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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This report has been prepared for information purposes on the basis of various research sources independent from the National Bank of Poland.

General information on CEE countries

	Area (km2)	Population		GDP (km2)	GDP per capita	
		thous. persons	per km2		by nominal exchange rates	by purchasing power parity
Bulgaria	110,879	7,564	68	36,034	4,700	10,600
Czech Republic	78,867	10,507	133	145,049	13,800	19,500
Estonia	45,227	1,340	30	14,501	10,800	15,900
Lithuania	65,300	3,329	51	27,410	8,300	14,200
Latvia	64,559	2,248	35	17,970	8,000	12,600
Poland	312,685	38,167	122	353,667	9,300	15,200
Romania	238,391	21,462	90	121,942	5,700	11,000
Slovakia	49,035	5,425	111	65,906	12,100	18,100
Slovenia	20,273	2,047	101	35,974	17,600	21,200
Hungary	93,028	10,014	108	98,446	9,800	15,700

source: Eurostat

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

	2010			2011	2010			2011
	2010 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2009 Q3	2009 Q4	2010 Q1
	q/q				y/y			
Bulgaria	1.7	0.7	0.5	0.6	-0.4	0.0	3.8	3.4
Czech Republic	0.6	0.8	0.5	0.9	2.3	2.6	2.7	2.8
Estonia	2.2	1.2	2.5	2.4	3.1	5.4	6.8	8.6
Lithuania	1.0	0.3	1.8	3.5	1.2	1.6	4.6	6.8
Latvia	0.4	1.5	0.9	0.3	-2.8	2.6	3.5	3.2
Poland	1.1	1.2	0.8	1.0	3.6	4.6	3.9	4.3
Romania	0.2	-0.7	0.1	0.7	-0.5	-2.1	-0.6	0.3
Slovakia	0.8	0.9	0.9	1.0	4.3	3.9	3.4	3.6
Slovenia	0.9	0.3	0.5	0.3	1.3	1.4	1.9	2.1
Hungary	0.1	0.8	0.5	0.7	0.5	2.3	2.6	2.2

source: Eurostat

Executive summary

The economies of Central and Eastern Europe (CEE) entered the path of recovery in 2010, stimulated by external demand. As a result of steadily accelerating exports, the CEE economies significantly rebounded. GDP in the region climbed up to 2.3% and 3.4% respectively in 2010 and 2011 Q1.

Exports growth contributed to the increase in inventories (category with statistically the largest positive impact on economic growth) and expenditure on machinery and equipment in export-oriented enterprises, where capacity utilisation grew the most. An increase in a number of foreign orders helped gradually stabilise the labour market situation – principally due to halting the downward trend in the employment in the manufacturing sector. Consequently, 2010 saw exports soar up to win an all-time high share in regional GDP (57.5%), though, its impact then was not strong enough to stimulate domestic demand. Wage growth stood at a very low level. Lending to private sector remained very weak and decline in the construction sector persisted in some countries. Fiscal consolidation, undertaken by ever more countries in the region, also had a dampening impact on demand. Additionally, in effect of a flagging domestic demand, growth was lower in imports than in exports (the real growth in imports surpassed that in exports only in two countries, i.e. in Poland and in Lithuania,).

However, the growth in the CEE exports was lower than in other major regions, which reflects a declining CEE share in global exports. This happened for the first time since 1999 (when the exports in the region declined in the aftermath of the Russian crisis). Most recently, however, the CEE share in the global exports has pursued a steady growth, to attain 4.0% in 2009, according to WTO data. In effect of the exports from CEE rising less than global exports in 2010 this share ebbed down to 3.9%.

A lower growth in the CEE exports vis-a-vis other regions may be explained by a lower growth in demand in the major export markets, i.e. EU-15 states. Demand in EU-15 grew below the average global level (this being primarily attributable to the aggravation of debt crisis). Besides, it predominantly reflected the demand of the export sector (due to a relatively buoyant economic growth in non-European countries). Given the character of economic links between EU-15 and CEE countries, which to a large extent link mother companies with branches of corporations situated in CEE, export recovery in CEE concentrated in intermediate goods. Meanwhile, exports grew at a slower pace in consumer and capital goods.

High growth in intermediate goods occurred particularly in exports to Germany. A strong recovery sent the value of exports in this category above the level of 2008. It means that corporate links were re-instated in this case. Strongly export-oriented German economy, especially onto the strong growing markets, i.e. to emerging Asia, is the main link between CEE and global economy. Global recovery also stimulated the reconstruction of trade in intermediate goods between CEE countries. CEE-intra trade amounts for nearly 20% of their total foreign trade turnover.

COUNTRIES OF CENTRAL AND EASTERN EUROPE

- ***Foreign trade boosts economic activity in CEE countries***
- ***Labour market in stagnation***
- ***Inflation grows, stimulated by supply factors***
- ***Further fall in the ULC***
- ***Decliining of external imbalances***
- ***The CEE currencies exchange rates fluctuate, as debt crisis escalates in the euro area***
- ***Varying monetary policies***
- ***Further fiscal consolidation***
- ***Growth to accelerate in 2011 and 2012***

Economic growth

CEE countries have been recovering since the beginning of 2010. GDP growth gained momentum by each consecutive quarter. GDP for the region rose by 2.3% and 3.4%, respectively in 2010 and 2011 Q1.

The pace of economic recovery in the region was, however, diverse. Economies which followed the path of relatively balanced growth in the pre-crisis period reached the highest economic growth rates in 2010. Accordingly, they could earlier resume a path of economic recovery. The highest GDP growth in 2010 was observed in Slovakia (4.0%) and Poland (3.8%). Meanwhile, the efforts undertaken for fiscal consolidation negatively affected economic recovery in the Czech Republic. Positive growth occurred also in most countries which even prior to the outbreak of the global crisis had come through acute internal problems, i.e. in Estonia, Slovenia, Lithuania, Hungary and Bulgaria. Just the opposite situation prevails in those countries which persist in their struggle with serious internal and external imbalances. GDP in the CEE region in 2010 shrank only in Latvia (-0.6%) and Romania (-1.3%).

In 2011 Q1 for the first time since 2008 the average annual GDP growth was positive in all 10 countries, to amount to 3.4% for the entire region. It was the highest in Estonia (8.6%) and Lithuania (6.8%)[1], and the lowest, albeit already positive in Romania (0.3%).

Regional economic activity was primarily boosted by external demand and inventories rebuilding. Domestic demand – most specifically private consumption – had also had a rising impact on the growth.

Rebound in foreign trade, following the severe decline at the turn of 2008 and 2009, became the driving force of an economic recovery in the Central and Eastern Europe both in 2010 and in 2011 Q1. The value of regional exports resumed its pre-crisis levels already in 2010 Q2, whereas GDP reached that level in 2011 Q1. The lag occurred due to a considerably slower rate of growth of domestic demand, especially in fixed capital formation in the region.

Already at the beginning of 2010 the CEE countries showed a rapid exports expansion, as trade accelerated within the regional and global production networks. The increase in exports of consumer goods was partially due to fiscal stimulation programmes in EU-15 states (especially new car subsidies) as well as to the shift in the imports structure towards cheaper products from the CEE region. These tendencies resulted in a prompt (in most countries, two-digit) increase in exports in 2010.

As of 2010 Q2 a rapid growth in exports has coincided with equally fast, at times even faster, growth in imports. Those tendencies were related on the one hand to growing demand of export-oriented sector and the rebuilding of inventories (primarily reflected in the growing import of intermediate goods), and on the other hand with the intensifying domestic demand. Accordingly, both the imports and the exports rose at a similar pace in 2010, thereby limiting the positive impact of net exports to GDP growth.

In 2011 Q2 as a result of further strong external demand, in particular in rapidly developing German and emerging Asian economies, export continued to grow rapidly, whereas growth in imports lost some of its momentum. Therefore, net exports expanded its contribution to annual GDP growth to 1.0 pp.

Table 1.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-3.4**	**2.8**	**2.9**	**3.0**	**3.5**
Private consumption	-3.5	1.2	1.7	1.5	1.8
Public consumption	1.3	1.2	1.6	1.7	-0.3
Fixed capital formation	-11.7	-2.6	-3.1	0.0	3.2
Exports	-10.3	14.5	13.5	13.3	14.4
Imports	-16.3	14.4	12.9	13.7	12.7

source: Eurostat

2010 saw inventories accumulation across the region, following a strong decline, especially visible at the turn of 2008 and 2009. In terms of the entire region, the change in inventories contributed 2.6 pp. to GDP growth, i.e. made the highest contribution among all the categories of national accounts. In 2011 Q1 the growth in inventories slowed down considerably to reach only 0.6 pp. In other words, the process of their rebuilding in the CEE countries appears to come to an end.

GDP growth recorded a positive contribution in 2010, also from consumption, both private and public. Private consumption in quarter-to-quarter terms rose in each quarter of 2010 and in 2011 Q1. Most of positive growth in private consumption in 2010 stemmed from its significant growth in Poland (by 3.0% y/y). Aside from Poland, household spending edged up only in the Czech Republic and Slovenia, while in other countries of the region they

[1] Baltic states, most specifically Estonia and Lithuania showed a large boost in annual GDP growth both in 2010 and in 2010 Q1, which resulted primarily from a very low base effect in 2009.

decreased compared with 2009. In 2011 Q1 regional growth in private consumption rose to 1.8% y/y. Poland was joined by the Baltic states, where private consumption grew at 3.6-5.5% y/y[2]. In turn, in the Czech Republic, Romania, Slovakia and Hungary, household consumption expenditure declined in 2011 Q1 when compared to the end of 2010.

A growth in consumption in the region was additionally inhibited by a very slow improvement on the labour markets of the CEE countries. Bank lending also proceeded very slowly (in the Baltic countries and Hungary, both in 2010 and in 2011 Q1 loans to the private sector continued to decrease). In addition, the countries of the region entered a process of fiscal consolidation, which further inhibited the growth in household income[3].

Fiscal tightening most specifically impacted public consumption. Even though throughout the region, both in 2010 and in 2011 Q1, its annual growth rate was positive, it primarily reflected strong growth in public consumption in Poland.

Fiscal tightening was particularly evident in countries that in previous years had received financial assistance from international institutions under the auspices of the IMF and the EU (Hungary, Latvia, Romania). These countries committed themselves to reducing the budget deficit, both via reduction in expenditure and increase in tax revenues. This significantly contained domestic demand, especially consumption, in these countries

In 2010 Q4, following 7 consecutive quarters of decline, expenditure on fixed investments in the region showed an increase. The growth consolidated in 2011 Q1 to spread across the region. It resulted from an increase in capacity utilization in mainly export-oriented enterprises. An increase in expenditure on machinery and equipment coincided with a decline in construction investment. Low commercial credit growth also hampered new investment.

As external demand substantially increased and the process of rebuilding inventories continued, it fuelled a strong increase in industrial activity in the CEE countries. Industrial output rose in 2010 in all countries of the region. It mainly affected the production of transport vehicles, machinery and equipment as well as durable consumer goods, i.e. production increased the most in export-oriented sectors. From the beginning of 2011 the process slowed down somewhat, but persistently high demand from rapidly developing major euro area economies, especially Germany, continued to stimulate growth in industrial production[4].

Labour market

Labour markets in the CEE countries neither in 2010 nor in 2011 Q1 showed signs of significant improvement. Harmonised unemployment rate has remained near its highest level in recent years. It even increased in comparison with the end of 2009 in Bulgaria, Romania, Slovenia and Hungary. Unemployment markedly declined in 2010 only in Estonia and Latvia, remaining however at the highest levels in the region.

Data on employment in the region also imply a stagnation in the labour market in 2010. The number of employees in the whole group of the CEE countries increased only slightly last year (0.2%). Bulgaria, the Czech Republic, Slovenia and Lithuania reported further reduction in employment. Despite the increase in industrial activity, employment in this sector declined in 2010, similarly as the employment in agriculture, while a growth occurred in the service sector

Inflation and labour costs

Rising energy and food prices were the main driving force behind inflation growth in the CEE countries in the second half of 2010 and first half of 2011. In July 2010, the annual HICP inflation in the region amounted to 2.5%, to climb to 4.6% in May 2011. Although similar trends prevailed among the CEE countries, the level of inflation in individual countries varied widely. The lowest growth in consumer prices in May 2011 could be observed in the Czech Republic (2.0%), the highest in Romania (8.5%).

Food prices decisively impacted inflation in the region and fuelled its growth. Between July 2010 and May 2011, their contribution to the annual HICP growth rate increased by 1.5 pp., and its gradual increase could be observed throughout this period. In the second half of 2010 a growth in energy prices also gained a considerable momentum. However, they started to stabilize at the beginning of 2011. On the other hand, core inflation, which remained low through 2010, started to slowly growth in the first half of 2011. This hike resulted from increases in rates of indirect taxes in early 2011 and a spill-over of high food and energy prices to other groups of goods and services. Meanwhile, demand pressure remained low, due to persistent negative impact of labour market conditions.

Following a strong decline in 2009, average wage in most of the CEE region entered a rising path in 2010. This trend persisted in 2011 Q1.[5] The increase in nominal wages was not high and for the whole region it was lower than the rate

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[2] Very slow consumer demand recovery was reflected in retail trade data. Both in 2010 and in the first four months of 2011 retail sales in the region grew very slowly, whilst in Latvia, Romania and Hungary it continued its downward trend. Only in Poland, Estonia and Lithuania did it show a clear increase.

[3] Following a period of growth in the first half of 2010 indicators of consumer confidence in the CEE countries resumed a path of decline in the second half of 2010 and in early 2011. Consumer optimism declined, primarily in the aftermath of the deteriorating assessment of the current and prospective financial situation of households in the context of rising inflation and the continuing stagnation in the labour market.

[4] The increase in external demand, particularly the growing number of foreign orders has encouraged a significant improvement in sentiment among manufacturers in 2010. Its level was maintained during the first months of 2011 r

[5] The average wage in the economy decreased in 2011 Q1 (annualized) only in Estonia and Romania.

of inflation. which means that in real terms wages in the region in 2010 and 2011 Q1 slid further down.

Economic recovery at the turn of 2010 and 2011, coupled with continuing unfavourable situation in the labour markets, contributed to further decrease in unit labour costs growth (ULC). Although in the second half of 2010 nominal wages in CEE countries slowly began to rise, their increase was not as significant as the increase in labour productivity in this period.

Balance of payments

Following a very rapid decrease in the current account deficits in the CEE countries, in some of them, including the Baltic countries and Hungary, even a large surplus being posted, this process definitely slowed down in 2010. The current account deficit across the region decreased in 2010 to 1.7% of GDP (compared with 2.1% of GDP in 2009), which resulted from its decline in Bulgaria, Romania and Hungary. In other countries, current accounts balances deteriorated last year. In 2011 Q1 the current account deficit further declined in most countries (except Poland and the Baltic states). Both in 2010 and in 2011 Q1 this improvement resulted primarily from a decrease in the goods account deficit.

As with the current account balance in 2010, the trade balance improved only in Bulgaria, Hungary and the Baltic states. In other countries in 2010 a marked boost in imports translated into a lower balance of trade in goods and services. In 2011 Q1 foreign trade balance increased further in the Czech Republic and Slovakia, which resulted in a further decline in the deficit in goods and services account. Since the beginning of 2010 a trend has been reversed in the income account. Higher corporate profits, as well as the increasing involvement of foreign investors in debt instruments of the CEE countries, resulted in a greater outflow of income from foreign investments, which increased the deficit in this account.

2010 and 2011 Q1 also saw a persistent decline in foreign capital inflow to the CEE markets. This trend affected the other investment account. Inflow of foreign loans and credits continued to wane, additionally the residents of the CEE countries has been gradually moving their savings to financial institutions outside the region. Meanwhile the inflow of FDIs and portfolio investment intensified. The inflow of portfolio investment, which reached historically high levels in the largest economies of the region (Poland, the Czech Republic, and also Slovenia) in late 2009 and 2010, clearly weakened in the second half of 2010 and 2011 Q1.

Exchange rates and interest rates

Following a depreciation of the currencies of the region in 2010 Q4 (debt crisis in peripheral countries of the euro area intensified the risk in financial markets), in 2011 Q1 they appreciated. Only Polish zloty continued to depreciate against the euro, because of the negative assessment of changes in the public finance in Poland.

As a result of increased concern about the sovereign debt crisis in Greece, in May 2011 the risk aversion returned with even greater impact to the world's financial markets. Investors withdrew from euro-denominated assets and the European currency weakened against the major currencies of the world. This process took on even greater intensity on the currency markets of the CEE countries. This resulted in a weakening of the currencies of the region (with the exception of the Czech crown) against the euro, and even more against the U.S. dollar and Swiss franc in May and June 2011.

The speculations concerning devaluation of the Baltic states currencies, especially the Latvian lat, ended in 2010. These countries managed to increase their global competitiveness through the so-called "internal devaluation", i.e. depreciation of the real exchange rate via an decrease in inflation and labour costs. However, due to a rapid rise in inflation in the Baltic states as of mid-2010, the real effective currency rate in those countries began to strengthen again.

In 2010 and the first half of 2011 the countries of the region which adopted a direct inflation targeting diversified their monetary policy stance. In Poland and Hungary, in response to rapidly rising inflation, central banks opted for a series of interest rate hikes. The National Bank of Hungary at the turn of 2010 and 2011, raised its policy rate three times (a total of 75 bps), while the National Bank of Poland between January and June 2011 did so four times (a total of 100 bps). The Czech National Bank did not decide in that period to change interest rates, which remain at a record low (0.75%). Those decisions were explained by the need to support weak economic growth, especially in view of tightening fiscal policy. Inflation forecast for the Czech Republic indicated it should not significantly deviate from the target in the forthcoming quarters (less than 2% y/y).

Fiscal policy

The level of fiscal imbalance in the CEE countries in 2010 remained high and reached the average level of 6.1% of GDP (except Estonia[6]) as compared to 7.1% of GDP in 2009. In half of the CEE countries the deficit outturn was lower[7] than forecasted in their individual Convergence/Stability Programmes (Update 2010), thanks to gradual improvement on the revenue side, maintenance of spending discipline and the implementation of additional consolidation measures during the year (the Czech Republic, Slovenia). The fiscal target for 2010 was exceeded in Bulgaria (3.2 pp.), Slovakia (2.4 pp. of GDP), Poland (by 1.0 pp. of GDP),

[6] Estonia was the only EU state with a general government surplus in 2010. It amounted to 0.1% of GDP against the budget deficit at 1.7% of GDP in 2009.

[7] In Estonia by 2.3 pp. of the GDP (i.a. due to the sale of $CO2$ emission rights), in Lithuania and Latvia, respectively by: 1.0 and 0.8 pp. of the GDP, in the Czech Republic 0.6 pp. of the GDP, and in Slovenia by 0.1 pp. of the GDP.

Hungary (0.4. pp. of GDP) and Romania (by 0.1 pp. of GDP).

In 2011 further reduction of general government deficit in the countries of the region will be continued. Compared to 2010, it is forecasted to decrease on average by 2.1 pp. of GDP (excluding Estonia). A substantial adjustment is anticipated in Hungary (about 6 pp. of GDP), most of which will stem from one-off measures. This year funded pension funds shall transfer to the government assets (ca. 10% of GDP) for persons who have opted to discontinue their membership. The planned magnitude of the budget deficit reduction in 2011 will be significant also in Latvia (3.2 pp. of GDP), Slovakia (3.0 pp. of GDP) and Poland (2.3 pp. of GDP), with the two latter countries having commenced the process of fiscal consolidation only this year. Despite the continuation of the adjustment measures a the general government deficit in Slovenia will ebb down marginally this year (0.1 pp. of GDP), as a result of the government decision to recapitalize one of Slovenian commercial banks (0.7% of GDP).

The deadline for reducing budget deficit below the reference value (3% of GDP) imposed under excessive deficit procedure (EDP) is 2011 for Hungary and Bulgaria, 2012 for Poland, Romania and the Baltic states (except Estonia) and 2013 for the Czech Republic, Slovakia and Slovenia. The consolidation measures planned by the CEE countries for the upcoming years are concentrated mainly on the expenditure side. They concern, i.a., rationalization of public sector employment, social transfers review and keeping wages in public administration or pension benefits frozen (e.g. Bulgaria, the Czech Republic, Latvia, Slovenia). The general government balance will also improve from the anticipated economic recovery. Achievement of fiscal targets enshrined in the Convergence/Stability Programmes is burdened with risk associated with adoption of the planned measures (parliamentary elections, lack of details concerning proposed changes), or the optimistic macroeconomic assumptions (according to EC's assessment this applies to the Czech Republic, Slovakia and Slovenia).

In order to support the consolidation of public finances, the countries of the region intend to strengthen the institutional framework of the general government, through, inter alia, the introduction of fiscal rules (mainly expenditure and public debt limits) or the appointment of independent fiscal councils (Bulgaria, Czech Republic, Slovakia)[8].

With the projected improvement of economic situation, ongoing consolidation activities, and the assumption of lack of support to the banking system, public debt in the coming years will grow at a slower pace, whilst in Poland, Lithuania, Romania and Hungary it will decrease compared to 2011. Only in Hungary public debt is to exceed its reference value (60% of GDP).

Forecasts

According to the European Commission (EC) Spring 2011 forecasts, economic recovery observed in the CEE countries in 2010 and 2011 Q1 will continue in the coming quarters. GDP growth in 2011 should be positive in all countries of the region, possibly exceeding 4% y/y in Poland, Estonia and Lithuania. In almost all economies in the region the GDP growth rate is going to be higher than in 2010, only in the Czech Republic and Slovakia it can decrease due to the effects of fiscal consolidation. The average GDP growth for the entire region in 2011 is expected to amount to 3.2%. In 2012, the EC anticipates a further acceleration of economic growth in the region to 3.6%. Though GDP growth may ebb down slightly in Poland, Estonia and Lithuania, i.e. the fastest growing economies in 2011, it should increase in all other countries across the region.

Compared with the Autumn 2010 forecasts, the EC raised its expectations for the region, primarily due to steadily sound shape of the euro area economy, especially Germany, which allows to maintain a relatively high growth of exports in the CEE countries.

The forecast improvement in economic recovery will coincide with the changes in the structure of economic growth. The contribution of domestic demand will increase, while that of net exports and changes in inventories will be declining.

The Commission anticipates domestic demand should recover already in 2011. Both private consumption and capital formation should increase across the region. Private consumption is to grow in 2011 amidst a moderate pace of improvement in the labour market. The unemployment rate is going to drop slightly, and employment in the region's economies grow, but with the exception of the Baltic states, this should not be a big change. The recovery in private consumption is to be continued also in 2012, when the labour market is also anticipated to improve faster.

According to the latest EC forecasts, public consumption, in turn, should drop in 2011, due to restrictions on public spending. It is expected that the process of fiscal consolidation may slow down in 2012, which will translate in the increase in consumer spending of the public sector in most of the region.

Fixed capital formation is also projected to accelerate in 2011, partially due to a low base effect from 2010 (this is particularly evident in the Baltic states). In 2012, the high rate of investment should be continued. Growth in fixed capital formation is going to bear upon both the investment in buildings and investment in machinery and equipment.

Expected growth of exports and imports in the coming years should continue to be relatively high, but considerably lower than that observed in 2010, as a result of the forecasted

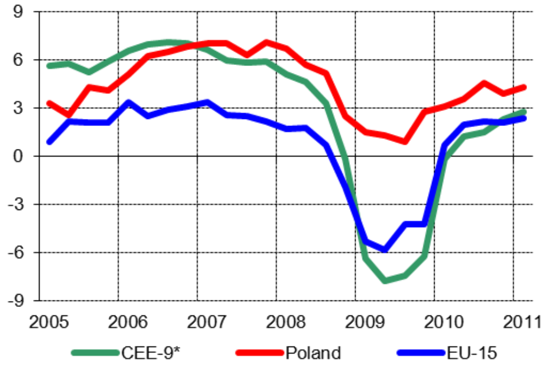
[8] Since 2010, the budget councils have operated in Romania and Slovenia, and since the end of 2008 in Hungary (in 2010 the rules concerning appointing its members were amended, and a separate analytical office was dissolved).

slowdown in world trade. In turn, a growth in domestic demand in the CEE countries is supposed to trigger imports. The latter should develop at the same pace as exports, which in turn will have a dampening impact on the contribution of net exports to GDP growth in 2011 and 2012 in most of the region (with the exception of the Czech Republic and Slovakia).

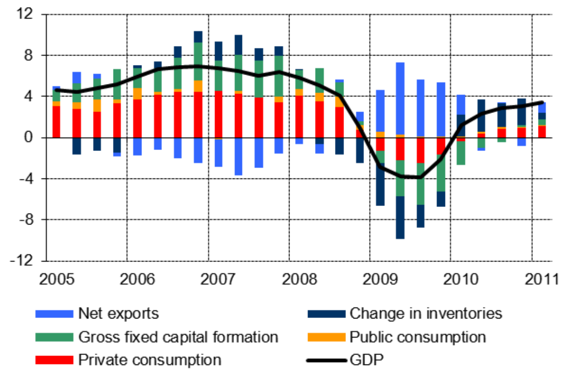
Strong impact of rising energy and food prices on inflation growth, observed in the first half of 2011, should expire in 2012. It will be reflected in a decline in HICP growth in the region. An additional factor in lowering inflation in the region will be the fading away of base effects, which stemmed from increases in indirect taxes and administered prices in many countries of the region at the beginning of 2011. On the other hand, as the situation on the labour market improves, the demand pressure intensifies, which may fuel the rise in core inflation.

Deteriorating foreign trade balance along with the increasing income account deficit are likely to be major factors in the current account deficit widening (or reducing the surplus in the Baltic states) in 2011 and 2012. According to the European Commission in 2012, all countries of the region will show the current account deficit. Opposite trends will only occur in the Czech Republic and Slovakia, where the current account deficits are to slightly decrease in the upcoming years due to the expected increase in the foreign trade surpluses.

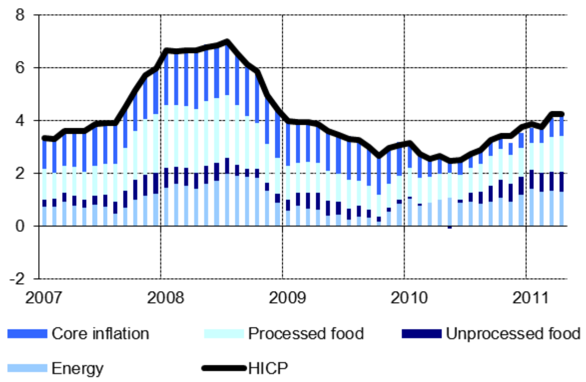
GDP growth rates (in %, y/y)



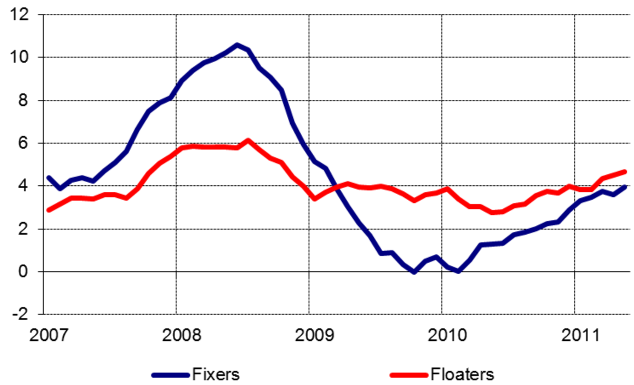
Contribution to GDP growth in CEE countries (in pp, y/y)



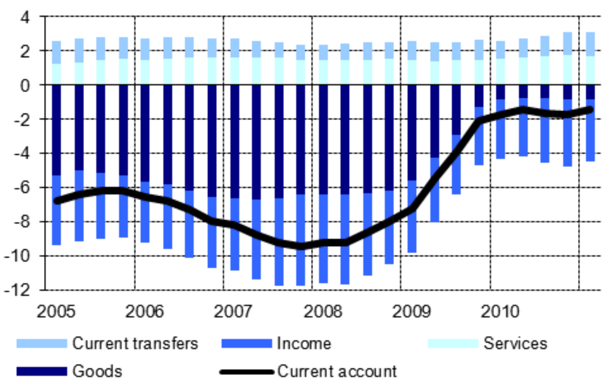
HICP and its components (in %, y/y)



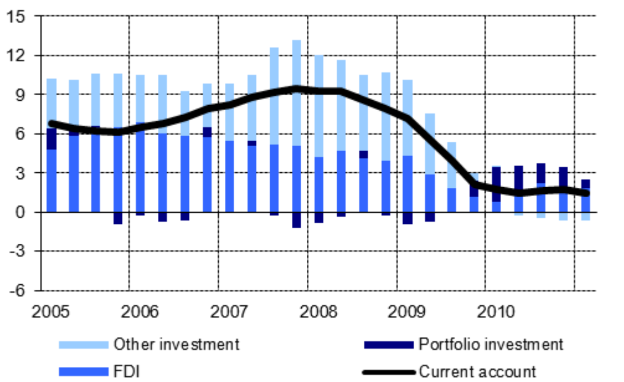
HICP (in %, y/y)



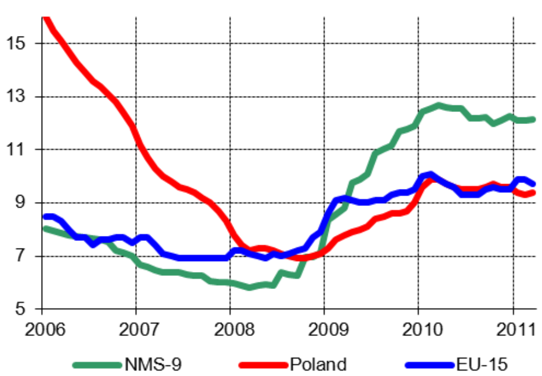
Current account and its components (in % of GDP, 4-quarter moving average)



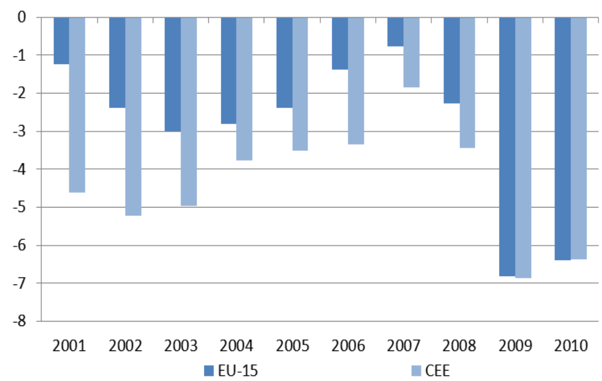
Financial account balance and its components (in % of GDP, 4-quarter moving average)



Unemployment rate (%)



General government deficit (in % of GDP)



Source: Eurostat, CSOs

BULGARIA

Economic growth

In the second half of 2010, Bulgaria's economy began to gradually recover from the 2009 recession. Rapid GDP growth in 2010 Q4 resulted in a positive (0.3%) growth rate in the whole 2010. Economic growth in 2011 Q1 points to a continuation of the recovery. GDP growth, as in 2010, was predominantly based on net exports as a result of both a high growth in exports and a subdued growth in imports. In early 2011, domestic demand - investment expenditures and private consumption - also positively contributed to GDP growth. In the case of investment expenditures it was the first positive contribution to growth after nearly two years of investments contraction.

Table 2.1

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

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-5.5**	**0.1**	**0.0**	**3.8**	**3.4**
Private consumption	-7.5	-1.3	-0.7	0.8	0.7
Public consumption	-6.5	-1.0	-2.8	0.2	-2.3
Fixed capital formation	-17.6	-16.5	-21.2	-1.0	1.6
Exports	-11.2	16.2	27.6	15.1	20.1
Imports	-21.0	4.5	5.3	10.7	8.6

source: Eurostat

The subsequent quarters of 2010 reduced the scale of decline in private consumption. Over 2010, private consumption in Bulgaria was decreasing as compared to 2009. Nevertheless, already in 2010 Q4, it edged up slightly, which was upheld in 2011 Q1. The biggest increases in consumption expenditures were recorded in the case of food, while the deepest decline affected spending on maintenance and households equipment. The main causes behind consumption sluggish growth were a further growth in the savings rate (including precautionary savings) and high unemployment.

The persistent weakness in private consumption fed into a relatively low growth rate of imports. Which, combined with a high exports growth rate, resulted in a large positive contribution of net exports to GDP growth. The strong increase in exports reflected primarily a rebuilding of intermediate goods trade, stemming from an improving economic situation of Bulgaria's major trading partners, namely Germany and Turkey.

At the beginning of 2011, for the first time in 9 quarters, investments increased. The largest increase in investment spending took place in manufacturing, where a rapid growth in exports contributed to increases in capacity utilization. Investment growth was also fuelled by some recovery on the corporate credit market.

In 2011 Q1, as in the previous year, a restrictive fiscal policy had a negative impact on GDP growth.

Data on retail sales, which were falling until the end of 2010, seem to confirm a significant share of the base effect in private consumption growth recorded in 2010 Q4. In 2011 Q1, thanks to a buoyant growth in the sales of textiles and fuels, retail sales increased by 2% q/q, even though annual growth dynamics remained negative. The continuing negative sales annual growth rate was mainly due to persistent declines in the sales of audio-visual equipment, computers and other household equipment. After marked increases in the second half of 2010 consumer confidence indicators have fallen back in 2011 Q1 to levels observed at the turn of 2010 Q3 and 2010 Q4. While consumer sentiment indicator deteriorated, the unemployment rate rose temporarily at the beginning of 2011.

Industrial output, dependent to a large extend on external demand, appeared to exhibit a growth trend in 2010. It grew most markedly in petrochemical, paper, chemical and automotive industries. Business confidence rose in 2010 to stabilise in 2011 Q1; it improved in most sectors except for services.

Labour market

High unemployment rate was one of the main reasons behind the decline in private consumption; in 2010, it rose from 8.8% to 11.4%. It was only in 2011 Q1 that the unemployment rate stabilised, reflecting mainly the waning of negative seasonal factors from 2010 Q4. No improvement should be anticipated on the Bulgarian labour market soon, which still suffers significant declines in employment (by 4.4% y/y in 2010 Q4) - deepest in the whole CEE region. In addition, a significant share of long-term unemployment and a relatively inflexible labour markets make the discouraged worker effect very likely.

A marked unemployment growth and negative growth of employment contributed to the decline in unit labour costs throughout 2010 and early this year. Nominal wages declined during this period, i.a. in the processing industry, which contributed to its competitiveness. Wages grew only in the public sector, education, healthcare, financial services and credit services.

Inflation and labour costs

In 2011 Q1 HICP resumed the rise initiated in 2010 and stabilized at 4.6% in March. Food and energy prices contributed the most to inflation growth both in 2010 and 2011. Nonetheless last year, in addition to these external factors, a significant contribution came from internal factors such as increases in excise duties on tobacco products and increases in some administered prices. However, core inflation, reflecting i.a. the weakness of domestic demand and a decline in unit labour costs, had no significant effect on the leading inflation index during this period. Data for April and May indicate a decline in inflation, however most of it stemmed from the waning effect of the April 2010 excise duty rises.

Table 2.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	maj-11
HICP	**2.8**	**3.3**	**4.0**	**4.5**	**3.4**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.6	0.0	0.9	1.2	1.9
Transport	1.2	1.1	1.1	1.5	1.2
Health	0.2	0.1	0.0	0.2	0.2
Housing	-0.1	0.2	0.4	0.3	0.2
Other	0.5	0.3	0.3	0.3	0.1

source: Eurostat

Balance of payments

In 2011 Q1 for the first time since the beginning of the publication of the balance of payments in 1998, Bulgaria has achieved a positive balance on the current account. This was attributable to a significant surplus in the trade balance; as in the previous quarters, it reflected such factors as: a strong demand from Bulgaria's major trading partners, increased competitiveness and a relatively weak domestic demand. Neither the increase in the income account deficit or the decline in the surplus of current transfers (due to a lower inflow of transfers from the European Union) prevented the current account form improving

Early 2011 saw an outflow of foreign capital from Bulgaria. In addition to a decline in portfolio investment and other investment (related to a decline in deposits and repayment of foreign loans by banks), a net outflow of direct investments was recorded. It was caused i.a. by a further withdrawal of investment from real estate services and the energy sector.

Table 2.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**-6.9**	**-4.4**	**-1.2**	**-1.0**	**1.1**
Goods	-10.3	-8.9	-6.7	-6.7	-4.9
Services	3.9	4.4	5.2	5.3	5.5
Income	-3.7	-3.3	-3.8	-3.9	-3.6
Current transfers	3.2	3.6	4.1	4.3	4.1
Capital account	**1.0**	**0.4**	**0.7**	**0.4**	**0.2**
Financial account	**3.9**	**4.0**	**1.2**	**1.1**	**-0.1**
FDIs	5.4	5.4	5.5	4.0	3.7
Portfolio investments	-0.6	-1.2	-1.4	-1.8	-1.9
Other investments	-2.0	-2.8	-2.9	-2.1	-2.5

source: Eurostat

Interest rates

Nominal interest rates on the Bulgarian interbank market stabilised in 2011 Q1 – the 3-m SOFIBID did not exceed 2.12%. Additionally, despite increases in interest rates in the euro area, April saw a further decline of the 3-m SOFIBID below 2%, which reflects a growing liquidity of the Bulgarian financial system.

Fiscal policy

General government deficit in Bulgaria in 2010 stood at 3.2% of GDP, lower than anticipated in the amendment to the Budget Act (3.8% of GDP). According to the latest update of the Convergence Programme, it is to be limited in 2011 to 2.5% of GDP against 2.7% projected by the European Commission. This will be achieved, i.a. by assumed improvement in the economic situation, measures aimed at improvement in tax collection and raising pension contributions by 1.8 pp.[9], while maintaining a freeze of state budget current and capital expenditure (including wages in public administration) and pension benefits. According to the European Commission, these actions suffice to reduce the fiscal imbalance below 3% of GDP this year, i.e. in accordance with the deadline imposed under the excessive deficit procedure, although at a slower pace than recommended by the Council of the European Union (¾% of GDP).

In 2012, the general government deficit in Bulgaria is to decrease by 1.0 pp of GDP, and in the next two years by 0.5% of GDP each year. Further reduction is assumed in the growth rate of budget expenditures (including extension of freezing wages and pensions by 2013, but no details of the proposed measures have been revealed yet.)[10] The government does not plan significant changes in the tax system (except excise duty). Bulgarian authorities have pledged to strive to achieve the medium-term budgetary objective at the level of -0.6% of GDP in 2014, i.e. below the minimum target of -1¾% of GDP, as required by the Stability and Growth Pact.[11]

Fiscal consolidation in Bulgaria should be supported by the adoption of the Financial Stability Pact (PSF), approved at the end of June 2011. It provides for the introduction of fiscal rules constraining the general government: deficit (not more than 2% of GDP) and expenditure (not more than 40% of GDP). Furthermore, changes in direct tax rates will be enabled only with the support of ⅔ of MPs, as compared to a simple majority of votes currently. The PSF provides for the establishment of the Budget Council. The Pact should enter into force in 2012.

Public debt in Bulgaria will remain, alongside with Estonia, at the lowest level among the EU countries. The Bulgarian authorities forecast that in 2011 the general government debt will reach 16.4% of GDP and in 2012 19.0% of GDP. In subsequent years it is expected to stabilize at 17% of GDP. The reserve fund, whose resources limited the growth in public debt in the period 2009-2010, is to be gradually replenished from 2013.

[9] Other changes on the revenue side include VAT hike on tourism services (7% to 9%).

[10] Part of the measures adopted to limit budget expenditures expires at year end, i.e. shift in payment obligation of sickness benefits for the first three days of absence to an employer and a freeze on expenditure in public administration.

[11] For the euro area countries and countries participating in ERM-II this limit should be at most -1% of the GDP.

Forecasts

The economy is expected to return to a sustainable growth path, relying on domestic as well as external demand. According to European Commission forecasts, GDP growth will amount to 2.8% in 2011 and 3.8% in 2012. The Bulgarian Ministry of Finance's forecasts[12], although based on similar assumptions concerning the main growth drivers, seem to be more optimistic and expect the GDP to grow by 3.6% and 4.1% in 2011 and 2012 respectively. Compared to the pre-crisis growth model, private consumption, constrained by restrained earnings growth, moderate lending, relatively low employment and the ongoing fiscal consolidation. will play a smaller role. A moderate growth of domestic demand and stable external demand will ensure a significant share of net exports in GDP growth over the forecast period.

Looking ahead, the situation on the labour market is expected to improve; according to European Commission's forecasts the unemployment rate will fall to the level of 9.4% in 2011 and 8.5% in 2012. However, unemployment is expected to fall very slowly, particularly in non-commercial sectors and among the youngest and least-skilled workers. In this context, the the Bulgarian Ministry of Finance projections assuming a drop of the unemployment rate by 0.1 pp on average in 2011 seems more probable.

Due to moderate inflationary pressures from consumer demand, inflation will predominantly depend on external factors. According to the European Commission, it is expected to reach 4.3% in 2011 and fall to 3.4% in 2012.

According to most forecasts, the balance of risks appears to be neutral. Main risks to growth may include: a slower than expected economic recovery among trade partners, a stagnation on the labour market and a limited credit availability. Meanwhile, growth could be boosted above expectations by factors such as: a bigger then expected capital inflow supporting investment growth as well as a dynamic decline of the savings rate reflecting better prospects for the labour market.

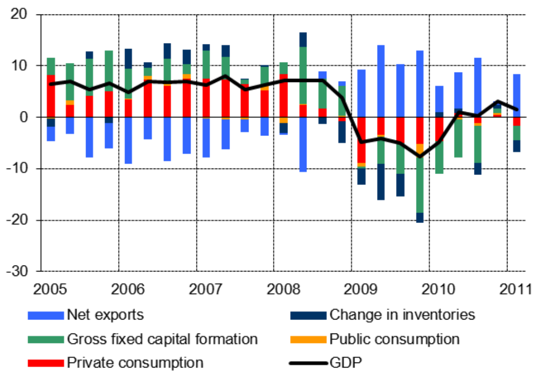
Table 2.4

Forecasts of main macroeconomic indicators

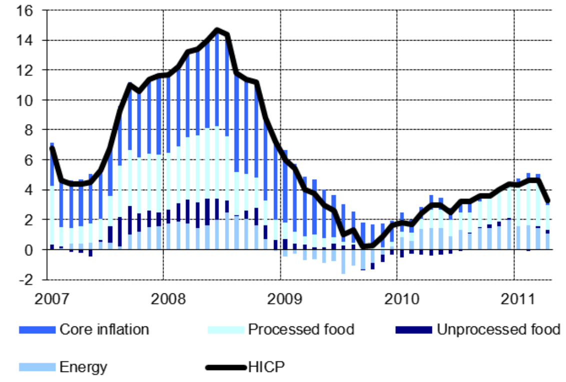
	EC	IMF	Consensus Economics
	05.2011 (11.2010)	04.2011 (10.2010)	06.2011 (12.2010)
GDP, in %, y/y			
2011	2,8 (26)	3,0 (2,0)	2,7 (2,6)
2012	3,7 (3,8)	3,5 (4,0)	3,6
2013		4,0 (4,0)	
Inflation, in %, y/y			
2011	4,3 (3,2)	4,8 (2,9)	4,4 (3,4)
2012	3,4 (3,1)	3,7 (3,0)	3,6
2013		2,7 (3,0)	
Current account balance, in % of GDP			
2011	-2,0 (-2,5)	-1,5 (-3,1)	
2012	-2,6 (-2,3)	-2,0 (-3,5)	
2013		-2,5 (-3,7)	

[12] Convergence Programme for Bulgaria 2011 – 2014 (15.04.2011).

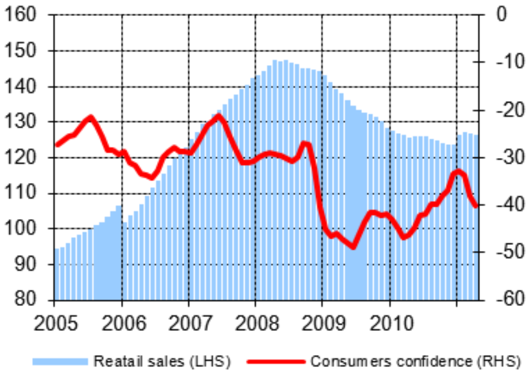
Contribution to GDP growth (in pp, y/y)



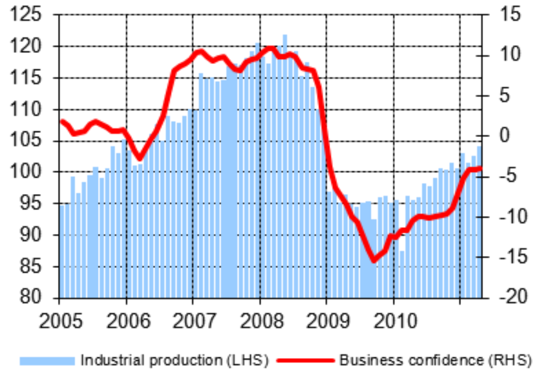
HICP and its components (in %, y/y)



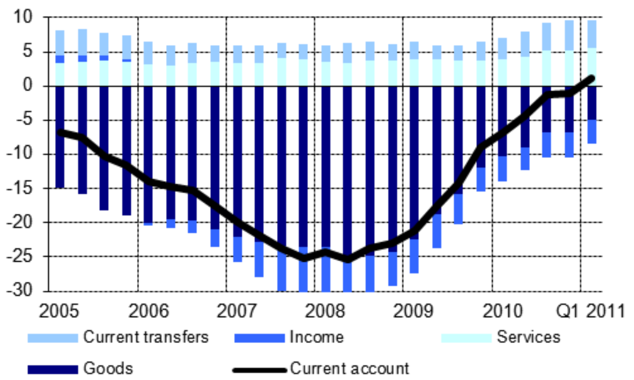
Retail sales (in %, y/y) and consumer sentiment index



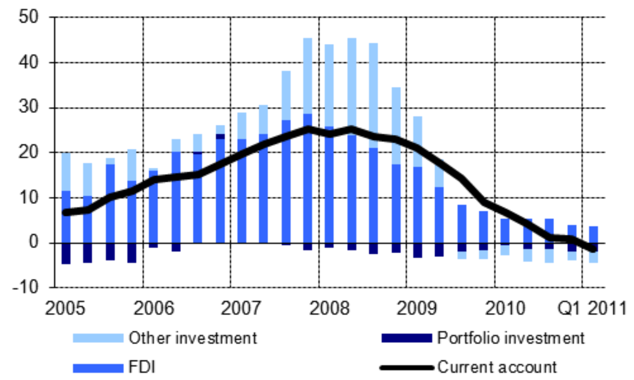
Industrial production (in %, y/y) and business sentiment index



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

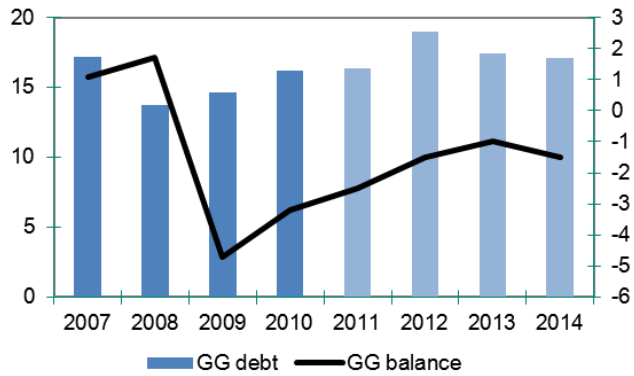


Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

CZECH REPUBLIC

Economic growth

In 2010, the Czech economy entered the recovery process. Real GDP, after declining by 4.1% in 2009, increased by 2.3% in 2010. The upward trend also continued in 2011 Q1. Most of GDP growth in the Czech Republic in 2010 resulted from the inventories rebuilding. This was seen especially in the second half of last year, when this category contributed 3.5 pp. to annual average GDP growth. Private consumption edged up in the first three quarters of 2010, only to resume a fall in Q4. Large falls in fixed capital formation in 2010 Q1 were not fully compensated for in subsequent quarters of last year. Hence, for another year domestic demand had a dampening impact on GDP growth in the Czech Republic. Positive contribution of foreign trade observed in the first half of last year decreased markedly in the second half of 2010.

Both private and public consumption edged up slightly in the Czech Republic in 2010. Private consumption grew only in in the first three quarters of last year, as a result of gradual improvement in labour market conditions and growth in households disposable income. However, in 2010 Q4, household consumption expenditure declined. This was probably the result of inflation, which translated into a fall in real disposable income, and of increasing savings rate in the Czech Republic. Public sector expenditure rose only in the first half of 2010. In the second half of 2010 the government already started to implement the plan of fiscal tightening, which resulted in a decrease in spending. In 2011 Q1, both private and public consumption still declined in annual terms.

Table 3.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-4.1**	**2.3**	**2.6**	**2.7**	**2.8**
Private consumption	-0.3	0.0	0.0	0.6	-0.4
Public consumption	4.2	-0.1	-0.7	-2.4	-1.2
Fixed capital formation	-9.2	-3.1	0.0	-0.1	3.8
Exports	-10.8	18.0	16.4	16.8	15.6
Imports	-10.6	18.0	19.2	17.4	13.2

source: Eurostat

Fixed capital formation in the Czech Republic in 2010 declined again. This was the third consecutive year of falling investment. Decline was wide-ranged, affecting most markedly investment in transport (-15%) and machinery and equipment (-8%). In 2011 Q1, however, a marked acceleration of investment could already be seen in the Czech Republic.

The main growth driver in 2010 was a marked increase in inventories. This increase was mainly due to increased demand in the export sector, which replenished stocks strongly depleted during crisis. In 2011 Q1, the positive contribution of inventories to GDP growth disappeared.

Foreign trade intensified in the Czech Republic since early 2010. The strong recovery in exports was due to the growing demand in quickly recovering economies of major trading partners (mainly German, Polish and Slovak). The second half of 2010 witnessed the acceleration of imports, mainly intermediate goods. As a result, the contribution of net exports to GDP growth for all the 2010 was relatively small. Meanwhile, in 2011 Q1 import growth slowed while export growth remained similar to that observed in previous quarters. Thus, the contribution of net exports to GDP markedly increased.

After a clear drop in retail sales in 2010 Q4, retail trade resumed its growth in 2011 Q1 in the Czech Republic (1.9%). In both cases, the changes in the volume of retail trade turnover were primarily affected by sales of fuels. Retail sale of other categories of goods did not change significantly during this period. Both in 2010 and in the first four months of 2011 the number of newly registered cars in the Czech Republic markedly increased, respectively by 4.7% and 3.7% y/y.

The rise in inflation in the second half of 2010 was a primary reason for decline in consumer confidence in the Czech Republic. The trend persisted over the first months of 2011 when it was additionally fuelled by worsening economic outlook for the country in the next 12 months.

Stimulated by external demand, industrial output grew rapidly in 2010, to rise by 9% over the whole year in comparison with 2009. A particularly rapid growth in output was observed in the case of electrical and electronic equipment and cars (over 20% y/y). In the period January-April 2011, the growth rate of industrial output in the Czech Republic remain high. Persistently, machinery and transport equipment continued to account for most of this rise. Additionally, output soared in the chemical, wood and paper industries. On the other hand, rising fuel prices and declining demand limited the output in the petrochemical industry.

The growth of industrial production in 2010 in the Czech Republic was backed up by continued improvement of business sentiment. It resulted mainly from a larger number of orders, especially foreign orders. Moreover, ever more businesses declared the intention to increase employment, especially in industry. In the first four months of 2011 the declining portfolio of orders, and deteriorating output outlook in the Czech Republic put an end to a business sentiment growth.

Labour market

After a slight increase in 2010 Q4 (due to the amendment of the regulations concerning the right to unemployment benefit) the harmonised unemployment rate in the Czech Republic resumed a gradual decline from the beginning of 2011 to reach 6.9% in April as against 7.2% in December 2010.

At the same time, a slowly improving labour market manifested itself in the reversal of a downward trend in the number of the employees. Though it remained almost 2% y/y lower than in 2009, it started to edge up already in 2010 Q2. In 2010, employment decreased in both agriculture and industry (recovery in the industrial sector began to translate into employment growth only in the second half of 2010), construction and services sector in general. The increase in the number of employees could be observed in the case of financial intermediation and real estate, but it resulted primarily from an increase in self-employment in these sectors of the economy

Inflation and labour costs

After a period of inflation in the Czech Republic in the last quarter of 2010 (up to 2.3% y/y in December 2010), from the beginning of 2011 it began to decline. In April 2011 the HICP annual growth rate fell to 1.6% to be the lowest in the region (apart from Ireland also the lowest in the EU).

The decline in inflation in the Czech Republic in 2011 is primarily the result of base effects related to recovery from the rise in administrated prices in early 2010 (mainly the introduction of higher VAT and excise duty rates). In 2011, a slight decrease occurred in the annual growth in energy and food prices. These effects were partially depreciated by a further increase in administrated prices in 2011 Q1, including energy, rents and services related to dwelling.

Table 3.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**1.0**	**1.6**	**2.0**	**1.9**	**2.0**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.0	0.5	0.8	0.7	1.1
Housing	0.2	0.5	0.5	0.7	0.6
Alcoholic beverages and tobacco products	0.4	0.5	0.4	0.3	0.3
Transport	0.4	0.2	0.2	0.3	0.2
Health	0.2	0.3	0.2	0.1	0.1

source: Eurostat

Food prices, especially processed food, and energy were, in fact, the only factors having a positive contribution to inflation in the first four months of 2011. The total contribution of other prices (except food and energy) to the HICP growth rate for the period January-April 2011, stabilised at -0.2 pp. Low core inflation in the Czech Republic resulted both from weak consumer demand as well as the appreciation of the koruna in that period.

In May 2011, the Czech Republic has seen a marked increase in food prices, especially bread and cereal or fruit. Hence the HICP growth rate, accelerated for the first time in 2011 (up to 2% y/y).

The nominal wages in the Czech Republic in 2010 rose by 2% y/y, i.e. half as much as in 2009. The decline in wage growth in the last year resulted primarily from the reduction of premiums in companies, while the basic salary growth rate was similar to that observed in the previous year.

Wages in the Czech economy grew fastest in the branches which posted the highest increase in their output. This applies in particular to industry, both mining and manufacturing, where nominal wages increased by 3.6%. In the case of the services sector wage growth was much lower. In financial intermediation, transport and storage or public administration, nominal wages fell in 2010. Wage growth deceleration concentrated in 2010 Q4 (up 0.9% y/y against 2.3% y/y in the previous three quarters), following the implementation of austerity measures in the general government sector. In 2010 Q4 the average nominal wage plummeted in education (by 5.8%), public administration and defence (by 3.5%).

Accelerating economic growth and the continued downward trend in the nominal wage growth resulted in a further decline in nominal unit labour cost (ULC). Admittedly, labour market recovery and minor increase in employment slightly countered this decrease. It was, however, too weak to fully reverse the downward trend of ULC growth observed in the Czech Republic since late 2008.

Balance of payments

Current account deficit in the Czech Republic in 2010 amounted to 3.8% of GDP, an increase compared with 3.2% of GDP in 2009. It primarily reflected the reduction in the goods account surplus. Also the income deficit increased, while the improved balance of current transfers account worked towards the reduction of the deficit. Current account deficit fell to 3.4% of GDP in 2011 Q1, following the improvement in the balances on goods and income accounts.

The balance of trade in goods in 2010, as in the previous 5 years, was positive, however, this surplus decreased significantly compared with the previous year (respectively 2.2% and 1.4% of GDP in 2009 and 2010). Despite a slight increase in the first quarter of 2011 (to 1.5% of GDP), it was the lowest since 2004. Exports grew stimulated by the restoration of external demand, but the pace of import growth accelerated since the second half of 2010, due to high import intensity of exports and growing demand for investment goods. An additional factor was the deteriorating terms of trade, especially in the case of petroleum products. It was the increasing deficit in trade in fuels that decisively and negatively impacted the goods balance. On the other hand, in 2010, a surplus in trade in manufactured goods increased. In geographical breakdown, the Czech Republic recorded a surplus in trade with EU countries, which further increased during 2010 by over 22%. Lower than in 2009 foreign trade balance resulted from a higher deficit in trade with countries outside the EU (increase by 40%).

The balance on the services account, both in 2010 and first quarter of 2011 remained unchanged compared with 2009 (1.8% of GDP). Most of this surplus, as in previous years, stemmed from the surplus in the transportation and tourism.

Income account deficit in 2010 was again the deepest among the main categories of current account. Its slight deterioration in 2010 resulted from the growing imbalance in direct and portfolio investment income. Meanwhile the deficit in remittances declined, which was associated with lower salaries paid to foreign workers in the Czech Republic. In 2011 Q1 income account deficit decreased slightly.

Current transfers were balanced in 2010 and 2011 Q1 (compared with the deficit reaching 0.3% of GDP in 2009). This resulted primarily from a surplus in the account of government transfers, while a deficit persisted in private transfers.

Table 3.3
Balance of payments, net balance (in % of GDP, 4q moving average)

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**-3.0**	**-2.5**	**-3.9**	**-3.8**	**-3.4**
Goods	2.4	2.3	1.7	1.4	1.5
Services	1.8	2.0	1.9	1.8	1.8
Income	-6.9	-6.5	-7.3	-7.0	-6.7
Current transfers	-0.4	-0.3	-0.1	0.0	0.0
Capital account	**0.8**	**0.9**	**1.2**	**0.7**	**0.7**
Financial account	**3.8**	**3.1**	**6.5**	**5.0**	**4.8**
FDIs	1.4	1.7	4.1	2.6	2.1
Portfolio investments	4.7	4.3	5.8	4.3	2.6
Other investments	-2.3	-2.9	-3.3	-1.8	0.1

source: Eurostat

Inflow of foreign capital to the Czech Republic in 2010 and 2011 Q1 maintained the upward trend observed since mid-2009, to reach 5% of GDP for the whole year as compared to 4.3% of GDP in 2009. The increase was particularly marked in direct investment, which soared more than fivefold. This rise was primarily due to a growth in reinvested earnings, which accounted for almost 2/3 of the total inflow of direct investment. Most of the inflow was directed into the in the metallurgical and retail trade companies.

Mainly due to a decline in 2010 Q4 the inflow of portfolio investments slowed down, and may signify a wane in foreign investors' interest in the Czech government bonds, much sought for in 2009 and 2010. The preliminary data as of 2011 Q1 apparently confirm the outflow of portfolio investment from the Czech Republic for the first time since 2008.

The 2010 saw an increase in the other investment deficit. It resulted on the one hand from the need to repay loans taken out abroad, on the other, from the growing deposits of Czech residents in foreign financial institutions. In turn, 2011 Q1 witnessed a small inflow of other investments into the banking sector, mainly in the form of deposits, which partly compensated for lower interest in government bonds.

Interest rates and exchange rate

Since May 2010, when the Czech National Bank (CNB) cut its main interest rate (2W Repo Rate) to its lowest ever level of 0.75%. It remained at this level until May 2011. The CNB decided not to raise interest rates, even though the move was made both the ECB and central banks in the region. The CNB explained this by low inflation forecast for the coming quarters (near the inflation target - less than 2%), while economic growth is expected to remain low. Interest rates on the interbank market during this period were very stable. Between May 2010 and May 2011, the 3M PRIBOR virtually stabilised around 1.19-1.22%.

As discussions about the continuation of financial assistance between Hungary and the IMF collapsed and information emerged about the financial problems of the euro area peripheral countries, turbulence developed in European financial markets in the second half of 2010, and investors started losing confidence in Czech assets. This was manifested by an increase in government bond yields (10-year bond yields rose from 3.3% in August 2010 to 4.1% in January 2011). Yields on Czech bonds remained at an elevated level (3.9-4.1%) from January to April 2011, despite abating concerns related to the debt crisis in the euro area. This again followed from global factors, especially political instability in North African countries and a rapid rise in oil prices. Bond yields markedly declined in May 2011 (by about 20 bps).

Between January-May 2011 the development of the Czech koruna (CZK) exchange rate reflected both the situation in global financial markets and domestic monetary policy bias. During this period, CZK strengthened against the euro by 3%. Yet the appreciation only took place in January, when risk aversion among investors due to the said crisis slowly weakened. Political turmoil in North Africa, on the one hand, and an increase in the negative spread between interest rates in the Czech Republic and the euro area (by the decision of the ECB to raise interest rates) on the other hand, stopped the appreciation of the koruna in the following months of 2011.

Fiscal policy

Czech general government deficit fell from 5.9% in 2009 to 4.7% of GDP in 2010 (against 5.1% projected by the government). Its reduction resulted from implemented measures focused on the revenue side (such as increase in VAT, excise, property taxes, a minimum social insurance and health contributions base), accompanied by reductions in social spending, freezing the indexation of pensions and current expenditures (including wages in public administration) cuts. In addition, the Czech government withdrew measures related to the anti-crisis package.

In 2011 fiscal imbalance in the Czech Republic is to reach 4.2% of GDP (4.4% of GDP according to the EC forecast). Its reduction, compared with the previous year, will result from the changes affecting mainly the expenditure side. These include, among others, cuts applied to wages in the public administration (by 10%[13]) and social benefits[14]

In the following years the Czech authorities plans to improve the general government balance by about 0.6 pp of GDP annually in 2012 and 2013 and by 0.9 pp of GDP

[13] Apart from teachers, whose wages are to increase by 3.5%.
[14] I.a. birth allowances, social and unemployment benefit.

in 2014. The medium-term budgetary objective (structural deficit at 1.0% of GDP) would be achieved in 2016. Adoption of pension and health care reform is to affect revenue and expenditure side in future years.

From 2013 a voluntary funded pension pillar is going to be introduced. The part of the pension contribution to be transferred to the fund from the PAYG scheme was set up at 3%[15]. The resulting loss of state budget revenues is to be offset by increases in VAT rates. In 2012, the reduced VAT rate is to rise from 10% to 14%, while the base rate will remain at its current level (20%). Since 2013, only one rate of VAT at 17.5% will be applicable.[16] The effect of the pension reform is to be neutral in the coming years, with a reduced VAT rate hike before a launch of the voluntary pension funds will temporarily reduce the budget deficit by ca. 0.6% of GDP. Parallely, the retirement age for men and women is going to be gradually raised and made equal (up to ca. 67 years in 2041). Currently there are also other changes under discussion aimed at ensuring the sustainability of the pension system in the Czech Republic, including further raising of the retirement age,[17] reducing the discretionary indexation of benefits and phasing out of the early retirement system. The health care reform is planned as of 2012 to allow charges for increased treatment standard, higher fees for hospital stays and for visits to a specialist doctor without a referral from a general practitioner.

In subsequent years, amendments to the tax system[18] are going to involve increasing the taxation of income from gambling, the introduction of incentives in the CIT (regarding the dividend, the exemption of investment and pension funds), while limiting them within the PIT (only child tax credit will be increased). The principles of paying social security contributions by self-employed persons also will be affected, and the taxation on employee benefits is to be more favourable than before. As a result of their adoption, the general government balance will show a small improvement in 2012 (by about 0.2% of GDP), while in subsequent years it will deteriorate (by about 0.2% of GDP in 2013 and 0.6% of GDP in 2014).

Moreover, in the Czech Republic in 2012-2014 wages in public administration are to be maintained at the level of 2011 (except teachers and health sector). Budgetary savings in 2013 will also stem from a review of spending of individual ministries (planned cuts of 5%) and changes in the system of public procurement. Reducing the budget deficit within the deadline set by the EDP (i.e. by 2013) may require additional consolidation measures. In the opinion of the EC, macro-economic assumptions of the Czech authorities for the years 2013-2014 are too optimistic, and the pace of fiscal tightening over the period 2010-2013 is below the recommended level (i.e. 1% of GDP annually).

The Czech government is considering strengthening the institutional framework of public finances, with the possibility of establishing a fiscal council.

Czech public debt is projected to increase from 38.5% of GDP to 42.0% of GDP in 2014, The government plans to reduce the borrowing needs of the sector, with the introduction of a treasury single account.

Forecasts

Recent CNB projections show a marked decline in GDP growth in 2011. The greatest impact will be attributable to the tightening of fiscal policy, which directly or indirectly will affect domestic demand. Fixed capital formation is expected to decline due to the limitations of public investment and the fading of the effect associated with the installation of photovoltaic cells in the second half of 2010. Inventory rebuilding, which used to strongly support economic growth in 2010, will stop. Private consumption is going to continue its growth at a slow pace, due to anticipated persistent stagnation in the labour market, especially in the public sector. Employment growth, which was observed at the beginning of 2011 resulted from a low base effect and in subsequent quarters it will come to a halt. Also a decline in public consumption is forecast. Most of the growth in the Czech economy will come from net exports.

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

In 2011 Q2, inflation should edge up in the Czech Republic. Both the overall and core inflation rate should slightly exceed the value of CNB inflation target (2%). Both measures of inflation are expected to oscillate around 2% in the second half of 2011 and 2012. Inflation rise will be mainly stimulated by the growing pressure associated with an increase in wages (especially in 2012) and additional increases in administered prices (especially energy prices). The anticipated appreciation of the koruna and the expected declines in the growth rate of energy and food prices should operate in the opposite direction.

Current account deficit in 2011 and 2012 may increase considerably. This will be linked to the likely deterioration in the income account balance, only partially compensated by an increase in the surplus in foreign trade.

[15] An employee shall pay also additional contribution from his own pocket, in the amount of 2% or 3% of his wages.

[16] Furthermore the threshold for registration as a VAT payer will be reduced (from CZK 1 mil to CZK 0.75 mil).

[17] After 2041 the pension age would be raised by 2 months every year (no upper limit is envisaged).

[18] Additionally the rates of PIT, contributions for social and health security will be converted due to a change in the reference base for their assessment. At present it is gross wage plus contributions for social and health security. After the change it will be only gross wage.

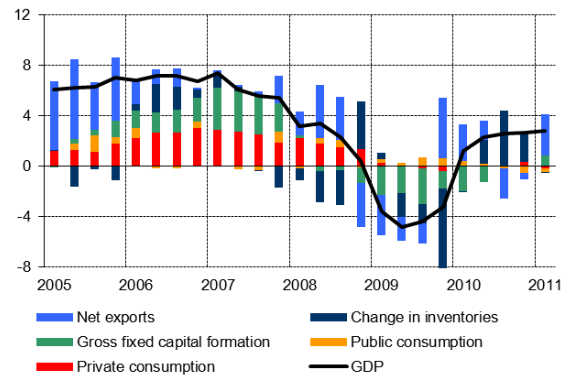
Table 3.4

Forecasts of main macroeconomic indicators

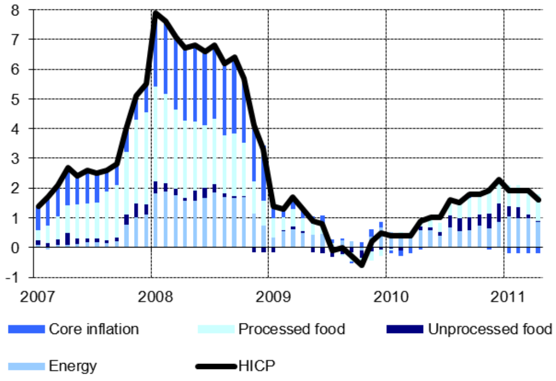
	ČNB	EC	OECD	IMF
	05.2011 (11.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	2011	1,5 (1,2)	2,0 (2,3)	2,4 (2,8)
2012	2012	2,8 (2,5)	2,9 (3,1)	3,5 (3,2)
2013	2013			
Inflation, in %, y/y				
2011	1,9 (1,9)	2,3 (2,1)	2,2 (1,9)	2,0 (2,0)
2012	2,2 (2,0)	2,5 (2,2)	3,1 (1,7)	2,0 (2,0)
2013				2,0 (2,0)
Current account balance, in % of GDP				
2011	-4,0 (-2,2)	-2,5 (-1,5)	-3,0 (-0,8)	-1,8 (-0,6)
2012	-4,3 (-2,5)	-1,9 (-1,1)	-3,4 (-0,7)	-1,2 (-0,6)
2013				-0,9 (-0,6)

ČNB – Inflation Report, Česká Národní Banka.

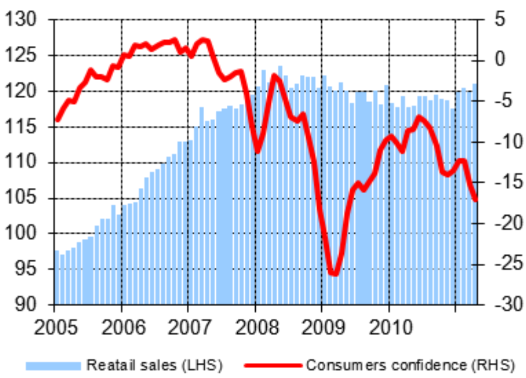
Contribution to GDP growth (in pp, y/y)



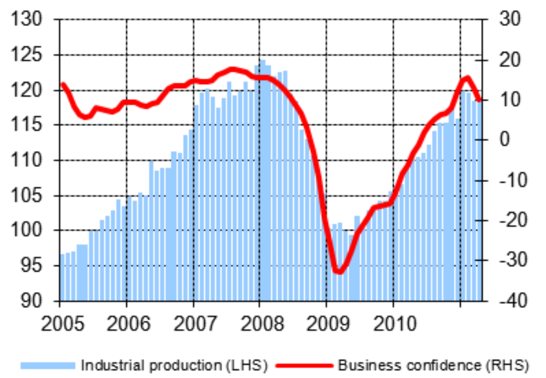
HICP and its components (in %, y/y)



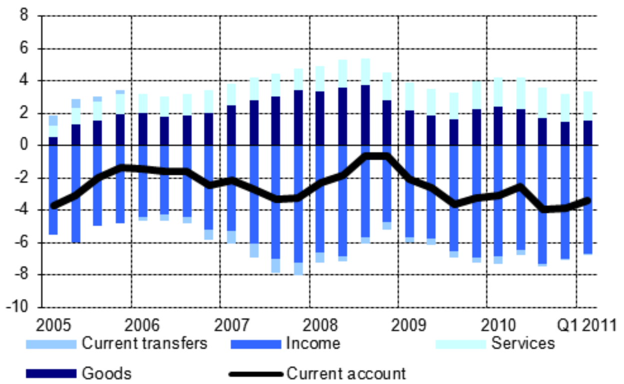
Retail sales (in %, y/y) and consumer sentiment index



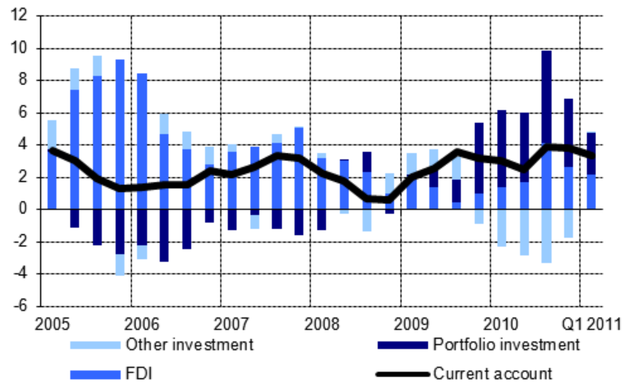
Industrial production (in %, y/y) and business sentiment index



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

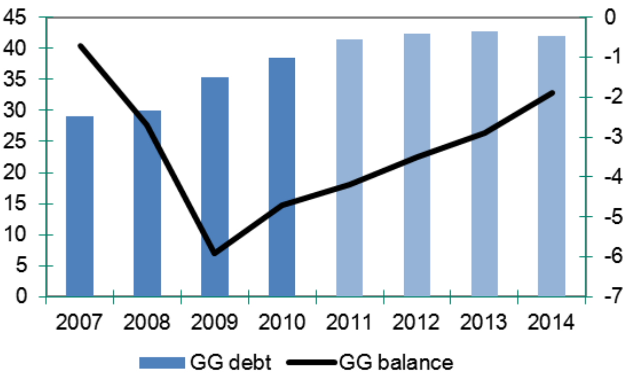


Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ESTONIA

Economic growth

Despite a strong downturn during the crisis (GDP lost a total of 19% in 2008-2009 in real terms), Estonia's economy relatively quickly emerged from recession, to grow at 3.1% y/y in 2010. Although the first signs of recovery occurred already in the first half of 2010, GDP markedly accelerated only in the second half of 2010, mainly as a result of recovery in the economies of major trading partners (mainly Sweden, Finland and Germany) which stimulated foreign demand[19].

Whereas Estonia's foreign trade intensified already in early 2010, the volume of trade in goods significantly increased only in Q3 and 4. Throughout 2010 exports increased by 21.7% and imports rose by 21.0%, which in turn resulted in a positive contribution of net exports to GDP growth.

In contrast to foreign trade, domestic demand for most of 2010 remained weak, showing no signs of recovery. Growth impulse for Estonian economy at that time came from the corporate sector. Over the first three quarters of 2010 the companies continued a process of rebuilding inventories, which supported economic activity. However, in 2010 Q4 the role of the latter clearly fell in favour of increasing investment, which had trended downwards as from 2007 Q3. Yet, despite the growth recorded during the period October to December last year, their growth rate in the whole 2010 was negative (-9.2% y/y).

Table 4.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-13.9**	**3.1**	**5.4**	**6.8**	**8.6**
Private consumption	-18.9	-1.9	0.9	2.6	5.0
Public consumption	-0.5	-2.1	-1.7	-1.4	1.2
Fixed capital formation	-34.4	-9.2	-8.8	11.7	12.0
Exports	-11.2	21.7	24.5	36.8	38.7
Imports	-26.8	21.5	29.8	32.5	38.3

source: Eurostat

Both private and public consumption had a dampening effect on the economy of Estonia in 2010. Private consumption fell by 1.9% y/y in 2010, mainly due to the ongoing process of "debt reduction" of households, high unemployment and wages lower than last year, although consumer spending accelerated slightly in the second half of 2010. The general government expenditures decreased in all quarters of last year, i.a. due to the ongoing fiscal consolidation.

According to preliminary estimates, Estonia's GDP rose by 8.5% y/y in 2011 Q1. In other words, Estonian economy climbed upwards for the fourth consecutive quarter. Economic upturn resulted this time from domestic demand, not like last year, from foreign trade, whose contribution has clearly diminished as a result of a significant acceleration in imports growth relative to previous quarters. This resulted from a marked revival of business investment activity, as evidenced by the second consecutive quarter of a double-digit growth in fixed capital formation (indirectly due to a low reference base in 2010) and rising inventories.

GDP growth in 2001 Q1 also reflected the improving private consumption, largely contributed to by rising transport and housing costs. In the first four months of 2010 retail sales in Estonia continued their upward trend, but remained below the level prior to the outbreak of the global financial crisis. On the other hand, according to a survey of the European Commission, consumer sentiment deteriorated in the period January-May this year, primarily weakened by the growing concerns about future financial position of households and developments in the domestic labour market.

Exports continued to grow at a rapid pace in 2011 Q1. On the other hand, industrial output, which continued upwards, started to level off over the first three months of 2011, to slow down in annual terms in April. This may represent a gradual deceleration of the two-digit growth in exports.

Labour market

The global financial crisis and subsequent recession triggered Estonian labour market adjustments. These were not only exceptionally large in terms of scale, but also occurred in a relatively short period of time. On the one hand it confirms a high flexibility of the Estonian labour market, while on the other hand it reflects active measures taken by the government in 2009-2010, to boost employment and evade a growth in unemployment, mainly a long-term one.

The unemployment rate reached its maximum (18.8%) in 2010 Q1, putting an end to a steady rise – since 2008 Q2 – in the number of the unemployed. More recently the unemployment rate has declined, to reach 14.5% in 2010 Q4. According to preliminary data of the first three months of 2011 it continued to tumble down, to average 13.8%.

High unemployment was reflected in the sustained negative employment growth in the economy of Estonia for the most part of 2010. In 2010 Q4 the number of employees edged up (0.6% y/y), along with a strong rebound in export-oriented industrial sectors. Throughout 2010, employment fell by 4.8% y/y as against a decline of 10% y/y in 2009. The largest declines occurred in industry (-9.7% y/y), while the scale of redundancy in the service sector was relatively low (-2.7% y/y).

[19] Those countries' share in the exports of goods from Estonia ranges within 35-40%.

Inflation and labour costs

In 2010, the annual HICP inflation rate in Estonia was 2.7% as against 0.2% in 2009. Most of its growth stemmed from global factors, such as rapidly growing oil and food prices. As a result of rising prices in foreign markets, domestic energy prices last year hiked by 11.5% y/y, and transport prices grew by 6.6% y/y. Core inflation, i.e. after excluding the prices of energy, food, alcoholic beverages and tobacco products, remained low in 2010 (0.4% y/y). Meanwhile, the upside pressure on prices of goods and services resulting from wage hikes in 2010, played a much smaller role. In 2010 Q1 nominal wages were falling across all the economy, while in subsequent quarters, they began to rise, to increase by 0.9% y/y throughout the year (after falling by 4.6% y/y in 2009)[20].

Table 4.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**2.9**	**3.1**	**5.0**	**5.2**	**5.5**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.3	0.9	2.2	2.5	2.6
Alcoholic beverages and tobacco products	0.3	0.5	0.6	0.5	0.7
Housing	0.7	0.7	0.9	0.7	0.6
Restaurants and hotels	-0.1	0.0	0.0	0.2	0.5
Transport	1.1	0.5	0.6	0.7	0.5

source: Eurostat

In the first four months of 2011, the annual inflation rate in Estonia remained above 5.0%, mainly due to the impact of above-mentioned global factors. In addition, some increase in consumer goods prices in Estonia, also stemmed from the introduction of the euro this year. (see Box 1). The monthly inflation growth in this period averaged 0.6% as against 0.4% in the second half of 2010.

In 2011 Q1 the domestic factors, i.e. wage hikes, had higher than before upward impact on inflation in Estonia, as these gained momentum for the fourth quarter in a row (4.5% y/y against 3.9% y/y in 2010 Q4), mainly in the manufacturing sector.

Balance of payments

In 2010, for the second time in a row, Estonia recorded a surplus on the current account, although this time it was slightly lower in nominal terms. Along with a higher gross domestic product last year this also resulted in a lower ratio in relation to GDP (3.9% versus 4.5% in 2009). Most of the growth in the current account may be attributable to a lower deficit on trade in goods (down 60% y/y to the level of 1994) and a surplus on services, which remained at a level similar to 2009. The positive balance on trade in goods reflected a faster growth in exports (35% y/y) than in imports (27% y/y), whereas the growth in both categories was mainly fuelled by markedly higher than in 2009 sales in machinery and equipment, i.e. the most important category of goods in Estonian foreign trade.

In turn, lower current account surplus in 2010 compared to 2009 was due to a double increase in the income deficit, including particularly deficit on investment by non-residents. Income payments on foreign direct investment in Estonia in the form of reinvested profits, which increased threefold, played a key role here. The balance on current transfers in 2010 remained virtually unchanged.

Table 4.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**4.1**	**3.8**	**3.9**	**3.5**	**3.0**
Goods	-3.5	-3.8	-3.1	-1.7	-1.6
Services	9.8	9.4	9.5	9.1	8.6
Income	-3.8	-3.7	-4.2	-5.6	-6.0
Current transfers	1.7	1.9	1.7	1.8	2.0
Capital account	**3.5**	**3.6**	**3.3**	**1.6**	**1.1**
Financial account	**-6.8**	**-6.2**	**-7.6**	**-11.4**	**-10.3**
FDIs	2.9	6.3	8.2	7.3	7.3
Portfolio investments	-10.2	-9.5	-9.8	-3.0	-1.9
Other investments	0.4	-3.0	-6.0	-15.9	-15.7

source: Eurostat

The financial account of Estonian balance of payments adopted more negative values in 2010 relative to 2009, primarily due to a strong outflow of capital in the form of so-called other investments. This resulted, on the one hand, from reducing reserve requirements for Estonian banks in the second half of 2010. Thus released funds were next transferred abroad, to be - most of them - placed in the form of deposits. On the other hand, the liabilities of Estonian banks from non-residents' deposits recorded a decline. This had a dampening impact on foreign liabilities in Estonian balance of payments. Inflow of direct investment in 2010, significantly higher than in 2009, failed to put a halt on the exodus from Estonia of capital from other investment.

According to preliminary data, in 2011 Q1 the current account recorded a deficit for the first time in eight quarters. It originated mainly from a doubling of the negative balance on income of non-residents, compared with the corresponding period last year, not netted by a declining goods deficit. As it was in 2010 Q1, the financial account recorded a negative balance, i.e. foreign capital flowed out of Estonia. This was due to a reduced non-residents' commitment under the so-called other investment, both short- and long-term.

Interest rates and exchange rate

On 1 January 2011, Estonia became a new member of the euro area, joining other 16 EU states which use the common euro currency[21]. The exchange rate from the

[20] Wages grew specially in industry (5.2% y/y) and construction (3.7% y/y), whereas they declined in the sectors of financial services and public administration (respectively by 8.0% y/y and 2.4% y/y).

[21] The first two weeks of January saw a gradual withdrawal of Estonian kroon. Accordingly, the two currencies were in a parallel circulation. For the sake of customers' convenience

Estonian kroon to euro has been irrevocably set at EEK 15.6466, i.e. central parity in ERM II, which Estonia joined on 28 June 2004.

Fiscal policy

Estonia was the only country in the European Union, which in 2010 recorded a general government surplus (0.1% of GDP). The fiscal balance was affected by a significant one-off revenue related to the sale of carbon emission permits (about 1.1% of GDP). Increasing exports boosted economic recovery, yet failed to translate into a significant increase in budget revenues, because of the tax preferences in this sector.

According to the EC's spring forecast, Estonia is the only country where fiscal balance will deteriorate over 2011-2012. However, the general government deficit will not exceed the reference value (3% of GDP). Its increase will stem from i.a. the realisation of investment suspended in previous years (including a one-off environmental investment growth in the amount of revenue from the sale of carbon emission permits) and expiration of temporary consolidation measures adopted in 2009-2010. As of 2012, the contribution transferred to pension funds will be restored to its full amount, thus resuming the level before mid-2009. Caps on public sector wages and limits on debt incurred by local governments will also terminate, and pensions will again be subject to indexation.

Pursuant to a fiscal strategy adopted by the Estonian government in April 2010 the ratio of government revenues to GDP will be reduced below the pre-crisis levels by 2015. The 2014 should generate fiscal surplus. On the expenditure side a reduction in pension benefits, amending the rules of remuneration of public sector employees, and reducing the rate of current expenditure are envisaged. In the mid-2010, overhaul of the social security system will be performed with the aim to develop measures improving its efficiency. Starting from 2015, the PIT rate is going to be reduced by 1 pp (but tax relief will be limited as from 2012), and in 2014 social and health insurance contribution assessment base will be capped. OECD appealed to Estonia to introduce multi-year expenditure limits and to establish an independent fiscal council. The ruling coalition plans to introduce a statutory ban on budget deficit in the years of economic growth.

Estonia's public debt in the coming years will remain among the lowest among EU member states. According to government estimates, the it will decrease from 6.6% of GDP in 2010 to 5.4% of GDP in 2015. The Estonian authorities plan to finance the budget deficit in the subsequent years with reserve funds. Since 2013, their level is to be gradually rebuilt.

retailers since 1 July 2010 started to quote price in both currencies and were committed to do so until 20 June 2011.

Forecasts

In the opinion of the European Commission, Estonia's economic growth will accelerate significantly over the next two years. According to the forecast of April 2010, the GDP will rise in 2011 by 4.9%, only to slow down to 4.0% in 2012. Moreover, its structure should consolidate, mainly due to the growing importance of domestic demand, including particularly the rebuilding of private consumption and higher business investment.

The former will be stimulated, i.a., by anticipated improvement in the labour market, as well as rising wage growth. Even though household savings should fall over the forecast horizon, following an unexpectedly strong growth during the crisis, they will remain positive due to the ongoing process of "deleveraging" in the household sector. In turn, the investment activity of enterprises will be driven primarily by satisfactory foreign demand growth prospects and rising profits of domestic firms. The European Commission expects a significant increase this year mainly in the replacement investments. Estonia's GDP growth in 2011-2012 will also benefit from higher public sector investment, particularly infrastructure investments, resulting from increased absorption of EU structural funds.

On the other hand, foreign demand over the forecast horizon will play an increasingly smaller role in the growth of Estonia's economic activity. This will be the result, i.a., of the expected slowdown of global economy, which would undoubtedly translate into a decline in global trade. Moreover, it is anticipated that in 2012 net exports will negatively affect Estonian economic growth.

The European Commission expects that in the years 2011-2012 global commodity prices will continue to shape inflation in Estonia. In 2011, this category is expected to increase to 4.7%, and in 2012 it will return to the level of 2010 (2.8%).

The surplus in the current account deficit will gradually decline over the forecast horizon, mainly because of the growing deficit in trade in goods. In relation to GDP it will amount to 1.8% and 0.1% respectively in 2011 and 2012.

Table 4.4

Forecasts of main macroeconomic indicators

	EP	EC	OECD	IMF
	06.2011 (10.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	6,0 (4,3)	4,9 (4,4)	5,9 (3,4)	3,3 (3,5)
2012	4,2 (3,8)	4,0 (3,5)	4,7 (4,1)	3,7 (3,4)
2013	4,2			3,7 (3,3)
Inflation, in %, y/y				
2011	4,7 (2,7)	4,7 (3,6)	4,6 (3,4)	4,7 (2,0)
2012	2,5 (1,7)	2,8 (2,3)	3,0 (2,5)	2,1 (2,0)
2013	2,9			2,5 (2,5)
Current account balance, in % of GDP				
2011	1,7 (-2,6)	1,8 (1,4)	3,2	3,3 (3,4)
2012	1,0 (-2,8)	0,1 (0,9)	0,7	3,1 (1,6)
2013	-0,2			1,4 (-0,4)

EP - Estonian Economy and Monetary Policy, Bank of Estonia

Box 1

Euro changeover effects on inflation in Estonia[22]

In May 2010, i.e. four months from the time when Estonia became the 17th full member of the euro area, the Eurostat has published a preliminary estimate of the impact of the changeover on prices of consumer goods and services in this country. Calculations were based on changes in HICP inflation in the period from December 2010 to March 2011. The following table summarizes the annual and monthly inflation dynamics in Estonia, the euro area and throughout the European Union.

Table 1 Inflation rates (measured by HICP) in Estonia, euro area and European Union

Month	Estonia		EU		Euro area	
	(y-o-y, %)	(m-o-m, %)	(y-o-y, %)	(m-o-m, %)	(y-o-y, %)	(m-o-m, %)
Dec-10	5.4	0.5	2.7	0.6	2.2	0.6
Jan-11	5.1	0.0	2.8	-0.4	2.3	-0.7
Feb-11	5.5	0.7	2.9	0.5	2.4	0.4
Mar-11	5.1	0.8	3.1	1.1	2.7	1.4

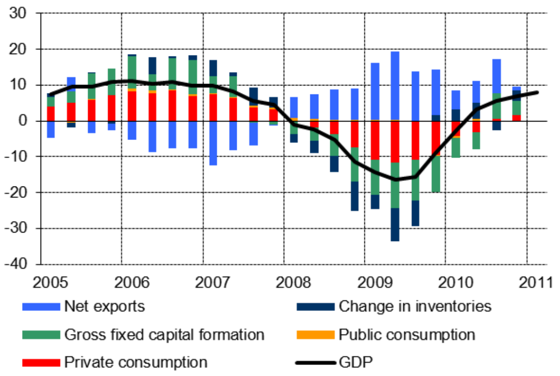
According to a preliminary assessment, the total (one-off) impact of the euro changeover on HICP inflation in Estonia during the period from December 2010 to March 2011 as a whole is likely to be between 0.2 and 0.3 pp. This estimate is in line with the experience of countries who had previously adopted the common currency: Slovenia in 2007 (0.3 pp.)., Cyprus and Malta in 2008 and Slovakia in 2009 (0.3 pp).

Eurostat, with a view to assess the euro changeover impact on consumer price inflation in Estonia, has identified such price increases, which were of "unusual" character. In the above period those "unusual" price increases where seen, in particular for cleaning services, recreational and cultural services, hairdressing services and repair services related to dwellings. Besides, during the period December 2010 to March 2011 unusual price increases were observed for services related to road transport, but their weight in the statistical consumer basket is too low to have a significant influence on a higher HICP inflation rate.

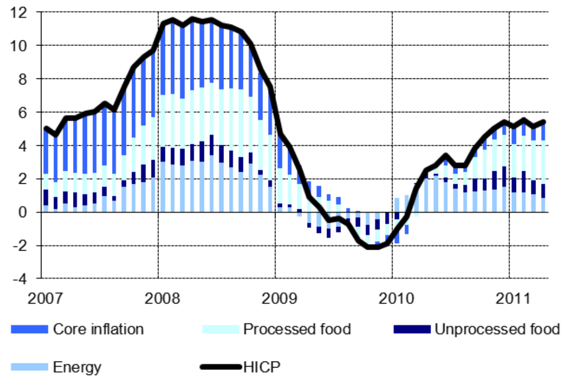
According to Eurostat, the euro changeover effects in Estonia seem to be noticeable, although their scale was not large enough to drive permanently headline inflation in the country.

[22] *Euro changeover and inflation in Estonia*, Eurostat, May 2011.

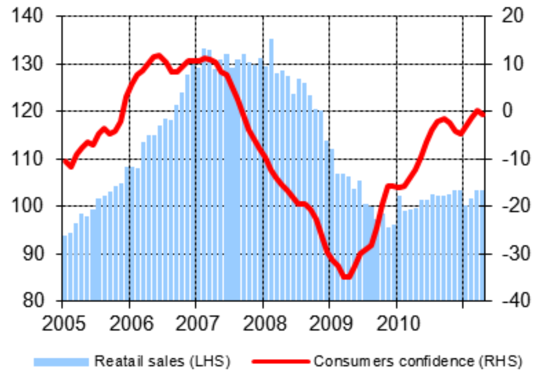
Contribution to GDP growth (in pp, y/y)



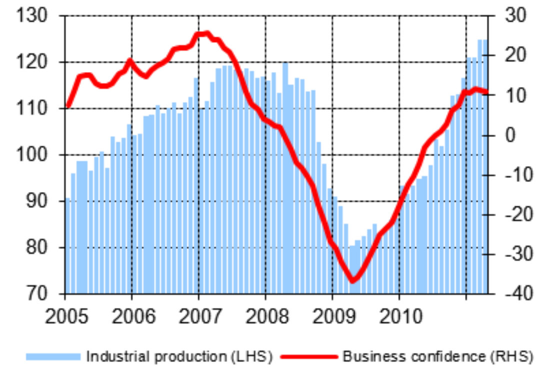
HICP and its components (in %, y/y)



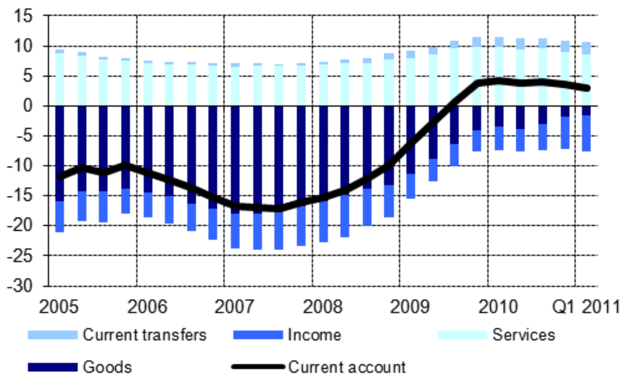
Retail sales (in %, y/y) and consumer sentiment index



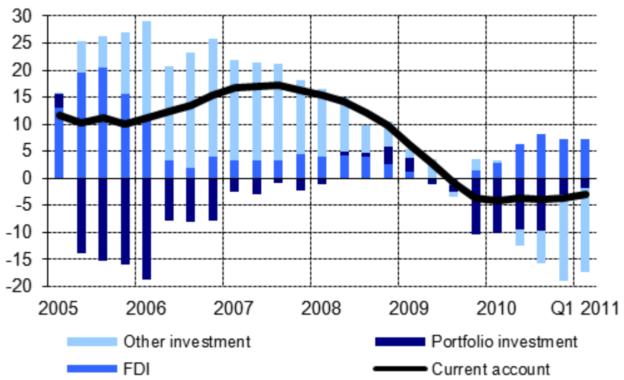
Industrial production (in %, y/y) and business sentiment index



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

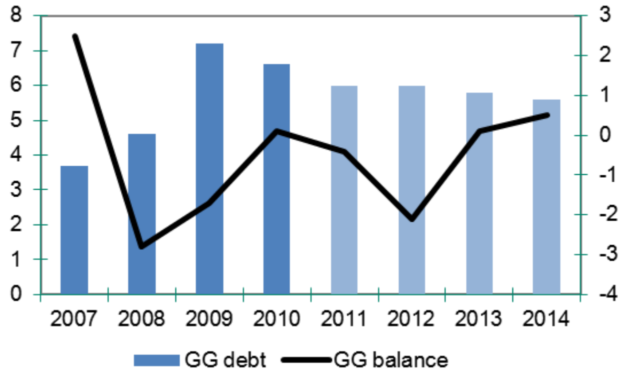


Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

LITHUANIA

Economic growth

From 2010 Q2, the Lithuanian economy has recovered after a deep crisis of 2009. The economic growth achieved last year was attributable to growing exports associated with improvement in global economic climate and intensive rebuilding of inventories. At the end of 2010 and early 2011 domestic demand, especially investment, started to increase its contribution to GDP growth.

Private consumption declined in 2010, for the second consecutive year, due to a negative growth in wages, loans for households, reductions in social benefits and an increase in indirect taxes. Consolidation of fiscal policy also resulted in a decrease of public spending.

The 2010 saw a marked improvement in fixed capital formation, which had been in a negative figures since the second half of 2008. Reversing the downward trend in 2010 Q4 was a result of increasing expenditure on machinery and equipment and investments in the residential construction sector. Since 2010 Q4 Lithuanian companies have also improved their profitability.

Table 5.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-14.8**	**1.3**	**1.6**	**4.6**	**6.8**
Private consumption	-16.9	-4.5	-3.4	-1.6	5.5
Public consumption	-1.2	-3.4	-3.6	-3.1	1.0
Fixed capital formation	-39.1	0.0	20.2	17.3	38.3
Exports	-14.3	17.4	21.5	25.3	19.5
Imports	-29.4	17.9	20.2	31.4	26.7

source: Eurostat

During 2010, due to a growth in imports exceeding that of exports, net exports decreased its stimulating role in the growth of the GDP. From 2010 Q3, its contribution was negative. The economic recovery among the main trade partners of Lithuania: Germany, Russia, other Baltic states and Poland favoured maintaining the high growth of exports, particularly petroleum products, capital goods, pharmaceuticals and transport services. At the same time, imports accelerated following the economic recovery and a growth in investment.

The economic growth accelerated in 2011 Q1, while showing a similar structure as prevailed in the Lithuanian economy before the crisis. The largest positive contribution to GDP growth in this period came from fixed investment (partly due to increase in infrastructure investment) and private consumption, while the deepening trade deficit led to the reduction of scale growth.

Declining scale of fiscal consolidation, some improvements on the labour market and increased transfers from abroad boosted revenue and, in effect, stimulated private consumption. By contrast, a further negative impact on consumption came from a stagnant domestic credit market. Demand for loans was also limited by low income and uncertainty associated with the labour market and financial outlook.

In 2011 Q1 due to faster growth in imports than in exports negative contribution of net exports enlarged. As in previous quarters, the intermediate goods were the most important import goods. Increase occurred also in the imports of capital and consumer goods associated with the growth in household expenditure. Exports also grew but at a slower pace. Its growth was supported by increasing demand from eastern neighbours[23] and the EU countries. In 2011 Q1, fuel exports grew due to an increase in their prices in world markets. Strong external demand led to significant increase in capacity utilisation in the export-oriented companies.

The continuous growth in household spending is reflected in the annual growth in retail sales, which has been on a rise since early 2011. In April, it rose to 7.3%, mainly due to increased sales of motor vehicles and clothing, as well as household appliances.

After a rapid increase at the beginning of 2011, consumers' optimism slightly decreased in the following months, mainly due to high food and energy prices. April 2010 brought about improvement in sub-indices describing expectations about the employment and households financial situation. On the other hand inflation expectations and plans for major purchases deteriorated.

Industrial output continued its the upward trend started in 2010 Q2. Increasing foreign demand caused its growth to 14.8% y/y in 2011 Q1. The highest annual growth rate occurred in furniture, leather and metal products manufacturing.

The increase in industrial output was associated with improved business sentiment in Lithuania. The growing optimism of businesses in 2011 Q1, is illustrated by a better growth outlook in industrial output, and next by outlook for competitiveness, employment and portfolio of orders.

Following a deep slump[24] in the first half of 2010 the situation on the real estate market shows stabilization. The end of the year saw new investment projects (construction output grew at ca. 16% y/y in 2010 Q4 -

[23] According to WIIW Institute total exports of Lithuania to Russia, Ukraine and Belarus grew by 55% in 2010 in nominal terms. The 2011 saw a high demand of Belarus citizens for second-hand Western cars imported i.a. from Lithuania due to the anticipated growth in customs duties in Belarus in July (following the establishment of customs union with Russia and Kazakhstan).

[24] In 2010 Q1 construction sector output fell by ca. 43%, continuing an abrupt downward trend of 2009 (declines by ca. 40-50% occurred through 2009).

2011 Q1), whereas mortgage loans also became more available. On the other hand, many construction projects, abandoned during the crisis, remained so in 2010. Rental prices also recorded a further decline.

Labour market

In 2010, the unemployment rate in Lithuania reached its historical maximum (17.8%)[25] and, despite relatively rapid GDP growth, it remained high. According to the Lithuanian Statistical Office, in 2011 Q1 unemployment reached 17.2%. Given a difficult situation in the labour market, unemployment reduction may result from growing emigration.[26]

In 2010 Its scale was not big - 5.1% in 2010 compared to 6.8% in 2009 During the year, the number of unemployed who have registered their own business has almost doubled. As of 2010 Q4 employment increased in some industries, such as transport, information and communication as well as in financial intermediation and insurance services.

Inflation and labour costs

Following disinflation in 2010 Q1, consumer prices in Lithuania accelerated in 2010 Q2, primarily fuelled by supply factors (high food and energy prices). Only in January 2011, the upward trend was disrupted by the low base effect.

In May 2011, as a result of further increases in commodity prices, food[27] and administered prices, HICP inflation reached 5.0% y/y - the highest level since April 2009

Table 5.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**0.5**	**1.8**	**2.9**	**3.2**	**5.0**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.5	0.3	1.2	1.9	2.8
Housing	0.1	0.8	1.7	0.9	0.9
Transport	0.7	0.6	0.6	0.8	0.8
Restaurants and hotels	-0.4	-0.4	-0.3	-0.3	0.1
Restaurants and hotels	-0.2	-0.2	-0.1	0.0	0.1

source: Eurostat

Core inflation in 2010 due to low demand pressure remained negative. However, it started to grow at the end of the year due to a faster recovery in the economy and buoyant consumption In March 2011, it bottomed at zero, and a month later reached a positive growth (0.1%).

In 2010 Q4, for the first time since early 2009, wages increased in annual terms (the growth was higher in the case of export sector workers). Negative impact on real wage growth came from rising inflation. Thus, unlike before the outbreak of the crisis - falling real wages (4.3%) coincided with an improvement in labour productivity (5.7%). Along with economic recovery this moderated unit labour costs (ULC).

Balance of payments

The current account surplus dropped to 1.8% of GDP in 2010 (from 2.6% a year earlier). This decline resulted from the increase in the deficit on the income (cashing of earning profits by foreign investors) and goods accounts. Meanwhile current transfers (partially due to the inflow of EU funds and remittances) and services (as a result of revenue growth from transport, tourism, construction) surpluses increased. In 2011 Q1 the current account recorded a deficit, mainly due to a further deterioration on goods and income accounts.

In 2011 Q1 despite the recovery in the transport sector, due to increased foreign demand[28], growth in exports of services was low. Continued upward trend persisted in exports of goods, primarily stimulated by exports of oil-related products (approximately 22.5% of the total value of exports in 2010) and fertilizers. The crisis did not affect the reorientation of exports - Russia, Germany, Latvia and Poland remained the major receivers of Lithuanian goods. However, growth occurred in the export to the Middle East.

Table 5.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**4.5**	**5.3**	**4.0**	**1.8**	**1.5**
Goods	-3.5	-3.5	-4.0	-4.3	-4.6
Services	2.2	2.7	3.3	3.6	3.2
Income	1.4	1.1	0.0	-2.5	-2.8
Current transfers	4.3	5.0	4.7	5.1	5.7
Capital account	**3.2**	**3.2**	**2.5**	**1.7**	**1.0**
Financial account	**-8.0**	**-8.6**	**-6.7**	**-4.6**	**-4.1**
FDIs	-0.8	-1.3	0.7	1.4	1.6
Portfolio investments	7.8	8.1	8.5	5.1	-1.0
Other investments	-13.8	-15.3	-14.6	-8.9	-3.1

source: Eurostat

As of 2010 Q3 the scale of the foreign capital outflow decreased, reflected in the declining deficit in other investments (mainly due to lower repayment of liabilities by the Lithuanian banking sector). From 2010 Q3, FDI posted a net inflow, mainly as a result of higher reinvested earnings. After the record inflows of portfolio investments during 2010, 2011 Q1 saw their outflow, due to increased investment in foreign debt securities. However, foreign investors were still interested in

[25] Long-term unemployed who sought work for over a year accounted for ca. 40% of total unemployed. Most of them displayed low qualifications. It is essential to conduct reforms in order to lower structural unemployment.

[26] In 2011 Q1, 14 thous. people migrated from Lithuania. At year end this figure may grow to 60-65 thous. (with the population of ca. 2.9 m). Source: *Spis dowodzi kurczenia się Litwy [The Census shows Lithuania shrinking]*, Dziennik Gazeta Prawna 16.05. 2011 Opening the labour market in Germany and Austria since 1 May 2011, and of Switzerland since June will prompt up further migration.

[27] Food prices hikes accounted for ca. 2/3 of inflation growth in 2011 Q1.

[28] Transport accounts for ca. 2/3 of the services exports value.

Lithuanian government bonds - in 2011 Q1, Lithuania issued a tranche of USD-denominated Eurobonds.

Interest rates and exchange rate

Interest rates on the interbank market in the second half of 2010 and early 2011 remained stable and low thanks to financial system stabilisation and economic rebound - 3M VILIBOR ranged between 1.4% - 1.7% (in the first week of April it was 1.4%). In subsequent weeks, the rate rose to 1.66% (mid-May) due to monetary policy tightening in the euro area.[29]

In the last months of 2010 the effective exchange rate of the lit strengthened (the lit appreciated against the currencies of trading partners and inflation rose since the second half of 2010).

Fiscal policy

The fiscal imbalance in Lithuania remained at a high level last year (7.1% of GDP as compared to 9.5% of GDP in 2009) in spite of continuation of consolidation measures, and is going to be limited to 5.3% of GDP in 2011. Consolidation measures pursued this year include the extension of the freeze of wages in the public administration, as well as pension and disability benefits and a reduction of contributions transferred to open pension funds.[30]

In 2012, i.e. within the period stipulated in the excessive deficit procedure, the budget deficit in Lithuania is planned to stand at 2.8% of GDP, and in the next two years it is expected to decrease at 1 pp. of GDP per year. The authorities plan to perform an expenditure review (including social transfers) next year, introduce measures to reduce pension benefits, improve the efficiency of state enterprises. However, the latest update of the Convergence Programme of Lithuania does not contain further details of proposals in this regard. Next year will see the expiry of temporary reduction of pensions (5%) and wages in the public sector, while the government may decide to extend them. According to the IMF estimates Lithuania should launch additional consolidation measures (ca. 1¼ pp of GDP) to achieve the fiscal target for 2012, for example by introducing taxation on property and motor vehicles. Due to the parliamentary elections scheduled for the autumn 2012 their adoption seems unlikely.

Lithuania's public debt, with projected improved economic situation should gradually decrease, to reach 35.4% of GDP in 2014, as compared to 38.2% of GDP in 2010.

Forecasts

According to the Bank of Lithuania, GDP growth in 2011 may reach 5.6%, and a year later - 4.8% (this is a significant increase in the forecasts as compared with November last year).

In 2011, most of buoyant economic growth will stem from investment rebuilding. The Bank of Lithuania expects that investment will increase this year by 17.9%. The fastest increase will occur in private investment in fixed assets.[31] An additional incentive for public investment will derive from the expected increase in the use of EU funds (financing of infrastructure projects and support for the growth of energy efficiency).

Additionally, household expenditure is anticipated to resume a positive growth, while exports growth is expected to slow down. In subsequent years, the reconstruction of national consumption will stem from the expected improvement in the labour market[32] (lower unemployment, higher employment), consumer sentiment (possible reduction in savings rate), the gradual renewal of credit and reduction the scale of fiscal consolidation. Consumption will grow, fostered by lower debt burden than in the neighbouring Baltic states. The autumn parliamentary elections may possibly further weaken fiscal restrictions in 2012. However, a relatively low real wage growth will have opposite impact.

Export will grow thanks to the continuous prosperity among the recipient countries of Lithuanian exports, including the former USSR countries. The pace of export growth may be lower due to saturation of the target markets, lowering the competitiveness due to rising commodity prices and high base effect. Along with the reconstruction of domestic demand, imports of goods and services will also accelerate.

Threats to growth are associated with a possible further increase in emigration and negative demographics. An increase in labour productivity associated with investment weakening may not be sufficient to compensate all the outflow of labour force. Higher than expected increase in energy prices is another downside risk to economic growth. Possible reduction in global risk aversion, along with improving economic situation in Lithuania will contribute to higher capital inflows.

Unemployment is expected to decrease in 2011-2012, most likely remaining relatively high. This would be related to low wages, often lower than unemployment benefits, which promotes the growth of employment in the informal economy.[33]

[29] On a small Lithuanian interbank market, a change in liquidity position of one bank may already impact interest rates.

[30] Originally reduction in contributions transferred in Lithuania to open pension funds from 5.5% to 2% was implemented temporarily for 2009-2010. At the end of 2010 it was decided that this rate will remain at the reduced level. Once the fiscal situation improves, the contributions are to be restored at full amount.

[31] According to a survey conducted by the Lithuanian Institute of Free Market (LFMI) enterprises in 2011 intend to reinvest more (ca. ¼ of their earnings), and they also anticipate a growth in margins.

[32] It will however develop slowly due to a persistently high structural undemployement.

[33] LFMI respondents assessed the size of grey economy at 28% of Lithuanian GDP In 2010. A similar proportion is anticipated for 2011.

According to the Bank of Lithuania forecasts the average annual inflation in 2011 may reach 3.8%,[34] continuously shaped by supply-side factors associated with high oil, gas[35] and food prices on global markets. Along with the improvement in GDP and growth in domestic demand in Lithuania, prices of industrial products and services may also increase. Additional pressure may come from the expected expansion in lending to the private sector. Increased inflation may weaken the purchasing power of households, especially low-income ones. According to the Bank of Lithuania, in 2012 inflation should remain at 3.9%. Core inflation over the forecast horizon of the will gradually increase along with closing of the output gap.

Bank of Lithuania expects the current account deficit of 1.2% of GDP in 2011, mainly due to growing deficit in the goods. The opposite effect will stem from the inflow of current transfers. Expected further steepening in the deficit in goods (reduced growth rate of exports) is expected to increase the current account deficit in 2012 to 1.8% of GDP.

Table 5.4

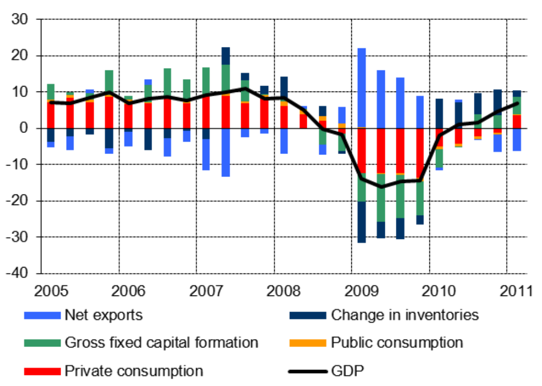
Forecasts of main macroeconomic indicators

	LB	EC	IMF	Consensus Economics
	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)	06.2011 (12.2010)
GDP, in %, y/y				
2011	5,6 (3,1)	5,0 (2,8)	4,6 (3,1)	4,7 (2,7)
2012	4,8	4,7 (3,2)	3,8 (2,6)	3,8
			3,7 (3,3)	
Inflation, in %, y/y				
2011	3,8 (2,3)	3,2 (2,3)	3,1 (1,3)	3,8 (2,0)
2012	3,9	2,4 (2,7)	2,9 (1,3)	2,9
			2,7 (1,5)	
Current account balance, in % of GDP				
2011	-1,2 (-0,4)	0,2 (1,3)	-0,9 (0,2)	
2012	-1,8	-0,6 (1,0)	-2,9 (-0,6)	
			-3,0 (-1,8)	

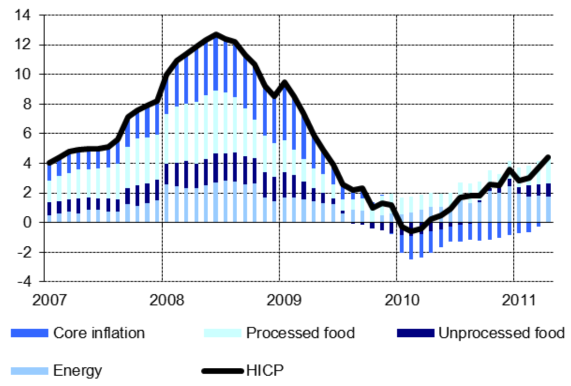
LB - Lietuvos bankas

[34] Keeping inflation at low levels is particularly important in connection with plans to adopt the euro in Lithuania in 2014.
[35] Price rise for gas supplies to Lithuania, planned by Gazprom may also be a growth factor.

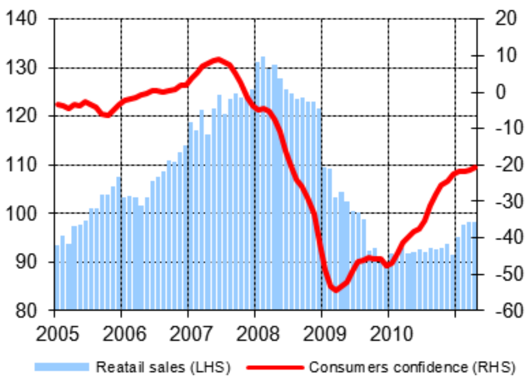
Contribution to GDP growth (in pp, y/y)



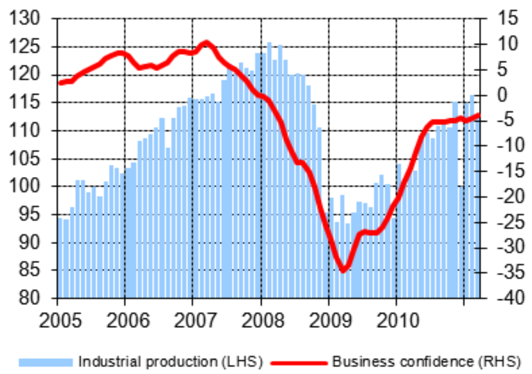
HICP and its components (in %, y/y)



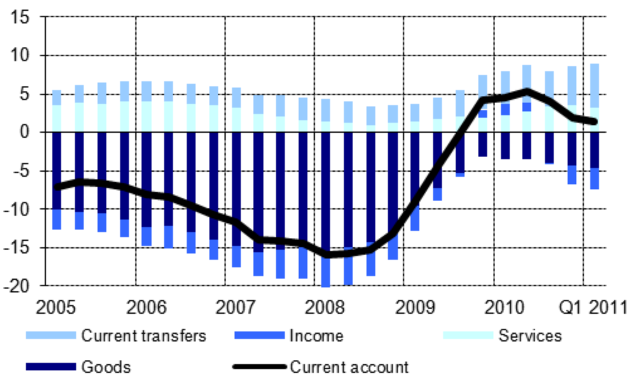
Retail sales (in %, y/y) and consumer sentiment index



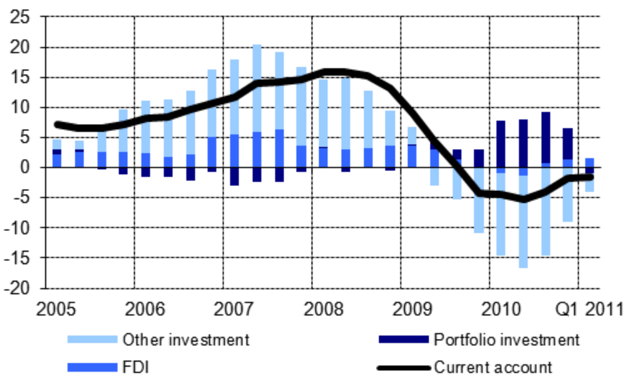
Industrial production (in %, y/y) and business sentiment index



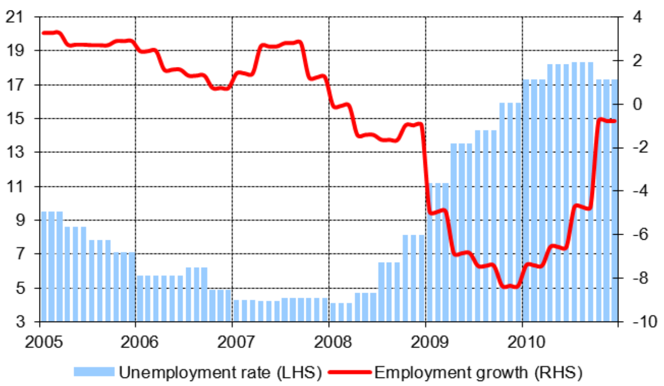
Current account and its components (in % of GDP, 4-quarter moving average)



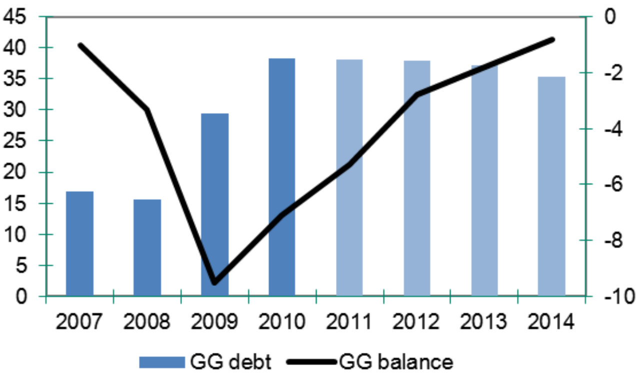
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

LATVIA

Economic growth

Since the second half of 2010, the Latvian economy has been again in a growth phase. However, this increase failed to offset the decline of the first 6 months of that year, resulting in 2010 being the third consecutive year of decline in Latvian GDP. The upward trend persisted in 2011 Q1, but the pace of recovery was slower here than in other Baltic states.

Table 6.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-18.0**	**-0.3**	**2.6**	**3.5**	**3.2**
Private consumption	-22.5	-0.1	3.5	5.8	3.6
Public consumption	-9.2	-11.0	-6.1	-9.1	0.2
Fixed capital formation	-37.7	-19.5	-11.8	0.1	14.5
Exports	-13.9	10.3	15.4	13.7	15.1
Imports	-34.2	8.6	12.8	15.8	18.8

source: Eurostat

Since the beginning of 2010, the annual growth in private consumption in Latvia increased to achieve positive values already in the second half of 2010. Throughout 2010, the contribution of private consumption to GDP growth remained however slightly negative (-0.1 pp.). The increasing growth in consumption was mainly due to the low base from 2009, when it fell by as much as 22.5%. Consumption growth was slowing down by fiscal consolidation, which continued for another year and changed the behaviour of consumers (building savings at the expense of reduced consumption). Continuation of fiscal tightening was much more evident in the case of public consumption. In 2010, it declined by as much as 11%, which means the second consecutive year of strong decline in public consumption. 2011 Q1 brought about a further growth in private consumption and also a slight increase in public consumption.

Gross fixed capital formation remained in 2010 the category with the highest negative impact on GDP growth. As compared to the corresponding period of 2009, the investments were nearly 20% lower. The second half of 2010 apparently reversed the downward trend in investments that had taken place in Latvia since 2007. Whereas their annual growth gained momentum in 2010 Q3, it remained negative. In the next quarter for the first time since 2007 there was a rise in investment in annual terms. It accelerated even further in the first quarter of 2011. Fixed capital formation boost in the second half of 2010 and 2011 Q1 concentrated in the investments in manufacturing and warehouse facilities, which could forerun hikes in other categories of investment in the coming quarters. However, it seems that in order to fully exploit the investment potential of Latvia, the return of foreign investors seem to be necessary. Regaining their confidence, however, depends on a successful completion of the process of economic reforms, particularly fiscal consolidation.

The limiting factor of domestic demand growth in Latvia in 2010, was a continuous fall in the lending of commercial banks. The value of loans to both households and private enterprises featured a steady decrease, which does not indicate lending to recover in Latvia in a short term. A small increase in the number of loans was visible only for the public sector, both general government sector and state-owned enterprises.

GDP growth was positively impacted by only one category of national accounts, namely inventories. Their contribution to annual GDP growth, however, decreased significantly in the second half of 2010 (it amounted to respectively 6.6 and 3.0 pp. in the first and second half of 2010). In other words, the process of rebuilding stocks by Latvian companies begins to slow down, which should also be observed in 2011 Q1.

Exports remained a driving force of the Latvian economy in 2010, propped up mainly by the growing demand from the EU-15. The increase in exports, demand for raw materials, and slowly rebuilding domestic demand brought about a growth in imports in the second half of last year. As a result, the contribution of net exports to GDP growth in the second half of the year began to fall, to turn negative in Q4. As a result of a rapid growth in imports in 2011 Q1, the negative contribution of net exports increased further.

After a period of a strong decline in 2009, retail sales in Latvia began to rise slightly in early 2010. This increase concentrated in durable goods, e.g. in 2010, the number of newly registered cars rose by more than 32% y/y. The increase in retail sale in Latvia was disproportionately high in relation to the scale of improvement on the labour market in 2010. The structure of consumer spending in this period (especially on durable goods) suggests that the increase in consumer expenditure in Latvia was caused by major purchases, financed from the funds saved during the crisis. This trend reversed in 2010 Q4, when the continuation and even exacerbation of fiscal tightening was announced. This information rapidly dampened consumption sentiment among Latvians. In addition, higher energy and food prices resulted in reduction in households real disposable income. In 2010 Q4 and 2011 Q1, the value of retail sales decreased, which affected especially durable goods.

Indicators of consumer optimism developed similarly. The first three quarters of 2010 saw its rise. Most of this growth reflected the rise in the sub-indices describing the condition of Latvian economy (current and expected in the upcoming months), as well as households' financial standing. In Q4 this trend reversed, which resulted mainly from a decrease in expectations about future income and financial situation of households.

The volume of industrial production sold in 2010 was more than 13% higher than in the corresponding period of 2009. The increase in industrial output was primarily a result of the increase in external demand. For this reason, the biggest increase in production was observed in the case of capital and intermediate goods (such as paper, wood products, metals, machinery and equipment as well as means of transport). In 2010 Q4, output growth declined, and its value even decreased in 2011 Q1. This was due to the weakening of both domestic and foreign demand, which was most noticeable in the chemical and rubber industries, as well as in electrical equipment manufacture.

Business confidence index in Latvia, which had been increasing rapidly until 2010 Q2, halted in the second half of 2010. Whereas the industrial trade portfolios continued to expand in the second half of 2010 and 2011 Q1, their growth decelerated. At the same time, entrepreneurs voiced increasing concerns about prospective output in view of a growth in of current inventories.

Labour market

The situation in the labour market in Latvia gradually improved during 2010. Between 2009 Q4 and 2010 Q4 the harmonised unemployment rate fell from over 20% to 17.2%. Despite this improvement, it remained among the highest in the region (along with Lithuania), and also throughout the EU (along with Spain).

As of 2010 Q2, the downward trend in employment, which could be observed in Latvia since early 2008, has been reversed. In 2010 Q3 and Q4, the annual growth rate of employment was positive for the first time since mid-2008 (2.1% y/y in 2010 Q4). Employment growth could be observed in almost all sectors of the economy. The number of employed increased both in industry, construction and in most services. It declined only in the public administration, which was an effect of continued fiscal tightening. Lack of a clear recovery in the retail trade also caused a further decline of employment in this sector

Inflation and labour costs

Annual HICP inflation rate in Latvia in January-July 2010 was negative, and the lowest in the region. In the second half of 2010, as in other CEE countries, the growth of consumer prices soared, to amount to 2.4% in December. In the first four months of 2011 inflation in Latvia continued to increase, to reach 4.8% in May 2011.

Table 6.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**-2.3**	**-0.3**	**1.7**	**3.8**	**4.8**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.5	0.4	1.5	2.1	2.6
Housing	-0.6	0.6	0.7	1.2	1.0
Transport	0.5	0.4	0.7	0.8	0.8
Restaurants and hotels	-0.4	-0.4	-0.2	-0.1	0.3
Restaurants and hotels	-0.6	-0.5	-0.2	0.0	0.2

source: Eurostat

The increase in inflation in Latvia in the second half of 2010 was mainly caused by the supply-side factors - rising food and energy prices. Inflation in 2010 received also a boost from increases in administrated prices (especially heat energy and gas). January 2011 saw a surge in inflation in Latvia, due to VAT increase (from 21% to 22%). As estimated by the Bank of Latvia, in its effect, the inflation rate rose by 1.3 pp. Additionally, in 2011, energy and food prices continued their rapid growth.

Increase in VAT, rising prices of energy and fuels, which began to be translated into other categories of goods and services. Along with visible improvement in the labour market it began to translate into an increase in core inflation in Latvia. Although still negative in 2011, it rose significantly over late 2010 to reach -0.3% in April 2011,up from -2.6% in December 2010.

A downward trend in nominal wages in Latvia persisted in 2010. An average wage fell by 5.5% compared to 2009. Decline affected both industry and services sector. Public finance austerity plan weighted on the wages in this sector, which used to rank among highest in the whole economy. Wage declines occurred mainly in the first half of last year, while in the second half wages already started to increase slowly. Q4 saw even nominal wage edge slightly up in annual terms (0.1%).

Growth in unit labour cost (ULC) in Latvia accelerated in the second half of 2010, but still remained negative. Despite wages rising in Latvia in the second half of last year, labour productivity continued to grow at a faster pace.

Balance of payments

The current account surplus in Latvia, after reaching a record 10.6% of GDP in the first quarter of 2010 (moving average for 4 quarters), decreased significantly in the subsequent quarters of 2010. Throughout 2010, it already amounted to only 3.6% of GDP, whereas 2010 Q4 shifted current account into deficit, for the first time since 2008. The deficit further increased in 2011 Q1.

Foreign trade turnover in Latvia grew significantly in 2010. Rise in exports (28%) and imports (20%) reduced goods deficit from 7.1% in 2009 to 6.4% of GDP in 2010. Growing demand from major trading partners of Latvia, as well as increase in the competitiveness of Latvian exports (*internal devaluation*) primarily contributed to rapid restoration of exports, which grew most in wood and paper industry, metallurgical, chemical industries, manufacturing of machinery and equipment and electronic devices. Following the increase in exports, demand intensified for intermediate and capital goods, which especially in the second half of 2010, resulted in a marked increase in imports of these goods. In 2011 Q1 the deficit on the goods account rose as a result of faster growth in imports than in exports.

Both the services and current transfers accounts in 2010, consistently showed a surplus, which remained broadly stable over the year. The surpluses continued at the same level also in 2011 Q1.

Most of decline in the positive current account balance came from a rapid income account deterioration. In 2009 its balance amounted to 6.3% of GDP, and in 2010 only 0.2% of GDP, to reach already a deficit (-1.0% of GDP) in 2011 Q1. This resulted from an increase in foreign-owned enterprises' profits, which led to the growing outflow of income from foreign investments in 2010 and 2011 Q1.

Table 6.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**10.6**	**8.6**	**6.5**	**3.6**	**2.0**
Goods	-6.2	-6.0	-6.0	-6.4	-6.5
Services	6.1	6.3	6.3	6.2	6.1
Income	6.8	4.7	2.7	0.2	-1.0
Current transfers	3.9	3.6	3.5	3.6	3.4
Capital account	**2.5**	**2.2**	**2.3**	**1.6**	**0.9**
Financial account	**-14.0**	**-10.6**	**-8.8**	**-5.3**	**-2.9**
FDIs	-0.5	0.5	0.3	1.4	3.5
Portfolio investments	0.8	0.7	0.5	-0.8	-2.8
Other investments	-2.8	2.2	-2.9	-1.0	-4.8

source: Eurostat

The year 2010 significantly reduced the scale of foreign capital outflow from Latvia. The outflow of capital was due to repayment of long-term liabilities by Latvian businesses (both in the financial and non-financial sector), showed on the other investment account (-1.0% of GDP in 2010). On the other hand, the scale of related capital outflow was far smaller than in the two preceding years. The balance of portfolio investments, which had shown a surplus in 2009, decline markedly in 2010. Foreign direct investments were the only category where the inflow to Latvia in 2010 was far greater than the outflow. Net inflow of direct investment increased especially in the second half of 2010, when the inflow of capital transfers was supplemented by reinvested earnings. In 2011 Q1 foreign capital again resumed its outflow from Latvia. Although the inflow of direct investment grew at the same time portfolio and other investments deficit widened, among others due to a much smaller transfer of funds under the Cohesion Fund, compared with 2010 Q1.

Interest rates

As other Baltic states, Latvia experienced a considerable decrease in interest rates on the interbank market, resulting primarily from its over-liquidity. The 3M Rigibor rate decreased from almost 8% in early 2010 to less than 1% in December. In the first five months of 2011 interest rates remained low. In May, 3M Rigibor fell to its historical low of 0.79%. Following a strong decline in 2010 (from 15.5% in January to 7% in December), yields on Latvian bonds have remained at a low level also to date in 2011, which can be regarded as signs of stabilization on Latvian financial markets.

After a real effective exchange rate depreciation in 2010 (as a result of the so-called. "internal devaluation") in 2011, the lat has started to appreciate against the currencies of major trading partners. Over December 2010 - April 2011 CPI-deflated REER appreciated by 2.5%. This resulted primarily from the rapid growth in inflation in Latvia, as of early 2011.

Fiscal policy

In 2010, fiscal consolidation in Latvia continued , in accordance with the terms of the EU and IMF assistance package. In 2010 the general government deficit amounted to 7.7% of GDP as compared to 9.7% of GDP in 2009. The total magnitude of the consolidation measures was ca. 4.0% of the GDP (distributed evenly on the revenue and the expenditure side), accompanied by a negative impact on fiscal balance related to providing support to the banking system (2.3% of GDP compared to 1.1% of GDP in 2009).

In mid-April 2011 Latvian Parliament amended the Budget Act for 2011. Accordingly, the general government deficit target was set at 4.2% of GDP compared to 5.4% of GDP planned before and the limit of 6.0% of GDP, set forth in the EU and IMF assistance package. The revised budget reflected the concerns of the IMF and the European Commission about budget execution in 2011, i.a. as a result of optimistic economic assumptions and expected growth of tax revenues due to combating smuggling and shadow economy. Budgetary revenue estimates were adjusted upwards (about ¾% of GDP), followed by a slight increase in expenditure limits[36] (0.2% of GDP). At the same time it was decided to raise the excise tax and VAT on natural gas (from 12% to 22%)[37], and maintain cuts on social security payments (till 2012), sickness, maternity and unemployment benefits(to 2014).

Thanks to improving fiscal situation in Latvia the scale of consolidation measures in subsequent years could be reduced. The general government deficit is to be reduced below 3% of GDP in 2012 (2.5% of GDP), i.e. the deadline imposed under excessive deficit procedure. The proposed adjustment measures for 2012, estimated at ca. 1.1-1.3% of GDP, include the further sealing of the tax system and property tax increases, limiting expenditure on salaries and subsidies (i.a. airport in Riga, support of the social activities carried out by local government units) and debt incurred by local government sector related to infrastructure projects. In addition, no indexation of pension and disability benefits will be implemented before late 2013. The government of Latvia is not planning currently to postpone further the increase in the rate of contribution transferred to funded

[36] Supporting producers of bio-components in the amount payable for 2010.

[37] Measures entered in force mid-year. The changes also apply to increases in game tax rates and to eliminating the reduced VAT rate on natural gas. The list of measures in force since 2011 includes an increase in VAT (standard rate from 21% to 22%, reduced rate from 10% to 12%; followed by abolishment of some preferences in VAT), property tax, excise duties (including the elimination of tax relief for bio-components) and the rates of social security contributions paid by employees (from 9% to 11%). By contrast, the rate of personal income was reduced (from 26% to 25%).

pension scheme.[38] Until August this year, the strategy should have been developed concerning social security system. Fiscal consolidation should be facilitated by the strengthening of medium-term budgetary framework. Starting from 2013, caps on expenditure and budget deficit will be binding for all the years covered by the multiannual plan.

Due to a significant deterioration in fiscal balance as a result of the economic crisis and the need to apply for financial support to international institutions, public debt increased sharply in Latvia. At the end of 2010 it amounted to 44.7% of GDP compared with 9.0% of GDP in 2007. At the end of this year the assistance package expires. It will not be renewed due to the absence of threats to the functioning of the Latvian economy. In June this year, for the first time since 2008, Latvia held a foreign bond issue. The authorities plan to raise funds in advance to repay foreign currency loans related to the EU and IMF assistance package (approximately EUR 4.5 billion), the largest amount due in 2014 and 2015 Thus, despite the improving economic situation and reduction of the general government deficit in subsequent years, Latvia's public debt will increase to 52% of GDP in 2014, and in 2015 will decline to 45% of GDP.

Forecasts

According to forecasts by the European Commission, Latvia's GDP in 2011, after 3 years of decline, may increase by 3.3%. The economic recovery will result primarily from the expected strengthening of domestic demand. Projections indicate a growth acceleration in private consumption, despite the lack of clear improvement in the labour market. Gross fixed capital formation should also resume a path of rapid growth. Continued fiscal consolidation will most likely lead to a further decline in public consumption. The process of rebuilding of inventories, which was one of the main growth contributors in previous years, is also due to be completed. The impact of net exports on GDP growth should decline slightly, due to slower than in 2010 export growth. In 2012, the trends in the Latvian economy will be similar, with even higher contribution of domestic demand, both of consumption and investment.

Annual HICP growth in 2011 should clearly increase, due to the sustained effect of increases in indirect tax rates in January 2011. Inflation will rise in 2011, stimulated by intensifying inflationary pressures associated with increased households spending. In 2012, inflation should decline as the above base effect wanes and prices stabilise on energy and food markets.

The current account surplus which was built in 2009 and persisted in 2010 should disappear in 2011. The current account deficit is to be further deepened in the next year, yet not even approaching the pre-crisis level (over 20% of GDP). The widening of the deficit on goods and income account should be the main drivers of growth in external imbalances in Latvia in the coming years.

Table 6.4

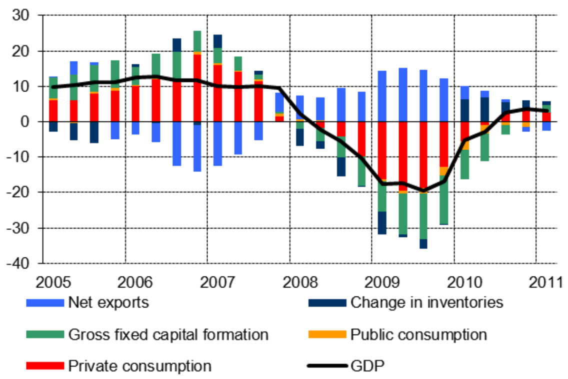
Forecasts of main macroeconomic indicators

	MF	EC	IMF	Consensus Economics
	04.2011 (11.2010)	11.2010 (05.2010)	04.2011 (10.2010)	06.2011 (12.2010)
GDP, in %, y/y				
2011	3,3 (3,3)	3,3 (3,3)	3,3 (3,3)	3,6 (2,9)
2012	4,0 (4,0)	4,0 (4,0)	4,0 (4,0)	3,8
2013			4,0 (4,0)	
Inflation, in %, y/y				
2011	3,5 (1,1)	3,4 (1,1)	3,0 (0,9)	4,1 (1,7)
2012	2,0	2,0 (1,8)	1,7 (1,0)	3,1
2013			1,7 (1,2)	
Current account balance, in % of GDP				
2011		-0,3 (-0,5)	2,6 (2,9)	
2012		-1,6 (-2,9)	1,5 (0,8)	
2013			-0,3 (-0,2)	

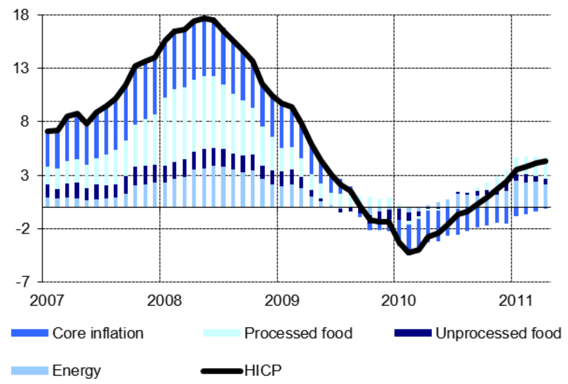
MF – Ministry of Finance

[38] At the end of 2010 the authorities resolved to postpone increase in contributions transferred to funded pension scheme to 2013. Originally they were to be raised from 2% to 4% in 2012 and since 2013 to 6%. It should be noted that since 2013 the original amount of contributions transferred to the second pillar of the pension system, i.e. 8% of the basis, will not be restored.

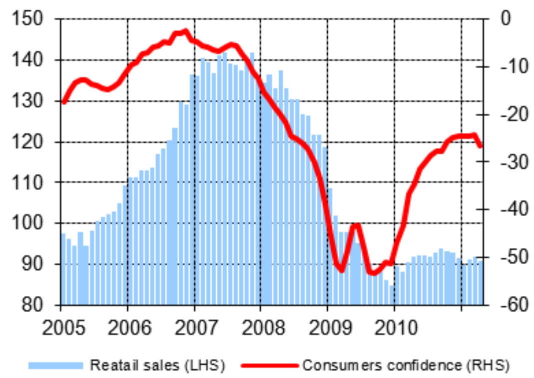
Contribution to GDP growth (in pp, y/y)



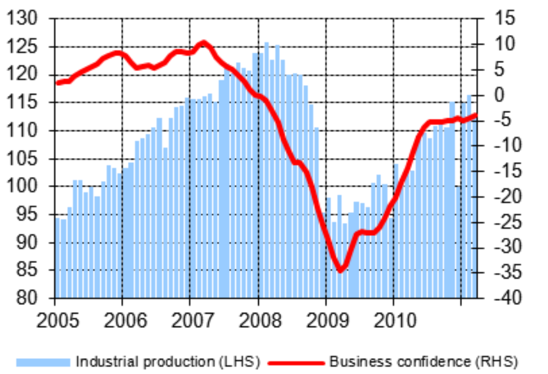
HICP and its components (in %, y/y)



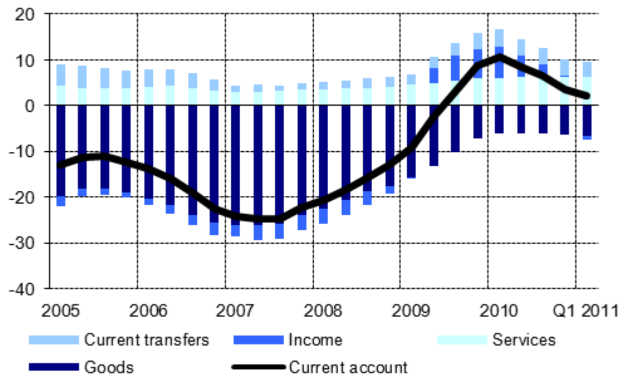
Retail sales (in %, y/y) and consumer sentiment index



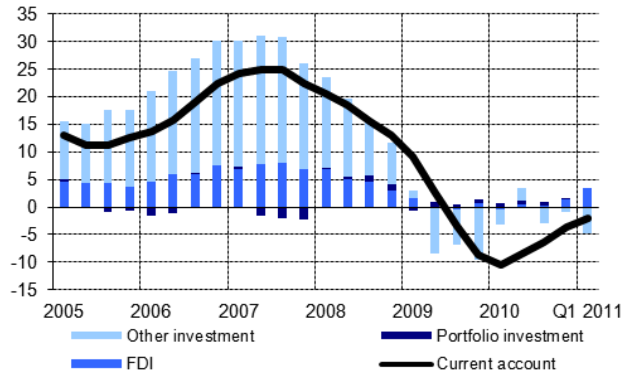
Industrial production (in %, y/y) and business sentiment index



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

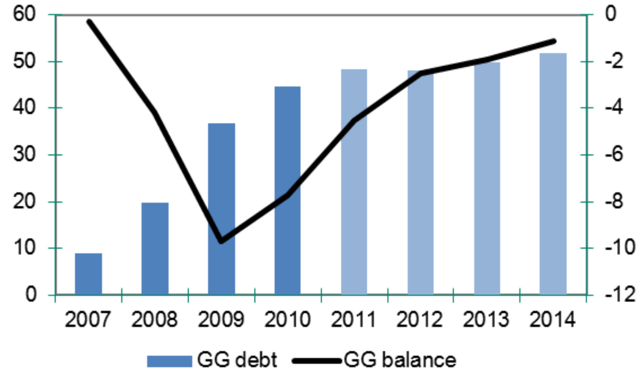


Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

POLAND

Economic growth

In 2010, the GDP in Poland grew by 3.8%, which, apart from Slovakia, was the fastest in the region However, the GDP growth composition differed significantly from other countries in Central and Eastern Europe. Private consumption played important role in the recovery. While external demand contributed to growth to a lesser extent.

Table 7.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**1.8**	**3.8**	**4.6**	**3.9**	**4.3**
Private consumption	2.2	3.1	3.5	3.5	3.5
Public consumption	1.9	4.0	3.7	4.9	2.1
Fixed capital formation	-0.8	-1.0	0.4	1.7	6.8
Exports	-9.5	10.0	8.5	7.3	5.8
Imports	-13.5	11.6	9.5	11.3	6.2

source: Eurostat

Economic growth in Poland in 2010, was in 50% due to the increase in household spending. The GDP growth of 3.0% y/y was the fastest in the region, whose average GDP growth decreased for the second consecutive year by 1.4%. Along with Sweden, the GDP growth was the fastest in the entire European Union. The growth in private consumption accelerated significantly in the second half of 2010 and was close to its long-run average. The growth in consumer demand can be attributed to an improvement in disposable income of households, which resulted from surge in compensation of employees. Public sector expenditure also accelerated compared with 2009.

In 2010, gross fixed capital formation fell at a similar pace as in the previous year. Significant reduction in gross fixed capital formation throughout the year came from adverse weather conditions in 2010 Q1. However, fall in investments reversed in the second half of 2010. This was due to a rapid acceleration in investments of the general government, large and medium-sized companies. In 2010 Q4, gross investment growth was stimulated i.a. by housing. In the beginning of 2010, enterprises started to rebuild their inventories, as a result of which the contribution of the stock increases to GDP growth was then positive and significant (greater than of other components of GDP).

The upward trend in exports has continued since 2009 Q4. However, in the second half of 2010, this trend weakened, which was due to slower the growth in demand among major export partners. In late 2009 they implemented fiscal austerity measures, which.in turn contributed indirectly to deceleration in household expenditures. Since consumer goods account for over 30% of exports to the EU-15 countries, i.e. much more than the average in other CEE countries, this fiscal tightening in the Western European economies s likely to exerted a severe impact on demand for Polish exports. Due to the recovery of external demand, industry was the fastest growing economic sector in 2010. Other export-related industries also experienced rapid growth, including in particular transport.

Given a high contribution of imports in the output for foreign markets, the rise in exports (as well as stock rebuilding) stimulated import demand. It started to increase on an annual basis in the beginning of 2010. In addition, the growth of imports in the second half of 2010 was also stimulated by the acceleration of consumer demand. As a result, imports grew faster than exports, which caused trade deficit to widen and a net exports to contribute negatively to GDP growth. Thus, Poland ranked among a few EU countries, with imports rising faster than exports. This was due to faster economic growth in Poland compared to a vast majority of its trading partners. In addition, faster import growth derived from the appreciation of the zloty, which took place in the whole of 2010.

Relatively fast GDP growth persisted in 2011 Q1. Domestic demand remained the main factor of economic growth, fuelled by accelerated growth of investments, sustained growth in consumption and further increase in inventories .

The growth of private consumption remained relatively rapid in 2011 Q1, even though inflation was high, consumer loans had been declining and there had been some intertemporal substitution in consumer demand between late 2010 and early 2011 because of anticipated VAT rates changes as of 2011. Presumably, the labour market improvement may have significantly impacted consumption growth as well. Meanwhile, public consumption slowed down significantly.

Investments continued to recover in 2011 Q1. At the same time, companies continued to rebuild their inventories, so that this category retained a positive contribution to GDP growth. On the other hand, a slowdown occurred in both exports and imports, with much stronger deceleration in the growth of imports. As a result, net exports decreased their negative contribution to GDP growth.

In the period from January to April 2011, retail sales gained further momentum. Throughout the period the sales boosted in certain categories of durable goods (furniture, electronics, household appliances) and non-durable goods other than necessities, which can reflect a broad-based revival in consumer demand.

Economic studies indicate still relatively weak consumer confidence. Since early 2011, all (except for changes in the level of unemployment) components of consumer confidence indicators have been lower than previous year. In particular, consumers systematically decreased their willingness to make major purchases. Relatively weak sentiment, however, did not translate into slowdown in private consumption, which seems can be attributed to an improvement in the labour market.

Data on industrial production growth and trade portfolio point to an improvement in the sector, although recently these indicators have somewhat declined. Also the recent drop in PMI may indicate that the recovery in industry might have weakened somewhat.

Labour market

As economic growth rebounded, demand for labour increased, and employment growth accelerated. In 2011 Q1, employment rose by 2.1% (against an increase of 1.1% in 2010 Q4). Seasonally-adjusted harmonised unemployment rate was 9.3% in April down 0.2 pp from December 2010. As unemployment rate levelled off, the number of newly registered unemployed trended down.

Inflation and labour costs

The Harmonised Index of Consumer Prices (HICP) in year-on-year terms has clearly accelerated since early 2011. In January 2011, primarily due to increases in VAT rates, inflation rose to 3.5% (from 2.9% in December 2010). Higher inflation in the following months originated from steadily rising food prices, which was largely due to an unfavourable supply situation in the domestic market for fruits, vegetables and cereals and a strong upward trend in prices of agricultural and energy commodities in global markets. The growth in inflation also drew from increases in administered prices of energy for households. In May 2011, the annual HICP rose to 4.3%.

Core inflation (excluding food and energy prices) increased from 1.1% y/y to 2.0% y/y. The growth rate was fuelled by price increases in most groups of goods and services. In January and February, it was associated with the above-mentioned rise in VAT rates, as well as the increase in administered prices of services related to housing. In the following months, the acceleration of core inflation was mainly due to higher prices of clothing and footwear, as well as the increase in prices of services in restaurants and hotels (partly linked to rising food prices) and prices of transport services (partly associated with an increase in fuel prices), and in May this year, also with an increase in the prices of medical services.

Table 7.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	maj-11
HICP	**2.5**	**2.1**	**2.7**	**3.6**	**4.3**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.2	0.6	1.0	1.3	1.8
Housing	0.5	0.6	0.7	0.9	1.0
Transport	0.5	0.2	0.4	0.5	0.5
Alcoholic beverages and tobacco products	0.7	0.4	0.4	0.4	0.3
Other	0.3	0.2	0.1	0.2	0.3

source: Eurostat

Acceleration of inflation observed since 2010 Q4 may indicate the increasing demand pressures in the economy.

After a clear acceleration in 2010 Q4, the growth rate of nominal wages in the economy declined in 2011 Q1. The pace of wage growth in enterprises in this period remained moderate. Amidst high inflation, real wage growth in the economy and the corporate sector oscillated around zero.

Due to the faster increase in the number of the employed, labour productivity in the economy in 2011 Q1 grew slower than in previous quarters. The parallel decline in wage growth, however, resulted in a decline in unit labour costs as against 2010 Q4. However, this growth was significantly faster than in the previous four quarters.

In April 2011 – for the first time since July 2009 – unit labour costs in industry rose in year-on-year terms. Unit labour costs in industry decelerated their fall mostly because labour productivity rose more slowly in recent months and wages markedly accelerated in April.

Balance of payments

As the economy continued to recover, the negative current account widened, affected mainly by a growing trade deficit in goods. The wider foreign trade deficit reflected a higher demand for imported goods amidst economic recovery and also, to some extent, deteriorating terms-of-trade (due to a higher import prices of raw materials). Sound corporate earnings, in turn, translated into higher income of foreign owners, and a revenue deficit in the current account.

The deficit in current account (in terms of four consecutive quarters) increased to 4.5% of GDP in 2010 (compared to 3.9% in 2009). At the end of 2011 Q1, the deficit widened to reach 4.6% of GDP.

At the same time, increased use of EU funds to finance investment projects accounted for a strong inflow of funds onto the capital account.

Table 7.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**-3.8**	**-3.8**	**-4.3**	**-4.5**	**-4.6**
Goods	-1.7	-1.9	-2.0	-2.4	-2.5
Services	1.0	0.9	0.9	0.7	0.8
Income	-3.8	-3.6	-3.8	-3.6	-3.6
Current transfers	0.7	0.8	0.7	0.8	0.6
Capital account	**1.4**	**1.3**	**1.6**	**1.8**	**1.9**
Financial account	**9.7**	**9.8**	**9.7**	**8.0**	**8.6**
FDIs	2.4	2.2	1.3	0.7	0.3
Portfolio investments	5.5	5.4	5.8	5.4	3.9
Other investments	1.8	2.2	2.7	2.1	4.5

source: Eurostat

According to the financial account, in 2010 Q4, net inflow of capital to the Polish was dominated by portfolio investment, with shares and equities playing an important role. However, in 2011 Q1 most of net capital flowed to companies in the form of so-called other investments. Data for 2010 Q4 and 2011 Q1, indicate a high foreign direct investment inflows to Poland. Polish direct investment abroad increased at that time.

Interest rates and exchange rate

Since early 2011, the MPC(l?) raised NBP policy rates four times by a total of 1.00 pp., taking the reference rate to 4.50%. Interest rate increases, each by 0.25 pp. took place at meetings in January, April, May and June 2011.

NBP interest rate increases translated into a corresponding increase in the interbank market rates. At the same time a tendency prevailed to reduce the spread between the interest rate on interbank deposits and the OIS (Overnight Index Swap) rate. Though the spread narrowed, the interbank market continuously underperformed, and banks took a primary recourse to interbank operations with the shortest maturities.

In the first half of 2011, nominal exchange rate of the zloty appreciated against the U.S. dollar by 7.2%, while it weakened against the euro and Swiss franc by respectively 0.5% and 2.9%. The Swiss franc, considered a safe and stable currency also strengthened against the U.S. dollar and the euro.

After the interim depreciation in mid-March, amidst higher insecurity in the financial markets in the aftermath of natural disasters in Japan, the zloty was gradually strengthening. The zloty appreciation was fuelled by the NBP interest rate increases and the launch by the Ministry of Finance of the programme to exchange a part of transfers from the European Union on the currency market. In the second half of May and in June 2011, the zloty weakened due to increased concerns about the fiscal situation in some euro area countries and the related sale of high-beta currencies, including the zloty.

Fiscal policy

In 2010, the general government deficit in Poland deteriorated further, from 7.3% to 7.9% of the GDP. Along with Slovakia, Poland posted last year the largest fiscal imbalance among the CEE-countries. This situation was attributable to lower than expected current taxes on income and wealth (including greater than expected impact of economic slowdown on corporate tax settlements) and higher ratio of public spending in relation to GDP, especially marked in capital expenditure, co-financed by EU funds and the amounts disbursed to mitigate the effects of floods.

In 2011 the general government deficit in Poland is expected to decline to 5.6% of GDP, whereas in 2012 it will drop by almost a half, to 2.9% of GDP. Over the next two years, the fiscal imbalance reduction is estimated at 0.5% of GDP each year. Consolidation measures on the revenue side concern in particular reduction of contribution transferred to the second pillar of the pension scheme[39] and implementation of temporary changes in the VAT (i.e. increase of rates in 2013 by 1 pp;[40] exclusion of VAT deduction on the purchase of passengers cars classified as goods vehicles and fuel consumed by them until 2013). With a view to constraining government spending, temporary expenditure rule will be implemented. It will cap growth of central budget discretionary and new mandatory spending items at the level not exceeding CPI+1 pp. This rule will be effective until the correction of the excessive deficit. A permanent expenditure rule is now under preparation, which will aim at stabilizing the general government balance at the level of medium-term budgetary objective (i.e. maintaining the structural deficit below 1% of GDP). Adjustment on the expenditure side will also stem, i.a., from freezing the wages in central government sector in 2011 and 2012 (except teachers). Fiscal balance will also improve due to the phasing out of early retirement and the introduction of rules for disciplining local government units.[41] The recent Convergence Programme announced the reform of the provisioning system for the uniformed services and social security for farmers.

The European Commission and the IMF suggest that the achievement of budgetary target in 2012 will require additional adjustment measures. Among the changes, the Fund proposes, i.a., the alignment of disability benefits with the pension formula,, as well as changes in the their indexation mechanism, reduction of tax expenditures and streamlining public administration employment.

In 2010, the general government debt in Poland amounted to 55.0% of GDP against 50.9% in 2009. Within the horizon of the forecast presented in the latest Update of the Polish Convergence Programme it will be gradually decreased (to 50.8% of GDP in 2014[42]), as a result of budgetary improvement and significant privatization receipts in 2011-2012.

Forecasts

In comparison with the projection of October 2010 presented in the previous "Analysis of the economic situation in the countries of Central and Eastern Europe" in July 2011, the National Bank of Poland lowered economic growth projections for the next two years and at the same time increased the inflation forecast.

The National Bank of Poland anticipates that a relatively rapid recovery in domestic demand, which used to boost growth in 2010, will be sustained also this year. According to European Commission forecasts published in

[39]Previously, it amounted to 7.3% of gross wage. Since May 2010, it has been at 2.3%, and will gradually grow in subsequent years, to reach the target of 3.5% in 2017.

[40] The exception here are basic food products, with the tax rate of 5% as of 2011, as against 7% previously. Following 2013, this rate will be maintained.

[41] The new Public Finance Act of 2009 prohibits a current deficit (since 2011) and provides for individual debt ratios since 2014.

[42] According to the domestic methodology the ratio of public debt to GDP – over the forecast horizon – is expected to run lower than 50% (i.e. the 1st prudential threshold).

May 2011, economic growth in Poland will continue in 2011 to be among the highest in the region. By contrast, in the years 2012-2013 the NBP anticipates a reduction in GDP growth in Poland. This decline will stem from the measures implemented to lower the public finance deficit, smaller absorption of EU transfers, reduced rate of consumption growth and the completion of the rebuilding of stocks.

In 2011, despite relatively high growth of nominal wage bill, the growth in real disposable income of households will remain low, which will result from high CPI inflation and lower growth rate of social transfers in this period. Growth in private consumption this year will therefore be financed largely from a fall in the saving rate. In the years 2012-2013, despite a slowdown in consumption growth, it will remain a important contributor to GDP growth. A moderate growth in disposable income of households, including payroll fund (the limited effect of improving the situation in the labour market) will have a dampening impact on the growth in consumption during this period.

After the reduction in 2010, the investment rate will increase slightly in the years 2011-2013. In 2011, most of investment growth will remain traceable to growth in expenditures in the public sector, financed in a substantial part from the inflow of EU structural funds. In the years 2012-2013 the absorption of EU funds and the expenditure of the public finance sector to co-finance it are likely to decrease, leading to a significant reduction in a growth of public investment. The increase in gross fixed capital formation will be supported, especially since 2012, by a growing corporate investment demand. A gradual increase in business investment will be encouraged by a growing capacity utilization and relatively low cost of ownership of capital.

The consumer prices in 2011 will grow significantly faster than last year, fuelled by supply factors, like a rapid increase in food and energy prices and the change of VAT rates as of January 2011. It is expected that as of 2012 Q2, inflation will decrease to a level close to the amount of the inflation target. The rate of inflation in the medium and long projection horizon will obtain an upward impact from rising labour costs. By contrast, moderate domestic demand and declining growth in global prices of agricultural raw materials and energy will suppress the growth of inflation.

Both GDP and inflation forecasts are subject to risks, on the one hand due to the forecast strength of economic activity in countries that have the greatest impact on the Polish economy, on the other hand - changes in fiscal policy. In consequence of the excessive deficit procedure, whereby Poland has to reduce the public finance deficit below 3% in 2012, further adjustments may increase revenues and reduce expenditures in this sector in the years 2012-2013.

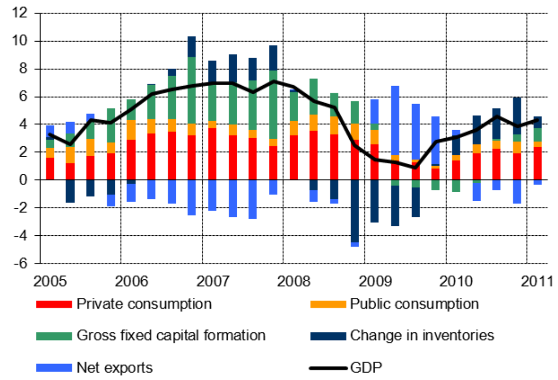
Table 7.4

Forecasts of main macroeconomic indicators (co to za January???)

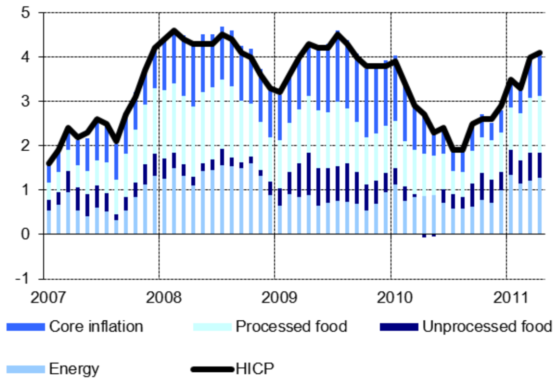
	NBP	EC	OECD	IMF
	07.2011 (10.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	4,0 (4,3)	4,0 (3,49)	3,9 (4,0)	3,8 (3,7)
2012	3,2 (4,2)	3,7 (4,2)	3,8 (4,3)	3,6 (3,9)
2013	2,9			3,7 (4,2)
Inflation, in %, y/y				
2011	4,0 (3,0)	3,8 (2,9)	4,2 (2,5)	4,1 (2,7)
2012	2,7 (3,0)	3,2 (3,0)	3,1 (3,1)	2,9 (3,0)
2013	2,4			2,6 (2,9)
Current account balance, in % of GDP				
2011		-4,1 (-3,3)	-4,5 (-3,2)	-3,9 (-2,6)
2012		-4,1 (-3,7)	-4,8 (-3,8)	-4,2 (-2,9)
2013				-4,4 (-2,7)

MNB – Report on Inflation, National Bank of Hungary

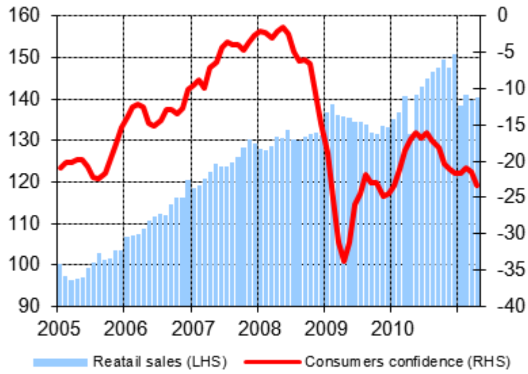
Contribution to GDP growth (in pp, y/y)



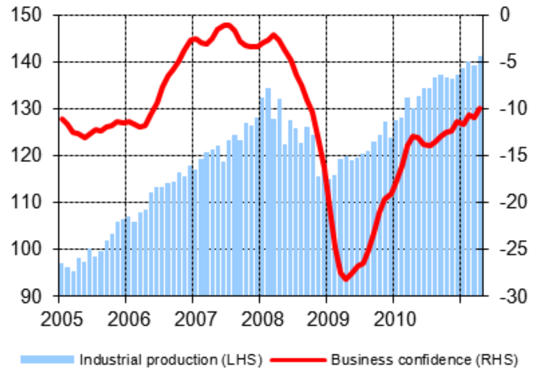
HICP and its components (in %, y/y)



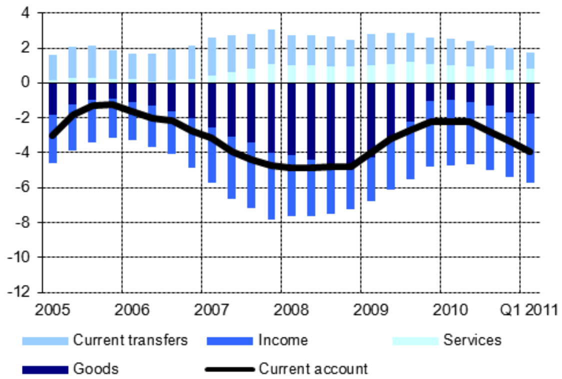
Retail sales (in %, y/y) and consumer sentiment index



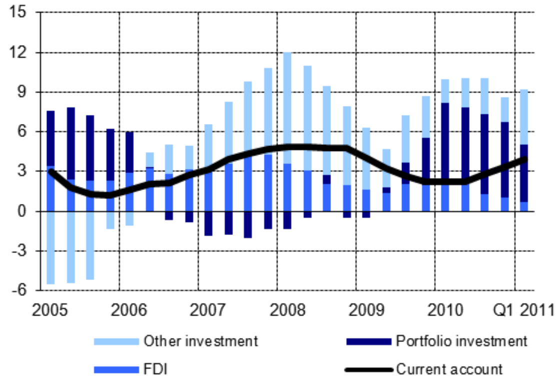
Industrial production (in %, y/y) and business sentiment index



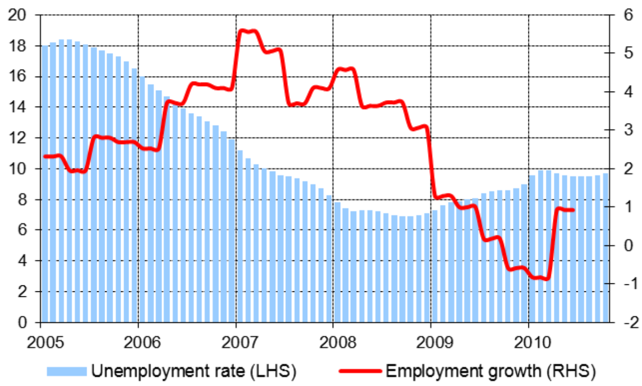
Current account and its components (in % of GDP, 4-quarter moving average)



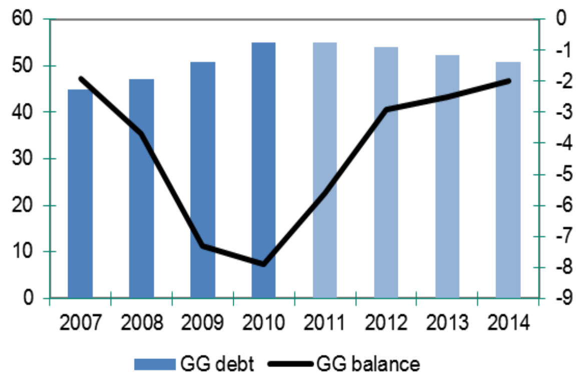
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

ROMANIA

Economic growth

After two subsequent years of decline in economic activity (2009-2010), in 2011 Q1, for the second consecutive quarter Romania posted an increase in GDP in quarterly terms, which probably constitutes the end of recession in this economy.

2010 was the second consecutive year in Romania, in which private consumption dropped. This was due mainly to the fiscal consolidation,[43] low growth in loans and a decline in real wages.

The expenditure of the government sector in 2010 was reduced due to restrictive fiscal policy to nearly the greatest extent among all the countries of the region. Part of the consolidation activities (among others the decrease in wages in the public sector by 25%) took place in the second half of 2010, contributing to the prolongation of recession in a period when the majority of CEE countries were already experiencing economic recovery.

Table 8.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-6.3**	**-1.3**	**-2.1**	**-0.6**	**0.3**
Private consumption	-7.6	-1.5	-1.2	-1.3	-0.4
Public consumption	-1.1	-3.6	-0.2	-5.7	-6.2
Fixed capital formation	-6.5	-13.1	-7.2	-4.5	-4.9
Exports	-9.1	14.3	12.1	18.0	21.2
Imports	-15.4	12.4	9.3	13.6	12.3

source: Eurostat

Fixed capital formation continued a downward trend mainly because of very low construction investment outlays (annual growth of value added in this sector was negative throughout the 2010). On the other hand, investments in machinery increased, which was to a large extent the result of a low base effect in 2009 (when expenditure on machinery and means of transport posted the deepest drop alongside the Baltic states) and of improved business sentiment.

The only category which made invariably a positive contribution to GDP growth in 2010 was a change in inventories. Coupled with the increase in external demand, it stimulated economic activity, particularly in the industrial manufacturing sector.

In 2010, order book and exports increased hand in hand with external demand. The recovery of investment demand was accompanied by an increase in the import volume of goods and services, whose growth was higher than that of exports, which in turn translated into negative contribution of foreign trade to GDP growth. The recovery in imports took place mainly due to the increasing demand on capital and intermediate goods triggered by increasing demand from the export-oriented sector and rebuilding of inventories.

In 2011 Q1, for the first time since 2008, GDP increased in annual terms (by 0.3%). This was due to the renewed improvement of the foreign trade balance and continued increase in inventories. On the other hand, the main categories of domestic demand continued to weaken.

Exports of goods and services was the only category whose volume exceeded (and significantly at that) the pre-crisis level. In 2011 Q1 the growth of exports continued to accelerate, and it was markedly bigger than in the other countries of the region. At the same time, the growth of imports to Romania weakened.

High external demand and the rebuilding of inventories influenced the growth of Romania's industrial production in 2011. In annual terms it remained above 4% for almost the entire 2010, and in 2011 Q1 it increased to more than 10%. The production of motor vehicles, electrical appliances and metals exceeded the pre-crisis level. The quick growth of industrial production was accompanied by improvement of business sentiment. In 2011 Q1 there was a significant rise in the level of sub-indices describing the expected number of orders, competitive position and the volume of output. They were only slightly lower than in the period preceding the drop of activity in industry of October 2008.

At the same time the scale of drop in domestic consumption was smaller, which was probably linked with the increase in wages in the public sector by 15% (in February 2011) and the reduction of unemployment rate. In 2011 Q1 the negative growth in retail sales also moderated due to the increasing demand on durable goods. The downward trend in the sales of passenger cars (where the scale of decrease from 2009 to 2010 Q1 exceeded 40%) stopped as well, propped up by the policy of support to the automotive industry carried out by the government.[44] The slow stabilization in consumer demand is also indicated by a moderate improvement in consumer sentiment. Since the beginning of 2011 there has been an improvement in the sub-indices describing the assessment of future financial situation of households, planned major purchases and situation on the labour market.

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[43] According to the WIIW institute, consolidation measures led to a decrease of GDP in the order of at least 1% per year.

[44] The so-called *Rable Programme*. Its objective is the renewal of the car fleet in the country by writing-off old cars. A system of vouchers (worth RON 3.8 thousand each) granted for the scrapping of over 10 year-old cars enables the holder of max. 3 vouchers to buy a new car or sell the vouchers. In 2011 the programme is being continued. In the opinion of the Romanian Association of Car Producers and Importers (APIA), the initiative has achieved its objectives. According to government data, within the framework of the programme, ca. 63 thousand cars were bought, almost half of which having been manufactured in Romania (in total ca. 94.5 thousand new cars were registered). http://www.gov.ro/ and ACEA.

On the other hand, the continued fiscal consolidation in 2011 Q1 augmented the drop in public expenditure.

Negative growth was also posted in fixed capital formation. The deepest declines were still being recorded in investments in building and structures.

Labour market

Situation on the labour market in Romania is relatively stable. The harmonized rate of unemployment remained in 2010 at the average level of 7.3% and in 2011 Q1 this growth rate decreased to 7%. It seems that this was not related to the creation of new jobs but to the decrease in the number of jobseekers and the increase in employment in the grey economy. On the other hand, employment in 2010 was in decline. One of the deepest declines was posted in the construction sector. There was also an increase in the number of part-time employees.

Situation on the labour market remains stable, among others, due to a still high employment in the public sector and job protection legislation which favour the employees. In 2011 new laws will be introduced, aiming to achieve more flexibility which, according to the government, will contribute to the increase in the number of new jobs. Yet the process of creating new jobs in 2011 is in arrears on account of slow economic recovery.

Inflation and labour costs

In 2010 inflation in Romania remained above the target of the National Bank of Romania, which was mainly attributable to supply side factors. Since 2010 Q3 the harmonised index of consumer prices (HICP) remained above 7.5% in annual terms. This was related to increases in VAT (from 19% to 24%), excise duty and higher prices of food and energy on global markets. Floods in Romania contributed as well, limiting the supply of food products. In 2011 Q1 these factors also had a significant impact on inflation, which in May reached 8.5%.[45]

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**4.3**	**7.5**	**7.8**	**7.5**	**8.5**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.1	1.3	2.3	3.3	4.3
Housing	0.6	1.3	1.4	1.3	1.6
Alcoholic beverages and tobacco products	2.1	2.4	1.7	0.7	0.9
Transport	0.7	0.7	0.9	0.9	0.8
Restaurants and hotels	0.2	0.2	0.2	0.2	0.2

source: Eurostat

Core inflation (excluding administered prices and prices of food and energy) dropped from 7.0% in Q3 to 6.4% in Q4, due to low domestic consumption. In 2011 Q1 its level dropped further to ca. 5%, among others due to the appreciation of the lei exchange rate and consequently a lower growth in the prices of imported goods.

The drop in nominal wages in the public sector and increase in inflation since mid-2010 contributed to a drop in average real wages by 4% in 2010. However, labour productivity dropped to a greater degree than wages at the end of 2010, which led to a smaller falls in unit labour costs in quarterly terms. Annual wage growth in March 2011 remained negative (-1.1%). Together with the improvement of labour productivity observed in Q1, and with economic recovery, further declines in unit labour costs are to be expected.

Balance of payments

In 2010 current account deficit remained at the level close to 2009, i.e. 4.1% of the GDP. Although the goods balance improved due to a quicker increase in exports than imports,[46], the balance of all the remaining categories deteriorated. Income and services contributed to this development to the greatest extent. Income deficit widened stimulated by higher interest on loans granted and profits received by foreign investors. The surplus of current transfers decreased from 4.3% of GDP in 2009 to 2.8% of GDP a year later, which was attributable to the increase in unemployment and decrease in wages in countries where Romanian emigrants found employment (e.g. Spain and Italy). In 2011 Q1 the deficit on the goods account remained at a historically low level thanks to a further increase in exports. As a result of a growing economic activity in the countries of the UE, there was an increase in transfers. Consequently, the current account deficit narrowed as well.

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**-5.1**	**-5.3**	**-4.8**	**-4.1**	**-3.3**
Goods	-5.6	-5.7	-5.2	-4.8	-4.2
Services	-0.5	-0.7	-0.6	-0.5	-0.5
Income	-1.9	-1.5	-1.6	-1.5	-1.6
Current transfers	2.8	2.5	2.6	2.8	3.0
Capital account	**0.6**	**0.6**	**0.4**	**0.1**	**0.1**
Financial account	**4.4**	**5.8**	**4.6**	**4.6**	**5.0**
FDIs	2.0	1.6	1.8	2.1	2.1
Portfolio investments	1.6	1.5	0.8	0.9	0.2
Other investments	5.8	5.0	4.9	4.4	3.9

source: Eurostat

The reduction of current account deficit was accompanied by a reduction of financial account surplus in the second half of 2010. This was attributable to the reduction of direct investment, which was partially offset by inflow of portfolio investment following the improvement of investors' sentiment toward the region. Other investment were also high on account of IMF capital inflow since the beginning of 2010. In 2011 Q1, the balance of direct foreign investment in annual terms declined again, which was due both to an increase in

[45] The rising inflation coupled with low economic activity rises concerns about stagflation.

[46] The most important items in exports included electronics and passenger cars. Imports comprised mainly fuels, electronics and engines.

Romanian investment abroad and a decrease in foreign direct investment in Romania, coupled with the reduction of net portfolio investment.

Interest rates and exchange rate

Since May 2010 the National Bank of Romania kept the central bank interest rate at the level of 6.25%. Despite inflation remaining above the target, the bank did not decide to raise interest rates on account of low internal demand. Due to higher inflation, no interest rate reductions are expected in the second half of the year, when the base effect wanes following the VAT rise. However, in March the reserve requirement ratio was reduced, which may contribute to an increase in loan growth.[47] Even though monetary policy was eased no more, the interest rate on loans and deposits in the banking sector remained in 2010 on a low level. Similarly in 2011, when high liquidity on the interbank market was accompanied by a reduction of the ROBOR 1M rate to ca. 4.4% in March 2011.

The exchange rate of the Romanian lei (RON) depreciated since September 2010 till the end of 2010. Its fluctuations were cushioned by occasional interventions by the central bank, resulting in the exchange rate remaining near the 2009 level. In January-April 2011 the exchange rate of the RON against the euro began to strengthen again, due to the improvement in external position, reduction of political tensions and fulfilment of obligations given to the IMF.[48] However, due to concerns about the impact of debt crisis in Greece, the exchange rate of the lei depreciated once again in May and June 2011.

Fiscal policy

As a result of deteriorating public finances, in 2010 Romania undertook determined steps aimed at reducing the general government deficit below the level of 6.8% of GDP, as required under the IMF, EU and World Bank assistance package. The Budget Act for 2010 was revised twice. The amendments primarily introduced wage cuts in the public sector by 25% and a significant increase in VAT rate from 19% to 24% as well as raised the transfers from state enterprises. As a result the general government deficit amounted last year to 6.4% of GDP against 9.8% of GDP in 2009, with Eurostat expressing its reservations to this figure.[49]

In 2011, the fiscal deficit in the Romania is anticipated to amount 4.9% of GDP. State budget expenditure for 2011 was frozen. Pension and disability benefits will not be indexed again, while wages in the public sector will increase by 15% as compared with a 25% cut in mid-2010. Simultaneously, additional annual remunerations, as well as other fringe benefits were abolished. Restrictions concerning the employment of new civil servants (1 new employee for each 7 employees leaving the job) will still be binding. The government is also planning to reduce the social security insurance contributions by 2 pp since the 2nd half of 2011 with the level of PIT, CIT and VAT taxation frozen for the next three years.

Romania's general government deficit in 2012, i.e. at the deadline of its reduction below the reference level, should amount to 3% of GDP against 3.8% forecast by the EC. In the subsequent years the fiscal balance is envisaged to improve in the pace of 0.4-0.5 pp of GDP. Among the proposed measures, the authorities are planning to continue efforts in streamlining public sector employment, a reform of state enterprises and the social security system. The latter is going to consist of increased control and improvement of benefit targeting as well as the introduction of a joint limit of social transfers per person. An unstable political situation and parliamentary elections in 2012 may pose a risk to the achievement of the intended deficit target. Moreover Romania has to solve the problem of indebtedness of state enterprises, estimated at 5% of GDP.

The president of Romania put forward a legislative motion concerning introduction of a cap on budget deficit to the Constitution in order to prevent the widening of fiscal imbalance. The Parliament is set to conduct work on this draft in mid-2011. In 2010 the Act on Fiscal Responsibility was adopted, which established a fiscal council and multi-annual expenditure limits.

The level of public debt in Romania is going to stabilize in subsequent years at the level of ca. 32-33% of GDP and will be among the lowest in the countries of the region. Since 2012 Romania is planning to restart issuance of foreign currency denominated bonds.

Forecasts

In the first half of 2011, Romanian economic outlook did not change significantly. In 2011 this country should recover from recession with a one-year lag in comparison to other CEE countries. Expectations for the coming 6 months are positive, which is indicated, among others, by

[47] The reserve requirement rate in the case of loans in foreign currency (with maturity of up to 2 years) was reduced in April 2011 from 25% to 20%, in the case of loans in domestic currency it remained unchanged at 15%. The dependence on foreign crediting was one of the reasons behind a deepening recession in Romanian economy in 2008-2009. At present, consumption is once again financed by foreign financing.

[48] Romanian authorities resigned from the last tranche of the IMF loan package granted in 2009, on account of high reserves of the central bank and the improvement of economic situation. Romania also obtained a two-year preventive credit line in the amount of EUR 3.5 bn from the IMF, EUR 1.4 bn from the EU and EUR 0.4 bn from the World Bank. The programme is aiming at supporting structural reforms (among others more effective implementation of EU funds, restructuring and privatization of state enterprises in the energy and transport sector as well as reducing public indebtedness towards the private sector), as well as improving the trust of foreign investors and has been devised as a financial backup in case of future economic shocks. The programme will be accompanied by government actions aiming at reducing the budget deficit to 4.4% of GDP in 2011 and 3% of GDP in 2012. The repayment of the IMF loan will take place in 2012-2015, the repayment of interest begins in 2011.

[49] Eurostat doubts concern the classification of transfers to/from state enterprises as well as the consolidation of income and expenditure within the general government.

the improvement in the ZEW index (established on the basis of the surveys of economic prospects assessment) in April 2011, and the GDP will be gradually coming back to the path of growth in the coming two years. According to the European Commission, Romania will reach GDP growth at 1.5% in 2011 and in 2012 it will accelerate to 3.7%, i.e. above potential growth.

European Commission assumes that since 2011 net exports will be replaced by fixed capital formation and private consumption as main factors spurring GDP growth. Private investment will be accompanied by expected further growth of manufacturing and new orders (still strong foreign demand). Public investment may grow, stimulated by faster implementation of new infrastructural projects financed primarily from EU funds. Private consumption will lost its momentum, inhibited by high interest rates and low wage growth. Within the next 2 years, however, a reversal of negative tendencies on the labour market and a limitation of fiscal consolidation are expected. The coming parliamentary elections may trigger an increase in government expenditure, which will constitute another incentive towards an increase in consumption and GDP in 2012. [50] It is also expected that in mid-2011 inventories will reach the level from before the crisis, thus their contribution to the GDP growth will also be decreasing.

Threats to growth stem from political climate in Romania and in peripheral countries of the euro area. They may affect investors' sentiment toward the developing European countries and reduce the inflow of capital to Romania.[51] The risk also comes from a gradual reduction of IMF monitoring and impact on the economic policy in this country. A weaker than expected economic recovery in Western Europe may negatively affect Romanian exports. An important obstacle to growth are state-owned enterprises generating high losses.[52] On the other hand, their restructuring and privatization are envisaged, which may contribute to the increase of inflow of direct foreign investment.

Inflation in 2011 will be running probably highly above the inflation target of the National Bank of Romania (i.e. 3%+/-1%). The European Commission expects that the average inflation rate in this year will amount to 6.7%. In May 2011 the NBR raised the forecast from 3.4% (November 2010) to 5.1% (in July inflation may still be high – up to 9%). The scale of its growth will depend on the persisting high level of energy and food prices[53] and the increase in administered prices in part of state enterprises. In 2011, subsidies on heat energy should diminish. The high (but decreasing) output gap will be acting in the reverse direction, as will the waning of the base effect related to the VAT increase in mid-2010 (expected inflation drop by ca. 3 pp.). The European Commission expects the inflation to return to the level of 4% in 2012.

The current account deficit in 2011-2012 probably will not decrease, due to the increase in the goods deficit s related to a fast growing imports (which will be affected by the recovery in domestic demand and investment). It is expected that 2011 it will amount to 4.4% of GDP and in 2012 it will widen to 4.8%,

Table 8.4

Forecasts of main macroeconomic indicators

	CNP/NBR	EC	IMF	Consensus Economics
	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)	06.2011 (12.2010)
GDP, in %, y/y				
2011	1,5 (1,5)	1,5 (1,5)	1,5 (1,5)	1,7 (1,5)
2012	4,0 (3,9)	3,7 (3,8)	4,4 (4,4)	3,6
2013	4,5 (4,5)		4,3 (4,2)	
Inflation, in %, y/y				
2011	3,4 (2,8)	6,7 (5,5)	6,1 (5,2)	6,5 (5,4)
2012		4,0 (3,2)	3,4 (3,0)	4,3
2013			3,0 (3,0)	
Current account balance, in % of GDP				
2011	-5,5	-4,4 (-5,6)	-5,0 (-5,4)	
2012	-4,9	-4,8(-6,2)	-5,2 (-5,1)	
2013			-5,2 (-5,0)	

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

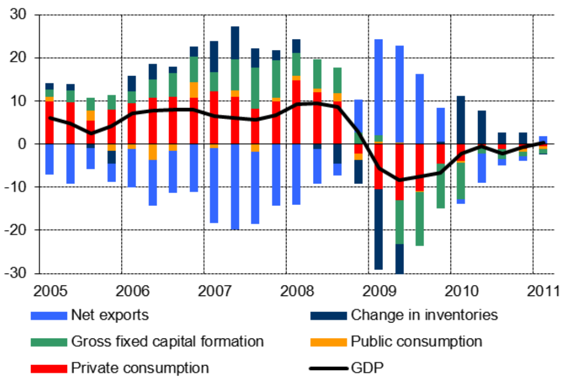
[50] A similar situation took place in the case of earlier parliamentary elections in Romania in 2004 and 2008. Consumption in the year preceding and following elections was significantly lower than in the year in which they took place. This time the scale of consumption growth may be reduced on account of reduced access to foreign sources of financing as a result of crisis.

[51] Romania despite a slight improvement in February 2011 posts besides Lithuania one of the lowest loan ratings among the 9 New Member States of the EU.

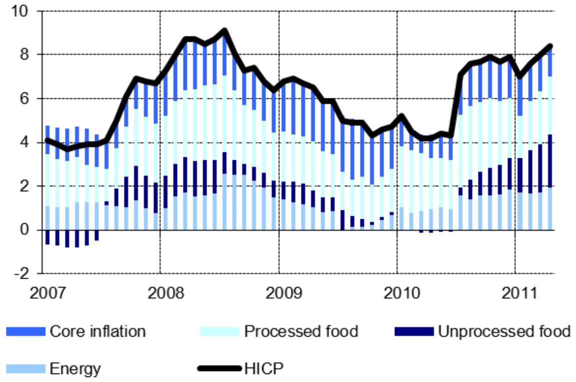
[52] According to IMF estimates, ten biggest unprofitable state enterprises generated a loss in the amount of 1.1% of GDP in 2010.

[53] The contribution of fuels and energy in the Romanian CPI basket amounts to 48% with 21% for EU-27.

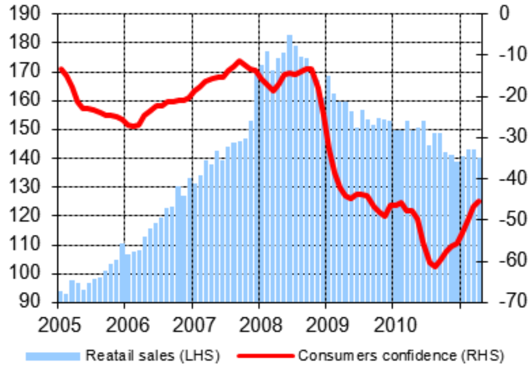
Contribution to GDP growth (in pp, y/y)



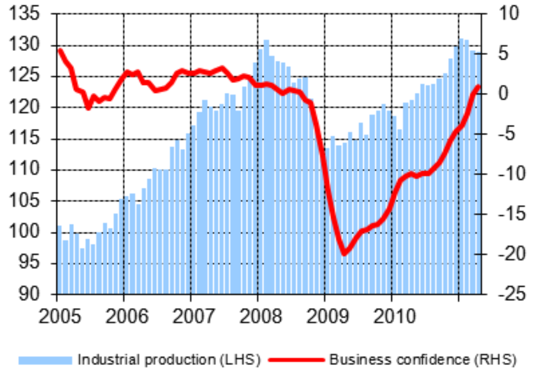
HICP and its components (in %, y/y)



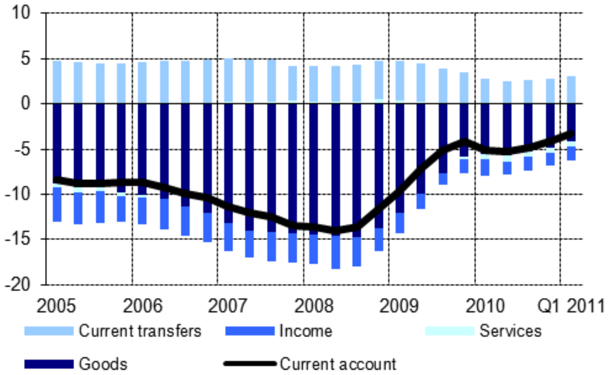
Retail sales (in %, y/y) and consumer sentiment index



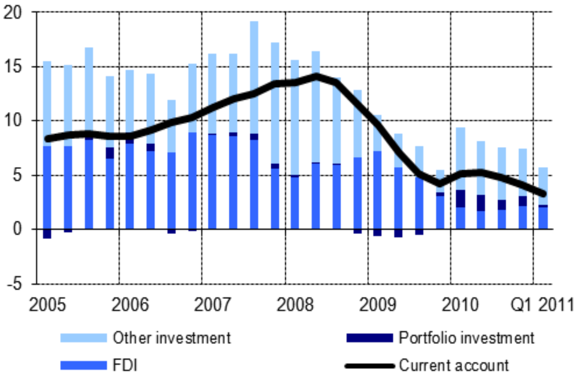
Industrial production (in %, y/y) and business sentiment index



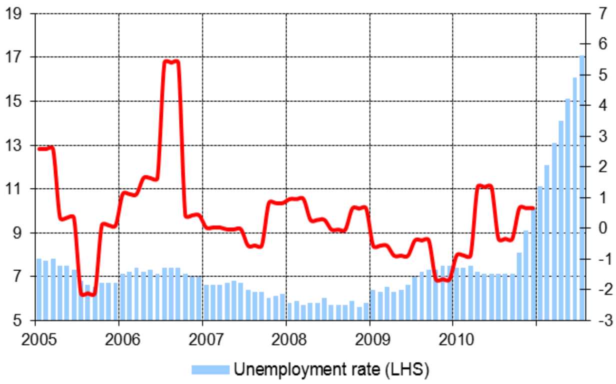
Current account and its components (in % of GDP, 4-quarter moving average)



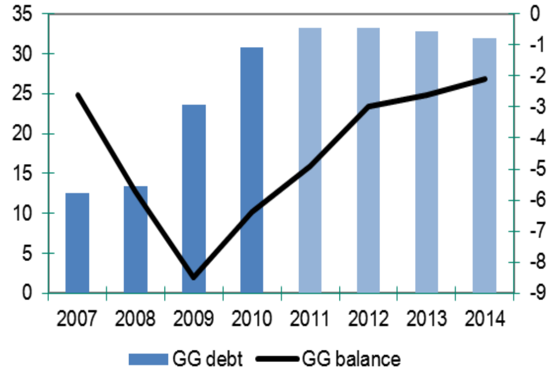
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVAKIA

Economic growth

The downturn in economic activity registered in 2009, for the first time since the formation of the independent Slovakian state in 1993, was on the one hand relatively moderate (-4.8%) in comparison with other Central and Eastern Europe countries, but on the other – it was relatively short-lived as it lasted only 4 quarters. In 2010 Slovakia's gross domestic product increased in real terms by 4.0%, i.e. most of all other countries of the region. To a large extent this was attributable to a recovery in global economy, and particularly in Germany, i.e. the biggest trade partner.

Table 9.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-4.8**	**4.0**	**3.9**	**3.4**	**3.6**
Private consumption	0.3	-0.3	-0.6	0.8	0.0
Public consumption	5.6	0.1	0.5	-3.2	-2.3
Fixed capital formation	-19.9	3.6	6.4	10.4	1.3
Exports	-19.9	16.4	18.0	13.2	17.0
Imports	-18.6	14.9	19.0	13.5	11.2

source: Eurostat

Following a faster growth in exports (16.4% y/y) than that of imports (14.9% y/y) foreign trade affected positively economic growth in Slovakia last year. In the first three quarters of 2010 both categories grew at a relatively quick pace, while 2010 Q4 saw a clear slowdown in their growth. The largest increases in 2010 were observed primarily in the sales of passenger cars, which are the most important item in Slovakian exports.

Among domestic factors a dominant role in stimulating economic activity in 2010 was played by an fixed capital formationand rebuilding of inventories in enterprises. The rebound in investment activity observed in 2010, following its strong drop in 2009 (companies' outlays on modernization and the expansion of the existing production capacity decreased by 19.9% y/y), resulted mainly from the improvement of the financial situation of enterprises, industrial production rising at a two-digit pace (this justified the need to increase production capacity) and from the easing of banks' lending policy.

In turn, the drop in GDP growth reflected a decrease in individual consumption (by 0.3% y/y, after an increase by 0.3% y/y in 2009). Lower consumer spending in 2010 resulted not only from a persistently difficult situation on the domestic labour market, but also a restrictive fiscal policy of the Slovakian government. The undertaken consolidation measures aimed at reducing the budget deficit, including mainly tax increases (VAT and excise tax), translated into a drop in consumption demand.

According to preliminary data in 2011 Q1 Slovakian GDP increased by 3.6% y/y following an increase by 3.4% y/y in 2010 Q4. Similarly as in 2010, the main driving force behind the growth was the net exports. In the first three months of 2010, enterprises sold 17.0% more goods abroad than in the corresponding period of 2010, while at the same time 11.2% more goods were imported to Slovakia.

In turn the domestic demand negatively affected the pace of economic growth in 2011 Q1. This resulted both from a renewed drop in budgetary expenditure (which should be explained mainly by the continuation of actions aimed at fiscal consolidation) as well as from the drop in the growth rate of private consumption.

Data on retail sales indicate that the drop in the consumption expenditure of Slovakian households observed in the first three months of 2011 was probably temporary. During the period January to April 2011 the annual sales growth remained at a high level (4.1% y/y) except in March when an increase was posted of only 1.0% compared with the corresponding month of 2010.

On the other hand, the investment outlays increased once again in 2011 Q1. The scale of this increase was definitely lower than in the previous three quarters.

In the first four months of this year the industrial output in Slovakia continued along the rising trend started in 2009 Q2, reaching the level seen before the crisis. This was due to the ongoing global recovery, in particular recovery at the most important exports markets.

Labour market

Despite the fact that during the period January to December 2010 the unemployment rate in Slovakia dropped from 14.5% to 14.0%, in the whole 2010 it stayed at a heightened level in comparison with the previous years[54]. The slow pace of adjustment in the labour market was related, among others, to high percentage of long-term unemployed (last year it amounted to 64.1% against 54.1% in 2009). The latter reveals various structural problems on the Slovakian labour market, including in the first place low mobility of the labour force, large disproportions in development between particular regions of the country and a mismatch between employee skills and market's needs.

According to preliminary data in 2011 Q1 unemployment rate amounted to 14%. Once again the highest percentage of unemployed was registered in industry. On the other hand, the largest increase in the number of unemployed took place in public administration and in trade.

The employment growth in Slovakia remained negative in 2010. In the first three quarters of 2010 the scale of the job reduction rate was admittedly decreasing and the employment still edged up in 2010 Q4 (0.5% y/y). The

[54] In 2008-2009 the unemployment rate amounted respectively to 9.5% and 12.0%.

decrease in employment hit the industrial sector to the largest extent (a drop by 3.4% y/y), while in the service sector the number of employees did not change in annual terms.

Preliminary estimates indicate that in 2011 Q1 the upward trend in employment strengthened (a rise by 2.1% in comparison with 2010 Q1). The number of employed persons went up most in industry and in the services sector. In turn the biggest decreases were recorded in trade.

Inflation and labour costs

In 2010 the annual HICP inflation rate in Slovakia fell to 0.7% (as against 0.9% in 2009) thus setting a new historic minimum. Most of the drop in the consumer prices in 2010 derived from a drop in energy prices (-1.3% y/y against their growth by 0.3% in 2009), and in the prices of housing-related services (-1.4% y/y against their rise by 3.4% in 2009)., Food prices admittedly rose in 2010 but eventually this did was not enough to raise inflation. There was no clear upward pressure on inflation coming from wages which in 2010 increased at a moderate pace (3.3% y/y compared to 3.0% in 2009). Core inflation remained in 2010 at a stable level reaching 0.4% y/y.

Table 9.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**0.7**	**1.1**	**1.1**	**3.5**	**4.2**
Contribution to HICP growth rate (in pp)					
Housing	-0.3	-0.3	-0.4	1.3	1.4
Food and beverages	0.2	0.6	0.9	1.2	1.3
Transport	0.0	-0.1	0.0	0.5	0.6
Other	0.1	0.1	0.2	0.2	0.3
Alcoholic beverages and tobacco products	0.4	0.4	0.2	0.1	0.2

source: Eurostat

In turn, in the first months of 2011, a strong rise in HICP inflation was observed in Slovakia. According to preliminary estimates in May 2011 it amounted to as much as 4.2% y/y against 1.3% y/y in December 2011. This was attributable on the one hand to rapidly increasing global oil and food prices, which translated into a higher growth in domestic energy prices (9.8% y/y) and food prices (7.4% y/y) in this period, and on the other hand to tax rises (excise and VAT), constituting part of the government programme of public finance consolidation. The acceleration in consumer goods and services in January-May 2011 was also due to the increase in regulated prices. Core inflation in this period amounted to 1.4% y/y.

The pace of wage growth in Slovakia decreased in 2011 Q1 to 2.9% y/y from 3.8% y/y in 2010 Q4. Wages increased in all sectors of economy, excluding public administration in which a slight decrease (-0.1% y/y) was seen.

Balance of payments

In 2010 the current account deficit widened in nominal terms, though the scale of this increase was not very large (ca. EUR 150 m). On the other hand, the structure of this deficit changed considerably, as 2010 brought a strong decrease in the goods and services surplus which resulted from a stronger growth in imports than in exports. The high growth in imports was attributable to higher global commodity prices and an upturn in the investment activity in Slovakia. On the other hand, the deficit on services decreased markedly, while the negative balance on income remained virtually unchanged. Even though the current account deficit increased, in terms of GDP in 2010 decreased slightly to -3.0% (from -3.2% in 2009), due to a higher growth of gross domestic product.

Table 9.3

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	**-2.3**	**-2.3**	**-2.8**	**-3.0**	**0.4**
Goods	2.1	2.1	1.5	0.4	0.1
Services	-1.6	-1.5	-1.4	-1.1	0.1
Income	-2.1	-2.3	-2.1	-1.7	0.0
Current transfers	-0.7	-0.7	-0.8	-0.6	0.2
Capital account	**1.4**	**1.3**	**1.8**	**1.8**	**1.0**
Financial account	**3.3**	**0.5**	**0.9**	**-0.5**	**0.3**
FDIs	-0.5	0.7	0.8	-0.3	-0.4
Portfolio investments	-3.3	-3.5	-2.8	-2.0	1.5
Other investments	7.1	3.4	2.9	1.8	-0.8

source: Eurostat

A negative balance was recorded on Slovakian financial account, in other words foreign capital flowed out of the country. Most of the exodus was attributable to a drop in surplus in the so-called Other investment as a result of reduction in the liabilities of the National Bank of Slovakia towards the European System of Central Banks[55]. Additionally residents increased their exposure abroad, by purchasing financial assets. In effect, the negative balance on portfolio investment increased. At the same time, foreign direct investment in Slovakia rose, mainly in the form of reinvested gains.

Preliminary estimates indicate that in the first two months of 2011, there was a slight surplus in the current account, which was attributable, among others, to persisting positive balance on trade in goods and decreasing deficit on services. Moreover an inflow of foreign capital to the country occurred in all three forms of investment.

[55] Following Slovakia's entry to the euro area in 2009, the Slovakian Central Bank in order to settle its liabilities towards the domestic banking sector started borrowing funds from central banks of other Member States of the euro area. The payment of the bigger part of the contracted loan was due in 2010.

Fiscal policy

In 2010, the general government deficit in Slovakia was similar (7.9% of GDP) to its level from 2009 (8.0% of GDP). This situation apart from a weaker impact of improvement of the economic situation on the increase in tax income,[56] was attributable to higher than planned expenditure of local government units (among others related to the flood damages) and to the subsidies to hospitals and state-owned railways from the state budget.

While in the previous two years automatic stabilizers were allowed to operate freely, in 2011 a definite fiscal tightening will take place. Measures adopted in the first consolidation package (ca. 2.5% of GDP) are evenly distributed among revenue and expenditure. State budget expenditure has been reduced by 10%,[57] and effectiveness of the public procurement system has been improved. Since 2011 many rates have been raised: VAT (temporarily[58] from 19% to 20%), excise – including the tax relief for bio-components together with the abolition of some tax preferences in PIT coupled with the increase in some charges.[59] These actions are supposed to reduce the general government sector deficit in 2011 by ca. 3 pp of GDP, to 4.9% of GDP.

In the subsequent years the magnitude of fiscal adjustment is supposed to be lower and is estimated by the Slovak government at 1% of GDP in 2012 and 0.9% of GDP in 2013.[60] Measures described in the second consolidation package concern further cuts in public expenditure (current,[61] capital and subsidies). On the revenue side, the proposed changes include an increase in excise on beer and wine, real estate tax (by 50%), the introduction of a banking tax and uniform principles of CIT amortization. The Slovak government proposed also other legislative drafts concerning pension indexation mechanism (since 2013[62]) and the postponement of payments related to building and maintenance of the electronic system of toll collection, reduction of support to the housing sector, reform of the special pension scheme for the uniformed services, disbandment of some budget units and agencies. However, they have not been adopted by the Parliament. Moreover, the decision of the previous government concerning the voluntary membership in funded pension scheme for persons entering the labour market is going to be reversed. In the assessment of the European Commission, macroeconomic assumptions for 2013-2014 are too optimistic and the achievement of fiscal deficit targets at the level of 3.8% of GDP in 2012 and ca. 2.8-2.9% of GDP in the following two years will be conditioned by the implementation of measures proposed by the authorities.

The latest Slovak Stability Programme stipulates an introduction of fiscal rules limiting: the budget expenditure, debt of local government units and general government debt (60% of GDP), as well as the appointment of an independent fiscal council.

Public debt in Slovakia in 2011 is anticipated to reach 44.1% of GDP (as compared to 41.0% in 2010). In 2012 it is forecast at 45.3%, and in the following years expected to stabilize at that level.

Forecasts

In its latest forecast, the National Bank of Slovakia anticipates that in 2011 the country's economy will develop at the rate of 3.6%, i.e. slightly slower than in 2010 (4.0%). The expected deceleration in GDP growth will stem primarily from the ongoing process of fiscal policy tightening by the Slovakian government, which will translate into a decrease in budget expenditure. This fiscal consolidation will also be reflected in a moderate increase in private consumption. Additionally, the expected lack of improvement on the local labour market will be conducive to a slow pace of increase in the consumption of households. On the other hand, foreign demand should continue to support economic activity, with an expected significantly lower exports growth. In 2012, a GDP growth of 4.7% is expected, mainly on account of higher consumer spending and growing investment outlays of enterprises.

Over the forecast horizon, consumer prices in Slovakia will be still shaped by external factors. In 2011, on account of expected higher global oil prices, HICP inflation will rise to 4.1% y/y from 0.7% y/y in 2010. In turn, following the anticipated slower increase in oil prices in 2012 domestic prices of consumer goods and services will decelerate their growth to 3.3% y/y.

In 2011-2012 the current account deficit will be gradually decreasing as a result of a growing surplus in trade. The deficit on services, on the other hand, should remain at the previous level, limiting the negative impact of this component on the whole current account balance.

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[56] Budget revenue execution in Slovakia was lower in 2010 by 1% of GDP than planned (mainly on account of lower VAT collection).

[57] Cuts will be applied to wages (except teachers and soldiers, and to a lesser extent in the case of uniformed services and academic workers). National Defence expenditure in 2011 was slashed by 20%.

[58] Effective till correction of the excessive deficit procedure. Since 2015 it should return to the previous level. In the case of some medicines and medical articles as well as books, the binding rate is 10%.

[59] Charges for state material reserves, the National Atomic Energy Fund, and a twofold increase in the annual highway tolls.

[60] In 2014, no consolidation measures are envisaged.

[61] Some small wage rises are anticipated for 2013 and 2014, respectively by 1% and 3%. Scrutiny of employment in the public sector will be carried out.

[62] At present the indexation ratio takes into consideration in equal proportions the CPI and the wage growth in the domestic economy. After 2013, it will take into account inflation only.

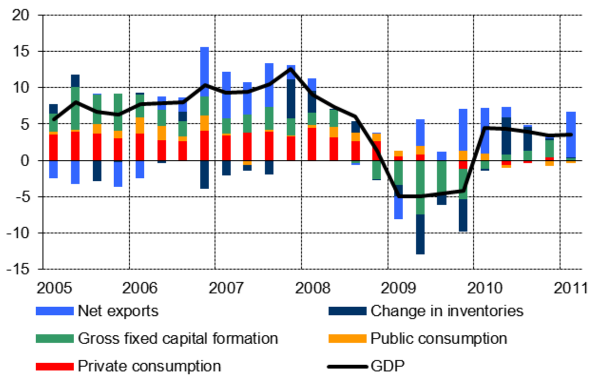
Table 9.4

Forecasts of main macroeconomic indicators

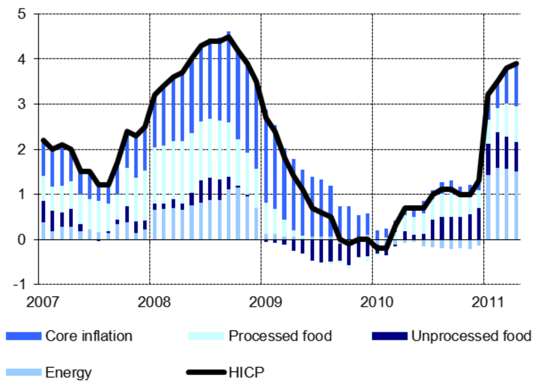
	NBS	EC	OECD	IMF
	06.2011 (12.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	3,6 (3,0)	3,5 (3,0)	3,6 (3,5)	3,8 (4,3)
2012	4,7 (4,0)	4,4 (3,9)	4,4 (4,4)	4,2 (4,4)
2013	5,3			4,3 (4,3)
Inflation, in %, y/y				
2011	4,1 (3,9)	3,6 (3,2)	3,9 (3,4)	3,4 (1,9)
2012	3,3 (2,6)	2,9 (2,8)	2,9 (2,9)	2,7 (2,4)
2013	2,5			2,9 (2,6)
Current account balance, in % of GDP				
2011	-1,6 (-1,3)	-2,8 (-1,9)	-2,4 (-0,9)	-2,8 (-2,6)
2012	-0,2 (-0,4)	-2,6 (-1,7)	-1,3 (-0,3)	-2,7 (-2,5)
2013	0,4			-2,6 (-2,5)

NBS – Medium Term Forecast, Národná Banka Slovenska

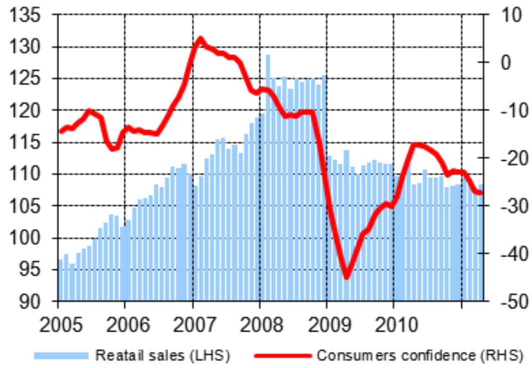
Contribution to GDP growth (in pp, y/y)



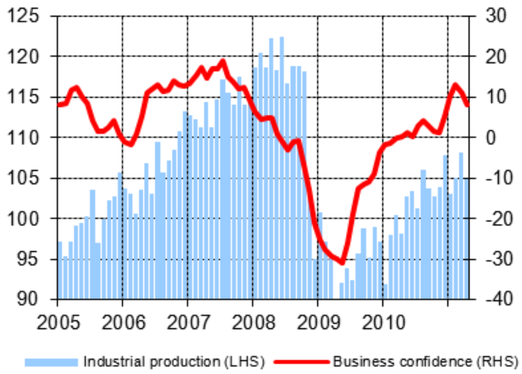
HICP and its components (in %, y/y)



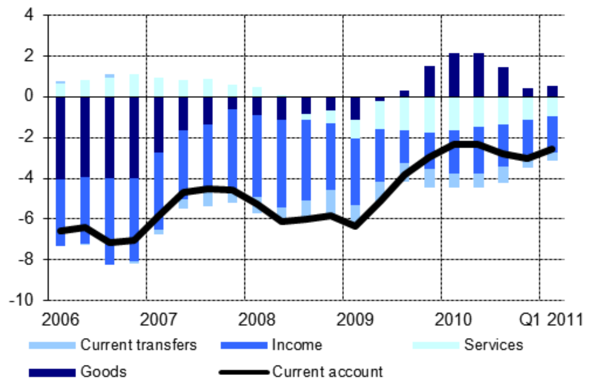
Retail sales (in %, y/y) and consumer sentiment index



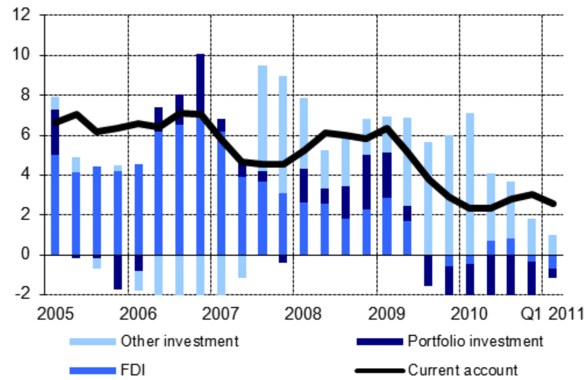
Industrial production (in %, y/y) and business sentiment index



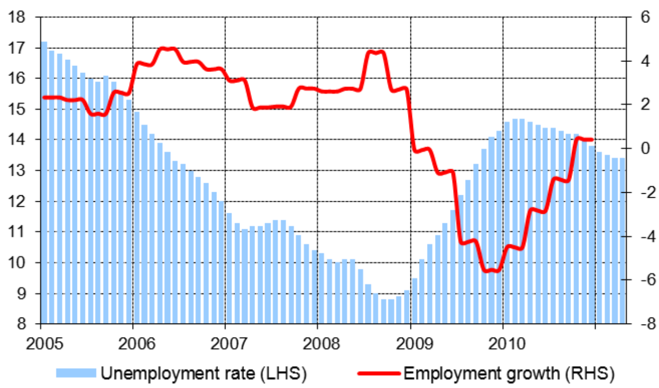
Current account and its components (in % of GDP, 4-quarter moving average)



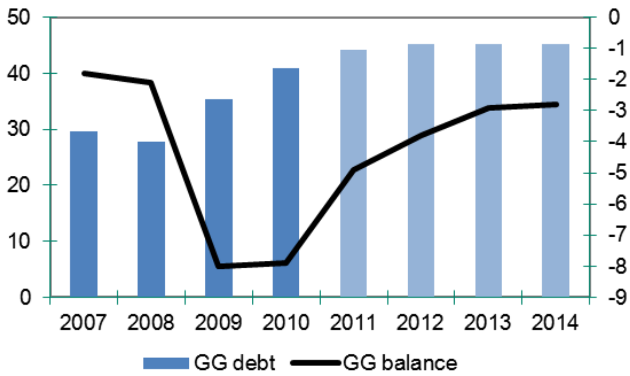
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVENIA

Economic growth

Slovenia is among those countries of the region, which were hit the hardest by global recession. After the euro area entry (in 2007) most of high economic growth in this country came from lending expansion and a booming construction sector. The global crisis led to the collapse of both these pillars and heavily impacted the pace of economic recovery. Although since 2010 Q1, Slovenian economy has been experiencing economic growth in annual terms, its pace was among the slowest in Central and Eastern Europe. Economic pick-up in Slovenia results from a recovery in external demand, while domestic demand remains very weak. Consumption is additionally negatively affected by government's actions – on the one hand resulting from abandoning anti-crisis policy (mainly by retaining the number of jobs), on the other – actions aiming at fiscal consolidation taken up starting from 2010.

Table 10.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-7.8**	**1.2**	**1.4**	**1.9**	**2.1**
Private consumption	-1.4	0.7	1.4	0.9	
Public consumption	3.1	0.8	-0.7	3.2	
Fixed capital formation	-21.6	-7.1	-7.4	-6.0	
Exports	-15.6	7.7	8.3	6.6	
Imports	-17.9	6.7	5.1	7.1	

source: Eurostat

The most important growth factor in 2010 was the external demand. It contributed not only to the increase in exports but also to the increase in expenditure on machinery and equipment in export-oriented enterprises and to a gradual rebuilding of inventories (which started at the beginning of 2010). At the same time value added increased most in sectors with the strongest influence of external demand, i.e. in manufacturing (by 8%) and transportation (6%). Exporters, a lot of them joint-ventures had also easier access to loans, while conditions of crediting for enterprises in Slovenian banks remained very tight.

The biggest significance for Slovenian exports can be attributed to demand in EU countries, where the sales growth was the highest. Meantime, exports to other trade partners, particularly to the ex-Yugoslavia countries[63] practically stopped at the level from 2009, which negatively influenced the total exports growth (Slovenian exports rose at the slowest pace among CEE countries in 2010).

Recovery in the export-oriented sector affected the increase in imports demand – focused mainly on intermediate goods and partially on capital goods. As a result of steadily rising growth of imports, the direct contribution of net exports to economic growth declined in 2010 and in 2010 Q4 it was already negative.

In 2010, the expenditures of households continued a weak rising trend. While their slight rise in 2009 may be interpreted as a positive phenomenon (particularly against the background of other countries of the region), in 2010 they rather induced the deceleration of the recovery process in Slovenia. A negative impact on the growth of private consumption was exercised by a worsening situation on the labour market and a low growth in loans to households.

A positive impact on economic growth was exercised by public expenditure, though smaller than in 2009. The reduction of increase in expenditure were attributable to measures aiming at reducing budget deficit.

In turn, a negative impact on growth of economic activity in Slovenia came from construction investment, both housing and commercial. Following a drop in expenditure on construction investment in 2009 by 19.2%, in 2010 this category decreased by 15.7%.

In 2011 Q1 the structure of economic growth continued the trends observed in 2010. In comparison with 2010 Q4, growth in the categories dependent on external demand accelerated, while domestic demand weakened (or its decline steepened). Further sharp declines took place in the construction sector , where the drop in 2011 Q1 was steeper than in 2010, on average.

The still low consumer demand is testified by slow increase in retail sales, which took place largely as a result of the increase in fuel sales. Excluding fuels, the real volume of retail sales in January-April 2011 increased merely by 0.6% (against a drop by 1.3% in 2010). Sales declined in the majority of categories including durable goods.

Consumer sentiment indices do not promise a significant improvement in the coming months either. Households assess their current situation and the general economic situation of the country as particularly unfavourable. In January-May, expectations improved slightly. More Slovenians declared the intention for major purchases within the coming 12 months than in the previous two years. It is probably due to the willingness to make purchases put off in the period of deepest recession.

Manufacturing remained the main economic growth driver in 2011 in Slovenia. In January-April 2011 industrial production increased by 8.7%, i.e. more rapidly than on the average in 2010 (6.8%). A rapid increase in the number of new orders (by 11.2%) within the first

[63] The countries of the former Yugoslavia before the crisis (i.e. in 2008) accounted for 17.5% of Slovenian exports. In 2009 the value of exports in current prices to these countries decreased by 23.9% and in 2010 increased merely by 1.2% (including the still decreasing value of exports to Croatia, which before the crisis was the third exporting market of Slovenia).

four months of 2011 suggests that the increasing trend in production will probably persist in the coming months. Foreign order books still rose the most rapidly, although the portfolios of domestic orders gradually accelerated their expansion.

At the beginning of 2011, business sentiment continued to improve. The indices of reached the level from before the crisis. The largest impact could be attributed to the increase in the volume of foreign orders. Relatively high expectations of output increase made the entrepreneurs consider more and more often the possibility of increasing employment.

Very sharp declines prevail in the construction and assemblage. In 2011 Q1 it fell in annual terms by 23.6% and preliminary data for April 2011 suggest a sharpening of declining tendencies. In the first half of 2011 the scale of declines in the Slovenian construction sector was the largest in the region.

Labour market

In 2010 falls in employment intensified. The number of jobs in comparison with 2010 declined by 2.2% (following a decrease by 1.9% in 2009). Employment decreased the most in construction (by 9.5%) and in manufacturing (by 6.3%). Decrease in employment in the whole economy was moderated by its increase in the public sector (by 1.8%). The harmonized rate of unemployment increased relatively quickly, as for Slovenian conditions (Slovenia up to that moment stood out against other countries of the region by high stability of labour market indices). In late 2010 it amounted to 7.7%.

In 2011 Q1 the decrease in employment steepened while the growth in unemployment rate accelerated. Such a significant lag in the reaction of employment to the deterioration in economic conditions resulted from the termination of actions undertaken by the Slovenian government in order to warrant employment to some employees within the framework of programmes weakening the impact of the crisis. In the December 2010 – January 2011 period these contracts expired, which led to a further drop in employment and rise in unemployment. In April 2011 the rate of unemployment increased to the level of 8.2%, i.e. the highest since the Eurostat published data for Slovenia (since 1996). Since the beginning of the crisis the unemployment rate in Slovenia increased almost twofold.

In the period from January to March 2011 employment decreased by 2.3% in comparison with the corresponding period of previous year. The number of jobs further decreased in construction and industry. However, employment increased in some services sectors, particularly in healthcare and education.

Inflation and labour costs

Inflation in Slovenia is among the lowest in the region besides the Czech Republic. In May 2011 the harmonized index of consumer prices (HICP) amounted to 2.4% (while in the whole 2010 it amounted to 2.1%). The main factor for inflation growth in 2011 are the prices of food while the impact of the increase in the prices of fuels in global markets on domestic inflation was weakened by the decrease of excise tax on motor fuels. According to estimates, these measures have made the level of current inflation drop by 0.4 pp. to date.

Core inflation (HICP index after excluding the prices of energy and food) remained for almost the whole 2010 below zero. This development was attributable to a significant drop in car prices, deceleration in the growth service prices and introduction of subsidies to school meals. Low consumption demand brought a sharpening of the decrease of core inflation in 2011. This partly contributed to the reduced fee of radio and TV licence.

Table 10.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**2.4**	**2.3**	**2.0**	**2.2**	**2.4**
Contribution to HICP growth rate (in pp)					
Food and beverages	0.1	0.4	0.3	0.7	1.2
Housing	1.2	1.2	1.0	0.8	0.7
Alcoholic beverages and tobacco products	0.4	0.4	0.4	0.4	0.3
Transport	0.4	0.0	0.3	0.5	0.3
Housing	0.0	0.1	0.1	0.1	0.2

source: Eurostat

The gross average wage increased by 5.1% in 2010 (against an increase by 1.8% in 2009), and the wage in manufacturing by 8.9% (0.9% in 2009). Wage increase is primarily attributable to the reductions being concentrated in the segment of the least paid jobs, raise of minimal wage and raising of wages for those employees who in the period of the deepest economic slowdown were covered by the programme of wage subsidies. At the same time the growth in labour costs in the public sector decreased visibly. In 2009 gross wage increased by 6.6%, while it remained at an unchanged level in 2010 as a result of the introduction of a new wage system.

In March 2011 nominal wage growth rate decelerated. It was related to the waning impact of minimal wage rise, which in 2010 was introduced by enterprises much more rapidly than indicated by government forecasts. Wages in the public sector still remained practically unchanged.

Balance of payments

In 2010 the current account deficit in Slovenia narrowed for the second consecutive year, both in nominal terms and in relation to GDP (to -1.1%, from -1.5% in 2009). On the one hand this was due to lower interest rates paid to non-residents from contracted loans, which positively affected the income balance. On the other, the the acceleration of payments from European Union funds in 2010 found its reflection in the current transfers surplus (0.3% of GDP) against the deficit registered in 2009 (-0.4% of GDP). Balance in services, though fell slightly, remained positive. On the other hand the deficit in goods widened in 2010 on account of terms of trade deterioration, despite the fact that more goods were exported than imported with respect to 2009.

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

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Current account	-0.9	-1.3	-0.8	-1.1	-1.1
Goods	-1.9	-2.4	-2.2	-2.7	-3.1
Services	3.1	3.1	3.0	2.9	3.1
Income	-2.0	-1.8	-1.5	-1.7	-1.7
Current transfers	-0.2	-0.2	0.0	0.3	0.6
Capital account	0.1	0.0	0.1	0.0	-0.1
Financial account	0.8	1.8	2.0	1.6	2.1
FDIs	-1.6	-0.3	-0.1	1.4	1.7
Portfolio investments	13.8	11.9	5.2	5.4	9.5
Other investments	-11.6	-9.6	-3.0	-5.0	-8.8

source: Eurostat

In 2010 Slovenian financial account once again posted a surplus. The inflow of both direct and portfolio investment increased. In the first case this was attributable to taking up shares in domestic entities by foreign investors. In turn the increase in foreign portfolio investments was linked to the purchase of bonds issued by one of local banks. At the same time, however, Slovenian consumers and enterprises increased investments in foreign debt securities, which eventually brought about a decrease in positive balance on a portfolio investments account. In 2010 there was also a significant drop in the scale of capital outflow from Slovenia in a form of other investment. This was attributable to the fact that Slovenian banks granted at that time less loans to foreign entities than in 2009.

Fiscal policy

Slovenian budget deficit slightly decreased in 2010 in Slovenian general government deficit decreased slightly in 2010 compared to 2009, (from 6.0% of GDP to 5.6% of GDP). On account of lower than expected CIT revenue execution, in mid-2010 the budget act was revised, which anticipated, among others, spending cuts on wages in the public sector, subsidies and capital expenditure.

In 2011 consolidation measures are continued. Indexation was reduced both of wages in the public sector (some fringe benefits were cancelled) and of social and pension benefits.[64] Later in 2011 a review of budget expenditure will be performed. Despite above mentioned adjustments, general government deficit in Slovenia is estimated at the level close to that registered in 2010 (5.5% of GDP), as a consequence of a one-off recapitalization by state of one of the commercial banks[65] (ca. 0.7% of GDP) and subsidies to the state railways (0.3% of GDP).

[64] It took into consideration only ¼ of CPI.

[65] Nova Ljubljanska Banka d.d. At the end of June 2011, the bank addressed the shareholders asking for another recapitalization.

The Slovene government targets the general government deficit at 3.9% of GDP in 2012 and in the subsequent years it is supposed to decrease at the pace of ca. 1% of GDP annually. Fiscal adjustment will solely base on the expenditure side. The government is planning no increase in the ratio of tax revenue to GDP in fear of its negative impact on economic growth. The adopted changes will concern only shift in tax burdens from income to consumption. In 2012 freezing of wages and streamlining of public sector employment are expected (redundancies will affect ca.1% of employees in 2011-2012), as well as no indexation of pensions and disability benefits, and in subsequent years their indexation mechanism will be revised. Changes will also affect the public procurement. Social benefits will be reduced. The improvement of fiscal situation will also result from lower investment expenditure. In the opinion of the EC Slovenian macroeconomic assumptions for 2013-2014 are too optimistic, and the achievement of fiscal targets in the subsequent two years will depend on the implementation of planned measures, which may be impeded by lack of social support (which led to rejection of the pension reform in the referendum and withdrawal of changes reducing preferences for working students by the government).

Slovenia belongs to a group of countries, in which a long-term stability of public finances is significantly burdened by the population aging, and, what is more, where the age of retirement is one of the lowest among the EU member states. A pension reform tabled in December 2010 sought to improve the long-term sustainability of the pension scheme. It assumed a gradual raise of the retirement age and modification of the indexation mechanism.[66] The Slovene Constitutional Court following the motion submitted by trade unions ruled that the pension reform should be voted in a referendum. At the beginning of June 2011 the changes proposed therein were rejected. The government declared adoption of additional consolidation measures,[67] yet according to the law, no initiative concerning changes in pension scheme can be put forward within a year after referendum.

The Slovenian parliament debates on the new Act on Public Finances, which is supposed to strengthen the position of the fiscal council and multi-year budgetary

[66] The retirement age may be raised gradually in 2021-2025 to 65 years for women (from 61 years) and men (from 63 years), with the possibility of earlier retirement in the case of a long insurance record (ca. 40 years). Until 2015 the indexation ratio will be based in 60% on the average growth of wages in the national economy and in 40% on the CPI. Since then these figures will be 70% and 30%. The insurance period which will be taken into consideration in the calculation of benefits is going to be gradually prolonged from 18 to 27 years.
According to the IMF assessment of the Slovene pension reform it is not sufficient to safeguard public finance stability in the long run. The changes postulated by the organization apply among others to the further reduction of the replacement rate (including a larger reduction of the early retirement benefits) and linking the retirement age with expected life span.

[67] The level of state budget expenditure is to be reduced by 4.5%. Slovenian Prime Minister announced that he will dismiss his government, should the the budget not be revised.

framework. The act will include fiscal rules limiting the level of budgetary expenditure, public debt (45% of GDP), guarantees (13% of GDP) and indebtedness of local government. Moreover social insurance and health care funds will not be allowed to incur liabilities.

Slovenian public debt is to amount to 43.4% of GDP at the end of 2011 against 38.0% of GDP in 2010. In the following years, as a result of a decrease in fiscal deficit and improvement of economic situation it is supposed to decelerate. In 2014, the general government debt is anticipated to stand at approx. 46% of GDP.

Forecasts

According to European Commission (EC), Slovenia will be one of the slowest developing economies in the region. Probably only in 2013 will the real GDP reach the level from before the crisis. In April, the Bank of Slovenia (BS) raised the significance of the of external factors impact on economic growth, while it lowered its forecast on domestic demand, as compared with the previous forecast (of October 2010).

Recovery in Slovenia will be going on very slowly. According to BS, in 2011 the GDP will increase by 1.8%. In 2011 external demand will remain the main factor of economic growth. Domestic demand will increase merely by 0.6% – primarily as a result of increase in households expenditure, while public consumption and investment will decrease. The increase in private consumption will be driven by increase in wages (in the private sector by 4.5%). On the other hand, the collective bargain between the government and the largest trade unions from the public sector limits the increase in wages in the public administration in 2011 and 2012.

In 2011 the decrease in unemployment is likely to persist. The expected scale of economic activity growth in 2011 will be, however, too small to reverse negative trends on the labour market. The rate of unemployment is expected to reach the highest level in mid-2011. Decrease in unemployment in the consecutive two years will, however, be very slow.

Gross fixed capital formation will probably further decrease in 2011, brought down to a large extent by a drop in construction investments (on account of a large number of unsold dwellings). On the other hand, a slight increase is expected in investment in machinery and equipment, particularly in export-oriented enterprises, where production capacity markedly increased. A slow growth in investment is expected only starting from 2012. It will be dependent on the sustainability of the improvement in financing conditions and earnings of enterprises.

Fiscal consolidation in 2011 will have a dampening impact on public consumption and investment. Its spread in time (according to government decision) will make the increase in expenditure in the coming two years very low.

In the current year, 2/3 of economic growth will be due to a continued improvement of foreign trade balance. This will be, however, attributable not to a large increase in exports but to a still low increase in imports.

A slight increase is anticipated in the current account deficit. In 2011, the slight increase in deficit (from 1.1% of GDP in 2010 to 1.6% in 2011) will be primarily attributable to the deterioration of the terms of trade on account of increase in commodity prices) and steepening of the income deficit. A more rapid increase in the volume of exports of goods and services in comparison to imports will be conducive to the opposite direction.

However, in subsequent years a decrease in the current account deficit is expected in relation to GDP. The growth in exports in the whole projection horizon (i.e. till 2013) will be higher than the growth in imports.

Inflation may rise to 2.7% in 2011 (on account of food and energy prices). Weak domestic demand, in particular a still unfavourable situation on the labour market, moderates inflationary pressure. As a result, also in 2011 core inflation may be negative. Anticipated recovery should be conducive to growth in core inflation in subsequent years. On the other hand, the impact on the inflation of food and energy prices will decrease. As a result, the HICP index in 2013 may decrease to 1.9%.

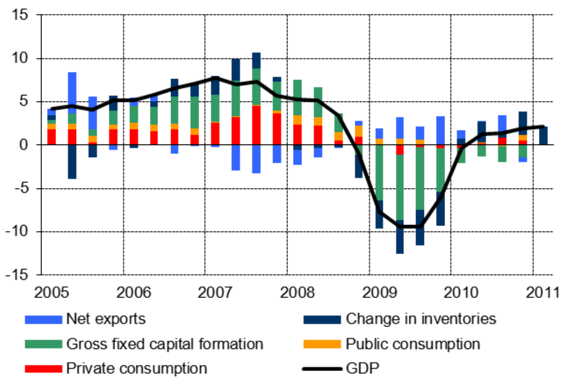
Table 10.4

Forecasts of main macroeconomic indicators

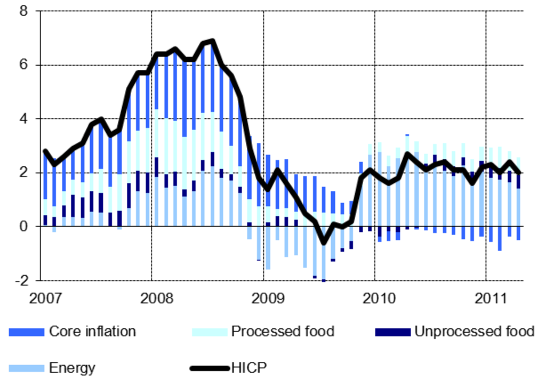
	BS	EC	OECD	IMF
	06.2011 (12.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	1,8 (1,9)	1,9 (1,9)	1,8 (2,0)	2,0 (2,4)
2012	2,7 (2,9)	2,5 (2,6)	2,6 (2,7)	2,4 (3,0)
2013	3,1			2,5 (3,2)
Inflation, in %, y/y				
2011	2,7 (2,1)	2,6 (2,0)	2,5 (1,9)	2,2 (2,3)
2012	2,3 (2,0)	2,1 (2,2)	2,2 (2,2)	3,1 (2,5)
2013	1,9			2,3 (2,7)
Current account balance, in % of GDP				
2011	-1,6 (-1,7)	-1,4 (-0,6)	-1,3 (-3,9)	-2,0 (-0,7)
2012	-1,1 (-2,3)	-1,9 (-0,8)	-1,3 (-4,5)	-2,1 (-0,9)
2013	-0,9			-2,1 (-0,8)

BS - Price Stability Report, Banka Slovenije.

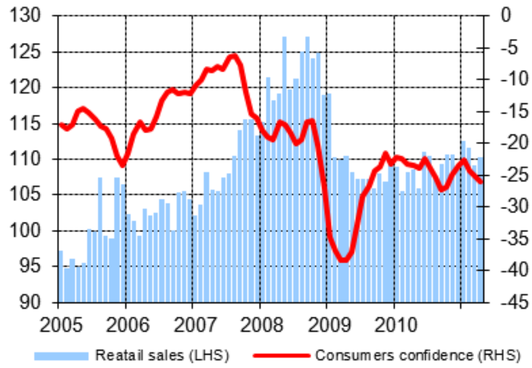
Contribution to GDP growth (in pp, y/y)



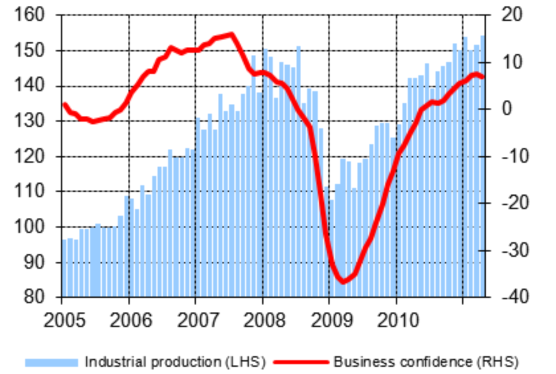
HICP and its components (in %, y/y)



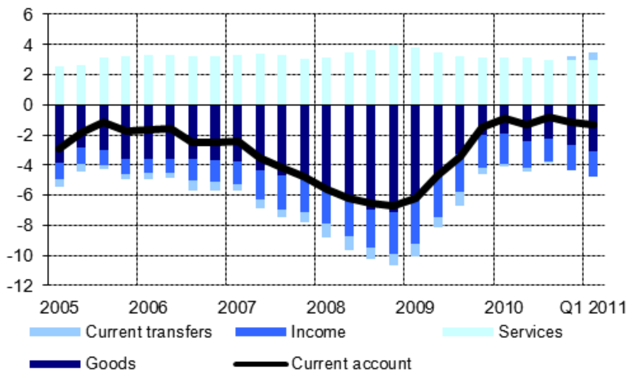
Retail sales (in %, y/y) and consumer sentiment index



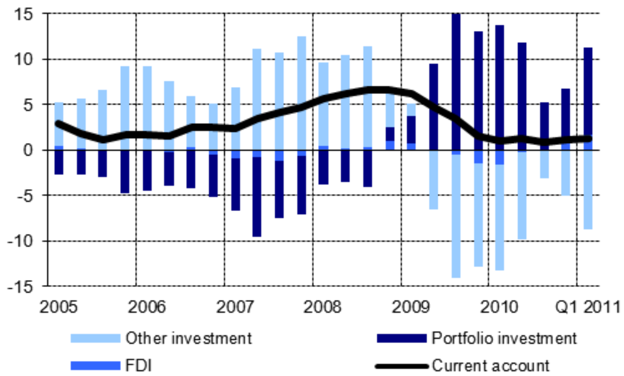
Industrial production (in %, y/y) and business sentiment index



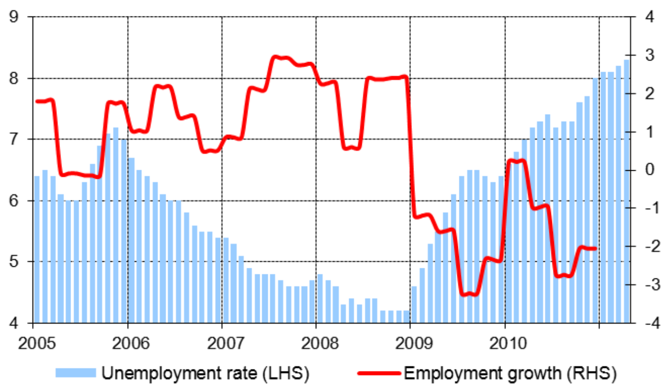
Current account and its components (in % of GDP, 4-quarter moving average)



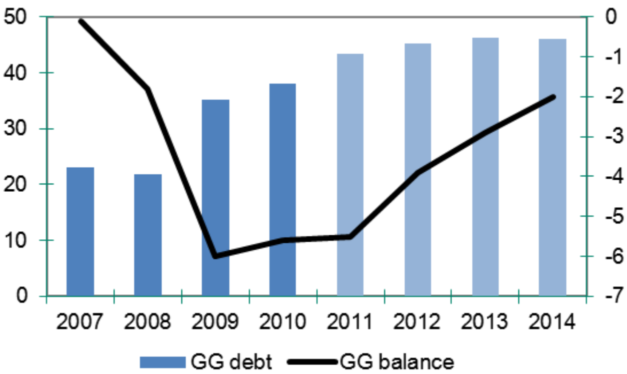
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

HUNGARY

Economic growth

Hungarian economy in 2010 started the process of recovery following the crisis of 2008-2009. GDP in quarterly terms increased in each consecutive quarter, and in the whole 2010 was higher by 1.2% than in the previous year. This trend persisted also in 2011 Q1. The main force driving the Hungarian economy in 2010 and 2011 Q1 was exports. Strong demand from the main trade partners, coupled with persisting declines in consumption and investment meant that net exports was the main contributor to GDP growth in 2010. Change in inventories also had a positive contribution to the GDP growth rate.

Table 11.1

GDP and its components (in % y/y)

	2009	2010	Q3 2010	Q4 2010	Q1 2011
GDP	**-6.3**	**1.2**	**2.3**	**2.6**	**2.2**
Private consumption	-7.6	-2.1	0.1	-0.3	-0.9
Public consumption	-1.1	-1.7	-0.7	-3.6	
Fixed capital formation	-6.5	-5.6	-4.5	-5.5	-3.7
Exports	-9.1	14.1	14.0	12.0	14.1
Imports	-15.4	12.0	13.0	10.4	14.2

source: Eurostat

Private consumption in Hungary in 2010, for the third consecutive year, continued a decreasing trend. It recovered slightly only in 2010 Q3, since direct taxes grew in 2010, and in effect disposable income fell. At the end of 2010 consumer demand in Hungary weakened again. Rising inflation, cancellation of annual bonuses in enterprises and the appreciation of the Swiss franc, which affected the growth in the instalments of the majority of mortgage loans dampened the growth in households consumer expenditure in 2010 Q4 and 2011 Q1. In the case of public consumption decreases were bigger and lasted for the whole year long.

Gross fixed capital formation in Hungary in 2010 trended further down, in spite of a very low base in 2009. The majority of investment projects planned for 2010 was halted during the year. In the context of a hindered access to banking loans, enterprises attempted to increase the already existing production capacity rather than expanding it. Only in the manufacturing enterprises, there was a visible increase in investment outlays, which was primarily due to new investment in the automotive sector[68]. Investment outlays dropped again in 2011 Q1.

At beginning of 2010 in Hungary a process of inventories rebuilding, following the period of their utilization in 2008-2009 started. This involved primarily inventories in industry. It seems however, that the process of inventory rebuilding in Hungary is undergoing a deceleration, as manifested in their smaller share in GDP growth in 2011 Q1.

Weak domestic demand resulted also from stagnation on the loan market. Admittedly in the first half of 2010 the market recovered, but already in the second half of that year and in 2011 Q1, the value of loans granted, both for enterprises and households decreased again. Changes introduced in May 2011, concerning the payment of loans denominated in foreign currency should not contribute significantly to an increase in lending in Hungary, but they may lead to a temporary deburdening of household budgets and as a result foster domestic demand in the coming quarters.

The contribution of net exports to GDP growth in 2010 in Hungary amounted to 3.8 pp., i.e. the most among the main categories of national accounts. The high contribution of foreign trade is primarily attributable to rapidly growing external demand, both from Western European, CEE countries and emerging markets. In the result exports grew by 14% last year. Imports in 2010 rose slightly slower (12%), which was the result of weak domestic demand. In 2011 Q1, export still rose rapidly but the pace of imports growth markedly increased, which resulted in the decrease in the net export contribution to the GDP growth in Hungary, although it remained positive.

The value of retail sales in Hungary in 2010 practically levelled off, which reflected the weakness of consumer demand in this period. In 2011 Q1 turnover in retail trade remained at a low level, similar to the one observed in 2010.

Increase in consumer sentiment, which was visible in the 1st half of 2010 was halted in the second half of 2010. These decreases were also continued in the first five months of 2011. Increase in inflation and appreciation of the Swiss franc brought about a drop in real disposable income of households, which in turn brought a worse assessment of their present and future financial situation.

The volume of industrial output in Hungary, similarly as in other countries of the region markedly rose in 2010, which was attributable primarily to a strong foreign demand. The greatest increase was posted in the production of machinery and equipment as well as computers and electronics. In 2011 Q1 industrial output increased further, fuelled by rapidly increasing production in the automotive sector.

A large number of orders, both domestic and foreign ones, as well as rapidly increasing volume of production brought about a significant rise in business confidence indicators. This development took place in 2010 and in the first four months of 2011. In turn, in May 2011 the indices of business confidence published by the European Commission showed a marked drop in the number of

[68] Investment in the Hankook and Mercedes plants.

new orders, which also translated into a deterioration of the entrepreneurs optimism.

Labour market

Situation on the Hungarian labour market in 2010 and in the first months of 2011 showed no signs of significant improvement. The harmonized unemployment rate in Hungary in 2010 rose slightly in comparison with the previous year. In December 2010 it amounted to 11.3% against 10.9% in December 2009. January 2011 saw its abrupt rise to 12.1%. In subsequent months a slight decline could be seen (to 11.6% in April).

Employment statistics in Hungary indicate, however, a recovery on the labour market in the second half of 2010, as the number of employed in the economy started to increase in annual terms. Employment increased the most rapidly in the sector of services (particularly in the sector of financial intermediation and real estate services). Its growth also took place in industry. This development resulted from improving conditions in these sectors in 2010. In 2010, employment rose also in the public sector. This followed from the public employment programme. At the end of 2010, budgetary funds earmarked for this plan were significantly reduced and already in 2011 Q1 the number of employees in the public sector was nearly 5% lower than in 2010 Q1. This affected also the decline in employment growth, even though the number of employees in the enterprise sector, particularly in the manufacturing sector, still increased. In turn, agriculture and construction, both in 2010 and in 2011 Q1, experienced a steady decline in the number of employees.

Inflation and labour costs

Rapid growth in food and energy commodity prices on the global markets since the second half of 2010 also translated into rising inflation in Hungary. It is the food and energy prices which constituted the main reason behind the increase in inflation in this period. From July 2010 until April 2011, the annual HICP growth increased from 3.6% to 4.4%. In May 2011 inflation in Hungary declined to 3.9% as a result of a drop in energy prices and a significant slowdown in the pace of food price growth.

Core inflation (excluding energy, food, alcoholic beverages and tobacco product prices) since July 2010 (a drop in core inflation as a result of waning of the base effect related to the increase in indirect taxes in mid-2009) to May 2011 remained at a relatively low level (1.1-1.6%) although in March and April 2011, a slight increase could be seen. A low level of core inflation is a result of a continuously low inflationary pressure related to the prevailing stagnation on the labour market. Until now, there were no contagion effects from high prices of food and fuels, or costs of temporary sectorial taxes (imposed in January 2011 on banks, telecommunication operators and retail trade networks) onto the prices of other goods and services.

Table 11.2

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

	Q2 2010	Q3 2010	Q4 2010	Q1 2011	May-11
HICP	**5.2**	**3.6**	**4.3**	**4.3**	**3.9**
Contribution to HICP growth rate (in pp)					
Food and beverages	-0.1	0.7	1.3	1.7	2.0
Transport	2.0	1.2	1.3	1.1	0.9
Housing	1.1	0.7	0.8	0.9	0.5
Restaurants and hotels	-0.1	-0.1	0.0	0.1	0.2
Health	0.3	0.2	0.1	0.1	0.1

source: Eurostat

The average wage in Hungary increased slightly in 2010 (by 2.6% in comparison with 2009). The increase in the annual growth of wages took place only in the first half of 2010. In the second half of 2010 nominal wages already declined in annual terms, which was primarily attributable to their drop in the public sector (among others due to a lower remuneration of temporary employees, many of them working part-time). Cancellation of annual bonuses in enterprises, particularly in enterprises burdened with new taxes and public sector institutions, was an additional factor lowering the growth of wages at the end of 2010.

Increase in nominal wages in the first half of 2010 was the main reason for the increase of unit labour costs in this period. However, following the deceleration in their growth, and as a result of a marked acceleration of annual pace of economic growth, a renewed decline could be observed in the second half of 2010.

Balance of payments

The current account surplus which materialized in 2009 (0.4% of GDP) in 2010 increased further and amounted to 2.1% of GDP. It resulted from increased positive balance in goods and services. The current transfers balance did not change in comparison with 2009, while the deficit in income increased slightly.

Table 11.3

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

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Current account	**0.4**	**1.5**	**1.9**	**1.9**	**2.1**
Goods	3.6	4.4	4.5	4.6	4.7
Services	1.4	2.0	2.2	2.3	2.4
Income	-5.1	-5.2	-5.3	-5.4	-5.5
Current transfers	0.4	0.4	0.5	0.4	0.4
Capital account	**1.2**	**1.4**	**1.4**	**1.5**	**1.3**
Financial account	**4.9**	**3.0**	**5.2**	**0.9**	**1.3**
FDIs	-0.5	-1.4	-0.4	0.2	0.6
Portfolio investments	-2.9	2.9	2.7	-1.3	0.6
Other investments	8.2	1.6	2.9	2.0	0.1

source: Eurostat

Surplus in goods and services in 2010 exceeded 7% of GDP. The trade in goods in 2010 posted a big increase both in exports and in imports (respectively by 25% and 23% y/y). In the case of exports and imports, the increase in foreign trade was to the largest extent affected by trade in products of the manufacturing. In turn, the increase in the services account is primarily attributable to the increase in net income from tourism, financial services and licence fees. Increased deficit in income is, in turn, the result of a higher outflow of earnings from foreign investments in Hungary, mainly direct investments due to the improvement of foreign-owned companies financial condition, despite the sectorial taxes introduced in 2010.

The year 2010 saw further foreign capital inflow to Hungary. Its scale, however, diminished significantly as compared to the levels from 2009. It was attributable primarily to the withholding of subsequent tranches of financial aid, granted to Hungary in 2008 by the International Monetary Fund, the World Bank, the European Commission and governments of some EU member states. The decision to stop granting subsequent tranches of aid was caused by termination of negotiations with the IMF by the Hungarian government, which did not want to agree to further cuts in budget expenditure, taking into account the already difficult economic situation of the country.[69] This was reflected in the decline in other investment surplus. Meanwhile, both direct and portfolio investments flowed into Hungary in 2010 in larger amount than a year before, when a net outflow was posted in both these categories.

Interest rates and exchange rate

Following a period of record low interest rates in Hungary (5.25% in the period April-November 2010) the National Bank of Hungary (MNB) decided to raise them at the turn of 2010 and 2011. In November and December 2010 and in January 2011 the main interest rate was raised by 25 bps each time, to the level of 6%, at which it remained till June 2011. The tightening of monetary policy in Hungary was due mainly to supply shock on food and energy commodities markets, which brought a rapid increase in inflation in Hungary in the second half of 2010.

The changes in the National Bank of Hungary interest rates were also the main indicator of changes in the level of interest rates on interbank market. The three-month Bubor in November 2010-June 2011 increased from 5.4 to 6.1%. During all this period it was slightly higher (by 0.1-0.2 pp.) than the main interest rate.

The development of the exchange rate of the Hungarian forint and the yields on treasury bonds in 2010 and 2011 were affected by both external factors – in particular the situation in the euro area – and the situation in the domestic economy. In the second half of 2010 there was a visible weakening of the forint against the euro, as well as an increase in the yields on Hungarian bonds. This was due, on the one hand, to a new wave of information on debt crises in peripheral countries of the euro area, which increased investors' risk aversion. This is when the flight of foreign investors from European markets, including CEE country markets, took place into assets denominated in USD. In mid-2010 Hungary broke negotiations concerning prolongation of financial aid from the IMF, which additionally decreased investors' confidence with respect to this country. The proposed and implemented own measures adopted in the second half of 2010, aimed at limiting general government deficit (primarily the nationalization of open pension funds and temporary taxes imposed on the financial, energy, telecommunication and retail trade sectors) were unfavourably received by financial institutions and rating agencies. It resulted in the ratings of long-term Hungarian debt downgrade (Fitch and Moody's agencies) at the beginning of December 2010 and was another factor in the increase of foreign investors' aversion towards Hungarian financial markets at the end of 2010. The situation started to change in 2011 when the forint began to strengthen vis-a-vis the main world currencies. The first of the factors, which affected such a development of the forint exchange rate, was a growing difference in the level of interest rates between Hungary and the euro area or the United States, resulting from the tightening of the monetary policy by the National Bank of Hungary. In April 2011, a new plan of structural reforms was announced in Hungary, which included a long-term strategy of public finance consolidation. This time it did not focus solely on the temporary increase on the revenue side, as it took place in 2010. This plan was received by financial institutions and investors as "a step in the good direction", which was an additional impulse for the strengthening of the forint and a decrease in the yields on Hungarian bonds in 2011 Q2.

Fiscal policy

In order to maintain the general government deficit in 2010 at the level agreed with international organizations (3.8% of GDP against 4.5% of GDP in 2009), the Hungarian government adopted temporary measures increasing the budgetary revenue (suspension of contribution transferred to the second pillar of the pension scheme, introduction of special taxes – among others imposed on the financial sector[70]), coupled with simultaneous strict expenditure discipline. Nevertheless the registered fiscal deficit in 2010 was higher then assumed – 4.2% of GDP. This was, among others, the related to worse than planned local government units balance (by 0.2 % of GDP) and lower revenues from the PIT and social insurance contributions, as a result of i.a.

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

[70] They were imposed also on enterprises from the energy and telecommunications sectors as well as retail chains. Budgetrevenue due to this are estimated at ca. 0.6% of GDP in annual terms.

the shift of bonuses and premiums owing to the decrease of the PIT rate, entering into force from 2011 (ca. 0.2 % of GDP).

In 2011, Hungary, besides Sweden, will be the only European Union country to record general government surplus (2% of GDP, the European Commission forecast – 1.6% of GDP). It will be generated as a result of a one-off revenue related to the transfer of assets of individuals returning from the private pension funds into the state PAYG pension scheme[71] (almost 10% of GDP). This measure will allow to offset the negative impact on fiscal balance of changes in the tax system[72] (1.9% of GDP), assumption of state enterprises debt (railway and public transport company of Budapest – ca. 1.3% of GDP) and the buyout of investments projects carried out in the formula of public-private partnership[73] (ca. 0.7% of GDP). Excluding the assets transfer from private pension funds, the budget deficit would have amounted to 8% of GDP, the largest figure since 2006. Adjustments introduced since 2011 include also the nominal freeze of social transfers (family allowances, social assistance benefits) and the reduction in their indexation rate. Moreover, at the beginning of the year, the government adopted a decision to block a part of ministries' appropriations (stability reserve, ca. 0.9% of GDP). At the end of May, Hungarian government concluded an agreement with the Banks' Association with respect to the assistance programme for persons repaying mortgage loans denominated in Swiss francs. The cost to the general government is estimated at approx. 0.05% of GDP per year.

In the Széll Kálmán Plan(SKP) announced in March 2011, and elaborated in the National Reform Programme (NRP), the Hungarian government presented a wide range of measures aiming at deficit and public debt reduction. In contrast to the changes adopted in 2010, the NRP focuses mainly (in ¾) on the expenditure side. Proposals mainly involve cuts in social transfers[74] and current expenditure[75]. On the revenue side, contrary to earlier announcements, the special tax imposed on financial institutions is going to be retained after 2012. Moreover there will be no reduction of the CIT rate from from 19% to 10% as planned of 2013. Assets transferred by private pension funds[76] will be earmarked for the newly created Pension Reform and Public Debt Reduction Fund. The fund will be also financed by a special tax paid by financial institutions as well as by revenue from electronic toll (effective from 2013). Funds can be disbursed only to reduce public debt.

The magnitude of measures envisaged in the NRP is estimated at ca. 2-3% of GDP yearly. As a result, the fiscal deficit in Hungary in 2012-2014 is going to be kept below reference value, and allows for its decrease from 82% of GDP in 2010 to ca. 66% in 2014. The achievement of the above-mentioned targets will require the implementation of actions in accordance with the timetable adopted by the government. The IMF and the EC forecast that the reduction in fiscal imbalance in Hungary below 3% of GDP in subsequent years will require additional consolidation measures.

In April 2011 a new Hungarian Constitution was adopted, envisaging changes within the institutional framework of public finances. It stipulated the public debt rule (cap set at 50% of GDP[77]), strengthened control mechanisms (among others, the possibility of vetoing the budget act by the fiscal council) and sanctioned suspension of referring amendments in the tax law and social insurance system to the Constitutional Tribunal, in the case of public debt exceeding 50% of GDP. The government proposals require adoption of relevant subordinate legislation determining in a detailed way the procedure for reducing public debt in accordance with the enacted fiscal rule. At the beginning of 2011, Hungarian Prime Minister informed about the possibility of introducing a statutory provision, which would restrict the possibility of amending the provisions in the scope of tax law, social insurance system and budgetary law (they would require the support of at least ⅔ of deputies).

[71] As a result of changes introduced at the end of 2010, almost 97% of private pension fund members (more than 3 m persons) decided to opt-out. The decision was supposed to be made till the end of January 2011 (in some cases – until the end of February 2011). Continued participation in the funded pension scheme involves loss of entitlement to state pension and state's guarantee for payment of future benefits from the second pillar, while the social insurance contributions would be still collected in full amount. The returning to the PAYG scheme enabled the insured to receive the yield earned by pension funds and in the case of negative rate of return, the state will adjust the balance on the insured person's notional account in the first pillar.

[72] The introduction of a flat PIT rate (16%) instead of the previous rates of 17% and 32% coupled with the increase in the tax allowance for raising a child, the reduced CIT rate for small taxpayers (10% against 19%, measure introduced in mid-2010).

[73] The decision to continue or phase out particular projects (there were ca. 100 projects under implementation) is to be taken up in June 2011. According to the statement by the Hungarian minister of national development, termination of PPP contracts are supposed to generate savings in the long run at the level of ca. HUF 400 bn (i.e. ca. 1.4% of GDP in terms of 2011).

[74] The formulae for the calculation of benefits are to be revised, early pensions phased out and the qualification conditions to disability benefits tightened (followed by an overhaul of granted benefits). Changes are also going to include prescription drug subsidies as well as higher education financing. The government is planning to centralize public purchases and tasks fulfilled by local government units. The decrease in budget expenditure in the coming years is also going to be brought about by the restructuring of public transport (creation of the National Transport Holding Company) and reduction of tariff preferences.

[75] Among others, 5% reduction of employment in administration, no filling in of vacant posts, freezing of expenditure on the purchase of goods and services at the level of 2011.

[76] In the case of enterprises, whose tax base exceeded in the given tax year the amount of HUF 500 m. The rate for small taxpayers since mid-2010 is 10%.

[77] Transfer is going to begin in June 2011. The value of transferred assets, is estimated at ca. 10% of GDP, out of which ca. 4.7% of GDP come in the form of Hungarian securities. In 2010, a part of that revenue (ca. 1.9% of GDP) is going to be assigned to cover the expenses of the Hungarian social insurance fund, not on the reduction of public debt.

Forecasts

As shown by the MNB forecasts published in June 2011, the pace of economic growth in 2011-2012 will be below 3% y/y, i.e. definitely lower than expected at the end of 2010. Expectations for 2011 and 2012 include a persisting high external demand, with the demand on the part of euro area countries being gradually replaced by a strong demand from countries outside Europe, in particular from Asian ones. This will allow to maintain high exports growth, leading to a renewed positive contribution of net exports to GDP growth in this period. At the same time the MNB expects an increase in domestic demand, primarily private consumption and fixed capital formation. Increase in private consumption is going to take place already in 2011, however it is going to be relatively slow. Stagnation on the labour market is going to be the driving force behind this development, as well as plans of further fiscal consolidation (SKP). According to the NBH, measures adopted by the Hungarian government, which took place at the beginning of 2011 (lower income taxes, pay-out of interest from nationalized pension fund assets) will contribute rather to the increase in household savings than to increase in their consumption. In 2012 employment in Hungary will continue to rise slowly. An increase in average wage is also anticipated, particularly in the private sector. On the other hand, while the plan of restructuring foreign currency loans should not affect significantly the increase in lending, it should still be conducive to the reduction of the burden of households and thus indirectly improve their financial situation. This may favourably affect consumption in the next year. In turn, the NBH expects a decrease in public consumption in the coming two years, which is going to be the consequence of the newly adopted savings plan. In the case of fixed investment, the NBH counts on a successful ending of investment projects in the automotive sector, which would have an upside effect on investment outlays in the economy, though only as of 2012.

The inflation forecast of the NBH assumes its gradual decrease in 2011 and 2012 to the level below the NBH inflation target (3%) at the end of 2012. The contribution of food and energy prices to inflation should decrease with each consecutive quarter. The expected increase in private consumption should not have big impact on inflation growth, however, contrary to energy and food prices, core inflation in 2011 and 2012 will not decrease and will be running at the level observed in 2011 Q1.

Expected persistence of a strong external demand and no visible recovery of domestic demand will be conducive to the persistence of current account surplus observed in Hungary since 2009, or even its slight increase in the subsequent quarters of 2011 and 2012.

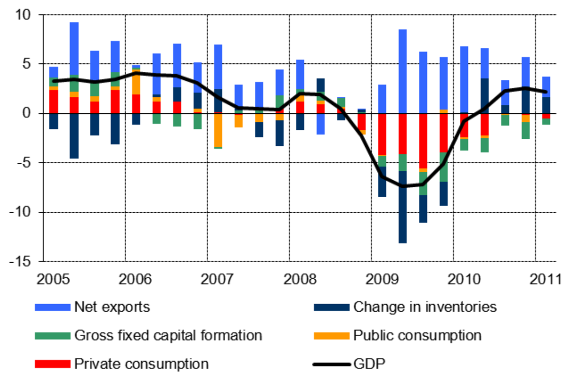
Table 10.4

Forecasts of main macroeconomic indicators

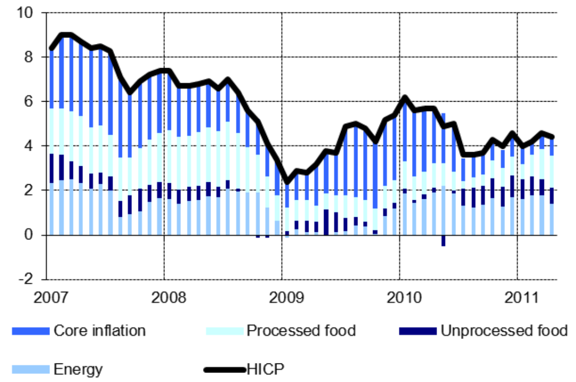
	MNB	EC	OECD	IMF
	06.2011 (11.2010)	05.2011 (11.2010)	05.2011 (11.2010)	04.2011 (10.2010)
GDP, in %, y/y				
2011	2,6 (3,1)	2,7 (2,8)	2,7 (2,5)	2,8 (2,0)
2012	2,7 (4,0)	2,6 (3,2)	3,1 (3,1)	2,8 (3,0)
2013				2,8 (3,0)
Inflation, in %, y/y				
2011	3,9 (4,0)	4,0 (3,9)	4,0 (2,9)	4,1 (3,3)
2012	3,6 (3,3)	3,5 (3,7)	3,3 (3,1)	3,5 (3,0)
2013				3,0 (3,0)
Current account balance, in % of GDP				
2011	1,9	1,6 (0,4)	2,7 (-1,1)	1,5 (0,7)
2012	3,2	1,9(-0,4)	1,8 (-1,3)	0,9 (-0,7)
2013				-0,8 (-0,9)

MNB – Report on Inflation, National Bank of Hungary

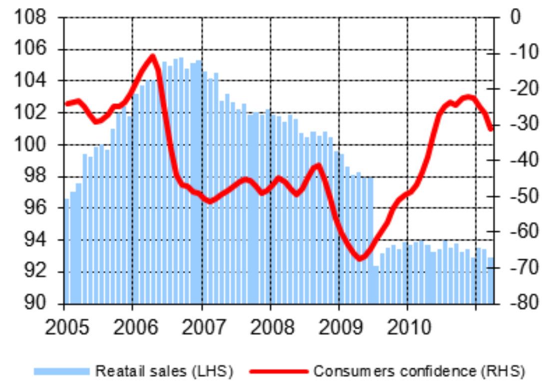
Contribution to GDP growth (in pp, y/y)



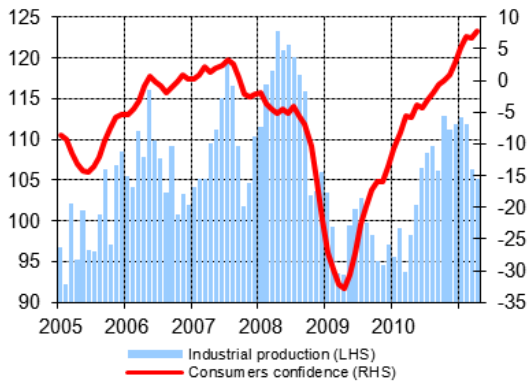
HICP and its components (in %, y/y)



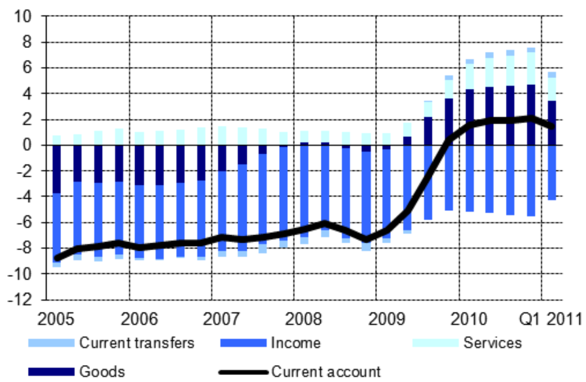
Retail sales (in %, y/y) and consumer sentiment index



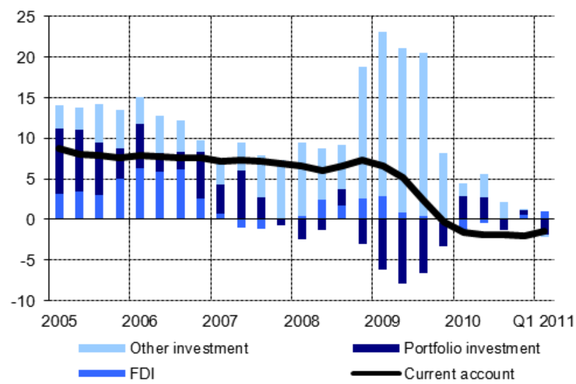
Industrial production (in %, y/y) and business sentiment index



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

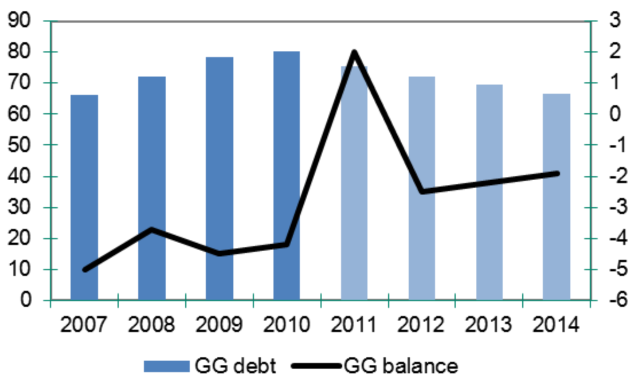


Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

General government debt and deficit (in % of GDP)



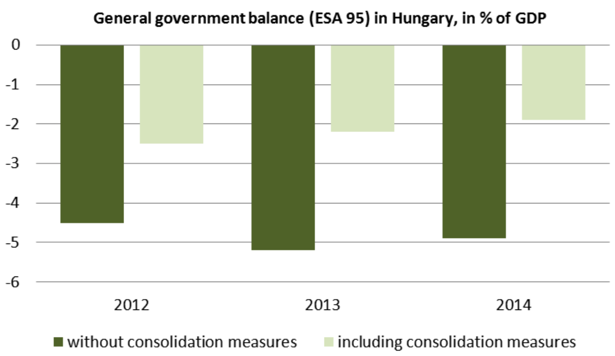
Source: Eurostat, CSOs

Annex 1

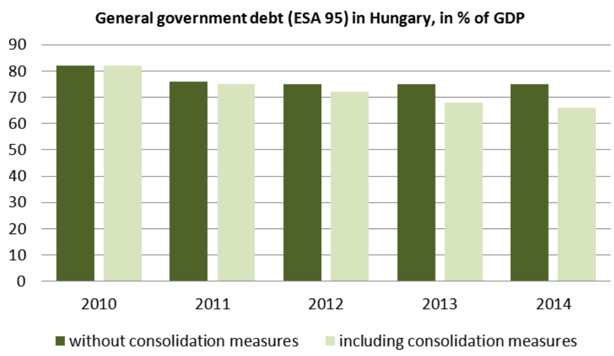
Széll Kálmán Plan

At the beginning of March 2011, the Hungarian government presented the Széll Kálmán Plan[78] (SKP)[79] constituting a wide range of measures to consolidate public finances. Contrary to changes implemented in 2010, improvement of the fiscal balance is going to be primarily the effect of a permanent reduction of expenditure (see table on the next page).

The magnitude of measures assumed in the SKP is estimated at ca. 2-3% of GDP per year (see chart below). As a result, the fiscal deficit in 2012-2014 is going to remain below the reference value and the public debt is going to be reduced from 82% of GDP in 2010 to ca. 66% in 2014 (see chart below). The IMF and the EC forecast that it will require additional consolidation measures in subsequent years. The EC estimates the impact of the KSP on deficit reduction at ca. 1-2% of GDP.



Source: Hungarian Ministry of National Economy



Source: Hungarian Ministry of National Economy

The government plan provides, among others, for the following:

- cuts in social transfers,
- modification of prescription drug subsidy system,
- change in higher education financing (reduction of available places at full-time studies by half),
- restructuring of public transport enterprises (creation of the National Transport Holding Company, reduction of tariff preferences),
- rationalization of tasks performed by government administration and particular units of local government.

Measures referring to social transfers aim at rise in the labour market participation rate by eliminating disincentives to work. The formulae for the calculation of benefits are to be revised, early pensions and special pension scheme for uniformed services phased out and the qualification conditions to disability benefits tightened (followed by an overhaul of granted benefits).The total amount of family allowances and social benefits received by an individual will be capped at a level lower than minimum wage. The family allowances will remain frozen. The period for receiving unemployment benefits is going to be shortened, while share of EU funds in financing of active labour market policy will increase.

On the revenue side electronic toll is going to be introduced since 2013. Contrary to earlier announcements, the special tax imposed on financial institutions will be retained, though initially it was going to remain in force till 2012. Moreover, the Hungarian government withdrew from the reduction of the CIT tax from 19% to 10%[80] since 2013. These revenue are going to be earmarked

[78] As this threshold is breached, regulations provide for the enactment of Budget Act assuming reduction of the public debt.
[79] Széll Kálmán was Hungary's Prime Minister in 1899-1903, his government introduced a tax and financial system reform.
[80] Subsequently elaborated in detail in the National Reform Plan (of mid-April 2011).

for newly created Pension Reform and Public Debt Reduction Fund. The fund is also going to receive assets transferred by private pension funds.[81]

Hungarian authorities are also going to reduce administrative burden (by 25%), mainly with respect of tax law and requirements of financial and statistical reporting as well as improved transparency of the functioning of regulatory bodies.

The achievement of objectives stipulated in the SKP will require the implementation of measures in accordance with the timetable adopted by the government. The majority of bills are going to be prepared by 1 July 2011 and not later than in September 2011 they are going to be enacted. Longer deadlines (end of 2011) are envisaged for changes in the pension scheme and railways restructuring. In total the government is planning to amend 42 acts and 18 government and ministerial decrees.

Table. Hungarian fiscal adjustment measures adopted in 2010 and assumed in the Széll Kálmán Plan

Measure	2010	2011	2012	2013	2014	Comment / Short description
	% of GDP					
MEASURES ADOPTED IN 2010						
Tax imposed on financial institutions	0.7	0.6	0.6	0.3	0.3	2013-2014 replaced by bank tax harmonised within the EU (part of revenues will be directed from 2012 to the Pension Reform and Public Debt Reduction Fund, see below). It is applicable also to insurance and leasing companies
Crisis tax	0.6	0.6	0.5			Imposed on taxpayers from energy, telecommunications sector and retail chains
Suspension of the social contribution transfer to private pension funds	0.2	1.3	1.1	1.1	1.0	In force since November 2010 till December 2011;Estimates for 2012-2014 assume effects of 97% private pension funds members returning to the state pension scheme
Financing budgetary deficit by assets transferred form the funded pension scheme		1.8				Solely in 2010, a part of assets transferred by the private pension funds (ca. 1.9% of GDP out of ca. 10% of GDP) is going to be assigned to cover the expenses of the Hungarian social insurance fund, not on the reduction of public debt.
Spending cuts	0.8	0.9				blocking appropriations of particular ministries, freeze of budget reserves
TOTAL:	**2.3**	**3.3**	**2.2**	**1.3**	**1.3**	
MEASURES ASSUMED IN THE KSP						
Employment and labour market		0.01	0.6	0.7	0.6	Changes comprise of i.a.: • unemployment benefits granted for shorter period • larger share of EU funds in financing active labour market policies • the total amount of family allowances and social benefits received by an individual will be capped at a level lower than minimum wage • nominal freeze of family allowances
Pension scheme		0.04	0.3	0.4	0.4	Above all • unification of pension calculation formula• abolishment of early retirement and special pension scheme for uniformed forces • modification of pension indexation mechanism • review and overhaul of disability benefits scheme • gradual replacement of pension supplements by social benefits
Public transport			0.1	0.2	0.2	Measures include i.a.: • integration and restructuration of state railways MÁV, bus operator Volán and Public Transport Company of Budapest BKV into National Transport Holding Company • review of tariff exemptions

[81] In the case of enterprises whose tax base exceeded in the given tax year the amount of HUF 500 m.

Measure	2010	2011	2012	2013	2014	Comment / Short description
Higher education			0.0	0.1	0.1	Reduction of enrolment in state-subsidized higher education, taking into account labour force demand
Health sector			0.3	0.4	0.4	Cuts in prescription drug subsidies
Other measures			0.1	0.4	0.4	i.a.:• centralization of public procurement • ban on debt incurred by the central government units to finance current deficit, introduction of Government control on drawing loans for investments • simplifying of tax administration • rationalisation of the functioning of the central and local governments
Establishment of Pension Reform and Public Debt Reduction Fund			0.3	0.7	0.6	For debt reduction will serve revenues from electronic toll system (effective since 2013), withdrawal of CIT rate reduction (for yearly tax base >500 mil HUF) from 19% to 10%, and tax imposed on the financial institutions
TOTAL:	**0.0**	**0.05**	**1.8**	**2.8**	**2.7**	
Source: Kálmán Széll Plan, Convergence Programme of Hungary 2011-2015						

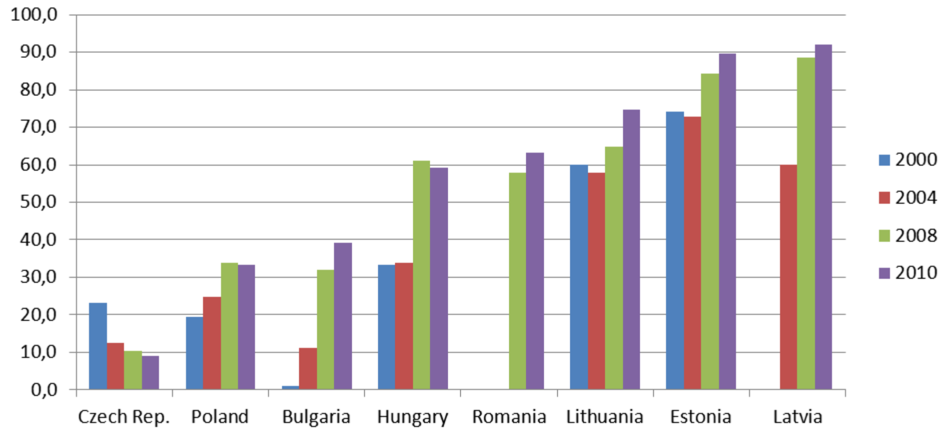
Annex 2

Foreign currency loans in Central and Eastern Europe – a Hungarian approach

The real convergence process in developed countries is usually related to fast increase in lending. It was similar in CEE countries. The process of liberalization of economies, financial markets development and inflow of foreign investment led to a rapid development of the banking sector in these countries, and thus to an increase in loans to enterprises and households. This process accelerated even more after the accession of CEE countries to the European Union. It enabled international financial institutions to easily and quickly enter onto Eastern European markets. Since the moment of the European Union accession, there has been a marked acceleration in the growth of loans for private sector. In the case of the Baltic states or Romania it even exceeded 50% y/y in 2005-2008.

The characteristic feature of the loan market in CEE countries was a very large share of foreign currency loans. In 2004-2008 their share in total loans increased significantly. Since 2008, in Hungary, Romania and Lithuania they already accounted for over 60% of all granted loans, and in Estonia and Latvia even c.a. 90%. The largest share of foreign currency loans in Baltic countries resulted, among others, from the fixed exchange rate regime, which significantly reduced the exchange rate risk.[82] Loans in foreign currencies were usually granted for housing purposes to households. In the case of Romania and Baltic states, however, they dominated in almost all types of loans, both to households and enterprises. In the majority of countries the dominating currency of loans was the euro. Only in Poland and Hungary it was loans in the Swiss franc turned out to be the most popular lending currency.

The share of loans in foreign currencies in total loans to the private sector in Central and Eastern European countries which were not members of the euro area



Source: Central banks, own calculations

A big "success" of foreign currency loans in the region is related primarily to their lower price in comparison with the domestic currency loans. Interest rates on the interbank market in the euro area or Switzerland, and thus loan interest, were definitely lower than local ones.[83] Nominal exchange rates of CEE currencies appreciation in 2004-2008 was an additional factor lowering the cost of foreign currency loans and thus another incentive to contract this type of loans.

At the same time only a minority of borrowers attempted to hedge against currency risk. The majority of foreign currency loans, in particular granted to households, lacked security backing. Particular risk was taken by residents from countries with a floating exchange rate regime, i.e. primarily Hungary, Poland and Romania. The outbreak of the global financial crisis in the second half of 2008 led to a massive outflow of capital from CEE country markets, abrupt depreciation of these currencies, and an increase in the cost of loan servicing. Coupled with a worsening situation on the labour market in this period, the cost of loan repayment was becoming an ever greater burden for households.

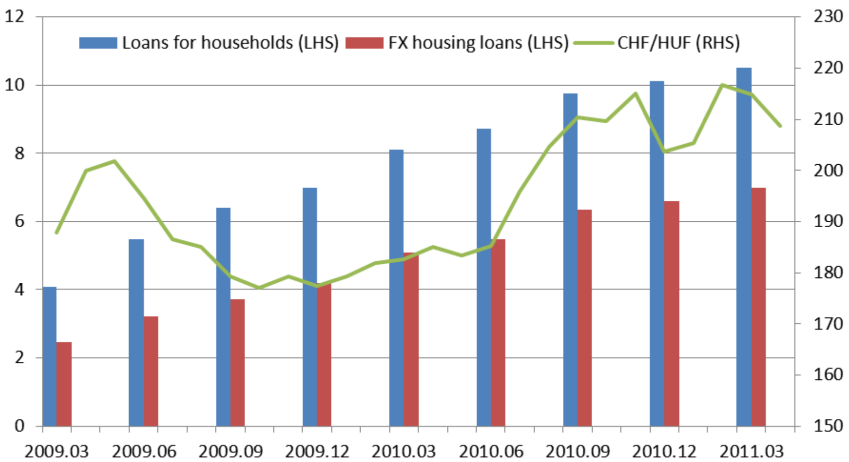
[82] Only in 2011 is part of revenue from the sales of assets transferred by pension funds (ca. 1.9% of GDP compared with total revenue of ca. 10% of GDP) going to be assigned to cover the expenses of the social insurance fund. In subsequent years they are going to serve solely the purpose of reducing public debt.

[83] The fixed exchange rate regime against the euro did not guarantee, however, full insurance against changes in currency exchange rates. In 2010, there was a serious concern about the devaluation of the currency exchange rate.

The foreign currency market in Hungary

In the case of Hungary it seems that situation on the FX loans market constitutes a threat both for the vast number of household consumption and for the financial sector stability. Foreign currency loans became very popular after 2004, when the access to them became easier and their interest rates were markedly lower than in the case of loans granted in the domestic currency. In the case of Hungary, the share of loans in foreign currencies increased from less than 30% in 2004 to more than 60% of total loans in 2008. This was primarily attributable to the rising popularity of foreign currency housing loans. In 2004 nearly all long-term loans for households were granted in forint (almost 99% of total volume) and till 2010 already almost 2/3 of all loans for households granted for a period of over 1 year were was in foreign currency, primarily in Swiss franc.
The outbreak of the global financial crisis in Hungary led to a rapid and very strong depreciation of the forint. In the period from July 2008 to March 2009, the forint depreciated by 36% against the euro and by 45% against the Swiss franc. It led to a significant increase in the cost of foreign currency loans, which primarily affected households burdened with a mortgage loan. In tandem with a worsening situation on the labour market this led to households having ever bigger problems with loan repayment, particularly in the case of foreign currency mortgage loans. In April and May 2011 the Swiss franc exchange rate again visibly strengthened against the majority of currencies in the world, including the forint. The CHF/HUF exchange rate in the course of less than two months weakened by almost 10%, which again increased the burden for holders of loans in this currency. In the period from 2009 Q1 to 2011 Q1 the share of non-performing loans for households (90 or more days of delay in repayment) markedly increased from 4% to over 10%. An even larger increase took place in the case of irregular housing loans granted in foreign currencies, whose share in total volume increased from 2.5% to 7% in the corresponding period. Such a big increase in NPL value began to constitute a serious risk for the stability of the financial sector in Hungary.

The share of non-performing loans in Hungary (in %) i and CHF/HUF exchange rate in 2009-2011



Source: MNB

Hungarian programme of changes in the functioning of the foreign currency loan market.

Following electoral victory in parliamentary elections in April 2010, Viktor Orbán's government introduced a number of regulation aimed at protecting credit takers, in particular households indebted in foreign currency. The 2010 saw the introduction of a ban on granting new loans in foreign currency to households, as well as a possibility of earlier loan repayment without additional fees, a possibility of prolonging the period of loan repayment by 5 years and the limitation on foreclosures.
At the end of May 2011, the Hungarian government, this time in agreement with the representatives of the banking sector decided to put into force as of 1 July 2011 **a programme of assistance to loan takers indebted in foreign currency.** This programme involved:

- **The establishment of a fixed exchange rate at which liabilities in foreign currencies will be repaid**, running below the market rate (180 CHF/HUF, 250 EUR/HUF. 2 JPY/HUF). The remaining part of liabilities will be changed into a forint loan, which interest rate will be set in relation to the BUBOR interest rate and its repayment postponed till 1 January 2015. Participation in the programme is voluntary. Applications will be admitted till the end of 2011, and the programme itself will end in 2014.

- **Gradual withdrawal from the ban on foreclosures by banks as a result of failure to repay mortgage loans.** Since 1 July 2011 banks will be able to sell seized real estate, but only those, whose value exceeds HUF 30 mn and the loan taker owes banks more than HUF 20 mn if the payment being overdue more than 90 days. Since 2011 Q4, auctions of all seized real estate is going to be allowed. However, quota restrictions will be introduced. In 2011, a maximum of 2% of the seized real estate will be allowed to be put to auction. This quota is going to be raised by 1 pp. per year and reach 5% in 2014.
- **Creation of an institution aiming to assist debtors in particularly difficult situation (*National Asset Management Company*).** This assistance is going to be carried out in two directions. First, the institution is going to assist the programme of building cheap housing for less affluent citizens. Secondly, flats threatened by seizure are going to be taken over by this institution and then rented to the occupants.
- **Partial cancelling of the ban on granting mortgage loans in foreign currency introduced in 2010.** Present regulations allow loans in euro, but they are accessible to a very restricted pool of clients. In order to become eligible for such a loan, debtor must receive his/her remuneration in euro and their income must exceed 15-fold the minimum national wage.
- **Introduction of subsidies for debtors who decide to move into a cheaper dwelling.** The maximum period for subsidies is going to be 5 years. In the first year the maximum interest rate of a new loan is going to amount to 3.5% and decrease by 0.5 pp. in every subsequent year.

Despite good reception, this plan does not seem to permanently solve the problem of foreign currency loans in Hungary. It seems that risks related to the insolvency of Hungarian households have only been postponed and will be faced again in 2015. At the same time this programme involves additional costs for the general government, which at present is particularly important, as Hungary is forced to carry out a vast fiscal consolidation. On the other hand, economic growth and household financial condition forecasts for Hungary indicate a marked improvement in the coming years, which suggests that the problem of FX denominated debt in 2015 may constitute a lesser risk for the financial sector and the whole economy than it is now.

STATISTICAL ANNEX

1. National accounts

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

	2009	2010	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	1.7	3.8	3.0	3.4	4.2	4.5	4.4
Czech Republic	-4.1	2.3	1.2	2.9	2.3	3.0	3.1
Slovakia	-4.7	4.0	4.7	4.2	3.8	3.5	3.5
Slovenia	-8.2	1.0	-0.3	1.3	1.4	1.9	2.1
Hungary	-6.3	1.2	0.1	1.0	1.7	1.9	2.5
Estonia	-14.1	3.1	-2.6	3.1	5.0	6.6	11.1
Lithuania	-14.8	-0.3	-2.0	1.0	1.2	4.8	6.9
Latvia	-18.0	1.3	-6.1	-2.6	2.8	3.6	3.5
Bulgaria	-5.0	0.2	-4.8	1.0	0.3	3.1	1.5
Romania	-7.1	-1.3	-2.2	-0.4	-2.2	-0.6	1.7
EU-15	-4.3	1.7	0.7	2.0	2.2	2.1	2.4

Source: Eurostat, CSOs

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

	2009	2010	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	2.3	3.2	2.2	3.2	3.4	4.0	3.9
Czech Republic	-0.2	0.2	-0.4	-0.1	-0.5	0.8	-0.5
Slovakia	-0.7	-0.3	-0.1	-1.4	-0.3	0.5	-0.1
Slovenia	-1.4	0.7	-0.9	0.1	2.0	1.6	1.2
Hungary	-7.5	-2.1	-3.7	-5.0	0.8	-0.4	-0.8
Estonia	-18.5	-1.9	-7.7	-3.3	1.0	2.6	7.9
Lithuania	-16.8	-0.1	-8.9	-8.2	-2.7	1.7	5.5
Latvia	-24.0	-4.5	-6.2	-2.4	2.9	5.2	3.6
Bulgaria	-6.3	-1.2	-4.6	1.7	-1.1	1.1	-1.5
Romania	-10.5	-1.7	-4.4	-1.0	-1.1	-1.7	-1.7

Source: Eurostat, CSOs

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

	2009	2010	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	-0.3	-2.0	-11.4	-0.4	1.5	1.6	6.0
Czech Republic	-9.2	-3.1	-7.8	-4.7	-0.2	-0.1	3.7
Slovakia	-10.5	3.6	-3.4	1.8	4.8	10.6	1.2
Slovenia	-21.6	-7.1	-10.5	-3.8	-8.7	-5.8	-6.1
Hungary	-6.5	-5.6	-4.8	-4.5	-2.6	-9.1	-1.6
Estonia	-34.4	-9.2	-20.3	-17.1	-10.3	11.9	14.7
Lithuania	-39.1	-19.5	-30.0	-5.5	15.0	13.9	41.0
Latvia	-37.3	0.0	-44.4	-35.9	0.3	-1.8	28.4
Bulgaria	-26.9	-16.5	-22.1	-21.9	-27.2	3.2	-12.4
Romania	-25.3	-13.1	-28.3	-7.7	-15.5	-4.7	-2.2
EU-15	-12.2	-0.4	-4.8	-0.1	1.4	2.1	3.3

Source: Eurostat, CSOs

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

	2009	2010	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	-9.1	10.2	10.1	14.9	8.7	7.0	5.9
Czech Republic	-10.8	18.0	18.4	21.0	15.9	17.7	16.3
Slovakia	-16.5	16.4	18.3	16.1	17.3	14.3	15.8
Slovenia	-15.6	7.7	5.6	10.4	8.2	6.6	10.6
Hungary	-9.1	14.1	15.5	15.8	13.9	11.7	14.4
Estonia	-11.2	21.7	6.1	18.0	24.0	36.5	42.2
Lithuania	-14.3	10.3	4.9	21.1	19.4	22.9	21.8
Latvia	-15.5	17.4	3.8	7.5	15.5	13.8	14.7
Bulgaria	-9.8	16.2	6.9	16.3	22.9	15.8	25.8
Romania	-5.5	13.1	8.4	15.8	11.3	17.1	23.6
EU-15	-12.6	10.2	6.2	12.1	11.5	10.7	9.9

Source: Eurostat, CSOs

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

	2009	2010	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	-14.3	10.7	7.5	17.9	9.3	11.6	6.2
Czech Republic	-10.6	18.0	15.3	20.0	18.6	17.9	13.9
Slovakia	-17.6	14.9	10.9	16.0	19.2	13.5	11.3
Slovenia	-17.9	6.7	4.0	10.4	5.2	7.0	11.1
Hungary	-15.4	12.0	10.4	14.4	13.0	10.3	14.4
Estonia	-26.8	21.0	1.8	23.0	29.0	30.0	41.8
Lithuania	-29.4	8.6	3.4	15.9	19.6	31.2	27.2
Latvia	-35.5	17.9	-3.0	7.1	12.8	16.7	20.7
Bulgaria	-22.3	4.5	-1.5	2.9	5.3	10.7	10.0
Romania	-20.6	11.6	7.8	18.5	7.8	12.2	15.4
EU-15	-11.7	9.1	4.1	11.2	10.6	10.6	8.2

Source: Eurostat, CSOs

2. Indices of business cycle and economic activity

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

	2009	2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	-3.5	10.7	11.0	8.6	9.4	5.2	9.1	8.7
Czech Republic	-12.8	9.8	9.9	12.6	12.3	8.8	7.7	
Slovakia	-13.1	18.9	20.0	19.0	11.0	6.8	8.3	
Slovenia	-17.1	6.4	10.9	12.1	7.2	7.6	6.8	
Hungary	-17.3	6.5	15.2	17.9	12.9	13.6	7.9	9.3
Estonia	-25.6	20.0	35.1	29.5	32.1	33.6	31.8	
Lithuania	-14.4	13.9	16.9	7.6	10.7	10.3	13.5	
Latvia	-15.7	10.2	5.9	10.6	14.6	9.3	9.7	
Bulgaria	-18.2	2.0	5.7	7.7	15.9	6.7	9.0	
Romania	-5.7	5.6	8.6	10.5	12.2	7.0	6.3	

Source: Eurostat

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

	2009	2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	3.0	6.2	13.4	2.5	3.0	-0.8	6.5	0.8
Czech Republic	-1.5	-1.1	-2.8	1.2	2.3	0.4	2.8	
Slovakia	-10.2	-2.2	-2.8	-0.4	-0.3	-3.4	-0.2	-2.7
Slovenia	-10.3	-0.3	-0.6	3.3	5.8	0.9	1.6	1.8
Hungary	-5.1	-2.3	-1.0	-0.3	-0.5	-1.2	-1.2	
Estonia	-18.3	-0.5	7.5	-2.0	2.4	4.2	3.3	1.9
Lithuania	-21.3	-6.7	1.8	3.8	7.1	5.7	7.5	5.4
Latvia	-27.2	-2.2	7.7	0.6	3.7	1.4	-1.1	0.8
Bulgaria	-8.6	-7.0	-3.7	-0.8	0.2	0.2	0.9	1.2
Romania	-10.0	-5.8	-9.2	-6.2	-4.7	-6.5	-6.2	

Source: Eurostat

Table 8 DG ECFIN consumer sentiment index

	2009	2010	01.2011	02.2011	03.2011	04.2011	05.2011	06.2011
Poland	-26.2	-18.8	-21.0	-18.9	-24.3	-26.7	-22.0	-22.9
Czech Republic	-16.6	-10.5	-12.4	-13.3	-19.6	-18.0	-20.1	-20.2
Slovakia	-35.4	-20.4	-27.5	-23.5	-29.9	-28.4	-23.1	-25.7
Slovenia	-29.6	-24.1	-23.3	-26.3	-25.7	-26.0	-25.1	-23.6
Hungary	-59.3	-29.4	-26.9	-28.5	-37.8	-36.1	-36.6	-38.8
Estonia	-26.3	-6.7	0.7	-0.7	0.3	-1.6	-2.5	-2.1
Lithuania	-49.1	-32.4	-20.9	-22.7	-21.0	-18.3	-15.6	-16.0
Latvia	-50.1	-29.7	-23.2	-24.4	-25.3	-29.7	-26.2	-21.2
Bulgaria	-44.6	-40.6	-34.4	-36.3	-43.1	-40.9	-39.7	-40.1
Romania	-44.8	-54.6	-48.7	-46.3	-45.3	-44.5	-42.6	-40.7

Source: EC

Table 9. DG ECFIN business sentiment index

	2009	2010	01.2011	02.2011	03.2011	04.2011	05.2011	06.2011
Poland	-24.1	-13.0	-12.8	-9.1	-10.7	-9.7	-11.2	-12.3
Czech Republic	-22.8	3.5	16.6	13.0	10.0	7.5	3.7	3.2
Slovakia	-17.9	1.9	17.6	10.7	4.4	9.4	7.2	-9.5
Slovenia	-25.6	0.0	9.0	7.8	6.2	6.6	5.2	1.5
Hungary	-23.3	-1.9	6.7	8.1	5.2	9.8	0.4	1.8
Estonia	-28.0	0.5	10.9	11.3	11.7	10.0	9.0	10.6
Lithuania	-33.5	-13.1	-5.2	-6.0	-3.1	2.1	0.1	3.6
Latvia	-27.9	-7.5	-5.9	-3.0	-2.8	-3.0	-3.8	-5.2
Bulgaria	-10.8	-9.1	-4.1	-3.8	-4.5	-3.7	-5.0	-4.2
Romania	-13.9	-8.3	-3.1	0.2	2.7	0.1	-1.8	-2.0

Source: EC

Table 10. PMI manufacturing index

	2009	2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	45.6	53.5	57.3	58.4	60.5	59.8	58.6	59.0
Czech Republic	42.5	56.8	55.6	54.1	54.7	56.9	53.8	56.7
Hungary	45.3	52.8	55.9	56.3	55.6	53.8	54.8	54.4

Source: EcoWin Economic

3. Prices

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	2.8	2.7	3.1	3.6	3.6	4.3	4.5	5.0
Czech Republic	2.0	2.0	2.3	1.7	1.8	1.7	1.6	2.0
Slovakia	1.0	1.0	1.3	3.0	3.3	3.6	3.7	4.0
Slovenia	1.9	1.4	1.9	1.8	1.4	1.9	1.7	2.2
Hungary	4.2	4.2	4.7	4.0	4.1	4.5	4.7	3.9
Estonia	4.7	5.3	5.7	5.3	8.0	10.3	14.0	12.8
Lithuania	2.7	2.7	3.8	2.9	3.1	3.8	4.4	5.0
Latvia	1.0	1.9	2.5	3.7	4.0	4.2	4.5	5.0
Bulgaria	3.9	4.6	4.5	4.5	5.2	5.6	4.6	4.8
Romania	7.9	7.7	8.0	7.0	7.6	8.0	8.3	8.4

Source: CSOs

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	5.8	6.1	7.2	7.3	8.4	9.6	9.4	
Czech Republic	2.6	2.7	3.7	4.6	5.4	6.3	6.3	6.1
Slovakia	-1.1	-1.1	-0.8	1.9	3.4	3.3	3.1	3.2
Slovenia	3.1	3.2	3.5	4.0	4.8	4.8	5.0	3.6
Hungary	10.0	10.7	10.9	9.6	9.2	8.7	6.4	
Estonia	3.5	4.5	4.7	4.7	4.3	5.1	6.0	5.9
Lithuania	8.6	9.0	9.7	10.0	9.4	10.3	9.8	9.9
Latvia	4.4	6.2	5.8	7.4	7.4	7.7	9.4	9.7
Bulgaria	10.1	11.1	12.0	11.1	12.5	12.1	10.7	
Romania	6.9	7.4	8.4	8.8	9.0	9.5	8.8	

Source: CSOs

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	2.6	2.6	2.9	3.5	3.3	4.0	4.1	4.3
Czech Republic	1.8	1.9	2.3	1.9	1.9	1.9	1.6	2.0
Slovakia	1.0	1.0	1.3	3.2	3.5	3.8	3.9	4.2
Slovenia	2.1	1.6	2.2	2.3	2.0	2.4	2.0	2.4
Hungary	4.3	4.0	4.6	4.0	4.2	4.6	4.4	3.9
Estonia	4.5	5.0	5.4	5.1	5.5	5.1	5.4	5.5
Lithuania	2.6	2.5	3.6	2.8	3.0	3.7	4.4	5.0
Latvia	0.9	1.7	2.4	3.5	3.8	4.1	4.3	4.8
Bulgaria	3.6	4.0	4.4	4.3	4.6	4.6	3.3	3.4
Romania	7.9	7.7	7.9	7.0	7.6	8.0	8.4	8.5

Source: Eurostat

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	6.2	5.4	4.4	5.9	5.6	6.5	6.0	7.2
Czech Republic	5.5	7.5	8.7	4.8	4.8	1.5	0.5	3.1
Slovakia	6.9	7.7	9.8	8.4	9.6	8.8	7.9	8.3
Slovenia	4.1	5.0	5.1	7.8	5.9	6.1	6.4	10.5
Hungary	11.9	11.8	13.0	11.5	11.3	9.2	9.5	6.1
Estonia	7.4	11.0	12.4	8.8	12.4	8.5	8.3	10.3
Lithuania	1.9	3.0	4.2	3.7	6.4	6.5	8.0	9.0
Latvia	3.9	6.2	8.5	6.4	7.5	5.5	5.7	6.2
Bulgaria	2.7	3.3	1.1	0.4	-0.5	1.2	2.4	3.0
Romania	7.5	8.1	8.5	9.8	12.1	13.3	14.8	14.8

Source: Eurostat

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	3.9	4.2	4.2	4.8	5.3	6.2	6.4	6.6
Czech Republic	3.1	3.7	4.1	3.7	3.9	4.6	4.6	6.2
Slovakia	3.2	2.6	2.6	3.5	3.4	4.7	5.0	5.8
Slovenia	3.2	2.8	3.2	3.7	5.0	4.8	4.4	5.0
Hungary	3.8	4.1	4.1	3.2	4.3	6.3	6.6	6.5
Estonia	8.7	9.6	9.4	9.5	10.0	11.4	12.4	11.7
Lithuania	5.6	4.3	5.6	5.8	5.8	6.7	7.5	8.3
Latvia	3.5	5.3	5.5	7.3	8.2	8.6	9.4	10.7
Bulgaria	11.1	12.0	12.2	12.5	13.4	13.5	7.3	7.4
Romania	11.8	10.8	10.2	7.0	8.1	8.8	9.6	10.2

Source: Eurostat

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	6.2	5.7	7.8	9.6	8.2	8.7	9.1	8.6
Czech Republic	5.4	4.7	6.5	7.4	7.1	7.0	6.1	5.8
Slovakia	-1.7	-1.8	-1.2	9.2	10.3	10.1	9.8	9.5
Slovenia	14.0	10.3	12.6	12.6	12.3	11.4	10.0	8.6
Hungary	12.1	9.3	12.5	10.5	11.6	11.6	9.1	7.0
Estonia	10.3	10.7	12.1	8.5	8.6	7.5	6.0	5.1
Lithuania	16.9	16.1	19.7	12.8	11.3	11.9	11.3	11.3
Latvia	10.1	10.3	13.0	15.8	14.6	15.2	13.5	13.0
Bulgaria	10.3	11.2	14.3	12.9	13.6	12.0	9.1	9.0
Romania	9.5	9.6	11.2	9.6	9.5	9.7	11.0	10.9

Source: Eurostat

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	0.9	0.7	0.9	1.1	1.2	1.7	1.8	2.0
Czech Republic	0.1	-0.1	0.1	-0.3	-0.3	-0.3	-0.3	-0.4
Slovakia	0.3	0.4	0.5	1.0	1.0	1.3	1.6	1.9
Slovenia	-0.8	-0.9	-0.6	-0.9	-1.4	-0.6	-0.8	-0.5
Hungary	1.5	1.4	1.6	1.6	1.1	1.4	1.6	1.7
Estonia	1.2	1.2	1.3	2.1	2.0	1.7	2.2	2.6
Lithuania	-2.1	-1.9	-1.5	-1.4	-1.3	-0.5	0.1	0.7
Latvia	-3.0	-2.5	-2.6	-1.6	-1.3	-0.8	-0.3	0.0
Bulgaria	0.0	0.1	0.4	0.5	0.7	0.7	0.7	0.8
Romania	4.7	4.7	4.8	4.7	4.6	4.5	3.8	3.7

Source: Eurostat

4. Balance of payments

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	-5.1	-4.4	-3.9	-3.8	-3.8	-4.3	-4.5	-4.7
Czech Republic	-2.6	-3.6	-3.2	-3.0	-2.5	-3.9	-3.8	-3.4
Slovakia	-5.1	-3.8	-2.9	-2.3	-2.3	-2.8	-3.0	0.4
Slovenia	-4.7	-3.5	-1.5	-0.9	-1.3	-0.8	-1.1	-1.1
Hungary	-5.1	-2.4	0.4	1.5	1.9	1.9	2.1	1.4
Estonia	-2.9	0.8	3.7	4.1	3.8	3.9	3.5	3.0
Lithuania	-4.4	-0.3	4.3	4.5	5.3	4.0	1.8	1.5
Latvia	-2.4	3.3	8.6	10.6	8.6	6.5	3.6	2.0
Bulgaria	-17.7	-14.2	-8.9	-6.9	-4.4	-1.2	-1.0	1.1
Romania	-7.1	-5.1	-4.2	-5.1	-5.3	-4.8	-4.1	-3.3

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	-2705	-2958	-4489	-2174	-3020	-4987	-5671	-3364
Goods	-1108	-1534	-1632	-1285	-1800	-2283	-3236	-1899
Services	875	726	1055	581	774	517	754	783
Income	-3362	-2753	-3370	-2708	-3261	-3589	-3072	-2968
Current transfers	890	603	-542	1238	1267	368	-117	720
Capital account	1018	451	1729	1265	1064	1302	2859	1636
Financial account	3946	11212	6861	9379	5448	11740	1943	11870
FDI	318	2875	1413	3159	109	-217	-607	1713
Portfolio investment	3073	5114	2973	6691	3222	6984	2234	1770
Other investment	707	3106	2509	-356	2139	4988	585	8476

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	-2016	-1601	-868	248	-1328	-3642	-843	811
Goods	1041	690	554	1113	853	-110	246	1284
Services	588	646	660	621	878	526	582	666
Income	-3635	-2532	-1894	-1507	-3217	-3870	-1613	-1180
Current transfers	-10	-404	-188	22	158	-188	-58	40
Capital account	175	229	599	85	379	585	304	11
Financial account	1734	1209	3063	-737	864	6148	1046	-957
FDI	339	-669	1129	1183	761	2819	-939	545
Portfolio investment	2782	936	2375	527	2254	3117	341	-1833
Other investment	-1247	969	-459	-2421	-2133	243	1734	242

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	-269	-523	-480	-205	-287	-837	-660	2078
Goods	385	255	570	151	398	-171	-83	-62
Services	-369	-222	-282	-167	-260	-188	-124	668
Income	-196	-396	-502	-237	-354	-243	-304	872
Current transfers	-89	-161	-266	49	-72	-235	-148	600
Capital account	225	176	282	215	177	479	345	-345
Financial account	856	237	1215	-213	-891	445	334	326
FDI	-487	-437	392	235	252	-357	-346	216
Portfolio investment	-814	-791	452	-972	-963	-344	983	1296
Other investment	2157	1465	371	524	-181	1146	-303	-1186

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	64	-235	-51	-107	-78	-64	-160	-87
Goods	-29	-228	-286	-135	-204	-174	-461	-283
Services	311	296	269	234	300	261	263	307
Income	-200	-241	-112	-152	-130	-158	-157	-162
Current transfers	-18	-62	79	-53	-43	7	194	52
Capital account	41	-4	-42	46	2	16	-57	-7
Financial account	-98	134	214	44	256	189	73	238
FDI	-415	-46	-81	-39	63	32	443	90
Portfolio investment	1151	2293	307	1106	504	-48	388	2584
Other investment	-891	-2112	-29	-1063	-195	201	-759	-2446

Source: Eurostat, central banks, own calculations

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
Current account	-549	236	417	228	600	627	439	366

Goods	441	1011	829	1089	1252	1223	914	1286
Services	90	354	603	303	612	627	754	413
Income	-1027	-1251	-1195	-1275	-1217	-1458	-1350	-1415
Current transfers	-53	122	179	111	-47	236	121	82
Capital account	241	378	308	183	452	389	439	509
Financial account	4128	-1983	2629	-211	2471	172	-1557	222
FDI	544	-1365	-357	735	-385	-354	196	1123
Portfolio investment	-2940	-551	2903	-2085	2515	-750	-950	-201
Other investment	6523	-68	83	1139	341	1276	-803	-700

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	120	233	209	6	74	264	169	-63
Goods	-86	-115	-155	-131	-128	-23	31	-117
Services	393	400	321	235	347	444	287	209
Income	-213	-113	-92	-110	-204	-196	-296	-206
Current transfers	26	60	135	11	59	39	147	52
Capital account	54	122	237	67	76	93	283	143
Financial account	-22	-624	-113	-174	53	-841	-685	-72
FDI	-169	-135	503	200	305	152	405	232
Portfolio investment	-376	-150	-903	31	-289	-224	41	183
Other investment	502	-356	321	-408	23	-785	-1130	-456

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	98	254	806	16	321	-84	254	-76
Goods	-263	-253	-129	-279	-266	-394	-242	-388
Services	86	135	174	192	220	294	274	111
Income	-23	52	422	-76	-104	-244	-259	-195
Current transfers	297	320	338	179	471	260	481	396
Capital account	178	265	206	179	202	87	271	171
Financial account	-353	-467	-1068	-208	-512	-11	-518	-127
FDI	16	-95	-124	-20	-109	451	57	60
Portfolio investment	6	65	642	1338	70	216	-217	-349
Other investment	-212	-445	-1559	-1411	-613	-311	-110	160

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	651	412	486	348	260	52	-16	75
Goods	-300	-323	-212	-272	-245	-333	-310	-305
Services	281	274	277	257	296	291	269	267
Income	434	323	253	204	48	-31	-176	-24
Current transfers	236	137	169	160	161	126	202	136
Capital account	128	80	103	137	63	96	55	5
Financial account	-905	-531	-563	-512	-258	-218	28	-76
FDI	-98	137	27	-147	71	108	218	236
Portfolio investment	56	-40	61	60	39	-65	-174	-304
Other investment	-1356	1008	-458	301	-471	116	-127	-388

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	-1191	249	-902	-554	-308	1343	-837	210
Goods	-1257	-856	-905	-568	-786	-118	-941	53
Services	213	1140	-9	7	380	1447	68	141
Income	-468	-238	-199	-379	-349	-395	-270	-330
Current transfers	322	204	211	386	447	409	305	347
Capital account	121	76	97	62	-90	178	140	13
Financial account	524	189	509	145	534	-770	474	-263
FDI	433	368	1061	24	420	443	573	-80
Portfolio investment	-114	39	7	-145	-316	-47	-153	-189
Other investment	332	-386	-130	-512	52	-433	119	-649

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Current account	-1849	-946	-1722	-1544	-2101	-481	-843	-678

Goods	-1732	-1693	-1907	-1287	-1900	-1216	-1502	-537
Services	15	-154	-158	-279	-224	-112	-21	-264
Income	-1053	-261	-479	-412	-582	-427	-422	-603
Current transfers	49	223	351	49	36	53	79	97
Capital account	921	1162	822	434	605	1275	1102	724
Financial account	1266	1728	1159	1017	3014	341	1177	1650
FDI	1135	743	79	453	695	1008	394	446
Portfolio investment	-32	324	268	1319	-109	-472	398	440
Other investment	1988	1886	607	2410	1059	1831	46	1909

Source: Eurostat, central banks, own calculations

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	26.2	27.6	29.1	31.4	34.9	29.8	30.2	29.7
Czech Republic	45.4	46.7	46.6	46.8	46.0	45.8	44.5	42.2
Slovakia	1.7	2.5	2.8	2.9	3.3	3.1	3.3	3.1
Slovenia	1.4	1.9	1.9	1.8	2.0	1.8	2.0	1.8
Hungary	20.5	23.1	22.5	23.8	24.8	24.4	24.5	25.7
Estonia	14.9	13.7	15.6	15.0	15.8	12.9	11.1	0.0
Lithuania	19.3	19.8	19.8	19.8	19.6	21.7	21.9	
Latvia	10.0	15.7	16.4	19.1	19.4	21.2	19.4	18.2
Bulgaria	32.1	33.5	34.3	32.8	32.6	35.0	35.4	33.7
Romania	37.4	37.8	38.0	40.2	39.9	40.1	39.5	38.7

Source: Eurostat, central banks, own calculations

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

	2006	2007	2008	2009	2010	06.2011
Poland	BBB+	A-	A-	A-	A-	A-
Poland	A	A	A+	A+	A+	A+
Czech Republic	A	A	A+	A+	A+	A+
Slovakia	AA	AA	AA	AA	AA	AA
Slovenia	BBB+	BBB+	BBB	BBB	BBB-	BBB-
Hungary	A	A	A-	BBB+	A	A
Estonia	A	A	BBB+	BBB	BBB	BBB
Lithuania	A-	BBB+	BBB-	BB+	BB+	BBB-
Latvia	BBB	BBB	BBB-	BBB-	BBB-	BBB-
Bulgaria	BBB	BBB	BB+	BB+	BB+	BB+

Source: FitchRatings

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

	2006	2007	2008	2009	2010	06.2011
Poland	A	A	A	A	A	A
Czech Republic	A+	A+	AA-	AA-	AA-	AA-
Slovakia	A+	A+	A+	A+	A+	A+
Slovenia	AA	AA	AA	AA	AA	AA
Hungary	A-	A-	BBB+	BBB+	BBB	BBB
Estonia	A+	A+	A	A-	A	A
Lithuania	A+	A+	A-	BBB+	BBB+	BBB+
Latvia	A	A-	BBB	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)

	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011	06.2011
Poland	3.50	3.50	3.75	3.75	3.75	4.00	4.25	4.50
Czech Republic	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Hungary	5.50	5.75	6.00	6.00	6.00	6.00	6.00	6.00
Romania	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Euro area	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25

Source: Central Banks, EcoWin Financial

Table 33. 3m interbank rates (average)

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	3.8	3.9	3.9	4.0	4.1	4.2	4.3	4.4
Czech Republic	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Slovakia	1.0	1.0	1.0	1.1	1.1	1.2	1.4	1.4
Slovenia	1.0	1.0	1.0	1.0	1.1	1.2	1.3	1.4
Hungary	5.4	5.4	5.7	5.9	6.1	6.1	6.1	6.1
Estonia	1.1	1.1	1.1	1.1	1.1	1.1		
Lithuania	1.6	1.6	1.6	1.4	1.4	1.4	1.5	1.7
Latvia	1.2	1.0	0.8	0.8	0.9	0.9	0.8	0.8
Bulgaria	4.0	4.0	3.9	3.9	3.9	3.9	3.8	3.8
Romania	6.7	6.6	6.3	5.3	5.7	6.1	5.7	5.5

Source: EcoWin Financial

Table 34. Exchange rates against EUR (average)

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	3.95	3.95	3.99	3.88	3.92	4.01	3.96	3.94
Czech Republic	24.51	24.62	25.13	24.39	24.26	24.37	24.24	24.36
Hungary	273.72	275.52	277.24	275.01	270.86	270.63	264.94	266.91
Latvia	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	4.29	4.29	4.26	4.24	4.16	4.09	4.11

Source: Eurostat

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	-6.3	-5.0	-3.7	-4.5	-2.1	3.3	2.3	-3.0
Czech Republic	-5.3	-4.6	-3.6	-6.6	-6.5	-4.4	-4.1	-4.9
Hungary	2.0	1.7	1.5	2.1	0.0	2.1	-0.1	-3.5
Romania	-0.1	0.2	1.5	2.9	3.1	1.9	-0.7	-1.6

Source: Eurostat, own calculations

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	3.4	1.7	-0.4	1.3	0.3	-4.0	-2.0	4.3
Czech Republic	2.1	1.0	-0.5	3.4	5.1	4.0	4.6	6.6
Slovakia	-3.2	-3.5	-3.7	-3.3	-2.1	-0.8	0.1	0.6
Slovenia	-2.0	-2.2	-2.4	-2.0	-1.1	-0.4	0.3	0.7
Hungary	-5.4	-5.5	-5.7	-5.6	-1.9	-2.8	0.5	5.1
Estonia	-3.4	-3.6	-4.4	-3.8	-2.5	-1.3	-0.1	0.5
Lithuania	-3.0	-3.1	-3.7	-3.2	-2.0	-0.6	0.5	0.8
Latvia	-2.8	-2.9	-3.7	-2.2	-1.2	-0.6	-0.1	0.1
Bulgaria	-3.2	-3.7	-3.8	-2.6	-1.2	-0.1	1.0	2.0
Romania	-2.8	-3.5	-5.2	-5.4	-4.2	-2.0	1.4	3.1

Source: BIS, own calculations

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

	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011	05.2011
Poland	4.0	2.0	0.0	2.2	1.1	-2.9	-0.9	5.4
Czech Republic	1.5	0.4	-0.9	2.3	4.0	2.4	2.8	5.2
Slovakia	-4.5	-4.7	-4.9	-3.0	-1.6	-0.2	0.7	1.4
Slovenia	-2.2	-3.0	-3.0	-2.7	-2.5	-1.4	-1.1	-0.2
Hungary	-3.9	-4.0	-4.0	-4.6	-0.9	-1.6	1.8	5.7
Estonia	-1.3	-1.1	-1.8	-1.8	-0.1	0.4	1.6	2.2
Lithuania	-3.0	-3.3	-3.1	-3.5	-2.3	-0.5	1.1	1.9
Latvia	-4.5	-3.8	-4.4	-1.9	-0.6	-0.1	0.5	1.1
Bulgaria	-2.3	-2.2	-2.5	-1.2	0.8	2.0	2.1	3.1
Romania	2.0	1.3	-0.4	-1.6	0.1	2.6	6.4	8.1

Source: BIS, own calculations

6. Labour market

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4

Poland	1.3	1.0	0.2	-0.6	-0.8	0.9	1.1	1.1
Czech Republic	-0.4	-1.5	-2.0	-2.3	-2.5	-1.1	-0.2	-0.2
Slovakia	-0.1	-1.1	-4.2	-5.5	-4.5	-2.8	-1.4	0.4
Slovenia	-1.2	-1.6	-3.2	-2.3	0.2	-1.0	-2.7	-2.0
Hungary	-2.1	-1.9	-3.5	-2.6	-1.3	-0.5	1.0	0.6
Estonia	-6.4	-8.8	-10.0	-11.3	-9.8	-7.0	-2.2	2.8
Lithuania	-4.9	-6.8	-7.4	-8.3	-7.4	-6.6	-4.7	-0.8
Latvia	-8.2	-12.1	-13.7	-12.7	-10.9	-4.6	0.6	2.2
Bulgaria	-0.8	-2.0	-3.8	-5.6	-7.6	-6.7	-5.3	-4.7
Romania	-0.6	-0.9	-0.4	-1.7	-0.9	1.3	-0.3	0.7

Source: Eurostat

Table 39. Unemployment rate (in %)

	09.2010	10.2010	11.2010	12.2010	01.2011	02.2011	03.2011	04.2011
Poland	9.6	9.6	9.6	9.5	9.4	9.3	9.3	9.3
Czech Republic	7.1	7.0	7.0	7.2	7.0	7.0	6.9	6.8
Slovakia	14.3	14.3	14.1	14.0	14.0	14.0	14.0	13.9
Slovenia	7.3	7.6	7.7	8.0	8.0	8.1	8.1	8.2
Hungary	11.0	11.1	11.1	11.3	12.1	11.9	11.8	11.6
Estonia	16.0	14.5	14.5	14.5	13.8	13.8	13.8	
Lithuania	18.3	17.3	17.3	17.3				
Latvia	18.3	17.2	17.2	17.2				
Bulgaria	10.6	11.1	11.4	11.4	11.5	11.5	11.4	11.4
Romania	7.3	7.4	7.4	7.4				
EU-15	9.4	9.6	9.5	9.5	9.9	9.8	9.8	9.4

Source: Eurostat

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

	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1
Poland	-18.4	-17.2	-6.1	16.5	14.2	7.3	8.8	4.9
Czech Republic	-3.0	0.1	2.9	4.5	4.9	8.1	7.5	8.4
Slovakia	5.4	3.0	0.6	0.0	-0.2	4.0	3.9	2.6
Slovenia	9.9	4.5	-1.1	3.7	-0.5	-1.1	2.7	2.5
Hungary	-10.4	-11.7	-5.4	13.1	4.6	-2.2	-3.9	0.2
Estonia	-1.2	-4.9	-7.6	-4.8	-2.4	-0.1	1.3	-0.5
Lithuania	-3.7	-7.6	-11.1	-9.4	-6.1	-2.3	1.4	0.9
Latvia	-0.8	-6.8	-12.7	-9.2	-7.0	-2.6	1.3	4.2
Bulgaria	16.1	11.7	9.4	10.4	10.6	11.6	9.3	7.0
Romania	-3.3	-8.8	-8.9	8.4	3.0	-1.8	-1.8	-4.7

Source: Eurostat

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

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
Poland	-14.6	-18.7	-17.9	-9.6	12.5	11.5	3.8	6.1
Czech Republic	2.4	0.5	2.6	5.2	3.4	2.9	6.4	6.1
Slovakia	13.0	9.2	3.7	-0.7	-8.9	-7.3	-1.3	0.9
Slovenia	16.7	17.2	10.8	0.8	0.2	-4.3	-4.7	-1.4
Hungary	-6.5	-4.9	-8.1	-2.9	12.7	3.6	-3.4	-5.9
Estonia	9.9	5.6	0.9	-9.7	-11.8	-11.2	-8.8	-3.4
Lithuania	14.1	9.7	5.4	-4.0	-11.3	-10.8	-10.3	-3.4
Latvia	7.8	-0.2	-8.8	-10.8	-19.9	-13.6	-3.2	-1.3
Bulgaria	21.8	18.6	13.3	12.6	4.7	4.1	6.2	0.9
Romania	8.1	1.5	-7.4	-10.0	1.1	-4.7	-6.7	-7.5

Source: Eurostat, own calculations

7. Public finance

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

	2007	2008	2009	2010	2011f	2012f	2013p	2014p
Poland	-1.9	-3.7	-7.3	-7.9	-5.6	-2.9	-2.5	-2.0

Czech Republic	-0.7	-2.7	-5.9	-4.7	-4.2	-3.5	-2.9	-1.9
Slovakia	-1.8	-2.1	-8.0	-7.9	-4.9	-3.8	-2.9	-2.8
Slovenia	-0.1	-1.8	-6.0	-5.6	-5.5	-3.9	-2.9	-2.0
Hungary	-5.0	-3.7	-4.5	-4.2	2.0	-2.5	-2.2	-1.9
Estonia	2.5	-2.8	-1.7	0.1	-0.4	-2.1	0.1	0.5
Lithuania	-1.0	-3.3	-9.5	-7.1	-5.3	-2.8	-1.8	-0.8
Latvia	-0.3	-4.2	-9.7	-7.7	-4.5	-2.5	-1.9	-1.1
Bulgaria	1.1	1.7	-4.7	-3.2	-2.5	-1.5	-1.0	-1.5
Romania	-2.6	-5.7	-8.5	-6.4	-4.9	-3	-2.6	-2.1
EU-15	-0.8	-2.3	-6.8	-6.4	-4.7	-3.8	-	-

p – CEE- nawest available updates from Convergence/Stability programmes, EU-15 - Spring 2011 EC forecasts
Source: Eurostat, EC

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

	2007	2008	2009	2010	2011f	2012f	2013p	2014p
Poland	45.0	47.1	50.9	55.0	54.9	54.1	52.4	50.8
Czech Republic	29.0	30.0	35.3	38.5	41.4	42.4	42.8	42.0
Slovakia	29.6	27.8	35.4	41.0	44.1	45.3	45.3	45.2
Slovenia	23.1	21.9	35.2	38.0	43.3	45.3	46.2	46.0
Hungary	66.1	72.3	78.4	80.2	75.5	72.1	69.7	66.7
Estonia	3.7	4.6	7.2	6.6	6.0	6.0	5.8	5.6
Lithuania	16.9	15.6	29.5	38.2	38.1	37.9	37.1	35.4
Latvia	9.0	19.7	36.7	44.7	48.3	48.1	49.9	51.9
Bulgaria	17.2	13.7	14.6	16.2	16.4	19.0	17.4	17.1
Romania	12.6	13.4	23.6	30.8	33.3	33.2	32.8	31.9
EU-15	60.7	64.8	76.8	82.9	85.2	86.3	-	-

p – CEE- nawest available updates from Convergence/Stability programmes, EU-15 - Spring 2011 EC forecasts
Source: Eurostat, EC

Table 44. Termin korekty nadmiernego deficytu budżetowego (EDP)

	Year
Poland	2012
Czech Republic	2013
Slovakia	2013
Slovenia	2013
Hungary	2011
Estonia	nie objęta EDP
Lithuania	2012
Latvia	2012
Bulgaria	2011
Romania	2012

Source: EC