NBP

National Bank of Poland

Economic Institute
Bureau of World Economy and European Economic Integration

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

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General information on CEE countries

	Area (km²)	Population		GDP (EUR bn)	GDP per capita (EUR)	
		in thousand of inhabitants	inhabitants per 1 km²		current prices	PPP adjusted [a]
Bulgaria	110 879	7 607	69	34 118	4 500[a]	10 100
Czech Republic	78 867	10 468	133	147 879	13 100	20 100
Estonia	45 227	1 340	30	16 073	10 200	17 100
Lithuania	65 300	3 350	51	32 203	8 000	15 300
Latvia	64 559	2 261	35	23 160	8 200	14 000
Poland	312 685	38 136	122	362 415	9 500[a]	14 400
Romania	238 391	21 499	90	137 035	6 400[a]	11 500
Slovakia	49 035	5 412	110	64 778	11 700	18 000
Slovenia	20 273	2 032	100	37 135	17 100	22 700
Hungary	93 028	10 031	108	105 536	9 300	15 700

[a] 2008, remaining 2009
source: Eurostat

Gross domestic product growth rate (in %)

	2009			2010	2009			2010
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	q/q				y/y			
Bulgaria[b]	14.5	15.9	-4.4	-24.0	-4.9	-5.4	-5.9	-3.6
Czech Republic	-0.5	0.5	0.5	0.5	-5.0	-5.0	-2.9	1.1
Estonia	-2.1	-0.2	2.4	-2.0	-16.1	-15.6	-9.5	-2.0
Lithuania	-1.0	1.0	1.3	-3.9	-19.5	-14.2	-12.1	-2.8
Latvia	-0.1	-3.8	-1.5	0.3	-18.1	-19.1	-16.8	-6.0
Poland	0.6	0.6	1.1	0.5	1.2	1.2	3.5	2.9
Romania	-1.5	0.1	-1.5	-0.3	-8.7	-7.1	-6.5	-2.6
Slovakia	0.8	1.2	1.7	0.8	-5.5	-4.9	-2.6	4.8
Slovenia	-0.1	0.1	-0.3	-0.5	-9.2	-8.3	-5.5	-1.2
Hungary	-1.4	-0.6	0.2	0.9	-7.5	-7.1	-4.0	0.1

q/q – seasonally adjusted, y/y – non-seasonally adjusted
[b] – q/q – non-seasonally adjusted
source: Eurostat

EXECUTIVE SUMMARY

In 2009, Central and Eastern Europe (CEE) was one of the world's economic regions most severely affected by the crisis. The recession hit the CEE economies mainly as a result of the decline in global demand (as reflected in a dramatic decrease in the global trade), a strong reduction in bank lending and the decline in foreign capital inflows. In consequence, domestic demand in the CEE region decreased by 7.4% in 2009 (in EU-15 it decreased by 3.9%).

The largest economic decline was observed in 2009 Q1. At that time, GDP in the region fell by 2.8% as compared with 2008 Q4 (and excluding Poland – by 5.4%). However, in 2009 Q2 the scale of GDP decline was visibly reduced quarterly basis. Starting from 2009 Q3 some CEE economies noted a regular quarterly GDP growth. This was driven mainly by an increased demand from EU-15 countries, i.e. the main trading partners in the region countries.

The decline in the region's domestic demand was caused by a severe tightening in banks' lending policy, which resulted in a strong reduction in bank credit to private sector. Its growth rate, which amounted to more than 30% y/y in 2008, fell at the end of 2009 to 0%. In the case of the Baltic states, the Czech Republic and Hungary, it was even negative. The decrease in the new credit value deepened in 2010 Q1. The banks reduced to the largest extent their corporate and consumer lending, whereas housing loans suffered less.

In all countries of the region the number of the unemployed rose considerably. The average unemployment rate in the region increased from 6.5% in mid-2008 to more than 12% in March 2010. The strongest growth in the unemployment rate was observed in the Baltic states (especially in Latvia, where the unemployment rate reached the level of 22.5%) and in Slovakia.

The annual HICP growth rate in the Central and Eastern Europe countries, which was rising at the end of 2009 as a result of higher energy prices, slowed down in the first months of 2010. A decrease in headline inflation in January and February was primarily caused by the fading of the base effect related to an increase in regulated prices in early 2009 and still low inflationary pressure resulting from weak consumption in the region. At the same time, a rapid fall in core inflation was observed in the entire region.

The year 2009 in the CEE countries was marked by narrowing current account deficits, and in the case of certain countries – by large surpluses. An improvement of external imbalances was observed worldwide; however, in the case of the CEE region countries this was a markedly faster and larger-scale process. At the end of 2009, the current account deficit in the region amounted to 1.5% of GDP as compared with almost 8% of GDP at the end of 2008.

The economic crisis contributed to a considerable increase in the fiscal imbalances in Central and Eastern Europe. All countries, excluding Estonia, noted a significant growth in the general government deficit, mostly driven by the erosion of tax revenues being the consequence of a decrease in GDP growth rate. Facing unfavourable trends in the general government sector, some countries were forced to take decisive consolidation measures already in 2009. These measures have been continued by a number of countries in 2010, both as part of the EU-IMF aid programmes and in the context of obligations imposed by the excessive deficit procedure. However, in 2010 the general government deficit in all countries, excluding Estonia, will remain above the reference rate of 3% of GDP, stipulated in the Maastricht Treaty.

According to the European Commission spring forecast, the gross domestic product in the CEE countries in 2010 will grow by 1.6% as compared with the previous year's decrease by 3.4%. The improving foreign trade balance will be the main growth driver. Inventories are also expected to rise. On the contrary, household expenditure is anticipated to decline, albeit on a much smaller scale than that observed in 2009. According to the European Commission, in 2010 the household consumption in the region will go down by 0.1% (and excluding Poland – by 1.4%). Only an slight growth in fixed capital formation is expected – by 1.1% (excluding Poland – a decrease in investments by 0.2%). In 2010, the decrease in GDP is predicted only for Latvia and Lithuania. The highest economic growth rate is expected in Poland and Slovakia.

The strenghtening of upwards trends is expected in 2011 (GDP growth is to go up to 3.1%). Then, private consumption will again become the main factor stimulating economic growth (basically as a result of the improving developments on the labour market). In response to the growth in consumption and external demand, a higher level of fixed capital formation is also expected. Despite the expected recovery, the economic growth will be much lower compared with the pre-crisis period. In 2011, GDP growth is expected in all countries of the region. According to the European Commission's forecasts, the highest rate of economic growth will be noted in Estonia and Slovakia.

COUNTRIES OF CENTRAL AND EASTERN EUROPE

Economic growth

In 2009, Central and Eastern Europe (CEE) was one of the world's economic regions most severely affected by the crisis. The recession hit the CEE economies mainly as a result of the decline in global demand (as reflected in a dramatic decrease in the global trade), a strong reduction in bank lending and the decline in foreign capital inflows. In consequence, domestic demand in the CEE region decreased by 7.4% in 2009 (in EU-15 it decreased by 3.9%).

The trends observed in particular countries of the region were similar, although their scale varied considerably. The scale of the impact of the global recession on the economies in the CEE region was primarily determined by such factors as the openness of the economies or the share of debt financing of private consumption and business activity. Owing to a relatively smaller importance of those factors in the Polish economy, Poland as the only CEE country continued to note a positive economic growth in 2009 (in 2009 GDP in Poland rose by 1.7%). In other countries of the region GDP contraction was noted, by 7.1% on average. The smallest GDP contraction was observed in the Czech Republic (by 4.1%) and Slovakia (by 4.7%), being countries with relatively stable growth foundations. In other countries, especially in the Baltic states where the strongest decline was noted (15.6%, of which in Latvia by 18.0%), the crisis coincided with the previously noted deepening of domestic problems.

The largest economic decline was observed in 2009 Q1. At that time, GDP in the region fell by 2.8% as compared with 2008 Q4 (and excluding Poland – by 5.4%). However, in 2009 Q2 the scale of GDP decline was visibly reduced quarterly basis. Starting from 2009 Q3 some CEE economies noted a regular quarterly GDP growth. This was driven mainly by an increased demand from EU-15 countries, i.e. the main trading partners in the region countries.

Table 1.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**4.1**	**-3.4**	**-4.0**	**-1.6**	**1.1**
Private consumption	4.7	-3.5	-4.1	-3.2	-0.4
Public consumption	4.6	1.3	-0.1	1.6	1.5
Fixed capital formation	6.2	-11.7	-14.2	-10.9	-11.4
Exports	6.8	-10.3	-9.2	0.7	12.3
Imports	6.8	-16.3	-15.5	-6.9	9.8

source: Eurostat

The most important factor behind GDP contraction in the region was the decrease in domestic demand. It concerned both consumption and fixed capital formation. In 2009, private consumption decreased in all countries of the region, except for Poland. The decrease was relatively small in the Czech Republic and Slovakia (below 1%). On the other hand, in those countries where the increase in private consumption in the previous years was the driving force of economic growth (Baltic states, Romania), the scale of the decrease in 2009 was much deeper. The decreasing private consumption was in the majority of countries partly offset by increased general government expenditure, except for the Baltic states and Hungary, where the fiscal policy was tightened.

Fixed capital formation in the region decreased to a greater extent than private consumption. Downward trends in fixed capital formation were noted in all countries – on average by nearly 12%. It was relatively small in the case of Poland and Hungary (by 0.8% and 6.5% y/y, respectively). In other countries of the region, a two-digit decrease in fixed capital formation was observed, and a decrease greater than 35% y/y in the Baltic states.

The decline in the region's domestic demand was caused by a severe tightening in banks' lending policy, which resulted in a strong reduction in bank credit to private sector. Its growth rate, which amounted to more than 30% y/y in 2008, fell at the end of 2009 to 0%. In the case of the Baltic states, the Czech Republic and Hungary, it was even negative. The decrease in the new credit value deepened in 2010 Q1. The banks reduced to the largest extent their corporate and consumer lending, whereas housing loans suffered less.

The deepening recession in the global economy in early 2009 adversely affected the foreign trade. On the one hand, the weakening external demand resulted in weaker exports which used to play an important pro-growth role for the region's economies, and, on the other hand, the declining domestic demand in the CEE countries led to the decrease in imports. The scale of decrease in exports was relatively similar in all the countries while in imports they varied. The largest decreases in imports were noted in countries which suffered from the most severe economic slump, i.e. in the Baltic states, where imports fell by over 30% y/y. In 2009, exports from the CEE countries fell by 10%, and import by 16%. Since the decrease in imports was greater than that of exports, contribution of foreign trade balance to the GDP growth rose considerably in the countries of the region. It was a key factor mitigating the decreases in domestic demand.

In the second half of last year, exports were the driving force behind growth in most economies of the region. The export growth in quarter-on-quarter terms, which has been observed already since 2009 Q3, was mostly determined by the larger demand in the old EU countries. It resulted, on the one hand, from bigger consumer demand prompted by the fiscal stimulation programmes in numerous EU-15

Member States (especially as a result of the car scrapping subsidies), and on the other hand, from growing demand of the export sector in the Western Europe (in response to a growing demand in non-European countries – primarily in the developing countries in Asia). The exports recovery was followed by the stabilisation in imports.

In 2010 Q1, GDP in the region in year-on-year terms rose for the first time in more than a year (1.1%). Apart from Poland, economic growth was also noted by Slovakia, the Czech Republic and Hungary. The growth was partly caused by the statistical base effect as in 2009 Q1 the economies of the CEE countries already suffered a deep crisis. However, growing external demand contributed to the strengthening of the growth trends in exports. In some countries, the GDP growth was positively affected by a change in the inventory cycle. The exceptionally severe winter further reduced fixed capital formation, whereas the deteriorating situation on the labour market was the main factor sustaining the downward trend in private consumption.

After a period of strong downward trends in the first half of 2009, the value of industrial output in the CEE countries started to recover in the subsequent months. Output growth was also observed in the first months of 2010. In Q1 a decline in output in year-on-year terms was noted only in Bulgaria and Lithuania. On the other hand the Poland and Slovakia recorded already two-digit growth rates. In Poland, Slovakia and Romania the value of industrial output was already close to the figure observed in the record year 2008. Output growth in the region was mostly driven by growing external demand, since the industry recovery was accompanied by an increase in exports. Higher industrial output coincided with a rise in business sentiment indicators, which have been growing steadily in the region since 2009 Q2.

The weakness of private consumption in the CEE countries in early 2010 manifested itself in low retail sales. During the first 4 months of 2010 downward trends in retail trade turnover were noted in most countries. The sales rose slightly only in the Baltic states (a very low base resulting from approx. 30% decline in 2009) and in Poland. Despite the diminishing retail sales in the countries of the region in the second half of 2009, the consumer sentiment indices were rising considerably in the whole region. In 2010 the situation changed. The consumer sentiment indices continuted on the rise in the Baltic states, Poland and Slovakia, while in other countries of the region the growth stopped.

Labour market

The biggest economic crisis in the CEE countries since the transformation led to a considerable deterioration on the labour markets. In all countries of the region the number of the unemployed rose considerably. The average unemployment rate in the region increased from 6.5% in mid-2008 to more than 12% in March 2010. The strongest growth in the unemployment rate was observed in the Baltic states (especially in Latvia, where the unemployment rate reached the level of 22.5%) and in Slovakia.

Employment in the region was also going down. In 2009, the number of the employed in all countries of the region decreased on average by 1.6%. Poland was the only country where an upward trend in employment continued in 2009 (although the growth rate decelerated strongly; from 3.7% in 2008 to 0.4% in 2009). The other nine countries noted a decline in employment (on average by 2.8%). The number of jobs decreased the least in Romania, the Czech Republic and Slovenia (in the last country it was the effect of anti-crisis measures) and the most – in Latvia, Lithuania and Estonia.

Employment fell to the largest extent in the construction and manufacturing sectors. In services the employment level remained relatively stable, while in certain countries the number of jobs in services was even slightly up. In the case of countries which were forced to tighten their fiscal policy (Latvia, Lithuania), employment also strongly fell in the public sector.

Inflation and labour costs

The annual HICP growth rate in the Central and Eastern Europe countries, which was rising at the end of 2009 as a result of higher energy prices, slowed down in the first months of 2010. A decrease in headline inflation in January and February was primarily caused by the fading of the base effect related to an increase in regulated prices in early 2009 and still low inflationary pressure resulting from weak consumption in the region.

In the floating exchange rate regime countries, especially in Poland, Romania and Hungary, where inflation in 2009 and first months of 2010 was undoubtedly the highest in the region, the downward trend continued early in this year. It was caused in the first place by the appreciation of national currencies which followed the previously observed strong depreciation. The appreciation mitigated the impact of growing energy commodities prices on inflation. In other countries of the region (fixed exchange rate regime or the euro area members), an increase in inflation was observed during the period of March–April 2010, despite persistently low inflationary pressure. It stemmed primarily from an increase in energy prices, mostly fuels, triggered by growing prices of energy commodities (especially expressed in euro). At the same time, a rapid decline in core inflation was observed in the whole region.

Deteriorating situation on the labour markets in the CEE region affected also the wages growth rate in 2009. In 2008, nominal wages in the region rose on average by 12%, while in 2009 they fell by 1.3%. In Poland, the Czech Republic, Slovakia, Bulgaria and Romania, wage growth rate remained positive. In other countries, an average nominal wage went down in 2009. Especially harsh declines were noted in the Baltic states. The wages is Lithuania and Latvia fell last year by 10%.

Declining employment and smaller wages contributed to a fall in unit labour costs. A considerable GDP contraction had an opposite effect, yet it did not manage to fully offset the deteriorating situation on the labour market. It was visible in particular in the case of the Baltic states. Those countries succeeded in making their economies more competitive by reducing labour costs, which lessened the pressure on devaluation of their currencies.

Balance of payments

The year 2009 in the CEE countries was marked by narrowing current account deficits, and in the case of certain countries – by large surpluses. An improvement of external imbalances was observed worldwide; however, in the case of the CEE region countries this was a markedly faster and larger-scale process. At the end of 2009, the current account deficit in the region amounted to 1.5% of GDP as compared with almost 8% of GDP at the end of 2008.

The largest decline took place in countries which noted the highest deficit in the previous years, i.e. in the Baltic states, Bulgaria and Romania. However, incomplete preliminary data for 2010 Q1 indicate that the downward trend slowed down. The deficit was still narrowing in Poland, Slovenia and Slovakia, however in the case of Lithuania or Romania, a considerable deficit growth was observed as a result of growing imports.

An improvement in the current account balance was primarily triggered by the narrowing foreign trade deficit. In 2008 in the region it amounted to 6% of GDP, and in 2009 it fell to 0.4% of GDP. Weakening imports reflecting a low domestic demand were the main driving force behind it. The income account deficit also narrowed slightly (smaller profits from foreign investments), and the surplus in the current transfers account increased. On the other hand, the balance of services deteriorated slightly.

Significant changes were also noted in the financial account. In 2009, the inflow of foreign investments went down in the whole region. The biggest decline was noted in the Baltic states, and a relatively small decline in Poland and the Czech Republic, which was mostly connected with a smaller scale of reinvested profits. The balance of other investments also deteriorated. Declining foreign trade and, first of all, the banking system crisis resulted in stopping the inflow of foreign credit to the CEE countries, which was the main growth engine for a domestic demand in the region in the previous years.

Smaller risk aversion in the second half of 2009 translated into a very large inflow of portfolio investments to the countries of the region. In the case of Poland, the Czech Republic and Slovenia, such amounts had not been observed at least since the year 2005. The expanding debt crisis in the euro area generated a considerable investors' aversion to the region and such a large inflow of portfolio investments should not be expected in the remaining period of 2010.

Exchange rates and interest rates

The sovereign debt crisis in the euro area peripheral countries led in mid-April 2010 to the weakening of the floating CEE currencies (Poland, the Czech Republic, Hungary, Romania), ending the period of their appreciation lasting from February 2009. From that time until early June 2010, the Polish zloty weakened against the euro by 7%, the Hungarian forint by 8%, the Czech koruna by 4%, and the Romanian leu by 2%. In addition, inopportune comments made by Hungarian politicians, who compared their country to Greece, triggered another, fortunately short-lived, wave of investors' aversion to the region's countries..

The monetary policy in 2010 remained loose. None of the central banks in the region raised interest rates. On the contrary, the central banks in the Czech Republic, Hungary and Romania continued to cut interest rates. The scale of those reductions in 2010 amounted to 25 basis points (to 0.75% - the lowest level in the history), 100 basis points and 175 basis points, respectively. Only in Poland the interest rates did not change over the first five months of 2010.

Fiscal policy

The economic crisis contributed to a considerable deepening of the fiscal imbalance in Central and Eastern Europe. In 2009, the general government deficit exceeded the reference rate of 3% of GDP in all countries of the region, except for Estonia, despite the measures taken by numerous countries. Estonia, owing to introduction of the consolidation package in 2009, which accounted for approx. 9.0% of GDP, reduced the general government deficit in relation to GDP from 2.7% in 2008 to 1.7% in 2009, despite a considerable contraction of the gross domestic product (by 14.6% y/y). The aim of the ambitious consolidation package was to comply with the fiscal criterion stipulated by the Maastricht Treaty and to adopt the common currency in the year 2011. The highest level of the general government deficit in relation to GDP was noted in 2009 in Latvia (9.0%), Lithuania (8.9% of GDP) and Romania (8.3%), primarily as a result of a rapid economic decline in those countries. In 2010, the general government situation in most countries of Central and Eastern Europe is to remain difficult, therefore it will be necessary to continue the consolidation efforts. Slovakia and Poland are the least advanced in this regard as compared with other Central and Eastern Europe countries. Thus, in their case it will be required to present detailed plans of consolidation measures. The public debt in most countries of the region is growing due to the economic crisis, however it remains at a much lower level than that recorded in Western Europe. It needs to be noted that developing countries are less resistant to debt (especially foreign one) than developed countries (Reinhart et al., 2003, Reinhart and Rogoff, 2010).[1] Furthermore, developing countries are generally more exposed to sharp changes in the investors' sentiment, thus to capital outflow when risk aversion is growing, which may cause problems with market funding. In this context, reliable consolidation efforts in Central and Eastern Europe countries are indispensable since they allow for mitigating risks for general government.

Forecasts

Growing demand in Western Europe, stimulated, on the one hand, by governments' programmes (especially new car subsidies), and, on the other hand, by an increasing number of export orders, improved the economic situation in the CEE countries in the second half of 2009. An expected faster recovery of the global economy was also reflected in improved economic growth prospects in the region's countries. In May 2010, the European Commission revised upwards the economic growth forecasts for all the countries of the region (except for Slovenia).

According to the European Commission spring forecast, the gross domestic product in the CEE countries in 2010 will grow by 1.6% in year-on-year terms, as compared with the increase by 3.4% in 2009. The improving foreign trade balance will be the main growth driver. Inventories are also expected to increase. A decrease in household expenditure is predicted, however on a much smaller scale than that observed in 2009. According to the European Commission, in 2010 the private consumption will go down in the region by 0.1% (excluding Poland – by 1.4%). Only a slight growth in fixed capital formation is expected – by 1.1% (excluding Poland – a decrease in investments by 0.2%). In 2010, the decrease in GDP is forecasted only for Latvia and Lithuania. The highest economic growth rate is expected in Poland and Slovakia.

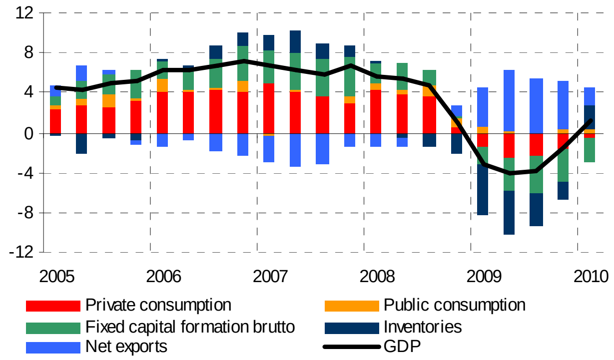
Upwards tendencies are expected to strengthen in 2011 (GDP growth is to go up to 3.1%). Then, private consumption will again become the main factor stimulating the economic growth (basically as a result of the improving developments on the labour market). In response to the growth in consumption and external demand, a higher level of fixed capital formation is also expected. Despite the anticipated recovery, the economic growth will be much lower as compared with the pre-crisis period. In 2011, GDP growth is expected in all countries of the region. According to the Commission's forecasts, the highest rate of economic growth is to be noted by Estonia and Slovakia.

Better economic growth forecasts also contributed to improving inflation forecasts in the region. The European Commission slightly revised downwards the predicted HICP level in 2010 only in the case of the Czech Republic and Slovakia. Inflation in 2010 is supposed to remain at low levels and in most countries it should not exceed 2.5% (only in Hungary and Romania it may be higher than 4%).

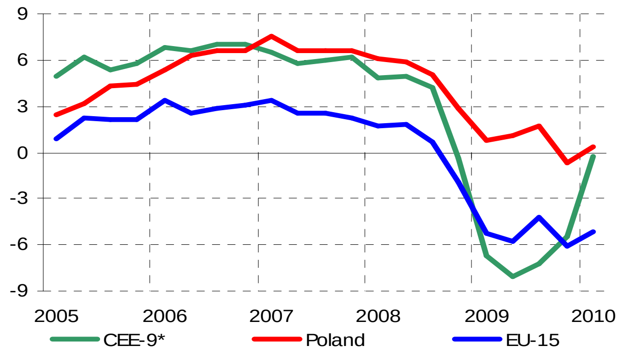
After the period of narrowing current account deficits in 2009 (and even a surplus generated in the Baltic states), forecasts for 2010 indicate that the deficit will also remain at a relatively low level in 2010. However, the forecasts vary across countries. The deficit is expected to go up in Poland, Slovenia and Hungary, whereas in other countries it will go down or the current account surplus will prevail.

[1] C. M. Reinhart, K. S. Rogoff, M. A. Savastano (2003) *Debt intolerance,* NBER, Working Paper 9908; C. M. Reinhart, K. S. Rogoff (2010), *Growth in a Time of Debt*, NBER, Working Paper 15639.

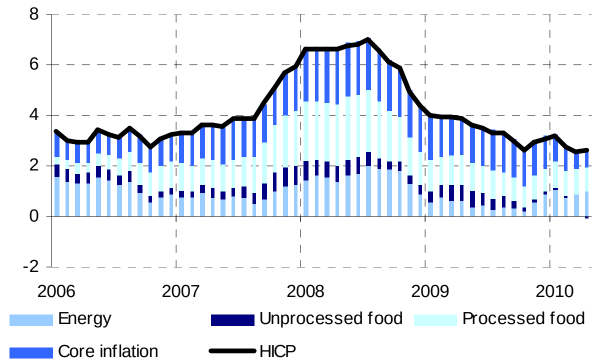
Contribution to GDP growth (in pp, y/y)



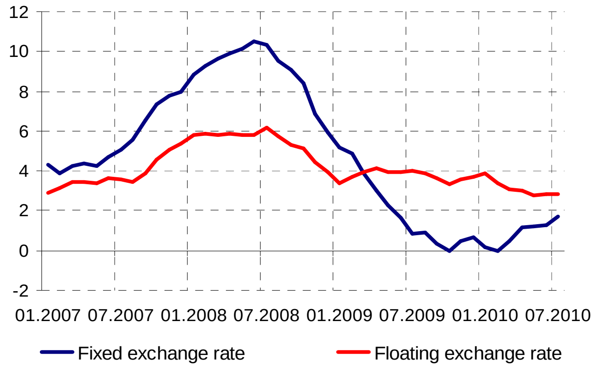
GDP growth rates (in %, y/y)



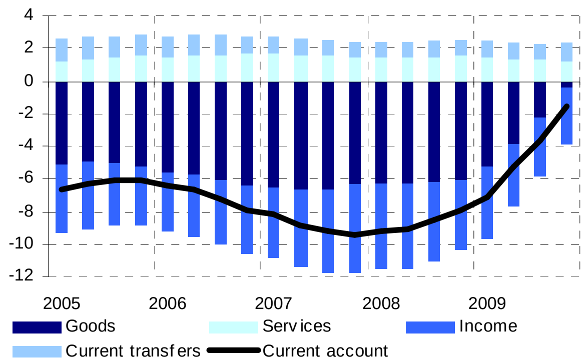
HICP and its components (in %, y/y)



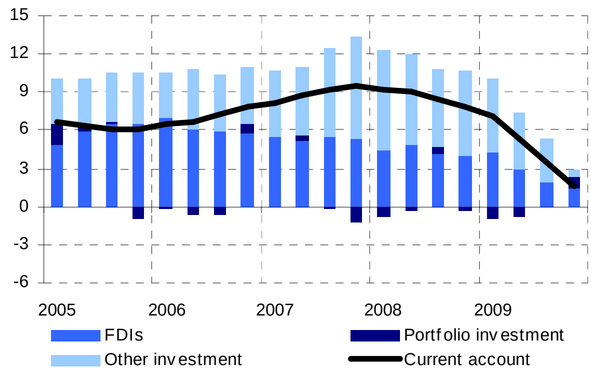
HICP (in %, y/y)



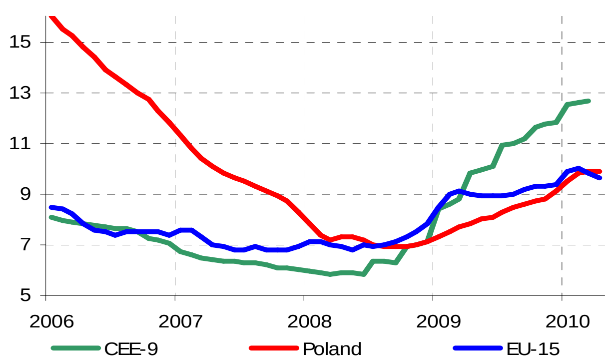
Current account balance and its components (in % of GDP, 4q moving average)



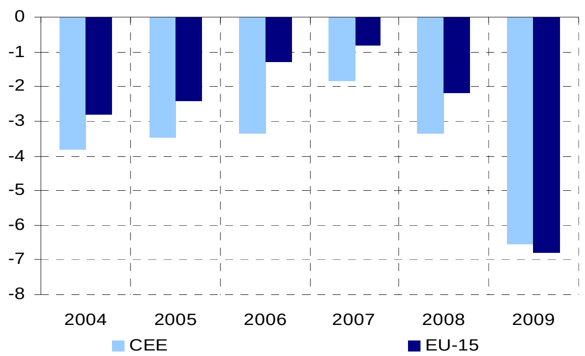
Financial account balance and its components (in % of GDP, 4q moving average)



Unemployment rate (%)



General government deficit (in % of GDP)



Source: Eurostat, CSOs

BULGARIA

Economic growth

In 2009, the gross domestic product in Bulgaria fell by 5.0% compared to the previous year, which resulted primarily from a decline in domestic demand. Fixed capital formation went down by 26.9%, and private consumption by 6.3%. At the same time, a stronger decline in domestic demand than that in external demand considerably reduced the trade deficit. In consequence, net exports eased up the scale of GDP contraction. In subsequent quarters of 2009, the decline in domestic demand deepened, mostly in respect of fixed capital formation. Thus, as opposed to other countries of the region, the strongest GDP contraction took place in 2009 Q4, which resulted from the delayed reaction of the labour market and fiscal austerity measures. In this context, an slight reduction of the scale of declines in investment and private consumption in 2010 Q1 was to a large extent an effect of a low base. However, the increase in exports (in year-on-year terms) was additionally driven by rising external demand.

Table 2.1

GDP and its components – growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**6.0**	**-5.0**	**-5.4**	**-5.9**	**-3.6**
Private consumption	4.9	-6.3	-5.3	-8.0	-7.3
Public consumption	0.1	-5.5	1.0	-18.8	7.3
Fixed capital formation	20.3	-26.9	-36.5	-35.4	-14.9
Exports	2.9	-9.8	-6.7	0.8	5.9
Imports	4.9	-22.3	-23.4	-20.0	-2.6

source: Eurostat

In 2009, fixed capital formation, which, apart from private consumption, was the main driving force for economic growth in Bulgaria in the past few years fell by more than 1/4. Such an large decline in investments was caused by a number of factors such as a decline in internal and external demand, limited lending, a smaller inflow of foreign investments and uncertainties as to future economic developments. Declines in fixed capital formation were observed in most sectors. In subsequent quarters of 2009 the downward investment trend deepened, and in 2009 Q4 investment fell by 35.4% y/y. The factors which triggered the decline in investment also led to a strong adjustment in inventories.

Apart from fixed capital formation, domestic demand decreased as a result of a strong decline in private consumption, mostly in respect of durable goods. However, expenditure food, medicines and housing expenditure did not show any downward trends. The main determinants of falling consumption included primarily the deteriorating situation on the labour market, tightening of the credit policy by banks and a limited fiscal stimulation. However, those factors were partly compensated by a continuing growth in wages. Therefore, gross disposable income decreased last year by only 1.1% (compared with an average decrease of 8.9% in the whole CEE region). One may suspect that the reduced consumption was also of a prudential nature. It is illustrated by the growing rate of savings.[2] Similarly to investments, the largest decline in private consumption took place in 2009 Q4 (8.0% y/y).

The decline in domestic demand translated directly into a very strong fall in imports (22.3%), which proved much deeper than that of exports (9.8%). The main factor which contributed to the smaller scale of the export decline was its increase in 2008 Q4 (of 0.8% y/y). The deeper decline in imports was mainly an effect of a substantial fall in the import of capital goods and fuels.

In 2009, the expected deterioration of the households' financial situation was also reflected in the consumer sentiment index. Despite some fluctuations, it remains close to its historically low level reached early last year. Unfavourable assessments, especially of the financial situation of households, contributed to a strong decline in retail sales.

The falling domestic demand combined with a decline in external demand drawn down the industrial output which started to fall in the second half of 2008. Such tendency was continued in the first months of 2010. Apart from a decline in foreign demand, it was triggered by a collapse in the construction sector, which generated large demand for intermediate goods in the previous years. Both external and internal negative factors which affected the industrial output also resulted in a decline in annualised business sentiment index. On the other hand, the prospects for the global economic recovery positively affected the business sentiment indices and early in 2010 the index have climbed up.

Labour market

Last year the labour market played a dominant role in modelling the expectations and consumer behaviour of households. Weakening labour demand was reflected in a negative employment growth rate, which systematically decreased, reaching -4% y/y in the second half of 2009. The negative employment growth rate resulted in a rise in the unemployment rate from 6.7% in 2009 Q1 to 10.1 in 2010 Q1.

Inflation and labour costs

Considerable declines in commodity prices on the international markets and in food prices due to abundant harvests were the main determinants of inflation in Bulgaria in 2009. It fell from 12.0% in 2008 to 2.5% in

[2] According to the National Bank of Bulgaria, the savings rate rose from approx. 7% in 2008 to approx. 12% in 2009.

2009. This downward inflation trend reversed early in this year. The harmonised index of consumer prices rose from 1.8% in January 2010 to 3.0% in April 2010, which was connected with growing fuel prices on global markets, an increase in excise for tobacco products and a sustained upward trend of unit labour costs. The increase in ULC has its source in a decline in employment, delayed by more than two quarters in relation to the economic activity.

Table 2.2

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**3.6**	**1.6**	**0.9**	**2.0**	**3.0**
Contribution to HICP growth rate (in pp)					
Transport	-1.0	-1.5	-0.3	1.0	1.4
Alcoholic beverages and tobacco products	0.9	0.8	0.7	0.8	1.3
Other	0.4	0.4	0.4	0.3	0.6
Recreation and culture	0.4	0.3	0.2	0.2	0.3
Health	0.1	0.2	0.3	0.2	0.2

source: Eurostat

Balance of payments

In 2009, the current account deficit considerably narrowed (from 24% in 2008 Q4 to 9.4% of GDP in 2009 Q4). It was mainly caused by a narrowing foreign trade deficit, which was determined by a very strong plunge in imports resulting from limited production, investment activity and weak consumer demand in Bulgaria. However, changes in the balance of other categories (narrowing of the income account deficit and an increase in the current transfers surplus) did not influence the changes in the current account balance in any significant way.

Table 2.3

Balance of payments, balance (in % of GDP, 4-quarter moving average)

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-22.4**	**-19.0**	**-15.4**	**-9.4**	**-6.6**
Goods	-23.2	-19.5	-16.3	-12.1	-10.6
Services	4.3	4.2	4.2	4.6	4.7
Income	-5.9	-5.8	-5.5	-4.7	-4.1
Current transfers	2.4	2.1	2.2	2.7	3.3
Capital account	**0.8**	**1.1**	**1.2**	**1.4**	**0.9**
Financial account	**27.4**	**21.7**	**16.0**	**8.3**	**5.8**
FDIs	18.3	14.4	10.8	9.8	7.0
Portfolio investments	-3.6	-3.2	-2.2	-1.8	-0.5
Other investments	11.4	6.1	-1.7	-1.6	-1.8

source: Eurostat

In 2009, the inflow of foreign capital to Bulgaria considerably decreased in year-on-year terms (in 2009 Q4 the financial account balance amounted to 8.3% of GDP as compared to 31.4% in 2008 Q4). This was mainly the result of a decline in the inflow of direct investments and other investment. The smaller inflow of direct investments resulted primarily from decreasing investments in the services connected with the real estate market and in the manufacturing sector. A decline in inflow of other investments resulted from a strong decline in domestic lending, observed since the second half of 2008.

Fiscal policy

The contraction of Bulgaria's GDP in 2009 of 5.0% y/y was to a large extent conducive to a considerable fiscal deterioration. As a result of diminishing tax revenue and growing expenditure, in 2009 the general government sector recorded a deficit of 3.9% of GDP as compared to a surplus of 1.8% of GDP in 2008. Since the reference level of the general government deficit was exceeded last year, the European Commission issued a recommendation to the Council of the European Union in May 2010 stating that Bulgaria should be subject to the excessive deficit procedure. Furthermore, the scale of the deficit revision in relation to GDP for 2009 (2.0 percentage points) gave rise to the Commission's concerns. In consequence, the quality of statistical data provided by Bulgaria is to be verified by Eurostat.

In the first months of 2010, a downward trend in tax revenues continued, especially as regards indirect taxes. In consequence, in June 2010 the government of Bulgaria presented an amended draft of the budget act with the general government deficit in the current year at the level of 3.8% of GDP, compared to a balanced budget assumed in the latest revision to the Convergence Programme. The change resulted from adopting a lower income forecast while at the same time increasing the limits for some expenditure categories (including health care, agriculture, social benefits). The draft amendment also includes anti-crisis and consolidation efforts, presented by the government late in March (including imposing taxes on real estate, high-value motor vehicles and gambling, sales of carbon emission rights, reducing subsidies for political parties by 15% and cutting other expenditure).

According to the European Commission spring 2010 forecast, the general government deficit in Bulgaria was supposed to reach the level of 2.8% of GDP in 2010, however, in view of the planned budget amendment this estimate seems no longer valid. Compared to 2008, the public debt of Bulgaria in the time horizon of EC forecasts is expected to grow slightly (by approx. 4.7 percentage points) to the level of 18.8% of GDP in 2011. It needs to be emphasised that the public debt in Bulgaria is one of the lowest in the entire European Union.

Forecasts

The economic recovery is expected in Bulgaria only in 2011. Although exports are expected to increase in 2010 (with a continuing decline in imports this will result in maintaining a positive contribution of net exports to the GDP growth rate), yet the decline in domestic demand will be among the deepest ones in the region. In particular, a relatively deep investment drop is expected.

Diminished economic activity is also supposed to result from continuing reduction in inventory levels.

Positive GDP growth will be probably achieved only in the final quarters of 2010. However, the expected economic growth in 2011 will be among the lowest ones in the Central and Eastern Europe. Main growth-stimulating factors will include household spending, which will be triggered by the expected improvement of the labour market situation and an easier access to bank credit. Stronger consumer demand and higher exports will stimulate enterprises to increase their investment.

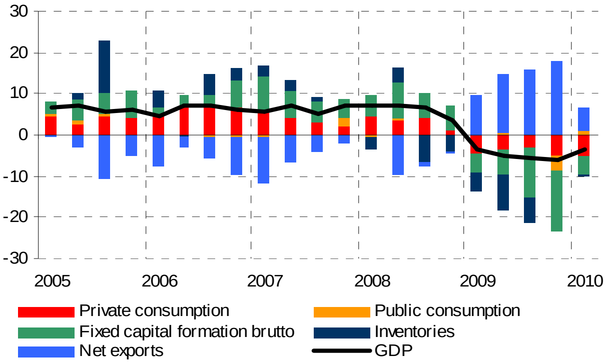
Compared with the pre-crisis period, the consumption growth rate and the entire domestic demand will remain at relatively low levels even in 2011, which will be reflected in a low inflation level.

Table 2.4

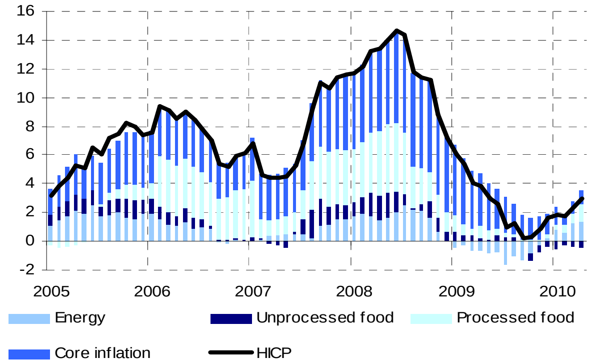
Forecasts of main macroeconomic indicators

	EC	IMF	Consensus Economics
	05.2010 (10.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y			
2010	0.0 (-1.1)	0.2 (-2.5)	-0.1 (-0.1)
2011	2.7 (3.1)	2.0 (2.0)	2.5
Inflation, in %, y/y			
2010	2.3 (2.3)	2.2 (1.6)	2.6 (2.7)
2011	2.7 (2.9)	2.9 (1.9)	3.0
Current account balance, in % of GDP			
2010	-6.0 (-9.8)	-6.3 (-8.3)	
2011	-5.2 (-7.9)	-5.8 (-6.6)	

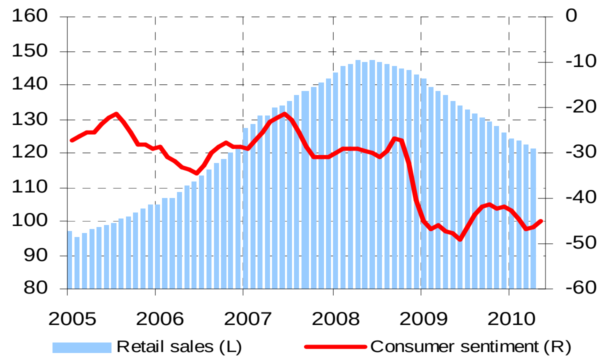
Contribution to GDP growth (in pp, y/y)



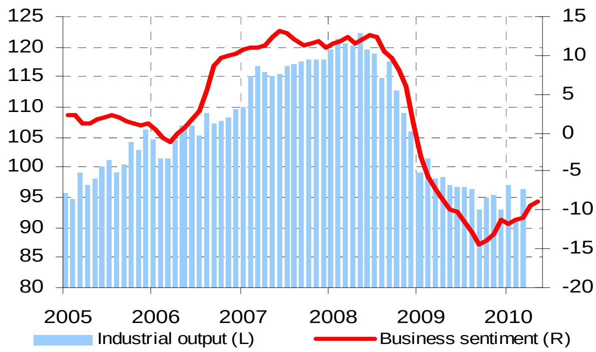
HICP and its components (in %, y/y)



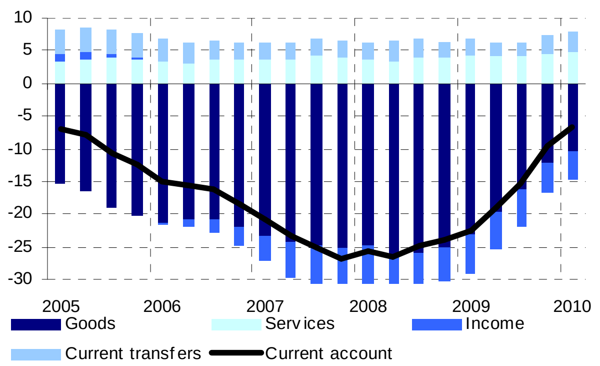
Retail sales (in %, y/y) and consumer sentiment index



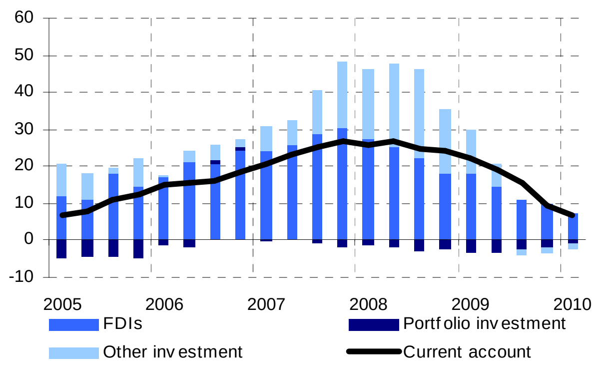
Industrial production (in %, y/y) and business sentiment index



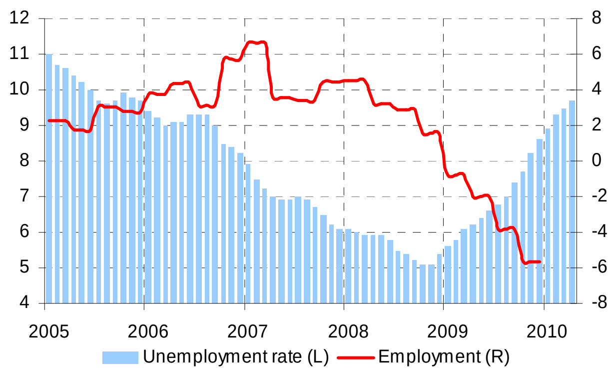
Current account and its components (in % of GDP, 4-quarter moving average)



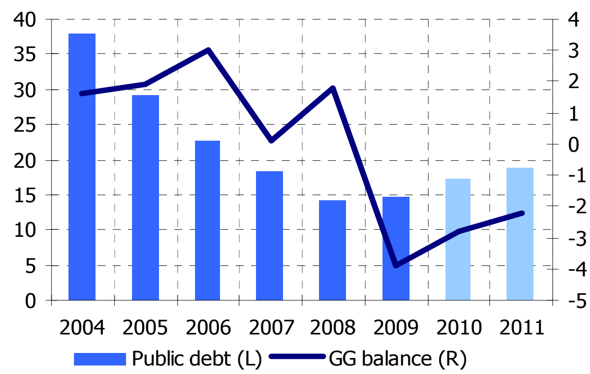
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSO

CZECH REPUBLIC

Economic growth

The economy of the Czech Republic, similarly to most economies in Central and Eastern Europe, suffered in 2009 from the global crisis. However, GDP contraction (by 4.1% in year-on-year terms) was one of the lowest in the region. The strongest economic decline was noted in the first half of 2009 (especially in Q1). In 20109 Q3 the Czech GDP started to rise on quarterly basis, which resulted in smaller GDP contractions on annual terms. In 2010 Q1 the quarterly economic growth rate recorded in the second half of 2009 (0.5% q/q) was maintained. Owing to that factor combined with the low base effect, year-on-year GDP rose in 2010 Q1 (1.1%) for the first time since 2008. Thus, the Czech Republic and also Slovakia and Hungary joined Poland as countries with positive GDP growth rates.

The most important factors affecting GDP contraction in 2009 included a decline in fixed capital formation and a fall in the level of inventories. Fixed capital formation went down by 9.2%. Contribution of the change in inventories to the economic growth amounted to -5.3 percentage points. Investment demand slightly recovered only in 2009 Q4, when fixed capital formation rose by 0.2% on a quarterly basis, however it did not change the overall 2009 picture. Almost all sectors of the economy suffered from declining investment. The fall in private investments, which decreased by 10% in 2009, was particularly severe. Due to uncertainty as to the future demand, a decline in production capacity utilization and tightening of the banks' lending policy, the largest decline in investments was observed in expenditure on machinery and equipment and means of transport.

Table 3.1

GDP growth rate and its components (in %, y/y)

	2008	2009	Q3 2009	Q4 2009	Q1 2010
GDP	**2.7**	**-4.1**	**-5.0**	**-2.9**	**1.1**
Private consumption	3.4	-0.3	-0.6	-0.8	-0.3
Public consumption	1.6	4.2	5.6	4.7	1.9
Fixed capital formation	-1.1	-9.2	-11.7	-6.8	-6.6
Exports	6.6	-10.8	-9.3	2.6	13.0
Imports	5.0	-10.6	-8.0	-1.7	10.7

source: Eurostat

In 2009 private consumption also fell (by 0.3%, compared with the increase by 3.4% in 2008). The decline in private consumption, similarly to most countries in the region, resulted from diminishing household income driven by deteriorating labour market (decline in employment and wage growth rate) and tightening banks' lending policy. The decline in private consumption in the Czech Republic was relatively small compared with most countries in the region. In the first half of 2009 its annual growth rate remained positive. A very fast disinflation and higher government expenditure aimed at spurring households expenditure mitigated the declines in consumption. At the same time, the public sector's consumption rose considerably (by 4.4% in 2009, and its contribution to GDP growth in 2009 amounted to 0.8 percentage point), thus the total consumption's contribution to GDP in the Czech Republic was positive last year.

The Czech Republic was the only country in the region in which the foreign trade contribution had a negative effect on GDP growth in 2009. Last year it amounted to -0.3 percentage points. This occurred for the first time since 2003. The negative net exports contribution was particularly strong in the first three quarters of 2009 as a result of a bigger decline in exports as compared with imports in that period. In 2009 Q4, year-on-year exports of the Czech Republic rose[3], which, combined with the sustaining decline in imports, mitigated the adverse impact of the foreign trade balance on growth rate.

Economic growth in 2010 Q1 was resulted from an increase in the levels of inventories, which were dragged it strongly down in the previous quarters. Thel scale of consumption and investment declines also slightly decreased on annual basis. However, their contribution to GDP growth remained negative. Nevertheless, the net exports contribution fell as a result of a substantial increase in imports.

The weak consumption in the Czech Republic was also illustrated by the persisting decline in retail sales in 2010 Q1. It went down on by 2.5% an annual basis and 0.7% as compared with the last quarter of 2009. by The decline in retail sales was bigger in the case of food than consumer durable goods. It resulted, among others, from an increase in sales of cars. During the first four months of 2010, the number of newly registered vehicles went up in the Czech Republic by 12%, despite the absence of new car subsidies, promised a year ago.

An increase in the consumer sentiment index, observed in the Czech Republic throughout most of 2009, fell considerably at the beginning of 2010. The Czech consumers were less optimistic about the current and future financial situation as a result of the deteriorating labour market conditions. The number of persons planning major purchases in the nearest future also declined.

Since mid-2009, the upward trend in industrial output has continued. In 2010 Q1, industrial output rose by almost 8% on an annual basis and by almost 3% compared with 2009 Q4. Industrial output increased mainly in manufacturing, especially in metallurgy, production of electronic equipment and computers. On the other hand, the automotive industry,

[3] It resulted mainly from a low base in Q4 2008, however an upward trend in export was also observed in the Czech Republic in Q3 2009.

which was the main driving force for the Czech industry in the second half of 2009[4], declined in 2010 Q1.

The increase is industrial output in the Czech Republic was accompanied by improved sentiment among manufacturers. During the period of January - May 2010 it resulted mainly from a better assessment of trends in production and a growing number of orders, both domestic and export ones.

Labour market

The situation on the Czech labour market systematically deteriorated over 2009, despite the recovery in industry in the second half of 2009. In the first months of 2010, this trend continued. The unemployment rate, which amounted to 5% early in 2009, reached the level of 7.9% in March 2010. Since the beginning of 2009, the decline in the number of the employed was also observed in the Czech Republic. In 2009 Q4, the number of the employed went down by 2.3% in year-on-year terms. Initial estimates of the Czech statistical bureau indicate further decline in employment in 2010 Q1. It fell on an annual basis by 2.4% and it was the biggest decline in the number of the employed since 1999.

The decline in employment affected mainly the manufacturing and construction sectors. However, the employment in services rose. 2009 and early 2010 witnessed the trend where the diminishing number of the employed was partly offset with a growing number of the self-employed.

Inflation and labour costs

In 2010 Q1, the annual HICP growth rate stabilized at the level of 0.4%. Growth in annual inflation rate was stopped mainly as a result of the base effect. Early in 2009, inflation rose as a result of the koruna depreciation and an increase in import prices. It cushioned the price growth at the beginning of 2010 stemming from an increase in VAT rate from 19 to 20% and continued growth in energy prices[5]. In April inflation went up to 0.9%. It stemmed mainly from increased gas prices (by 3.2%) and continued growth in fuel prices. Fading of the aforesaid base effect was another factor.

Core inflation in the Czech Republic remained low as consumer demand was still weak.

In the first half of 2009, wage growth rate in the Czech Republic fell considerably as compared with the previous quarters. In the second half of 2008 it stood almost at 8% y/y, and in the first half of 2009 it went down to 3.1% y/y. In the second half of 2009, the growth rate of wages in the Czech Republic accelerated. In Q4 it reached already 5.2% y/y. The biggest growth in wages was noted in the case of those employed in energy production and distribution, gas and water supply (16%). On the other hand, wages in the hotel and catering sector fell by 1.6% last year.

Table 3.2

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

	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Apr-10
HICP	**1.3**	**0.2**	**0.0**	**0.4**	**0.9**
Contribution to HICP growth rate (in pp)					
Transport	-1.0	-0.8	0.1	0.6	0.5
Alcoholic beverages and tobacco products	0.9	0.7	0.2	0.3	0.4
Health	-0.1	-0.2	-0.2	0.0	0.2
Housing	2.0	1.6	1.0	0.1	0.2
Restaurants and hotels	0.2	0.1	0.0	0.1	0.1

source: Eurostat

The growth rate of unit labour costs substantially decreased only in 2009 Q4 as a result of improved labour productivity. In the previous quarters of 2009, declines in ULC as a result of decreasing employment and wages growth rate was offset by GDP contraction.

Balance of payments

The Czech Republic was the only country in the CEE region where the current account deficit rose in 2009, both in nominal terms and in relation to GDP. In 2009, it amounted to -1.1% of GDP as compared with -0.6% of GDP in 2008. The driving forces behind it included diminishing surplus in the services account and growing deficit in the income account. In 2010 Q1, the current account deficit slightly rose (to 1.3% of GDP), which resulted mainly from persisting decrease in the surplus in services.

However, some signs of improvement were observed in the goods account, showing a surplus in the Czech Republic since 2005. In 2009, it rose to 5% of GDP as compared with 2.8% of GDP in 2008. This increase resulted mainly from over 22% decrease in imports (CZK, current prices) while exports went down by 18.5%. At the same time, the surplus in the services diminished (0.7% of GDP and 1.8% of GDP, respectively in 2009 and 2008). It stemmed primarily from rising transport costs abroad.

The foreign trade balance in the Czech Republic, especially in the case of exports, was influenced to the greatest extent by machinery and means of transport, representing approx. 60% of total exports. In 2009 Q1, a decline in exports of those categories of goods reached approx. 25%. However in the following quarters it already showed an upward trend in response to the increased Western European demand (as a result of governmental new car subsidies in the EU countries, mainly in Germany). However, the declines were not completely offset and in the whole of 2009 exports of machinery and means of transport fell by approx. 14.5% as compared with 2008.

In contrast to other countries in the region, the income account deficit in the Czech Republic increased in 2009 (6.1% of GDP in 2009 and 4.7% of GDP in 2008). It was mainly caused by a relatively great involvement of the Czech

[4] In 2009, the automotive production in the Czech Republic rose by 3% y/y, making it the only EU country apart from Slovenia and Romania where this production increased. Source: ACEA

[5] In January 2009, consumer prices in the Czech Republic went up by 1.2% as compared with December 2009. The prices of food rose by 1.9%, housing costs rose by 1.6% and fuel prices by 6.9%.

investors abroad and the fact that their income from investments abroad fell considerably in 2009 (by more than 50%), while the decrease in income from foreign investments in the Czech Republic was much smaller (approx. 5%). The deficit in the current transfers account remained unchanged as compared with 2008.

Growing volume of foreign trade in the Czech Republic, exports in particular, observed since mid-2009 continued in 2010 Q1. Consequently, a surplus appeared in the goods account. On the other hand, the surplus in the services account fell considerably. It resulted from larger imports of services linked with imports and re-exports of goods from the Czech Republic. The balance of income and current transfers remained unchanged in 2010 Q1.

Table 3.3

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

	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Current account	**-1.5**	**-1.4**	**-1.9**	**-1.1**	**-1.3**
Goods	2.7	3.0	3.6	5.0	5.6
Services	1.7	1.4	1.1	0.7	0.1
Income	-5.5	-5.5	-6.1	-6.4	-6.4
Current transfers	-0.4	-0.4	-0.4	-0.4	-0.5
Capital account	**1.0**	**0.8**	**0.9**	**1.1**	**0.7**
Financial account	**3.0**	**2.6**	**2.1**	**2.7**	**2.1**
FDIs	2.0	1.1	0.2	0.7	1.3
Portfolio investments	0.1	1.0	1.4	3.1	3.5
Other investments	1.2	0.9	0.9	-1.0	-2.6

source: Eurostat

The negative foreign investors sentiment towards the Czech economy softened, which translated into a bigger inflow of foreign investments to the Czech Republic since 2009 Q2 (to 2.7% of GDP in 2009 compared with 1.7% in 2008). This concerned mainly return of the portfolio capital to the Czech Republic, and, in particular, purchase of Czech government bonds by non-residents. At the same time, the inflow of direct investments to the Czech Republic declined, especially non-reinvested profits ones. The balance of other investments also deteriorated as a result of a declining inflow of short-term lending to the Czech banking sector and a growing involvement of the Czech banks in short-term foreign assets.

In 2010 Q1, foreign investors were still willing to purchase Czech treasury securities, which resulted in a further increase in the inflow of portfolio investments. Compared with 2009 the inflow of direct investments also increased. However, the balance of other investments continued to deteriorate.

Interest rates and exchange rate

In 2010, the Czech National Bank (CNB) continued to ease the monetary policy. Early in 2010, the CNB main policy rate reached the historical low at 1%. In May 2010, following the new inflation projection, the CNB decided to cut interest rates once again – to 0.75%.

The yield of Czech bonds in 2010 was mainly affected by the situation relating to the general government crisis in Greece which translated into a global increase in the risk aversion. The yields of 10Y Czech treasury bonds, after a decrease to 4% at the beginning of 2009, they rose by 50 basis points early in February. Bonds yield decline again to 3.6% early in April 2010. Another growth in the global risk aversion in response to the crisis in Greece combined with the ban on short sales of securities in Germany in May 2010 made the yields go up to 4.3% at the end of May 2010.

Since the beginning of 2010, interest rates on the Czech interbank market were slightly falling. The value of 3M Pribor at the beginning of 2010 was 1.6%, and it fell until early May to 1.4%. After the CNB's decision, the short-term rate in the interbank market fell by another 20 basis points.

In 2010 Q1 the Czech koruna (CZK) continued its appreciation started in 2009. From mid-January until mid-April it strengthened by over 5% against the euro. The April turmoil on the financial markets resulted in a rapid weakening of the koruna, by 4.5% until early May. In the subsequent month the koruna's rate slightly appreciated, however it remained weaker than at the end of 2010 Q1.

Fiscal policy

The general government deficit of the Czech Republic in relation to GDP increased in 2009 more than twice - to 5.9% from 2.7% in 2008. The fiscal imbalance deepened last year as a result of the anti-crisis package (approx. 2.0% of GDP) and automatic stabilisers of the economic situation. At the end of 2009, in view of a low realisation of the tax income, the government of the Czech Republic suspended some anti-crisis measures. Early in 2010 the actions aimed at fiscal consolidation were initiated in the Czech Republic (for example, 5% of ministries' expenditures were frozen, such as pensions and disability allowances VAT, excise and real estate tax rates were increased).

According to the European Commission's forecasts, the general government deficit in the Czech Republic will go down by 0.2 percentage points in 2010 and reach 5.7% of GDP. It is to remain at this level in 2011. The public debt in the Czech Republic will go up from 30.0% of GDP in 2008 to 43.5% of GDP in 2011.

Forecasts

In the past few months, the growth forecasts for the 2010-2011 period for the Czech Republic were adjusted upward. According to those forecasts, the Czech economy will slowly recover from recession in that period. In 2010 the main growth factors will include the recovery of the global economy to be reflected in growing exports. The industry's recovery, observed since mid-2009, is expected to continue also in 2010, which will be visible in the rebuilding of inventories. On the other hand, consumption and investments will stay on a downward path as a result of the continuing stagnation on the labour market in 2010 and tightening of the fiscal policy. The domestic demand is expected to recover not earlier than in 2011.

After a strong disinflation in 2009 (as a result of the base effect), a slow increase in inflation is expected in 2010. An increase in VAT rates will be the main driving force behind the rise in inflation. The persisting weak consumption should not give rise to any inflationary pressures. Compared with the forecasts at the end of 2009, a lower inflation path is expected, mainly as a result of its lower than previously expected price rises in the first months of 2010.

The current account deficit in the Czech Republic is expected to narrow in 2010, mainly as a consequence of the improved foreign trade balance. Spring 2010 EC forecasts for the current deficit are more optimistic than the autumn 2009 ones following the deficit narrowing in 2009 Q4.

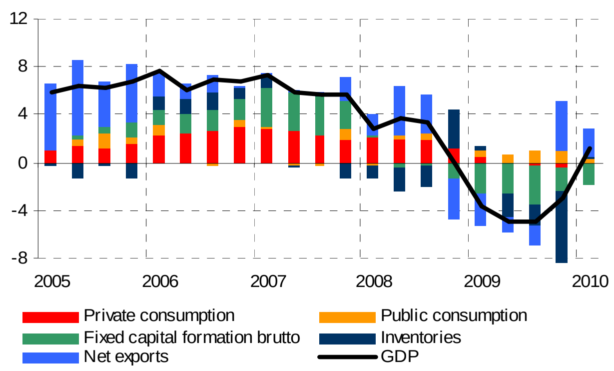
Table 3.4

Forecasts of main macroeconomic indicators

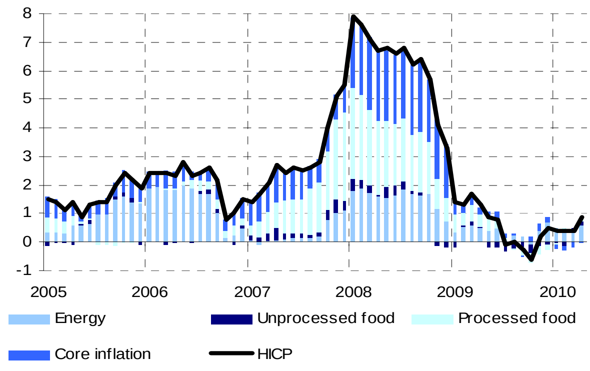
	ČNB	European Commission	OECD	IMF	Consensus Economics
	05.2010 (11.2009)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	1.4 (1.4)	1.6 (0.8)	2.0 (2.0)	1.7 (1.3)	1.6 (1.3)
2011	1.8 (2.2)	2.4 (2.3)	3.0 (2.8)	2.6 (2.5)	2.6
Inflation, in %, y/y					
2010	1.4 (2.4)	1.0 (1.5)	1.8 (1.4)	1.6 (1.1)	1.6 (1.6)
2011	1.8 (2.1)	1.3 (1.8)	2.0 (2.0)	2.0 (2.0)	2.3
Current account balance, in % of GDP					
2010	-1.1 (-0.8)	-0.3 (-1.4)	0.1 (0.3)	-1.7 (-2.2)	
2011	-1.3 (-0.8)	-1.5 (-0.8)	-0.4 (0.3)	-2.4 (-2.5)	

ČNB - Česká národní banka

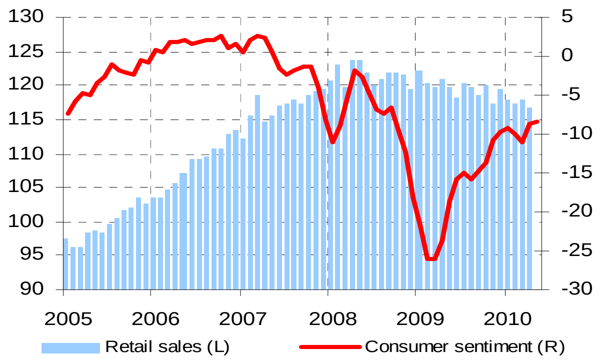
Contribution to GDP growth (in pp, y/y)



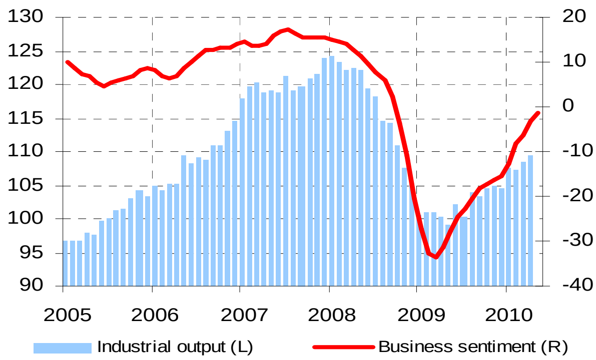
HICP and its components (in %, y/y)



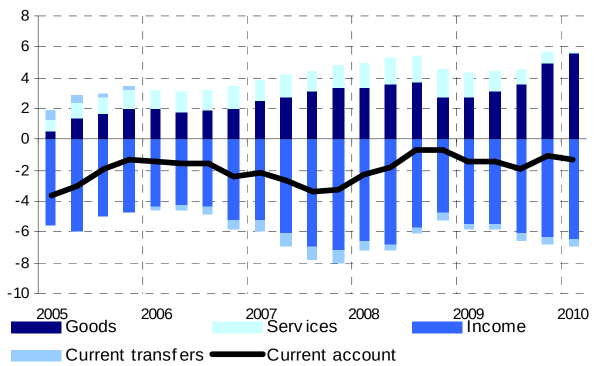
Retail sales (in %, y/y) and consumer sentiment index



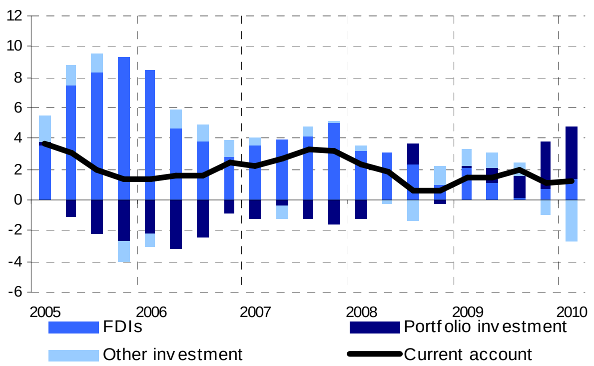
Industrial production (in %, y/y) and business sentiment index



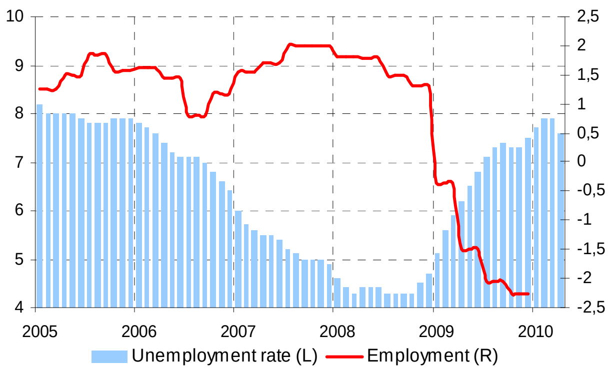
Current account and its components (in % of GDP, 4q moving average)



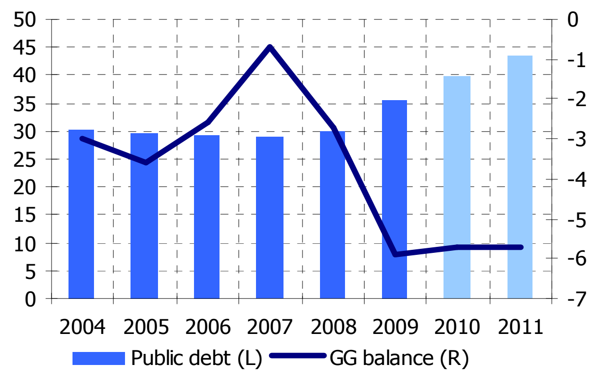
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ESTONIA

Economic growth

In 2009, economic activity in Estonia continued to decline. GDP contracted by 14.1%, following a 3.6% contraction in 2008. The sharpest GDP decline was observed in the first three quarters of 2009. In 2009 Q4 the economy of Estonia noted an unexpectedly high growth on a quarterly basis (2.5%), which was reflected in a lower (one-digit) year-on-year GDP contraction. It was caused, among others, by a slightly positive contribution of inventories which since 2007 Q3 practically continuously (except for 2008 Q3) had a positive contribution to the GDP growth rate in Estonia[6].

A lower domestic demand (down by 25.3%), which was the main source of economic growth till 2007, led to the deepening of the GDP decline in Estonia in 2009. A sharp decrease in household consumption in 2009, similarly to most countries in the region, stemmed both from a decline in disposable income (as a result of negative growth rates of wages and employment) and more strict bank lending conditions – credit growth rate fell by 6.4% on annual basis.

Table 4.1

GDP and its components growth rate (in %, y/y)

	2008	2009	Q3 2009	Q4 2009	Q1 2010
GDP	**-3.6**	**-14.1**	**-15.6**	**-9.5**	**-2.0**
Private consumption	-4.0	-18.9	-19.6	-16.5	-7.7
Public consumption	4.4	-0.5	-1.0	-1.0	-1.8
Fixed capital formation	-7.6	-34.4	-37.0	-34.3	-22.8
Exports	-1.1	-11.2	-9.6	-7.9	11.3
Imports	-7.9	-26.8	-26.6	-21.9	3.4

source: Eurostat

Weak private consumption in Estonia was also observed in 2010 Q1 which reflected another decline in the volumrretail sales, although its scale diminished. Year-on-year sales went down by 10% after 16% and 17% declines, in 2009 Q4 and Q3, respectively.

Fixed private capital formation fell as much as 34.4% y/y, i.e. three times more than in 2008. Such a large decline was mainly caused by a strong decrease in the volume of exports (by 11.2% y/y), whose contribution to GDP in Estonia accounts for approx. 80%. Investment activity of Estonian companies also diminished as a result of a limited access to external financing, primarily bank lending, due to lower availability and higher costs of credit. This was particularly perceptible when the companies generated much smaller profits in 2009, which led to a considerable decline in financial resources at the disposal of enterprises.

Declining domestic demand was combined with a strong decrease in the volume of imports (by 26.8%). With a smaller decline in the volume of exports it finally translated into a positive contribution of net exports to the GDP growth. Largest declines were noted in exports and imports of machinery and equipment, means of transport and metal goods, which accounted in total for approx. 33% of Estonia's foreign trade in 2009.

According to preliminary estimates, the scale of economic contraction narrowed considerably in 2010 Q1 (-2.0% y/y as compared with -9.5% y/y in 2009 Q4) mainly due to growing exports of goods and services and a relatively low reference base at the beginning of 2009. Yet, Estonia's GDP volume remains at a low level, which may be illustrated by the fact that it returned to the level recorded in 2005 Q1. It is also evidenced by the data on industrial output in Estonia, which rose in 2010 Q1 both on an annual (4.6%) and quarterly basis (4.8%). Its current level is much lower than that observed before the outbreak of the crisis. In April 2010, another rise in industrial output was noted which large scale (18% y/y) resulted mainly from the base effect.

The consumer and business sentiments, rising in Estonia since 2009 Q2, demonstrate the optimism of the domestic entities. In the case of consumer sentiment, it resulted basically from a better perception of the future financial standing of households and the future economic situation in Estonia. Yet, soaring business sentiment was mainly determined by sub-indices illustrating the expected value of future industrial output, export orders and employment.

Labour market

In 2010 Q1, a considerable deterioration on the labour market was noted in Estonia as compared with the second half of 2009. Unemployment rate in end-2009 was gradually stabilizing, driven by employment reductions being replaced with such measures as shorter working hours and lower wages.

[6] In Q4 2009, the change in inventories resulted in GDP growth by 0.4 percentage points, while in the first three quarters of 2009 it contributed to deepening the scale of GDP decline in Estonia on average by 7.6 percentage points.

Box 1

Estonia - new member of the euro area

The European Commission and the European Central Bank stated in the *Convergence Report* published in May 2010 that Estonia had reached a high level of sustainable economic and legal convergence and recommended to the Council of the European Union that Estonia be admitted to the euro area as of 1 January 2011. Furthermore, early in June 2010 the Ministers of Finance of 27 EU states debating in Luxembourg (ECOFIN Council) decided that Estonia would become the 17th member of the euro area as of the beginning of the next year. However, a formal decision in this respect will be taken in July 2010, upon obtaining the opinion of the European Parliament and discussing this issue at the summit of heads of EU Members States and Prime Ministers in June 2010. Estonia is currently the only country in the region complying with all convergence criteria.

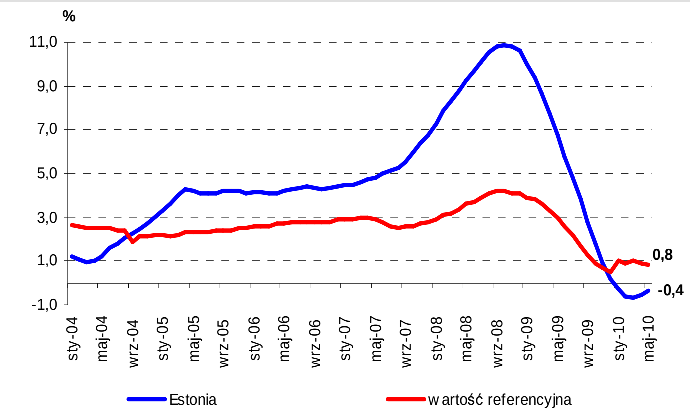
Legal convergence criterion

In order to harmonise the law in Estonia with the requirements of the *Treaty on the Functioning of the European Union* and the *ESCB/ECB Statute*, in April 2010 the *Eesti Pank Act* was amended. Moreover, the *Act on introduction of the euro* was passed, which will become effective as of 1 January 2011 and supersede the *Currency Law* and the *Law on the Security of the Estonian Kroon,* currently in force.

Price stability criterion

The 12-month average HICP inflation in Estonia, used to examine the degree of compliance with the Maastricht price stability criterion, has been again below the reference value since December 2009. In May 2010, the inflation rate in Estonia amounted to -0.4% and the reference value to 0.8%. According to the European Commission's most recent forecast of May 2010, the inflation rate in that country should remain below the reference level until the end of 2010.

Figure 1. Annual average HICP inflation in Estonia versus the Maastricht reference rate



Source: Eurostat data, NBP calculations.

Exchange rate criterion

The Estonian kroon included into the exchange rate mechanism (ERM II) in June 2004 and has remained therein up to now. When the entered the ERM II, the Estonian monetary authorities unilaterally agreed to continue pursuing the currency board regime, in force since 1992. During the two-year stay within ERM II assessed in the *Convergence Report* it was stated that the rate of the Estonian kroon did neither materially deviate from the central parity nor was subject to any serious tension. Furthermore, it was stated that the balance of official currency reserves remained at a safe level during the examined period.

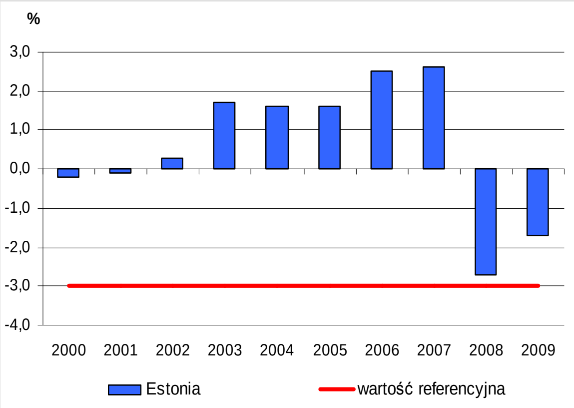
Long-term interest rates criterion

In view of a relatively low demand for lending, Estonia issued neither long-term treasury bonds nor any other securities which allow for assessing the degree of convergence in respect of long-term interest rates. However, it was stated in the *Report* that the qualitative analysis of relevant market ratios proved that Estonia complied with the interest rate criterion.

Fiscal criteria (general government deficit and public debt)

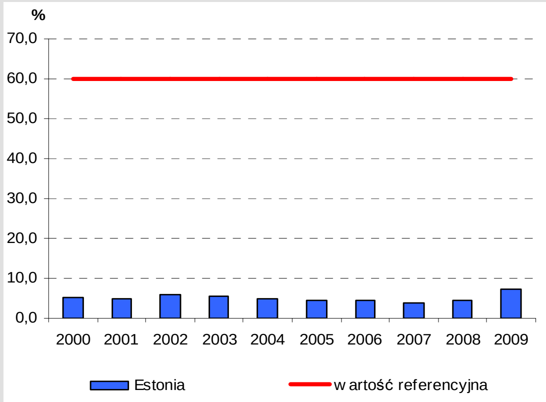
Estonia is not subject to the excessive deficit procedure. The fiscal stance is highly stable and despite a considerable decline in economic activity, Estonia is still rated as a low-risk country. The level of the general government gross debt is the lowest in the European Union.

Figure 3. General government balance in Estonia versus Maastricht reference rate (in % of GDP)



Source: Eurostat data

Figure 4. Public debt in Estonia versus Maastricht reference rate (in % of GDP)



Source: Eurostat data

The unemployment rate rose in the first three months of 2010 to 19.0% as compared with 15.6% in Q4 2009. It was mainly caused by unfavourable weather conditions (very low temperatures and abundant snowfall), which reduced the activity in some sectors of the Estonian economy, for example in the construction industry where employment in 2010 Q1 declined by as much as 36% y/y.

Inflation and labour costs

A decline in the overall price level in Estonia, persisting since November 2008, was stopped in December 2009. However, inflation measured by the HICP annual growth rate reached a positive value only in March 2010 (1.4%)[7]. A rise in inflation was the effect of both growing prices of energy and food worldwide and the effect of the low reference base as of the beginning of 2009[8]. The growth in inflation rate in Estonia was thus stimulated by higher prices of transport and housing resulting from rising prices of fuels and heating oil. In April 2010, further growth of the overall price level was noted in Estonia (2.5%).

On the other hand, a weak domestic demand in Estonia continues to adversely affect the core inflation, which remained below zero in January and February 2010 (at -1.5% and -0.9%, respectively). However, in April 2010 it rose to 0.1%.

Table 4.2

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

	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Apr-10
HICP	**1.2**	**-0.5**	**-2.0**	**0.0**	**2.5**
Contribution to HICP growth rate (in pp)					
Transport	-1.2	-1.1	0.0	1.2	1.4
Furnishings	0.6	0.1	-0.9	-0.5	0.5
Alcoholic beverages and tobacco products	1.6	1.0	0.0	0.2	0.3
Clothing and footwear	0.2	0.1	0.1	0.2	0.2
Other	0.4	0.4	0.4	0.2	0.2

source: Eurostat

A decline in nominal wages in the Estonian economy diminished from 6.5% y/y in 2009 Q4[9] to 2.3% y/y in 2010 Q1, mainly due to a relatively low reference base at the beginning of 2009.

Falling wages and a decline in employment translated into a further decrease in unit labour costs (ULC) in the Estonian economy, especially in the financial services sector.

Balance of payments

In 2009, the current account balance was positive and amounted to4.6% of GDP, following a deficit of 9.4% of GDP in 2008[10]. The surplus observed since 2009 Q2 was generated mainly by decreasing deficits in goods. It went down as much as 73% as compared with 2008, which

[7] Prices in the Estonian economy rose earlier, i.e. in July 2009, however this trend continued until August and then the prices went down again.

[8] Another increase in energy prices has been observed since June 2009, and in food prices since December 2009.

[9] The decline in wages deepened in the second half of 2009 as a result of lower wages in the public sector, being part of the measures taken by the Estonian authorities aimed at public finance consolidation.

[10] It needs to be reminded that in the previous years the deficit in the current account of Estonia remained within the range 10-18% of GDP.

was the result of exports declining at a slower rate (-24%) than imports (-33%).

Other current account components also contributed to changing the deficit into a surplus. A positive services balance rose by 11% y/y which, similarly to goods, should be attributed to exports declining at a slower rate than imports. Positive effect was also caused by an increase in the net inflow of EU funds as compared to the year 2008. On the other hand, the narrowing of the income account deficit resulted from a sharper fall in the income of non-residents than that of Estonian investors investing their capital abroad.

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-5.9**	**-2.1**	**1.7**	**4.6**	**4.6**
Goods	-11.4	-8.8	-6.4	-4.1	-3.7
Services	7.9	8.6	9.5	9.8	9.8
Income	-3.8	-3.4	-3.0	-2.8	-3.2
Current transfers	1.4	1.5	1.5	1.6	1.7
Capital account	**1.2**	**1.4**	**2.0**	**2.8**	**2.5**
Financial account	**5.8**	**2.6**	**-2.9**	**-6.6**	**-7.7**
FDIs	1.0	-0.5	-2.0	0.7	1.9
Portfolio investments	2.5	-0.9	-1.1	-10.5	-10.3
Other investments	2.2	3.8	-0.4	3.1	0.6

source: Eurostat

In 2009, a considerable outflow of foreign capital from Estonia was observed, mainly as a result of a significant reduction of residents' liabilities resulting from portfolio investments (EUR -9.0 bn as compared with EUR 19.4 bn in 2008). It was a result of the buyout of bonds issued by Estonian financial institutions from non-residents. Moreover, smaller interest of foreign investors in the domestic debt market was noted, which needs to be explained, among others, by a continuing high risk aversion on the global financial markets.

In 2009 the inflow of both direct investments and other investments was still observed, although much smaller than in 2008. The decline in direct investments was mainly driven by a smaller scale of reinvested profits, being the effect of the poorer performance of Estonian enterprises with foreign capital than in 2008. On the other hand, a strong decline in the Estonian foreign trade translated into a limited demand for trade credit facilities and that was reflected in a smaller scale of capital inflow resulting from other investments. In addition, it was noted that non-residents rather withdrew their funds from the Estonian banks.

Fiscal policy

Owing to the initiated consolidation measures totalling approx. 9.0% of GDP, the general government deficit in Estonia narrowed in 2009 in terms of GDP from 2.7% in 2008 to 1.7%, despite a considerable decline in the gross domestic product last year (by 14.6% y/y). The aim of the ambitious consolidation package was to fulfil the Maastricht fiscal criterion and to adopt the common currency by 2011.

The 2009 consolidation measures involved increasing the VAT rate by 2 percentage points, raising the excise rates for natural gas, petrol and diesel oil were as well as the unemployment benefit fund contributions. On the expenditure side, reductions included lower growth in pension, disability allowances, sickness benefits and current expenditure in the state administration. Some actions were only temporary measures (such as increased proceeds from dividends and temporary suspension of the government contributions to the capital part of the pension system). In 2010, the excise tax rates on alcoholic beverages, tobacco and fuel were further raised.

According to the European Commission forecasts, the general government sector imbalances are to slightly deepen in 2010 and 2011. The general government deficit is to reach 2.4% of GDP. However, it will remain one of the lowest in the European Union (according to the EC forecast, a better result of that sector will only be observed in Sweden). The level of the public debt in Estonia will rise over the forecast horizon from 4.6% of GDP 2008 to 12.4% of GDP in 2011, however this will continue to be the lowest level among all the EU states. The scale of the public debt growth in Estonia was additionally curbed by a partial financing of the 2008 and 2009 deficits from the financial surplus generated in the years preceding the outbreak of the economic crisis.

Forecasts

In autumn of 2009 most forecasts indicated that the Estonian economy would overcome the recession in 2011[11]. However, in the first months of 2010 those forecasts were revised upwards and at present it is expected that the economic activity is bound to pick up in 2010. The change in the perception of the growth outlook for that Baltic economy could be affected by a positive GDP growth rate observed in 2009 Q4 (2.5% q/q) and the public finance consolidation which allowed for keeping the budgetary deficit under control (-1.7% of GDP) in spite of a two-digit decline in the economic activity.

Net exports, in view of a faster growth in the volume of exports than that of imports, and a rise in inventories are regarded as the driving forces of the Estonian economic growth in 2010. However, domestic demand will continue to drag down the economy. In 2011, the situation will change. At that time, the role of the key driving force for the economic growth will be assumed by the consumer and investment demand.

In 2010, weak domestic demand and a negative wage growth should translate into a moderate rise in inflation

[11] The Bank of Estonia, which expected in October 2009 a positive GDP growth rate (1.4% y/y) as early as in 2010, was an exception.

in Estonia. However in 2011, along with faster GDP growth and increasing wages, higher growth in the overall price level should be expected.

In the years 2010-2011, the current account is expected to continue to show a surplus, mainly as a result of the narrowing deficit in the trade in commodities, being the consequence of a faster growth in the value of exports than that of imports.

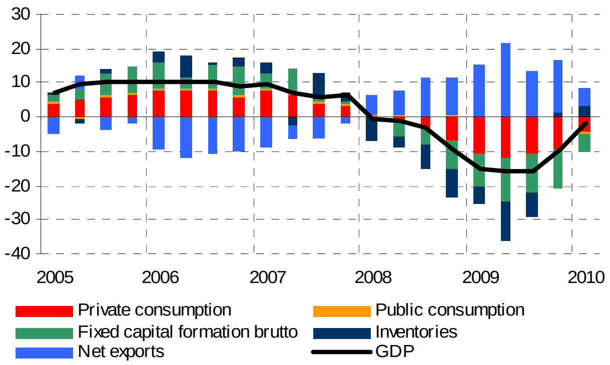
Table 4.4

Forecasts of main macroeconomic indicators

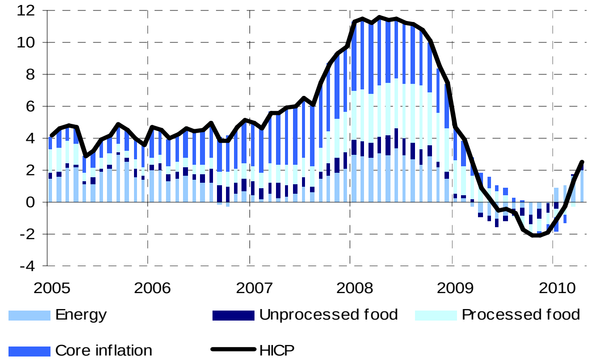
	EP	EC	OECD	IMF	Consensus Economics
	04.2010 (10.2009)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	1.0 (1.4)	0.9 (-0.1)	0.1 (-0.8)	0.8 (-2.6)	0.9 (-1.4)
2011	4.0 (4.7)	3.8 (4.2)	4.7 (3.9)	3.6 (1.4)	3.5
Inflation, in %, y/y					
2010	1.3 (-0.4)	1.3 (0.5)	1.5 (0.1)	0.8 (-0.3)	1.1 (-0.2)
2011	1.1 (1.7)	2.0 (2.1)	1.9 (0.4)	1.1 (0.5)	1.8
Current account balance, in % of GDP					
2010	3.4 (0.4)	4.9 (1.3)		4.7 (2.0)	
2011	1.5 (-5.3)	3.8 (-0.3)		3.9 (-1.1)	

EP - Eesti Pank

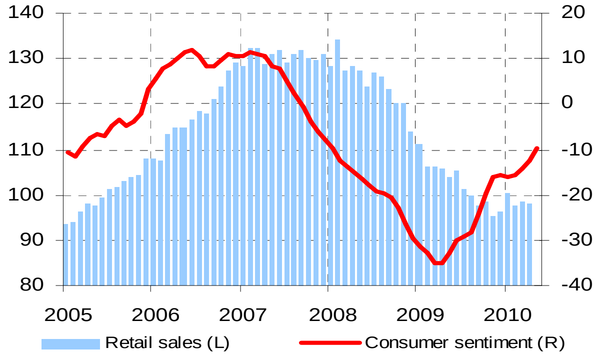
Contribution to GDP growth (in pp, y/y)



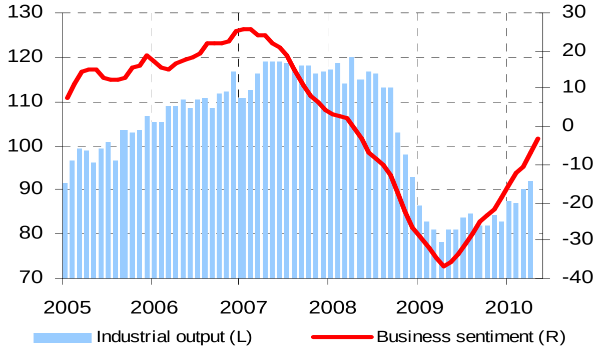
HICP and its components (in %, y/y)



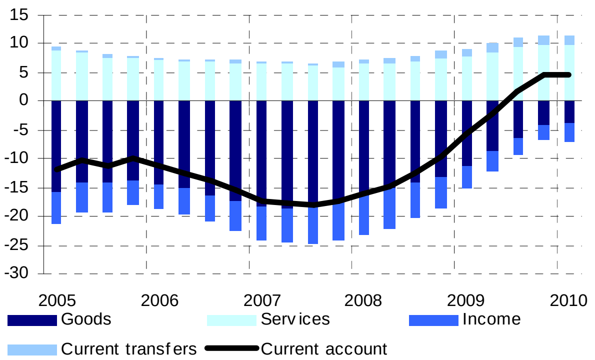
Retail sales (in %, y/y) and consumer sentiment index



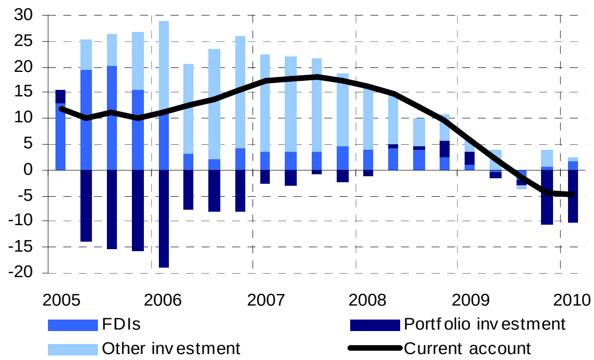
Industrial production (in %, y/y) and business sentiment index



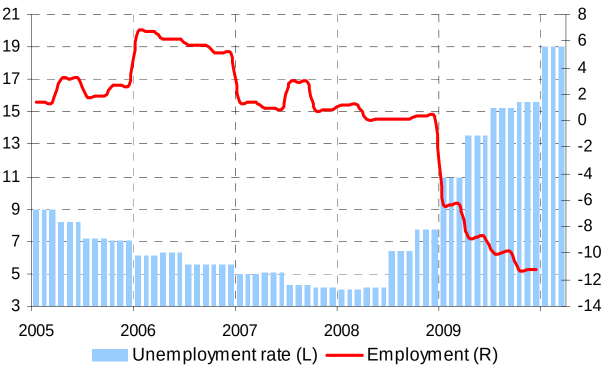
Current account and its components (in % of GDP, 4q moving average)



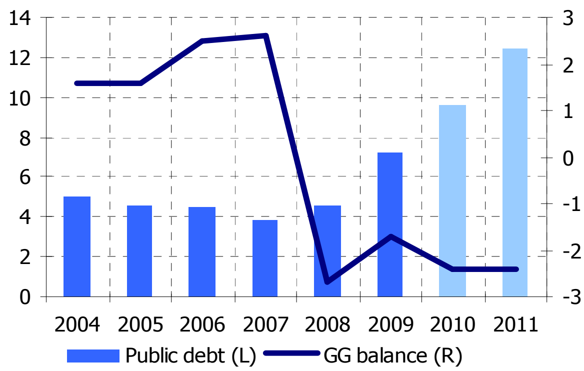
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

LITHUANIA

Economic growth

Lithuania, similarly to other Baltic states, suffered most from the global crisis. The crisis contributed to further deepening of the economic slowdown observed in this country since mid-2008. In 2009, GDP contraction amounted to 15% as compared with the 3% growth observed in 2008. The largest decline in the economic activity was observed in Lithuania in 2009 Q1, when GDP fell in quarter-on-quarter terms by 13.7%. However, in the second half of 2009, GDP in Lithuania was growing (by 1% in Q3 and by 0.5% in 2009 Q4 q/q). Preliminary estimates for 2010 Q1 indicated another GDP contraction (-3.9% q/q). The scale of the annual GDP contraction is much smaller (-2.8%), which was the result of the base effect (a substantial GDP decline in 2009 Q1). A decline in the economic activity resulted from an exceptionally cold winter and the closing of the nuclear power plant in Ignalina, which made electricity prices soar and domestic demand fall. [12]

Similarly to other countries in the region, GDP contraction in 2009 resulted mainly from a decrease in domestic demand, which went down by 21%. Another factor, apart from declining consumer and investment expenditure, was a decline in inventories, whose contribution to the GDP growth was -5.7 percentage points.

A rapid decline in lending activity was among the driving forces behind the considerable decrease in both consumer and investment demand. At the beginning of 2009, the annual credit growth rate amounted to 20%. At the end of 2009 that figure fell to -7.5% (it was the deepest decline in lending in the region). In the first months of 2010, the value of credit granted to the private sector was still decreasing at a rate observed at the end of 2009.

Table 5.1

Growth of GDP and its components (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**3.0**	**-14.8**	**-14.2**	**-12.1**	**-2.8**
Private consumption	5.9	-16.9	-16.5	-17.5	-9.9
Public consumption	4.1	-1.2	-2.5	-3.9	-0.2
Fixed capital formation	-6.4	-39.1	-41.4	-35.4	-30.2
Exports	11.5	-14.3	-16.5	-2.9	2.8
Imports	10.3	-29.4	-30.3	-19.0	5.7

source: Eurostat

The decline in imports, almost twice as big as that in exports, resulted in reducing the scale of GDP decline by nearly 15 percentage points. However, this effect was abating throughout the whole of 2009. After the slump in imports in 2009 Q1 (by almost 40% q/q), the subsequent quarters of 2009 brought their increase. On the other hand, exports were on a downward trend throughout the whole of 2009.

GDP contraction on a quarterly basis in 2010 Q1 was triggered mainly by over 20% decline in fixed capital formation, mainly investments in buildings and infrastructure (being the effect of the long and cold winter). However, private consumption recovered and noted, after seven consecutive quarters of decline, a nearly 4% growth on quarterly basis. However, on annual basis it was still approx. -10%. The closing of the nuclear power plant also contributed to the deterioration in the foreign trade balance. Imports of electricity and energy commodities rose considerably as compared to 2009. Amidst declining exports, this resulted in the foreign trade balance deterioratiion. In consequence, the contribution of net exports to GDP growth in Lithuania was negative for the first time since 2008.

After the time of a strong decline in retail sales in 2008 and 2009, in 2010 Q1 retail sales started to pick up slowly. They were still 15% lower in year-on-year terms, however since December 2009 retail sales rose by more than 7%. A large growth (by 12% in 2010) in sales of durable goods is a very optimistic sign for the future consumption trend in Lithuania.

The growth in retail sales was also accompanied by a rise in consumer sentiment. Consumers were more optimistic about the future of the Lithuanian economy and the price levels in the coming year.

Industrial output in Lithuania continued to fall in the first quarter of 2010. The annual decline amounted to 4.3% as compared to 3.7% in 2009 Q4. It resulted mainly from a falling production in the metallurgy. The situation in those sectors was adversely affected by the closing of the nuclear power plant in Ignalin and the related increase in energy prices.

The decline in the industrial output did not dampen the soaring business sentiment. The business sentiment index in Lithuania has been continually growing since 2009 Q2, among other things, as a result of a better assessment of the outlook for the Lithuanian economy.

Labour market

The situation on the Lithuanian labour market in 2009 had been rapidly deteriorating. The poor standing of the Lithuanian economy (despite a slight rebound in the second half of 2009) was reflected in a rapid growth of the unemployment rate. In 2010 Q1 it amounted to 17.4% as compared to 15.9% at the end of 2009 and 8.2% at the end of 2008.

In 2009 employment was decreasing at a higher rate. At the end of 2008, the number of the employed went down by 1% in year-on-year terms, while at the end of 2009 the employment decline exceeded 8% y/y. According to

[12] On 1 January 2010, in accordance with the earlier agreements with the EU, the nuclear power plant in Ignalina was closed down, which resulted in a decline in power supply by Lithuanian power plants by approx. 40%.

preliminary estimates, employment was declining in 2010 Q1 in Lithuania at a slightly lower rate, however it continues to exceed 7%. In 2009, the largest decline in employment was noted in the construction sector (by 36%), manufacturing (by 15%) and trade (by 14%). However, the number of the employed rose in agriculture, financial, consulting and real estate market services. A stronger decline of employment occurred in the private sector (by 10%) than in the public sector (by 4%).

Inflation and labour costs

The downward inflation trend, which was observed in Lithuania since mid-2008, continued in January and February of 2010. In February 2010, the harmonised index of consumer prices was by 0.6% lower in year-on-year terms, despite a considerable increase in energy prices (the prices of electricity rose by more than 33% as a result of the closing of the nuclear Ignalina power plant[13]). The decline in prices stemmed mainly from the base effect connected with an increase in the VAT rate at the beginning of 2009 (to 19% from two rates of 15% and 18%) and an increase in the gas prices, which at that time made the consumer prices pick up by 1 percentage point.

Since March 2010, an increase in inflation has been observed in Lithuania. In April 2010 it amounted to0.2%. Nevertheless, it was one of the lowest figures among the countries of the CEE region.

Key factors affecting the rise in inflation in March and April 2010 in Lithuania included growing prices of food and energy commodities, mostly fuels, and sustaining high prices of electricity and excise goods. On the other hand, the sustaining weak consumption and the absence of inflationary pressures from the labour market made the base inflation go down below zero in the first four months of 2010 (-1.4% in April 2010).

Table 5.2

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

	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Apr-10
HICP	**6.1**	**2.9**	**1.2**	**-0.4**	**0.2**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	1.0	1.0	1.6	1.5	1.2
Transport	-0.4	-0.6	0.5	0.5	0.9
Education	0.1	0.1	0.2	0.2	0.3
Health	1.1	0.9	0.8	0.2	0.1
Other	0.3	0.2	0.1	0.0	0.0

source: Eurostat

The deteriorating situation on the Lithuanian labour market in 2009 led to a considerable decline in wages. In 2009 Q4, the average wage in the economy fell by 11.5% in year-on-year terms. Wages fell in all key sectors of the economy. The largest declines in wages, by approx. 20%, were observed in the construction sector and in the local and general government sectors.

Declines in wages and employment, getting more and more severe over 2009, resulted in a decline in the unit labour cost growth in Lithuania. An slight economic recovery at the end of 2009 had an additional adverse effect. As a result, the annual nominal ULC in 2009 Q4 fell by 0.4%.

Balance of payments

In 2009, the current account balance in Lithuania was rapidly improving, similarly to the other Baltic states. In 2008, the current deficit amounted to almost 12% of GDP, but at the end of 2009 a surplus of 3.8% of GDP was noted. That improvement resulted mainly from the narrowing goods and income deficits. In 2010 Q1, the current account surplus fell slightly (to 3.3% of GDP), mostly as a consequence of the growing deficit in goods (an increase in imports, especially of energy commodities).

Table 5.3

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

	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Current account	**-8.1**	**-3.9**	**-0.1**	**3.8**	**3.3**
Goods	-8.9	-6.6	-4.8	-2.9	-3.3
Services	1.4	1.7	2.1	2.2	2.2
Income	-2.9	-1.7	-0.7	0.4	0.5
Current transfers	2.3	2.8	3.3	4.1	3.9
Capital account	**1.9**	**2.1**	**2.8**	**3.4**	**2.4**
Financial account	**7.0**	**2.2**	**-1.9**	**-7.2**	**-6.8**
FDIs	3.3	3.1	1.5	0.4	0.2
Portfolio investments	0.3	1.2	1.7	2.6	7.5
Other investments	2.4	-3.3	-5.4	-10.5	-13.4

source: Eurostat

The narrowing of the foreign trade deficit was mainly the effect of a deep decline in the imports of goods (by 38%). The largest fall was noted in the imports of cars (by 70%) followed by the fall in the imports of electronic equipment (by 50%). Imports of oil and fuels, which accounted nearly for 1/4 of the all the Lithuanian imports, also decreased considerably (by 35%) (smaller imports of oil and oil products resulted from a smaller domestic demand, but mainly from lower prices and a reduced foreign demand for products of the refinery in Mažeikiai). The scale of a decline in exports (by 27%) was smaller as compared to that of imports. The key factor behind the decline in exports was lower level of sales of oil products. Early in 2010, the foreign trade balance slightly deteriorated as a result of bigger imports of electricity following the closing of the nuclear power plant. Over the year 2009, the surplus in the service account also rose following smaller than in the previous years expenditure on transport and tourist services abroad. The income account deficit also narrowed considerably, which was mainly caused by a decline in dividends and reinvested profits of foreign enterprises operating in Lithuania.

The year 2009 was the first year in the history of Lithuania when the outflow of net foreign capital was noted. The outflow of capital took place early in 2009 and was

[13] An increase in energy prices resulted not only from the need to import the same but also from bigger utilisation of coal power plants whose operation is more expensive.

increasing in the following quarters of 2009 (calculated as a 4q moving average, the negative balance on the financial account has been observed since Q3 2009). The decline in the foreign capital inflow to Lithuania in 2009 resulted from stopping the foreign financing for the financial sector, which triggered the fastest decline in the credit growth rate in the region. That situation prevailed also in 2010 Q1.

A considerable decline in the inflow of direct investments in 2009 was mainly caused by a strong decline in reinvested profits. On the other hand, the inflow of portfolio investments increased. It occurred mostly in 2009 Q4 and continued in 2010 Q1, when foreign investors bought record quantities of the Lithuanian treasury bonds.

Interest rates

Nominal interest rates in the interbank market in Lithuania were decreasing in the first months of 2010. Three-month Vilibor rate fell from nearly 4% in January to 1.5% in June 2010 (a record low). The turmoil on the global financial markets connected with the sovereign debt crisis in Greece did not affect the situation on the Lithuanian financial markets.

In the first four months of 2010, both nominal and real effective exchange rates weakened in Lithuania, similarly to other Baltic states. In the period from January to April 2010, NEER fell by 3.3%, and CPI-deflated REER by 2.5%.

Fiscal policy

A considerable decline in the Lithuanian gross domestic product in 2009 (by 15.0% y/y) led to the deepening of the general government sector imbalance. The general government deficit in terms of GDP rose in 2009 by 5.4 percentage points and reached the level of 8.9%. The scale of the deficit growth would have been even bigger in the absence of the austerity measures launched by the government in 2009, whose value is estimated at 8.0% of GDP. Those measures included among others: increase in the CIT rate (by 5 percentage points) and VAT rate (by 3 percentage points), reduction of current expenditure of particular budget entities, property expenditures and wages in public administration, as well as temporary reduction of contributions transferred to open-end pension funds.[14] The 2010 budget law provides for continuation of public finance consolidation measures, including additional reduction in current expenditure (by approx. 4.0% of GDP; among other things, expenditure on wages in public administration, social allowances as well old-age and disability pensions). On the other hand, expenditure on health care, public debt servicing and fixed capital formation is expected to go up in 2010.

According to the forecasts of the European Commission, in 2010 the deficit will run at the level of 8.4% of GDP, and in 2011 at 8.5% of GDP. The continuing fiscal imbalance and a considerable GDP contraction resulted in a sharp increase in debt. The Lithuanian public debt in terms of GDP is expected to grow over the time horizon of EC forecasts from 15.6% in 2008 to 45.4% in 2011.

Forecasts

Good performance of the Lithuanian economy in the second half of 2009 resulted in a considerable upward revision of the economic growth forecasts for 2010 and 2011. According to the spring forecasts, GDP contraction in 2010 will be much smaller than in 2009 and GDP will pick up in 2011. The Lithuanian economy will be recovering at a relatively slow pace, especially as compared with other countries in the region. In 2010, consumption and investments are still expected to decline, however contribution of net exports and inventories to the GDP grow rate should be positive. Growth in private consumption and fixed capital formation is expected only in 2011. However, if the economic recovery comes to a halt, as in 2010, it may result in a downward revision of the economic growth forecasts in Lithuania.

Despite a considerable increase in energy prices in Lithuania early in 2010, the inflation will probably go down below zero in the whole year. The driving forces behind this will include the absence of inflationary pressures exerted by the labour market and the continued tightening of the fiscal policy.

The surplus of current account which showed up in 2009 is to be observed in the following years. It will result mainly from the record low foreign trade deficit which will be observed the following years along with a surplus noted in the case of services, income and current transfers.

Table 5.4

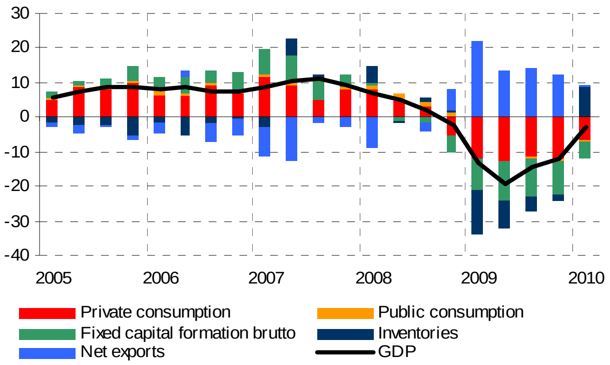
Forecasts of main macroeconomic indicators

	LB	EC	IMF	Consensus Economics
	05.2010 (11.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y				
2010	0.5 (-1.5)	-0.6 (-3.9)	-1.6 (-4.0)	-0.9 (-3.4)
2011	3.1	3.2 (2.5)	3.2 (3.0)	2.3
Inflation, in %, y/y				
2010	0.4 (-0.8)	-0.1 (-0.7)	-1.2 (-2.9)	0.5 (0.2)
2011	1.7	0.4 (1.0)	-1.0 (0.5)	1.0
Current account balance, in % of GDP				
2010	1.5 (0.6)	2.8 (0.3)	2.7 (0.5)	
2011	-0.6	2.0 (-0.4)	2.6 (0.0)	

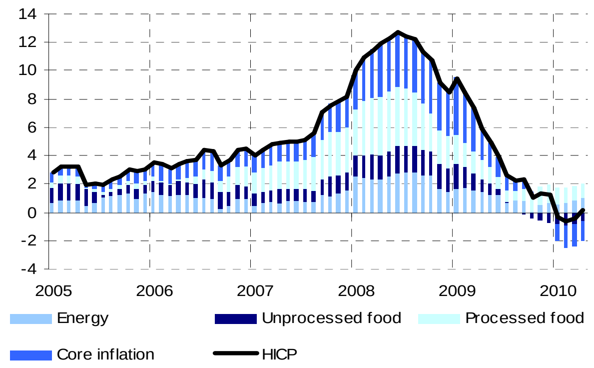
LB - Lietuvos bankas

[14] In the period of 2009-2010 – from 5.5% to 3.0% of wages.

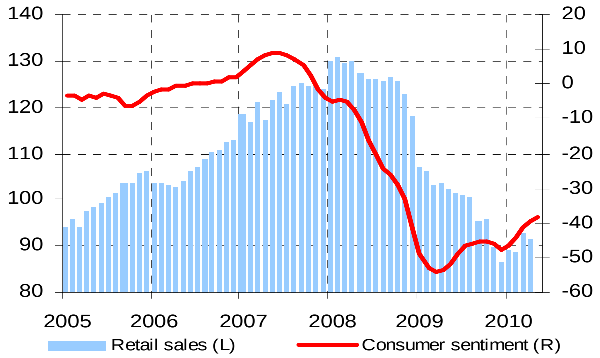
Contribution to GDP growth (in pp, y/y)



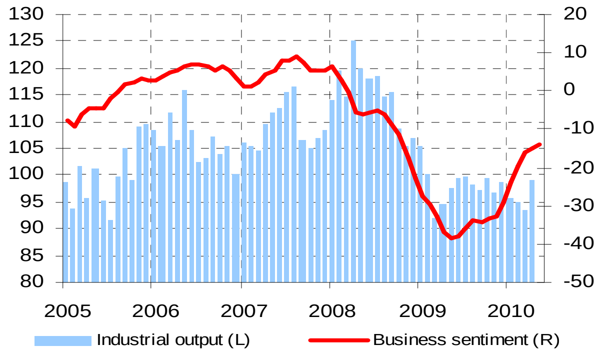
HICP and its components (in %, y/y)



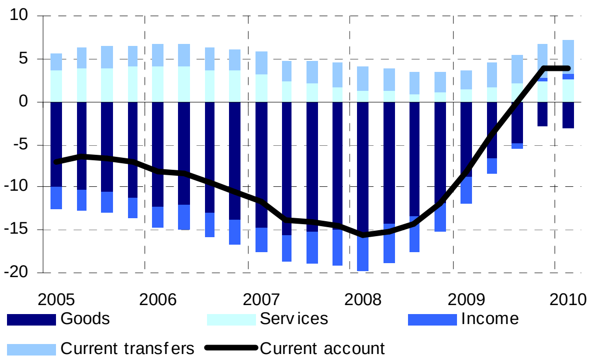
Retail sales (in %, y/y) and consumer sentiment index



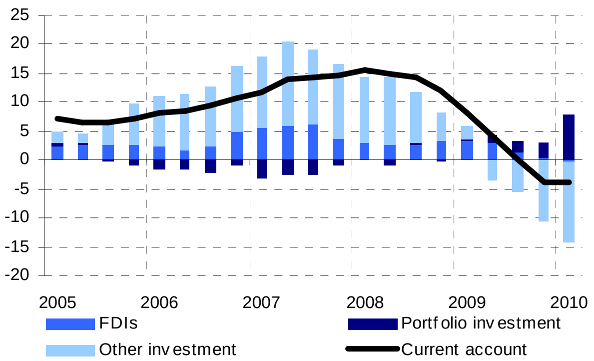
Industrial production (in %, y/y) and business sentiment index



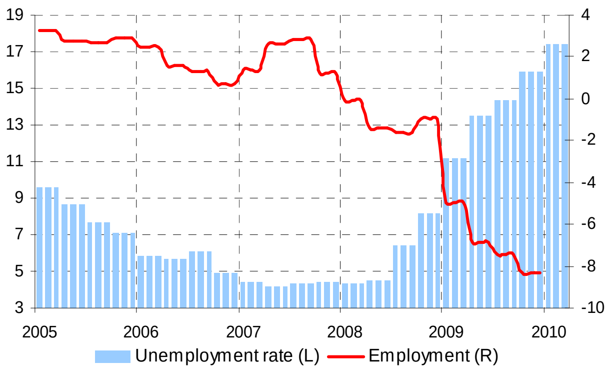
Current account and its components (in % of GDP, 4q moving average)



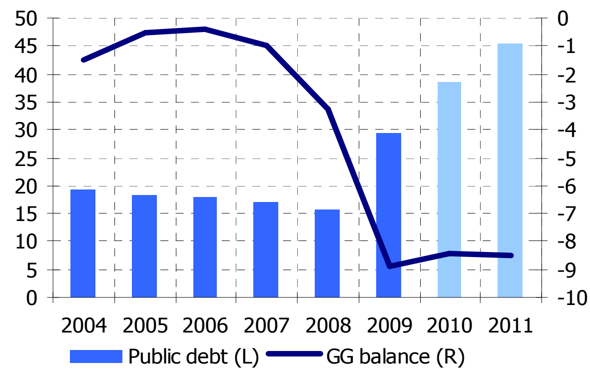
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSO

LATVIA

Economic growth

GDP contraction in Latvia in 2009 (by 18%) was not only the deepest among the countries of CEE region, but also the deepest one worldwide. At the same time, it was the second year in a row of GDP contraction in that country. On a quarterly basis, GDP in Latvia had been declining invariably since early 2008, and in 2009 Q4 that decline was nearly 3%. In 2010 Q1, GDP in Latvia slightly rose (by 0.3% q/q) after eight consecutive quarters of decline, though the GDP remained 6% below the level noted in 2009 Q1.

Similarly to other countries of the region, and especially the Baltic states, the economic decline resulted from the decreasing domestic demand. In 2009, considerable declines were noted in both private consumption (of 22.5% – the largest decline in the region), and in investments (of 37.7%). A negative contribution to GDP growth in 2009 was also made by declining public consumption (by 9% as a result of reduced public sector expenditure connected with the need to reduce the general government deficit to levels required by IMF) and by inventories. In quarter-on-quarter terms, private consumption, public consumption and fixed capital formation continued on a falling trend. In 2010 Q1, consumer and investment demand still did not show any signs of recovery. However, their negative contribution to GDP growth rate was smaller.

Table 6.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**-4.6**	**-18.0**	**-19.1**	**-16.8**	**-6.0**
Private consumption	-11.1	-22.5	-27.1	-19.5	-5.8
Public consumption	1.5	-9.2	-12.4	-14.3	-14.0
Fixed capital formation	-13.2	-37.7	-39.4	-38.3	-44.4
Exports	-1.3	-13.9	-15.3	-5.8	4.6
Imports	-13.6	-34.2	-36.7	-29.0	-2.7

source: Eurostat

Such a deep decline in consumption and investment was brought about by Latvia's sharp lending collapse. The lending growth rate had been declining since mid-2007 (when it exceeded 70%). The outbreak of the global crisis accelerated that process. Over the year 2009, the value of loans granted to the private sector went down by more than 4%, and the trend continued in the first months of 2010. An additional factor affecting the decline in private consumption was a deteriorating situation on the labour market. In 2009 and early 2010, unemployment was growing very fast and the wages were going down.

The only component which compensated for GDP contractions in 2009 was net exports. Its positive contribution to GDP growth rate (14 percentage points) resulted from the fact that imports fell twice as much as exports. This trend was sustained in 2010 Q1.

After a period of a strong decline in 2009, in 2010 Q1 retail sales in Latvia rose slightly. Considerable declines (of 13%) are still noted on an annual basis, but compared with 2009 Q4 sales went up by 2.5%. This resulted primarily from growing sales of durable goods (5.6% q/q), seemingly the first sign of the consumer demand stabilisation in Latvia.

In the first months of 2010, consumer sentiment also improved. The consumer sentiment index considerably rose as compared to the record low observed in the second half of 2009. This resulted mainly from a better assessment of economic situation over the next 12 months.

The industrial output volume in Latvia in 2010 Q1 fell slightly compared with 2009 Q4 (by 1.7%), though it was higher than a year before (by 4.6%). During the analysed period, a growing industrial output was observed in the wood and paper production. The output in mining and quarrying also rose considerably. A decline in industrial output resulted mainly from a smaller scale of activity in the metallurgical sector and manufacture of electric and electronic equipment in the first months of 2010.

The business sentiment index in Latvia has been invariably growing since 2009 Q1. That growth was also noted in 2010. The strongest impact on the sentiment of Latvia's producers resulted from the improvement in expected output, employment and sales prices in the forthcoming 12 months.

Labour market

The deep economic crisis in Latvia put also its mark on the labour market. The unemployment rate, which amounted to approx. 6% in mid-2008, rose to more than 22% in 2010 Q1 and was the highest not only in the CEE region, but also in the entire EU.

A rapid growth in the number of the unemployed was connected with a large decline in employment. In 2009 the number of the employed in the Latvian economy decreased by 14%. The largest decline in employment was noted in the construction industry (of 42%), public administration (of 23%) and manufacturing (of 16.5%). A slight growth in employment was noted only in financial and consulting services. Preliminary estimates for Q1 indicate a continuing decline in employment, even though its annual rate was reduced to 12.5%.[15] In total, since mid-2008 the number of the employed in Latvia has decreased by nearly 20%.

[15] Compared with 2009 Q4, the number of the employed fell by 1.7%, and a lower annual rate of employment decline resulted from the statistical base effect (at the turn of 2008 and 2009, Latvia's decline in the number of the employed was the highest, at over 4% in quarter-on-quarter terms).

Inflation and labour costs

In 2010, the annual HICP rate in Latvia was definitely the lowest in the region. In January and February 2010, the inflation continued its downward trend initiated in mid-2008. In February it reached the lowest level (-4.3%), mainly as a result of a decreasing core inflation.

In March and April 2010, the scale of deflation in Latvia decreased (-2.8% in April 2010). Even though the growth rate of consumer prices remained the lowest among CEE countries. Similarly to other countries of the region, the growth rate of consumer prices was determined by the global increase in prices of energy raw materials, which translated into an increase in prices of fuels and energy carriers in the domestic market. In April 2010, the prices of heating energy rose by 14%. On the other hand, continuing low consumer demand resulted in a further decrease in core inflation. In April it amounted to -3% and was definitely the lowest in the region.

Table 6.2

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**6.1**	**2.2**	**-1.3**	**-3.9**	**-2.8**
Contribution to HICP growth rate (in pp)					
Transport	-0.4	-0.6	0.0	0.6	0.7
Alcoholic beverages and tobacco products	1.3	1.4	1.4	0.6	0.3
Education	0.3	0.3	0.1	0.1	0.1
Health	1.1	0.9	0.8	0.3	-0.1
Other	0.3	0.2	0.1	-0.2	-0.2

source: Eurostat

Since the second half of 2009, nominal wages in Latvia have been declining. In 2009 Q4, an average wage in the Latvian economy fell by 12% in year-on-year terms. A decline in wages resulted mainly from their considerable downward trend in the public sector (by 23.5% y/y). This was an effect of a severe tightening of the fiscal policy, which represented one of the key conditions set out by the International Monetary Fund when granting aid at the end of 2008. On the other hand, the deepening economic crisis also led to a decline in wages in the private sector, though at a much smaller scale (of 5% y/y).

A decline in the wage growth rate combined with a decreasing employment resulted in a continuing rapid decline in the unit labour costs growth rate in 2009. A considerable economic slowdown in that period was only partially cushioning a decline in the ULC. In consequence, the nominal ULC growth rate, which was the highest in the region in mid-2008, fell to -8.5% y/y at the end of 2009. It was the largest decline in unit labour costs in all CEE countries.

Balance of payments

The scale of the current balance improvement in Latvia was the biggest in the entire CEE region. In 2008, the current account deficit amounted to 13% of GDP, while in 2009 a surplus of 9.4% of GDP was recorded. Such a great improvement resulted from all of the balance of payments components, narrowing goods deficit and a growing income surplus in particular. In 2010 Q1, the current account surplus further rose to 11.4% of GDP.

In 2009, the value of the Latvian foreign trade fell considerably. This applied to exports (a decline by 19%), but mainly imports (a decline by 39%). The largest declines were noted in the exports of metals, especially iron, steel and products of the timber industry, which represent the main commodity groups in the Latvian exports. On the other hand, a weakening domestic demand was the driving force behind declining imports, especially of machinery and equipment as well as means of transport.

Table 6.3

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

	2009 Q1	2009Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-9.2**	**-2.3**	**3.8**	**9.6**	**11.7**
Goods	-15.8	-13.1	-10.0	-6.6	-5.5
Services	4.5	5.0	5.7	6.3	6.3
Income	-0.2	3.2	5.5	6.5	7.0
Current transfers	2.3	2.6	2.7	3.4	3.9
Capital account	**1.9**	**1.9**	**2.1**	**2.4**	**1.7**
Financial account	**8.3**	**1.2**	**-5.9**	**-12.7**	**-15.7**
FDIs	1.6	-0.1	-0.5	0.4	-0.8
Portfolio investments	-0.5	0.9	0.8	1.5	1.5
Other investments	1.2	-8.2	-7.2	-11.2	-4.9

source: Eurostat

An increasing surplus in income resulted from declining investment profits, mostly from direct foreign investments. Along with the decline in the current deficit, the inflow of foreign capital was also decreasing at a very fast rate. In 2009, Latvia noted a deficit in the financial account for the first time. Despite the disbursement of three tranches of the credit granted to Latvia by a group of international institutions led by the IMF and the EU, the deficit in the financial account amounted to 2009 12.6% of GDP. A growing deficit resulted mainly from stopping the inflow of foreign loans to the Latvian banking system (other investments). It is of special importance for Latvia, since in the years 2004-2007 loans to the banking sector represented the key source of credit to demestic private sector and consequently of the Latvian economy's growth.

At the same time, an inflow of direct investments in Latvia dried out. It concerned both reinvested profits of enterprises and capital investments.

In 2009, a greater inflow of foreign portfolio investments was observed. However, it was much smaller compared with other countries in the region. It resulted mainly from little interest of foreign investors in the Latvian government bonds. The reasons for that included: the worst economic situation in the region, growing general government deficit debt, and last but not least the risk of the Latvian lat's devaluation.

Interest rates

In 2010, the speculations about the possible Latvian lat's devaluation faded away and the sentiments on the financial markets improved again. Three-month interest rate on the interbank market, which was close to 30% in mid-2009, fell in April and May 2010 to its historical low of 2.1%. Yields of treasury bonds also declined in 2010. Yields of 10-year bonds fell to 12% in May 2010, compared with 14.5% in early 2010 and 17% in mid-2009.

Despite the absence of any decisions on devaluation, Latvia and other Baltic states managed to make their economies more competitive by a considerable reduction of the labour costs. As a result of the "internal devaluation", Latvia managed to restore the foreign investors' confidence. In addition, from February 2009 until April 2010, the euro and subsequently the lat[16] weakened against the currencies of the Central and Eastern Europe and the Russian rouble, which resulted in the depreciation of the nominal effective exchange rate. In the period of January-April 2010 NEER depreciated by nearly 3%.

Fiscal policy

In 2009, the general government deficit in Latvia rose in relation to GDP more than twice and reached the level of 9.0% (compared with 4.1% in 2008). Last year's decline in the gross domestic product of 18% y/y caused a considerable decrease in tax income, which fell in nominal terms by approx. 25% y/y. Substantial cuts in expenditure in 2009 made it possible to mitigate, to some extent, the scale of the growing budgetary deficit in relation to GDP. Last year the Latvian government initiated actions with the aim of reducing expenditure on wages in the public sector (on two occasions: by 15% and 20%), on social benefits and old-age and disability pension benefits. In addition, contributions transferred to the capital part of the pension system were reduced (from 8% to 2% of the wage in 2009 and 2010).[17] The budget act for 2010 provides for further measures to consolidate the public finance of the total value of 4.2% of GDP (proportionally positioned on the side of income and expenditure). On the other hand, in 2010 additional expenditure will have to be made (approx. 1.5% of GDP), as a result of the Latvian Constitutional Tribunal's verdict which recognised the pensions by 10% as unconstitutional.

According to the European Commission's forecast, the general government deficit will narrow slightly in 2010 – to the level of 8.6% of GDP, and will subsequently rise in 2011 to 9.9% of GDP, mainly as a effect of increasing expenditure e the public debt service and decrease in non-taxed income. In view of the obligation to reduce the general government deficit to a level below 3.0% of GDP until the year 2012 as part of the excessive deficit procedure. It will be necessary to maintain the restrictive fiscal policy and to launch other adjustment measures. The continuing fiscal imbalance and the GDP's contraction resulted in a sharp rise of the public debt. The public debt is going to increase in relation of GDP in the time horizon of the Commission's forecasts from 19.5% in 2008 to 57.3% in 2011.

Forecasts

The economic growth forecasts of April and May 2010 indicate that the GDP downward trends will continue in 2010 and a slight economic recovery will be noted only in 2011. Compared with the forecasts as of the end of 2009 those are slightly less pessimistic, though the economy of Latvia is supposed to remain the slowest growing economy in the region.

According to the latest forecasts, the domestic demand collapse, which was the main reason for the strongest GDP contraction in the region in 2009, will be also a factor slowing down economic growth in 2010. Domestic demand is expected to grow only in 2011. Net exports, similarly to 2008-2009 period, are expected to have a positive impact on the GDP growth rate, both in 2010 and in the following year.

After a rapid inflation decline recorded in 2009, the consumer prices growth rate is expected to further decline in 2010, mostly as a result of a deteriorating situation on the labour market. Despite a slight improvement of forecasts in the recent months, the negative inflation rate is supposed to prevail in Latvia until 2011.

Since the end of 2009 the current balance forecasts have been continually improved. According to the most recent forecasts, after the period of a high current deficit (2004-2008), in the following years a relatively high surplus is to be observed.

Table 6.4

Forecasts of main macroeconomic indicators

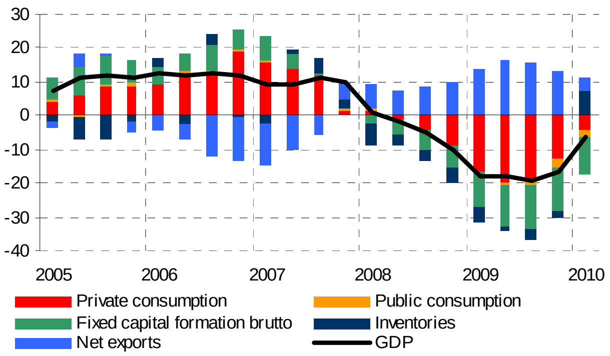
	MF	EC	IMF	Consensus Economics
	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y				
2010	-3.5 (-4.0)	-3.5 (-4.0)	-4.0 (-4.0)	-2.8 (-4.0)
2011	3.3 (2.0)	3.3 (2.0)	2.7 (1.5)	-2.5
Inflation, in %, y/y				
2010	(-3.7)	-3.2 (-3.7)	-3.7 (-3.5)	-2.3 (-2.2)
2011	(-2.8)	-0.7 (-1.2)	-2.5 (-2.5)	0.7
Current account balance, in % of GDP				
2010	(8.8)	8.3 (5.4)	7.0 (6.4)	
2011	(8.4)	4.6 (3.4)	6.3 (5.1)	

MF – Finance Ministry of the Republic of Latvia

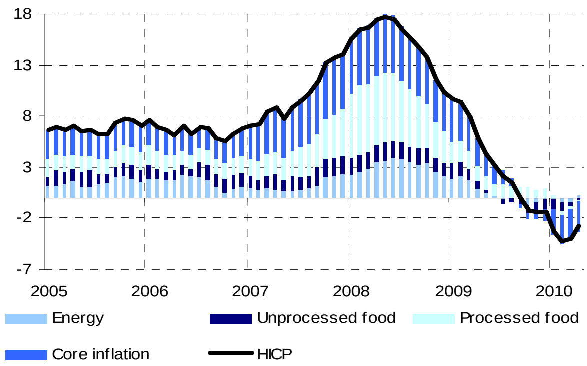
[16] The exchange rate of the Latvian lat against the euro oscillates within a narrow fluctuation band (+/-1% around the central parity).

[17] In 2011, the contribution is expected to amount to 4%, and from 2012 – to 6%.

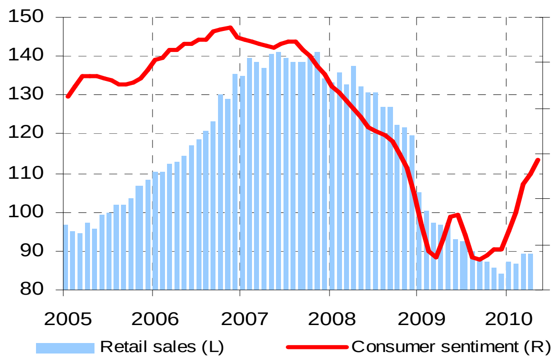
Contribution to GDP growth (in pp, y/y)



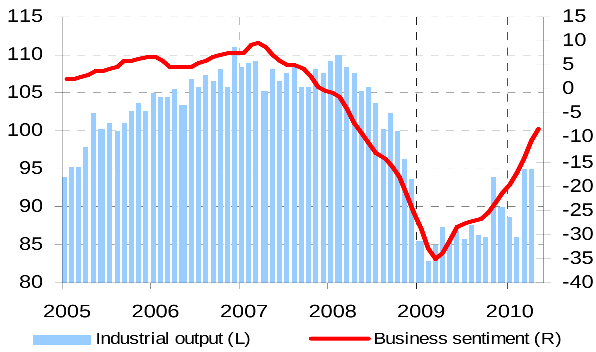
HICP and its components (in %, y/y)



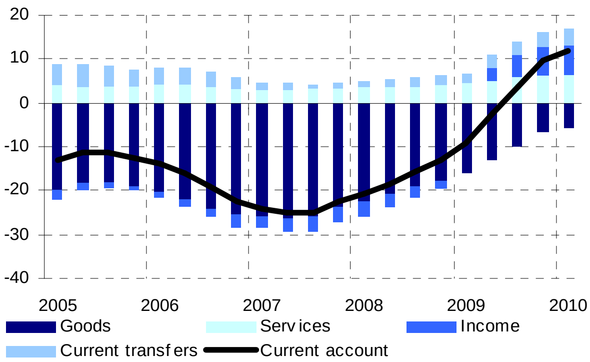
Retail sales (in %, y/y) and consumer sentiment index



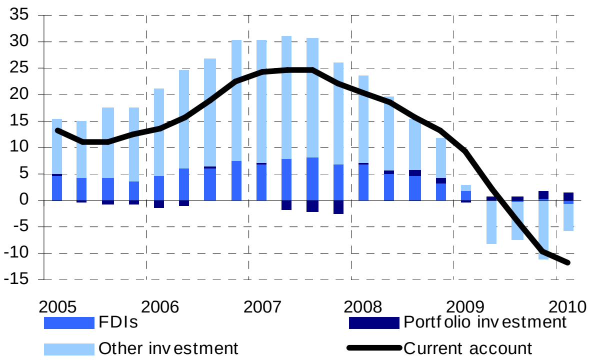
Industrial production (in %, y/y) and business sentiment index



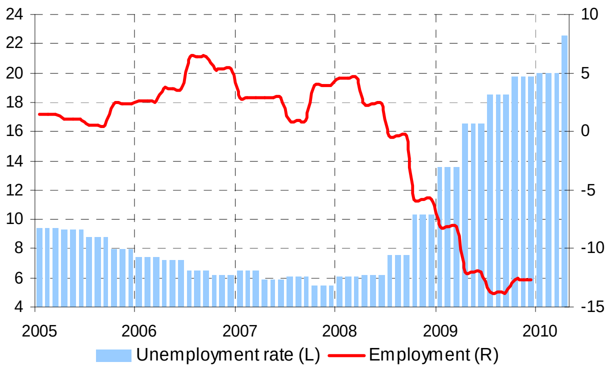
Current account and its components (in % of GDP, 4q moving average)



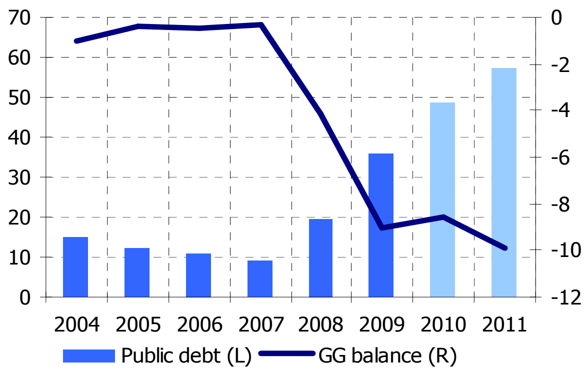
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

POLAND

Economic growth

Despite a considerable decline in the GDP growth rate in 2009 (to 1.8% from 5.0% last year), Poland was the only country in Central and Eastern Europe, and also in the European Union, which continued its economic growth. A smaller significance of exports in the economy and bank loans in financing household expenditure and enterprises activity, as compared with other countries in Central and Eastern Europe, mitigated the impact of the crisis on domestic demand. Among the region's countries, Poland reported both the largest rise – even if lower than in the previous year – in private consumption and the smallest decline in fixed capital formation.

Table 9.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**5.0**	**1.8**	**1.2**	**3.5**	**2.9**
Private consumption	5.9	2.2	2.3	1.0	2.3
Public consumption	7.5	1.9	-1.0	4.2	2.1
Fixed capital formation	8.2	-0.8	-0.1	-0.3	-12.4
Exports	7.1	-9.5	-9.4	0.5	10.4
Imports	8.0	-13.5	-13.3	-4.7	8.0

source: Eurostat

A decline in the private consumption growth rate was mainly triggered by a higher rate of households' savings in view of the deteriorating situation on the labour market and unfavourable outlook for economic growth. However, owing to a relatively small share of loans in the financing of household expenditure as compared with most countries in the region, a strong decline in banks' lending had a limited effect on consumption growth.

Meanwhile, the downward trend of fixed capital formation was caused by declining domestic and foreign demand. Fixed capital formation decreased despite good financial results of enterprises in 2009. In 2009, the housing investments of households were also reduced. However, the decline in investments in the economy was mitigated by a very strong increase in fixed capital formation by general government. At the same time, enterprises substantially reduced their inventories level due to the economic decline both in Poland and abroad.

Nevertheless, despite a slight decline in domestic demand (of 1.1%), especially compared with other countries of the region (where the decline was on average 13.1%), in 2009 Poland's imports (goods and services in total) fell only slightly less than in other countries of the region. One of the driving forces behind the disproportionally deep fall in import demand as compared with the fall in domestic demand was mainly a strong growth in import prices.[18] The disproportion between specific countries can be partly explained by the zloty depreciation, which proved to be much deeper than other CEE floating currencies.

However, such a large differentiation of exchange rate changes among the region's countries was not reflected in exports. Exporters in Poland suffered from the global crisis, similarly to exporters in other countries of Central and Eastern Europe. In 2009, exports from Poland went down in real terms by 9.5%, while in other CEE countries – by 10.8%. Thus, the impact of exchange rate changes on foreign trade proved asymmetric (stronger in the case of imports and weaker for exports). This is because the zloty exchange rate has a limited effect on foreign enterprises operating in Poland (and companies with foreign capital), which dominate in export.

A deeper decline in imports than in exports improved the foreign trade balance, which was an additional factor supporting the economic growth in Poland. In current prices, in 2009 the deficit was transformed into a small surplus (from -4.0% to 0.1% of GDP), which was additionally driven by the fact that export prices grew faster than import prices.

In 2010 Q1 , GDP rose by 2.9% y/y, i.e. at a slightly slower pace than in 2009 Q4. However, the growth structure changed. In 2010 Q1, enterprises started to rebuild their levels of inventories, which was reflected in a positive and quite substantial (bigger than in the case of GDP components) contribution to GDP growth. Private consumption was growing faster than in 2009 Q4 – however, the growth rate remained much below its pre-crisis average. Early in 2010, a decline in investments had a much bigger adverse effect on the economic growth rate than in the previous quarters. This was partly caused by unfavourable weather conditions in the first months of 2010, which mainly resulted in reducing the scale of construction investment projects (a much deeper decline than in previous quarters was also noted in expenditure on machinery and equipment). Furthermore, due to the rebuilding of import demand supported by exports recovery, accelerating domestic demand and zloty appreciation, the positive contribution of net exports to GDP growth considerably decreased.

In 2010 Q1, an upward trend in industrial output continued. Industrial output fell by 3.6% as compared to Q4, and by 10.2% on an annual basis. Thus, in March 2010 it reached the pre-crisis level. Faster growth in the industrial output at the beginning of 2010 was mainly

[18] In 2009, the prices of imported goods and services in Poland rose by 8.6%, while during the same period in Hungary they only increased by 1.5% and in the Czech Republic - by 3.7%.

triggered by export orders, whose growth rate (an increase of 16.8% y/y) was higher than that of domestic ones (an increase by 9.0%) for the first time since 2008 Q2.

At the same time, the assessment of current situation was still improving, as was the business sentiment, primarily due to more optimistic expectations concerning demand and exports. In consequence, an increasingly larger number of enterprises declare that they will increase their employment levels. However, the better sentiment has not translated into any investment plans yet. Despite the gradual improvement, the main problems that the corporate sector is still facing include low demand, exchange rate fluctuations and tough competition.

In 2010 Q1 the downward trend in the retail sales growth rate continued. In the first three months of 2010, sales fell by 0.1% as compared to 2009 Q1 (by 0.7% in Q4 and 2.1% in Q3). The period of national mourning resulted in an additional decline in sales in April 2010.

The retail sales growth rate declined despite a further improvement in the consumer sentiment index. The consumer sentiment index improved due to a better assessment concerning major purchases. More optimistic expectations for the following 12 months were mainly linked with a better assessment of the saving possibilities in the following year and a considerably smaller fear of unemployment.

Labour market

In March 2010, the unemployment rate in Poland rose to 9.9% (according to the Eurostat definition) and was 3 percentage points higher than in August 2008, i.e. since the crisis spread to the CEE countries. An increase in the unemployment rate represents an effect of the labour market's delayed reaction to the economic slowdown observed mainly in 2009. An increase in the unemployment rate was accompanied by a slight decrease in average employment. In 2010 Q1, the number of the employed went down again (by 1.0% y/y compared to 0.8% y/y in 2008 Q4).

Inflation and labour costs

In the period from January to April 2010, the harmonised index of consumer prices (HICP) went down from 3.9% to 2.4% on an annual basis. The downward trend in inflation was supported by the zloty appreciation, which continued until the beginning of April, low consumer demand and a decreasing growth rate of unit labour costs in the whole economy, especially in industry.

A decrease in the annual inflation in the January – April 2010 period was observed in all main groups of goods and services. It resulted from the negative base effects connected with a considerable increase in the prices of food and non-alcoholic beverages in the corresponding period of 2009[19], the prices of housing-related services and increased excise tax rates for alcoholic products in 2009. The annual inflation rate during the analysed period went down also as a result of changes in regulated prices, i.e. lower increases of energy (electricity and heating) prices than in 2009. on the other hand, the inflation decline in the analysed period was slowed down by an increase in the prices of tobacco products (the effect of increased excise tax rates both in 2009 and 2010) and a significant growth in the fuels prices.

The core inflation declined from 2.6% y/y in January to 1.5% y/y in April 2010. This was connected with low consumer demand (as indicated by a decline in the prices of *hotels and restaurants* growth rate) The earlier appreciation of the zloty and, a slower growth rate of prices of imported goods also played an important role in pulling core inflation down.

Table 9.2

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**4.2**	**4.3**	**3.8**	**3.4**	**2.7**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.9	1.0	0.8	0.7	0.8
Transport	-0.3	-0.1	0.3	0.8	0.7
Housing	1.7	1.4	0.9	0.6	0.5
Other	0.4	0.6	0.7	0.6	0.5
Health	0.2	0.2	0.2	0.2	0.2

source: Eurostat

2010 Q1 brought a decline in the nominal and real wages growth rate. Nominal wages rose in 2010 Q1 by 4.1% y/y (compared to 4.7% y/y in 2009 Q4), while real wages rose by 1.1% y/y (compared to 1.4% y/y in 2009 Q4). Labour productivity growth in the whole economy in 2010 Q1 slowed down slightly to 3.9% y/y (compared to 4.1% y/y in 2009 Q4). The stabilisation of the labour productivity growth rate combined with a lower wages growth rate led to a further decline in the of unit labour costs growth rate in the whole economy (to 0.2% y/y in 2010 Q1 as compared to 0.6% y/y in the previous quarter). Unit labour costs in industry have been falling since August 2009.

Balance of payments

In 2009, the current account deficit amounted to EUR 5.0 bn (as compared to EUR 18.3 bn in 2008). The ratio of the current account deficit to GDP decreased from 5.1% in 2008 to 1.6% in 2009. The current account balance improved mainly as a result of the narrowing trade deficit in goods. An increasing income deficit and a decreasing

[19] Declining growth rate of food prices in the period of January – April 2010 resulted also from an advantageous supply situation in the domestic produce market, caused to a large extent by cyclic factors.

surplus on the current transfers account had the opposite effect.

In 2009, the value of the Polish exports fell by 17.1%. The smallest decline (of 13.8%) was recorded in exports to EU-15 countries, which illustrated the relatively smallest decline in the economic activity in that region among Poland's main trade partners. The scale of the export decline to the Western European countries was mainly limited by growing exports of consumer goods (by 0.6%; including cars by 13.9%) due to measures taken by governments of numerous EU-15 countries in order to mitigate the decline in household expenditure. The decline in exports to the Central and Eastern European countries was much deeper (at 22.6% compared to 2008). It was not only the effect of a stronger economic activity decline in that region as compared to EU-15, but also of a diminishing scale of corporate trade between branches of foreign enterprises. Among the main trade partners of Poland, the deepest export decline (of nearly 40%) was observed in the trade with CIS economies, as this region suffered the most from the global financial crisis.

Table 9.3

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-4.0**	**-3.0**	**-2.3**	**-1.6**	**-1.9**
Goods	-4.3	-3.2	-2.2	-1.0	-1.0
Services	1.1	1.1	1.2	1.1	1.0
Income	-2.5	-2.7	-2.9	-3.2	-3.5
Current transfers	1.7	1.8	1.6	1.5	1.6
Capital account	**1.3**	**1.1**	**1.2**	**1.6**	**1.0**
Financial account	**5.3**	**4.3**	**6.8**	**8.2**	**10.0**
FDIs	1.8	1.7	2.3	2.0	1.5
Portfolio investments	-0.5	0.4	1.5	3.5	3.6
Other investments	4.6	2.8	3.5	3.0	1.9

source: Eurostat

In 2009 Q4 a continued net inflow of capital to Poland was observed, even though its scale was smaller than in the previous quarter. The financial account surplus amounted to EUR 6.3 bn, mainly due to further net inflow of portfolio investments. In 2010 Q1 the surplus on the financial account also resulted from the net inflow of portfolio investments, went up to approx. EUR 9.9 bn. Foreign investors deposited funds primarily in the treasury bonds issued on both the domestic and foreign markets. The net inflow of foreign direct investments, which amounted to approx. EUR 3.5 bn in 2010 Q1, also increased.

Interest rates and exchange rate

In the period from January until mid-June 2010, the nominal zloty exchange rate went down by approx. 15% against the dollar, yet it slightly increased (by 1%) against the euro.

From the beginning of 2010 until April, the zloty continued on its appreciation trend started in February 2009. In mid-April 2010 the zloty started to depreciate against the above mentioned currencies. The fastest depreciation rate was observed at the end of April and at the beginning of May 2010. This was connected with an increasing risk aversion on global financial markets after the Standard&Poor's agency downgraded sovereign ratings for Greece, Portugal and Spain. This led to a sale of currencies of the Central and Eastern European countries.

After the cut in June 2009, NBP interest rates remained unchanged. Despite unchanged NBP interest rates, in April 2010 the interest rates on the interbank market went down: 3M WIBOR fell from 4.10% at the end of March 2010 to 3.86% at the end of April 2010 and since then it remained stable. A decline in WIBOR rates resulted probably from better sentiment on the financial markets, which is reflected by a smaller spread between the interbank deposits rates and the OIS rate. Despite an increased global risk aversion in May and June 2010, short-term interest rates in Poland did not change during that period. However, a bigger risk aversion resulting from the turbulences on the euro area financial markets and comments made by Hungarian politicians affected the yields on Polish bonds. The yields on 10-year bonds, which had fallen from 6.3% at the beginning of the year to 5.5% in mid-April 2010, rebounded to the level of 6% at the end of May 2010.

Fiscal policy

The general government deficit in terms of GDP rose in 2009 by 3.4 percentage points and amounted to 7.1%. The deficit increased as a result of a considerable decline in tax income, which was the effect of economic slowdown and cuts in PIT rates, as well as dynamically growing expenditure on investments and social benefits.[20]

In accordance with the Convergence Programme Update 2009, the general government deficit will slightly narrow in 2010 as compared to the 2009 figure and will amount to 6.9% of GDP. On the other hand, the spring forecast of the European Commission provides for a slight deficit increase in 2010, to the level of 7.3% of GDP. It is justified by a more conservative forecast for tax income of the general government in the current year due to a less dynamic economic recovery expected by the Commission.[21]

In the Convergence Programme Update 2009, the government expects the general government deficit to narrow in 2011 to 5.9% of GDP, and then to 2.9% of GDP in 2012. According to the European Commission, the

[20] Among others as a result of indexation of benefits and system changes.

[21] According to the EC estimates, the total income of the sector will grow in 2010 by 1.3 percentage points of GDP to the level of 38.7% of GDP, while the Finance Ministry expects a much greater increase, i.e. by 2.2 percentage points of GDP to 39.6% of GDP.

deficit may prove higher than the government forecasts in the following years in view of probably less vigorous recovery and insufficient consolidation measures planned by the government. Moreover, the deficit reduction measures are concentrated in the last year of the Convergence Programme period, which may pose a risk for its implementation. According to the European Commission, the temporary expenditure rule proposed by the government aiming at limiting the real growth rate of the central budget's flexible expenditure to 1% in annual terms may turn to be ineffective in reducing the growth rate of budget expenses. The rule comprises only a small portion of the general government expenditure (less than 15%), thus savings from its introduction are estimated at less than 0.2% of GDP annually in the years 2011-2012. The European Commission believes that it is recommended to initiate additional measures to mitigate the public finance imbalance in 2011.

Within the time horizon of the EC forecast, the public debt in relation to GDP in Poland is expected to grow from 47.2% in 2008 to 59.3% in 2011, which would be the second highest level of public debt in the region (after Hungary).

Forecasts

The spring forecasts of the European Commission indicate once again that in the years 2010-2011 Poland, apart from Slovakia, will be the fastest growing country in the region. Good results of the Polish economy in the second half of 2009 and in 2010 Q1 led to raising the growth forecasts for the current and following years vis-à-vis those presented in autumn 2009.

Faster economic growth in 2010 and 2011 is to be mainly driven by strengthening domestic demand. In 2010 the growth will probably not accelerate at a fast rate due to weak private consumption reflecting a low level of activity on the labour market. The European Commission predicts that the situation on the labour market will stabilise in 2011, which will also lead to bigger consumption. At the same time, the forecasts indicate that both in 2010 and in 2011 fixed capital formation will rapidly grow while inventories will be rebuilt. An increase in the domestic demand in the following years will be followed by an increase in imports, which is expected to generate a bigger foreign trade deficit and, consequently, a negative contribution of net exports to GDP growth rate, both in 2010 and the following year.

According to the European Commission forecasts, inflation in Poland in the following years will be markedly lower than in 2009, mainly as a result of declining core inflation. Headline inflation is expected to go down over the year and reach the level of 2% at the end of 2010. In 2011, along with the rebuilding of domestic demand and stabilisation on the labour market, the inflationary pressure is expected to increase and the growth rate of prices should step up.

The current account deficit, which considerably narrowed in 2009 (to 1.6% of GDP compared to 5% of GDP in 2008), is expected to go up again over the next two years. This increase will probably be the effect of a deepening foreign trade deficit as a result of growing imports and bigger profits of foreign enterprises operating in Poland.

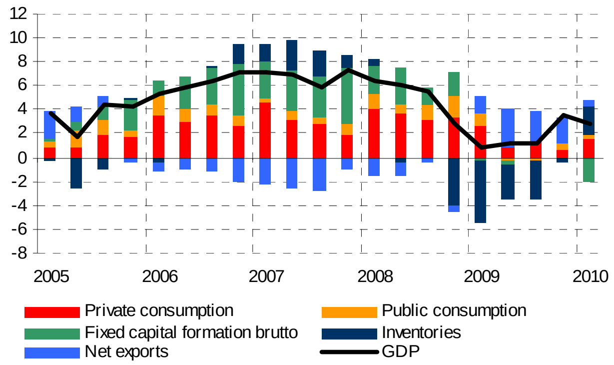
Table 9.4

Forecasts of main macroeconomic indicators

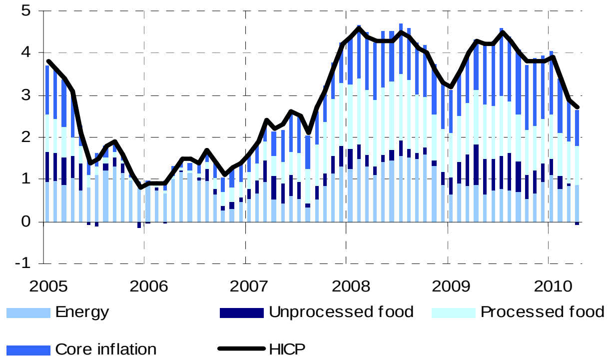
	NBP	EC	OECD	IMF	Consensus Economics
	06.2010 (10.2009)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	3.2 (1.8)	2.7 (1.8)	3.1 (2.5)	2.7 (2.2)	2.9 (2.1)
2011	4.6 (3.2)	3.3 (3.2)	3.9 (3.1)	3.2 (4.0)	3.4
Inflation, in %, y/y					
2010	2.5 (1.5)	2.4 (1.9)	2.7 (2.1)	2.3 (2.6)	2.4 (2.4)
2011	2.7 (2.1)	2.6 (2.0)	2.8 (1.8)	2.4 (2.7)	2.5
Current account balance, in % of GDP					
2010	-1.0 (-3.4)*	-2.8 (-2.8)	-1.6 (-2.3)	-2.8 (-3.1)	
2011	-1.3 (-4.7)*	-3.3 (-3.2)	-2.7 (-2.5)	-3.2 (-3.3)	

NBP – Narodowy Bank Polski, *current and capital account

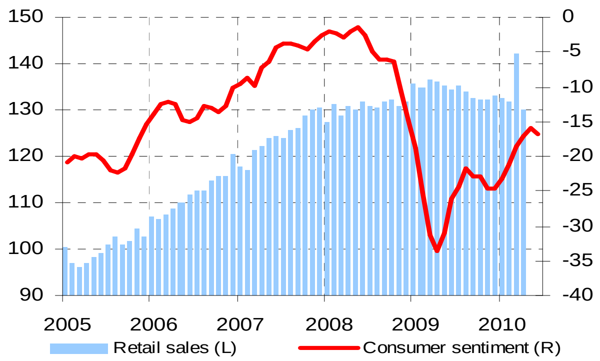
Contribution to GDP growth (in pp, y/y)



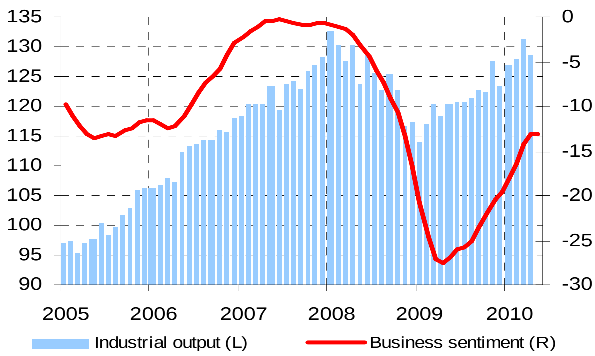
HICP and its components (in %, y/y)



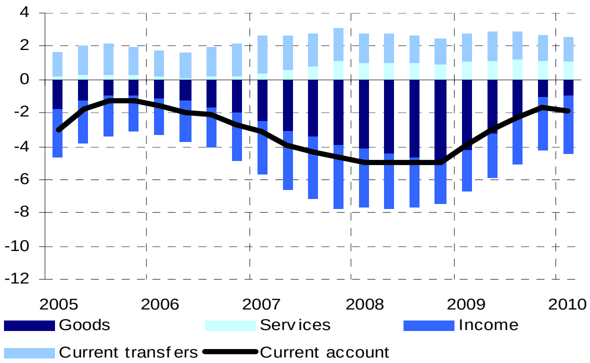
Retail sales (in %, y/y) and consumer sentiment index



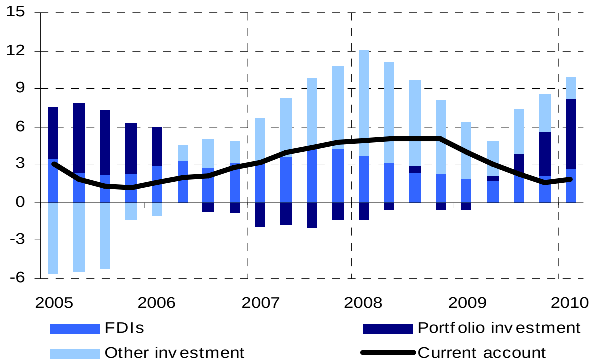
Industrial production (in %, y/y) and business sentiment index



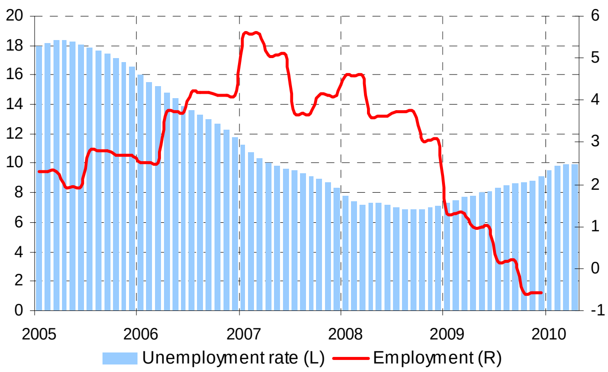
Current account and its components (in % of GDP, 4q moving average)



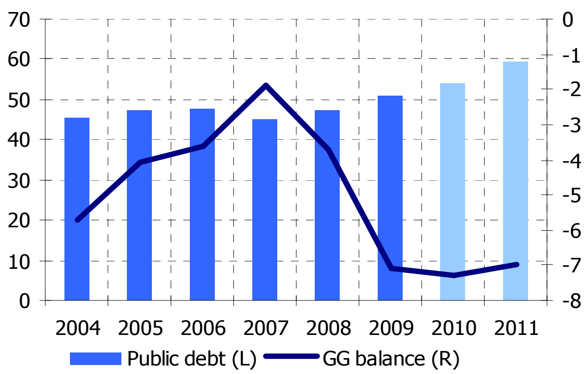
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ROMANIA

Economic growth

In 2009 the rapid growth of the Romanian economy came to a halt. As a result of such factors as a limited access to bank loans, increase in debt following depreciation of the Romanian currency and decline in global trade, GDP fell by 7.1%. Similarly to other countries of the region, the deepest plunge was observed in investment. A relatively large decline in consumption was also recorded (the deepest apart from the Baltic states). However, the decline in Romanian exports was the smallest among CEE countries.

Table 7.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**7.1**	**-7.1**	**-7.1**	**-6.5**	**-2.6**
Private consumption	9.2	-10.9	-11.1	-5.3	-4.7
Public consumption	3.1	0.7	-0.4	-0.1	-1.7
Fixed capital formation	19.3	-25.3	-27.6	-31.4	-28.9
Exports	18.9	-5.2	-3.7	3.9	21.6
Imports	17.1	-21.3	-20.7	-11.4	16.1

source: Eurostat

A decline in fixed capital formation, which affected all sectors of the Romanian economy, was most pronounced in the case of the expenditure on machinery and means of transport as well as construction investments. A strong reduction of fixed capital formation resulted from the deteriorating financial situation of enterprises and households, limited access to investment loans and decline in the direct foreign investments inflow.

The decline in consumer expenditure was noted in most categories of goods and services – the strongest one in durable goods and fuels. Consumption decline was mainly driven by deteriorating current financial situationand expectations, which translated into a bigger propensity for saving (the structure of savings changed for the benefit of investment funds as an alternative for term deposits). The deterioration in households financial situation was caused, on the one hand, by lower disposable income (by 3.3% in real terms), and on the other, by a plunge in the total value of new consumer loans(by more than 70%).[22]

A strong decline in both investments and consumption was reflected in a comparable decline in imports, which was much higher than that in exports. The stabilisation of demand, both in the countries of Western Europe, as a result of the implementation of stimulus programmes, and outside the European Union, contributed to halting the downward trend in exports, which have been falling, on annual basis, since 2009 Q4. This was primarily due to higher exports of passenger cars, which were stimulated, apart from the subsidies in some EU countries, by new models of cars being launched over the recent years.

In 2010 Q1 the scale of GDP contraction decreased. Apart from the low base effect (i.e. a deep plunge in 2009 Q1), this was caused by a considerable increase in inventories. Despite the highest export growth in the region (more than 20% y/y), the contribution of foreign trade to GDP growth in 2010 Q1 was negative due to even larger import growth. Early in 2010 Romanian enterprises regained the pre-crisis level of sales to foreign markets. The growth in export production was reflected in the increasing import demand, especially for intermediate goods. In turn, due to the fact that the impact of the crisis on investment expenses had been delayed by one quarter in relation to other countries, their decline remained very deep. Household expenditure also went down again (though to a smaller extent than in the previous quarters).

Reflecting the weakness of private consumption, retail sales had been already declining since the second half of 2008. In 2009 the decline in sales amounted to 10.1%, which was mainly caused by a strong reduction in expenditure on durable goods. However, the sales of other goods (except for fuels) remained at the level recorded at the end of 2008. In 2010 Q1 the level of retail sales stabilised. Reflecting a deteriorating economic situation, consumer sentiment plunged in the first half of 2009 and oscillated around its historical lows in the second half of the year. In addition, after stabilising in 2010 Q1 the consumer sentiment index continues on a downward trend.

Industrial output, after a deep plunge in 2008 Q4, was increasing in quarter-on-quarter terms in the first three quarters of the last year. Despite a short-term correction of that trend in 2009 Q4, the figures for 2010 Q1 indicate stabilisation (with the perspective for gradual growth) of the industrial output level. Business sentiment started to improve in the second half of 2009.

Labour market

Declining economic activity was relatively promptly reflected in a growing unemployment rate. . It started to rise slowly in 2008, yet this trend accelerated considerably in 2009. At the end of 2009, the unemployment rate reached 7.6%. Growing unemployment affected the employment growth rate, which was negative throughout 2009 and mainly resulted from employment adjustments in the private sector.

Inflation and labour costs

In March 2010, the annual inflation rate fell to 4.2%, being below the upper limit of the inflation target for the first time in nearly three years The downward trend in

[22] Inflation Report – February 2010, National Bank of Romania.

inflation started in the second half of 2008, and was supported by a weakening consumer demand, a large supply of food, declining energy prices in global markets and leu appreciation. In 2010 Q1, the harmonised index of consumer prices rose temporarily as a result of an increase in excise tax on tobacco products and alcoholic beverages as well as growing fuel prices.

Table 7.2

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**6.4**	**5.3**	**4.5**	**4.6**	**4.2**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	1.2	1.3	1.8	2.8	2.2
Transport	0.0	0.1	0.5	0.8	0.9
Housing	1.7	0.9	0.4	0.5	0.5
Other	0.2	0.2	0.2	0.2	0.2
Recreation and culture	0.2	0.2	0.2	0.2	0.2

source: Eurostat

Balance of payments

In 2009, the negative current account balance decreased considerably. This was mainly caused by the narrowing of the foreign trade deficit and the income account deficit. A smaller deficit in goods was the effect of a stronger collapse of the domestic than foreign demand. Yet, smaller income deficit resulted from declining profits of foreign companies.

Table 7.3

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-10.0**	**-7.3**	**-5.4**	**-4.5**	**-4.9**
Goods	-12.0	-9.9	-7.7	-5.8	-5.5
Services	0.3	0.2	0.1	-0.3	-0.5
Income	-2.7	-1.7	-1.5	-1.8	-1.8
Current transfers	4.4	4.2	3.8	3.5	2.9
Capital account	**0.4**	**0.3**	**0.4**	**0.5**	**0.5**
Financial account	**10.7**	**7.6**	**6.0**	**4.8**	**5.4**
FDIs	7.1	5.6	4.9	3.8	3.1
Portfolio investments	-0.9	-0.8	-0.5	0.4	1.8
Other investments	3.2	3.0	2.7	1.6	5.6

source: Eurostat

At the same time, the fall in the surplus on the financial account was so strong that Romania was forced to seek aid from the International Monetary Fund. Such a rapid decline in the capital inflow was caused by a sharp fall in the inflow of direct investments and other investments. In the case of direct investments, their decline reflects the slump in investment activity in Romania and concerns mostly investments in real property and manufacturing. However, a decline in other investments was caused by the stoppage of the inflow of foreign bank loans. However, it needs to be noted that this stop was eased up by funds from IMF credit facility.

Interest rates and exchange rate

The cycle of monetary policy loosening, initiated in Romania early in 2009, was continued in 2010. From January to May 2010, the National Bank of Romania (NBRO) cut the main policy rate four times, by 175 basis points in total, to its historical low of 6.25%. In response to an eased monetary policy and declining risk aversion in 2010 Q1, the short-term interest rates on the interbank market also fell considerably. In mid-April 2010, 3M Bubor amounted to 4.7% as compared with 10.5% at the beginning of 2010. In May and June, as a result of growing risk aversion in the aftermath of the sovereign debt crisis in the euro area peripheral countries, short-term interest rates rose considerably (to 7% in June), despite cuts of interest rates by the central bank at that time. A similar response to the growth in global risk aversion was noted in the case of Romanian bonds. Their yields, which exceeded 10% (10-year bonds) at the beginning of 2010, fell to 6.5% in April to rise again by 100 basis points in June.

The Romanian leu, similarly to other currencies in the region, was strengthening against the euro in 2010 Q1 (by 4.5%). In the following months, similarly to the Polish zloty, the Hungarian forint and the Czech koruna, it suffered from dampened investors sentiment toward the region and the EUR/RON rate in mid-June 2010 returned to the level observed early in 2010.

Fiscal policy

The general government deficit in Romania rose in 2009 by 3.1 percentage points and reached 8.3% of GDP,[23] mainly as a result of a considerable slowdown in economic growth (GDP contraction by 7.1% in 2009 as compared with an increase by 7.3% in 2008). In order to mitigate the scale of the growing deficit the government initiated austerity measures in 2009. Those involved increasing social insurance contributions (by 3.3 percentage points), rising excise tax on alcoholic beverages and tobacco products, limiting VAT exemptions on the purchase of vehicles and fuels, freezing wages, employment limits in public administration, filling vacancies and abandoning paid overtime.

According to the terms and conditions of the aid package granted to Romania by the EU and the IMF, the government agreed to narrow the general government deficit in 2010 to 6.4% of GDP. The budgetary act for 2010 provides for a package of consolidation measures (approx. 2.0% of GDP on the expenditure side and approx. 0.5% of GDP on the income side) to facilitate the accomplishment of that objective. As part of the consolidation measures, wages in the public sector were frozen, such as pensions and disability allowances,[24] expenditure on intermediate consumption was reduced,

[23] The last year's result was higher by 0.5 percentage point that the target of the Romanian authorities (7.8% of GDP), resulting among others from the need to pay pastdue amounts in the health care sector.

[24] Excluding social benefits launched in 2009 in order to mitigate the economic crisis effects.

the excise tax rates on fuel and tobacco products were increased and a sales tax was imposed on distributors of medical equipment. In addition, the pension system reform is to come into force as of 2011, which provides, for increasing and equalising the pension age for men and women, changing the benefit calculation formula, tightening the disability allowances system and eliminating privileges enjoyed by uniformed services.

In the opinion of the European Commission, there is some risk that the measures planned in the budget law will prove insufficient to reduce the deficit to the level of 6.4% of GDP in 2010, mainly due to poorer performance of the sector in 2009, deeper-than-expected decline in tax income in 2010 Q1 and the risk of exceeding expenditure limits. According to the European Commission forecast, without additional austerity measures the general government deficit in Romania will reach the level of level 8.0% of GDP in 2010 and 7.4% of GDP in 2011. In this context, the Romanian authorities announced that additional measures would be taken with the aim of slashing, on a temporary basis, the expenditure on wages of civil servants by 25% and pensions and benefits by 15% by the end of 2010. However, the draft budget law was rejected by the Tribunal of Justice. As a substitute measure, Romania decided to increase the VAT rate from 19% to 24%.

In view of such a large increase of deficit, GDP contraction and weakening of the domestic currency, the Romania's public debt will go up over the EC forecasts time horizon almost 2.5-times – from 13.3% of GDP in 2008 to 35.8% of GDP in 2011.

Forecasts

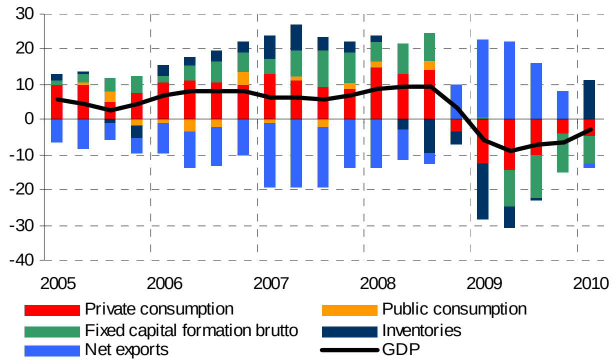
In 2010 growth forecasts for the Romanian economy have been slightly revised upwards. However, it is expected that the growth in 2010 will be relatively small (it will probably not exceed 1.0%) as a result of a continuation of the downward trend in consumer and investment expenditure. However, the strengthening of the economic growth is expected in 2011. At that time, Romania should become one of the fastest growing countries in the region. The scale of GDP growth will primarily depend on exports, which role in the economy is becoming more and more important. An increase in foreign demand will also contribute to an increase in fixed capital formation, among other things, through the inflow of foreign direct investments. The expected improvement in the enterprises condition and the expected normalisation on the labour market (the unemployment rate is expected to go down from 8.5% in 2010 to 7.9% in 2011) should stimulate consumer expenditure in 2011 (at the highest rate in the region).

In the present and forthcoming years, the relatively low domestic demand will be conducive to inflation decline. However, the rate of inflation decline will slow down as a result of growing taxes. In 2010, the current account deficit should remain at a similar to the previous year's level. The accelerated import growth as an effect of a bigger consumer demand, especially investment demand, should translate into a slight increase in the current account deficit in 2011. However, it will be much smaller than in the pre-crisis period.

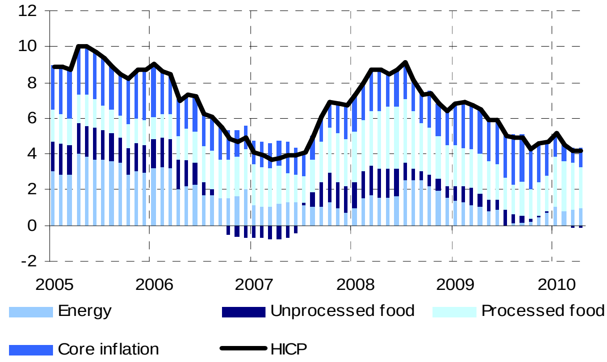
Table 7.4
Forecasts of main macroeconomic indicators

	EC	IMF	Consensus Economics
	05.2010 (10.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y			
2010	0.8 (0.5)	0.8 (0.5)	0.6 (0.6)
2011	3.5 (2.6)	5.1 (4.6)	3.3
Inflation, in %, y/y			
2010	4.3 (3.5)	4.0 (3.6)	4.4 (4.2)
2011	3.0 (3.4)	3.1 (3.1)	3.6
Current account balance, in % of GDP			
2010	-4.4 (-5.5)	-5.5 (-5.6)	
2011	-5.6 (-5.7)	-5.5 (-6.0)	

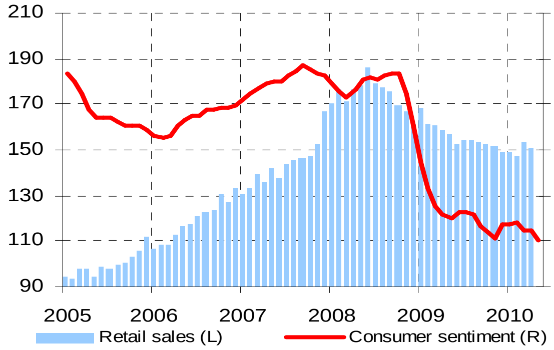
Contribution to GDP growth (in pp, y/y)



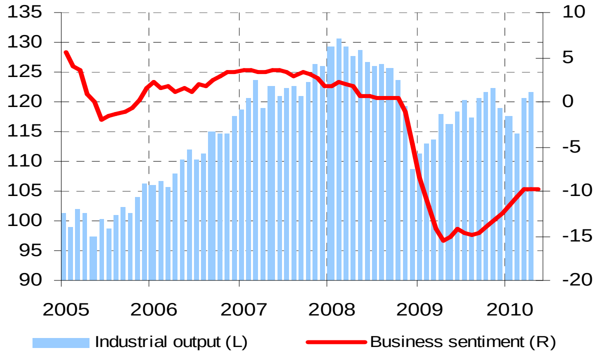
HICP and its components (in %, y/y)



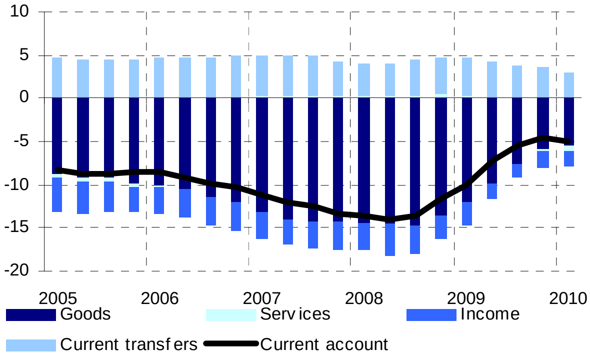
Retail sales (in %, y/y) and consumer sentiment index



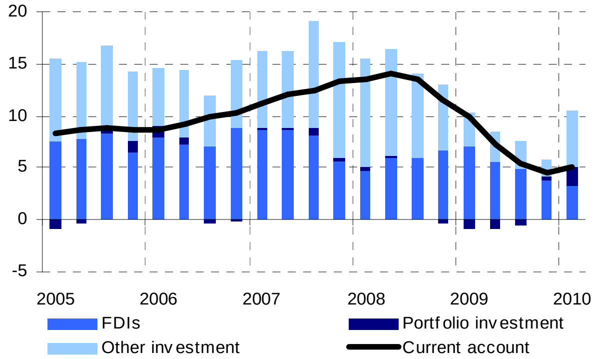
Industrial production (in %, y/y) and business sentiment index



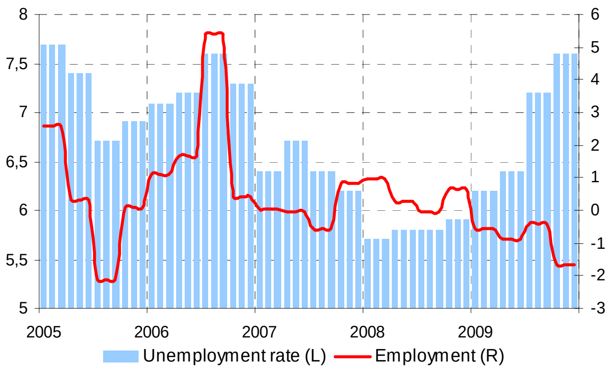
Current account and its components (in % of GDP, 4q moving average)



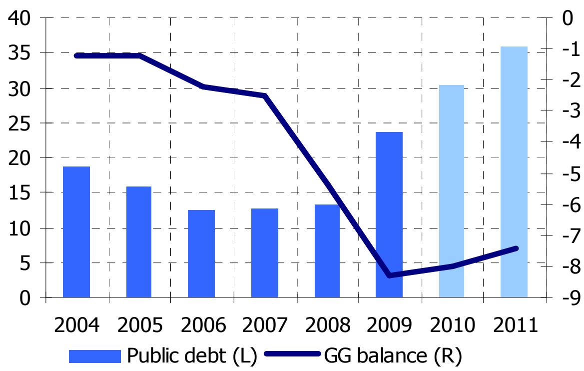
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVAKIA

Economic growth

In 2009, a decline in the economic activity was noted for the first time since the emergence of the sovereign state of Slovakia, i.e. since 1993. Gross domestic product went down in real terms by 4.7%. The worst GDP contraction was registered in 2009 Q1, however since 2009 Q2 the Slovak economy started to grow in quarter-on-quarter terms, which resulted in a smaller rate of the year-on-year GDP contraction in subsequent quarters.

A sharp decline in the global demand, also in the Western European countries (main trade partners of Slovakia), translated – due to the strong dependence of the Slovak economy on developments in foreign economies – into a two-digit decline in the export volume (-16.5% y/y) in 2009. The key driving force behind it was a considerable slump in the exports of cars (-23.2% y/y), which represent one of the main export products sold abroad (approx. 15% of the total exports).

Table 8.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**6.4**	**-4.7**	**-4.9**	**-2.6**	**4.8**
Private consumption	6.1	-0.7	-0.3	-1.9	0.4
Public consumption	4.3	2.8	-0.2	2.9	6.2
Fixed capital formation	6.8	-10.5	-11.4	-7.3	-0.4
Exports	3.2	-16.5	-15.0	-5.2	16.8
Imports	3.3	-17.6	-15.6	-10.3	9.9

source: Eurostat

The decline in exports, and consequently the decline in profits of Slovak exporters, considerably affected their investment activity. Gross expenditure on fixed assets went down by 10.1% as compared with an increase by 2.4% in 2008. This, in turn, contributed, among other things, to reducing the demand for imported capital goods. As a result, there was a strong decline in the import volume whose scale, in view of further decline in exports and a relatively high import intensity of the Slovak exports, got even larger (-17.6% y/y). Finally, the net exports had a slightly positive effect on GDP growth in Slovakia (0.4 percentage point).

The decline in the global demand, which led to a decline in the domestic demand in Slovakia by 6.2% (as compared with an increase of 6.0% in 2008), resulted mainly in a reduced amount of fixed capital formation of companies. However, the scale of decline in private consumption, despite the deteriorating situation on the labour market (lower employment and negative wage growth) was relatively small (-0.7% y/y), among other things, due to the positive effect of countercyclical measures adopted by the Slovak government to stimulate economic growth.

In 2010 Q1, GDP growth in Slovakia amounted to 4.8% y/y after the decline of 2.6% y/y in 2009 Q4. The exports of goods and services, higher that a year ago, were the key growth factor. However, the quarterly economic growth rate (after seasonal adjustments) slowed down to 0.8% as compared with 1.7% in the last three months of 2009. It was caused by unfavourable weather conditions (exceptionally low temperature and abundant snowfall) which rendered it impossible to carry out construction and assembly works.

Continuously weak consumer demand was confirmed by the figures on retail sales which remained in 2010 Q1 at a level similar to that observed in the previous three quarters. The Slovak consumer sentiment indices, despite a considerable improvement in 2010 Q1, continue to illustrate unfavourable opinions of households, especially concerning the employment prospects in the following quarters.

In 2010 Q1, an upward trend in industrial output continued. Thus, the industrial output volume came close to the level prevailing before the exacerbation of the crisis on the financial markets and its strong impact on the real economy (i.e. 2008 Q3).

Despite the increase in industrial output, lasting since 2009 Q2, the business sentiment in Slovakia improved only slightly in 2010 Q1, mainly due to growing expectations as to an increase in export orders. On the other hands, the outlook for future production remains uncertain.

Labour market

The response of the Slovak labour market to the economic slump in 2009 was strong and immediate – the unemployment rate rose to 12% (from 9.5% in 2008). It resulted from the substantial scale of economic decline and insufficient labour market flexibility. Initially, some enterprises reduced employment (mainly low earners) in order to reduce costs. Then, as the recession trend continued, enterprises pursued to a bigger extent other strategies, such as shortening of working hours and/or freezing bonuses.

In 2010 Q1, the unemployment rate in Slovakia rose again (14.1% as compared to 14.0% in 2009 Q4), although at a much slower rate.[25] It may prove that the Slovak companies took advantage of the crisis period to enforce more flexible forms of employment (e.g. part-time or seasonal employment, contracting, employee leasing, etc.).

[25] From 2009 Q1, the unemployment rate was growing quarter-on-quarter on average by 1.4 percentage points.

Inflation and labour costs

In January and February 2010, the annual HICP inflation rate was negative (in both months it amounted to -0.2%), and in March and April it was positive (0.3 and 0.7%, respectively). The decline in consumer prices in the first two months of 2010 was mainly caused by lower prices of energy and transport than a year ago. However, since March 2010, growing prices of food and alcoholic beverages played an increasingly important role and they led to the overall price growth in the Slovak economy. The inflation also went up as a result of the low reference base registered at the beginning of 2009.

Table 8.2
HICP and its components (in %, y/y)

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**1.4**	**0.6**	**0.0**	**0.0**	**0.7**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.5	0.5	0.5	0.4	0.5
Health	0.4	0.4	0.4	0.3	0.2
Food and non-alcoholic beverages	-0.5	-1.0	-1.0	-0.5	0.1
Other	0.3	0.2	0.1	0.1	0.1
Education	0.1	0.1	0.1	0.1	0.1

source: Eurostat

In 2010 Q1, the deteriorating situation in the Slovak labour market translated into a slowdown in nominal wages (down to 2.1% y/y from 2.5% y/y in 2009 Q4). However, an increase in wages was noted almost in all sectors of the economy, except for some groups of services.

Balance of payments

In 2009 the current account of Slovakia continued to show deficit, however it was considerably smaller, both in nominal terms and in relation to GDP (-2.6%) as compared to 2008 (-5.8% of GDP). The negative current account balance started to decline in 2009 Q2, mostly as a result of the gradually increasing surplus in the trade in goods.[26]

This resulted both from an earlier recovery in exports than imports (exports started to grow on quarterly basis already in 2009 Q2). Exports growth rate was also higher than that in imports. The narrowing of the current account deficit was also caused by a reduction of the negative balance in the income account. This was connected with a considerable decline in the income of non-residents resulting from their capital investments in Slovakia. On the other hand, growing deficits on the services and current transfers accounts contributed to an increase in the negative current account balance.

Table 8.3
Balance of payments, net balance (in % of GDP, 4q moving average)

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-6.3**	**-5.0**	**-3.6**	**-2.6**	**-1.6**
Goods	-1.1	-0.1	0.5	1.9	2.3
Services	-0.9	-1.3	-1.6	-1.8	-1.4
Income	-3.3	-2.6	-1.6	-1.8	-1.7
Current transfers	-1.0	-1.0	-0.9	-0.9	-0.8
Capital account	**2.0**	**1.7**	**1.7**	**1.3**	**1.1**
Financial account	**6.9**	**6.9**	**4.1**	**3.9**	**3.6**
FDIs	2.9	1.7	0.0	-0.6	-0.8
Portfolio investments	2.2	0.8	-1.5	-1.4	-1.8
Other investments	1.8	4.4	5.6	6.0	6.3

source: Eurostat

In 2009, further inflow of foreign capital to Slovakia was registered, yet, its scale was much smaller than in 2008. This was the effect of the observed outflow of both direct and portfolio investments. On the other hand the inflow of other investments increased. The decline in direct investments resulted primarily from repayment of some loans granted to domestic enterprises by their foreign owners, while the outflow of portfolio investments was connected with a larger scale of capital invested abroad by Slovak companies.

Fiscal policy

The general government deficit in Slovakia in relation to GDP tripled in 2009 and reached the level of 6.8% (as compared to 2.3% in 2008). The increase in deficit, apart from business cycle factors, was triggered by the structural weaknesses of the Slovak public finance, which was less apparent before due to a high rate of economic growth. It should be noted that the structural deficit of the general government rose from the level of 1.8% of GDP in 2005 to 4.8% of GDP in 2008. The anti-crisis measures launched by the government in 2009 were neutral for the budget.[27]

According to the European Commission forecasts, the general government deficit in relation to GDP will go down in 2010 by approx. 0.8 percentage point (to 6.0%), and in 2011 by another 0.6 percentage point (to 5.4%). The deficit reduction in 2010 will be the effect of limited public consumption and fixed capital formation as well as improved economic situation. According to the EC forecasts, public debt is expected to grow from 27.7% of GDP in 2008 to 44.0% of GDP in 2011 as a result of growing deficit and capital injections to state-owned banks.

Forecasts

The upward trend of the quarterly Slovak GDP growth continuing since 2009 Q2 was an additional factor in convincing foreign centres that the Slovak economy would register growth in 2010. This was reflected in the latest forecasts published in spring 2010. Those forecasts

[26] In 2009 Q1, the commodity trade balance remained negative in view of a faster decline in exports than in imports.

[27] Wage subsidies, car subsidies, etc. were financed by shifts in other expenditure categories.

indicate that 2010 is expected to bring higher economic growth than anticipated in the 2009 autumn estimates.

Growing exports, accompanied by an increase in fixed capital formation of enterprises, are expected to be the main driving force behind the recovery of the Slovak economy. This should, in turn, stimulate imports, whose growth rate may be even higher than that of exports. Finally, the net exports are expected to be a factor adversely affecting GDP growth in 2010. It may be expected that in 2011 growth rates of both categories will gradually equalise, which will lead to a neutral or slightly positive contribution of net exports to GDP growth. Moreover, a positive contribution of the government sector expenditure and recovering inventories to GDP growth is expected.

On the other hand, the consumer demand will remain at a low level in 2010 due to, among other things, negative wage growth and a difficult situation on the labour market. The labour market is expected to recover in 2011. Weak domestic demand should mitigate excessive inflationary pressures in 2010. However, the overall price level is expected to go up faster in 2011, along with a considerable economic recovery in Slovakia.

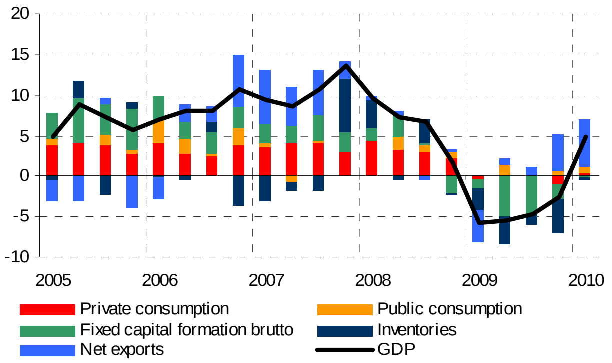
Table 8.4

Forecasts of main macroeconomic indicators

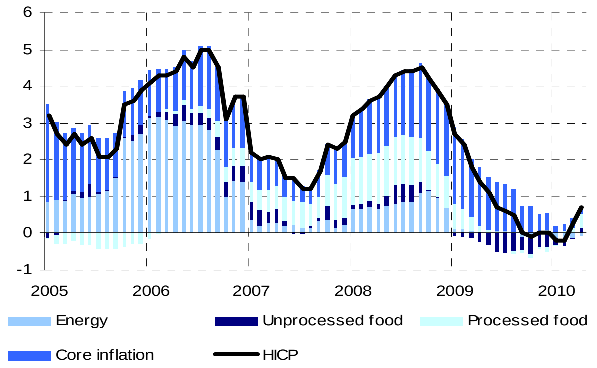
	BS	EC	OECD	IMF	Consensus Economics
	04.2010 (09.2009)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	1.3 (1.6)	1.1 (1.3)	1.4 (2.7)	1.1 (0.6)	1.1 (0.7)
2011	1.8 (1.7)	1.8 (2.0)	2.4 (3.0)	2.0 (3.8)	2.4
Inflation, in %, y/y					
2010	1.6 (1.5)	1.8 (1.7)	1.9 (1.1)	1.5 (2.1)	1.8 (1.8)
2011	1.4 (1.7)	2.0 (2.0)	1.3 (2.7)	2.3 (2.3)	2.2
Current account balance, in % of GDP					
2010	-0.5 (-3.2)	-1.4 (-0.2)		-1.5 (-4.7)	
2011	-1.4 (-3.7)	-1.6 (-0.6)		-1.2 (-5.0)	

NBS – Národná Banka Slovenska

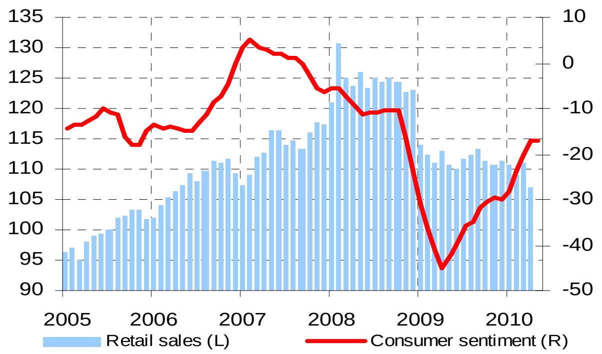
Contribution to GDP growth (in pp, y/y)



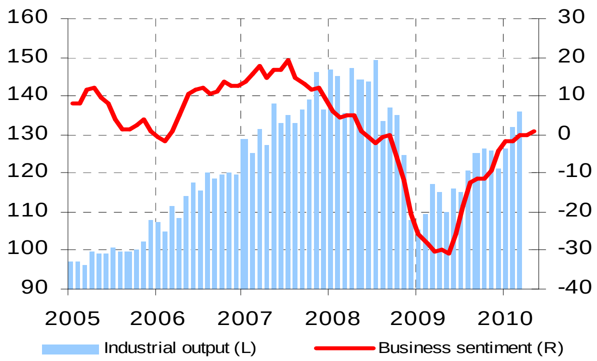
HICP and its components (in %, y/y)



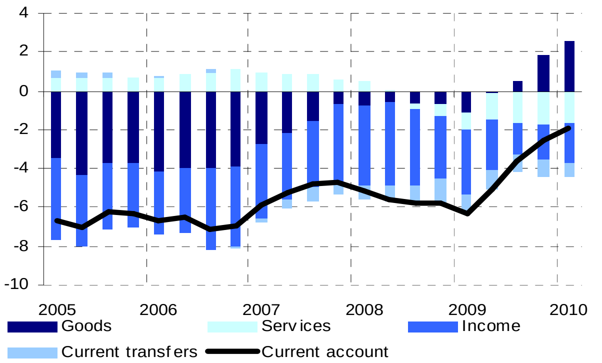
Retail sales (in %, y/y) and consumer sentiment index



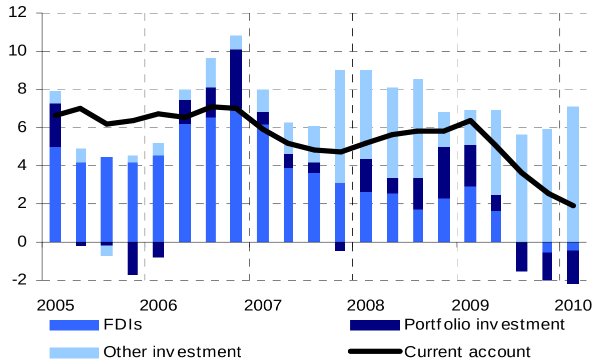
Industrial production (in %, y/y) and business sentiment index



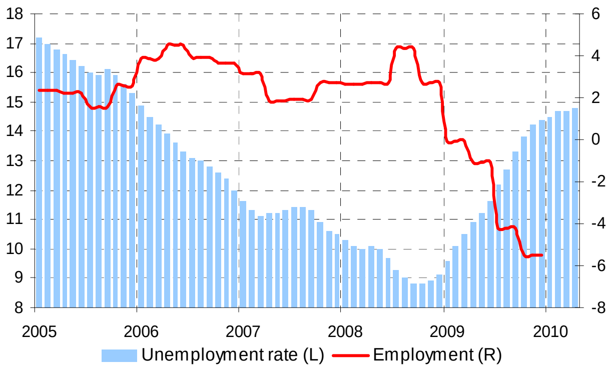
Current account and its components (in % of GDP, 4q moving average)



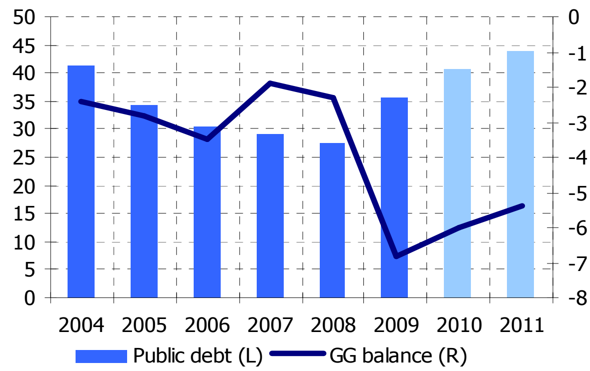
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVENIA

Economic growth

In 2009, gross domestic product in Slovenia declined by 7.8%, thus making this small country rank among the most crisis-hit economies. Among the Central and Eastern European countries, only the Baltic states experienced a deeper decline in economic activity. The crisis-related developments spread into the Slovenian economy mainly as a result of exports. Due to substantial openness of the economy, the decline in external demand had an immediate adverse effect on the Slovenian enterprises situation. A slump in demand for goods manufactured in Slovenia forced enterprises in that country to strongly limit their fixed capital formation. At the same time, enterprises reduced the level of inventories, which caused a deeper GDP contraction. The construction sector also noted a strong decline. Construction investment projects, which represented one of the most important factors of economic growth until mid-2008, fell sharply.

However, the measures taken by the Slovenian government led to mitigating the impact of the crisis on household consumption. Owing to a relatively small decline in employment and continuing positive growth rate of wages, private consumption diminished only by 1.4% (it was mainly caused by a strong reduction in consumer credit which considerably stimulated consumption when Slovenia joined the euro area). Active measures initiated by the government aimed at mitigating the impact of the crisis on the economy, especially on employment, resulted in one of the region's highest growths in public sector expenditure. Furthermore, the scale of GDP contraction was mitigated by a smaller trade deficit, following a slightly stronger decline in imports than in exports.

Table 9.1

Growth rate of GDP and its components (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**3.5**	**-7.8**	**-8.3**	**-5.5**	**-1.2**
Private consumption	2.2	-1.4	-0.4	-0.9	0.0
Public consumption	3.7	3.1	4.3	-1.4	1.8
Fixed capital formation	6.2	-21.6	-21.8	-16.5	-10.1
Exports	3.3	-15.6	-16.3	-3.6	4.5
Imports	3.5	-17.9	-17.7	-8.5	3.8

source: Eurostat

The deepest decline in the Slovenian economy was noted in 2009 Q1 (when GDP fell by 6% in quarter-on-quarter terms). In the following quarters, the economic activity stabilised, however as compared to most of the region's economies, recovery from recession was delayed. In 2010 Q1, GDP contraction was observed for the sixth time (by 1.2% y/y – the scale of contraction was mainly determined by the low base effect). As compared to the previous quarters, the decline in household expenditure was put to a halt and the cycle of inventories changed (after five consecutive quarters early in 2010, the level of inventories slightly rose). Yet, fixed capital formation continued to decline considerably. Although the scale of expenditure on machinery and equipment decreased (due to the growing demand of export enterprises), the declines in the construction sector remained very deep – especially in housing construction. The economic growth was positively affected by growing exports; yet, it was slightly limited as a result of larger import demand, especially in the export oriented sectors.

A certain stabilisation, observed in the Slovenian economy since the second half 2009, is mainly connected with the growing foreign demand. Industrial output rose in export oriented companies (especially exports of intermediate goods), which is supported by rising demand in the external environment of the euro area, especially in the developing Asian countries, and also the change in the inventories cykle. In the past, growth in the output of cars was stimulated by new car subsidies, especially in Germany and France. The increasing inflow of export orders translated into a considerable improvement of the business sentiment index. On the other hand, domestic market oriented sectors continue to register deep declines in production volume.

Early in 2010 retail sales continued on a downward trend. Consumer expenditure on durable goods continued to decrease (the sales of cars, which rose early this year owing to good offers of automotive dealers, is an exception). This is illustrated by a low level of the consumer sentiment index (which has practically seen no improvement since June 2009). The Slovenians have an especially negative opinion of the overall economic situation in Slovenia, mainly as a result of the harsh labour market conditions. They are more positive about the financial outlook for households. However, this outlook also deteriorated in the recent months as a result of the deepening debt crisis in the euro area.

Labour market

Employment in the Slovenian economy started to go down sharply in last two months of 2008. Since the outbreak of the crisis until February 2010, the number of jobs decreased by more than 52 thousand, i.e. by 5.9%. The decline in employment up to date proved to be smaller than in most countries of the region. The impact of the crisis on the labour market was mitigated by the measures taken by the Slovenian government (reportedly, those allowed to maintain 20 thousand jobs), such as working time subsidies and wage subsidies to employees made redundant on a temporary basis. In consequence, the unemployment rate, which remained the lowest in the region, was increasing until the end of 2009 Q3 and then stabilised above 6%.

Early in 2010, employment continued to go down, albeit more slowly. In March 2010, the number of jobs rose (in month-on-month terms) for the first time since the outbreak of the crisis, mainly in manufacturing. At the same time, the employment was still declining in the construction sector.

Inflation and labour costs

A relatively high inflation rate in Slovenia, as compared to the euro area and the CEE floating exchange rate regime countries, was connected with a rise in regulated prices (inflation of regulated prices in Slovenia is currently the highest in the region). It was caused mainly by rising prices of public utility services (at the same time, the government empowered local government authorities to fix the level of those prices, thus the scale of increases was slightly higher than expected). Moreover, in November 2009 the excise tax rate on fuels was raised, and in April 2010 higher excise tax rates were imposed on alcoholic beverages and tobacco products. In addition, due to the increase in fuel prices following the euro depreciation, in April 2010 the harmonised index of consumer prices rose to 2.7% (the highest level since November 2008). On the other hand, low demand (resulting primarily from decline in employment and lower wage growth) translated into lower core inflation, which was negative early in 2010 (mainly as a result of lower prices of clothing and durable goods in year-on-year terms).

Table 9.2

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**1.1**	**-0.1**	**1.4**	**1.7**	**2.7**
Contribution to HICP growth rate (in pp)					
Housing	-0.3	-0.6	0.2	0.9	1.2
Alcoholic beverages and tobacco products	0.3	0.4	0.4	0.4	0.6
Transport	-0.8	-1.0	0.3	0.6	0.6
Restaurants and hotels	0.6	0.5	0.3	0.2	0.2
Other	0.3	0.3	0.3	0.2	0.2

source: Eurostat

After a very high growth of unit labour costs in the first half of 2009 (following the declines in GDP and productivity as well as a high increase in wages in the general government sector), in the subsequent quarters ULC went down substantially.

Gross wages rose by 3.5% in the whole of 2009, thus showing a slower growth than in the last year (8.3%). In 2009 Q4, wage growth fell to 1.7%. The increase in wages was mainly the effect of growing wages in the public sector. However, the measures taken by the government allowed to stabilise the level of wages in the private sector. In February 2010, the Slovenian Parliament adopted a law on raising minimum wages (according to estimates, this will result in a 0.9% increase in labour costs in 2010).

Balance of payments

In 2009, the current account deficit narrowed considerably. In 2008, it amounted to 6.2% of GDP, while in 2009 it fell to 1.0%. A strong decline in the goods deficit represented the key factor in the considerable reduction of the external imbalance. This was the effect of a deeper decline in imports (by 25.9%) than that of exports (19.2%). The deepest decline in the trade in commodities was observed in the first half of 2009. However, in the second half of 2009 situation in the Slovenian exports started to stabilise. It was mainly a result of new car subsidies introduced in EU-15 countries, especially in Germany, and growing demand in Asian countries, which translated into higher demand for the EU exports.

Other factors which were conducive to the narrowing of the current account deficit included decrease in the negative income (in view of a decline in net transborder payments) and current transfers balances (greater absorption of EU funds). However a surplus in the services decreased at the same time – mostly in view of a large decline in exports.

In 2010 Q1, trends observed in the main current account componentss, observed in 2009, continued. A further decrease was registered in goods (the value of exports rose by 6.9% y/y, while import by 4.8%), income and current transfers deficits. The services account balance remained unchanged.

Table 9.3

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	**-5.8**	**-4.2**	**-2.8**	**-1.0**	**-0.4**
Goods	-6.3	-4.6	-3.2	-1.8	-1.6
Services	4.1	3.7	3.2	2.9	2.9
Income	-3.0	-2.8	-2.2	-1.9	-1.7
Current transfers	-0.6	-0.5	-0.7	-0.3	0.0
Capital account	**-0.1**	**0.0**	**0.0**	**0.0**	**-0.1**
Financial account	**5.0**	**2.8**	**1.3**	**0.1**	**1.0**
FDIs	0.3	-0.1	-0.7	-1.9	-2.0
Portfolio investments	3.1	9.5	15.9	13.3	14.0
Other investments	0.9	-7.1	-14.3	-11.7	-11.4

source: Eurostat

In 2009, the financial account surplus fell considerably. The balance of foreign investments in Slovenia was primarily determined by the outflow direct and other investments, which was not fully compensated by the record high inflow of portfolio investments. Withdrawal of capital by non-residents was caused, as in other countries in the region, by a decline in liabilities of the Slovenian banking sector resulting from loans received and deposits accepted from non-residents.

Fiscal policy

As a result of automatic stablisers and implementation of the anti-crisis package (approx. 1.5% of GDP), the general government deficit in Slovenia rose from 1.7% of GDP in 2008 to 5.5% of GDP in 2009. The government adopted a number of consolidation measures in the 2010 budget law, especially on the expenditure side (approx. 1.3% of GDP), in order to put to a halt further rise in deficit. The scheduled wage increases in the general government sector were stopped, the rules of indexation of pensions and other benefits were changed and the capital transfers were reduced. In anticipation of lower-than-planned tax income after May 2010, the government announced excise tax hikes and a reduction in fixed capital formation. In the latest version of the Stability Programme, the government expected deficit in 2010 to reach the level of 5.7% of GDP.

According to the European Commission, the general government deficit in Slovenia will amount to 6.1% of GDP in 2010 and 5.2% of GDP in 2011. The public debt in relation to GDP over the time horizon of the forecasts will double – from 22.6% in 2008 to 45.4% in 2011. Yet, this increase is partly the result of providing the banking sector with capital injection and more liquidity.

Forecasts

The forecasts for the Slovenian economy were slightly adjusted downward in spring 2010 as compared to the forecasts at the end of 2009. The pace of the economic recovery will probably be slower as compared to other countries in the region. It will be affected, to a certain extent, by the government abandoning the programmes aimed to stabilise the situation on the labour market. Moreover, the rise in minimum wages is expected to have an adverse effect on employment and competitiveness of the economy. The expected improvement in external demand in 2010 will translate into reversing the negative trends in domestic demand to a limited extent only. In 2010 the decline in employment may be as large as in 2009. Consequently, both Slovenian and international forecasting centres expect private consumption to continue to fall. The economic growth will be also adversely affected by substantial cuts in public expenditure as compared to the years 2008-2009. The forecast increase in exports will, in the first place, put an end to the downward trend in investments. Owing to stronger growth in exports, the improved trade balance will be the most important driving force behind GDP growth in 2010.

In 2011, GDP growth is expected to rise, although it will remain much lower, not only as compared to the years immediately preceding the crisis but also in the entire period of the Slovenian statehood. The key role in the economic growth is to be played by domestic demand – an increase in household expenditure and a faster upward trend in investments are expected. Growing inventories will also have a greater positive impact on the GDP growth rate. However, a faster growth in imports, as a result of a growing domestic demand, will weaken or even neutralise the impact of net exports on economic growth. In general, in 2011 the GDP growth rate in Slovenia will remain one of the lowest among the countries of Central and Eastern Europe.

A growing unemployment rate (in 2011 it is expected to exceed 7.0%, on average) and a low growth rate of wages (although Slovenia is expected to remain one of the few countries in the region where wage growth in real terms is expected) will limit the inflationary pressures. The current account deficit will be increasing in the two next years; however it will remain at a low level. The export growth rate will be one of the lowest in the region. It results mainly from a relatively large share in the Slovenian exports of the former Yugoslavia countries, where the demand will recover at a slower rate compared with the Western European countries.

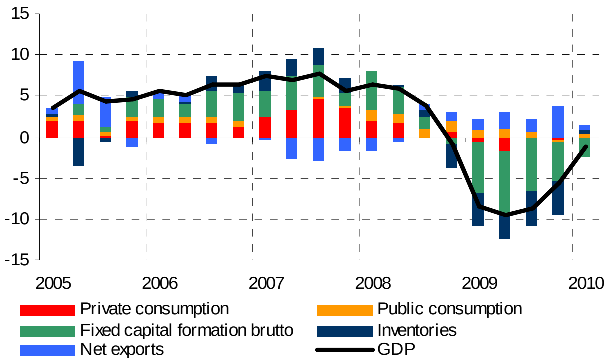
Table 9.4

Forecasts of main macroeconomic indicators

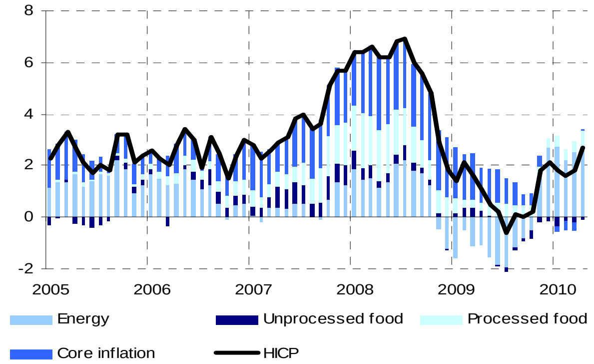
	BS	EC	OECD	IMF	Consensus Economics
	04.2010 (09.2009)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	1.3 (1.6)	1.1 (1.3)	1.4 (2.7)	1.1 (0.6)	1.1 (0.7)
2011	1.8 (1.7)	1.8 (2.0)	2.4 (3.0)	2.0 (3.8)	2.4
Inflation, in %, y/y					
2010	1.6 (1.5)	1.8 (1.7)	1.9 (1.1)	1.5 (2.1)	1.8 (1.8)
2011	1.4 (1.7)	2.0 (2.0)	1.3 (2.7)	2.3 (2.3)	2.2
Current account balance, in % of GDP					
2010	-0.5 (-3.2)	-1.4 (-0.2)		-1.5 (-4.7)	
2011	-1.4 (-3.7)	-1.6 (-0.6)		-1.2 (-5.0)	

BS – Banka Slovenije

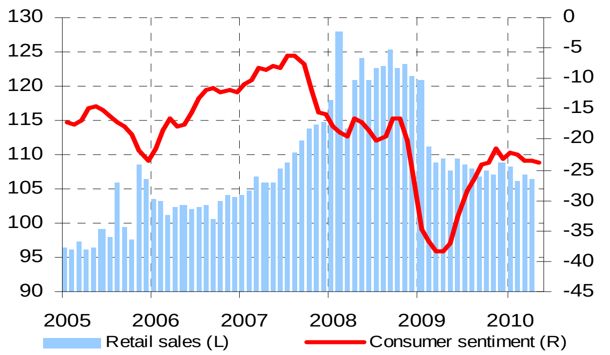
Contribution to GDP growth (in pp, y/y)



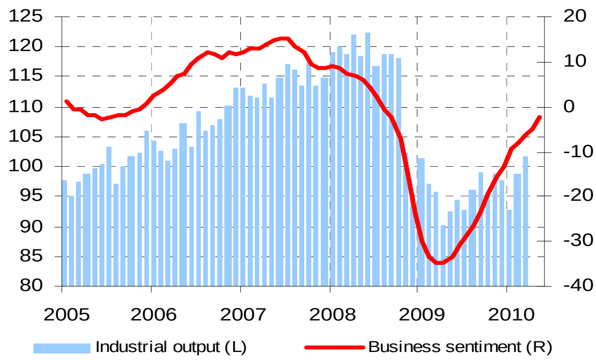
HICP and its components (in %, y/y)



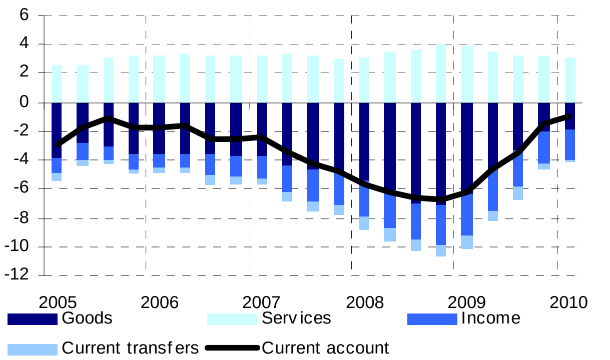
Retail sales (in %, y/y) and consumer sentiment index



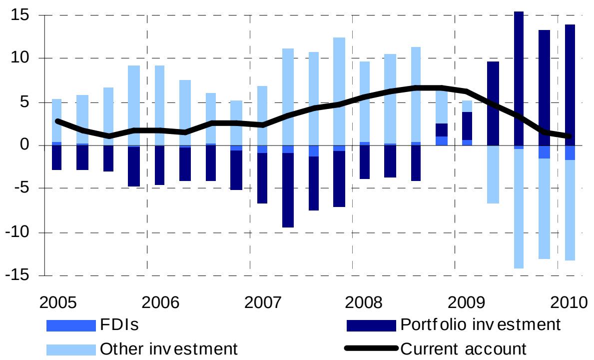
Industrial production (in %, y/y) and business sentiment index



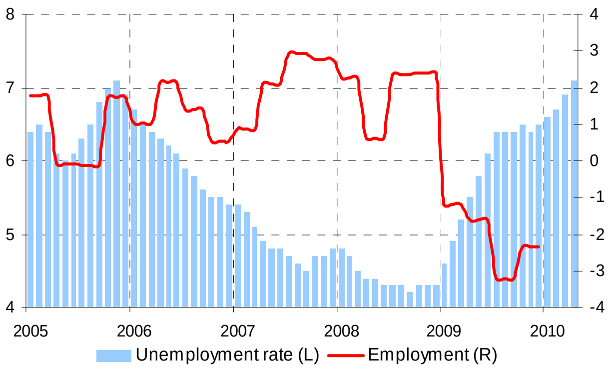
Current account and its components (in % of GDP, 4q moving average)



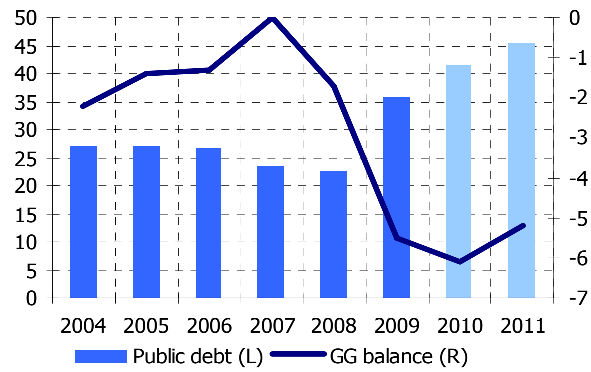
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSO

HUNGARY

Economic growth

In 2009, the gross domestic product in Hungary decreased by 6.3% after an increase of 0.6% in 2008. The biggest decline in economic activity was observed in 2009 Q1, when the quarterly GDP contraction amounted to 2.3%. In the following quarters the recession trends were gradually slowing down.

Table 10.1

GDP and its components growth rate (in %, y/y)

	2008	2009	2009 Q3	2009 Q4	2010 Q1
GDP	**0.6**	**-6.3**	**-7.1**	**-4.0**	**0.1**
Private consumption	-0.5	-7.6	-9.7	-6.3	-4.6
Public consumption	0.7	-1.1	-3.1	1.0	0.8
Fixed capital formation	-2.6	-6.5	-6.8	-8.1	-4.4
Exports	4.8	-9.1	-6.9	3.1	13.7
Imports	4.7	-15.4	-14.6	-2.0	11.6

source: Eurostat

A strong GDP contraction was primarily the effect of a declining domestic demand (-11.7% compared with 0.7% in 2008). Private consumption went down by 7.6% y/y (compared to a decrease of 0.5% in 2008); the investment expenditure of enterprises fell by 6.5% y/y (compared to a decrease of 2.6% in 2008). The limited consumer demand resulted mainly from the declining households disposable and uncertainties as to the recovery of the Hungarian economy from the recession in a foreseeable future. In contrast, the fact that banks introduced more stringent terms and conditions to be met in order to receive consumer and housing loans played only a minor role.

W 2010 Q1, the consumer demand remained low. This was illustrated by retail sales figures, which again fell in real terms, although this time the scale of the decline was smaller (-4.6% y/y compared to -7.4% y/y in 2009 Q4).

Despite the continuously negative growth rate of retail sales, the sentiment of Hungarian households improved again in 2010 Q1, which was visible in the rising consumer sentiment index. The most important role is still played by the more optimistic expectations of households as to their own financial standing and the economic situation in their country.

A decline in the value of loans granted to enterprises (of 11.7% in 2009) influenced gross fixed capital formation to a considerable extent. Additionally, a sharp reduction of excessive inventories in enterprises, resulting from an unexpected and strong decline in household consumption, led to a deeper GDP contraction (of 5.6 percentage points).

The net exports proved to be the only factor which mitigated the scale of decline in the economic activity in Hungary in 2009. Its positive contribution to GDP growth (7.3 percentage points) resulted from the fact that the decline in the exports volume was nearly two times smaller (9.1% y/y) than that in imports (15.4% y/y). The differences observed in the annual growth rates of the above mentioned categories were an indirect effect of an earlier growth in exports in quarter-on-quarter terms (starting from 2009 Q2) compared with imports (from 2009 Q3).

Preliminary data indicate that in 2010 Q1, the GDP growth rate in Hungary was positive (0.1% y/y), for the first time since 2008 Q3. It was primarily the effect of growing exports of goods and services and a low reference base from the early 2009. The quarterly economic growth rate (excluding the impact of seasonal factors) accelerated to 0.9% from 0.2% in 2009 Q4.

The industrial output in Hungary rose in 2010 Q1 on average by 4.5% y/y, after an increase by 1.0% y/y in November 2009. The key reason was an increase in the industrial output volume designed for foreign markets (12.5% y/y), while the industrial output for the domestic market continued to go down (-9.2% y/y).

The industrial output keeps growing, which is reflected in the systematically improving business sentiment indices in Hungary. In 2010 Q1, rising entrepreneurs optimism was based on their expectations of the future output, export orders and employment.

Labour market

In 2009, the scale of adjustments on the Hungarian labour market turned to be rather moderate compared with a high rate of GDP contraction in that country. It may illustrate the fact that enterprises, after an initial period of a strong reduction of employment in response to the outbreak and spread of the crisis, preferred such measures as shortening the working time and/or freezing wages when the first signs of the global economic recovery appeared.[28] Early in 2010, this trend continued, which is illustrated by the fact that in 2010 Q1 the unemployment rate rose to 10.9% from 10.6% in 2009 Q4.[29]

The aforesaid statement seems to be confirmed by a employment growth rate in the Hungarian economy. Total employment decreased in 2010 Q1, though to a smaller extent (-1.3% y/y) than in the last three months of 2009 (-2.5% y/y). The number of jobs fell both in the private and public sectors, even though the scale of

[28] The aforesaid statement refers mainly to the private sector, while realignments in the central and local government sector took mainly the form of reduction in nominal wages.

[29] For comparison, the unemployment rose to 9.2% in 2009 Q1 from 8.1% in 2008 Q4.

workforce reduction was much bigger in the former one (-5.1% y/y, compared with -0.5% in the latter).

Inflation and labour costs

The upward trend of the harmonised index of consumer prices continued during the first months of 2010.[30]

In 2010 Q1, the annual inflation rate amounted to 5.8% (compared with 4.9% in 2009 Q4), and in April it fell to 5.7% y/y. A sharp growth of inflation in early 2010 was mainly caused by the fast growing global energy prices, which translated into an increase in fuel and heating oil prices in the Hungarian economy. This was reflected in higher prices of transport compared with the same quarter of the previous year (14.5%) and housing services (5.2%). Apart from that, an increase in prices in the period from January until April 2010 was an effect of higher indirect taxes (excise tax and VAT) introduced in 2009. It was particularly visible in the case of alcoholic beverages and tobacco products, whose prices were growing by 12% y/y, on average, in the first four months of 2010 compared with 10% y/y in the second half of the last year.

Table 10.2
HICP and its components (in %, y/y)

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	Apr-10
HICP	**3.3**	**4.5**	**4.9**	**5.8**	**5.7**
Contribution to HICP growth rate (in pp)					
Transport	-0.5	0.1	1.0	2.2	2.1
Housing	1.3	1.1	0.8	0.7	1.0
Alcoholic beverages and tobacco products	0.5	0.7	0.8	1.0	1.0
Restaurants and hotels	0.4	0.5	0.5	0.5	0.4
Food and non-alcoholic beverages	-0.5	0.1	1.0	2.2	2.1

source: Eurostat

The growth rate of nominal wages in 2010 Q1 amounted to 3.0% y/y. Wages in the private sector rose by 5.1% y/y and in the public sector they went down by 1.5%. These data combined with the employment growth rate figures seem to confirm the thesis that the cost reduction in the public sector was basically achieved by wage adjustments, while in the private sector the number of employees was reduced to a bigger extent.

Balance of payments

In 2009, a slight surplus of 0.2% of GDP was recorded in the current account, while a relatively high deficit had prevailed in the previous years (7.1% of GDP in 2008). It was linked to a positive current account balance, which was gradually increasing since 2009 Q2.

The current account surplus was an effect of improving balances in all current account components. However, an increasing surplus in goods was of the greatest importance (in 2009 Q4 it amounted to 4.8% of GDP, compared with 3.0% of GDP in 2009 Q1).[31] It was driven by the fact that exports declined at a slower rate than imports. Decreasing declines in exports were supported by the recovering global demand, while domestic demand remained low and had an adverse effect on imports.[32] The increased inflow of current transfers also contributed greatly to the current account surplus. Improving services and income balances were less important in Hungarian external imbalances reduction.

Table 10.3
Balance of payments, net balance (in % of GDP, 4q moving average)

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4
Current account	**-7.1**	**-6.7**	**-5.4**	**-2.8**	**0.2**
Goods	-0.1	0.2	1.3	2.8	4.3
Services	0.9	1.0	1.1	1.3	1.6
Income	-7.3	-7.3	-7.3	-6.7	-6.0
Current transfers	-0.6	-0.6	-0.4	-0.2	0.3
Capital account	**1.0**	**1.3**	**1.6**	**1.9**	**1.3**
Financial account	**16.1**	**17.2**	**13.4**	**13.9**	**5.0**
FDIs	2.6	2.6	0.7	0.4	-0.2
Portfolio investments	-3.0	-6.2	-7.9	-6.6	-2.7
Other investments	16.6	20.8	20.6	20.1	8.0

source: Eurostat

In 2009, foreign capital continued to flow to Hungary (EUR 4.7 bn), though at a much smaller scale than in 2008 (EUR 17.1 bn). This was mainly the effect of a decreasing value of other investments An exceptionally high level of other investment in 2008 resulted from the financial aid that Hungary received from the World Bank, the International Monetary Fund and the European Commission.

A smaller inflow of foreign capital was also observed both in the case of direct investments and other investments. An outflow of net direct investments (for the first time since 1995, i.e. since the first publication of the balance of payments figures in Hungary) resulted both from a smaller scale of residents' investments abroad and non-residents in Hungary. It was also the case with portfolio investments. Their decline, continued for the third year in a row, resulted from non-residents' withdrawal from portfolio investments, mainly from the treasury bond market. The largest effect on the scale of outflow of capital due to portfolio investments in 2009 was caused by their strong decline in 2009 Q4.

Interest rates and exchange rate

W 2010 Q1, the National Bank of Hungary continued the cycle of interest rates cuts initiated in November 2008. In April 2010, the base policy rate of the central bank (two-week deposit rate) fell to its historical low, i.e. 5.25%.

During the period from August 2009 until April 2010, the nominal rate of the forint against the euro was stabilising. After that period, as a result of the reports on growing fiscal difficulties of Greece and other euro-area

[30] The inflation has continued to grow since January 2009.
[31] The figures refer to 4q moving average.

[32] In 2009 Q4, the volume of commodity export fell by 3.5% y/y, while the import volume fell as much as 11.5% y/y.

countries (Spain, Portugal, Ireland, Italy) and fears of the impact that the crisis in the euro area might have on the standing of banks in Western Europe, which are the main lenders for the Central and Eastern Europe countries, a considerable weakening of the region's currencies, including the forint, was observed. The scale of the currencies depreciation also increased as a result of a mass sell-off in the world stock exchanges, which was accompanied by investors retreat from markets perceived as more risky ones.

The foreign investors' aversion to Hungary grew as a result of the statements made by representatives of the governing party, who compared the situation of the Hungarian general government sector to Greece. This initiated another phase of forint depreciation in the first days of June 2010 (by nearly 5% against the euro) and an increase in the yields on state treasury bonds[33] (more than 100 basis points in the case of 10-year bonds). The subsequent disclaimer announced by representatives of the Hungarian government, supported by IMF assurances of the Hungarian general government sector's stability, as well as better-than-expected euro-area figures calmed down the sentiment on the Hungarian financial market in the following weeks of June.

Fiscal policy

Despite the economic crisis in Hungary in 2009 (GDP contraction by 6.3% y/y), the general government deficit in relation to GDP increased last year only by 0.2 percentage point and reached the level of 4.0%. The scale of growth in the fiscal imbalance was reduced owing to consolidation measures initiated in 2008-2009.[34]

As part of the EU-IMF aid programme, the socialist Hungarian government agreed to reduce the deficit in relation to GDP to 3.8% in 2010. The parliamentary elections in April 2010 brought to power the Centre-Right coalition. The statements made by the new government's members, announcing much worse results of the general government sector in 2010[35] than those agreed earlier as part of the rescue package and suggesting that the state of Hungary might become insolvent gave rise to panic in financial markets. In consequence, the yields on Hungarian bonds and CDS on that country's debt rose and the forint weakened. In order to quiet the financial markets, on 7 June 2010 the new Prime Minister of Hungary presented in the Parliament a 29-item economic action plan for the government. It provides for considerable changes in the tax system (replacement of the current two rates (17 and 32%) of PIT with a 16-percent flat rate, reduction of CIT from 19 to 10%, introduction of a special tax to be imposed on banks and financial institutions) and a 15-percent decrease in wages in public administration and state-owned enterprises. In addition, a ban on foreign currency denominated mortgage loans was announced. Furthermore, the Hungarian Prime Minister emphasised that the budgetary target of the new government this year would be the deficit agreed upon by his predecessors with the EU and IMF at 3.8% of GDP. However, the government's proposals were not regarded as fully credible by financial markets.

The European Commission predicts in its spring forecasts that without additional adjustment measures in 2010 the deficit of the general government sector in Hungary will exceed by 0.3 percentage point of GDP the level of 3.8% of GDP, agreed upon with the EU and IMF as part of the rescue package.[36] The general government debt in Hungary will substantially increase from 72.9% of GDP in 2008 to 77.8% of GDP in 2011. It is the highest level of public debt among the region's countries.

Forecasts

In the first half of this year, the foreign centres slightly revised upwards the forecasts for economic growth in Hungary in the years 2010-2011, although most of them – similarly to the autumn of 2009 – still expect that the recession will continue in the current year.

Net exports are still expected to have a positive impact on the GDP growth rate in Hungary. This will result from a faster growth in the value of exports than that of imports, even though in 2011 both the growth rates may come up to the same level. This year, the domestic demand will continue to decrease, and in 2011 it will become the main source of GDP growth. This will be an effect of a gradual increase in consumer expenditure of households (driven by growing wages, better employment prospects and lower VAT and excise tax[37]) and, consequently, the fixed capital formation of enterprises.

The continuing weak domestic demand should reduce the inflationary pressures in 2010. On the other hand, the

[33] The investors' confidence in the Hungarian general government sector fell as a result of the first (since 2008) unsuccessful tender of 12-month treasury bills carried out on 10 June 2010. Despite the fact that the yield on those bills was 180 basis points higher as compared to previous tenders, only 70% of bills were bought.

[34] Sickness and accident benefits were reduced, wages in the public sector were frozen for two years, 13th salary for the public administration staff was liquidated, the mechanism of old-age and disability pension indexation was changed, 13th pension was liquidated and the local government was reformed. In mid-2009 the VAT rates were raised (from 20% to 25%), just like the excise tax rates (by approx. 5-6 percentage points).

[35] Deficit at the level of 7.0-7.5% of GDP.

[36] As a result of higher expenditure (including, among others higher subsidies for renationalised MALEV air lines, possibly higher expenditures of ministries in connection to the weaknesses of the new expenditure control system) and a probable decrease in income following, among others, the Constitutional Tribunal decision on the lawfulness of the real property tax.

[37] Numerous actions were taken in mid-2009 in order to reduce an excessive general government deficit, e.g. the VAT rate was raised from 20% to 25% and the excise tax rate was raised by approx. 5-6 percentage points. From 2011 the rates will return to their former levels.

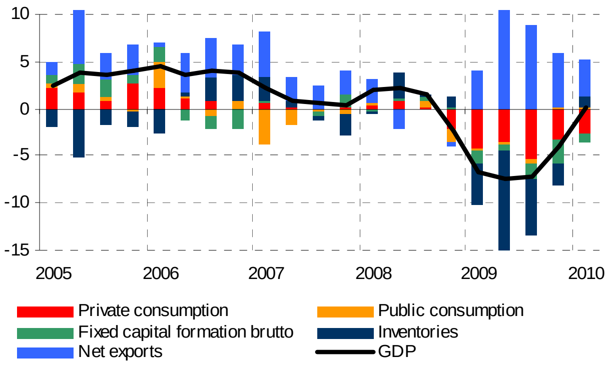
higher rates of indirect taxes will contribute to an increase in an overall level of prices in the Hungarian economy, which in the opinion of most centres may result in a slight growth in inflation in 2010 compared with 2009. In turn, the expiring effects of indirect tax increases in 2011 is expected to be conducive to inflation decline.

Table 10.4
Forecasts of main macroeconomic indicators

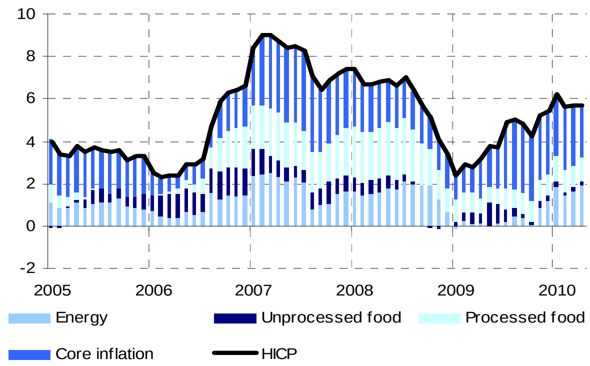
	MNB	EC	OECD	IMF	Consensus Economics
	05.2010 (02.2010)	05.2010 (10.2009)	05.2010 (11.2009)	04.2010 (10.2009)	05.2010 (11.2009)
GDP, in %, y/y					
2010	0.9 (-0.2)	0.0 (-0.5)	1.2 (-1.0)	-0.2 (-0.9)	0.1 (-0.2)
2011	3.2 (3.4)	2.8 (3.1)	3.1 (3.1)	3.2 (3.2)	2.6
Inflation, in %, y/y					
2010	4.9 (4.4)	4.6 (4.0)	4.5 (4.0)	4.3 (4.1)	4.5 (3.7)
2011	3.0 (2.3)	2.8 (2.5)	2.3 (3.0)	2.5 (2.5)	3.0
Current account balance, in % of GDP					
2010	(-0.4)	-0.2 (-1.7)	0.8 (-1.8)	-0.4 (-3.3)	
2011	(-0.4)	-0.3 (-1.8)	-0.4 (-2.6)	-1.0 (-3.4)	

MNB – National Bank of Hungary

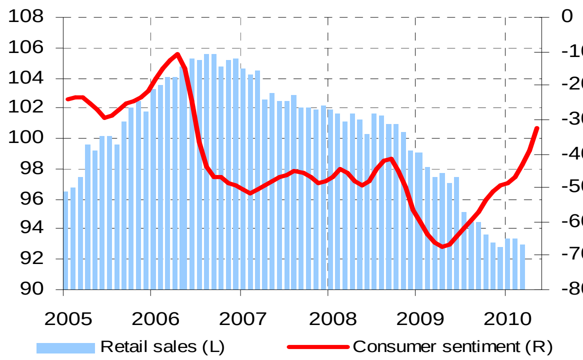
Contribution to GDP growth (in pp, y/y)



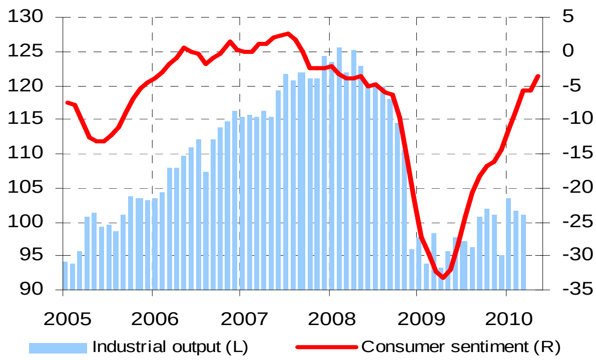
HICP and its components (in %, y/y)



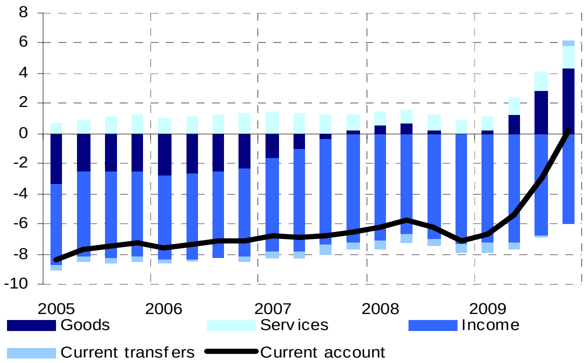
Retail sales (in %, y/y) and consumer sentiment index



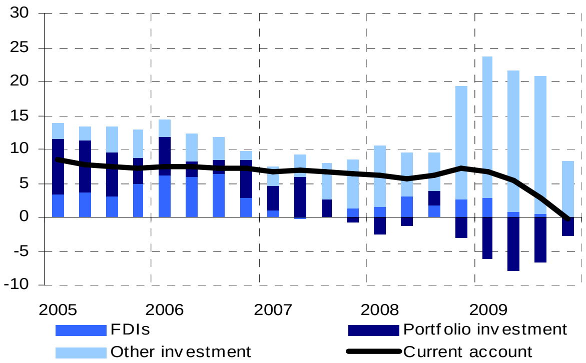
Industrial production (in %, y/y) and business sentiment index



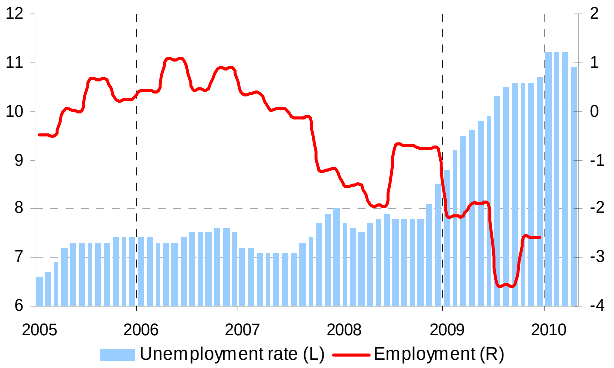
Current account and its components (in % of GDP, 4q moving average)



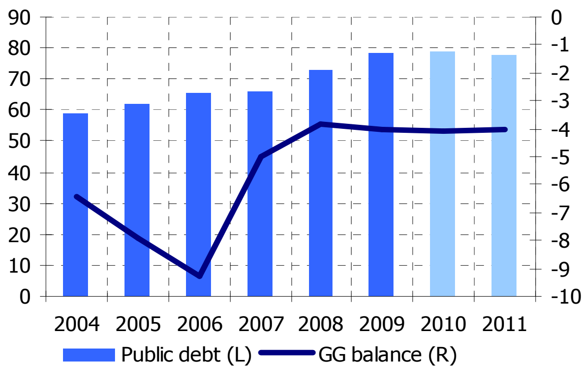
Financial account balance and its components (in % of GDP, 4q moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

Annex 1

Sovereign debt crisis in the euro area and the Central and Eastern Europe economies

The Greek government announcement of a higher than previously estimated general government sector deficit (nearly 13% of GDP in 2009) triggered speculations about the future of the Greek economy, and even the entire euro area. The sovereign debt crisis in Greece and the growing anxiety about the fiscal stance in the peripheral countries of the euro area[38], observed in the past few months, resulted in another escalation of fears about collapse of global financial markets. It led to an increase in the global risk aversion and, in consequence, to adjustments of financial asset prices as well as depreciation not only of the euro but also of the currencies of the CEE region's countries. The CEE countries, which at the turn of 2009 and 2010 were slowly overcoming the most severe crisis since their transformation, suffered from another shock which may slow down the process of their economic recovery.

The effect of the "Greek crisis" has been already observed on the financial markets of the region's countries. Turmoil on the European financial markets led to an **increase in the global risk aversion**. This has an especially adverse effect on the CEE region economies. This is illustrated by the fact that despite rapid weakening of the euro against the US dollar in the past few months, even deeper depreciation was registered in the case of CEE currencies, especially the Polish zloty and the Hungarian forint. Stock exchanges in the CEE countries also responded to increasing risks on the financial markets. In April and May 2010, the stock indices in Prague and Budapest fell by more than 15%, and in Warsaw by more than 8%.

Figure 1. CEE floating currencies vis-à-vis EUR and EUR/USD exchange rates, 01.01.2008=100, increase means depreciation

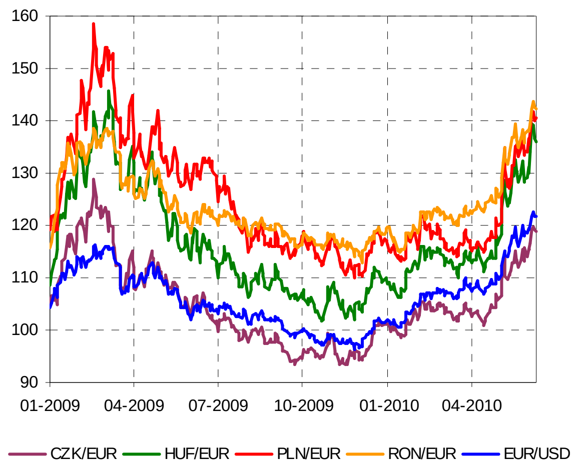
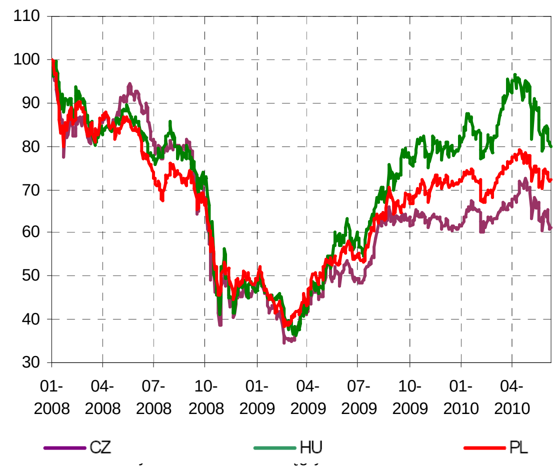


Figure 2. Main CEE stock exchange indices



Source: EcoWin Financial

The persisting negative investors sentiment toward the region may lead to the situation already observed at the end of 2008. At that time, a massive withdrawal of foreign investors from developing countries was registered, triggering crisis on their financial markets. It resulted in liquidity problems in the banking sector and difficulties linked with roll-over of public debt.[39] This would represent a considerable change as compared to the second half of 2009, when a record inflow of investments to the region's countries was registered (especially to Poland, the Czech Republic and Slovenia) in particular portfolio investments in government bonds.

Higher risk aversion and the absence of foreign capital inflow also translated into an increase in costs of public debt financing in the CEE region. Growing prices of CDS contracts, observed in the region's countries in April and May 2010, led to an increase in the treasury bonds yield, especially in Hungary, Bulgaria and Romania.

[38] Portugal, Ireland, Italy, Greece, Spain
[39] For that reason Hungary and Latvia sought aid from the IMF and other international institutions.

Figure 2. 5Y CDS, in basis points

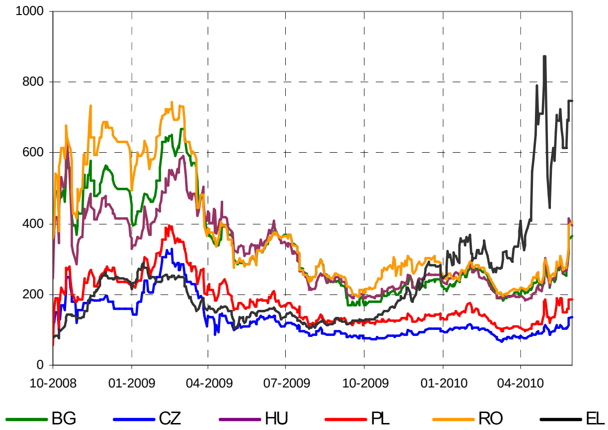
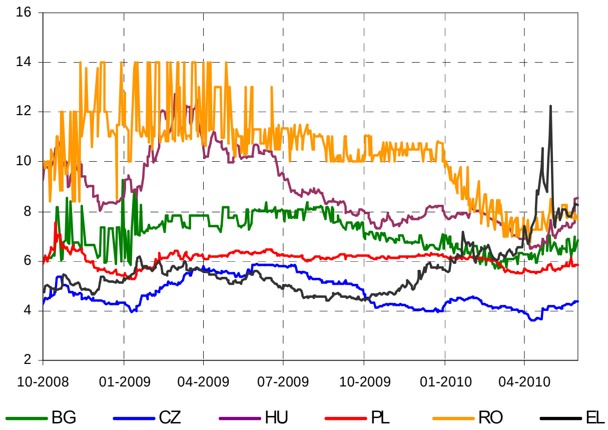


Figure 3. 10Y yields, in %



Source: EcoWin Financial

Higher risk aversion is not the only channel through which the public finance crisis in the euro area countries may spread to the CEE region. Possible channels of transmission of the present crisis to the CEE countries may include:

- foreign trade,
- foreign investments,
- banking sector,
- public finance.

It seems that the **foreign trade** channel in the case of the majority of the CEE countries should not play a major role in a potential crisis spillover, given a relatively small share of Greece in exports of the region's countries. Only in the case of Bulgaria, Greece is the major trade partner. In other countries its share in exports is much smaller (0.1-1.5% of total exports).

Table 1. Exports of the CEE countries to the euro area peripheral countries and EU-15, in % of total exports

	Greece	Spain	Ireland	Portugal	Italy	**peripheral countries**	EU-15
Bulgaria	6.1	1.6	0.3	0.2	7.8	**16.0**	43.9
Czech Republic	0.1	1.6	0.7	0.3	4.0	**6.7**	60.7
Estonia	0.1	1.0	0.3	0.1	2.2	**3.7**	50.7
Lithuania	0.1	1.5	0.2	0.1	3.8	**5.6**	35.6
Latvia	0.1	1.3	0.3	0.1	3.8	**5.6**	38.5
Poland	0.2	2.1	0.6	0.2	6.5	**9.7**	61.8
Romania	1.5	1.9	0.6	0.3	11.7	**16.2**	54.1
Slovakia	0.2	1.1	0.2	0.1	4.3	**6.0**	41.9
Slovenia	0.7	2.4	0.3	0.1	15.9	**19.5**	60.6
Hungary	0.1	1.5	0.5	0.2	4.1	**6.4**	53.3

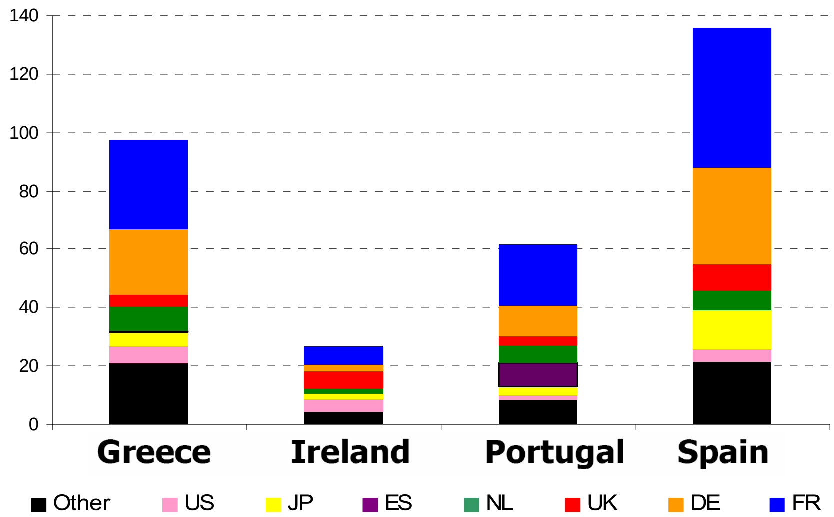
Source: Eurostat

The probability of the crisis transmission through the trade channel will increase considerably if the crisis spreads into other euro area peripheral countries, especially Italy, one of the major trade partners of the CEE countries. The CEE countries represent small and open economies where the share of exports in GDP oscillates within the range of 40-80%. A relatively strong external demand in the past few quarters offset, at least partially, substantial declines in domestic demand and enabled to slowly recover from the crisis. Should foreign demand fall, the rate of the anticipated economic recovery in the CEE countries would go down considerably.

This is also the case of the inflow of **foreign investments**. If we consider Greek investments only, in the majority of the CEE economies their inflow did not exceed 1% of the total direct investments in the past few years. Greece was an important foreign investor only for Bulgaria and Romania, where Greek FDIs accounted for approx. 7% of the total FDIs. Yet, cessation of the inflow of investments from other euro area countries, in the case of the crisis spreading, would have more severe consequences for the development of the region's economies (which was demonstrated by the financial crisis in 2008 and 2009).

In the case of Bulgaria and Romania, intensive activity of **Greek banks** poses a substantial risk to the financial system of those countries, thus to their entire economy. Their role is particularly important in the case of Bulgaria, where the Greek banks represents nearly 30% of the banking sector total assets. In the case of Romania this share does not exceed 10%. The banking systems in the CEE countries, including Bulgaria and Romania, were specific in that they did not fully finance domestic lending from domestic deposits. The remaining portion of financing came from loans taken from the main branches of foreign banks. As early as in 2009 a considerable decline in the banking sector lending was registered and the deteriorating financial standing of Greek banks may lead to further reduction in the financing of branches in Central and Eastern Europe. This would be conducive to continued slowdown in lending, which was one of the key reasons for the collapse in domestic demand in those countries.
In the case of other countries of the region, a large involvement of European banks, especially German and French banks, in treasury securities of the peripheral countries represents a higher risk. A decline in the value of those bonds and, in the worst case scenario, even insolvency of their issuers would be a huge shock for the entire European banking system, affecting also the CEE region.

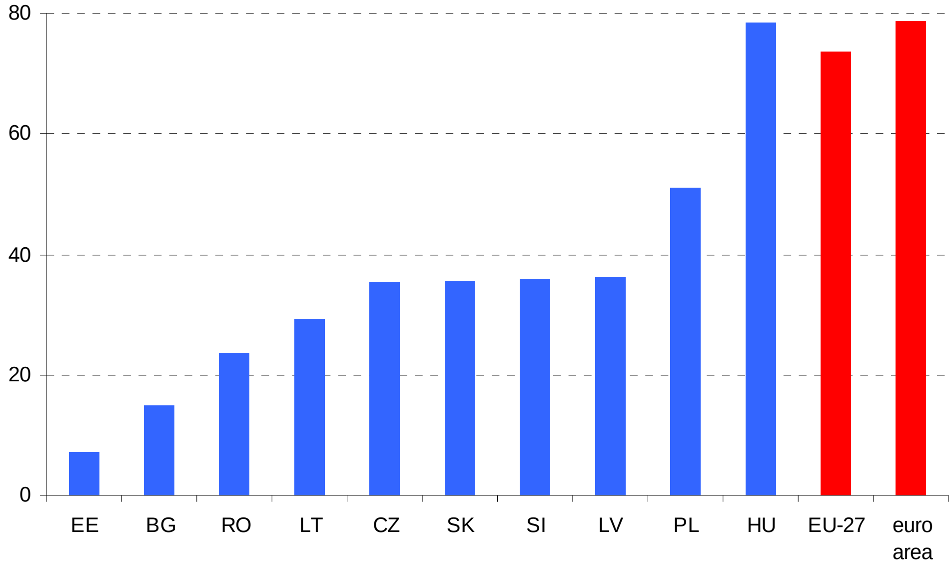
Figure 6. The euro area peripheral countries treasury bonds held by foreign banks, in USD bn



Source: BIS

Sovereign debt crisis in Greece and in other peripheral countries is also connected with the risk of **lower ratings of countries where the fiscal stance deteriorated** considerably over the last year. This is illustrated by downgraded ratings for Portugal and Spain. In 2009 the CEE countries registered a substantial increase in the general government deficit and public debt which, together with prolonged high risk aversion, creates the possibility of investors' exit from treasury securities markets of the countries of the region.
Public sector debt in relation to GDP in the new EU Member States was much lower in 2009 than in the euro area (it was similar only in Hungary). However in view of the continuing aversion of investors toward the developing markets, CEE region may face difficulties with the public debt financing of (little interest in treasury bonds). The investors are extremely sensitive to the condition of the public sector in the EU countries, which was illustrated, among others, by a very strong reaction to the unconfirmed statement of the spokesperson of the Hungarian Prime Minister, Peyer Szijjarto, comparing the situation in Hungary to that in Greece. This resulted in a rapid weakening not only of the Hungarian currency but also of the currencies of the entire region and further growth in CDS.
The June 2010 developments show that Hungary is the country which is the most sensitive to the risk of the crisis spreading through the abovementioned channel. Poland also seems to be at risk given its relatively high public sector's debt. Only in those countries of the region the value of public debt exceeds 50% of GDP. In other countries the debt was significantly lower and did not exceed 40% of GDP in 2009.

Figure 6. Public debt, in % of GDP



Source: Eurostat

Considering direct relations of the Greek economy with the CEE region, it seems that the risk of Greek crisis contagion is rather small. Only in the case of Bulgaria and Romania, the economies having the closest relations with Greece, there is a possibility of transmitting the crisis effects to the real sphere. However, if the crisis spreads to other euro area countries, the sovereign debt crisis may pose a more serious threat for the stability of the region's economies. Turmoil on the financial markets and higher risk aversion caused by the "Greek crisis" seem to pose higher risk for the CEE countries. This may result in the outflow of capital from the region, similar to that in the second half of 2008, and lead to growing costs of public debt financing.

Annex 2

Exports of the Central and Eastern Europe countries to Russia and Ukraine during the crisis

The former USSR countries represent a region which, apart from Central and Eastern Europe, suffered most from the global crisis. A sharp economic slowdown was observed in two major economies – Russia (where GDP contracted by 7.9% in 2009) and Ukraine (a GDP contraction of 15.1%). Both the countries belong to the group of major trade partners of CEE countries. Furthermore, in the previous years, especially after the year 2004, a fast growing demand in those countries contributed to the intensification of trade exchange between those regions. In 2009, however, a strong decline in the demand in Russia and Ukraine (much deeper than in the case of other main trade partners) translated into a deeper decline in CEE exports.

The former USSR countries, especially Russia and Ukraine, represented the fastest growing export market for the countries of Central and Eastern Europe until 2008. In view of a very dynamic growth in exports to those countries (in the years 2000-2008 the value of exports to Russia rose more than seven times, and to Ukraine – five times) their importance was considerably growing. In 2008, Russia accounted for 4.5% of the total exports of CEE countries (and 20.3% of exports outside the EU), and Ukraine – for 2.2% (9.7%).

The share of Central and Eastern European countries in exports to Russia and Ukraine is two times higher than in total EU exports. The importance of both countries as export markets varies among particular Central and Eastern Europe countries. In 2008, Russia accounted for 16.1% of Lithuania's, 14.7% of Latvia's and 10.4% of Estonia's exports. Apart from the Baltic states, Russia plays the biggest role in Poland's exports at 5.2%. Ukraine plays the most important role in the exports from Poland (3.7%). The Ukrainian market has also a relatively big significance for enterprises from Lithuania (3.3%) and Romania (2.4%).

The dynamic growth in exports to Russia observed until 2008 was supported by a high economic growth rate in that country. In the years 2000-2008, GDP rose on average by 6.9% a year, thus Russia was among the fastest growing world economies. At the beginning of the decade this was mainly the effect of recovering from a crisis (which deeply affected Russia in summer 1998). In the following years, a high GDP growth rate was driven by advantageous external developments – primarily the growing prices of energy commodities, which led to a substantial increase in the export income. A high economic growth rate translated into a considerable improvement in the situation of households, which in turn was reflected in growing imports of consumer goods. The inflow of foreign investments from EU countries to Russia resulted, on the one hand, in growing investment imports and, on the other hand, in growing imports of intermediate goods as a result of the continuing intensification of corporate trade. Furthermore, a rapid growth of the Russian economy led to an increase in the demand for investment goods (although until 2008 its share remained at a relatively low level, considering the economic potential of that country, and especially the needs for the modernisation of the economy). In consequence, the Russian market became one of the most important targets of European companies. Mainly in view of the geographic proximity and historical relations, the enterprises from the EU countries became the biggest beneficiaries of the import boom in Russia.[40]

The key role in boosting the exports of the CEE countries to Russia was played by products classified as machinery and transport equipment. In the years 2000-2008, the value of their deliveries rose on average by almost 40%. An exceptionally high growth in exports was noted after the year 2004. The average annual growth rate in exports in the years 2004-2008 amounted to 53.8% (!), while in the years 2000-2003 exports rose on average by 23.8% a year. In consequence, their share in the exports to Russia in 2008 exceeded 50% (while in 1999 it had accounted for slightly more than 1/3).

Such a strong effect of export creation in that group was connected with the strategy of multinational corporations which, as a result of delocation of some manufacturing processes, used their subsidiaries

[40] In 2000-2008 the growth of Russia's share in the global imports was the highest apart from China. According to WTO data, it increased during that period from 0.7% to 1.8%.

in the Central and Eastern European countries as a platform for exports to Russia. Thus, the export creation was also accompanied by its shift (mainly between the new and old EU Member States), which is illustrated by a declining growth rate of exports of machinery and transport equipment in EU-15 countries despite a continuing strong demand in Russia.

The biggest acceleration of exports from new Member States to Russia, according to main economic categories, was noted in the case of durable consumer goods and some means of transport (i.e. those categories of products which are classified mostly as machinery and transport equipment). In both cases the share of Central and Eastern European countries in EU exports rose considerably – in the case of durable consumer goods the CEE exports represented 27.1% in 2008 (compared with 5.9% in 2003), and in the case of parts for means of transport – 43.4% (14.2%).

The exports to Ukraine was characterised by similar trends. The consumer demand in that country was growing at a slightly lower rate than in Russia, but multinational corporations additionally contributed to the growth in trade. In view of the geographic proximity of Ukraine, they merged the subsidiaries located in that country into regionally integrated manufacturing networks with enterprises from EU countries, including the Central and Eastern European countries. This was reflected in a substantial increase in exports of intermediate goods to Ukraine.

In 2009, in the conditions of a global recession the value of exports to both countries substantially decreased. Compared with 2008, the value of sales to Russia fell by 1/3 and to Ukraine – by nearly 45%. The decline in exports to both Eastern European partners proved to be much bigger than to other countries, and in consequence the shares of Russia and Ukraine in the exports of CEE countries went down to 3.7% and 1.5%, respectively. This was already the third such strong decline in exports to those countries in the last two decades (the first took place after the collapse of USSR in 1991, and the second during the 1998-1999 crisis).

A stronger decline in exports to Russia compared with exports to other main trade partners of the European Union resulted from the economic slump in that country, as Russia is among the countries which suffered most from the global crisis. GDP contraction in Russia amounted to 7.9%, the biggest decline among the largest world economies. It took place despite the fact that in autumn of 2008 Russia, similarly to other large economies, launched the rescue package to improve the banking sector liquidity and stop further decline of confidence towards financial institutions. Moreover, some actions were taken with the aim of limiting the impact of the crisis on the exchange rate and household consumption.

Despite taking the consumption spurring measures, a strong depreciation of the rouble and a sharp reduction in banks' lending to enterprises and households (which had stimulated consumer expenditure in the previous years) resulted in a deep decline in imports. In addition, the macroeconomic situation in Russia deteriorated as an effect of a huge decline in world oil prices. The inflow of foreign investments also collapsed.

Contrary to the EU exports to other partners, the relatively smallest decline in exports to Russia was observed in the category of intermediate goods. In 2009 it went down by 32%. At that time, exports of consumer goods fell by 28% and sales of investment goods nearly halved. A slightly smaller decline in exports of intermediate goods may be probably explained by the fact that the demand of the export sector in Russia (mainly foreign enterprises), and so in fact the foreign demand, decreased less that domestic demand. In the situation of a collapsing domestic demand the structure of imports of consumer goods drastically changed. The largest declines were noted in the exports of passenger cars (which value in 2009 was nearly two times smaller in year-on-year terms) and consumer durable goods. However, the smallest decline was observed in the case of such consumer staples as food and consumer non-durable goods. Thus, contrary to the crisis of 1998-1999, the recent crisis resulted in a stronger decline in higher processed goods.

Table 1
Exports of Central and Eastern European countries to Russia

	Value		Russia's share in total exports		Annual changes	
	2008	2009	2008	2009	2004-2008	2009
	(EUR mn)		(%)		(%)	
Bulgaria	413	299	2.7	2.5	34.7	-27.5
the Czech Republic	2 911	1 887	2.9	2.3	41.3	-35.2
Estonia	880	602	10.4	9.3	41.4	-31.6
Lithuania	2 582	1 562	16.1	13.2	36.3	-39.5
Latvia	1 011	720	14.7	13.1	49.1	-28.8
Poland	6 041	3 596	5.2	3.7	35.1	-40.5
Romania	610	515	1.8	1.8	67.6	-15.6
Slovakia	1 811	1 416	3.7	3.5	50.4	-21.8
Slovenia	1 117	682	4.8	3.6	26.3	-39.0
Hungary	2 666	2 121	3.6	3.5	35.8	-20.4
CEE	**20 042**	**13 400**	**4.5**	**3.7**	**38.0**	**-33.1**
EU-15	84 966	52 245	2.4	1.8	20.7	-38.5

Source: Own calculations based on Eurostat data

Table 2
Export of CEE countries to Russia in main economic categories

	Value		Share		Annual changes	
	2008	2009	2008	2009	2004-2008	2009
	(EUR mn)		(%)		(%)	
TOTAL	**20 042**	**13 400**	**100.0**	**100.0**	**38.0**	**-33.1**
CONSUMER GOODS	**7 257**	**5 245**	**36.2**	**39.1**	**32.0**	**-27.7**
Food and beverages	1 660	1 342	8.3	10.0	23.0	-19.2
Cars	1 068	486	5.3	3.6	34.4	-54.5
Consumer durable goods	1 408	772	7.0	5.8	72.7	-45.2
Consumer non-durable goods	3 104	2 638	15.5	19.7	28.7	-15.0
CAPITAL GOODS	**5 366**	**3 001**	**26.7**	**22.4**	**54.6**	**-44.1**
Capital goods	4 448	2 743	22.2	20.4	55.9	-38.3
Industrial means of transport	918	258	4.6	1.9	49.4	-71.9
INTERMEDIATE GOODS	**7 342**	**4 989**	**36.6**	**37.2**	**36.7**	**-32.0**
Industrial supplies primary	237	252	1.2	1.9	36.4	6.3
Industrial supplies processed	3 712	2 467	18.5	18.4	27.9	-33.5
Parts and accessories for capital goods	1 356	1 035	6.8	7.7	39.7	-23.7
Parts and accessories for means of transport	2 037	1 235	10.2	9.2	69.1	-39.4
FUELS	**78**	**93**	**0.4**	**0.7**	**9.3**	**19.9**

Source: Own calculations based on Eurostat data

The scale of the decline of exports to Russia was slightly smaller in CEE countries as compared to old EU countries. The exports of new Member States in 2009 went down by 1/3 (while the exports of EU-15 countries – by nearly 40%). The scale of the export decline in capital and intermediate goods was similar in both groups, though the largest difference concerned the exports of consumer goods. The exports of Central and Eastern European countries fell in this category by less than 30%, while the exports of EU-15 by more than 40%. The largest decline in exports was noted in the case of machinery and transport equipment, i.e. the group which had previously demonstrated the highest growth rate. In 2009 the exports of those products decreased by 42.2% (with the strongest decline in recorded road vehicles and parts of them).

According to preliminary Eurostat data, the Polish exports to Russia fell by 40.5% in 2009, more than in other CEE countries (by 30.1%). At the same time, it was the strongest decline in exports among the region's countries. The export of products from the group of machinery and transport equipment decreased to the largest extent, i.e. by more than 60%. It was the deepest decline in exports in that group among new Member States and one of the deepest in the entire European Union. The reasons for the stronger decline in Poland's exports to Russia as compared with other Central and Eastern European countries mainly lie in corporate relations (i.e. the Polish exports were more connected with those enterprises located in Russia which reduced their production to a larger extent than it was true for other CEE countries). The main reason for a deep decline in exports of machinery and transport equipment from Poland was the collapse (of 80%) of the exports of automotive parts (following a substantial growth in 2008). In 2008 Poland was the second largest supplier of automotive parts to Russia after Germany. In 2009, an increase in the exports of automotive parts to Russia was noted by Slovakia, which replaced Poland as the second largest supplier of parts.

In turn, the smallest decline in the main groups of products took place in 2009 in agricultural products. The value of agricultural goods fell only by 15% in relation to 2008. It is quite interesting that in 2009 the Polish exports of agricultural products to Russia increased (by 16.4% – the strongest growth in the agricultural products exports to Russia since 2005). In consequence, last year the share of agricultural production in the Polish exports to Russia doubled (from 7.7% in 2008 to 15.0% in 2009). The largest growth in exports was observed in those groups of products which had been earlier most strongly affected by protectionist practices, fruit in particular.

The decline in exports to Ukraine was even deeper, which resulted from a bigger economic slump in that country (last year GDP contraction in Ukraine was 15.1%) and a stronger depreciation of the Ukrainian hrywna. The bigger economic slump in Ukraine was caused by the collapse of the world demand for steel goods and their prices (this sector's output accounts for approx. 20% of GDP), a sharp growth in unemployment (unprecedented mass lay-offs) and the declining demand in Russia, i.e. the biggest trading partner of Ukraine. This was reflected in the decline in the value of CEE countries' exports by nearly 45%. The deepest decline was observed in those categories where the biggest growth had been previously observed, namely capital goods and intermediate goods.

Table 3
Exports of Central and Eastern European countries to Ukraine

	Value		Ukraine's share in total export		Annual changes	
	2008	2009	2008	2009	2004-2008	2009
	(EUR mn)		(%)		(%)	
Bulgaria	176	96	1.2	0.8	27.4	-45.5
the Czech Republic	1 064	542	1.1	0.7	35.8	-49.0
Estonia	141	72	1.7	1.1	14.2	-48.7
Lithuania	523	354	3.3	3.0	29.9	-32.3
Latvia	109	63	1.6	1.1	15.4	-41.8
Poland	4 341	2 464	3.7	2.6	25.8	-43.2
Romania	821	348	2.4	1.2	70.0	-57.6
Slovakia	667	293	1.4	0.7	27.9	-56.1
Slovenia	227	172	1.0	0.9	19.6	-24.0
Hungary	1 518	926	2.1	1.5	31.1	-39.0
CEE	**9 586**	**5 330**	**2.2**	**1.5**	**29.2**	**-44.4**
EU-15	15 500	8 570	0.4	0.3	19.8	-44.7

Source: Own calculations based on Eurostat data

Table 4
Exports of CEE countries to Ukraine in main economic categories

	Value		Share		Annual changes	
	2008	2009	2008	2009	2004-2008	2009
	(EUR mn)		(%)		(%)	
TOTAL	**9 586**	**5 330**	**100.0**	**100.0**	**29.2**	**-44.4**
CONSUMER GOODS	**2 467**	**1 638**	**25.7**	**30.7**	**21.4**	**-33.6**
Food and beverages	448	320	4.7	6.0	18.1	-28.6
Cars	346	76	3.6	1.4	14.1	-78.2
Consumer durable goods	503	287	5.2	5.4	25.8	-43.0
Consumer non-durable goods	1 165	953	12.1	17.9	23.7	-18.2
CAPITAL GOODS	**1 630**	**756**	**17.0**	**14.2**	**37.2**	**-53.6**
Capital goods	1 359	658	14.2	12.3	37.2	-51.6
Industrial means of transport	271	98	2.8	1.8	37.1	-63.8
INTERMEDIATE GOODS	**4 380**	**2 426**	**45.6**	**45.5**	**27.0**	**-44.6**
Industrial supplies primary	157	120	1.6	2.2	9.8	-24.0
Industrial supplies processed	2 587	1 666	27.0	31.2	22.4	-35.6
Parts and accessories for capital goods	457	391	4.8	7.3	20.9	-14.3
Parts and accessories for means of transport	1 179	250	12.3	4.7	62.2	-78.8
FUELS	**1 098**	**504**	**11.4**	**9.5**	**75.4**	**-54.1**

Source: Own calculations based on Eurostat data

Among Central and Eastern European countries, exporters from the Baltic states and Poland suffered most from the decline in demand in Russia and Ukraine, mainly due to the large share of those markets in the export structure. However, it seems that the scale of decline of exports to Russia and Ukraine will not be as deep as in 1999. This is suggested by the fact that forecasts for those economies have been revised upwards in recent months. In May 2010, the European Commission expected the economic growth in Russia to amount to 3.7% in 2010. The economic recovery in that country is supported by the continuously high oil prices. In 2010 Q1 GDP in Ukraine increased by 4.8% (y/y).

STATISTICAL ANNEX

1. National accounts

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

	2008	2009	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	5.0	1.7	0.8	1.2	1.2	3.5	2.9
the Czech Republic	2.5	-4.1	-3.6	-5.0	-5.0	-2.9	1.1
Slovakia	6.2	-4.7	-5.7	-5.5	-4.9	-2.6	4.8
Slovenia	3.5	-7.8	-8.2	-9.2	-8.3	-5.5	-1.2
Hungary	0.6	-6.3	-6.7	-7.5	-7.1	-4.0	0.1
Estonia	-3.6	-14.1	-15.0	-16.1	-15.6	-9.5	-2.0
Lithuania	2.8	-14.8	-13.3	-19.5	-14.2	-12.1	-2.8
Latvia	-4.2	-18.0	-17.8	-18.1	-19.1	-16.8	-6.0
Bulgaria	6.0	-5.0	-3.5	-4.9	-5.4	-5.9	-3.6
Romania	7.3	-7.1	-6.2	-8.7	-7.1	-6.5	-2.6
EU-15	0.5	-4.3	-5.2	-5.2	-4.3	-2.2	0.5

Source: CSOs

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

	2008	2009	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	5.9	2.3	4.0	1.4	2.3	1.0	2.3
The Czech Republic	3.6	-0.2	0.8	0.0	-0.6	-0.8	-0.3
Slovakia	6.0	-0.7	-0.9	0.4	-0.3	-1.9	0.4
Slovenia	2.0	-1.4	-1.1	-3.2	-0.4	-0.9	0.0
Hungary	-0.5	-7.5	-7.2	-6.7	-9.7	-6.3	-4.6
Estonia	-4.7	-18.5	-17.3	-20.4	-19.6	-16.5	-7.7
Lithuania	3.6	-16.8	-15.7	-17.5	-16.5	-17.5	-9.9
Latvia	-5.2	-24.0	-22.3	-26.6	-27.1	-19.5	-5.8
Bulgaria	4.8	-6.3	-6.3	-5.6	-5.3	-8.0	-7.3
Romania	9.5	-10.5	-12.1	-14.6	-11.1	-5.3	-4.7
EU-15	0.4	-1.6	-2.1	-1.7	-1.7	-0.8	-0.2

Source: CSOs

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

	2008	2009	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	8.2	-0.3	-1.9	-1.5	-0.1	-0.3	-12.4
the Czech Republic	-1.5	-9.2	-9.4	-9.2	-11.7	-6.8	-6.6
Slovakia	1.8	-10.5	-3.9	-17.7	-11.4	-7.3	-0.4
Slovenia	7.7	-21.6	-22.2	-25.4	-21.8	-16.5	-10.1
Hungary	0.4	-6.5	-7.0	-3.4	-6.8	-8.1	-4.4
Estonia	-12.1	-34.4	-27.3	-38.8	-37.0	-34.3	-22.8
Lithuania	-6.5	-39.1	-38.5	-40.9	-41.4	-35.4	-30.2
Latvia	-13.6	-37.3	-34.1	-36.6	-39.4	-38.3	-44.4
Bulgaria	20.4	-26.9	-14.1	-16.3	-36.5	-35.4	-14.9
Romania	16.2	-25.3	2.7	-29.7	-27.6	-31.4	-28.9
EU-15	-1.1	-11.5	-11.5	-12.8	-11.9	-9.8	-5.5

Source: CSOs

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

	2008	2009	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	7.1	-9.1	-15.2	-13.7	-9.4	0.5	10.4
the Czech Republic	6.0	-10.8	-18.8	-16.0	-9.3	2.6	13.0
Slovakia	3.2	-16.5	-25.2	-20.3	-15.0	-5.2	16.8
Slovenia	2.9	-15.6	-19.7	-21.5	-16.3	-3.6	4.5
Hungary	5.6	-9.1	-17.8	-13.9	-6.9	3.1	13.7
Estonia	-0.7	-11.2	-16.5	-11.1	-9.6	-7.9	11.3
Lithuania	12.2	-14.3	-13.1	-23.4	-16.5	-2.9	2.8
Latvia	2.0	-15.5	-20.1	-20.2	-15.3	-5.8	4.6
Bulgaria	2.9	-9.8	-17.4	-15.8	-6.7	0.8	5.9
Romania	8.7	-5.5	-9.6	-10.4	-3.7	3.9	21.6
EU-15	1.0	-12.9	-15.4	-16.4	-13.3	-5.4	5.2

Source: CSOs

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

	2008	2009	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	8.0	-14.3	-16.9	-18.8	-13.3	-4.7	8.0
the Czech Republic	4.7	-10.6	-17.0	-15.4	-8.0	-1.7	10.7
Slovakia	3.1	-17.6	-22.3	-22.2	-15.6	-10.3	9.9
Slovenia	2.9	-17.9	-21.1	-23.7	-17.7	-8.5	3.8
Hungary	5.7	-15.4	-21.5	-22.6	-14.6	-2.0	11.6
Estonia	-8.7	-26.8	-27.4	-30.9	-26.6	-21.9	3.4
Lithuania	10.5	-29.4	-33.7	-33.2	-30.3	-19.0	5.7
Latvia	-11.2	-35.5	-35.1	-40.7	-36.7	-29.0	-2.7
Bulgaria	4.9	-22.3	-21.1	-24.3	-23.4	-20.0	-2.6
Romania	7.8	-20.6	-24.8	-26.2	-20.7	-11.4	16.1
EU-15	0.9	-12.0	-16.9	-18.8	-13.3	-4.7	8.0

Source: CSOs

2. Indices of business cycle and economic activity

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

	2008	2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010
Poland	3.0	-3.5	10.0	4.9	11.0	10.2	11.4	8.6
the Czech Republic	-1.5	-12.8	-2.6	-0.2	7.6	6.9	8.4	10.0
Slovakia	3.3	-13.5	1.1	11.7	21.0	20.7	19.2	21.1
Slovenia	-1.9	-17.0	-4.0	2.4	-8.7	1.3	6.2	9.8
Hungary	0.1	-17.2	-8.9	-1.2	5.2	8.1	2.9	9.7
Estonia	-6.2	-25.5	-14.2	-10.7	2.5	4.8	11.1	18.3
Lithuania	5.7	-14.4	-8.0	-7.2	-7.9	-0.8	1.3	5.0
Latvia	-6.8	-15.6	-2.4	-3.5	6.1	4.4	11.4	9.7
Bulgaria	1.1	-17.4	-12.0	-12.1	-0.6	-9.8	-0.6	-2.6
Romania	2.8	-5.7	3.1	9.3	6.2	-0.4	6.2	4.2

Source: CSOs

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

	2008	2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010
Poland	9.7	2.8	1.2	0.9	-2.4	-2.1	4.2	-4.6
the Czech Republic	3.2	-1.5	-3.5	-0.1	-3.4	-2.5	-1.4	-3.6
Slovakia	9.5	-10.2	-9.9	-9.5	-3.0	-2.8	0.1	-5.3
Slovenia	10.6	-10.1	-13.0	-10.5	-10.5	-4.6	-1.7	-2.7
Hungary	-1.8	-5.1	-7.3	-6.4	-5.8	-4.8	-4.5	
Estonia	-2.3	-18.2	-20.5	-15.5	-9.6	-7.8	-7.2	-7.3
Lithuania	5.0	-21.5	-27.0	-26.8	-16.7	-16.7	-9.9	-11.7
Latvia	-6.9	-28.0	-29.7	-29.5	-16.7	-13.4	-7.7	-7.6
Bulgaria	3.7	-8.2	-11.4	-12.0	-12.2	-11.5	-11.5	-11.6
Romania	13.7	-10.0	-8.9	-7.3	-11.2	-8.7	-4.9	-5.1

Source: CSOs

Table 8. DG ECFIN consumer sentiment index

	2008	2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	-6.5	-26.2	-23.5	-20.9	-18.9	-15.8	-16.2	-16.0
the Czech Republic	-8.6	-16.6	-7.3	-12.3	-10.5	-10.3	-5.0	-9.8
Slovakia	-13.1	-35.4	-27.7	-25.3	-18.7	-17.1	-15.9	-18.6
Slovenia	-20.4	-29.6	-22.6	-22.6	-21.9	-25.5	-22.8	-23.4
Hungary	-47.9	-59.3	-49.0	-46.4	-44.6	-38.8	-33.4	-26.0
Estonia	-20.6	-26.3	-18.2	-15.8	-13.5	-12.9	-10.5	-5.4
Lithuania	-22.1	-49.1	-47.7	-44.2	-41.2	-38.9	-38.7	-37.7
Latvia	-27.2	-50.1	-51.8	-40.0	-37.8	-31.9	-33.7	-29.1
Bulgaria	-31.6	-44.6	-41.8	-44.7	-47.4	-48.2	-43.4	-43.0
Romania	-17.7	-44.8	-41.2	-47.7	-48.8	-46.8	-47.1	-55.6

Source: EC

Table 9. DG ECFIN business sentiment index

	2008	2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	-7.9	-24.1	-18.9	-15.9	-14.3	-12.3	-13.0	-13.9
the Czech Republic	1.4	-22.8	-11.5	-9.3	-3.2	-6.3	0.0	2.8
Slovakia	-4.2	-17.9	2.3	-2.3	-4.6	6.6	-2.3	-1.2
Slovenia	-3.5	-25.6	-11.3	-5.4	-7.8	-5.5	-1.4	0.4
Hungary	-9.3	-23.3	-11.6	-6.8	-8.0	-2.6	-6.6	-1.8
Estonia	-11.0	-28.0	-14.2	-12.3	-10.8	-8.0	-2.4	0.9
Lithuania	-9.5	-33.5	-25.3	-15.9	-17.2	-14.8	-12.6	-14.0
Latvia	-14.1	-27.9	-19.2	-18.1	-14.0	-10.4	-7.8	-6.2
Bulgaria	8.9	-10.8	-9.6	-13.1	-11.1	-8.6	-8.3	-9.3
Romania	-0.4	-13.9	-11.7	-9.8	-10.2	-9.3	-10.1	-9.9

Source: EC

Table 10. PMI manufacturing index

	2008	2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	47.0	45.6	46.9	43.8	51.0	54.6	55.8	53.3
the Czech Republic						56.8	57.3	57.6
Hungary	49.8	45.3	49.4	53.9	56.0	54.4	51.6	49.6

Source: Eurostat

3. Prices

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	3.1	3.3	3.5	3.5	2.9	2.6	2.4	2.2
the Czech Republic	-0.2	0.5	1.0	0.7	0.6	0.7	1.1	1.2
Slovakia	0.4	0.4	0.5	0.4	0.4	0.8	1.3	1.2
Slovenia	0.0	1.6	1.8	1.5	1.3	1.4	2.3	2.1
Hungary	4.7	5.2	5.6	6.4	5.7	5.9	5.7	5.1
Estonia	-2.2	-2.1	-1.7	-0.7	-0.2	1.7	2.9	3.0
Lithuania	1.3	1.5	1.3	-0.1	-0.5	-0.2	0.3	0.7
Latvia	-0.9	-1.2	-1.2	-3.1	-4.2	-4.0	-2.8	-2.3
Bulgaria	-0.3	-0.1	0.6	0.4	0.9	1.3	1.8	1.9
Romania	4.3	4.7	4.7	5.2	4.5	4.2	4.3	4.4

Source: CSOs

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	1.6	1.9	2.8	1.3	0.0	0.5	1.7	
the Czech Republic	-4.6	-2.4	-0.8	-1.5	-2.0	-0.8	0.4	1.5
Slovakia	-5.8	-5.7	-5.1	-5.5	-7.6	-6.2	-4.5	
Slovenia	-1.5	-1.1	-0.7	-0.1	0.1	0.5	0.7	
Hungary	-2.8	-1.0	0.7	1.5	0.0	1.2	5.2	
Estonia	-3.2	-3.3	-3.1	-2.6	-1.7	-0.6	0.3	
Lithuania	-12.5	-9.8	-5.6	-5.4	-2.4	0.6	2.5	3.7
Latvia	-10.2	-11.0	-10.1	-9.7	-8.5	-7.8	-4.5	
Bulgaria	-8.3	-5.3	-0.7	1.8	2.5	2.8	5.6	
Romania	0.1	1.9	3.6	3.7	3.2	4.5	5.1	

Source: CSOs

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	3.8	3.8	3.8	3.9	3.4	2.9	2.7	2.3
the Czech Republic	-0.6	0.2	0.5	0.4	0.4	0.4	0.9	1.0
Slovakia	-0.1	0.0	0.0	-0.2	-0.2	0.3	0.7	0.7
Slovenia	0.2	1.8	2.1	1.8	1.6	1.8	2.7	2.4
Hungary	4.2	5.2	5.4	6.2	5.6	5.7	5.7	4.9
Estonia	-2.1	-2.1	-1.9	-1.0	-0.3	1.4	2.5	2.8
Lithuania	1.0	1.3	1.2	-0.3	-0.6	-0.4	0.2	0.5
Latvia	-1.2	-1.4	-1.4	-3.3	-4.3	-4.0	-2.8	-2.4
Bulgaria	0.3	0.9	1.6	1.8	1.7	2.4	3.0	3.0
Romania	4.3	4.6	4.7	5.2	4.5	4.2	4.2	4.4
EU-15	0.2	0.8	1.3	1.5	1.3	1.8	1.9	

Source: Eurostat

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	6.0	5.5	4.6	3.8	3.3	0.8	-0.7	-0.4
the Czech Republic	-3.8	-1.9	-1.1	-0.7	-1.6	1.0	1.7	1.1
Slovakia	-6.2	-5.2	-5.2	-2.8	-2.0	-0.3	2.4	1.5
Slovenia	-3.9	-2.7	-2.2	-5.0	-2.2	-2.6	-1.2	-0.5
Hungary	2.5	4.5	3.2	2.9	1.7	3.1	2.8	-6.5
Estonia	-5.8	-6.0	-6.5	-4.5	-2.8	0.6	4.6	1.6
Lithuania	-3.4	-4.7	-6.0	-7.3	-8.0	-6.8	-5.2	-4.2
Latvia	-7.2	-8.1	-8.7	-9.3	-7.8	-4.5	-1.5	-1.2
Bulgaria	-4.9	-5.2	-3.6	-6.3	-2.9	-4.0	-5.0	-3.9
Romania	0.9	0.8	0.7	0.1	-0.3	-0.7	-0.7	-0.6

Source: Eurostat

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	5.1	5.1	5.1	4.9	4.8	4.5	4.3	5.1
the Czech Republic	-1.6	-1.1	-0.2	0.7	0.2	0.7	1.5	-1.6
Slovakia	-0.2	-0.8	-0.3	0.3	1.0	2.4	2.6	-0.2
Slovenia	2.9	2.3	2.3	2.5	2.5	4.0	2.5	2.9
Hungary	4.9	4.9	5.8	5.1	4.8	5.2	4.9	4.9
Estonia	-3.8	-3.6	-2.8	-2.6	-1.5	0.2	1.8	-3.8
Lithuania	6.2	6.3	5.6	5.1	4.9	4.3	4.3	6.2
Latvia	4.1	4.4	1.4	-1.8	-1.2	-0.7	-0.8	4.1
Bulgaria	0.8	1.6	2.1	3.1	3.7	7.1	7.0	0.8
Romania	6.9	7.4	10.4	10.6	9.8	8.5	8.3	6.9

Source: Eurostat

Table 16. HICP – energy (in %, y/y)

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	4.3	5.4	7.5	8.9	6.0	6.6	6.9	7.0
the Czech Republic	-0.7	2.8	5.1	3.8	2.8	3.0	4.4	4.4
Slovakia	-1.1	-0.2	0.9	-1.0	-1.8	-1.1	-0.6	-0.5
Slovenia	-3.2	9.3	16.5	17.0	13.8	15.6	16.7	17.0
Hungary	0.2	6.1	8.7	13.7	10.7	11.8	14.0	16.1
Estonia	-6.3	-3.6	-0.5	6.8	8.0	13.1	15.9	17.0
Lithuania	0.4	4.0	5.0	4.1	5.4	6.7	8.6	8.2
Latvia	-6.4	-3.5	-1.9	-1.5	-4.0	-3.4	1.5	3.7
Bulgaria	-6.6	-2.4	1.8	6.1	4.2	9.9	10.3	10.3
Romania	1.3	2.7	4.1	6.1	4.6	5.2	5.8	6.3

Source: Eurostat

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	2.7	2.8	2.6	2.6	2.3	1.7	1.5	1.0
the Czech Republic	0.3	0.4	0.3	-0.2	-0.3	-0.3	-0.1	0.0
Slovakia	1.1	0.8	0.7	0.3	0.3	0.4	0.3	0.3
Slovenia	0.8	0.7	0.0	-0.3	-0.6	-0.5	0.1	-0.1
Hungary	5.2	5.2	5.1	5.0	5.0	5.0	4.3	3.9
Estonia	0.0	-0.6	-0.8	-1.5	-0.9	0.0	0.1	0.3
Lithuania	0.5	0.1	-0.1	-2.2	-2.9	-2.9	-2.6	-2.1
Latvia	-1.1	-1.5	-1.9	-4.2	-4.9	-5.2	-5.1	-5.0
Bulgaria	2.6	2.7	2.4	2.1	1.4	1.4	1.6	1.4
Romania	5.7	5.6	4.8	3.3	2.4	2.1	2.8	3.0

Source: Eurostat

4. Balance of payments

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	-5.0	-5.0	-5.0	-4.0	-3.0	-2.3	-1.6	-1.9
the Czech Republic	-0.7	-0.7	-0.6	-1.5	-1.4	-1.9	-1.1	-1.3
Slovakia	-5.8	-5.8	-5.8	-6.3	-5.0	-3.6	-2.6	-1.9
Slovenia	-6.1	-6.1	-6.2	-5.8	-4.2	-2.8	-1.0	-0.4
Hungary	-6.3	-6.3	-7.1	-6.7	-5.4	-2.8	0.2	
Estonia	-12.4	-12.4	-9.8	-5.9	-2.1	1.7	4.6	4.6
Lithuania	-14.3	-14.3	-11.9	-8.1	-3.9	-0.1	3.8	3.3
Latvia	-15.6	-15.6	-13.1	-9.2	-2.3	3.8	9.6	11.7
Bulgaria	-24.8	-24.8	-24.0	-22.4	-19.0	-15.4	-9.4	-6.6
Romania	-13.5	-13.5	-11.6	-10.0	-7.3	-5.4	-4.5	-4.9
EU-15	-0.6	-0.6	-0.9	-1.3	-1.4	-1.1	-0.8	-0.4

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-5069	-4020	-4812	-95	-1088	-1142	-2734	-1158
Goods	-4687	-4496	-4983	-764	-510	-806	-1118	-952
Services	875	645	1378	819	889	700	1049	722
Income	-3045	-2159	-1996	-1607	-3128	-2338	-3000	-2746
Current transfers	1788	1990	789	1457	1661	1302	335	1818
Capital account	1753	439	536	1802	1023	447	1732	1308
Financial account	9987	3521	2287	2820	5523	10964	6226	9880
FDIs	1991	883	1968	1379	1284	2744	822	3166
Portfolio investments	727	1463	-3144	-765	3860	4942	2999	6503
Other investments	7295	1402	3977	3306	624	3106	2325	451

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-1251	-304	-1491	904	-1152	-927	-290	621
Goods	1585	1121	-259	1511	1966	1727	1629	2422
Services	768	622	499	534	351	104	8	-284
Income	-3631	-1663	-1409	-1299	-3436	-2330	-1688	-1468
Current transfers	27	-385	-322	158	-34	-428	-239	-48
Capital account	507	72	366	559	170	214	598	89
Financial account	1585	1832	1206	-316	989	1051	1950	-1118
FDIs	1322	682	424	533	-12	-701	1156	1400
Portfolio investments	1583	351	-1732	-38	2782	936	645	527
Other investments	-1247	918	2725	-676	-1641	843	133	-3019

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-1134	-1420	-1058	-580	-215	-473	-348	-190
Goods	-230	-93	-169	-262	438	305	702	166
Services	-101	-45	-208	-242	-369	-222	-282	-176
Income	-668	-1066	-415	-21	-196	-396	-502	-228
Current transfers	-136	-216	-266	-55	-89	-161	-266	48
Capital account	398	196	528	168	225	176	282	
Financial account	958	2088	1331	176	856	237	1215	
FDIs	329	643	765	161	-487	-437	392	
Portfolio investments	167	703	376	241	-814	-791	452	
Other investments	462	742	190	-225	2157	1465	371	

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-486	-642	-733	-267	142	-120	-95	-94
Goods	-668	-751	-743	-149	-17	-208	-246	-117
Services	475	487	314	236	302	292	193	230
Income	-259	-394	-236	-216	-154	-155	-126	-168
Current transfers	-33	16	-69	-137	12	-49	84	-38
Capital account	3	-8	-30	-5	41	-4	-43	-37
Financial account	738	640	618	-172	-70	76	208	148
FDIs	-142	128	281	-139	-312	-89	-132	-161
Portfolio investments	-1152	165	1257	873	1149	2326	308	1113
Other investments	1947	340	-947	-996	-964	-2160	21	-849

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-1463	-2242	-2384	-777	151	356	456	
Goods	104	-427	-88	605	1164	981	1263	
Services	325	534	33	111	371	681	311	
Income	-1820	-2275	-2080	-1287	-1513	-1444	-1366	
Current transfers	-72	-74	-249	-206	129	138	248	
Capital account	122	129	732	300	416	346	199	
Financial account	2526	2843	8185	4089	-2013	2851	-227	
FDIs	725	171	1405	393	-1305	-113	820	
Portfolio investments	899	1405	-5664	-2940	-542	2907	-1968	
Other investments	902	1267	12444	6636	-166	57	922	

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-423	-294	-204	10	177	257	184	12
Goods	-545	-512	-511	-199	-81	-111	-170	-137
Services	352	326	315	242	390	397	317	227
Income	-270	-157	-114	-55	-174	-76	-76	-109
Current transfers	40	48	107	21	42	47	113	32
Capital account	37	40	69	40	52	125	167	127
Financial account	467	183	442	-192	-42	-622	-54	-335
FDIs	38	48	90	-18	-195	-157	470	137
Portfolio investments	144	-122	380	-17	-376	-150	-900	28
Other investments	285	294	-68	-166	508	-333	411	-504

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-1292	-849	-361	-16	63	286	690	-156
Goods	-1030	-849	-716	-171	-241	-231	-133	-278
Services	36	76	198	133	84	187	191	116
Income	-456	-297	29	-182	-69	19	347	-161
Current transfers	158	221	128	203	289	312	284	167
Capital account	139	109	78	258	178	265	206	136
Financial account	1192	713	453	-168	-329	-477	-956	-59
FDIs	166	428	252	168	60	-63	-71	126
Portfolio investments	-271	-39	416	-11	-4	68	641	1305
Other investments	1518	38	-207	-599	-222	-489	-1499	-1373

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-898	-758	-458	60	680	467	567	372
Goods	-1056	-1055	-927	-495	-289	-274	-169	-256
Services	251	226	239	299	292	289	282	262
Income	-281	-98	164	169	442	315	285	210
Current transfers	188	170	66	86	235	137	169	157
Capital account	162	53	73	140	128	80	103	137
Financial account	708	789	544	-194	-882	-643	-645	-639
FDIs	266	227	-158	29	-119	153	5	-190
Portfolio investments	-233	28	27	62	68	3	153	50
Other investments	689	509	61	-987	-1325	836	-610	227

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-2348	-1083	-2839	-1432	-1216	197	-746	-522
Goods	-2477	-2009	-2341	-1141	-1252	-848	-861	-600
Services	256	1223	-15	-1	261	1181	112	61
Income	-562	-444	-525	-501	-540	-334	-203	-369
Current transfers	436	149	42	212	315	198	206	385
Capital account	16	34	41	183	121	76	97	62
Financial account	2677	2390	3499	869	750	382	821	128
FDIs	1976	1877	1528	904	667	597	1142	109
Portfolio investments	-222	-345	-155	-507	-114	28	0	-118
Other investments	2103	2308	38	-548	324	-411	108	-640

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Current account	-5642	-4030	-3114	-910	-1520	-1062	-1676	-1506
Goods	-5145	-5288	-4511	-1547	-1725	-1673	-1843	-1169
Services	221	6	289	-64	-26	-120	-146	-273
Income	-2049	-826	-238	-518	-677	-439	-498	-518
Current transfers	172	57	252	9	44	203	281	40
Capital account	1331	2078	1345	1217	908	1171	810	454
Financial account	5997	4652	3584	454	1390	1994	1775	1209
FDIs	3453	2369	2395	1471	1122	1076	731	716
Portfolio investments	2	-59	-826	-296	138	331	339	1318
Other investments	2469	2442	1934	-2404	1952	1788	491	2347

Source: Eurostat, central banks, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	28.1	29.0	23.9	26.7	26.3	27.7	29.2	
the Czech Republic	38.3	39.5	44.5	48.8	46.4	48.2	48.1	
Slovakia	42.1	40.6	43.3	2.2	1.7	2.5	2.8	
Slovenia	1.8	1.8	1.8	1.6	1.4	1.9	1.9	1.8
Hungary	15.2	14.6	19.6	21.7	20.7	23.3	23.5	
Estonia	13.9	13.1	14.8	14.3	14.9	13.6	15.4	15.2
Lithuania	21.1	19.5	20.7	19.3	19.4	19.8		
Latvia	14.5	14.7	13.1	11.7	10.0	15.6	16.4	19.2
Bulgaria	39.4	40.5	34.3	32.1	32.1	33.5	34.3	33.0
Romania	40.3	39.8	39.1	38.4	38.2	38.5	38.5	40.4

Source: Eurostat, central banks, own calculations

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

	2005	2006	2007	2008	2009	06.2010
Poland	BBB+	BBB+	A-	A-	A-	A-
the Czech Republic	A	A	A	A+	A+	A+
Slovakia	A	A	A	A+	A+	A+
Slovenia	AA-	AA	AA	AA	AA	AA
Hungary	BBB+	BBB+	BBB+	BBB	BBB	BBB
Estonia	A	A	A	A-	BBB+	BBB+
Lithuania	A-	A	A	BBB+	BBB	BBB
Latvia	A-	A-	BBB+	BBB-	BB+	BB+
Bulgaria	BBB	BBB	BBB	BBB-	BBB-	BBB-
Romania	BBB-	BBB	BBB	BB+	BB+	BB+

Source: FitchRatings

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

	2005	2006	2007	2008	2009	06.2010
Poland	A	A	A	A	A	A
the Czech Republic	A+	A+	A+	AA-	AA-	AA-
Slovakia	A+	A+	A+	A+	A+	A+
Slovenia	AA	AA	AA	AA	AA	AA
Hungary	A-	A-	A-	BBB+	BBB+	BBB+
Estonia	A+	A+	A+	A	A-	A-
Lithuania	A	A+	A+	A-	BBB+	BBB+
Latvia	A	A	A-	BBB	BBB-	BBB-
Bulgaria	BBB+	BBB+	BBB+	BBB	BBB	BBB
Romania	BBB	BBB+	BBB+	BBB-	BBB-	BBB-

Source: FitchRatings

5. Interest rates and exchange rates

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
the Czech Republic	1.25	1.25	1.00	1.00	1.00	1.00	1.00	0.75
Hungary	7.00	6.50	6.25	6.00	5.75	5.50	5.25	5.25
Romania	8.00	8.00	8.00	7.50	7.00	6.50	6.50	6.25
Euro area	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Source: Central banks, EcoWin Financial

Table 33. 3m interbank rates (average)

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	4.2	4.2	4.2	4.2	4.2	4.1	3.9	3.9
the Czech Republic	1.9	1.8	1.6	1.5	1.5	1.4	1.4	1.3
Slovakia	0.7	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Slovenia	0.7	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Hungary	7.2	6.8	6.4	6.1	5.9	5.7	5.4	5.2
Estonia	5.4	4.5	3.3	2.7	2.1	1.9	1.8	1.7
Lithuania	6.6	5.4	4.6	3.1	2.2	1.9	1.6	1.5
Latvia	13.5	11.9	8.4	4.8	3.2	2.3	2.1	2.3
Bulgaria	4.8	4.8	4.7	4.4	4.3	4.2	4.2	4.2
Romania	10.3	10.4	10.4	8.8	7.2	6.3	5.2	6.6

Source: EcoWin Financial

Table 34. Exchange rates against EUR (average)

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	4.21	4.16	4.14	4.07	4.01	3.88	3.87	4.06
the Czech Republic	25.87	25.80	26.07	26.11	25.94	25.50	25.29	25.62
Hungary	268.24	270.82	273.13	269.36	270.91	264.97	265.13	276.73
Estonia	15.64	15.64	15.64	15.64	15.64	15.64	15.64	15.64
Lithuania	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Latvia	0.71	0.71	0.71	0.71	0.71	0.71	0.71	0.71
Bulgaria	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Romania	4.28	4.28	4.22	4.14	4.11	4.08	4.12	4.18

Source: Eurostat

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	17.5	11.5	3.4	-3.8	-13.8	-15.8	-12.1	-7.8
the Czech Republic	4.5	2.5	-0.2	-3.8	-9.0	-6.0	-5.2	-4.1
Hungary	2.9	2.3	3.3	-3.7	-9.2	-12.7	-9.7	-1.8
Romania	14.5	13.5	7.7	-1.9	-3.9	-4.6	-1.6	0.3

Source: Eurostat, own calculations

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	-12.3	-7.3	-2.4	4.0	14.7	16.4	11.8	5.0
the Czech Republic	-0.7	1.4	1.5	4.3	8.7	4.3	3.4	0.6
Slovakia	4.7	4.4	1.4	-0.5	-2.2	-3.2	-3.0	-3.5
Slovenia	2.5	2.5	0.9	-0.2	-1.1	-2.0	-1.9	-2.3
Hungary	0.7	2.0	-1.6	4.1	8.9	12.1	8.7	-1.9
Estonia	4.1	4.0	1.3	-0.3	-1.9	-3.3	-3.2	-4.0
Lithuania	5.2	4.7	1.8	-0.4	-2.5	-3.7	-3.5	-3.9
Latvia	4.3	3.9	1.5	-1.2	-2.8	-3.4	-3.0	-3.2
Bulgaria	4.2	4.2	1.8	0.0	-1.1	-2.5	-2.4	-3.5
Romania	-9.7	-9.0	-6.0	2.2	2.7	2.4	-0.6	-3.4

Source: BIS, own calculations

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

	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010	05.2010
Poland	-9.5	-4.9	-0.4	6.1	16.3	17.2	12.2	5.3
the Czech Republic	-1.2	0.9	0.8	3.1	7.4	2.9	2.4	-0.4
Slovakia	4.6	3.7	0.3	-1.8	-3.4	-4.2	-3.7	-4.3
Slovenia	1.9	3.1	1.2	-0.4	-1.3	-2.4	-1.5	-2.2
Hungary	5.2	6.2	2.3	9.1	13.4	16.5	12.6	1.3
Estonia	1.3	0.7	-2.0	-2.5	-3.5	-3.4	-2.2	-2.9
Lithuania	5.5	4.8	1.2	-2.4	-4.6	-5.7	-5.2	-5.3
Latvia	2.6	1.3	-1.4	-5.9	-8.4	-9.0	-7.6	-7.5
Bulgaria	3.0	2.5	0.3	-1.8	-2.5	-3.7	-3.3	-4.1
Romania	-6.4	-6.0	-3.3	5.3	5.1	4.2	1.2	-1.5

Source: BIS, own calculations

6. Labour market

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	3.5	3.6	3.0	1.3	1.0	0.2	-0.7	-0.9
The Czech Republic	1.8	1.5	1.3	-0.2	-1.3	-1.9	-0.9	0.1
Slovakia	2.9	4.5	2.8	-0.1	-1.1	-4.3	-5.5	-4.4
Slovenia	3.1	3.0	2.3	-0.2	-2.1	-3.1	-4.1	-3.8
Hungary	-1.9	-0.6	-0.7	-2.1	-1.8	-3.6	-2.5	-1.2
Estonia	-0.3	-0.2	-0.2	-6.8	-9.7	-9.4	-11.0	-9.6
Lithuania	-1.2	-1.4	-1.2	-5.1	-6.7	-7.4	-8.2	-7.3
Latvia	3.1	0.2	-5.5	-8.0	-12.5	-15.8	-14.1	-12.4
Bulgaria	3.7	3.1	1.7	-0.8	-2.1	-4.0	-5.7	-7.7
Romania	2.0	1.8	1.1	-0.3	-3.5	-6.0	-7.7	-9.4

Source: CSOs, own calculations

Table 39. Unemployment rate (in %)

	09.2009	10.2009	11.2009	12.2009	01.2010	02.2010	03.2010	04.2010
Poland	8.6	8.7	8.8	9.1	9.5	9.8	9.9	9.9
The Czech Republic	7.4	7.3	7.3	7.4	7.7	7.8	7.9	7.7
Slovakia	13.3	13.8	14.1	14.2	14.1	14.1	14.1	14.1
Slovenia	6.4	6.5	6.4	6.3	6.2	6.2	6.2	6.3
Hungary	10.6	10.6	10.6	10.6	11.0	10.9	10.8	10.4
Estonia	15.2	15.6	15.6	15.6	19.0	19.0	19.0	
Lithuania	14.3	15.9	15.9	15.9	17.4	17.4	17.4	
Latvia	19.6	19.9	20.3	20.4	20.9	21.5	22.1	22.5
Bulgaria	7.3	7.7	8.1	8.3	8.4	8.7	8.8	8.8
Romania	7.2	7.6	7.6	7.6				
EU-15	9.2	9.3	9.3	9.4	10.0	10.1	9.9	9.8

Source: CSOs

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	10.3	9.4	9.3	7.3	6.4	4.8	3.9	3.4
The Czech Republic	6.5	4.1	9.5	7.3	4.0	6.1	4.7	-2.2
Slovakia	7.8	5.9	5.4	8.9	5.3	2.7	0.4	0.3
Slovenia	9.0	12.8	11.5	9.2	10.2	4.2	-1.5	3.6
Hungary	8.4	7.2	7.9	0.7	3.2	1.4	-2.6	3.7
Estonia	16.9	14.1	8.7	2.4	-1.3	-5.0	-7.6	-4.9
Lithuania	20.6	17.1	13.4	1.9	-3.8	-7.6	-11.1	-9.3
Latvia	24.4	20.6	13.8	3.7	0.9	-7.1	-12.7	-9.1
Bulgaria	25.1	23.5	1.0	19.5	16.2	11.7	9.4	10.4
Romania	25.8	24.0	22.0	18.7	11.0	7.8	1.9	4.6

Source: CSOs, own calculations

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

	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1
Poland	6.5	11.2	11.3	9.8	10.1	2.6	-5.6	-0.3
The Czech Republic	4.5	2.2	10.8	10.7	7.7	9.1	6.8	-3.2
Slovakia	3.4	3.6	6.6	14.5	9.7	3.3	-2.6	-8.9
Slovenia	8.0	8.9	12.3	15.3	13.5	9.9	5.3	0.9
Hungary	4.3	5.2	9.6	5.3	8.9	4.9	-1.2	2.4
Estonia	17.7	17.2	17.7	10.6	5.1	1.2	-9.2	-12.5
Lithuania	18.1	16.0	14.8	11.9	13.6	-0.3	-8.8	-13.6
Latvia	25.1	21.4	18.0	11.7	1.8	-4.2	-8.4	-15.7
Bulgaria	21.7	19.9	-0.8	22.2	19.0	13.1	9.6	6.7
Romania	18.1	16.4	20.0	24.6	16.2	8.8	0.7	-2.2

Source: Eurostat, CSOs, own calculations

7. Public finance

Table 42. General government deficit (in % of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009
Poland	-5.0	-6.2	-5.4	-4.1	-3.6	-1.9	-3.7	-7.1
The Czech Republic	-6.8	-6.6	-3.0	-3.6	-2.6	-0.7	-2.7	-5.9
Slovakia	-8.2	-2.8	-2.4	-2.8	-3.5	-1.9	-2.3	-6.8
Slovenia	-2.5	-2.7	-2.2	-1.4	-1.3	0.0	-1.7	-5.5
Hungary	-8.9	-7.2	-6.4	-7.9	-9.3	-5.0	-3.8	-4.0
Estonia	0.3	1.7	1.6	1.6	2.5	2.6	-2.7	-1.7
Lithuania	-1.9	-1.3	-1.5	-0.5	-0.4	-1.0	-3.3	-8.9
Latvia	-2.3	-1.6	-1.0	-0.4	-0.5	-0.3	-4.1	-9.0
Bulgaria	-0.8	-0.3	1.6	1.9	3.0	0.1	1.8	-3.9
Romania	-2.0	-1.5	-1.2	-1.2	-2.2	-2.5	-5.4	-8.3
EU-15	-2.4	-3.0	-2.8	-2.4	-1.3	-0.8	-2.2	-6.8

Source: Eurostat

Table 43. Public debt (in % of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009
Poland	42.2	47.1	45.7	47.1	47.7	45.0	47.2	51.0
The Czech Republic	28.2	29.8	30.1	29.7	29.4	29.0	30.0	35.4
Slovakia	43.4	42.4	41.5	34.2	30.5	29.3	27.7	35.7
Slovenia	28.0	27.5	27.2	27.0	26.7	23.4	22.6	35.9
Hungary	55.6	58.4	59.1	61.8	65.6	65.9	72.9	78.3
Estonia	5.7	5.6	5.0	4.6	4.5	3.8	4.6	7.2
Lithuania	22.3	21.1	19.4	18.4	18.0	16.9	15.6	29.3
Latvia	13.5	14.6	14.9	12.4	10.7	9.0	19.5	36.1
Bulgaria	53.6	45.9	37.9	29.2	22.7	18.2	14.1	14.8
Romania	24.9	21.5	18.7	15.8	12.4	12.6	13.3	23.7
EU-15	61.6	63.1	63.4	64.3	62.8	60.4		

Source: Eurostat