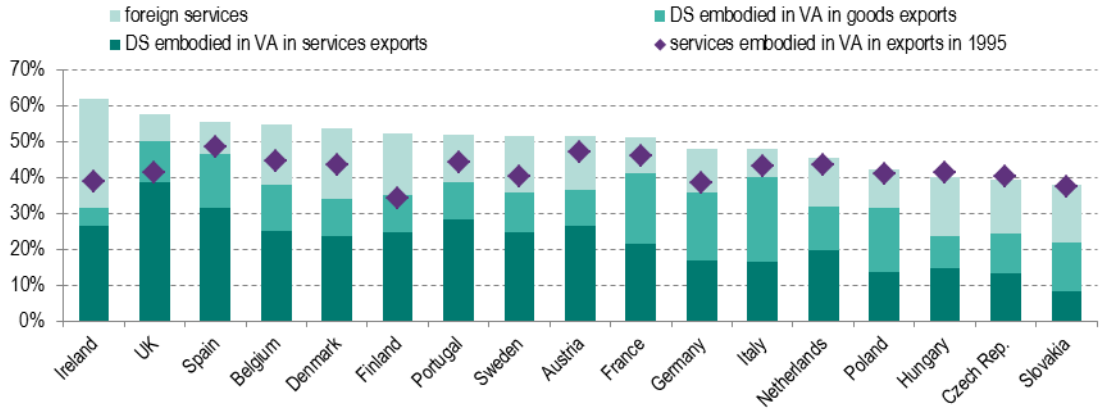
The share of services in the value added in exports of goods in the CEE countries increased – both for foreign services (from 8% to 12%) and domestic services (from 11% to 13%). In the EU-15 countries, the growth of those categories in gross exports also occurred, however, at a smaller scale (only by 1 pp in both categories). Foreign services in the value added in exports of goods were not only the fastest growing category of services in CEE (in 1995-2009, their value increased over seven-fold, whereas in the case of other categories a four-fold growth was recorded), but also the only category whose share in gross exports of the CEE countries was higher as compared to the EU-15 countries.

The role of services (and its change) explicitly divides the European Union into developed economies (EU-15) **and developing economies** (CEE and other new member states). **Moreover, since 1995 this division has deepened**. In the majority of the EU-15 countries, over a half of the value added in exports is generated by services (in 2009, only in Germany, Italy and the Netherlands, services made less than a half of the value added in exports). A higher share of services in the value added in exports is usually observed in smaller EU-15 economies. In this group, the strongest growth of the role of services in exports occurred (on average, by over 9 pp, including Ireland by 23 pp, Finland by 18 pp). Smaller EU-15 economies differ from big economies in terms of the higher importance of foreign services (16% of gross export against 10% in big EU economies), i.e. the imported value added. In big EU economies (excluding the United Kingdom), the share of services in the value added in exports remains at a relatively lower level. However, in Germany, France and Italy, domestic services play a considerable role in creating the value added in exports of goods (20% of gross exports on average).

Among the CEE countries, exports of Poland demonstrate the highest share of services in value added (in 2009, it was 41% of gross exports), however, it is lower than in a Western European country with the lowest share of services in exports (the Netherlands – 46%). Moreover, other than in the EU-15, in the CEE countries the growth in the share of services in exports was very limited, irrespective of strong changes in the structure of those economies which occurred mainly under the influence of foreign direct investment. As compared to 1995, the highest growth in the role of services was recorded in exports of Poland (by 2 pp), whereas in Hungary and the Czech Republic, according to the TiVA

data, the share of services decreased in 1995-2009 (in both cases by 1 pp), opposite to the trends observed in Western Europe.

Figure 2.20. Share of services in creating the value added of gross exports in selected countries of the European Union in 2009



Source: OECD.

The common phenomenon for both groups of countries is the increased role of services in the value added in goods exports. In the EU-15 countries, 35% of the value added in goods exports is generated (against 29% in 1995), and in the CEE countries – 31% (26% in 1995). However, whereas in the Western European countries the value added in exports of goods is mainly generated by domestic services[45], in the CEE countries the share of the domestic and foreign value added in exports of goods is similar[46].

The 1995-2009 period saw an increase in the share of services in the CEE exports in all 12 sectors associated with the production of goods (10 sectors of manufacturing, agriculture and mining), for which OECD data are published.

Services play the most significant role in exports of transport vehicles. In 2009, the share of services amounted to 40% of UE-15 exports and 34% of the CEE exports of transport vehicles. In the EU-15 countries, services also play a considerable role in exports of electronic products, textiles and food products (in all those sectors – 38% of value added). In the CEE countries, the share of services in all those sectors is smaller. Services play a relatively high role in exports of food products (33%), whereas in exports of electronic products and textiles, the share of services remains at below EU average.

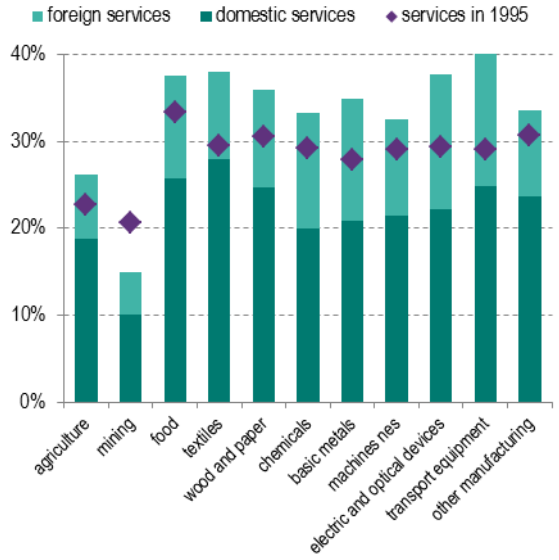
The structural weakness of exports (and production in general) **in the CEE countries is indicated by the structure of value added in exports in individual groups of services**. In the new member states, the value added in exports of goods is generated mostly by services associated with trade (warehous-

[45] It is primarily the result of the considerable role of domestic services in the creation of the VA of goods exports in such countries as France, Germany, Italy and United Kingdom, where domestic services make over 2/3 of the services sector contribution to the creation of the VA of exported goods. On the other hand, in small EU-15 countries the share of domestic services is slightly higher than the share of foreign services.

[46] In 2009, 53% of the value added created in services, forming a part of goods exports, was attributed to domestic services. Since 1995, the share of domestic services has gradually decreased (from 59% to 51%).

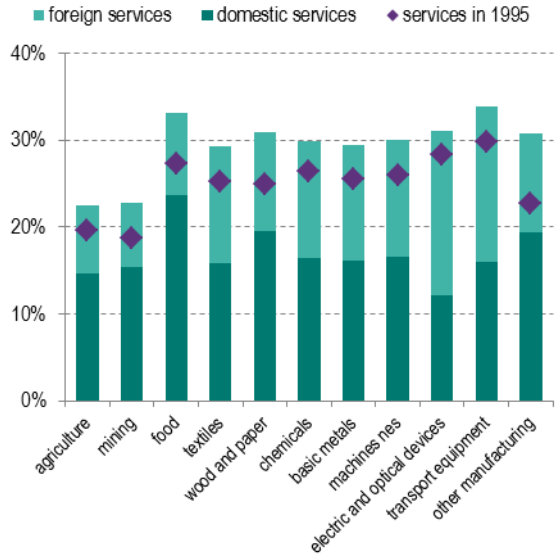
ing, logistics, transportation), i.e. services generating low value added. On the other hand, in the countries of the "old" European Union, the major part of the value added is generated by business services (professional, scientific and technical services), thus, ranked much higher in the hierarchy of value added chains.

Figure 2.21. Share of services in exports of goods in the EU-15 countries, by sectors



Source: OECD.

Figure 2.22. Share of services in exports of goods in the CEE countries, by sectors



Source: OECD.

Both groups of countries differ in terms of the structure of the value added in exports of goods. In the CEE countries, services classified as trade play the major role. In 2009, they accounted for 12% of gross exports of goods and 39% of the value added generated in services and used in exports of goods. On the other hand, in the EU-15 countries the share of the corresponding group of services amounted, respectively, to 9% and 26%.

In the EU-15 countries, business services contribute most to the value added in exports of goods. In 2009, they accounted for 14% of gross exports of goods and 41% of the value added generated in services and used in exports of goods. In the CEE countries, the role of this group of services in exports was markedly smaller – 9% and 29%, respectively.

In the CEE countries, the domestic value added had the highest share in trade (61%). In other groups of services, foreign services generated the largest share of value added in exports of goods. The lowest share of the domestic value added was characteristic for the contribution of financial services (39%) and business services (44%). On the other hand, in the EU-15 countries, domestic services accounted for 63% of the value added of services in exports of goods. The highest share of the domestic value added was observed in business services (68%) and the so-called other services (65%).

In exports of all manufacturing sectors, the share of business services is higher in the EU-15 countries as compared to the CEE. The biggest differences occur in exports of transport vehicles and electronic equipment (in both cases, in the EU-15 – 17%, whereas in the CEE – 10%), i.e. in the sectors which have been most significantly dominated by international corporations.

In the CEE countries, foreign services are mainly directed to the industrial sector (in 2009, 89% of foreign services created the value added in exports of goods and only 11% in exports of services). On the other hand, in small EU-15 countries, even 43% of foreign services create the value added in exports of services (whereas in 1995 it was 24%, i.e. similar to the CEE). Thus, besides the fact that in the CEE countries services play a much smaller role in generating value added in exports of goods, the fact that in gross exports the role of foreign services is bigger than the role of domestic services is also important.

In the CEE countries, the contribution of foreign services to the value added in exports of goods is also relatively high, as compared to other EU countries (12%). On the other hand, the contribution of the foreign value added supporting exports of services remains very low (only 1.5% of gross exports). Such a structure of the foreign value added may indicate that for international corporations the transfer of manufacturing to Central and Eastern Europe is more beneficial, whereas the development of service activities associated with exports of goods either remains in the home country or is transferred to smaller economies of Western Europe. The relatively high growth in foreign value added in the services sectors (over four-fold growth in 1995-2009) in smaller economies of the EU-15 may indicate that, at least partly, services associated with production developed in the CEE were transferred to this group of countries.

Interesting conclusions can be drawn from the interpretation of changes in foreign value added content of gross exports, in particular, foreign services value added content of gross exports[47].

Data on the value added in trade indicate that all CEE countries are importers of the net value added generated in the services sector and used in exports. It means that the domestic value added generated in services, exported to third countries and then used in their exports is smaller as compared to the foreign value added generated in services and used in the CEE exports. The growth in international corporations activity in the CEE region may have probably had an adverse impact on the services sector in the new member states, in particular, the services which were exported. On the one hand, the strong change in the commodity structure of exports resulted in a reduction in the share of these services which were associated with exports of sectors whose share significantly decreased. On the other hand, international corporations that organised and took over the existing production processes replaced the accompanying domestic services with imports.

[47] Taking into account the domestic value generated in services and used in exports of other countries, four European countries may be indicated which, according to this criterion, are the largest organisers of global supply chains. They include the major European economies which are the home countries of the highest number of international corporations – Germany, France, United Kingdom and Italy. Those countries, next to the United States and Japan, represent economies with the highest mobility of production.

Thus, the CEE countries became, to a larger extent, manufacturing centres, whereas the countries of Western Europe shifted their specialisation towards the services sector. Subsidiaries of international corporations in the CEE countries have become an important destination of exports of services from the EU-15.

Impact of FDI inflow on changes in the structure of enterprises

Growing role of foreign enterprises in industry

The rapid growth in industrial production as well as changes in its structure can be, to a significant extent, attributed to foreign enterprises. Even before the formal EU accession, the presence of foreign companies in the CEE countries was noticeable, especially in manufacturing branches strongly incorporated into GSC[48]. In 2003, foreign companies were already responsible for generating over 40% of value added in the Czech Republic and over 50% in Slovakia and Hungary. Following the accession of the CEE countries to the EU, the role of foreign companies increased even more. In 2011, the share of the value added created by foreign enterprises in the total value added grew to almost 60% in the Czech Republic and to over 60% in Slovakia and Hungary. It was slightly smaller (50%) in Poland, however, also in this case the upward tendency was noticeable. The growing predominance of foreign companies was even more visible in the case of their share in the industrial production value. It reached up to 80% in Slovakia in 2011. The share of foreign companies in the production and value added in sectors strongly included into GSC was even higher. Almost 100% of production volume and over 90% of the value added in the automotive sector in 2011 was generated by foreign companies, in particular, companies from Germany (they were responsible for over a half of production in the Czech Republic, Slovakia and Hungary).

Figure 2.23. Value added of foreign companies in manufacturing, in % of the total value added

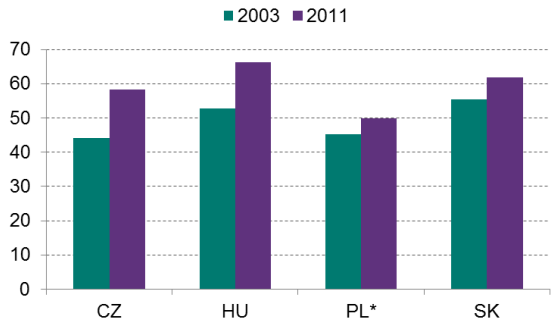
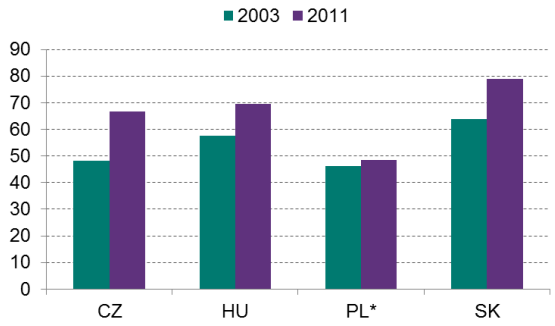


Figure 2.24. Production volume of foreign companies in manufacturing, in % of the total manufacturing production



* For Poland – a period from 2007 to 2011.
Sources: Eurostat, EI NBP calculations.

[48] Similar conclusions concerning the growing role of international companies and supply chains in the CEE economies arise from the analysis of foreign trade in those countries. See. *Analysis of economic situation in the countries of Central and Eastern Europe*, NBP, January 2014.

Impact of foreign companies on labour productivity

Foreign investment had an explicit impact on growth of labour productivity in the CEE countries, especially in manufacturing. In 2003-2011 labour productivity (value added per employee) increased by 56% in Hungary, by 64% in Slovakia and by 66% in the Czech Republic[49]. This growth resulted from several factors. First of all, in the analysed period, the presence of foreign enterprises, characterised by higher productivity, increased. In the CEE countries, labour productivity in foreign enterprises was, on average, twice higher than in domestic enterprises. However, this difference decreased in 2004-2011, since the labour productivity of domestic companies in manufacturing grew faster than in the foreign companies. At the same time, it may be argued that the impact of the presence of foreign companies on productivity in domestic companies is positive (*spillover effect*)[50]. It was particularly visible in Slovakia and Hungary, where the productivity of domestic companies in 2004-2011 increased by 84% and 60%, respectively, whereas in the case of foreign companies – it rose by 42% and 22%, respectively.

Figure 2.25. Labour productivity in manufacturing (value added per employee)

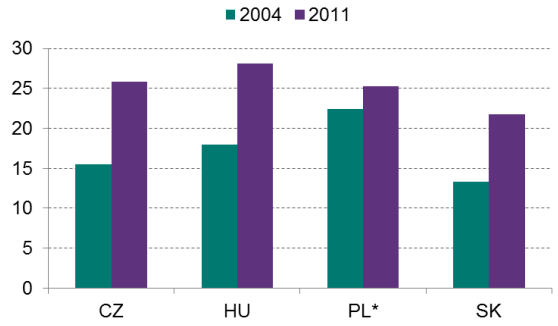
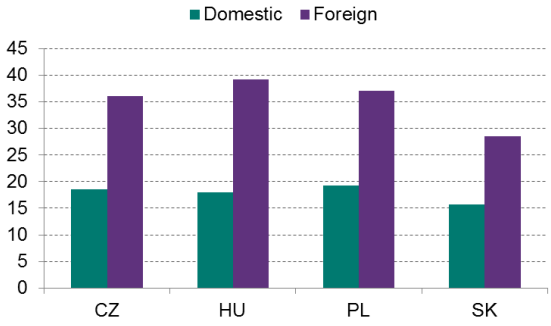


Figure 2.26. Labour productivity in manufacturing (value added per employee)



* For Poland – a period from 2007 to 2011.

Sources: Eurostat, EI NBP calculations.

The growth in labour productivity in the EU-15 countries was significantly lower than in the CEE countries. In Germany, it amounted to 6% in the analysed period. In France and the United Kingdom, productivity in industry in 2003-2011 even decreased. Irrespective of the aforementioned marked growth in productivity in the CEE manufacturing in the recent years, its level still remained definitely lower than in the EU-15 countries. In 2011, the average labour productivity in the CEE countries was over two-fold lower than in Germany, France or even Spain, but higher than in Portugal.

[49] In Poland, this growth amounted to 12.5% in 2007-2011.

[50] The empirical studies do not show the explicit assessment of spillover effects arising from foreign investment on productivity in domestic enterprises in the CEE countries. However, the majority of them, inter alia, Monastiriotis (2014), Kolasa (2007), Barrell and Holland (2000) indicate that such effects exist, in particular, vertical effects, i.e. growth of productivity in domestic companies incorporated into production chains with foreign companies.

The relatively low labour costs still make the CEE countries an attractive destination for investors

CEE countries still seem to be an attractive market for production expansion due to the still relatively low costs of labour. In 2013, labour costs in the CEE countries were still three-fold lower than in the EU average and four-fold lower than in Germany. Labour costs were also almost two-fold lower than in the peripheral countries of the euro area.

Considering the share of labour costs in the production value, the CEE countries are still more competitive as compared to other EU member states. Total labour costs in 2011 in the CEE countries constitute less than 50% of the value added, whereas in the EU-15 countries they were definitely higher (, approx. 70% of the value added in Germany and 75% in France). The share of costs associated with employment in the CEE countries was also definitely lower than in the peripheral countries of the euro area, where it exceeded 60% of the value added in industry.

The dominant role of foreign companies in exports

Foreign companies, irrespective of their relatively limited number, have a decisive impact on exports of the CEE countries[51]**.** The percentage of foreign companies in the total number of enterprises in 2011 ranged from 8% in Poland to 25% in Slovakia. However, taking into account the value of exports of domestic and foreign companies, these proportions are almost reversed. In Poland, over a half of total exports (56%) in 2011 was attributed to foreign companies. In Slovakia and Hungary, this percentage was even higher and exceeded ¾ of total exports in those countries[52].

Figure 2.27. Number of exporting foreign companies, in % of the total number of exporting companies, 2011

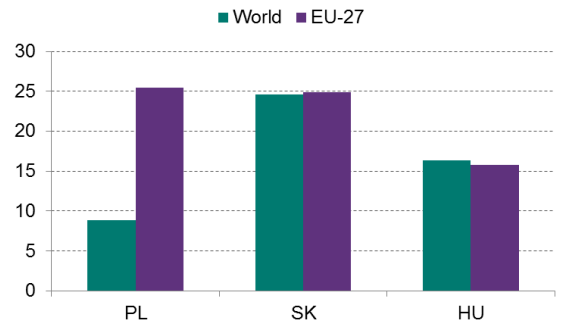
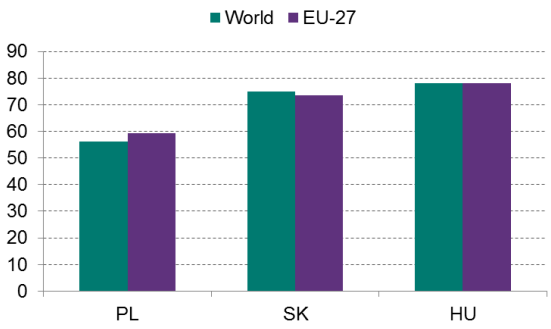


Figure 2.28. Value of exports of foreign companies, in % of total exports, 2011



Sources: Comext, EI NBP calculations.

[51] Comparable data for the Czech Republic are not available, therefore, in this part of the report only three CEE economies are described.

[52] The relatively lower share of foreign companies in Polish exports, as compared to other economies described, results from the higher involvement of small and medium-sized enterprises, mostly domestic, in trade with the countries of the former Soviet Union.

An even greater disproportion may be observed in the case of enterprises operating in industry, and manufacturing in particular, where the presence of foreign investors was most evident. Sectors integrated in GSC may serve as the best example, i.e. production of computers, optical and electronic equipment as well as the automotive sector. In the case of the aforementioned sectors, the value of exports of foreign companies exceeds 90% of the total export of enterprises. In Slovakia, this percentage amounted to over 97%.

Figure 2.29. Value of exports of foreign industrial companies, in % of total exports, 2011

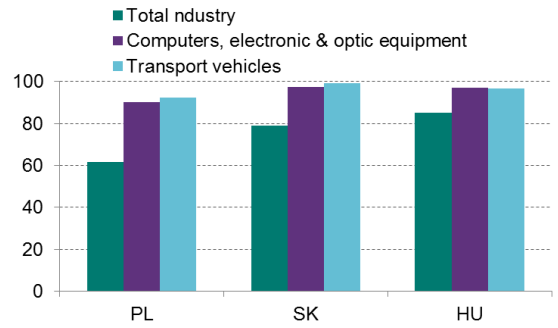
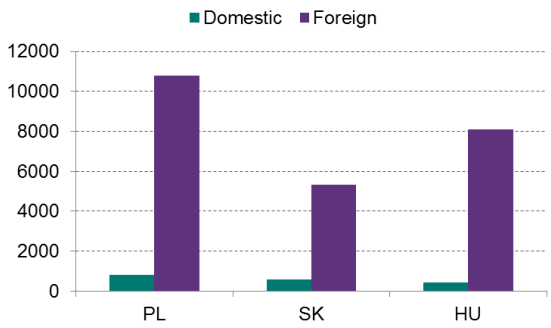


Figure 2.30. Average value of exports of a single company in EUR thousand, 2011



Sources: Comext, EI NBP calculations.

Foreign investors were present in the group of large exporting enterprises, whereas small and medium-sized enterprises mostly include enterprises with domestic capital. It is confirmed by the average value of exports of individual foreign enterprises, which was definitely higher than in the case of domestic companies. The average value of exports of a domestic CEE enterprise in 2011 amounted to approx. EUR 500 thousand, whereas the average value of sales of a foreign company ranged from over EUR 5 million in Slovakia to over EUR 10 million in Poland. The most significant differences were noticeable in the case of exports of electronic products and computers, where the average value of exports of a domestic company was even 100-fold smaller than of a foreign company.

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Statistical Annex

1. National accounts

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

	2012	2013	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	0.5	1.1	1.1	1.9	1.5	1.8	1.5
Croatia	-2.2	-0.9	-0.8	-0.9	-0.4	-1.0	-0.6
Czech Republic	-1.0	-0.9	-0.5	1.1	2.6	2.3	2.4
Estonia	4.7	1.6	0.5	1.5	0.4	2.4	2.3
Lithuania	3.8	3.3	2.9	3.1	3.4	3.3	2.6
Latvia	4.8	4.2	4.1	4.4	2.3	3.3	2.4
Poland	1.8	1.7	2.1	2.7	3.5	3.4	3.4
Romania	0.6	3.5	4.2	5.4	4.0	1.4	3.2
Slovakia	1.6	1.4	1.5	2.0	2.3	2.6	2.4
Slovenia	-2.6	-1.0	-0.8	1.9	1.9	2.8	3.1
Hungary	-1.5	1.5	2.2	3.5	3.5	3.6	3.1

Source: Eurostat, seasonally adjusted data, constant prices of 2010 (for the Czech Republic - fixed prices of 2005)*, for Romania and Slovakia - seasonal non-working days adjustment.

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

	2012	2013	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	3.8	-2.3	-2.2	-1.5	2.1	1.0	1.6
Croatia	-3.0	-1.3	-0.5	-1.4	-0.4	-1.0	-1.2
Czech Republic	-2.1	0.1	1.0	1.6	0.9	1.7	1.5
Estonia	5.1	3.8	2.6	3.2	3.7	3.5	5.0
Lithuania	3.6	4.2	6.1	6.3	6.0	5.6	3.8
Latvia	2.7	6.4	6.7	4.4	3.5	2.3	1.4
Poland	1.0	1.1	1.3	1.9	2.5	3.1	3.5
Romania	0.8	0.9	1.5	2.5	6.6	4.1	4.1
Slovakia	-0.5	-0.8	-0.9	-0.7	2.9	2.3	1.6
Slovenia	-2.9	-4.0	-4.1	-1.9	1.0	0.3	1.0
Hungary	-2.0	0.1	0.8	0.7	1.4	1.8	1.6

Source: Eurostat, seasonally adjusted data, constant prices of 2010 (for the Czech Republic - fixed prices of 2005)*, for Romania and Slovakia - seasonal non-working days adjustment.

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

	2012	2013	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	2.0	-0.1	2.1	4.2	4.8	5.1	1.8
Croatia	-3.3	-1.0	0.2	-3.0	-3.6	-5.2	-3.6
Czech Republic	-4.5	-3.5	-4.0	0.0	2.4	4.5	3.9
Estonia	10.4	2.5	5.1	1.3	10.5	0.0	-9.9
Lithuania	-1.6	7.0	10.0	12.3	12.3	9.6	5.5
Latvia	14.5	-5.2	-2.1	-3.4	9.3	1.3	-1.0
Poland	-1.5	0.9	2.4	4.6	9.5	9.2	9.9
Romania	1.9	-4.9	-1.9	-7.9	-8.1	-12.3	-1.9
Slovakia	-9.3	-2.7	-5.7	5.8	2.1	5.3	7.7
Slovenia	-8.9	1.9	1.2	7.5	4.4	6.8	7.2
Hungary	-4.2	5.2	8.1	12.9	16.9	16.1	14.9

Source: Eurostat, seasonally adjusted data, constant prices of 2010 (for the Czech Republic - fixed prices of 2005)*, for Romania and Slovakia - seasonal non-working days adjustment.

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

	2012	2013	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	0.8	9.2	11.5	10.5	2.1	3.0	-1.2
Croatia	-0.1	3.0	3.4	7.0	11.7	8.4	3.9
Czech Republic	4.5	0.2	0.6	5.6	11.3	8.6	6.1
Estonia	6.2	2.4	-0.8	-1.0	-0.8	0.3	5.0
Lithuania	12.2	9.4	7.3	3.4	1.5	4.3	4.2
Latvia	9.8	1.5	0.8	0.5	2.2	1.4	1.2
Poland	4.3	5.0	6.8	6.1	7.1	5.1	4.1
Romania	1.0	21.5	28.4	27.6	14.7	7.4	0.5
Slovakia	9.3	5.2	3.3	7.2	12.4	4.9	1.6
Slovenia	0.3	2.6	2.7	3.9	3.7	5.1	6.7
Hungary	-1.5	5.9	7.5	10.7	8.3	9.2	7.8

Source: Eurostat, seasonally adjusted data, constant prices of 2010 (for the Czech Republic - fixed prices of 2005)*, for Romania and Slovakia - seasonal non-working days adjustment.

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

	2012	2013	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	4.5	4.9	6.5	6.4	5.5	3.7	-0.9
Croatia	-3.0	3.2	5.3	6.2	7.8	1.9	3.3
Czech Republic	2.3	0.6	1.7	5.5	10.2	10.7	6.9
Estonia	11.8	3.3	2.6	-2.8	3.2	-1.9	2.2
Lithuania	6.6	9.0	7.5	6.4	1.2	7.8	3.8
Latvia	5.4	0.3	1.5	-0.8	0.1	2.0	-0.9
Poland	-0.6	1.8	4.1	5.5	6.9	8.7	7.8
Romania	-1.5	8.2	14.2	12.7	12.9	5.1	-0.2
Slovakia	2.6	3.8	1.4	8.4	12.9	6.7	1.7
Slovenia	-3.9	1.4	1.7	4.5	2.6	4.2	5.5
Hungary	-3.3	5.9	6.8	9.8	8.9	10.5	11.0

Source: Eurostat, seasonally adjusted data, constant prices of 2010 (for the Czech Republic - fixed prices of 2005)*, for Romania and Slovakia - seasonal non-working days adjustment.

2. Business cycle and economic activity indicators

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

	03.2014	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014
Bulgaria	3.6	3.7	5.0	0.9	-0.3	-2.0	0.0	0.4
Croatia	0.7	0.5	1.4	-1.7	1.4	-4.7	3.8	2.7
Czech Republic	7.0	8.3	4.6	5.7	5.7	-3.3	5.9	3.2
Estonia	-2.3	3.8	2.2	1.5	2.4	2.6	3.9	2.8
Lithuania	-10.1	0.2	10.7	3.4	2.8	-4.5	0.3	1.2
Latvia	-1.6	1.6	-0.2	-2.0	-1.5	-0.4	1.3	1.6
Poland	5.5	5.6	2.1	1.8	2.4	0.3	1.9	1.6
Romania	9.8	2.1	15.2	9.9	5.1	1.9	4.2	3.9
Slovakia	4.1	3.5	4.7	7.5	4.0	3.8	0.4	2.7
Slovenia	2.5	0.8	1.6	2.8	6.0	1.2	1.0	3.9
Hungary	8.1	9.7	10.3	11.4	12.2	2.9	5.1	1.7

Source: Eurostat, working days adjustment.

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

	03.2014	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014
Bulgaria	5.6	2.2	1.4	2.3	4.1	4.5	5.4	3.0
Croatia	1.0	-1.0	-3.5	-2.2	-3.1	-0.3	1.9	-
Czech Republic	3.0	3.0	1.1	4.1	1.2	2.7	1.8	4.8
Estonia	5.5	9.3	3.4	7.8	7.6	6.7	8.2	6.9
Lithuania	5.7	8.8	4.8	3.1	5.6	4.8	4.9	4.8
Latvia	4.0	10.4	2.3	2.5	3.7	3.4	3.1	4.7
Poland	1.9	2.2	-0.7	-0.1	0.2	1.1	-1.1	0.6
Romania	13.4	4.6	10.3	10.1	6.4	5.0	5.1	5.8
Slovakia	5.7	5.8	1.6	2.5	3.0	1.3	3.0	6.5
Slovenia	-0.2	2.3	-2.1	-2.7	2.8	0.7	4.1	-0.1
Hungary	8.3	6.6	4.8	4.2	2.5	2.5	4.5	5.2

Source: Eurostat, working days adjustment.

Table 8. Consumers' confidence indicator

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-30.5	-31.1	-36	-35.2	-36.9	-39.8	-42.5	-37
Croatia	-34.7	-36.2	-34.3	-37.5	-34.1	-34.6	-35.8	-35.9
Czech Republic	-2.6	-3.4	-1.6	-1.7	-5.0	-6.3	-0.8	0.3
Estonia	-2.7	-5.0	-3.7	-1.4	-4.0	-5.7	-2.7	-0.3
Lithuania	-11.5	-12.1	-11.5	-14.6	-21.1	-20.1	-17.0	-16.2
Latvia	-7.5	-8.0	-9.3	-6.1	-11.7	-13.2	-10.6	-8.3
Poland	-20.2	-15.9	-14.7	-19.3	-20.3	-20.5	-16.2	-14.9
Romania	-33.4	-34.1	-30.6	-27.6	-27.5	-29.4	-26.0	-20.9
Slovakia	-13.4	-12.3	-12.6	-12.2	-11.7	-15.5	-11.8	-11.5
Slovenia	-29.0	-23.4	-21.8	-16.8	-20.1	-12.9	-11.5	-18.6
Hungary	-15.1	-17.6	-18.3	-17.6	-21.2	-17.8	-17.0	-19.2

Source: European Commission

Table 9. Business confidence indicator

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-8.3	-2.2	-0.7	-1.9	-0.4	-2.5	-1.7	0.0
Croatia	-3.0	0.7	-1.9	-1.5	5.0	-0.5	-2.5	-2.0
Czech Republic	2.4	3.5	2.7	1.9	2.8	4.2	3.3	3.0
Estonia	-1.2	-2.0	-3.9	-2.0	-0.5	-3.2	-0.6	0.5
Lithuania	-4.9	-6.9	-9.0	-10.2	-8.0	-8.4	-3.4	-5.2
Latvia	-3.2	-5.5	-4.2	-3.5	-4.7	-4.7	-5.2	-4.2
Poland	-12.6	-12.7	-12.6	-11.5	-12.5	-13.5	-12.0	-11.9
Romania	-0.5	-1.0	-1.0	1.4	-0.1	-0.4	0.6	-0.1
Slovakia	2.1	1.1	-2.0	5.3	5.5	4.6	2.4	9.0
Slovenia	1.3	3.2	6.3	7.2	4.8	2.4	5.3	4.3
Hungary	8.7	6.4	3.3	0.7	1.6	2.5	7.9	8.3

Source: European Commission

Table 10. PMI manufacturing

	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014	12.2014
Czech Republic	57.3	54.7	56.5	54.3	55.6	54.4	55.6	53.3
Poland	50.8	50.3	49.4	49	49.5	51.2	53.2	52.8
Hungary	54.0	51.7	56.7	51.2	52.8	55.0	55.1	50.7

Source: Markit Economics

3. Prices

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

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-1.3	-1.8	-1.8	-1.1	-1.0	-1.4	-1.5	-1.9
Croatia	-0.1	0.4	0.5	0.5	0.3	0.2	0.5	0.3
Czech Republic	0.2	0.5	0.0	0.6	0.7	0.8	0.7	0.6
Estonia	0.8	0.6	0.4	0.0	-0.2	0.2	0.5	0.0
Lithuania	0.3	0.1	0.3	0.5	0.3	0.0	0.3	0.4
Latvia	0.8	0.8	0.8	0.6	0.8	1.2	0.7	0.9
Poland	0.3	0.3	0.3	0.0	-0.1	-0.2	-0.3	-0.3
Romania	1.6	1.3	0.9	1.5	1.3	1.8	1.8	1.5
Slovakia	-0.2	0.0	-0.1	-0.2	-0.2	-0.1	0.0	0.0
Slovenia	0.5	1.0	1.0	0.3	0.0	-0.1	0.1	0.1
Hungary	-0.2	0.0	-0.1	0.5	0.3	-0.5	-0.3	0.1

Source: Eurostat

Table 12. HICP – food (including alcohol and tobacco) (in %, y/y)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-0.5	-1.3	-1.4	0.0	0.2	0.2	-0.1	0.1
Croatia	-0.1	-1.3	-1.6	-1.6	-1.9	-1.4	-1.1	-0.4
Czech Republic	2.9	2.7	0.5	1.7	1.8	2.5	2.4	1.7
Estonia	2.1	0.6	1.1	-0.5	-0.1	0.9	1.2	0.6
Lithuania	1.9	1.4	1.3	1.8	1.7	1.8	1.6	1.6
Latvia	0.8	-0.1	-0.2	-0.3	0.5	0.7	0.1	1.2
Poland	1.4	0.7	0.6	0.0	-0.4	-0.4	-0.5	-0.7
Romania	-0.7	-1.6	-1.5	-0.1	-0.3	1.2	1.2	1.0
Slovakia	-0.1	0.2	-0.9	-1.0	-1.0	-1.0	-0.8	-0.5
Slovenia	0.6	0.7	0.9	0.1	-0.1	0.8	0.7	0.8
Hungary	1.5	1.4	1.0	1.6	1.5	0.9	0.8	0.3

Source: Eurostat

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

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-3.4	-3.9	-4.1	-2.0	-2.2	-2.9	-0.8	-3.7
Croatia	0.2	3.5	2.8	3.3	1.0	-0.1	2.5	-0.4
Czech Republic	-5.5	-3.6	-3.7	-2.5	-2.7	-2.7	-2.3	-2.7
Estonia	-4.7	-2.3	-4.8	-2.2	-4.6	-5.0	-4.0	-3.7
Lithuania	-2.9	-3.4	-2.8	-3.3	-4.4	-6.1	-4.8	-4.9
Latvia	-1.8	-1.0	-0.9	-0.4	-1.5	-1.6	-1.0	-2.4
Poland	-1.5	-0.1	-0.5	-0.1	-0.4	-1.4	-1.2	-1.7
Romania	4.5	5.1	4.4	3.4	2.9	3.0	2.7	1.3
Slovakia	-2.3	-1.7	-1.6	-1.7	-2.1	-1.8	-1.6	-1.7
Slovenia	-1.6	1.1	1.2	0.1	-2.0	-2.7	-0.9	-0.7
Hungary	-7.3	-6.0	-5.9	-5.5	-6.8	-8.1	-7.2	-3.8

Source: Eurostat

Table 14. HICP – excluding energy, food, alcohol and tobacco (in %, y/y)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-1.2	-1.5	-1.4	-1.5	-1.3	-1.9	-2.4	-2.5
Croatia	-0.1	0.5	0.9	0.9	1.3	1.2	0.8	0.9
Czech Republic	0.3	0.4	0.7	0.7	0.9	0.9	0.7	0.8
Estonia	1.6	1.4	1.3	0.9	1.0	1.3	1.3	0.7
Lithuania	0.4	0.3	0.5	0.7	0.8	0.7	0.9	1.0
Latvia	1.6	1.8	1.8	1.5	1.7	2.3	1.6	1.7
Poland	0.3	0.3	0.4	0.0	0.1	0.1	0.0	0.2
Romania	2.7	2.7	2.0	2.2	2.2	2.0	1.9	2.0
Slovakia	0.3	0.3	0.6	0.6	0.7	0.7	0.7	0.7
Slovenia	1.0	1.0	1.0	0.4	0.5	0.2	0.0	0.0
Hungary	1.1	1.1	1.0	1.7	1.8	1.1	1.3	1.2

Source: Eurostat

Table 15. PPI (in %, y/y)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	-0.9	-0.6	-0.5	-0.6	-1.0	-0.6	0.8	0.3
Croatia	-3.0	-2.4	-2.8	-2.4	-3.2	-3.1	-2.1	-2.2
Czech Republic	-0.4	-0.1	-0.2	-0.1	0.0	-0.4	-0.4	-1.7
Estonia	-4.6	0.5	-6.6	0.1	-2.1	-2.0	-3.6	-3.0
Lithuania	-3.4	-4.5	-4.5	-5.1	-5.1	-5.5	-5.6	-6.6
Latvia	0.1	-0.8	0.1	0.2	0.3	0.1	-0.1	-0.3
Poland	-0.5	-0.8	-1.1	-1.4	-1.1	-1.4	-1.5	-1.9
Romania	1.0	0.9	0.6	0.2	0.7	0.4	0.5	0.5
Slovakia	-4.6	-3.7	-3.4	-2.9	-3.8	-3.9	-4.0	-3.0
Slovenia	-1.5	-1.5	-1.2	-1.0	-1.2	-1.1	-1.0	-0.9
Hungary	-1.9	-2.4	-2.3	-2.4	-2.9	-2.3	-1.7	-

Source: Eurostat

4. Balance of payments

Table 16. Current account balance (in % of GDP, 4-quarter moving average)

	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Bulgaria	3.4	3.4	2.1	2.5	2.4	2.8	2.9	2.2
Croatia	-0.7	-0.1	0.5	0.6	1.1	0.8	0.5	0.2
Czech Republic	-1.0	-1.6	-1.9	-2.1	-1.8	-1.4	0.2	-0.2
Estonia	-0.5	-1.8	-1.4	-0.5	-1.3	-1.1	-1.4	-1.8
Lithuania	4.2	4.2	2.6	3.0	2.8	3.2	3.3	2.5
Latvia	-3.5	-3.3	-2.9	-2.1	-2.4	-2.3	-2.5	-3.0
Poland	-4.3	-3.5	-2.9	-2.4	-1.8	-1.3	-1.1	-1.2
Romania	-4.5	-4.4	-3.6	-1.9	-1.1	-0.9	-1.1	-1.5
Slovakia	1.0	2.2	2.4	2.9	2.7	2.4	2.5	1.8
Slovenia	1.5	2.8	4.2	5.2	5.8	5.8	5.4	5.2
Hungary	1.8	1.9	2.8	3.0	3.5	4.1	4.3	4.3

Source: Eurostat, European Commission, calculations of IE NBP

Table 17. Foreign direct investment balance (in % of GDP, 4-quarter moving average)

	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Bulgaria	3.4	3.4	3.2	2.5	2.0	1.7	2.4	3.8
Croatia	2.2	2.7	3.5	3.0	2.4	2.0	1.0	1.8
Czech Republic	3.2	3.0	3.3	2.3	1.5	1.4	1.5	2.8
Estonia	2.8	2.5	2.0	-0.1	0.5	2.2	2.0	1.9
Lithuania	1.0	0.7	0.6	1.6	1.1	0.9	0.3	0.8
Latvia	3.1	3.2	2.5	2.6	1.8	1.6	1.1	1.1
Poland	1.5	1.3	1.7	1.6	1.6	0.7	1.2	0.7
Romania	2.0	1.7	1.8	2.2	1.2	2.2	2.1	1.9
Slovakia	2.4	2.1	0.9	0.1	0.5	0.5	0.5	0.8
Slovenia	1.3	0.5	-0.2	-2.3	-2.3	-1.7	-1.2	1.8
Hungary	2.2	2.0	2.0	1.5	0.1	0.4	0.4	-0.7

Source: Eurostat, central banks, calculations of EI NBP

Table 18. Official reserve assets to foreign debt ratio* (in %, end of quarter)

	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	41.3	41.2	38.3	38.8	39.9	37.9	38.5	40.4
Croatia	24.9	25.0	25.1	26.2	26.1	26.1	26.8	-
Czech Republic	41.0	43.8	44.7	42.4	44.4	42.6	43.0	43.2
Estonia	1.4	1.4	1.5	1.2	1.3	1.5	1.7	2.0
Lithuania	24.9	26.2	22.5	23.3	25.2	22.4	25.0	25.5
Latvia	17.8	18.9	18.6	18.5	18.7	8.5	8.0	7.8
Poland	29.7	30.3	29.7	28.1	27.8	26.9	26.1	27.5
Romania	37.0	35.5	36.2	35.7	37.0	36.9	37.1	-
Slovakia	3.9	3.5	3.3	3.0	2.6	2.0	1.9	1.9
Slovenia	1.9	1.8	1.6	1.6	1.8	2.5	2.6	2.6
Hungary	26.7	27.1	28.6	27.7	26.3	30.1	29.2	29.9

*Official reserve assets according to central banks statements

Source: Eurostat, central banks, calculations of EI NBP

5. Financial markets and financial system

Table 19. Central banks' policy rates (end of period)

	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014	12.2014
Croatia	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Czech Republic	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Poland	2.50	2.50	2.50	2.50	2.50	2.00	2.00	2.00
Romania	3.50	3.50	3.50	3.25	3.25	3.00	2.75	2.75
Hungary	2.50	2.40	2.30	2.10	2.10	2.10	2.10	2.10

Source: Central banks, EcoWin Financial

Table 20. 3m interbank rates (average)

	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014	12.2014
Bulgaria	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Croatia	0.6	0.6	0.6	0.6	0.8	0.9	0.9	0.9
Czech Republic	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Estonia	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Lithuania	0.4	0.4	0.4	0.4	0.3	0.2	0.2	0.2
Latvia	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Poland	2.7	2.7	2.7	2.7	2.6	2.4	2.1	2.0
Romania	3.0	2.9	2.5	2.2	2.2	2.8	2.7	1.8
Slovakia	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Slovenia	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Hungary	2.7	2.5	2.4	2.3	2.1	2.1	2.1	2.1

Source: EcoWin Financial

Table 21. Exchange rates vis-à-vis EUR (average)

	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014	12.2014
Croatia	7.62	7.59	7.58	7.61	7.63	7.62	7.66	7.67
Czech Republic	27.43	27.43	27.43	27.45	27.80	27.57	27.57	27.65
Poland	4.18	4.18	4.13	4.14	4.19	4.19	4.20	4.21
Romania	4.46	4.42	4.39	4.41	4.42	4.41	4.41	4.43
Hungary	306.95	304.23	305.85	309.68	313.64	313.06	307.43	306.64

Source: Eurostat

Table 22. NEER (in %, y/y – growth means appreciation)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	4.0	3.5	2.0	1.9	1.1	0.3	0.0	-0.1
Croatia	2.2	1.9	0.1	-0.2	-0.7	-0.4	-1.1	-1.2
Czech Republic	-3.3	-3.4	-5.1	-4.6	-7.0	-7.0	-8.0	-3.5
Estonia	4.0	3.3	1.9	2.0	1.3	0.9	0.7	1.3
Lithuania	3.6	3.0	1.4	1.4	1.0	0.7	0.7	1.3
Latvia	3.1	2.4	1.2	1.3	1.0	0.7	0.9	1.5
Poland	1.7	2.6	5.1	4.5	1.4	1.0	-1.1	-1.1
Romania	1.2	0.8	3.8	1.7	1.1	1.2	0.6	-0.1
Slovakia	2.8	2.5	1.2	1.2	0.7	0.2	-0.1	-0.2
Slovenia	2.4	2.0	1.1	1.0	0.5	0.0	-0.3	-0.2
Hungary	0.1	-1.6	-2.2	-3.8	-4.3	-4.6	-5.1	-3.7

Source: BIS, EI NBP calculations

Table 23. REER (in %, y/y – growth means appreciation)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	0.5	-0.3	-1.6	-0.7	-1.0	-1.9	-1.9	-2.1
Croatia	0.6	0.5	-1.4	-1.4	-2.1	-1.5	-1.6	-1.6
Czech Republic	-4.4	-4.3	-6.3	-5.2	-7.5	-7.2	-8.2	-3.8
Estonia	2.5	1.8	-0.1	0.0	-1.0	-1.1	-0.9	-0.8
Lithuania	2.2	1.4	0.1	0.3	-0.2	-0.7	-0.5	0.3
Latvia	2.4	1.6	0.6	0.7	0.6	0.7	0.3	1.1
Poland	0.9	1.7	4.2	3.2	0.1	-0.3	-2.6	-2.5
Romania	1.0	0.3	3.0	1.3	0.7	1.7	0.9	0.3
Slovakia	1.3	1.1	-0.1	-0.2	-0.6	-0.9	-1.2	-1.1
Slovenia	1.4	1.4	0.6	-0.2	-0.9	-1.3	-1.5	-1.5
Hungary	-1.4	-3.1	-3.7	-4.9	-5.3	-6.1	-6.5	-5.3

Source: BIS, EI NBP calculations

Table 24. Loans to private sector (in %, y/y)

	04.2014	05.2014	06.2014	07.2014	08.2014	09.2014	10.2014	11.2014
Bulgaria	1.6	1.8	2.1	1.8	1.9	2.0	1.9	-7.5
Croatia	-1.9	-1.1	-0.6	-0.3	-0.9	-1.5	-0.5	-0.7
Czech Republic	3.3	3.8	3.7	3.8	3.2	3.1	3.7	2.5
Estonia	1.4	2.2	2.5	3.1	3.3	2.8	3.3	3.1
Lithuania	-2.8	-0.4	-0.2	-0.6	-0.4	0.0	-0.4	-1.5
Latvia	-9.4	-9.8	-8.6	-8.7	-8.4	-7.4	-7.3	-7.4
Poland	6.0	5.3	5.1	5.6	6.2	6.5	6.9	6.1
Romania	-1.2	-2.4	-4.3	-3.8	-4.2	-4.9	-3.6	-3.1
Slovakia	6.4	6.4	6.2	7.5	8.0	7.4	7.6	8.4
Slovenia	-17.4	-17.4	-18.2	-18.1	-18.5	-18.6	-20.8	-20.8
Hungary	-4.8	-4.3	-2.5	-3.2	-2.6	-3.9	-3.1	-3.9

Source: Central banks

6. Labour market

Table 25. Employment (in %, y/y)

	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Bulgaria	-0.6	-0.7	0.0	0.8	-0.4	-1.0	1.0	1.0
Croatia	-0.8	-5.2	-0.8	-0.6	0.1	0.5	1.9	1.6
Czech Republic	0.5	0.6	0.8	1.0	0.4	0.7	0.7	0.2
Estonia	1.1	1.7	1.1	2.5	-0.1	0.4	-0.8	-1.1
Lithuania	3.0	0.9	1.6	1.5	1.2	2.1	1.9	1.0
Latvia	2.2	1.8	3.4	2.5	0.9	0.3	0.3	0.1
Poland	0.2	0.1	-3.8	-1.7	-0.7	-1.9	0.5	1.7
Romania	2.4	1.9	-0.1	0.1	0.0	0.0	-6.8	-7.4
Slovakia	0.5	-0.1	0.2	-0.2	-0.4	0.5	0.1	1.1
Slovenia	-2.0	-1.2	-2.9	-2.6	-1.8	-0.7	-0.6	0.6
Hungary	2.1	1.5	0.8	1.5	1.4	2.8	7.0	4.9

Source: Eurostat

Figure 26. Unemployment rate (in %, of labour force)

	03.2014	04.2014	05.2014	06.2014	072014	08.2014	09.2014	10.2014
Bulgaria	13.0	11.5	11.5	11.4	11.3	11.2	11.2	11.1
Croatia	17.2	16.8	16.8	16.6	16.5	16.4	16.1	16.0
Czech Republic	6.6	6.1	6.1	6.0	5.8	6.3	5.7	5.7
Estonia	7.7	7.5	7.5	7.4	7.6	7.7	7.5	-
Lithuania	11.9	11.4	11.4	11.4	10.3	9.8	9.7	9.9
Latvia	11.5	10.8	10.8	10.8	10.8	10.8	10.8	-
Poland	9.8	9.2	9.2	9.0	8.8	8.6	8.5	8.3
Romania	7.2	6.9	6.9	7.0	6.8	6.8	6.7	6.7
Slovakia	14.0	13.4	13.4	13.3	13.2	13.2	13.0	12.9
Slovenia	9.6	9.5	9.5	9.3	9.1	9.1	9.0	8.8
Hungary	7.8	8.1	8.1	8.1	7.7	7.5	7.3	-

Source: Eurostat

Table 27. Nominal wages (in %, y/y)

	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Bulgaria	3.6	9.2	8.7	7.2	8.7	2.9	3.1	2.6
Croatia	1.8	1.7	-0.4	0.3	-0.2	-1.3	0.4	-
Czech Republic	2.1	-0.5	1.2	1.4	-1.7	3.3	2.3	1.8
Estonia	4.1	8.0	8.6	8.0	7.6	7.6	7.4	6.3
Lithuania	2.7	6.2	5.3	6.5	5.1	3.6	5.2	3.3
Latvia	3.0	4.9	4.7	6.4	6.7	7.8	7.3	6.4
Poland	3.4	3.4	2.2	3.0	4.9	5.1	5.0	3.9
Romania	7.0	8.1	6.0	4.2	3.2	5.3	5.0	5.2
Slovakia	2.1	4.7	3.0	1.6	0.8	3.5	6.0	5.6
Slovenia	3.9	-3.8	-5.9	-0.5	2.2	2.9	2.5	2.0
Hungary	4.9	5.4	3.7	3.0	4.6	3.0	4.9	3.6

Source: Eurostat

Table 28. ULC (in %, y/y)

	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Bulgaria	2.9	1.0	8.8	9.0	5.7	6.3	2.6	2.5
Croatia	3.5	4.1	1.9	-0.4	0.8	0.9	1.2	2.5
Czech Republic	3.1	5.1	2.7	3.9	2.8	-2.1	1.2	-0.2
Estonia	4.0	4.5	5.0	9.6	5.9	6.4	6.4	3.3
Lithuania	-0.1	0.6	2.4	2.1	5.1	5.4	6.5	5.0
Latvia	1.7	-0.9	2.8	3.2	3.2	1.7	1.5	1.7
Poland	-3.7	-3.2	-7.9	-8.7	-3.1	-2.2	-0.1	0.9
Romania	11.2	9.2	5.6	4.4	-0.1	-1.8	-5.3	-4.3
Slovakia	1.2	2.2	4.4	2.1	0.3	-0.2	1.4	4.6
Slovenia	4.5	3.5	3.6	1.2	2.0	2.2	2.9	3.7
Hungary	9.3	8.9	6.7	4.7	2.6	4.5	6.7	6.1

Source: Eurostat, EI NBP calculations

7. Public finance

Table 29. General government balance (ESA2010) (in %, of GDP)

	2010	2011	2012	2013	2014p	2015p	2016p
Bulgaria	-3.2	-2.0	-0.5	-1.2	-3.6	-3.7	-3.8
Croatia	-6.0	-7.7	-5.6	-5.2	-5.6	-5.5	-5.6
Czech Republic	-4.4	-2.9	-4.0	-1.3	-1.4	-2.1	-1.7
Estonia	0.2	1.0	-0.3	-0.5	-0.4	-0.6	-0.5
Lithuania	-6.9	-9.0	-3.2	-2.6	-1.1	-1.2	-0.6
Latvia	-8.2	-3.4	-0.8	-0.9	-1.1	-1.2	-0.9
Poland	-7.6	-4.9	-3.7	-4.0	-3.4	-2.9	-2.8
Romania	-6.6	-5.5	-3.0	-2.2	-2.1	-2.8	-2.5
Slovakia	-7.5	-4.1	-4.2	-2.6	-3.0	-2.6	-2.3
Slovenia	-5.7	-6.2	-3.7	-14.6	-4.4	-2.9	-2.7
Hungary	-4.5	-5.5	-2.3	-2.4	-2.9	-2.8	-2.5

p – European Commission forecasts of November 2014

Source: Eurostat, European Commission

Table 30. Gross public debt (ESA2010) (in %, of GDP)

	2010	2011	2012	2013	2014p	2015p	2016p
Bulgaria	15.9	15.7	18.0	18.3	25.3	26.8	30.2
Croatia	52.8	59.9	64.4	75.7	81.7	84.9	89.0
Czech Republic	38.2	41.0	45.5	45.7	44.4	44.7	45.2
Estonia	6.5	6.0	9.7	10.1	9.9	9.6	9.5
Lithuania	36.3	37.3	39.9	39.0	41.3	41.6	41.3
Latvia	46.8	42.7	40.9	38.2	40.3	36.3	35.1
Poland	53.6	54.8	54.4	55.7	49.1	50.2	50.1
Romania	29.9	34.2	37.3	37.9	39.4	40.4	41.1
Slovakia	41.1	43.5	52.1	54.6	54.1	54.9	54.7
Slovenia	37.9	46.2	53.4	70.4	82.2	82.9	80.6
Hungary	80.9	81.0	78.5	77.3	76.9	76.4	75.2

p – European Commission forecasts of November 2014

Source: Eurostat, European Commission

Table 31. Current deadline for excessive deficit correction (EDP)

	Year
Bulgaria	-
Czech Republic	-
Croatia	2016
Estonia	-
Lithuania	-
Latvia	-
Poland	2015
Romania	-
Slovakia	-
Slovenia	2015
Hungary	-

Source: European Commission

8. Forecasts

Table 32. Forecasts regarding economic growth rate (in %, y/y)

	2013	European Commission			IMF			Domestic sources		
		2014	2015	2016	2014	2015	2016	2014	2015	2016
Bulgaria	1.1	1.2	0.6	1.0	1.4	2.0	2.5	-	-	-
Croatia	-0.9	-0.7	0.2	1.1	-0.8	0.5	1.4	-0.5	0.7	-
Czech Republic	-0.7	2.5	2.7	2.7	2.5	2.5	2.4	2.5	2.5	2.8
Estonia	1.6	1.9	2.0	2.7	1.3	2.5	3.5	1.9	2.1	3.3
Lithuania	3.2	2.7	3.1	3.4	3.0	3.3	3.7	2.9	3.1	-
Latvia	4.2	2.6	2.9	3.6	2.7	3.2	3.4	2.8	2.7	-
Poland	1.7	3.0	2.8	3.3	3.2	3.3	3.5	3.2	3.0	3.3
Romania	3.5	2.0	2.4	2.8	2.4	2.5	2.8	2.6	2.5	3.0
Slovakia	1.4	2.4	2.5	3.3	2.4	2.7	2.9	2.3	2.6	3.3
Slovenia	-1.0	2.4	1.7	2.5	1.4	1.4	1.5	1.6	1.3	1.8
Hungary	1.5	3.2	2.5	2.0	2.8	2.3	1.8	3.3	2.3	2.1

Table 33. Inflation forecasts (in %, y/y)

	2013	European Commission			IMF			Domestic sources		
		2014	2015	2016	2014	2015	2016	2014	2015	2016
Bulgaria	0.4	-1.4	0.4	1.0	-1.2	0.7	1.8	-	-	-
Croatia	2.3	0.2	0.6	1.1	-0.3	0.2	1.0	0.3	1.6	-
Czech Republic	1.4	0.5	1.4	1.8	0.6	1.9	2.0	0.4	1.2	2.2
Estonia	3.2	0.7	1.6	2.2	0.8	1.5	2.1	0.6	1.1	2.4
Lithuania	1.2	0.3	1.3	1.9	0.3	1.3	2.0	0.3	0.9	-
Latvia	0.0	0.8	1.8	2.5	0.7	1.6	1.9	0.7	1.4	-
Poland	0.8	0.2	1.1	1.9	0.1	0.8	2.0	0.1	1.1	1.6
Romania	4.0	1.5	2.1	2.7	1.5	2.9	2.9	1.2	2.2	3.0
Slovakia	1.5	-0.1	0.7	1.4	0.1	1.3	1.5	-0.1	0.5	1.8
Slovenia	1.9	0.4	1.0	1.5	0.5	1.0	1.7	0.5	0.7	1.2
Hungary	1.7	0.1	2.5	3.0	0.3	2.3	3.0	-0.2	0.9	2.9

Table 34. Forecasts of current account balance (in %, of GDP)

	2013	European Commission			IMF			Domestic sources		
		2014	2015	2016	2014	2015	2016	2014	2015	2016
Bulgaria	2.2	2.1	2.3	1.9	-0.2	-2.3	-2.9	-	-	-
Croatia	0.4	0.3	1.6	1.8	2.2	2.2	1.8	1.4	1.1	-
Czech Republic	-1.4	-1.3	-0.9	-0.4	-0.2	-0.3	-0.4	0.0	0.0	0.2
Estonia	-1.4	-2.8	-3.1	-3.7	-2.2	-2.4	-2.5	-0.3	-0.7	-1.1
Lithuania	1.6	0.8	-0.4	-1.4	0.9	0.1	-0.4	0.7	0.2	-
Latvia	-2.2	-2.2	-2.3	-2.8	-0.1	-1.5	-1.8	-	-	-
Poland	-1.4	-2.0	-2.4	-2.8	-1.5	-2.1	-2.5	1.4	0.6	-0.9
Romania	-0.8	-1.2	-1.4	-1.5	-1.2	-1.8	-2.2	-1.0	-1.4	-1.5
Slovakia	0.9	0.5	0.2	0.3	1.9	2.2	2.4	0.6	0.6	0.7
Slovenia	5.8	6.2	6.1	5.9	5.9	5.8	5.5	5.2	4.8	4.6
Hungary	4.1	4.3	4.3	4.3	2.5	2.0	1.2	4.2	5.1	6.0

* - balance on current and capital account

Sources for tables 32-34: European Commission (11.2014), IMF (10.2014), Narodowy Bank Polski (11.2014), Ceska Narodni Banka (11.2014), Narodna Banka Slovenska (11.2014), Magyar Nemzeti Bank (12.2014), Comisia Naţională de Prognoză (11.2014), Banka Slovenije (10.2014), EestiPank (12.2014), Latvijas Banka (12.2014), Lietuvos Bankas (12.2014), Ekonomski Institut, Zagreb (06.2014).

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