National Bank of Poland
Economic Institute
Bureau of World Economy

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

July 2013

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

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General information on the CEE countries in 2011

	Area	Population		GDP (EUR bn)	GDP per capita (EUR)	
	(km2)	thousand of inhabitants	GDP (EUR bn)		current prices	PPP adjusted*
Bulgaria	110 879	7 282	65.7	39 668	5 400	11 600
Croatia	56 594	4 285	75.7	43 904	10 300	15 200
Czech Republic	78 867	10 516	133.3	152 311	14 500	20 100
Estonia	45 227	1 340	29.6	16 998	12 700	16 900
Lithuania	65 300	2 972	45.5	32 864	11 000	16 600
Latvia	64 559	2 018	31.3	22 258	10 900	14 700
Poland	312 685	38 533	123.2	381 214	9 900	16 200
Romania	238 391	21 305	89.4	131 747	6 200	11 800
Slovakia	49 035	5 411	110.3	71 463	13 200	18 400
Slovenia	20 273	2 059	101.6	35 466	17 200	21 000
Hungary	93 028	9 906	106.5	97 674	9 800	16 500

*2011
Source: Eurostat.

Gross domestic product growth rate (seasonally adjusted, constant prices, in %)

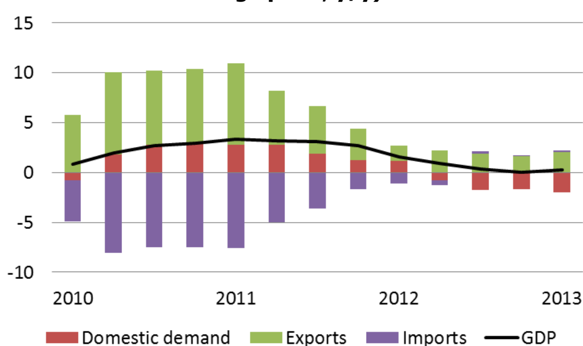
	2012			2013	2011			2013
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	q/q				y/y			
Bulgaria	0.1	0.1	0.1	0.1	0.8	0.7	0.6	0.4
Croatia*	-0.7	-0.6	-0.7	-	-2.1	-2.3	-2.6	-1.5
Czech Republic	-0.5	-0.3	-0.3	-1.1	-1.1	-1.4	-1.6	-2.2
Estonia	0.3	1.4	0.6	-1.0	2.8	3.1	3.0	1.3
Lithuania	0.6	1.5	0.7	1.3	3.1	3.8	3.1	4.1
Latvia	1.4	1.7	1.4	1.4	5.0	5.4	5.8	6.0
Poland	0.1	0.3	0.0	0.1	2.2	1.7	0.7	0.5
Romania	0.9	-0.4	1.0	0.7	1.8	-0.5	1.2	2.2
Slovakia	0.3	0.2	0.1	0.2	2.3	1.9	1.0	0.8
Slovenia	-1.1	-0.6	-1.0	-0.7	-2.3	-2.8	-2.8	-3.3
Hungary	-0.6	0.0	-0.4	0.7	-1.7	-1.8	-2.4	-0.3

*Data y/y for Croatia calculated from series not adjusted seasonally
source: Eurostat.

Summary

The euro area crisis, which deepened in 2012, fiscal consolidation and ongoing deleveraging of the private sector were the main factors of economic slowdown in the Central and Eastern European countries (CEE)[1] last year. The GDP growth rate in the region, which amounted to 3.1% in 2011, slowed down to 0.7% in 2012 and in Q4 was reduced to zero.

GDP and its component in the CEE countries (in percentage point, y/y)



Source: Eurostat

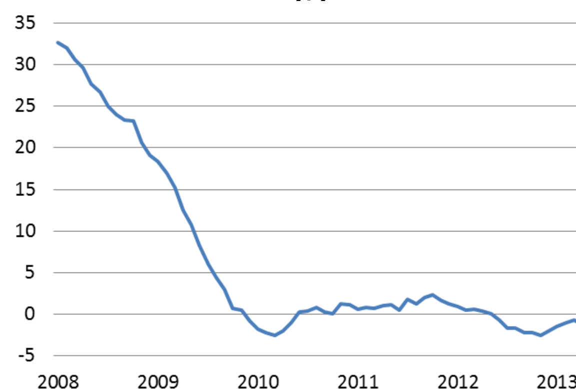
Euro area recession was the main driver of exports slowdown in the CEE region. Exports declined widely across the region, though to a different extent. A relatively small drop in its growth rate took place in the Baltic states, especially in Lithuania and Latvia. These countries offset falling euro area demand with rising sales outside the EU, mainly to the former Soviet Union countries. Slovakian exports driven by the sale of cars, following the best performance in the region in the first half of 2012, slowed markedly in the following quarters, hampered by the flagging automotive production. At the same time, 2012 saw exports in Bulgaria and Romania decline, on the back of a large share of the euro area peripheral countries in their exports.

Export growth in Bulgaria, Poland, Romania, Slovenia and Hungary picked up in 2013 Q1. As implied by product structure of exports, most of the growth stemmed from an upturn in the European automotive sector (driven by increased demand from outside the EU).

The ongoing process of deleveraging of the private sector in the CEE countries curbed domestic demand, both consumption and fixed investment. Lending to the private sector had lost its momentum already in 2008. Its growth rate turned negative in mid-2012. While in previous years lending had been considerably affected by supply-related factors (insufficient resident deposits in the face of foreign capital outflow from the banking sector), in 2012 and 2013, subdued demand for loans from domestic debt-stricken entities became a key factor.

The ongoing fiscal consolidation was another key factor limiting domestic demand growth in the CEE region in recent quarters. It was particularly visible in the Czech Republic, where fiscal consolidation weighed heavily on private consumption, which fell to its lowest level since the onset of transformation. Fiscal consolidation affected growth also in Croatia, Slovenia, Slovakia and Hungary. Consolidation measures scheduled for 2013 and 2014, are set to be less intense (except for Croatia and Slovenia, compelled to bail out the domestic banking sector), which should restrain their negative influence on consumption and investment growth.

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

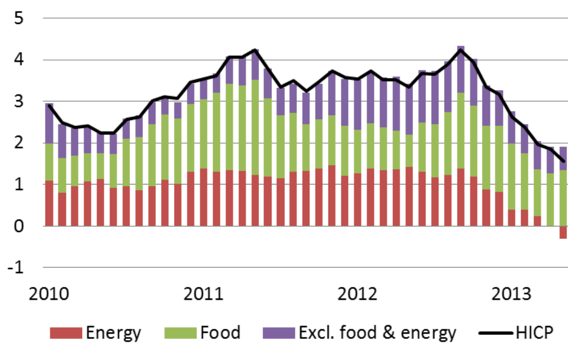


Source: Central Banks

Weak external demand hampered growth in industry in 2012. It was one of the main reasons (apart from the persistent crisis in construction in most of the economies) for worsening conditions in the labour markets. It seems that the slight recovery in manufacturing in the course of the first months of 2013 did not help reverse the negative tendencies in employment.

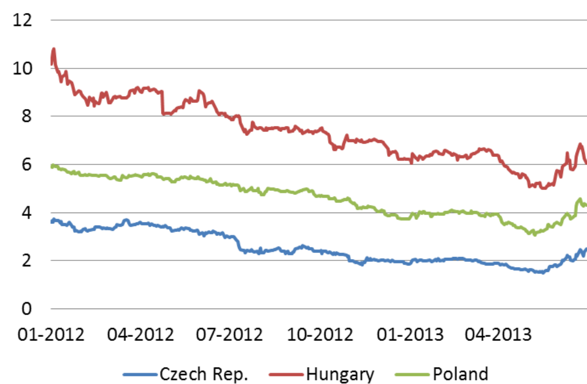
The fall in the prices of energy commodities as well as weak consumer demand in the CEE countries contributed to a marked drop in inflation in the first months of 2013. In May 2013, the weighted average of HICP growth rate for the region amounted to 1.5%, i.e. all-time low. The drop primarily resulted from a marked fall in energy prices growth rate, due to a fall in the prices of energy commodities, but also administrative decisions imposing the reduction of energy prices for private consumers. The declining consumer demand additionally contributed to a fall in core inflation in that period.

[1] Since the report of July 2013, Croatia has been added to the group of economies. Currently, the analysed group includes 11 countries of the Central and Eastern Europe that have joined the EU since 2004.



Source: Central Banks

Stabilisation in the European financial markets, falling risk aversion and major central banks' programmes aimed at increasing liquidity in the financial sector in the second half of 2012, heavily influenced financial assets prices in the CEE countries. Consequently, yields on Treasury bonds in the region fell to their record low at the beginning of 2013 Q2. In June, the situation began to reverse, once the Federal Reserves had indicated the quantitative tapering. Yields on Treasury bonds picked up but still remained below their mid-2012 level. The region's currencies, after a period of appreciation in the second half of 2012, have been depreciating against the major currencies from the beginning of 2013, especially at the end 2013 Q2.



Source: Reuters

The latest growth forecasts for 2013 and 2014 have been revised downwards for the region (like forecasts for almost all economies). Economic stagnation of 2012 is anticipated to continue into 2013. Slow recovery and return to the growth path will take place no sooner than in 2014.

Worsening growth prospects for the euro area, ongoing deleveraging of the private sector and mounting tensions in global financial markets are the factors that will uphold the persistent slowdown in the region's economies. On the other hand, the accommodative monetary policy in the region, as well as anticipated easing of consolidation measures should add to a slow recovery in the CEE countries in 2014.

COUNTRIES OF CENTRAL AND EASTERN EUROPE

The first quarter of 2013 saw a slight acceleration of growth in the CEE countries after a period of economic slowdown in 2012

The slowdown in the CEE economies was already visible at the beginning of 2012. In 2011 the annual GDP growth reached 3.1%, in 2012 it slowed down to 0.7%, and in 2012 Q4 to 0.0%. The downward trend was halted in the first quarter of 2013, when GDP in the CEE region rose by 0.2% y/y. However, the situation was not the same in all of the region's countries. Lithuania, Latvia and Romania saw their GDP growth accelerate. So did Croatia and Hungary, however, their GDPs continued to fall, albeit at a flatter rate than before. In the remaining economies, 2013 Q1 saw GDP growth trending down again. It implied a deepening of the recession for the Czech Republic and Slovenia, which had lasted since the beginning of 2012.

Substantial growth differences were observed across the countries of the region. A relatively strong growth was recorded in Lithuania (4.1% in the 2013 Q1) and in Latvia (6.0%) whereas the Czech Republic, Croatia, Slovenia and Hungary noted a decline in GDP in annual terms (from -0.3% in Hungary to -3.3% in Slovenia).

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

Economic slowdown in the region's countries in 2012 stemmed mainly from the deepening crisis in the euro area. The weakening demand from major trade partner of the region[2] led not only to a weaker exports growth but it also weighed on the activity of the export-oriented industrial sector. 2012 Q1 saw a slight rise in industrial output in the euro area. It paved the way to a revival in the CEE industry and stimulated exports growth. GDP growth picked up on the back of rising exports in the region in 2013 Q1, nevertheless it failed to break the investment slump or to reverse the adverse trends in the labour markets.

The recent quarters have seen continued deleveraging of domestic banks. In 2012, especially in the first half of the year, the banking sectors experienced an outflow of capital from the region's countries to foreign banks (through withdrawal of deposits and repayment of loans), which was one of the reasons for curbing domestic lending. The capital outflow began to slow down in the second half of 2012. Yet, lending in the region continued to stall. This shows that the low credit supply stems also from poor demand for loans.

Deepening slowdown in domestic demand

From the beginning of 2012, the region's countries have seen an ongoing decline in consumption and fixed capital formation growth rates. 2012 Q3 saw the annual growth rate in both categories go down below zero and remain negative for the next two quarters. At the same time, 2012 recorded a reversal of the inventory cycle. In the previous two years inventories had contributed positively to the GDP growth. Since the beginning of 2012 until the 2013 Q1 it had been dragging the GDP downwards.

A decrease in domestic demand in 2012 did not affect all economies in the region to the same degree. A relatively high growth of consumption and investment was recorded in the Baltic states[3], especially in Estonia, where the annual growth in both categories accelerated compared to 2011. A pick-up in domestic demand was also observed in Bulgaria and Romania, where it replaced net exports as the main growth driver. In the remaining countries of the region, domestic demand growth shifted downwards. It was especially marked in Croatia, the Czech Republic, Slovenia and Hungary, where the annual growth rate of individual consumption and fixed capital formation scored a slump below zero, contributing heavily to recessions in these countries.

A fall in demand affected more countries in 2013 Q1. Romania, Estonia and Latvia observed a marked downward shift in fixed investment (Estonia by 11.2% q/q). It meant that Bulgaria was the only country in the region to record investment expansion in annual terms. At the same time, the majority of the region's countries recorded a decline in consumption growth, also in Bulgaria and Romania, where in the course of the previous quarters it had been relatively high. Estonia, Latvia and Lithuania were the only countries of the region posting positive annual growth in private consumption in the first quarter of 2013.

Deleveraging of the private sector continues to drag down domestic demand growth

One of the main factors dampening domestic demand growth is the ongoing deleveraging of the private sector. The annual growth in bank lending to the private sector was negative in CEE countries from mid-2012 to April 2013. It was especially marked in Croatia and Slovenia, where the scale of the decline continued to increase. Lending dropped also in Latvia and Hungary at the beginning of 2013. However, the decline in these countries was smaller than in 2012. In the majority of the region's countries, growth in bank lending to the private sector was still increasing, albeit the oncoming quarters saw the decline in its growth rate. Only Estonia and Lithuania

[2] GDP in the euro area has been persistently trending downwards since the second quarter of 2011 and in the first quarter of 2013, its annual rate fell to -1.0%.

[3] A noticeable decline in investment outlays growth rate was recorded only in Lithuania, however the private consumption continued to grow at the pace of 5% y/y.

noted an increase in lending activity, which had basically stemmed from an exceptionally low base (from the mid-2009 until the end of 2012, all the Baltic states recorded an alarming fall in lending to the private sector). In most of the region's economies, low supply of loans was mainly caused by ailing demand. The supply-related factor associated with outflow of foreign capital from the banking sector (withdrawal of deposits and repayment of loans to foreign banks), which had contributed to weaker lending activity in 2009-2011, started to gradually wane. According to the data of the Bank for International Settlement (BIS), after a period of heavy deleveraging of the banking sector in the CEE countries in 2009-2011 (the amount of Western European bank claims decreased by almost USD 230 billion, i.e. 20% of all claims), in 2012, especially in the second half of the year, the process practically stopped. The Czech Republic, Estonia, Poland and Slovakia again recorded an increase in foreign claims against Western European Banks.

Net exports as the only positive contributor to GDP growth

The deepening economic crisis in the euro area contributed to a marked decline in exports growth in the CEE countries in 2012. Exports growth rate amounted to 2.7% compared to 9.1% in 2011. Relatively high growth was recorded in the Baltic states, especially in Lithuania and in Latvia. This was mainly driven by strong demand from the countries outside the EU (in the case of the Baltic states, basically exports to Russia and to the other CIS countries). Slovak exports posted fast growth in the first half of 2012. Yet, in the second half of 2012, it declined markedly as production and exports of the automotive sector stopped expanding. Exports in Bulgaria and Romania, in turn, shifted downwards comparing to 2011, which stemmed from shrinking demand from the major trading partners (the euro area peripheral countries, and especially Greece, remain the main exports recipients for both these economies).

2013 Q1 recorded a steep rise in exports, which was attributable to the rebound in the industrial sector (mainly in the automotive industry) of the euro area. However, the revival may not be permanent[4].

In spite of a slowdown in exports growth in 2012, the contribution of external trade balance to GDP growth amongst the CEE countries remained positive, or even rose comparing to 2011 (1.5 pp. and 0.9 pp., respectively). It mainly originated from a weak domestic demand, which markedly subdued imports growth. In 2012, it rose only by a mere 0.5%, and in the second half of 2012, it tilted to the downside. In 2013 Q1, the contribution of net exports moved up again (to 2.2 pp.). It was driven not only by the growth in exports but also by deepening imports decline, which clearly confirmed the continued slowdown in domestic demand.

Although in 2012 not all the CEE countries saw a positive contribution of net exports to GDP growth (it remained negative in the countries where the domestic demand was growing relatively fast, such as Bulgaria, Romania and Estonia), the situation was pretty much the same in all the countries of the region in the first quarter of 2013.

Due to weak domestic demand and a reversal of the inventory cycle, net exports was the only category of the national accounts, both in 2012 and at the beginning of 2013, that had a positive contribution to the GDP growth.

Slow improvement in current economic situation indicators

From January to April 2013, retail sales throughout the region went up by 2.5%. Its fall was only observed in the countries most affected by the recession in 2013 Q1, i.e. in the Czech Republic and in Slovenia. The increase was driven, to a large degree, by higher energy consumption (stemming from falling prices). Food sales at the beginning of 2013 practically did not change comparing to 2012 year-end. As for durable goods, a marked rise in sales volume was observed only in Bulgaria and Romania. In the course of January-May 2013, the consumer sentiment indices in the CEE countries were trending slightly upwards. The increase stemmed mainly from weakening inflation whereas the assessment of the future financial conditions of households or in the labour market remained low.

At the beginning of 2013, activity in industry have picked up slightly on the back of already mentioned recovery of the euro area industry. In the course of January-April 2013, the industrial output in the region went up by 1.9%, albeit the situation in the region was not the same. The increase in production was mainly attributable to strong performance in Poland, Romania and Hungary[5], while other economies saw stagnation or even decrease in output (in Bulgaria and the Baltic states). In annual terms, industrial production rose again after a period of decline in the second half of 2012. However, compared to 2010-2011 period, when industrial production grew at a two-digit rate, the increase was much smaller (1.1% in April 2013), stemming mainly from a significant growth in Romania.

Increase in the industrial production in the CEE region and in the euro area has also contributed to a slight improvement of business sentiment. In the majority of countries (except Bulgaria, Czech Republic and Latvia), business confidence index went slightly up, primarily due to a better assessment of the value of the current production and the growing number of new orders.

A lasting revival in the euro area, i.e. most important recipient of the CEE industrial production, seems to be a necessary condition for the industry in the region to continue to grow. True, the previous data provided a nice

[4] The increase of output in the automotive sector was associated with the increased demand for cars by countries outside the EU, especially those exported by Germany and France, while the domestic demand in the euro area countries was still ailing.

[5] In the fourth quarter of 2012, a severe drop in the industrial production of Hungary was still in progress so its increase in the first months of 2013 can be partially explained by the low-base effect.

surprise, however, they concerned only one subsector (the automotive industry). It does not necessarily mean that the entire European industrial sector, both in old and new Member States, has recovered from the crisis, especially amidst deteriorating prospects of global economic growth.

Persisting stagnation in the labour market

The persistently muted consumer sentiment was basically attributable to the situation in the labour markets of the CEE countries. In 2012 in the majority of the region's economies (except the Baltic states) positive signs from the labour markets were hard to find. The number of jobs in Bulgaria, Croatia, Czech Republic, Poland, Slovenia and Slovakia dropped. In the Baltic states, Romania and Hungary, employment rose last year, however, in the latter two it was not coupled with a decline in the unemployment rate. The number of unemployed also moved up in other six countries of the CEE region.

2012 and 2012 Q1 saw employment in the CEE countries drop in almost every sector of economy. The most sizeable drop in employment was registered in the construction and in the real estate intermediation. The slowdown in industry observed in 2012 also had a negative impact on employment, although already the first quarter of 2013 it posted a slight increase in the number of employees as production increased. A similar situation was observed in retail trade where turnover was trending slightly upwards after the decline of the second half of 2012. Public administration, in turn, as well as information technology and telecommunication demonstrated stable employment situation.

Rising unemployment rate was coupled with a steadily growing number of long-term unemployed, which in 2012 also significantly rose in the CEE region (except Estonia, Lithuania and Latvia). Long-term unemployed accounted for half of all unemployed in 2012 Q4 and for over 2/3 in Croatia and Slovakia, countries with the highest unemployment rate.

The period from January to April 2013 saw an improvement in the in the labour market situation in some countries of the region. A decline in the unemployment rate was already observed not only in the Baltic states but also in Hungary and Bulgaria, while in Croatia, Czech Republic and Slovakia the harmonised unemployment rate stayed at 2012 year-end level. Still, all these countries continued to be marked by a relatively high unemployment (from 10.6% in Hungary to 18.1% in Croatia in April 2013). Whereas in other CEE countries, the registered harmonised unemployment rate continued to grow in the course of January-April 2013; in the case of Slovenia it hit a peak of the past 20 years.

The lowest, but still high in comparison to the previous years, unemployment rate was recorded in the Czech Republic and Romania (7.2% and 7.3%, respectively). Croatia and Slovakia registered the highest unemployment rate (18.1% and 14.5%, respectively).

Flagging external demand, a decline in the activity in industry and increasingly dim prospects for domestic demand growth seem to imply that permanent reversal of negative trends in the labour markets is not expected this year. Forecasts of external institutions are still pessimistic. They assume that the unemployment rate in the region might even rise in 2014. It is expected to be the strongest in Croatia and Slovenia on the back of employment cuts in the public sector.

Further increase in unit labour costs despite slower wage growth

In spite of persistent stagnation in the labour markets in the CEE countries in 2012, nominal wage growth remained practically unchanged compared to 2011. The 2012 average for the entire region amounted to 4.2%, compared to 4.3% in 2011. A marked dip in wage growth took place in Poland, Slovenia, Bulgaria, Romania and Hungary. However, except for Poland and Slovenia (the only country in the region recording a decrease in nominal wages in 2012), these were the countries where the wage growth continued to be among the highest in the region. At the same time, rising inflation in 2012 resulted in shrinking real income in some CEE countries. Besides Slovenia, this was the case with Croatia, Czech Republic, Poland, Slovakia and Hungary.

A practically unchanged wage growth rate, coupled with a drop in labour productivity (the scale of economic decline in the region was higher than the drop of employment), boosted unit labour costs (ULC) in the region. It was specifically noticeable in the Czech Republic, Slovenia, and Hungary, the countries struggling with recession, where production decline was not accompanied by any significant drop in wage growth. ULC rose also in the Baltic states, where ULC growth was mainly associated with higher wage growth.

According to EC projections, wage growth in the majority of the CEE countries in 2013 is set to decline. Labour productivity is expected to remain at the same level as in 2012, so that nominal ULC is to go slightly down. Economic growth as well as the average wage growth is anticipated to speed up in 2014, which will set the nominal ULC at 2013 level.

Marked decline in inflation stemming from lower energy prices

Beginning from 2012 Q3, CEE countries have noted a marked fall in inflation. From September 2012 to May 2013, the annual growth in consumer prices throughout the region shifted downwards from 4.2% to 1.5%, posting the lowest level of inflation since the beginning of HICP statistics calculations for the CEE. The drop in HICP inflation took place in all the countries of the region and for similar reasons. It was primarily induced by a fall in energy prices, contributing to inflation decline in the described period by 1.7 pp. In May last year, energy prices had a negative impact on the HICP inflation in the region. On the one hand, the decline stemmed from lower global prices of energy commodities, which mainly

translated into a drop of fuel price growth. On the other, by administrative decisions. Authorities in Hungary (electrical energy) and in Poland (gas) obliged energy suppliers to reduce the prices for retail consumers, which resulted in a decline in energy price growth in 2013 Q1 below zero. Negative energy price growth rate in May 2013 was also observed in Bulgaria, Croatia, Czech Republic, Slovakia, Lithuania and Latvia. There was a less pronounced decline in food price growth. Its contribution to the decline of the HICP inflation growth in the analysed period amounted to 0.4 pp. and was mostly related to processed food, which is more sensitive to change in demand. At the same time, the prices of unprocessed food in many countries went up (the Baltic states, Slovakia, Slovenia, Croatia), despite a relatively good harvests.

Inflation levels in particular CEE economies in the first half of 2013 continued to remain distinctly diversified. In May 2013, the lowest inflation levels were seen in Latvia (-0.2% - the only country in the region experiencing a drop in prices) and Poland (0.5%). Romania in turn, noted the highest inflation (4.4% - the effect of the high growth rate of food prices), followed by Estonia (3.6%).

Apart from the supply-related factors, inflation in the region was curbed by lower core inflation. Slipping consumer sentiment and continuously declining consumption of households combined with the pass-through effect of energy and food prices to other categories of goods and services resulted in a gradual decline in core inflation. After a slight pick-up at the beginning of last year (mainly due to the increase of rates of direct taxes, inter alia, in the Czech Republic and Hungary), from the second half of 2012, core inflation was gradually subsiding in spite of an increase in direct taxes (mainly excise duty on spirits and tobacco products). May 2013 saw core inflation in the region amounting to 1.0%, i.e. two times lower than a year before. It was the lowest level in the last two years. However, not all the countries recorded such a decrease in inflation. At the beginning of 2013, core inflation went up in Croatia and Slovenia, that is, the countries where domestic demand fell at the fastest rate. Yet, it was associated with ongoing fiscal consolidation, inter alia, with indirect tax increase, which led to an increase in most prices of goods and services at that period.

Expected inflation stabilisation

Following the marked decline in inflation in the second half of 2012 and at the beginning of 2013, it should stabilise in the subsequent quarters of 2013. The fact is confirmed by the May figures, when price growth in some countries of the region came to a standstill while Bulgaria, Estonia, Latvia and Slovakia even recorded a rise. It seems that in the subsequent quarters of this year the fall of energy prices should become flatter, even amidst the anticipated further decline in the prices of energy commodities in the world markets. However, the exceptionally long and cold winter in the region's countries, may lead to a sharper increase in food prices, especially those of unprocessed food. At the same time, core inflation throughout the region should remain low as consumption demand in the second half of 2013 is not expected to grow significantly. According to forecasts, in 2014 a mild increase in inflation is expected. It should result from, on the one hand, the low base effects of 2013 and on the other, from the anticipated rebound in the real economy and effects of monetary policy easing in the region. At the same time, the planned consolidation measures, including the indirect tax hikes, should not be as restrictive as in the previous years.

Monetary policy easing

The marked fall in current, as well as projected inflation and ongoing economic slowdown in the CEE economies encouraged authorities to ease monetary policy in some countries of the region. +

It related to the central banks of Poland and Hungary. Since the beginning of 2013, the National Bank of Poland (NBP) has reduced the main interest rate five times - from 4.25% to 2.75%. The interest rate of the Hungarian National Bank (MNB) have been cut from 5.75% to 4.25% in that period (six reductions). The Czech National Bank (CNB) and the National Bank of Romania (BNR) left their rates unchanged in the first half of 2013. However, the CNB already in 2012 used up all its options to stimulate the economy by easing the interest rate policy. In November 2012, the base interest rate of the CNB (*2 week Repo rate*) was reduced to "the technical zero" (0.05%). At the same time, the BNR exercised quantity control of cash by changing the ceiling on the value of one week Repo transactions with commercial banks (from March this year the limit has been totally lifted). The situation in Poland's and Hungary's economies in the first half 2013 implies that further reductions in interest rates, especially in Hungary, are still expected.

The accommodative policy of the central banks of Poland, Hungary and Romania was accompanied by a decline in short-term interest interbank rates. In Poland and in Hungary, the scale of the decline was even bigger than the scale of reductions of central banks' policy rates. It resulted from the increased liquidity of the banking sector due to the effects of activities of central banks in advanced economies targeted at increasing the liquidity in the European and global financial system. In the case of Romania, the decline in the interbank market interest rates in the (to the level lower by over 1 pp. from the interest rate of the central bank) is an outcome of the increased liquidity of the country's banking sector.

Fiscal consolidation continued in 2012

In 2012, according to the spring fiscal notification (April 2013), fiscal imbalance decreased further in almost all of the CEE countries, as a result of implemented consolidation measures. The Czech Republic, Estonia and Hungary, where the general government deficit widened comparing to 2011, were an exception. The increase

stemmed, inter alia, from one-off measures[6]. The most substantial fiscal tightening in 2012 (measured by the change in the general government structural balance[7]) took place in Hungary (3.4 pp. of GDP), Slovenia (2.0 pp. of GDP), Poland and Lithuania (1.7 pp. of GDP). Economic headwinds hampered achievement of the budgetary targets assumed in the Stability/Convergence Programmes updates for 2012. In this situation, the majority of the CEE countries undertook additional adjustment measures (the Czech Republic, Croatia, Slovakia, Slovenia, Hungary), consisting mainly in spending cuts[8], which also applied to capital expenditure. Finally, higher than expected, under the Stability/Convergence Programmes updates, fiscal outturn was recorded in the Czech Republic (4.4% of GDP, i.e. by 1.4 pp. of GDP more), Poland (3.9% of GDP, i.e. by 1.0 pp. of GDP), Slovenia (4.0% of GDP, i.e. by 0.5 pp. of GDP), Romania and Lithuania (2.9%-3.2% of GDP, i.e. by approx. 0.1-0.2 pp. of GDP). By contrast, the headline deficit in Bulgaria, Estonia and Latvia in 2012 was much lower than initially projected (by app. 0.7 pp., app. 1.8 pp., and app. 0.9 pp.), owing to, among others, favourable economic conditions.

The deadline imposed on Poland, Hungary, Romania, Lithuania and Latvia under the excessive deficit procedure (EDP) expired in 2012. Except Lithuania (3.2% of GDP) and Poland (3.9% of GDP), all the countries brought fiscal imbalance below 3% of GDP. Weakening economic growth in Poland translated into budget deficit significantly above the reference value, despite large scale of adjustment measures. Though in Hungary the general government deficit was reduced below 3% of GDP (1.9% GDP), according to the EC the excessive deficit correction would not be sustainable (3.0% of GDP in 2013, 3.3% of GDP in 2014). The Hungarian authorities responded by launching additional consolidation measures. Budget outturn in Lithuania was close to the reference value (of 3.2% of GDP), which provided grounds for taking into consideration the net costs of the pension scheme reform (app. 0.2% of GDP) under EDP. Ultimately, at the end of May, the EC recommended the EU Council to abrogate the EDP for all these countries. Poland is the only exception, with the EC suggesting EDP extension by two years.

Slower pace of fiscal consolidation in 2013-2014

According to EC spring forecast (May 2013), the pace of fiscal consolidation (measured by the change in primary structural balance), is set to slow down in 2013 and 2014. In some CEE countries, fiscal policy[9] will be loosened. It results, firstly, from a noticeable improvement in the general government balance achieved in the recent years, which is reflected in closed EDPs for half of the CEE countries, on which they were imposed. Only in Croatia, Slovenia and Poland, the headline deficit is to significantly exceed 3% of the GDP (by: 5.6% of GDP, 4.9% of GDP and 4.1% of GDP[10] in 2014, respectively). Secondly, deteriorating growth prospects imply that fiscal tightening would be pro-cyclical.

Measures on the expenditure side introduced in the previous years are to stay in force in half of the CEE countries (except for Estonia, Romania, Latvia, Lithuania and Bulgaria[11]). In the Baltic states, Poland, Hungary and Slovakia consolidation involves cuts in capital spending. On the revenue side, in 2013-2014 the majority of the CEE have announced increases in certain taxes and fight against tax evasion. At the same time, Croatia, Estonia, Latvia and Hungary have planned reduction in direct taxes or social and health insurance contributions in order to support economic growth. Furthermore, old-age pension contributions transferred to the funded pillar (Poland, Lithuania, Latvia, Romania, Estonia), which have been reduced or suspended in previous years, will be increased. This implies lower general government revenue. In the case of Poland, further changes, having impact on public finances, to the second pillar are discussed (e.g., enabling opt-out of the pension funded scheme).

The deadline set under the EDP for the Czech Republic and Slovakia expires in 2013. According to EC spring forecast, headline deficit in 2013-2014 in both countries is expected to come close to the reference value (3% of GDP). Due to the gloomy economic outlook, the EC recommended EDP extension in case of Slovenia from 2013 to 2015.

Changes to the national fiscal frameworks, considered or already adopted by the CEE countries, will support budget discipline and increase national ownership of the EU

[6] In 2011, Hungary recorded general government surplus (4.3% of GDP) due to one-off assets transfer from the funded pension scheme (app. 10% of GDP). After eliminating this factor, reduction of the fiscal imbalance in Hungary (pp. 3.6 pp. of GDP) was the strongest among CEE countries.The headline deficit widened in the Czech Republic (from 3.3% of GDP in 2011 to 4.4% of GDP last year), inter alia as a consequence of enacted financial compensation to churches (app. 1.5% of GDP). The general government finances in Estonia reached a positive outcome in 2011 (1.2% of GDP) stemming from sale of greenhouse gases emission allowances (app. 1% of GDP). In 2012, a part of these resources was allocated for environmental investment, which coupled with reversal of temporary consolidation measures adopted in 2009 has contributed to the worsening of the *general government* balance (small headline deficit of 0.3% of GDP).

[7] Nominal fiscal balance net of the impact of economic cycle and one-off and temporary measures. Data for all the CEE countries except Croatia (data not available) according to the EC spring forecast (May 2013).

[8] Except Slovakia, where an array of measures focused on the revenue side and concerned, among others, cut in pension contribution transferred to the funded cheme, one-off banking tax, temporary levy on enterprises in regulated sectors and the acceleration of the excise duty hike on tobacco products.

[9] According to the EC data (May 2013), the weighted mean magnitude of fiscal adjustment in CEE countries amounted to app. 2.7% of GDP in 2010-2012 against app. 0.9% of GDP forecast for 2013-2014. The general government structural balance in Bulgaria, the Czech Republic, Latvia, Hungary and Slovenia is projected to worsen by 0.4 to 1.1 pp. of GDP.

[10] The EC spring forecast did not take into account impact of the temporary VAT hikes extension for 2014-2016 (app. 0.3% of GDP annually) included in the 2013 update of the Convergence Programme.

[11] This applies, among others, to wage increases in public sector and unfreezing of social spending.

fiscal rules. This process was triggered by the 'six-pack'[12] provisions. Additional constraints imposed on fiscal policy concern chiefly expenditure, debt and deficit rules (limiting budget balance in the medium term) and are expected to facilitate achievement of the medium-term budgetary objective (MTO)[13]. What is more important, they are in most cases based on cyclically-adjusted fiscal indicators. Moreover, the Czech Republic, Bulgaria and Latvia intend to set up Fiscal Councils. Thus Poland, Estonia and Lithuania would be the only CEE countries in which such institution has not been established.

Moderate public debt increase

The public debt-to-GDP ratio in the CEE countries will continue to grow in 2013-2014, except for the Baltic states and Hungary (decline of approx. 0.3-1.3 pp. of GDP), despite improving economic conditions. Nevertheless, according to the EC spring forecast, the increase will be moderate (0.7-4.6 pp. of GDP), except for Slovenia (12.4 pp. of GDP, impact of the banking system support[14]) and Croatia (by 8.8 pp. of GDP). In CEE countries being the euro area members, i.e. Estonia, Slovenia and Slovakia, public debt figures will be affected by contributions to the European Stability Mechanism (ESM) and European Financial Stability Facility[15]. Hungary will be the only country in the region, where the general government debt to GDP ratio will stay significantly above the Maastricht reference value (79.7% in 2013, 78.9% in 2014 r.). Within the EC spring forecast horizon, the 60%-of-GDP debt threshold will be exceeded in Slovenia (61.0% of GDP in 2013, 66.5% of GDP in 2014) and Croatia (62.5% of GDP in 2014). Hungary will remain the only CEE country with the 'junk' sovereign credit rating given by the three major rating agencies[16]. From 2012 year-end, some of them downgraded Croatia and Slovenia[17] to a "junk" status.

Further reduction in external imbalances

In 2012, the current account deficit in the CEE region decreased, as it had in 2011. In 2012 it amounted to 1.9% of GDP, compared to 3% of GDP in 2011. In the 2013 Q1, it further fell to 1.4% of GDP. This decrease in the deficit across the region resulted primarily from the improved balance on goods' account. Trade deficit declined in most of the countries in spite of an obvious drop in the exports growth. Weakening domestic demand, and hence weakening imports, being the reasons behind the decline. Services account also posted a slightly higher surplus while the balance in income and current transfers practically remained unchanged. Bulgaria and Estonia were the only countries with worsening balance of foreign trade which dragged on their current accounts balances (in the case of Estonia it was attributed to huge investment imports whereas in Bulgaria it stemmed from exceptionally inadequate export performance).

Current account balance is expected to improve further in 2013, although the scale of the improvement will be smaller than in 2012. Adjustments in the current account will continue primarily through the foreign trade. The balances in services, income and current transfers should not differ much from those recorded in 2012. Only in Lithuania and Latvia, where the surge in exports is hardly likely to remain at the 2012 level, current account gap is expected to widen. In 2014 the scale of imbalances should stabilise. The expected increase in external demand should stimulate exports and thereby the balance of goods account should show mild upward trend. However, the increased outflow of incomes will act in the opposite direction when improved economic situation in the region contributes to higher transfer of profits from enterprises with foreign capital.

Lower inflow of foreign investment and the changed investment pattern

In 2012 and in 2013 Q1, the net inflow of foreign investment to the CEE countries was evidently lower. In 2011, it amounted to 3.8% of GDP and in 2012 Q1 to a mere 1.4% of GDP. The inflow of direct investment in relation to GDP was the same (2.0%), albeit the structure of the investment changed. The share of intra-company loans was trending upwards whereas the role of equity investment displayed a downward trend. Other investment, that is, trade credits, but primarily the liabilities of the financial sector, were responsible for the rising outflow of capital. It was the noticeable outflow of capital from the banking sector (deposit withdrawals and loan repayment to foreign banks) that contributed to a record-high deficit on the other investment account in 2012 (-3.8% of GDP compared to -0.6% of GDP in 2011). How-

[12] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (Official Journal of the European Union L 306 of 23 November 2011, p. 33-49) Adopted provisions concern, inter alia, realistic forecasts used in budget planning, transparency of general government finances, medium-term budgetary frameworks, national fiscal rules promoting compliance with the SGP. It shall be transposed by the Member Countries by the end of 2013.

[13] Achieving MTO provides necessary room for manoeuvre allowing the automatic stabilisers to operate freely without bringing the deficit below 3% of GDP. It reinforces the stabilising function of fiscal policy and limits pro-cyclicality. See *Public finances in EMU 2006*, European Economy, 3/2006, Directorate-General for Economic and Financial Affairs, European Commission.

[14] According to the Slovenian government estimates, the cost of bank recapitalisations in 2013 will amount to app. 3.7% of GDP. Furthermore, a "bad bank" was established. It will issue bonds guaranteed by the State Treasury in order to purchase of non-performing loans portfolio (the limit of app. EUR 4 bn. i.e. app. 11.4% of GDP has been set). Impact of these measures on fiscal deficit and public debt was not taken into account in the EC spring forecast.

[15] In 2012, the ESM/EFSF contributions impact on the public debt in Slovakia amounted to app. 2.5% of GDP, in Estonia – to 2.1% of GDP and in Slovenia to 2.7% of GDP while in 2013 - 3.2% of GDP, 2.5% of GDP and 3.7% of GDP, respectively.

[16] Moody's, Standard&Poor's, Fitch.

[17] Croatia: Standard&Poor's – December 2012; Moody's – February 2013; Slovenia: Moody's in April 2013. Before 2011 year-end, Slovenia was awarded the highest credit rating among the CEE countries.

ever, preliminary figures from 2013 Q1 show that in some CEE countries (among others, in Poland, Estonia, Latvia and Slovakia), the outflow of other investment has subsided.

In 2012, the inflow of portfolio investment, especially into the debt securities markets (mainly in Poland, the Czech Republic, Slovakia, Romania and Croatia) went up. It was triggered by high liquidity of the European banking system (also due to withdrawal of capital from the Central European banking system), on the one hand, declining risk aversion and increasing sentiment for the region's countries on the other. However, the figures for 2013 Q1 indicate that the inflow of portfolio investment stopped increasing.

Debt securities markets dependent on the global sentiment

Increased demand for Central European Treasury bonds was observed throughout 2013. This was reflected in a further decline in the bond yields. At the beginning of 2013 Q2, most of the region's countries, except Slovenia, hit their all-time lows (among others, yields on 10-year Treasury bonds dropped below 1.5% in the Czech Republic, below 3% in Poland and below 5% in Hungary).

The markedly lower than in mid-2012 level of risk aversion and sustained good foreign investors sentiment for the region's countries was also indicated by CDS quotes. In mid- June 2013, they were still by 200 bp. lower, on average, than a year ago. The greatest drop, of 300 bp., took place in Hungary, Bulgaria and Romania. Yet in these countries, as well as Croatia, they continue to be among the highest in the region (over 300 bp. in Croatia and Hungary, 200 bp. in Romania), while in the Czech Republic, Estonia, Poland or Slovakia they ranged from 50 to 80 bp. The volatility of CDS quotes was not as big in the first half of this year as in the second half of 2012. Their sizeable increase was only observed in Slovenia and Croatia (resulting from persistently difficult situation in the financial sector) and in Hungary in February 2013 (due to uncertainty regarding the changes in the MNB authorities).

The stock markets in the CEE countries demonstrated diversified tendencies in the first half of 2013. Although 2013 Q1 saw a downward trend in all major markets of the region (Poland, the Czech Republic, Hungary, Slovakia), stock exchange indices in Warsaw and Budapest managed to make up for the losses in the course of further three months, whereas Czech and Slovak stock exchange indices stayed slightly below their 2012 year-end level.

Increased global risk aversion related to the announced unwinding of the FED's QE programmes[18] set off a withdrawal of investors from the CEE markets. It was observed already in the second half of May and in June 2013. This was signalled by, among other things, marked upward trends in CDS quotes, especially at the end of June 2013, and in the fall in financial asset prices in the CEE countries. Treasury bond yields went up again, particularly in the major CEE markets (Poland, the Czech Republic, Hungary and Romania), yet remained lower than at the beginning of the year. The outflow of capital also had an adverse effect on equity markets. Sharp drops in the last days of June 2013 pushed the indices down towards the year's lows.

Unwavering high inflow of portfolio investment and high interest in Treasury bonds in the CEE countries have not contributed to the appreciation of the region's currencies in 2013. From January to June, free floating CEE currencies of were showing a mild depreciation trend. During that period, the Polish zloty depreciated against the euro by almost 6.5%, the Czech koruna (CZK) by 4%, the Hungarian forint (HUF) by 2%, and the Romanian leu (RON) by 1.5%. The depreciation of currencies was noticeable especially in May and June this year, which coincided with the withdrawal of investors from the region's financial markets.

Expected slow recovery in 2013-2014

Worsening prospects for the world economy, especially for the euro area, have led to the downward revision of growth forecasts for the CEE countries for 2013-2014.

The latest forecasts indicate that the economic slowdown in the region will last throughout 2013, although GDP growth should pick up somewhat[19] in the second half of the year. It will take until 2014 for the economies to return on the moderate upward path. The Czech Republic, Slovenia and Croatia are not likely to avoid another year of recession, although surprising GDP growth in Hungary in Q1 2013 may presage the country's return on a growth path already in 2013.

Persistently weak economic situation in the euro area, contributing to slow export growth (in spite of temporary rebound in the Q1 2013) and long-standing stagnation in the labour market are likely to be the main factors dragging on growth in the CEE region in the oncoming months. Additionally, the private sector deleveraging is not likely to finish in any near future. While the deleveraging of the Central European banks did demonstrate a downward trend already in 2012 and the accommodative monetary policy has led to a sharp drop in lending costs in the region's countries. Yet concerns about the future economic and financial situation of households and enterprises combined with dim outlook for a prompt improvement in the labour markets are the main factors having impact on low interest in lending. The retreat of foreign investors noted at the end of Q2 2013 from financial markets should also be approached as yet another risk constituting a drag on the revival of economic growth in the region.

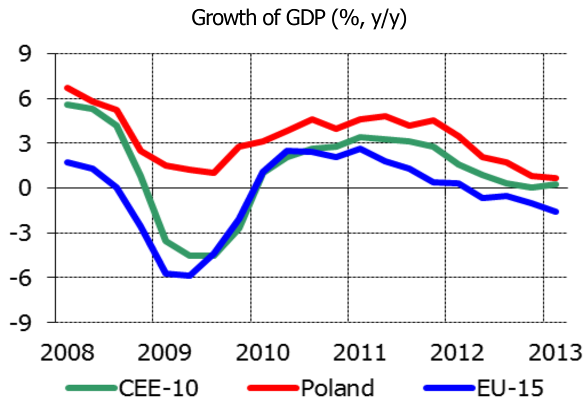
The above-mentioned long-standing stagnation in the labour market as well as aversion to lending will drag

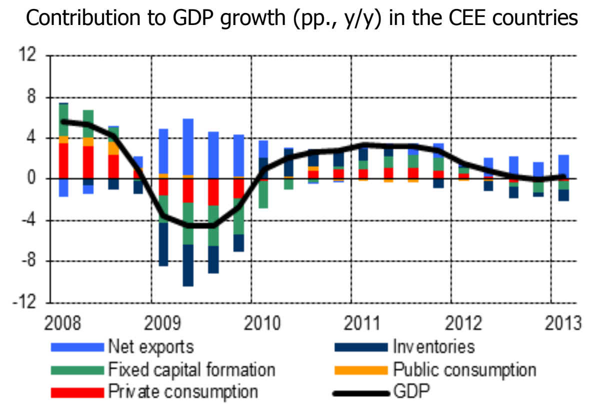
[18] FED announced the winding down of the Treasury securities purchase programme and to wrap it up in mid-2014.

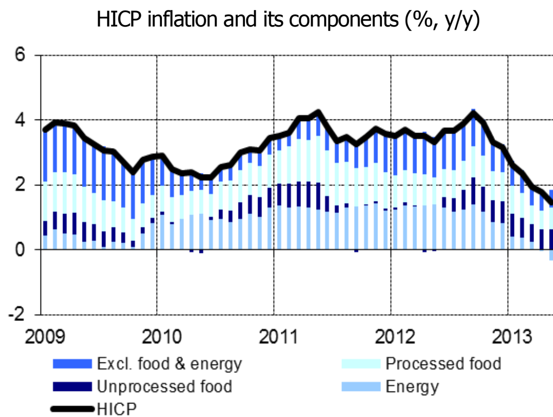
[19] According to the European Commission forecasts of May 2013.

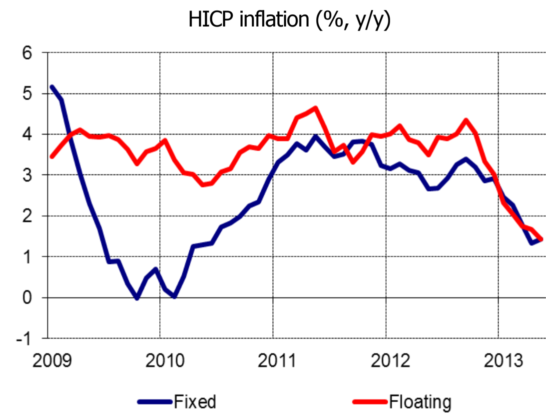
private consumption down in the CEE countries until the year-end. Investment growth, especially with regard to private investment, should not be significant comparing to 2012, which is largely due to weak business sentiment relating to the poor demand and lack of new orders within the country and from abroad. A slight upward trend in production in the Q1 2013, stemming, among others, from the rebound in the automotive sector in the euro area in the coming months may encourage entrepreneurs to launch new investment projects. Public investment should be marked by slightly higher growth as it will continue to be fuelled by EU funds. It seems that like in 2012, net exports, in spite of persistently weak export demand, will remain the only positive contributor to GDP growth in 2013, which will be a result of low imports, dragged by weak domestic demand in the CEE region.

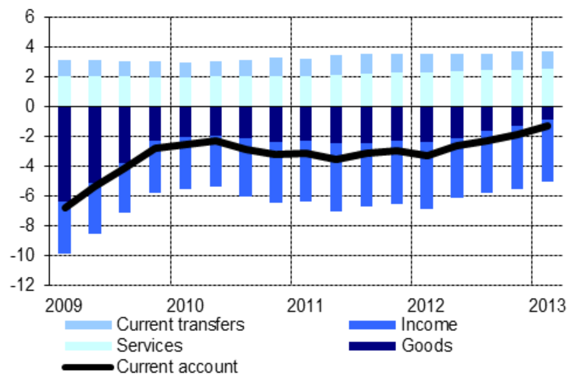
Expected economic revival in the euro area in 2014 will be a basic factor boosting up the region's economy next year. It should translate directly into higher exports and indirectly, through an improvement in labour market conditions, into domestic demand. Additionally, the negative impact of fiscal consolidation on consumption and on investment growth will fade away. In spite of the fact that the next year's revival will be triggered by the pick-up in external demand and exports, still, the import revival will pose a drag on the contribution of external trade comparing to 2012 and 2013 which will markedly go down.

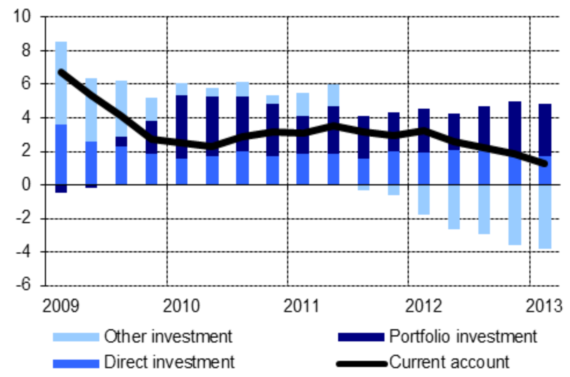


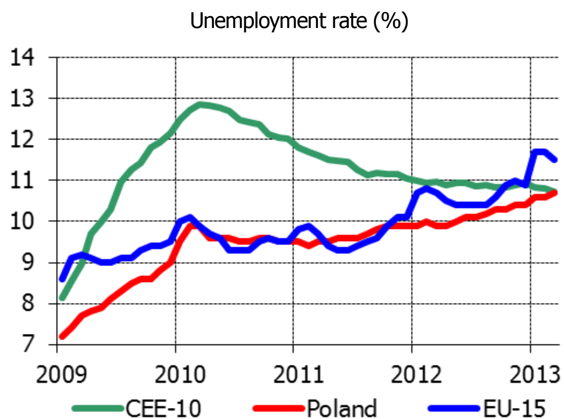


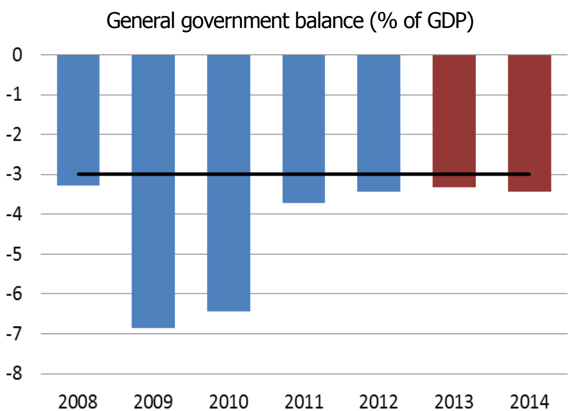












Source: Eurostat, CSOs

BULGARIA
Unfavourable external conditions cause exports to slip

The past year in Bulgaria has been marked by a deepening slowdown of economic activity. After a period of acceleration in the first half of 2012, domestic demand slowed down significantly due to a deceleration in households consumption (1.8% y/y in the second half of 2012 comparing to 3.6% y/y in the first half of 2012) and a stall in inventory build-up. Positive investment growth also turned out to be short-lived (stagnation in the second half of 2012 compared to a 1.4% y/y rise in the first half of 2012). Additionally, imports grew faster than exports throughout the entire year, resulting in a net exports' negative contribution to economic growth.

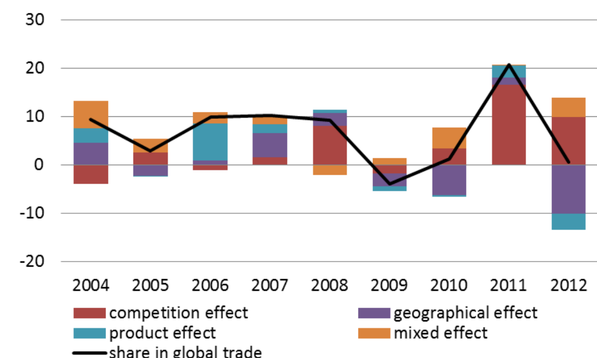
In 2009-2011, net exports were a significant driving force behind the GDP growth in Bulgaria; its average contribution to GDP growth in the course of the last three years has amounted to almost 6 pp. Even though in 2009 the increasing share of external trade stemmed from a sharp imports drop caused by falling domestic demand, in the course of the following two years it was supported by exports growth at an almost two-digit rate. Strong commercial ties with the severely affected by the crisis peripheral countries of the euro area (especially with Greece) did not have a considerable negative impact on trade[20]. This was possible, among others, due to a considerable improvement in the quality of exported goods, increased exports of tourist services and a relatively large share of sales to countries outside the EU where the demand for Bulgarian goods was, for a long time, sustained at a relatively high level.

Rising product competitiveness (in terms of both the product range and price) of the Bulgarian exports after 2009, that has contributed to the acceleration of foreign sales, is reflected in the *constant market shares*[21] analysis. It should be highlighted that the share of factors relating to the competitiveness counterbalanced the cumulative negative impact of structural determinants (geographical and product structure) in 2008-2012[22] and was responsible for the increase in the share in global trade. Bulgaria's product competitiveness, however, did not offset negative geographical and structural conditions. Eventually, last year for the first time since 2009, the Bulgarian exports slid down.

The above analysis confirms the development of unit labour cost (ULC) in Bulgaria. Although the ULC increase in the Bulgarian economy was definitely the highest amongst the region's countries in the post-crisis period, it concerned economy sectors targeting the domestic market. From mid-2008 until the Q1 2013 unit labour costs across the entire economy went up by over 20%, whereas the export oriented processing industry recorded a slight downward ULC trend at that time.

It seems, therefore, that the marked contraction in the demand from Bulgaria's trading partners dragged down exports in 2012. This is confirmed by the negative and substantial contribution of the geographical effect to the change in the Bulgaria's share in the global trade. In 2011, the Bulgarian export markets demand noted an increase amounting to 5.6%, and in 2012 it fell to zero, which was the worst result among all CEE countries (except Croatia) last year. The stagnation of demand in the export markets is associated mainly to the deepening crisis in the euro area and a considerable weakening of demand from partners outside the EU, especially from the Turkish economy that experienced economic slowdown after strong GDP growth over the previous years.

Decomposition of changes in Bulgaria's share in global trade



Source: IE NBP research

The increase in labour costs in the *non-tradable* sector in Bulgaria results from structural mismatch in the labour market in Bulgaria, which for years has been a barrier to faster economic growth. As a result of these mismatches, adjustments in the Bulgarian labour market in 2008-2013 were achieved practically entirely through workforce downsizing, whereas wage growth remained at a relatively high level. Consequently, the unemployment rate since mid- 2008 until 2012 year-end increased from 5.1% to 12.6%, and its increase was observed even under relatively good economic conditions in 2011, when the number of the unemployed was falling in the CEE countries. At the same time, the average nominal wage growth in 2009-2012 in Bulgaria amounted to almost 10%, while in other countries of the region it was, on average, four times lower.

Nevertheless, 2012 saw a slowdown in wage growth (to 5.7% in 2012 Q4). Amidst rising unemployment rate and declining supply of households loan, this held back the consumption of households, especially in 2012 Q2.

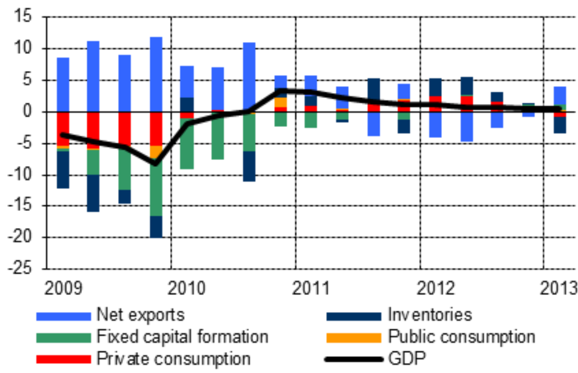
[20] 2010 saw a noticeable growth of sales to Greece induced by the process of replacing expensive Greek goods and services by cheaper equivalents imported from Bulgaria. Additionally, numerous strikes, among others, in the Greek energy sector, resulted in increased energy imports of mainly from Bulgaria.

[21] Based on the survey conducted by National Bank of Poland.

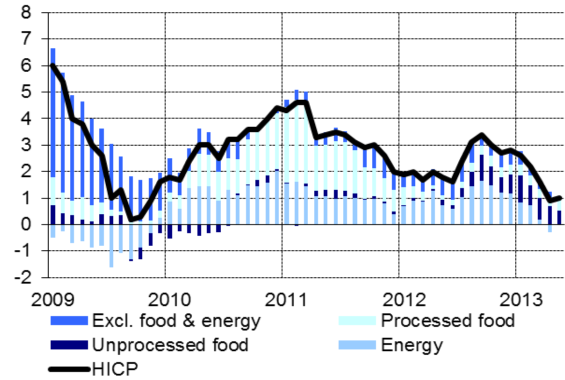
[22] In 2008-2012, the share of Bulgaria in the global trade increased by over 14% and amounted to 0.17 pp. in 2012. It concerned trading in goods from SITC sections 0, 1, 5-8 at the third level of aggregation.

2012 Q1 data, which showed a 0.4% y/y GDP growth, confirmed the weakness of domestic demand, especially consumption, which fell by 1% y/y. Consumption contraction was to some extent offset by expansionary fiscal policy, reflected in growing public consumption (3.2% y/y) and in investment (5.0% y/y), stimulated to a large extent by EU co-financed projects. The first quarter of this year saw a marked exports growth (10.8% y/y), especially of energy and base metals to countries outside the European Union. As a result, GDP picked up on the back of export growth. Still, according to the European Commission forecasts, this positive contribution of net exports to GDP growth will not last long and will, like last year, remain negative throughout the entire 2013. However, the negative contribution of net exports will mainly stem from a faster growth of domestic demand and imports. The increase in domestic demand in the coming quarters will continue to rely on expansionary fiscal policy. Additionally, further increases in lending to enterprises, noticeable already in 2012, are expected to stimulate private investment. Prospects for the labour market improvement remain bleak for 2013 and 2014. Also growth in lending for enterprises last year was not accompanied by more loans granted to households, remaining negative. Both factors will affect negatively private consumption impeding its growth in the oncoming quarters, especially in 2013.

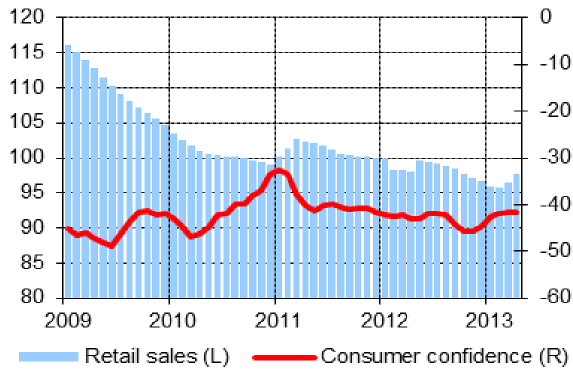
Contribution to GDP growth (pp., y/y) in the CEE countries



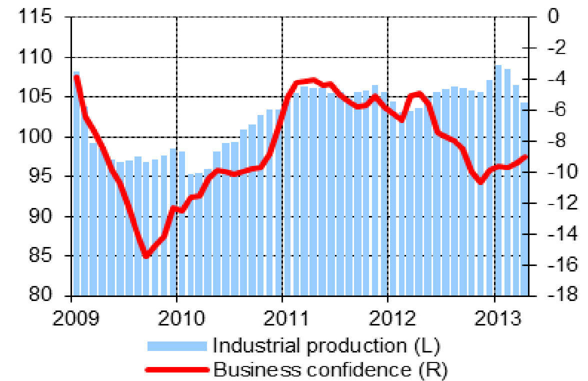
HICP inflation and its components (%, y/y)



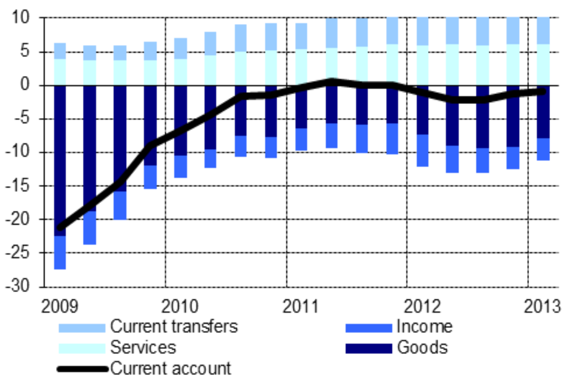
Growth of retail sales (%, y/y) and consumer confidence index



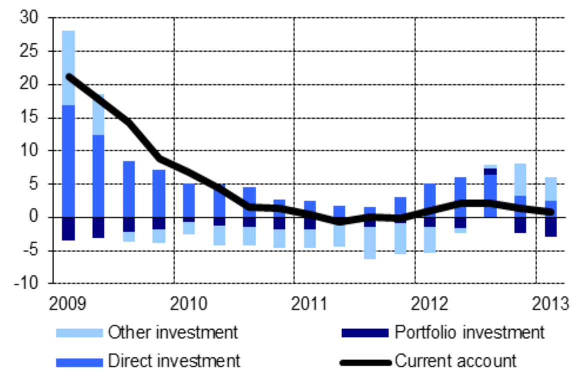
Industrial production growth (%, y/y) and business sentiment index



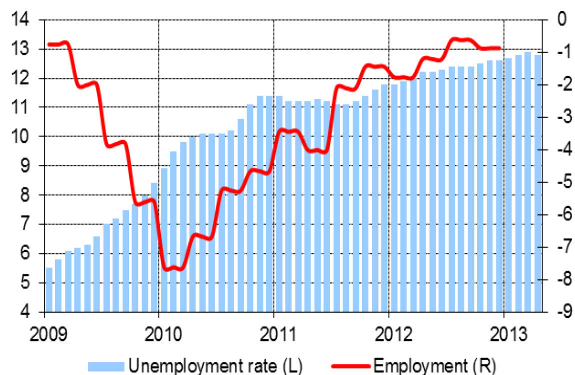
Current account and its components (in % of GDP, 4-quarter moving average)



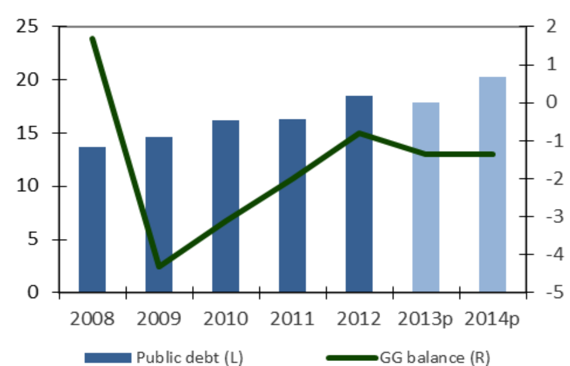
Financial account balance and its components (in % of GDP, 4-quarter moving average



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

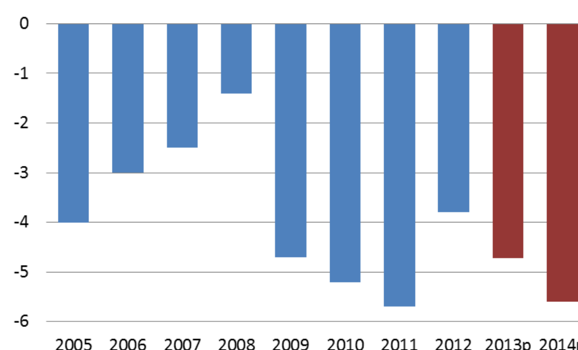
Croatia
Fiscal consolidation hinders economic recovery

The Croatian economy has been in recession for as many as four years, and there is every indication that this situation will continue in 2013. Real GDP declined (output dropped by 2% following a stagnation in 2011,) on the back of lower private consumption and shrinking gross fixed capital formation – both drivers of the economy prior to the financial crisis. Weak consumption demand, to a large extent, reflects a tough labour market situation, characterised by a growing unemployment rate and fall in real wages. This, in turn, combined with negative expectations regarding any sizeable improvement in the economic situation in the nearest future does not encourage enterprises to invest. Throughout the entire past year, gross fixed capital formation remained negative with the downward trend escalating in the second half of 2012.

Foreign trade balance was the only category adding to GDP in 2012. The volume of exports of goods and services last year was trending upwards although growth levelled off markedly compared to 2011 (0.4% and 2.0%, respectively). The observed growth resulted from higher revenue from the exports of services, especially tourist services while export volumes of goods have not changed on the 2011 level[23]. 2012 saw a fall in import volumes of goods and services (by 2.1% comparing to the 2011 drop of 1.3%), which mainly relates to shrinking consumption and investment demand. The above-mentioned movements in Croatia's foreign trade resulted in an improvement in the country's current account. 2012 saw a slight surplus after a gradual narrowing of the deficit[24] in previous years. The relatively large scale and faster reduction in the external imbalance may suggest that current adjustments are rather of cyclical than of structural nature.

Preliminary data show that in 2013 Q1 GDP in Croatia contracted again (a fall of 1.5% y/y); however, the scale of the decline was smaller than in the second half of 2012 (a decline of 2.5% y/y). The structure of the factors that shape the economic situation in the country has not changed. Domestic demand continued to have a dampening effect on GDP, while the boosting influence of foreign trade weakened as, following two consecutive quarters of growth, the volume of goods and services exports declined.

General government deficit in Croatia, in % of GDP



Source: Eurostat, European Commission

The ongoing fiscal consolidation is a major factor holding back domestic demand growth in 2012 and in the years to come.

General government debt and deficit in Croatia have risen markedly since the onset of the global financial crisis in 2008[25]. The year 2012 saw the beginning of fiscal adjustments, but measures that had been undertaken turned out to be insufficient to reverse negative trends in public finance.

The *General government* deficit amounted to 3.8% of GDP in 2012[26], compared to 5.7% of GDP in 2011. The general government budget position has improved as a result of fiscal consolidation. Nevertheless, as the deficit is maintained above the reference value, Croatia has been automatically covered by the excessive deficit procedure since the accession to the European Union. In line with the EC recommendations, the revision of excessive deficit should take place by 2016 year-end.

Considering the situation, consolidation measures are set to be continued. They apply to revenue as well as to expenditure side. In the first case, the consolidation will include, inter alia, the increase in VAT rates (in March 2012, VAT rate was increased from 23% to 25%, the reduced rate of 10%[27] was introduced in January 2013, zero rate was replaced by 5% rate). Additionally, the increase in excise duty was introduced in 2013 (for cigarettes and tobacco products, and electrical power. Tax on transport means has also been introduced). At the same

[23] The construction of ships, which are the most vital export product in Croatia, fell off significantly in 2012 mainly due to the lack of orders. Additionally, the domestic shipbuilding industry is undergoing the restructuring thereby the output of this sector in the oncoming future is set to be reduced.

[24] Croatia, for over a decade, has been recording high goods deficit (13.7% of GDP in 2012, which implies the improvement by 0.1 pp. compared to the level of 2011) and equally high surplus in services (14.5% of GDP in 2012, which means the improvement by 0.6 pp. compared to the level of 2011).

[25] The sector deficit increased from 2% of GDP in 2008 to 5.7% in 2011, and the sovereign debt from 28.8% of GDP (2008) to 46.7 % of GDP (2011).

[26] When the report was being drawn up the revision of national statistics and the adaptation of the same to the European Union standards was taking place. The data that would allow to assess the scale of tightening are not available (including the volume of the structural balance). The revised and completed data will be published not earlier than in the Convergence Programme in 2014.

[27] The reduced rate applied to, among others, oils and food fats, sugar, food for children, water supply services (earlier applicable rate was 23%).

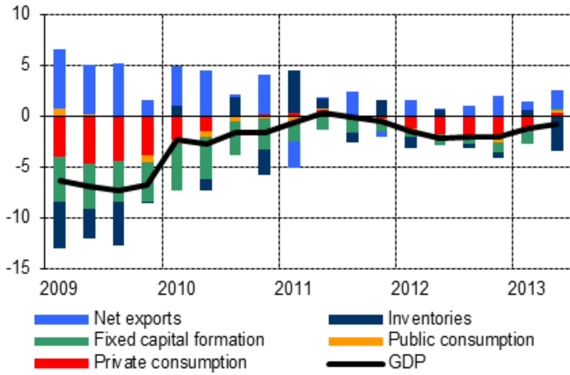
time, attempts of increasing the effectiveness of the tax regime are being made and grappling with the grey zone[28] carried out. On the other hand, solutions to uphold economic growth and employment by reducing labour costs are in progress (including the reduction of a health insurance contribution rate from 15% to 13%, increase of the Personal Income Tax threshold).

Adjustments in the expenditure side basically apply to the freeze on wages in civil service. Due to an obligation to pay contribution to the European Union (0.5% of GDP in 2013 and app. 1.1% of GDP in 2014) and the costs of restructuring of the shipbuilding industry and health care units, the sector's spending this year may move up.

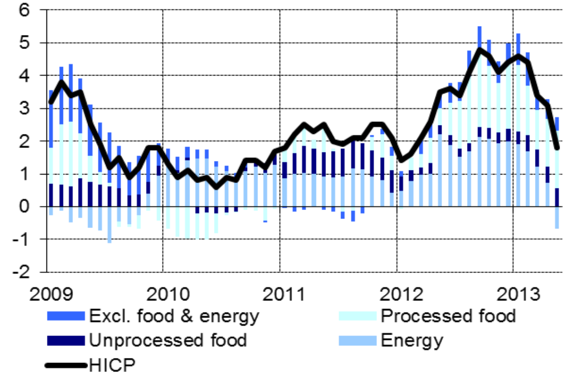
According to the Croatian government, the ongoing fiscal tightening may reduce the deficit of the general government (to -2.6% of GDP in 2016). According to the EC spring forecasts, however, it will deepen to 4.7% of GDP in 2013 and 5.6% of GDP in 2014. Differences in the forecasts primarily derive from differences in the assessment of macroeconomic prospects and related tax revenue. According to the EC forecasts, the amount of general government debt in 2014 will exceed 60% of GDP (in 2012, it amounted to 53.7% of GDP). According to the Croatian government, the sovereign debt is forecast to increase however, within the forecast horizon the sovereign debt will be maintained below the reference value.

[28] They include introducing an obligation to have a cash register and ban on the payment of wages without the payment of contribution (2013)

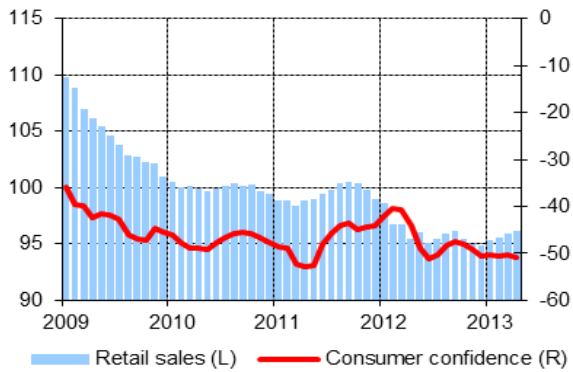
Contribution to GDP growth (pp., y/y)



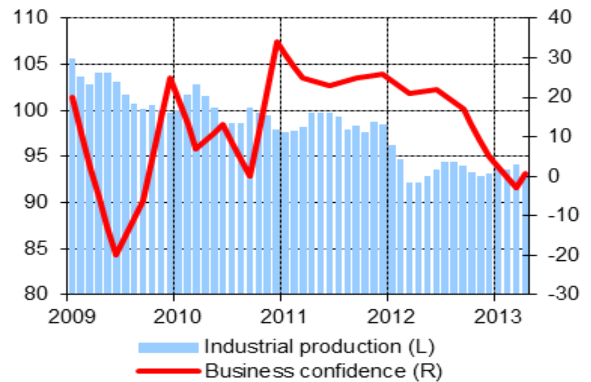
HICP inflation and its components (%, y/y)



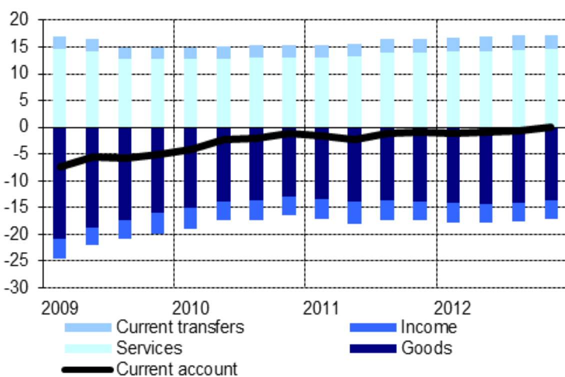
Retail sales (in %, y/y) and consumer sentiment index



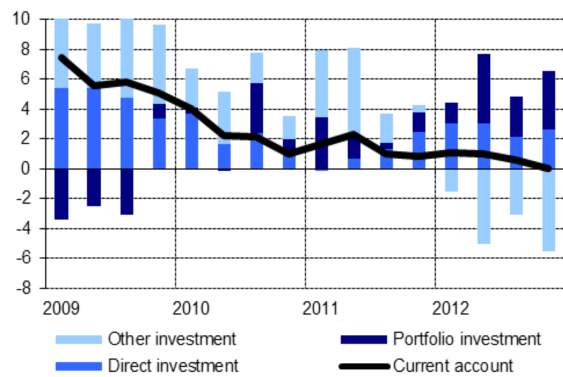
Industrial production (in %, y/y) and business sentiment index



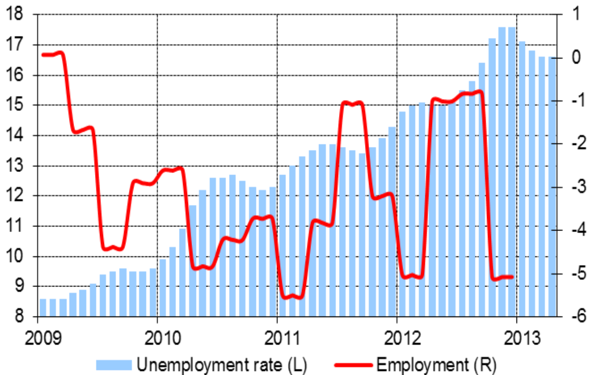
Current account and its components (in % of GDP, 4-quarter moving average



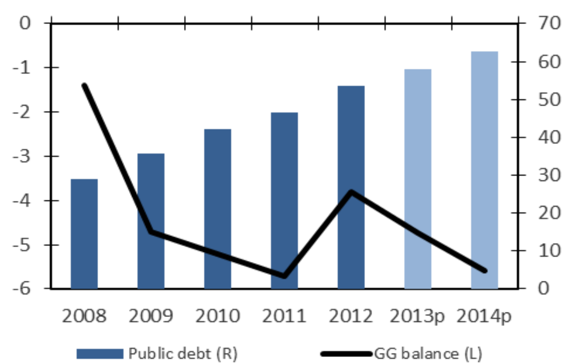
Financial account balance and its components (in % of GDP, 4-quarter moving average



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



General government debt and deficit (in % of GDP



Source: Eurostat, CSOs

CZECH REPUBLIC
The second dip of the Czech recession

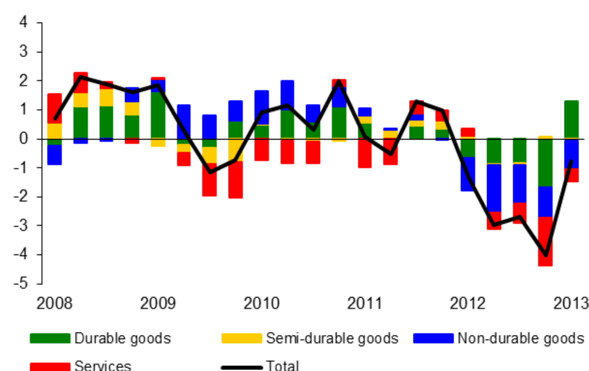
Since the second half of 2011, the Czech economy has been increasingly sliding into recession. In 2012, GDP was declining in every quarter, which led to a decrease of 1.2% in the entire last year. It clearly implies that alongside with Croatia, Slovenia and Hungary, the Czech Republic belonged to the CEE countries affected by recession last year. In 2013 Q1, Czech GDP shrank again (by 1.1% q/q) and its annual growth rate dropped to -2.2%. Only Slovenia was facing deeper recession.

The present recession, the second during the past five years, was triggered by different factors than the one during the global crisis in 2008-2009. It seems that the basic difference seems to be that the present GDP contraction has resulted from weak domestic demand, mainly in terms of private consumption, while exports bounced back in 2010-2012 (although the growth rate dropped markedly in 2012). The scale of the GDP decline in 2008-2009 was twice as large as in 2011-2013 (5.5% and 2.8%, respectively) but the private consumption did not go down that low. Its cumulated drop in the course of the first crisis wave amounted to "only" 1.6%, while in 2012 it was twice as big (3.4%).

The weak consumption can be put down to at least two factors. Firstly, when in 2009 the general government deficit reached 5.8% of GDP, the government sought to reduce it, which resulted in a series of austerity measures in 2010-2013. It included both measures related to the revenue side (indirect and direct tax increase) as well as the expenditure side (freeze on public-sector wages and pensions, cutbacks in public investment)[29].

On the other hand, after a period of a sharp drop in employment and rising unemployment in 2009, the situation in the labour market did not improve in the following years. From the beginning of 2012, along with the exacerbating economic situation in industry, it was again on a downward path. Employment in the economy shrank by 40 thousand people in 2012, i.e. 1%. Unemployment rate, although it was still among the lowest in the region, rose from 6.5% at 2011 year-end to 7.2% at 2012 year-end and remained at that level for the first four months of 2013. Additionally, 2012 was the third consecutive year during which the households real disposable income did not increase. It applied to both wages, which were rising in tact with inflation (3.5% in 2012), and to income from other sources, in particular in terms of ceilings imposed on social transfers. Both factors (fiscal consolidation and bad situation in the labour market) led to downbeat consumer sentiment and to a marked reduction in consumption due to a long-term negative impact. While as recently as 2011 consumption in the Czech Republic was still on a slight upward trend (0.5% y/y, which was three times less than in other CEE countries), 2012 saw it collapse. The above-mentioned drop of 3.4% in private consumption resulted from a decline in purchases of in both durable[30] and non-durable goods and services. In 2013 Q1, private consumption rose compared with 2012 Q4 (1.6% q/q). Yet its annual growth rate remained negative (-0.5%). The rise in consumption in 2013 Q1 is due to an increase durable goods purchases, whereas food or service consumption is persistently slipping. Since 2011, household investment, that is, primarily, housing investment, has also been trending downwards, which has indirectly contributed to weakening domestic demand in the Czech Republic.

Private consumption and its components in the Czech Republic in pp. y/y



Source: CZSO, IE NBP calculations

Weak private consumption cannot be attributed to restricted access to loans. Consumer and housing loans were expanding at a moderate pace (0.8% and 5.3% y/y in March 2013). The slow growth, however, did not result from supply-side factors but, was mainly due to low interest in incurring further loans on the part of households, who were pessimistic about their future. The downward consumption trend is also mirrored in accruing household savings. At the end of 2011, the saving rate amounted to 9.5%, and in 2013 Q3 it mounted to almost 13%.

Investment was another factor that weighed on domestic demand in the Czech Republic. In 2012, fixed capital formation slipped by 4% (the scale of the downturn did not change in 2013 Q1) while in 2011, it demonstrated a slight upturn (0.9% y/y). The decline was mainly induced by limiting the investment in the non-financial sector, especially corporate investment in plants and machinery. Until 2011, this was the only investment category in the Czech economy on the upward track. Public investment has slowed down steadily since 2010 and investment activity of households - since 2011. From the beginning

[29] In spite of these activities, the deficit of the general government sector has not been reduced to the level below 3% of GDP required by EDP. One-off factors have been responsible for the above (establishing the capital-funded pillar of the pension scheme, compensation for the church property).

[30] If curbing the expenses applied only to this category it could be assumed that it was only a delay in shopping. However, cutting down expenses on food and services demonstrates obvious change of the consumers' attitude.

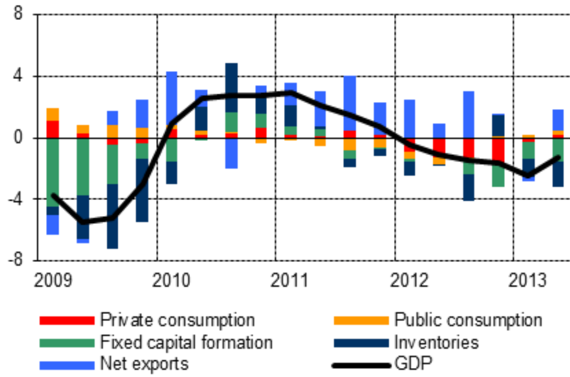
of 2012, activity of industrial enterprises noted a marked slowdown which was coupled with a marked decline in foreign demand. It was reflected in a decline in production (industrial output in the Czech Republic fell by almost 5% in 2012 and in 2013 Q1 it was still 3% lower than a year earlier, while in 2011 it increased by 5%). Value added generated by the manufacturing sector also decreased (-0.8 pp. in the fourth quarter of 2012 against 0.8 pp. a year earlier). The deteriorating economic situation dragged down corporate investment, whose growth rate gradually decreased in the course of last year, falling to zero in the fourth quarter. The change contributed to a fall in gross fixed capital formation in the entire economy.

Net exports were the only positive contributor to GDP growth in 2012, accounting for 1.6 pp of this growth. Yet this was less than the previous year's 2.3 pp. The positive contribution of net exports, especially in the first three quarters of 2013 resulted from a relatively fast exports growth (by 4.8% y/y)[31], which, however, weakened substantially in 2012 Q4. The first quarter of 2013 saw exports decline[32] in annual terms, and consequently the balance of the Czech foreign trade stopped adding to GDP growth.

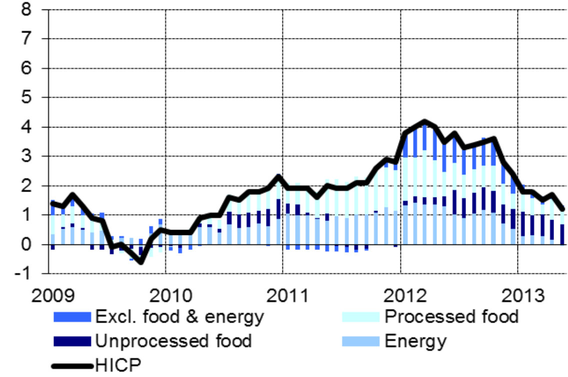
There are scant signs that 2013 is to be a breakthrough for the Czech economy. Consumer confidence does not seem set to rise sharply, which means no marked rebound in consumption, even considering the very low 2012 base. The effect of fiscal consolidation will persist. Since the beginning of 2013, indirect tax rates have been increased again, which prevented inflation from declining by as much as in other countries. On the other hand, flagging public investment coupled with continually weak external demand will not encourage entrepreneurs to launch new investment projects. Additionally, the Czech economy cannot rely on monetary policy to provide the necessary stimulation. In November 2012, the Czech National Bank (CNB) reduced the reference interest rate to the "the technical zero" (0.05%), practically fully limiting its possibilities to spur economy[33]. Hence, it seems that net exports, which in previous years were a positive contributor to economic growth, in 2013, may pose a drag on the GDP. It is indicated by the production figures and export figures for 2013 Q1, as well as by dim outlook for the euro area countries economic growth, especially Germany, being the Czech main trading partner.

[31] Its dynamics went markedly downwards comparing to 2011, however, except the Baltic states and Slovakia, it was one of the highest in the region.
[32] The drop was associated with lower exports to Germany, that is, to the major trading partner of the Czech Republic.
[33] It seems that CNB may stimulate only through the quantitative control of cash supply, still, taking into consideration the ongoing excess liquidity of the Czech banking sector, such activities are not likely to take place in the oncoming future.

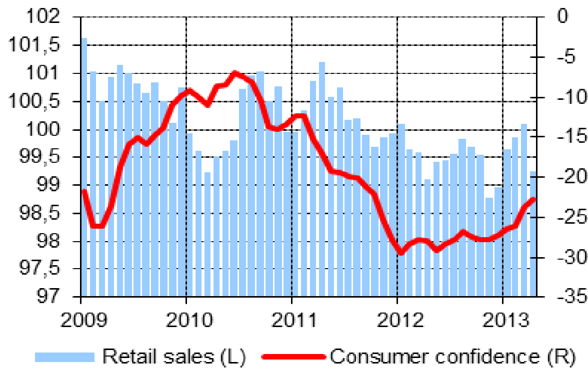
Contribution to GDP growth (in pp., y/y)



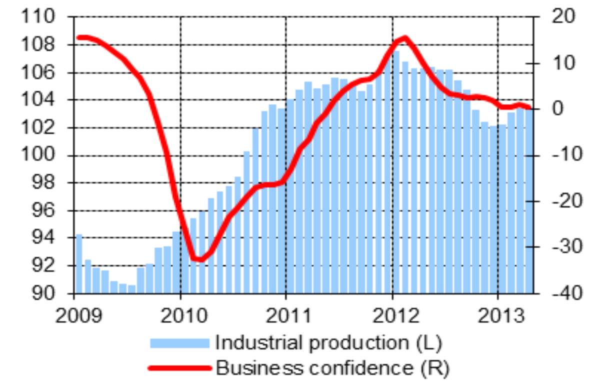
HICP inflation and its components (%, y/y)



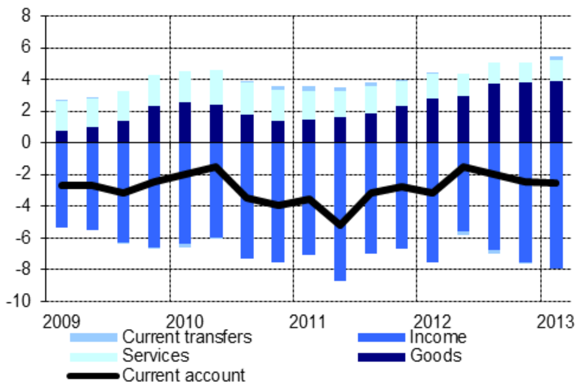
Retail sales (%, y/y) and consumer sentiment index



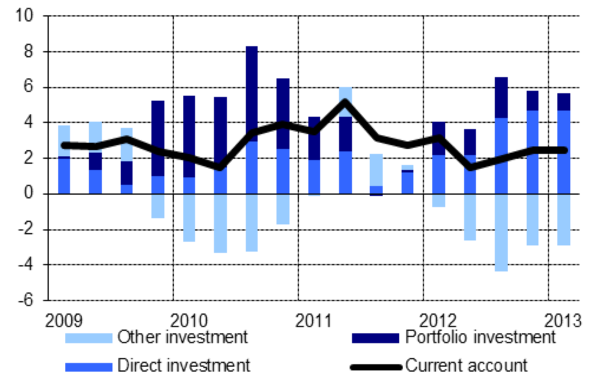
Industrial production (%, y/y) and business sentiment index



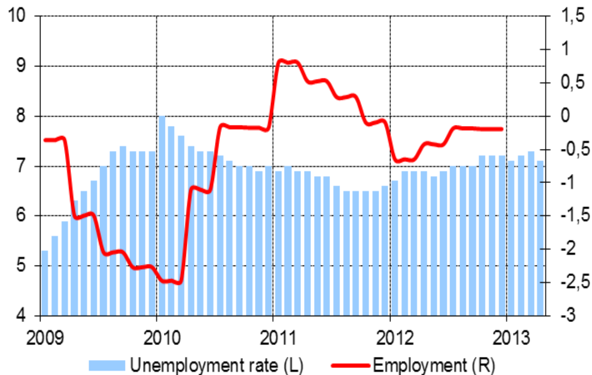
Current account and its components (% of GDP, 4-quarter moving average



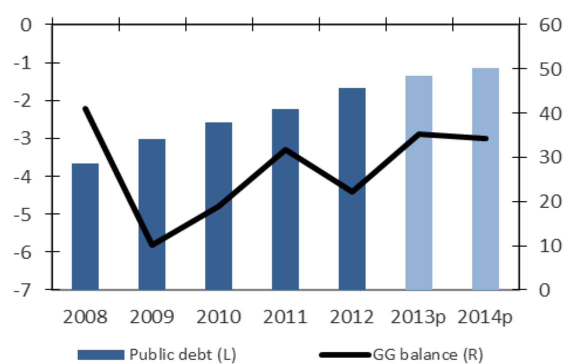
Financial account balance and its components (in % of GDP, 4-quarter moving average



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



General government debt and deficit (in % of GDP



Source: Eurostat, CSOs

ESTONIA **LITHUANIA** **LATVIA**

Demand from former Soviet Union countries continues to boost exports

The economies of the Baltic states managed the crisis in the euro area in 2012 better than the region's other countries. Last year, like in 2011, Estonia, Lithuania but first of all, Latvia, were the fastest developing economies not only amidst the CEE countries but also across the entire EU. GDP increased by 3.2% in Estonia, by 3.6% in Lithuania and by 5.5% in Latvia, which meant that Latvia was the only country in the region where the annual GDP growth accelerated in 2012. In the first quarter of 2013, this positive tendency was upheld in Lithuania and Latvia (4.1% and 6.0% y/y[34]), while Estonia recorded a severe drop (-1.0% q/q to 1.2% y/y).

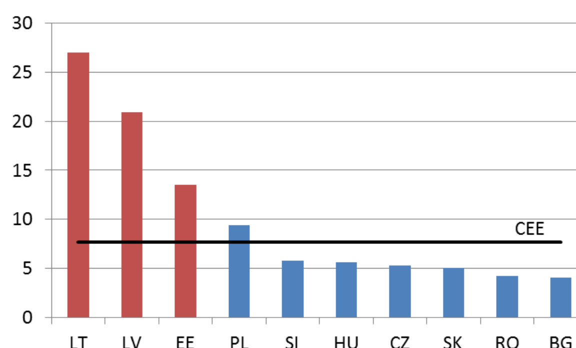
It should be noted, however, that in spite of a relatively fast growth, especially comparing to other European countries, Estonia, Lithuania and Latvia did not manage to make up for the losses they suffered in 2008 and 2009. In 2012 Q1, real GDP in these countries was at the level close to the second half of 2006 and was approx. 6% lower from that recorded at 2007 year-end. Exports were the only national accounts category that markedly exceeded the level of 2007 year-end. In the first quarter of 2013, exports was by over 44% larger than five years earlier.

Fast growth in the Baltic states exports was recorded not only in 2010 and 2011, when this tendency was observed in all the countries of the region, but also in 2012, when the economic slump in the euro area dampened exports growth in the CEE region. Strong growth was specifically observed in Lithuania and Latvia, where goods exports in nominal terms rose by 14.5% and 16% y/y, respectively. In Estonia, the growth rate amounted to 4.5%, which was still higher than in other region's countries (3.8% y/y in 2012).

High growth in demand maintained in the main export markets of these countries had a boosting effect on exports in Lithuania and Latvia last year. Demand in Lithuania's export markets (imports of goods and services in the trading partners' countries weighted by export structure) increased by 3.5% last year and in Latvia's by 4.0% (while on average, demand in the European Union export markets rose by a mere 1.2%). Such big difference in demand trends in export markets resulted from large differences in the geographical structure of exports in Lithuania and Latvia comparing to other countries of Central and Eastern Europe.

A large part of Lithuanian and Latvian exports goes to the markets of the former Soviet Union[35] (27% and 21%, respectively), or other Baltic states (19% and 27%). Both of these groups recorded high growth in demand in 2012, especially comparing to other European economies. The countries of EU-15, however, hold a relatively small share in the exports of both countries (in 2012, they accounted for 34% of Lithuania's exports and 28% of Latvia's, whereas in other CEE countries their share amounted to 53%, on average). Worse export performance in Estonia comparing to Lithuania or Latvia can be explained by a smaller share of the former Soviet Union countries (13.5%) and other Baltic states in exports (14%), while Sweden and Finland being the major trading partners (together, 30% of the total exports in 2012).

The share of exports to Russia, Ukraine and Belarus in the CEE countries in 2012, in %



Source: Eurostat, IE NBP calculations

Exports to the former Soviet Union countries in 2012 compensated, at least partially, for the downturn in demand from EU-15 countries in the majority of CEE economies. Exports of the CEE countries to EU-15 countries in 2012 rose by a mere 1.1% y/y (in current prices), comparing to a 13% increase of 2011. At the same time, growth in exports to the former Soviet Union countries was on the fast-track (19.2% in 2012 comparing to 22.7% in 2011). Strong growth in exports to Eastern Europe was upheld not only in the Baltic states but also in the majority of the CEE economies (except Bulgaria, Romania and Hungary). Hence it seems that the bigger role of Russia and other former Soviet Union countries in the trade with Estonia, and especially Lithuania and Latvia, stemming from stronger geographical and historical ties, was the main reason for faster growth of the trade turnover within this group of the countries.

A definitely smaller share of the EU countries in Lithuania's and Latvia's exports, comparing with other CEE countries, denotes minor involvement of multinational corporations in both countries. Consequently, Lithuania and Latvia remain on the peripheries of global value chains, which have determined the export structure of the region's countries (including Estonia). It is reflected in a small share of products classified as machinery and means of transport (SITC 7) in Lithuania's and Latvia's exports. Their share in the exports of both countries did not exceed 20% in 2012 (while in other CEE countries they accounted for, on average, over 45% of exports).

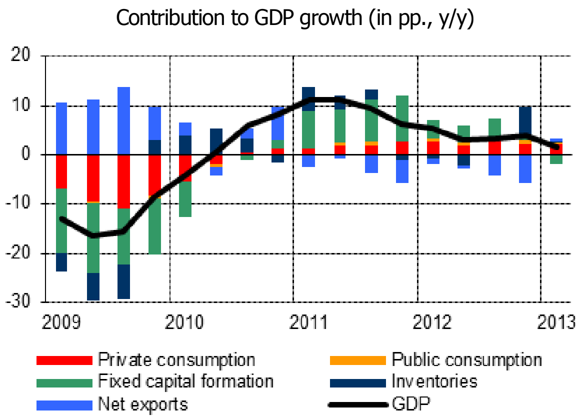
[34] However, according to not seasonally adjusted data presented by the Central Statistical Bureau of Latvia, the annual GDP growth rate in the first quarter of 2013 slowed down to 3.6%.
[35] Russia, Ukraine and Belarus are considered as the former Soviet Union countries.

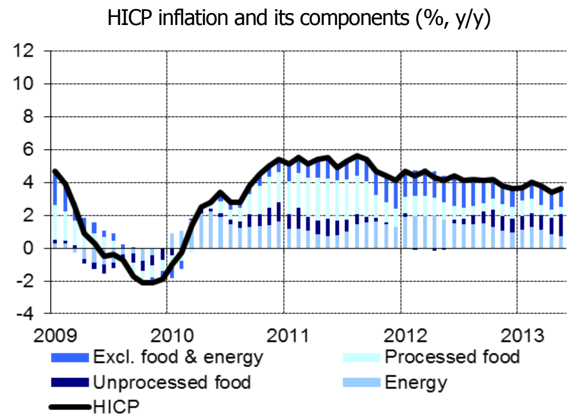
On the other hand, in the majority of CEE countries, the slowdown in exports induced by the crisis in the euro area, has had a particular impact on categories associated with intra-firm trade. This widened the gap in export growth between the Baltic states and other CEE countries.

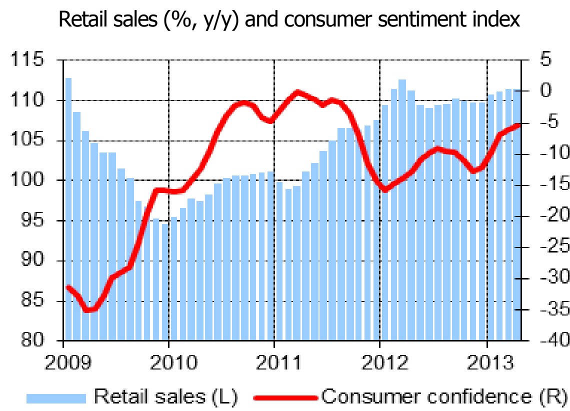
Apart from relatively high exports in 2012, Baltic economies were also boosted, like in 2010-2011, by rapidly expanding domestic demand. However, contrary to former years, in 2012, patterns of domestic growth within the Baltic differed. Estonia and Latvia recorded a fast (two-digit) growth in fixed capital formation. In Estonia, increase in investment was mainly driven by public investment provided EU funds and from auctioning of the CO_2 emission allowance. However, a considerable change was recorded already in the first quarter of 2013. The fall in GDP at that time was an outcome of flagging public investment, which had caused a decline of 11.2% in gross fixed capital formation in comparison to 2012 Q4. The upturn in investment in Latvia in 2012 was driven by private enterprises outside the financial sector. Like in Estonia, gross fixed capital formation demonstrated a downward shift (a decline of 1.8% q/q) in the first quarter of 2013. Lithuania, on the other hand, saw a contraction in capital expenditure in 2012. It was underpinned by entrepreneurs' mounting uncertainty relating to an anticipated drop in foreign demand and results of the parliamentary election. On top of everything, restricted access to loans for households and corporates and the slump in public investment played their part. Still, contrary to Latvia and Estonia, investment growth in Lithuania in the first quarter of 2013 demonstrated an upward trend (6.0% q/q – only partially attributable to low base). It is expected that the following quarters of 2013 will record accelerated growth of capital expenditure in Lithuania, mainly driven by the increase in public investment announced by a new government.

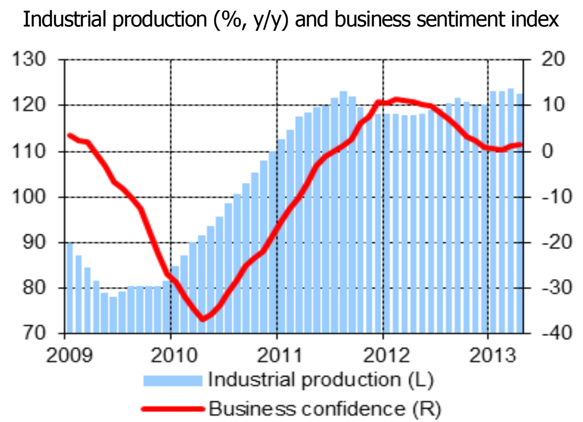
Private consumption was on a fast track in all the Baltic states, boosted by growing employment, particularly noticeable in Latvia, rising real income stemming from wage growth as well as a marked deceleration in inflation. Less restrictive fiscal policy also had positive effect on consumption.

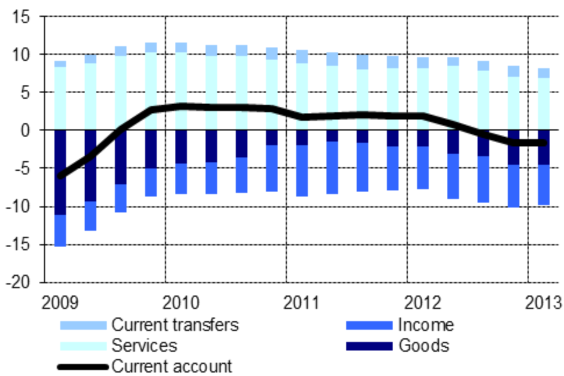
2013 is expected to see slight slowdown in the Baltic states, however, growth will continue to be the highest among the CEE economies. The dip in GDP growth in Lithuania will mainly be driven by ailing exports. Estonia, in turn, will see a deceleration in capital expenditure, especially in public investment, which was clearly visible already in 2013 Q1. Latvia, on the other hand, expects not only a further weakening in investment demand but also a subdued export growth rate.

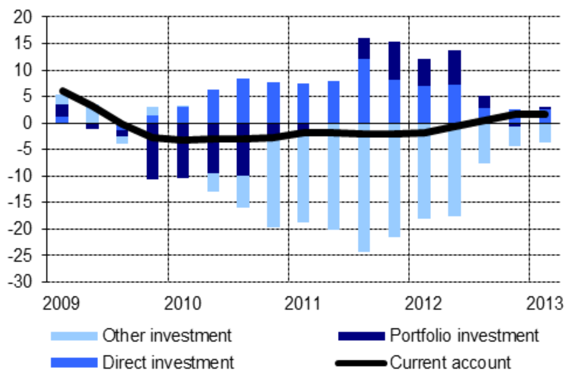


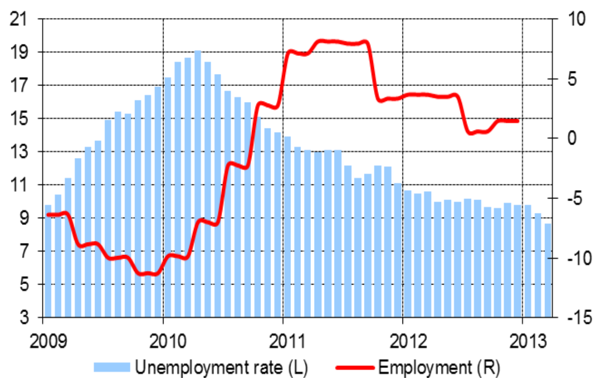


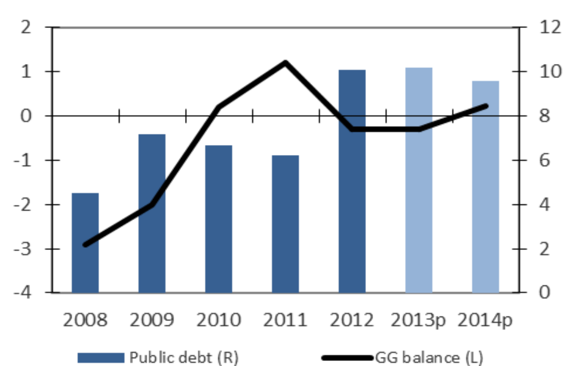






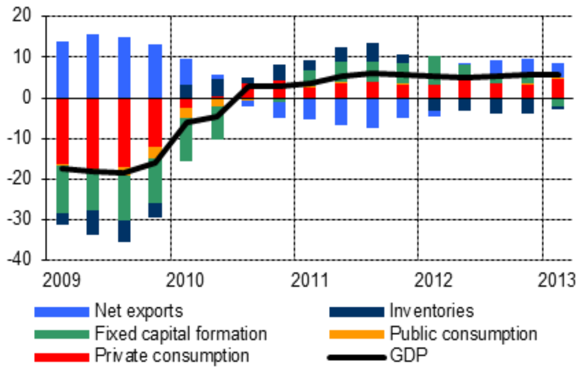




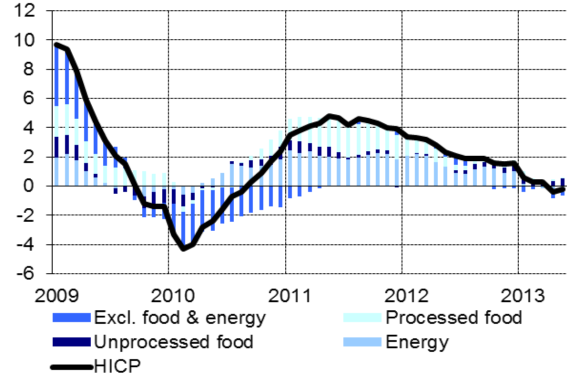


Source: Eurostat, CSOs

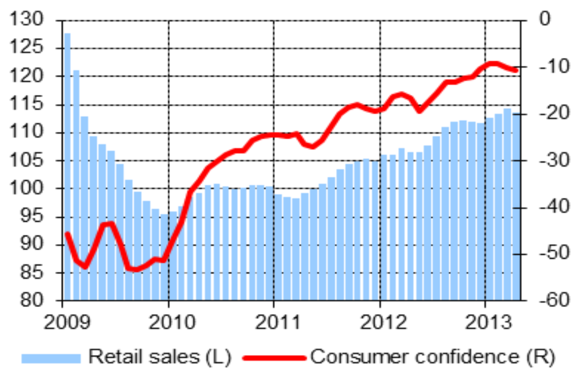
Contribution to GDP growth (in pp., y/y)



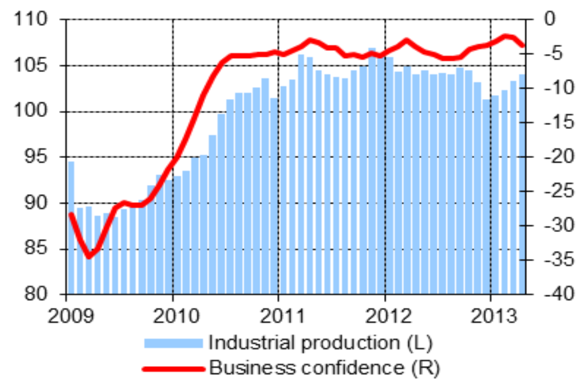
HICP inflation and its components (%, y/y)



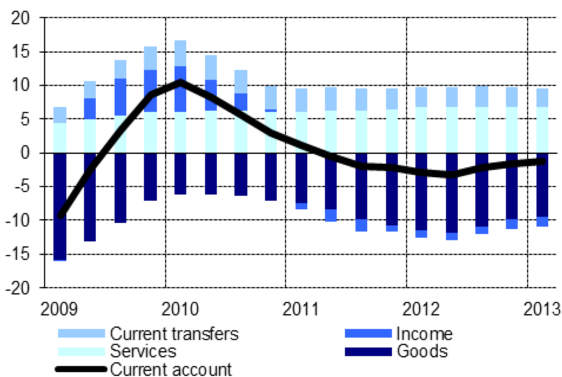
Retail sales (%, y/y) and consumer sentiment index



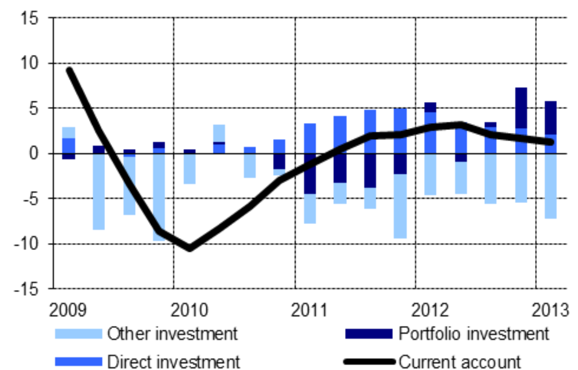
Industrial production (%, y/y) and business sentiment index



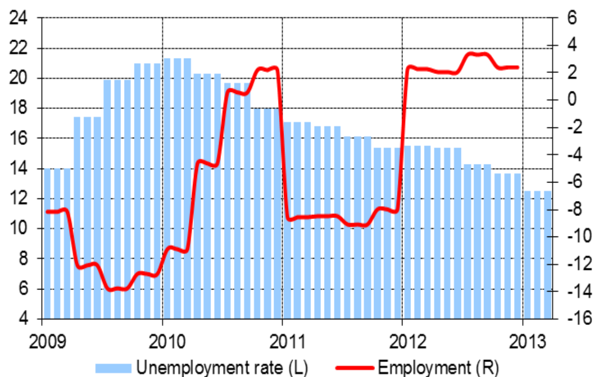
Current account and its components (% of GDP, 4-quarter moving average)



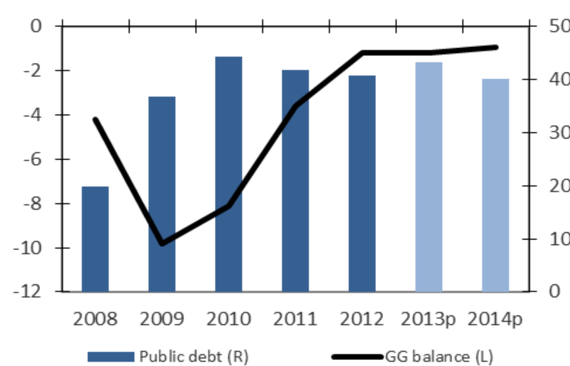
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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

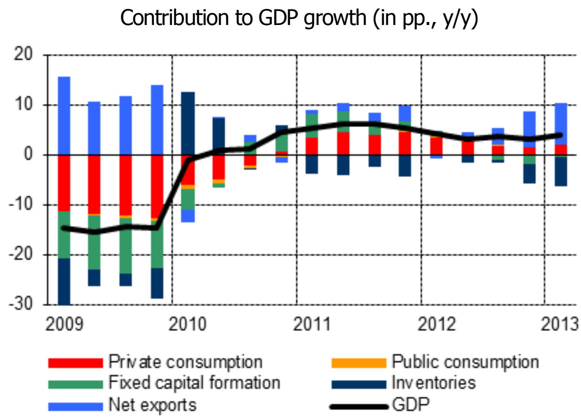


General government debt and deficit (in % of GDP)

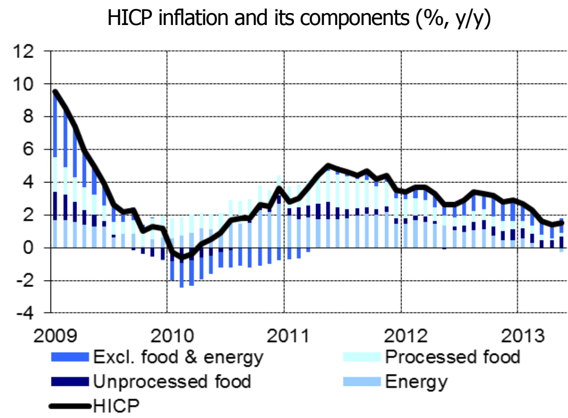


Source: Eurostat, CSOs

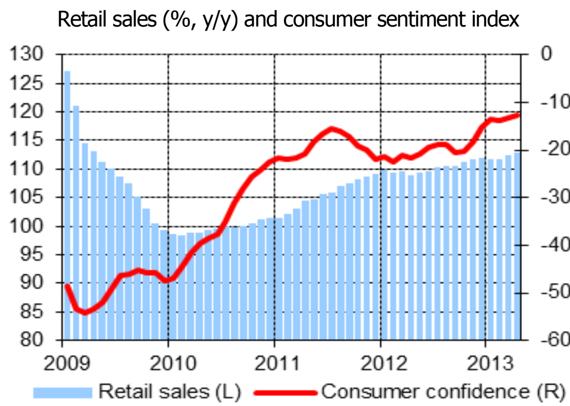
Contribution to GDP growth (in pp., y/y)



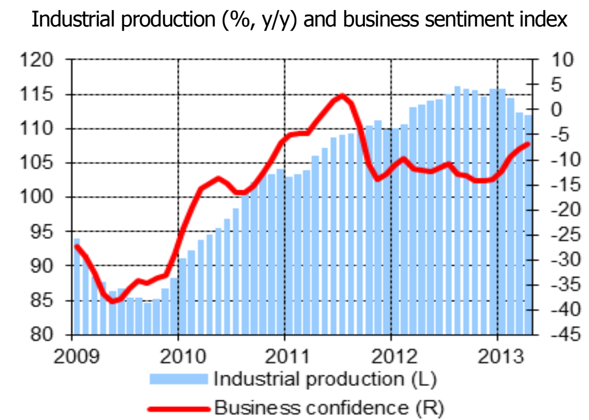
HICP inflation and its components (%, y/y)



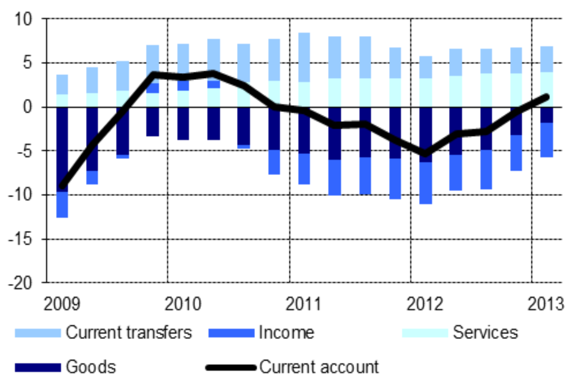
Retail sales (%, y/y) and consumer sentiment index



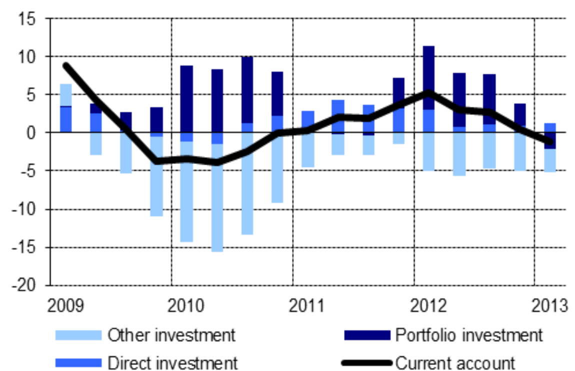
Industrial production (%, y/y) and business sentiment index



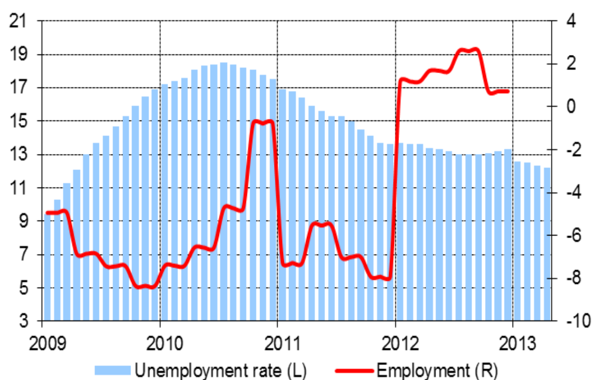
Current account and its components (% of GDP, 4-quarter moving average)



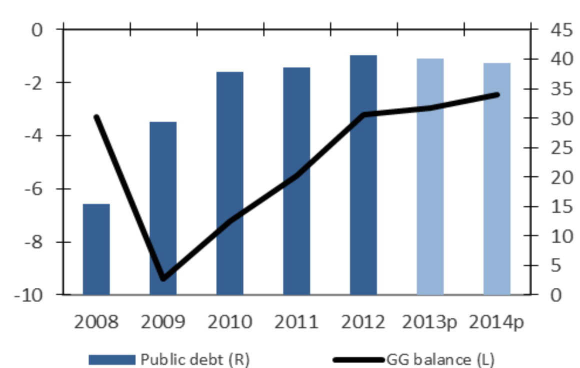
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

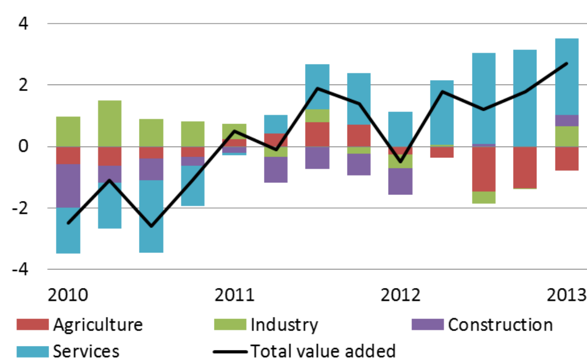
ROMANIA
Agricultural production drags economic activity

In 2012 economic activity in Romania, like in all countries of the region, slowed down noticeably [36], especially in the second half of the year. The third quarter of the last year brought GDP stagnation in annual terms; an improvement was recorded in 2012 Q4, originating mainly from a rebound of household consumption growth, principally with regard to durables, and from a weakening of the negative impact of trade attributable to sales of cars to countries outside the EU[37]. Still, the last quarter of 2012 was marked by another contraction in capital expenditure, which had demonstrated a relatively strong increase in the second half of 2011 and earlier in 2012[38].

According to analyses of the National Bank of Romania, one of the main reasons for a weak domestic demand in Romania in the second half of 2012 were adverse weather conditions (drought), which negatively affected the agricultural sector[39].

The situation in agriculture still is of great importance for the Romanian economy. This sector accounts for almost 7% of the value added of the economy (comparing to less than 5%, on average in CEE countries and 1.7% in EU countries), while its share in employment exceeds 30% (comparing to less than 15% on average in the CEE countries and 5.2% on in the EU countries)[40]. Thus, the disposable income and consumption of Romanian households depend closely on agricultural production. Additionally, land resources in Romania, although large, are heavily fragmented, with self-employment prevailing in the countryside. Fragmented farming not only translates into relatively low productivity of the entire sector but also increases the sensitivity of the sector's output and prices of agricultural products to weather conditions such as a drought or floods. At the same time, food products, whose prices depend on the prices of agricultural products, hold in Romania the largest share of the HICP basket in the entire European Union (32% comparing to on average less than 25% in the CEE countries and 15.4% in the EU countries), which additionally makes households' real disposable income dependent on the situation in agriculture. Therefore periods of economic slowdowns, driven by weak domestic demand and accompanied by high inflation, are relatively frequent in Romania. This was also the case last year, when drought had a negative impact on agricultural production and contributed to a rise in food prices. During this period, agriculture alone detracted 1.4 pp from economic growth, owing to which GDP rose by a mere 0.7%, whereas annual inflation rate in the second half of the last year amounted to 4.4% out of which 1.2 pp. was driven by unprocessed food prices.

Value added in Romania and its components, in pp., y/y



Source: Eurostat, IE NBP calculations

The effects of the slowdown in agriculture were also noticeable in the first quarter of 2013. Although GDP in Romania rose by 2.2% in annual terms, the upturn was mainly driven by external demand, as domestic demand was weak. At that time, exports picked up by 3.9% y/y while imports shrank by 1.3% y/y, which resulted in the largest positive contribution of net exports to GDP growth since the beginning of 2010.

In terms of value added generation, the acceleration of GDP growth in 2013 Q1 was mainly related to a revival in the export-oriented industrial sectors (especially automotive industry), which led to the first sizeable increase of the value added in industry since 2010. In contrast, the agricultural production and hence the value added of the agricultural sector was set to continue along a downward trend. This also contributed to a further contraction in consumption and investment demand of farms, thereby deepening the decline of domestic demand across the entire economy.

At the same time, rising food prices (in May 2013, the annual growth in unprocessed food prices in Romania amounted to 12.4%, twice the average in all CEE countries) were responsible for the highest inflation amongst the CEE countries in the first half of 2013 (4.4% in May 2013), which had a negative impact on households consumption expenditure.

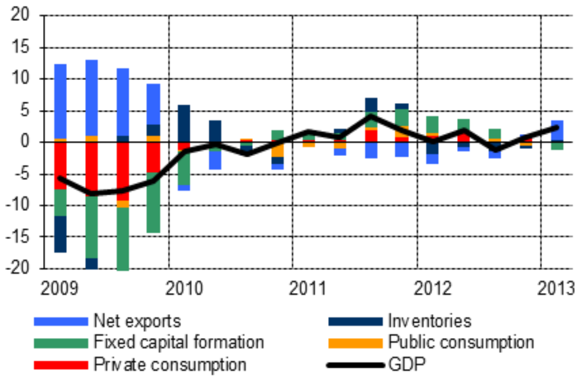
Intensive deleveraging of the private sector in Romania and especially of households was another important

[36] In the second half of 2012, GDP rose by 0.4% y/y comparing to 1.4% y/y in the first half of 2012.
[37] At that time, there was a rise in exports of cars (Dacia and Ford) as well as parts.
[38] The pick-up in investment through the entire period basically concerned plants and machinery in industry and services; however, in the first half of the last year it was mainly driven by construction investment, among others, in the agricultural sector.
[39] According to the *Inflation Report* NBR, the decline of the value added in agriculture reached 30% y/y in the third quarter and 25% y/y in 2012 Q4.
[40] Raiffeisen RESEARCH. *Economic overview ROMANIA*. Issue 5/2013.

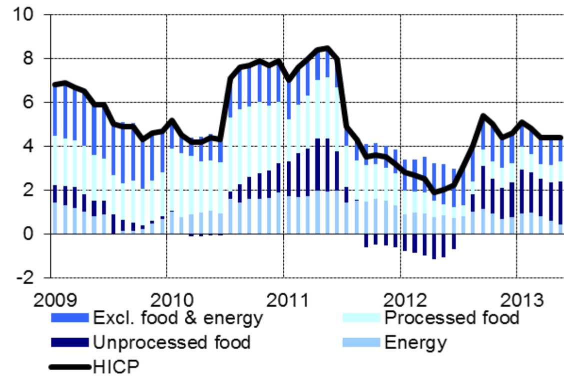
factor impeding consumption and investment in the second half of 2012 and the first half of 2013. Lending, after a period of moderate growth in 2011, began to slow down again in the second half of 2012. It was particularly marked in the case of loans to households, which contracted more than corporate lending and remained negative at the beginning of 2013.

However, assuming favourable weather conditions, negative trends in the economy are expected to reverse already in the second half of 2013. Nevertheless, domestic demand growth can still be partially curbed by a deteriorating situation in the credit market. External forecasts (such as, among others, the European Commission forecasts) seem optimistic; one expects a rebound of the domestic demand in the course of this year, including domestic consumption growth reaching 1.8% y/y and 1.9% y/y and 4.0% y/y and 5.0% y/y investment growth (supported by a wider use of EU funds) in 2013 and 2014, respectively.

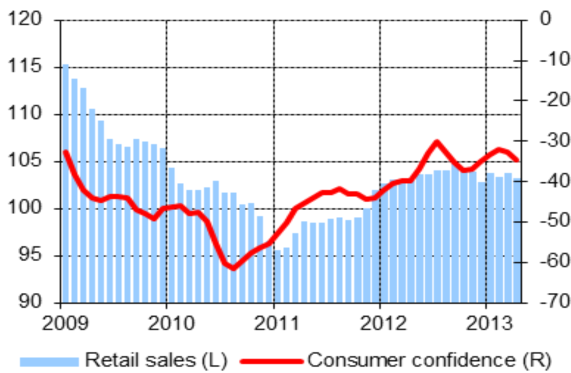
Contribution to GDP growth (pp., y/y)



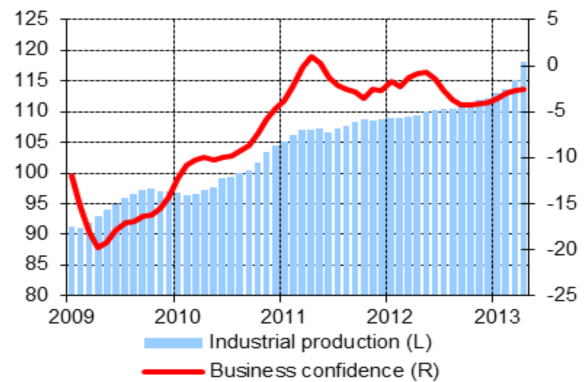
HICP inflation and its components (%, y/y)



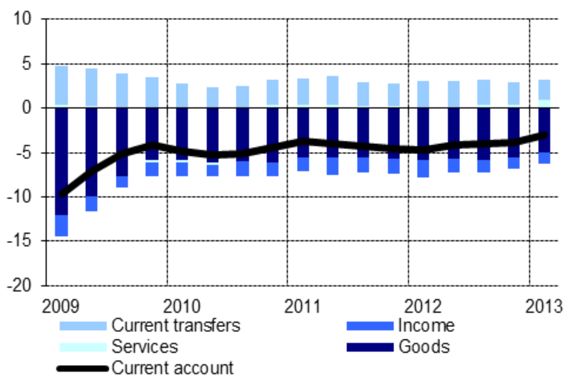
Retail sales (%, y/y) and consumer sentiment index



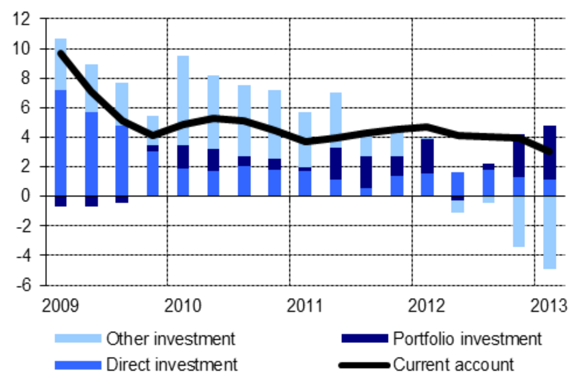
Industrial production (%, y/y) and business sentiment index



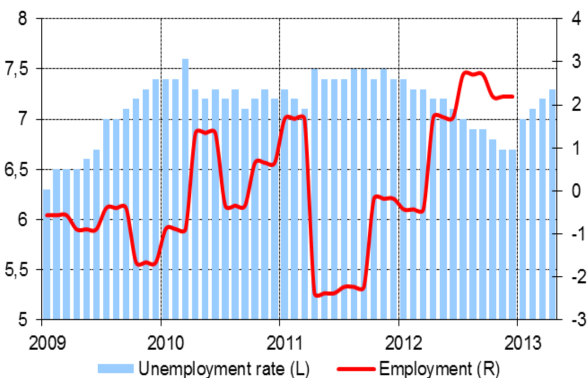
Current account and its components (% of GDP, 4-quarter moving average)



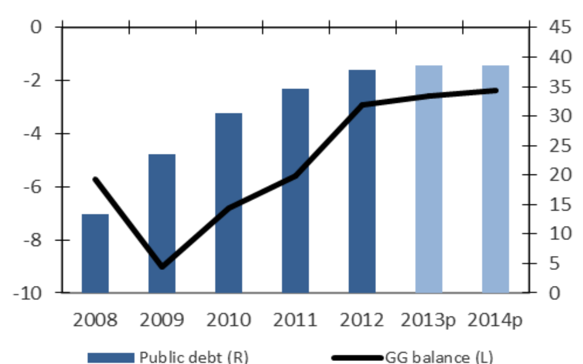
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

Slovakia
Economy driven by the automotive industry

GDP growth in Slovakia in 2012, like in the majority of the region's countries, recorded a noticeable downturn. It amounted to 2.0% y/y compared to 3.2% in 2011. In the first quarter of 2013 it fell to 0.8%, which hit the lowest point since 2009. Nevertheless, in spite of this marked dip, Slovakia was still one of the fastest developing economies within the CEE region in 2012 (except for the Baltic states).

In Slovakia, positive economic growth last year was attributable only to external demand. Consumption and capital formation contracted in the course of 2012. Net exports, which contributed 5.5 pp. last year, were the only category adding to GDP growth rate.

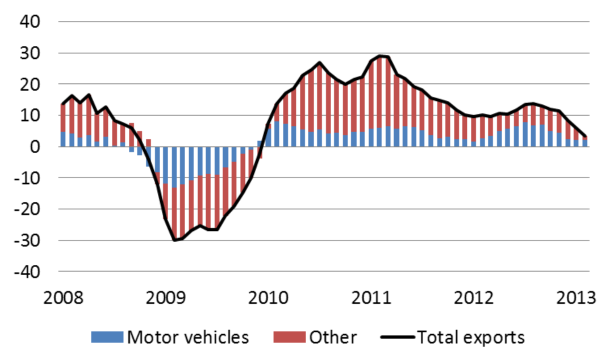
High - the highest out of all CEE countries - contribution of net exports in 2012 derives from sustained and relatively high exports growth and flagging imports, on the back of ailing domestic demand.

High exports growth in Slovakia in 2012 was basically driven by the automotive industry which for years had been playing an important role in the country's industry. The share of value added generated in the car manufacturing amounted to 17.6% of total value added in industry last year. Comparable size was observed only in the Czech Republic and Hungary. The year 2012 saw a significant pick-up in car production. Some 900 thousand new vehicles left Slovak plants, which is 40% more than in 2011 (the production volume in the automotive industry went up by 35%) in spite of the crisis in the automotive sector in other European states (EU countries noted a 7% slump in car production in 2012)[41]. Taking into consideration the number of manufactured cars per 1000 inhabitants, Slovakia is leading the way in the EU. The number was 166 cars in 2012, which is over five times more than the average for the EU and two and a half more than in Germany, being the largest European car manufacturer.

The automotive industry was the fastest growing industry in Slovakia, responsible for overall output growth in 2012. The increase in industrial output was the highest amongst the eleven presented CEE economies and reached 7% y/y, with the average for the CEE amounting to 1.4% y/y. Bulgaria, Croatia, the Czech Republic, Slovenia and Hungary even recorded a drop in the industrial production in 2012.

Slovakia can be described, even to a larger extent than other CEE countries, as a small open economy. Therefore, it is not surprising that a large part of cars manufactured in this country is exported. In 2012, only 78 thousand of the new cars were registered in Slovakia, which is over 11 times less than the country's output. Motor vehicle foreign sales accounted for almost ¼ of the entire 2012 exports in Slovakia. Strong performance of car sales to foreign markets thus gave a significant boost to the entire export sector. In 2012, exports expanded by almost 22%, while external sales of other goods, only by 7.5%. This meant that sales of motor vehicles accounted for the half of the growth in the Slovak exports.

Contribution of car exports to overall export growth in Slovakia, in pp., y/y



Source: Statistical Office of the Slovak Republic, IE NBP calculations

Other countries of the region, especially the Czech Republic, also belong to important automobile manufacturers. However, none of these countries posted such excellent performance of the motor vehicles' exports. It basically derived from the policy of automotive manufacturers present in Slovakia. On the one hand, companies concentrated on the production of models that fulfilled the largest demand in recent years (mainly cars from the SUV segment – VW Touareg or Kia Sportage). On the other, they were looking for new sales markets, alternative to the European Union countries. In effect, a large part of the output from Slovak plants went to the United States, Russia, or to the Asian market, mainly China[42].

It seems that the year 2013 will not be so prosperous for the automotive sector and thereby for the entire economy. According to manufacturers, the production of vehicles is forecast to remain at the level close to that seen in 2012 (app. 900 thousand), which implies that their exports will not increase either. Figures on the output and external sales of cars in 2013 Q1 seem to confirm these

[41] The increase in car production in Slovakia is mainly attributable to all car plants of the Volkswagen concern, which in 2012 doubled its output in this country. The production of KIA cars also increased by 15%, while the third major car manufacturer in Slovakia, the PSA group, limited the production volume, especially at the end of 2012 and at the beginning of 2013.

[42] Since the second half of 2012, the role of European markets in Slovak exports has been growing, particularly that of other CEE countries. It means that relatively high exports are attributable to the appropriately structured range of exported vehicles in that period.

forecasts. Their annual growth amounted to 8% and 10%, respectively, which is much less than in 2012.

At the same time, it does not seem that the domestic demand can make up for weaker exports growth. Private consumption in Slovakia will continue its downward trend on the back of fiscal consolidation[43]. At the beginning of 2013, the Slovak government abolished the flat tax of 19%, introduced upon the accession to the EU in 2004. A second PIT rate of 25% was introduced for people earning more than EUR 3311, which, however, should not have a significant effect on the vast majority of people[44]. The increase in the CIT rate to 23%, the increase in social security contributions for the self-employed and those working under commission contracts as well as the increase in administrative fees (e.g. relating to the registration of a new vehicle) may be more significant. These measures will curb the growth of households' real disposable income, which in 2012 was reduced to zero (in annual terms, real wages even edged down). However, the scale of the reduction in real income growth will be lower due to a marked decline in inflation observed from the beginning of 2013.

Another factor with a dampening effect on household activity is the rise in the bank[45] tax, introduced as of October 2012. Lending terms are expected to become more stringent, which will result in lower supply of loans to households and enterprises.

Investment outlays are not expected to rise, mainly due to enterprises' shrinking profits and high uncertainty prevailing in the markets. Only the capital investment in the automotive sector, under projects commenced back in 2012 in order to expand the capacity of factories located in Slovakia, is set to rise

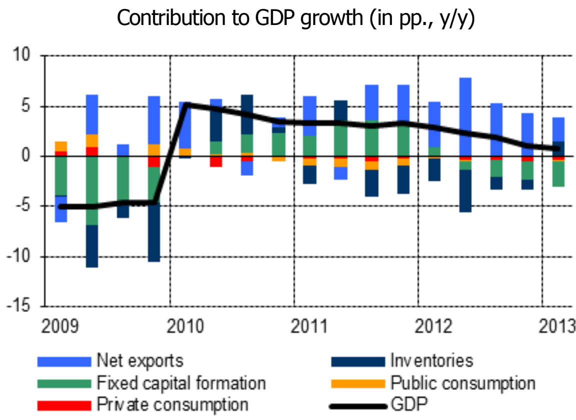
Thus the annual GDP growth in Slovakia will fall markedly on the 2012 figure. According to forecasts, the annual growth should amount to between 0.7% and 1.4% in 2013. It will continue to be driven by net exports. In the following year, the expected revival of the domestic demand should take GDP growth in Slovakia up to approx. 2.5%.

[43] The newly elected government is planning to reduce the budget deficit to 2.9% in 2013 and 1.9% in 2015.

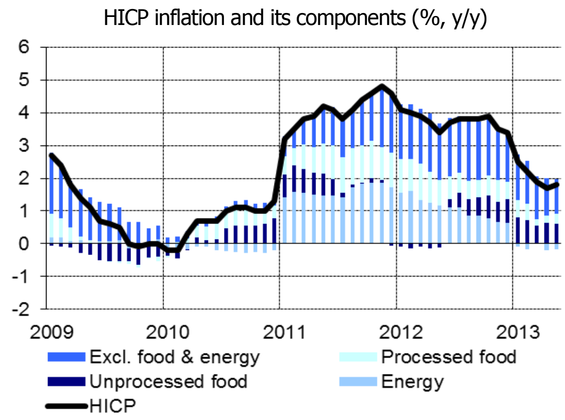
[44] The amount is four times higher than the average wages in Slovakia in 2012 and according to estimates, only 1% of taxpayers will exceed this threshold. The rate of income tax for high officials has also been increased by 5 pp., which should not practically render much to the entire economy.

[45] In January 2012, a banking tax of 0.2% was imposed on corporate deposits. In October 2012, it was raised to 0.4% and extended to include household deposits.

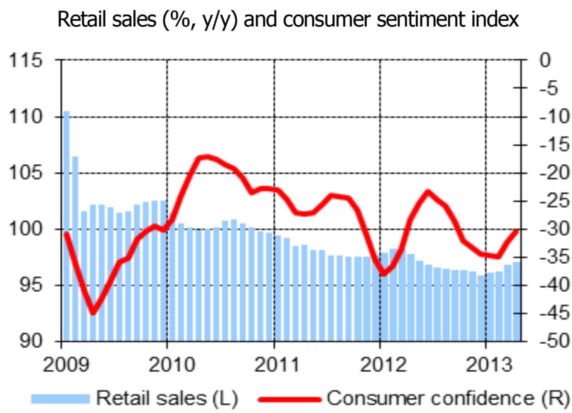
Contribution to GDP growth (in pp., y/y)



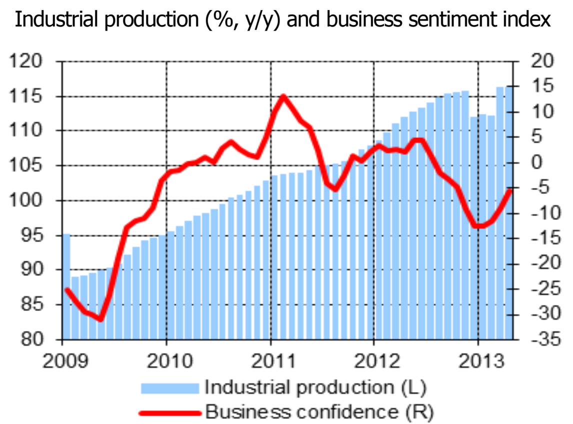
HICP inflation and its components (%, y/y)



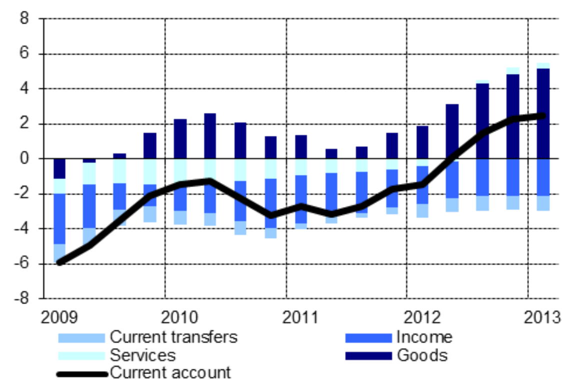
Retail sales (%, y/y) and consumer sentiment index



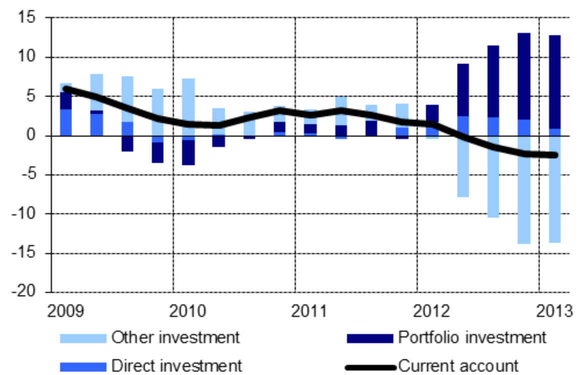
Industrial production (%, y/y) and business sentiment index



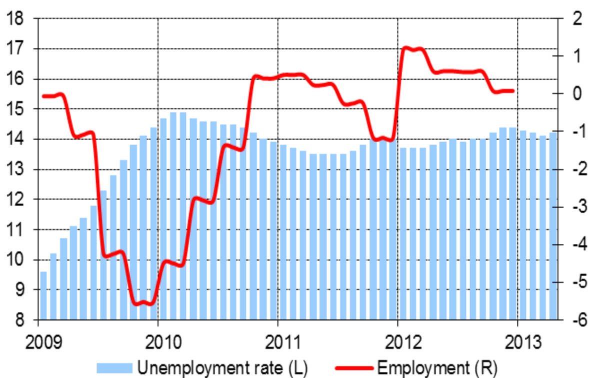
Current account and its components (% of GDP, 4-quarter moving average)



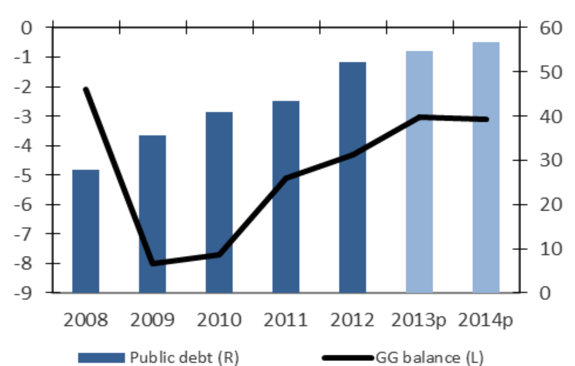
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt and deficit (in % of GDP)



Source: Eurostat, CSOs

SLOVENIA
Banking sector crisis holds back recovery

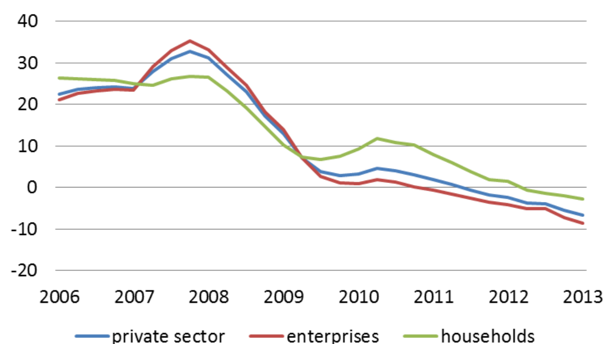
The Slovenian economy slipped back into recession in 2012. GDP went down by 2%, which meant that the scale of the fall was the largest amongst the region's countries. The fall even deepened in 2013 Q1, when the annual GDP growth rate dropped to -3.3%.

Slovenia recorded a strong decline in investment, shrinking continually since 2009. In 2012, the decline amounted to 9.3%. In spite of a slight recovery in fixed capital formation in 2013 Q1, they have decreased by over 50% since the onset of the global crisis in mid-2008. The main reason for the collapse of investment in Slovenia is the ongoing recession in construction following the burst of the real estate bubble, coupled with public investment cuts in recent years. From mid-2008 to the fourth quarter of 2012 capital expenditure on housing and other buildings and structures fell by over 60%.

2012 saw a marked deterioration in the confidence of Slovenian consumers, resulting from worsening situation in the labour market (increase in the unemployment rate of over 1 pp. and fall in employment by 1% in 2012), effects of currently implemented and announced fiscal policy. Political turmoil also added to the deterioration of consumer sentiment regarding their financial situation in the oncoming future. As a result, private consumption dropped by almost 3% last year. It was the first fall in household consumption since 1992.

Deepening crisis of the banking sector and ongoing deleveraging of the private sector were amongst the major factors driving consumption and capital expenditure downwards. Slovenian banks, in spite of the prevalence of domestic capital, were borrowing abroad very actively in order to finance consumption and investment boom after the accession to the EU and euro area. Since 2009, credit growth rate was sliding down sharply (which was also the case in the region's other countries), and since 2011 has been negative. The decline in lending to the private sector in 2012 and in 2013 Q1 was even steeper. In the first quarter of 2013, it amounted to -7% y/y, compared to -1% y/y with at the end of 2011. The decline affected almost all credit categories (except mortgage loans; still, their growth rate in Slovenia has also been gradually decreasing). Corporate loans were affected most. The fall was coupled with the deleveraging of the banking sector. According to BIS, foreign claims on banks in Slovenia were reduced by 40% compared to the 2008 peak. It seems, however, that it is not access to foreign funding that is the main reason for the decline in lending, but weak demand of the already indebted households and enterprises. Although the value of loans vis-a-vis the GDP has pursued a path of steady decline since 2011, notwithstanding the GDP drop, it continuously ran over 100% in 2012 (a fall from 115% in 2010 to 110% in 2012, in corporate lending, a drop from 84% to 81%). It implied, however, that the Slovenian private sector, especially enterprises, was among the most heavily indebted in the region. This, in the time of economic instability, forces entities rather to repay the outstanding liabilities than to take on new loans.

Bank lending for the private sector, in %, y/y



Source: BS, IE NBP calculations

The ongoing economic crisis in Slovenia also had noticeable impact on the condition and stability of the banking sector. The year 2012 was the third consecutive year of loss in the banking sector. At the same time, the value of non-performing loans pursued a steady growth, to account for 15% of all loans and credits, i.e. nearly 20% of GDP at the end of the last year (except Bulgaria and Romania the highest value among the CEE countries). In other words, bank clients are more than 90 days past due with the repayment of EUR 7 bn. loans and the total value of non-performing loans exceeds EUR 10 bn. (over ¼ of GDP). At the same time, the value of safety margins has not showed a considerable growth since 2008. Hence, Slovenia, additionally to a high percentage of non-performing loans, posts the worst capital adequacy ratio in the region.

It seems that the only rescue for the Slovenian banking sector is its recapitalisation by the state budget, which already took place in previous years. According to the government estimates, the volume of additional funding for the biggest banks is to amount to app. EUR 0.9 bn. The establishment of the "bad bank" programme will be another recovery measure. Whereby the non-performing mortgage and consumer loans will be take over in exchange for government-guaranteed bonds. Ultimately, Slovenia plans to guarantee the assets up to app. EUR 4 bn. However, whereas the level of non-performing loans as at 2012 year-end was nearly twice as high and prompt improvement of banks' assets quality is not to be expected (due to, among others, steady deterioration of Slovenian economic situation, which affects the debtors' financial situation), the scale of the support may markedly increase.

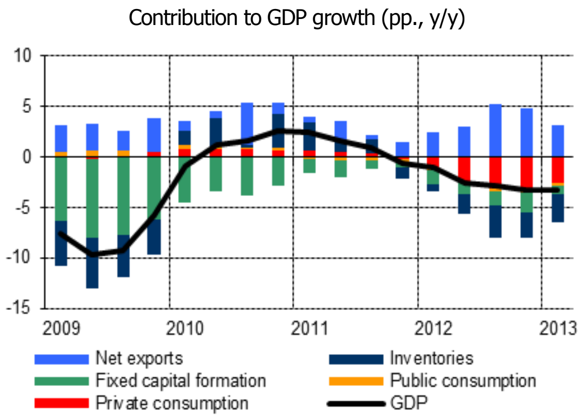
At the same time, the Slovenian export sector in also fell behind vis-a-vis other CEE countries. Exports in Slovenia both in 2012 and in 2013 Q1 remained broadly un-

changed comparing to 2011 (in nominal terms). This was primarily due to the falling exports to the EU countries (-3% y/y in 2012 and -2% y/y in 2013 Q1). Weak foreign demand has resulted in a noticeable output contraction in manufacturing. Between 2011 Q1 and 2013 Q1, the output fell by 6.5%. The automotive industry with the drop in output by over ¼ suffered the most severe losses.

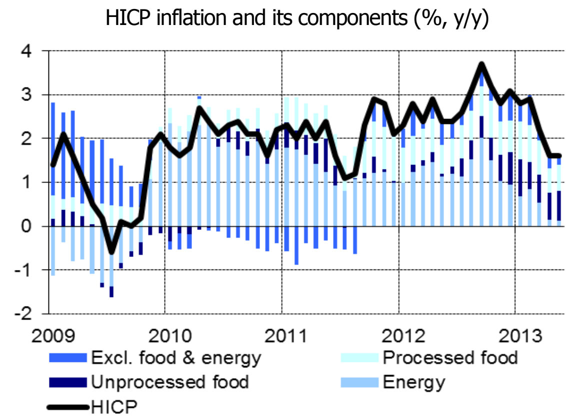
The nearest term outlook for the Slovenian economy continuously appears rather dismay. Apart from the flagging foreign demand which will also affect other economies of the region, Slovenia will continue to grapple with domestic problems. Accelerating fiscal consolidation process and ongoing deleveraging of the private sector, especially in enterprises, will be conducive to further decline of domestic demand in 2013. Moreover, it is not certain whether the government measures will restore stability in the financial sector. The threat of the banking crisis in Slovenia however, clearly waned in the first half of 2013. A successful issuance of bonds in early May this year (USD 3.5 bn.), in spite of earlier downgrading of Slovenia`s rating by major agencies, fulfils this year country's lending needs thereby raising funds to implement the bank support programme. Unstable political situation appears to be another greatest threat for Slovenia. Since the beginning of 2012, Slovenia has seen two cabinet reshufflings. This has exacerbated the image of the country in the eyes of investors and was one of the reasons for sovereign debt downgrades.

The forecasts of both international organisations and the Bank of Slovenia (BS) also mention the downward shift of the GDP in 2013. According to some forecasts (EC), this negative trend will persist even in 2014. The forecasts confirm that the decline will derive from the persistently waning domestic demand coupled with a small positive contribution of the net exports.

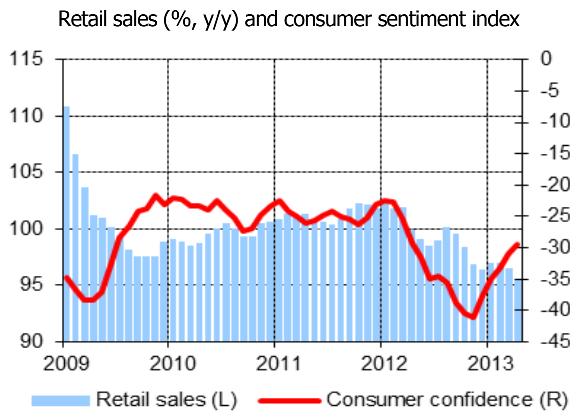
Contribution to GDP growth (pp., y/y)



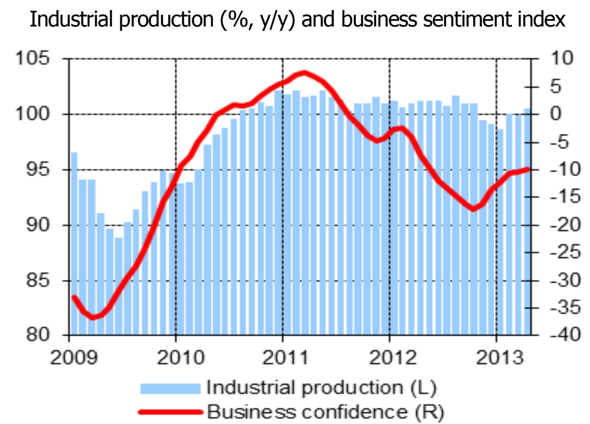
HICP inflation and its components (%, y/y)



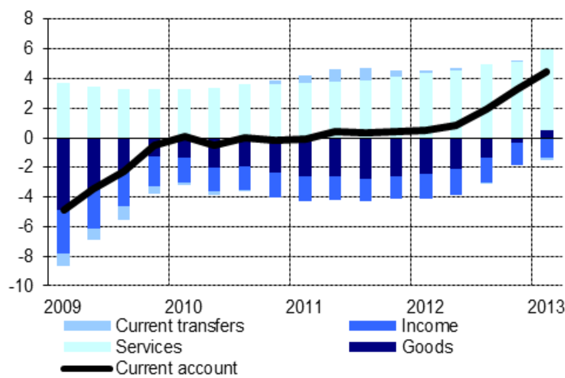
Retail sales (%, y/y) and consumer sentiment index



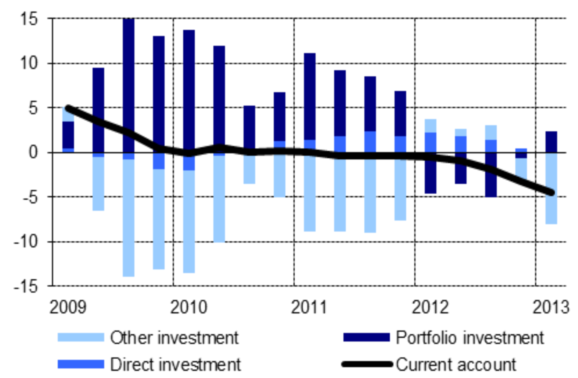
Industrial production (%, y/y) and business sentiment index



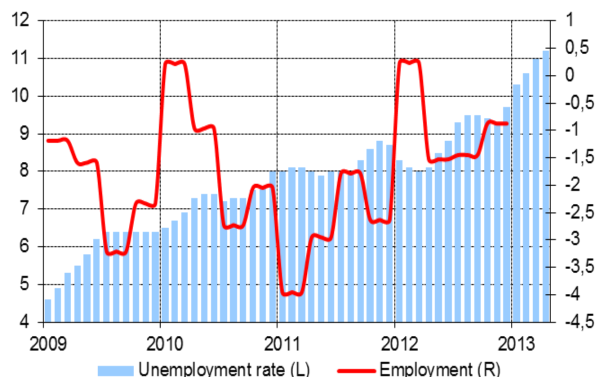
Current account and its components (% of GDP 4-quarter moving average)



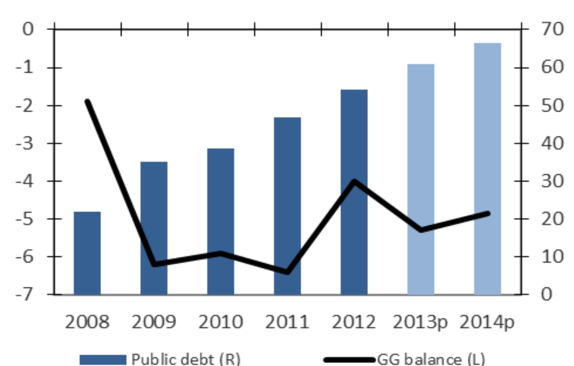
Financial account balance and its components (in % of GDP, 4-quarter moving average)



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



General government debt (in % of GDP)



Source: Eurostat, CSOs

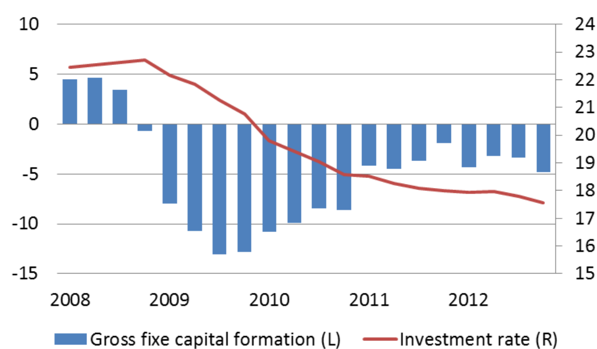
HUNGARY
Measures to stimulate investment

After two consecutive years of a moderate recovery, the Hungarian economy relapsed into recession in 2012, which is reflected in 1.8% GDP decline. Along with continuously weak demand in the major export markets, economic activity has been dragged down, to a large extent, by dwindling household consumption expenditures and diminishing investment outlays of private firms. The magnitude of the fall in the Hungarian GDP was also affected by one-off factors (such as low crops in the aftermath of drought, temporary reduction in the number of working shifts and headcount downsizing in production plants, etc.), which had a negative impact on agriculture and industry output.

Taking into account the abovementioned economic situation, figures for 2013 Q1 are quite optimistic and indicate the possibility of bringing the existing downward trend to a halt. The Hungarian GDP at that time rose by 0.7% q/q in real terms (after a decline of 0.3% q/q in 2012 Q4), whereas in annual terms it slipped down again although to a much smaller degree (-0.3%) than in 2012 Q4 (-2.4%). Economic activity in Hungary picked up due to net exports (but their influence has diminished compared to 2012) and due to the increase in inventories. Private consumption, public expenditure and gross fixed capital formation remained on the decline. By contrast, considering the structure of the value added in the country's economy, it may be noticed that the business conditions improved mainly in agriculture and construction industry (partially it resulted from a low statistical base in 2012), whereas downward output trend prevailed in other branches of the economy, most of all in processing industry.

The persistently low economic investment activity of enterprises continues to be one of the most urgent problems of the Hungarian economy, which poses a significant obstacle to the expected recovery. The value of gross fixed capital formation remains much below the pre-crisis period (in 2012 corporate investment was by over 20% lower than in the years 2005-2007). The consequence of the above is, among others, a steady decline in investment rate, which in 2013 Q1 dropped to the lowest level in the past decade (17% comparing to 23% in 2004). The observed decline in investment activity reflects shrinking investment both in the private and *general government* sector. Falling exports of goods and services, low consumption expenditure (due to, *inter alia*, slow increase in nominal wages and ongoing household deleveraging process) and constrained access to corporate loan facilities are the main brake on investment in the private sector. Investment of the *general government* sector, in turn, has been, until now, negatively affected by fiscal consolidation aiming at the reduction of the budget deficit to the level below 3% of the GDP. Taking into consideration the above circumstances, it may be assumed that the corporates' propensity to invest will remain low for a couple of years to come. Thus, investment outlays of private firms are not likely to support growth in the nearest future.

Gross fixed capital formation (in%, y/y) and investment rate in Hungary (in % of GDP)



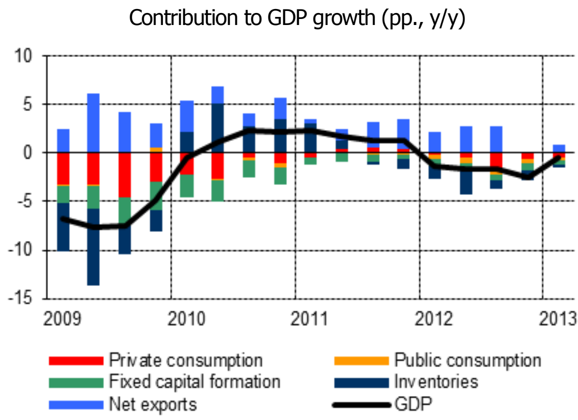
Source: KSH, IE NBP calculations

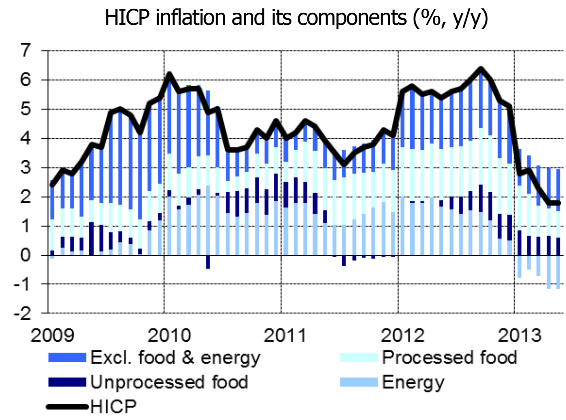
In order to stimulate economic activity, the central bank of Hungary (MNB) presented the objectives of its new programme called *Funding for Growth Scheme* (FGS) on 4th April this year. The overriding aim of the programme is to provide larger access to credit to small and medium enterprises (SME) playing the role of a flywheel of the Hungarian economy. It should be noted that companies from this sector, to a larger extent than large corporates, take recourse to the banking credit to finance their activity (due to insufficient own funds, high costs of financing by bond issuance). Respectively, it is extremely important to open this channel in order to boost the economic growth. The FGS programme also seeks to curb a supply of new foreign currency loans to enterprises and reduce the existing short-term foreign debt to make the Hungarian economy less dependent on external financing. These measures should lead to a decrease in the Hungarian external debt and thereby reducing the sensitivity of the country´s economy to negative shocks from its external environment.

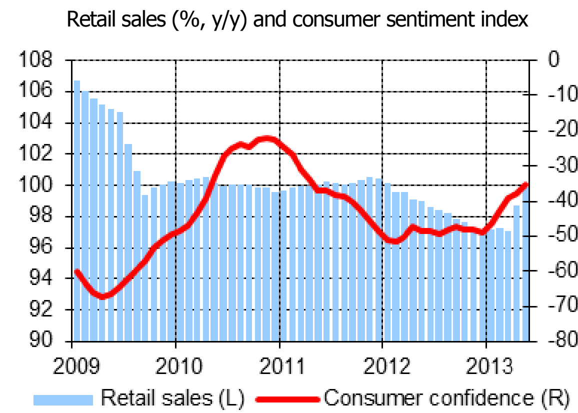
The FGS programme is of a temporary character. It is set to be in force from June to August 2013 and consists of three parts. The first part provides for granting by MNB non-interest bearing loans to commercial banks provided that the received funds are assigned for loans extended to SME on preferential terms. The loans may be used by enterprises, *inter alia*, for financing their daily business and/or new investment and for financing their own expenses relating to the application for the European Union funds. Upon the adoption of the programme, the total value of lending under this part of the programme was set at HUF 250 bn. However, due to enormous interest of commercial banks, the MNB has decided to increase the amount of loans to HUF 425 bn. Under the second part of the FGS programme commercial banks will provide

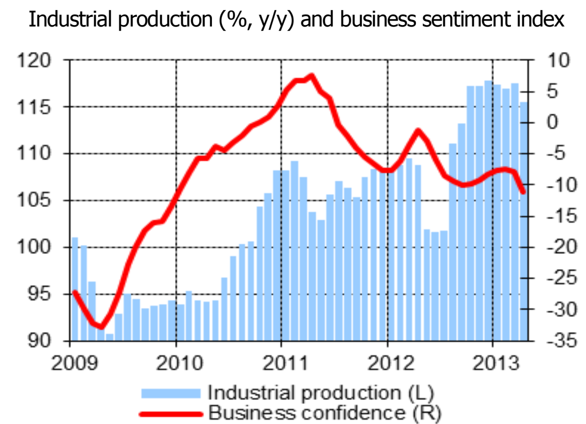
preferential financing to the SME sector in order to convert the foreign currency loans into loans denominated in forints. Banks will receive funds for the conversion of existing credits from MNB, which will exchange its reserve assets at a market rate. The total value of the credits granted under the second part of the programme will amount to HUF 325 bn (initially, the total amount of credits was expected to reach HUF 250 bn, but given high demand on the part of banks, the limit has been increased). The third part of the FGS programme seeks to reduce the Hungary's external debt repayment by cutting down the country's short-term debt with the original maturity of up to one year. The operation should not affect the ratio of Hungary's short-term debt to MNB foreign reserve as in line with the objectives, the banks will be obliged to allocate the received funds for the repayment of their short-term commitments in foreign currencies. According to the estimates, transactions scheduled for the second and third part of the programme will cut down the MNB foreign exchange reserves by app. 10%.

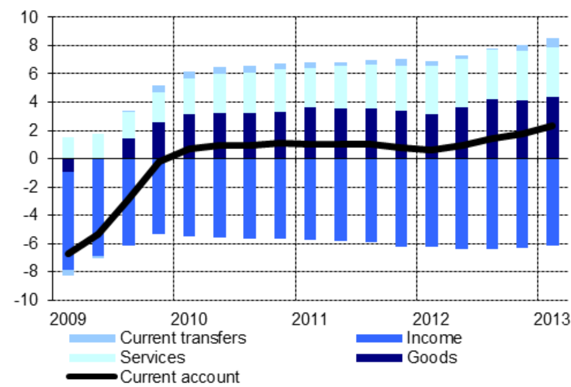
According to preliminary assessment of the central bank of Hungary, the implementation of the FGS programme will boost up the economy in 2013-14 by app. further 0.2-0.3 pp. (according to the MNB March forecasts, the GDP will increase at that time by 0.5% and 1.7%, respectively). Based on the optimistic scenario, the bank assumes that the increased access to lending for the SME sector should add to the projected GDP rate app. 0.5-1 pp. in the next two years. Hence, it seems that boosting up investment activity is an indispensable condition of the expected revival in Hungary as the role of net exports has substantially slumped and the private consumption remains weak.

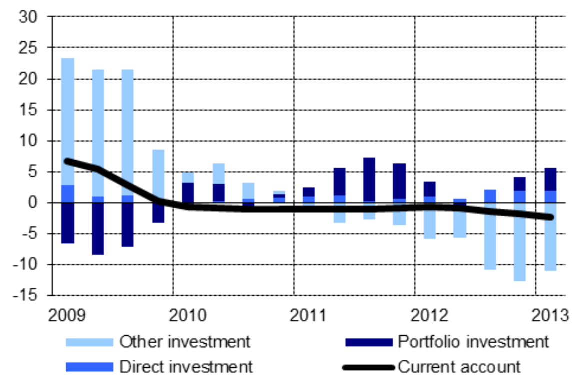


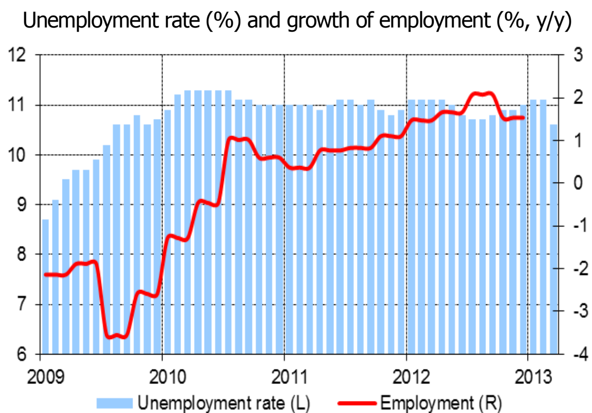


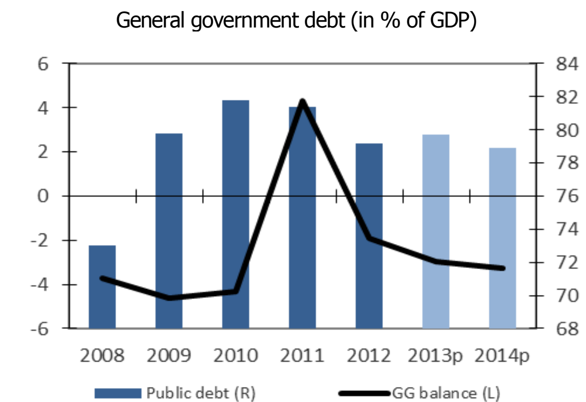












Source: Eurostat, CSOs

Annex 1

Foreign capital inflow into the CEE countries – changes in structure, impact on foreign debt

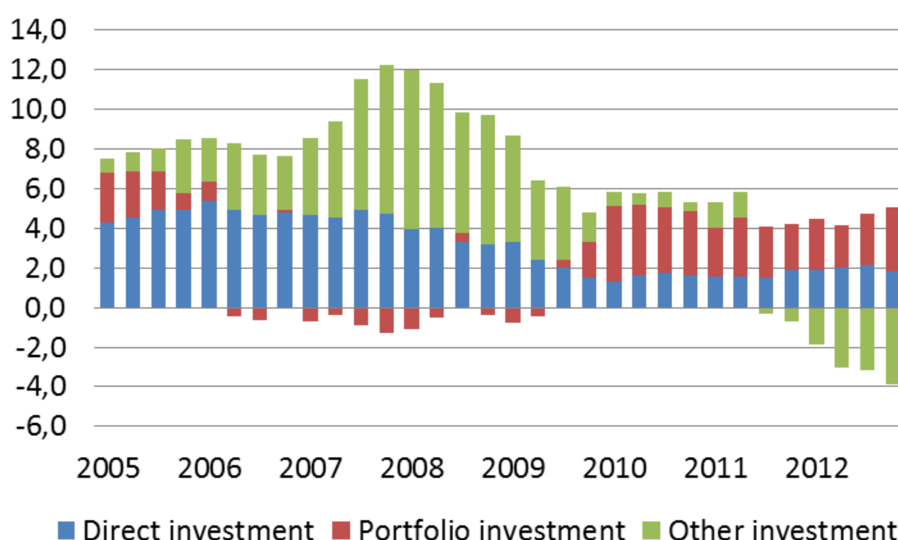
From the very onset of economic transition, the growth model in the CEE countries has assumed a sizeable inflow of foreign investment. While the capital was flowing to region, a high deficit persisted in the current account. It distinguished the CEE countries from other emerging economies (especially the Asian ones). Unlike CEE economies, these countries were also exporting capital, especially portfolio capital and at the same time, posted a surplus in the current account.

Along with the process of European integration and thus with a gradual liberalisation of financial flows, the scale of foreign capital inflow to the CEE countries ebbed up at the beginning of the 21st century and especially after 2004. In effect European financial groups, especially banks markedly expanded. Taking into consideration the situation in the financial markets in advanced countries (high liquidity, low rates of returns on local investment) and huge lending potential of households and enterprises in the CEE region at that time, this group of countries has become an important direction of the capital flows, mainly from the Western European banking groups.

Additionally financial liberalisation brought made loans less expensive. Lending cost considerably declined due to easy access to foreign currency loans, which triggered credit booms in the region. In most economies, (especially in the Baltic states, Bulgaria and Romania) they were financed by loans and deposits of foreign banks which mounted foreign debt of the banking sector in the region. In 2007-2008, the net inflow of other investment, i.e. mainly capital within the banking sector, already exceeded that of foreign direct investment became a major source of capital flows into the region's countries.

The global financial crisis has contributed to a severe drop in the inflow of foreign capital to the CEE countries (so called *sudden stop)*. It mostly affected Bulgaria, Estonia, Lithuania, Latvia, Romania, Slovenia and Hungary, i.e. the countries that in previous years had been largest recipients of foreign capital[46]. It should be noted that the Baltic states even experienced disinvestment in 2009, i.e., non-residents withdrew more capital from these economies than they had invested. The value of foreign investment across the entire region (measured in relation to GDP) fell to 6.3% in 2009, from an average of 14.5% in 2005-2007. Over the following years, the inflow of foreign capital further declined to 3.2% of GDP in 2012, inter alia, due to sustained high risk aversion.

Net foreign capital inflow to CEE countries, in % of GDP



Source: Eurostat

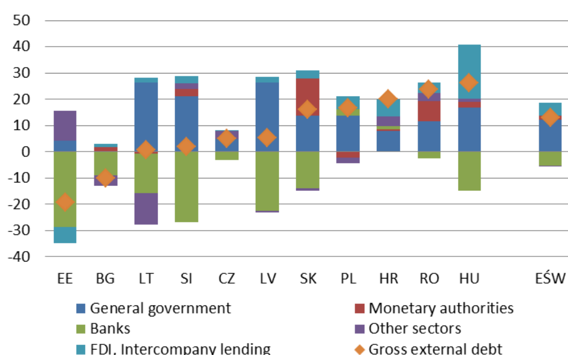
Not only did the inflow of foreign capital to the CEE countries decline but it also changed its composition. Firstly, the share of the other investment fell. Prior to the crisis it financed most of the current

[46] A sudden halt in the inflow of foreign capital triggered so serious implications that in 2008-2009, Latvia, Romania and Hungary applied to the World Bank, International Monetary Fund and the European Union for financial assistance.

account deficits in the region. It should be associated with the fall in the inflow of capital to the banking sector which in most of the CEE countries has been predominated by international financial groups. Secondly, the value of foreign direct investment declined, curbed, among others, by lower reinvested profits coupled with worse financial standing of foreign-owned enterprises. By contrast, the share of portfolio investment rose considerably in the region over the crisis to peak in 2010. It reflected the increased interest of non-residents in treasury bonds issued by the major CEE economies, offering the highest rate of return compared to debt securities in the developed countries at the acceptable investment risk level. The observed mounting inflow of the portfolio capital to the region also stemmed from non-standard measures undertaken by the main central banks determined to increase the liquidity of the global banking sector.

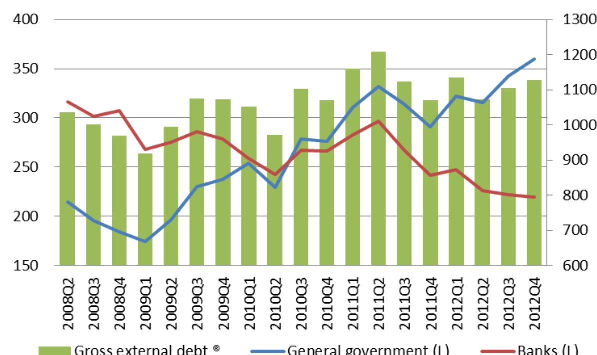
Although foreign capital inflow to the CEE countries declined, the sovereign debt in most of them did not, on the contrary, it even nudged up. From 2008 Q2 to 2012 Q4, all 11 CEE countries posted soaring foreign liabilities, the amount of which increased by nearly USD 91 bn. which accounts for nearly 9% of the total debt of the region. Foreign debt rose in the analysed group in Poland, the Czech Republic, Croatia, Romania, Slovakia and Hungary. In the analysed period, the ratio of foreign debt to GDP also went up across the entire region, from 72.5% in mid-2008 to 84.5% and at the end of 2012. The rising foreign debt to GDP ratio masked not only higher debt but also a decline in GDP at that time. This had a major dampening impact on this ratio in the Baltic states, Croatia, Slovenia and Hungary.

The change of volume and structure of foreign debt in the CEE countries in 2008-2012, in % of GDP



Source: the World Bank, Eurostat

Foreign debt in the CEE countries, in billions of USD

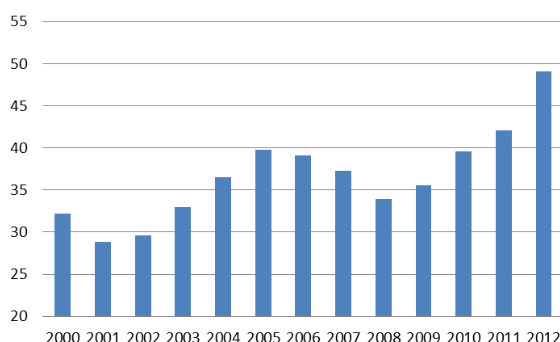


Source: the World Bank

The changes in the structure of foreign capital inflow in 2008-2012 had a sizeable impact on the change of foreign debt structure in the region. Since the onset of the global financial crisis in 2008, deleveraging in the banking CEE sectors took place. Foreign claims accumulated in former years (basically the liabilities of Central European bank branches and subsidiaries towards their foreign parent banks) posted a steady decline. The process was observed especially in the countries with the largest capital inflows to the banking sector before the crisis (Baltic states, Slovenia, Hungary). By contrast, the economies which financed lending mainly from domestic funds(the Czech Republic, Poland, Slovakia), posted substantially smaller outflow of capital from the banking sector. Meanwhile, in spite of the marked reduction in foreign claims in the CEE countries, the total debt in 2008-2012 went up, which was primarily attributable to two factors. First, a sizeable growth in interest of foreign investors grew more in CEE bonds was noted. Whereas they first targeted at bond markets in Poland, the Czech Republic and Slovenia, an economic slump in the two former countries in 2012 made them turn their interest rather to the Baltic states and Slovakia. The large inflow of foreign portfolio capital into the CEE countries increased the non-residents share in the –bond markets. Apart from Bulgaria, Estonia and Romania[47] it rose significantly (by 15 pp. in 2008-2012 across the entire region) to exceed 50% in Poland, Slovakia, Slovenia, Lithuania, Latvia and in Hungary in 2012. Thus general government foreign debt rose markedly by USD 146 bn. by 2012 year-end, i.e. by over 2/3 comparing to mid-2008.

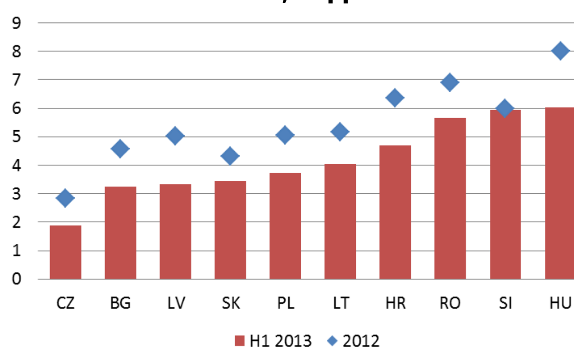
[47] The exposure of non-residents to T- bonds in Bulgaria and Estonia shifted downwards. In Romania, these proportions deteriorated even more although the value of T- bonds held by non-residents increased, which derived from the growing demand of residents for government debt securities.

The participation of non-residents in the sovereign debt in the CEE countries, in %



Source: the World Bank, Eurostat

Medium yields on 10-year Treasury bonds in 2012 and the first half of 2013 in the CEE countries, in pp.



Source: Reuters

Secondly, structure of FDO inflow also changed. In 2004-2008, equity investment (either in a form of equity purchases or reinvested profits) was the prevailing form of FDI. Since then, intra-company loans began to play the growing role. Such situation was observed in Poland, Croatia, Romania, Slovakia and Hungary. Foreign debt across the entire CEE region increased on this account by over USD 25 bn.

As the inflow of portfolio capital to the region has risen since 2008, prices of bonds soared and its yields declined. In most of the region (except Slovenia)at the beginning of 2013 Q2 they hit all-time lows (e.g., a decline in 10-year T-bond yields in the Czech Republic was below 1.5%, in Poland 3% and in Hungary 5%). Given a large foreign demand, even those countries of the region which had not have high rating grades (e.g. Hungary or Slovenia[48]), did not have major problems with the issuance of new debt securities in the first months of 2013. Thus, the decline in yields implies lower costs of sovereign debt service. It is particularly important in the present situation of the CEE countries which are grappling with fiscal consolidation amidst the deepening slump in their economies. Additionally, the increased demand of foreign investors for bonds triggered the appreciation of region's currencies, at least in the second half of 2012 (the trend however, reversed already in the first half of 2013). For the time being, it also helped to reduce the debt service cost (also in the case of in the private sector foreign currency debt).

It is worthwhile to mention certain risks incurred by increased foreign interest in CEE bond markets. The increased participation of non-residents makes them more prone to speculative transaction and thus implies higher potential volatility of securities prices. However, it seems that this scenario is not likely to happen as large financial groups of foreign investors are involved and there is a remote chance that they treat such investment in purely speculative terms. Still, this possibility cannot be absolutely excluded. In the case of increasing distress in the global financial markets, like the one after Lehman Brothers collapse, capital may rapidly fly away from the region, thus destabilising local financial systems. Besides, it should also be noted that such a sizeable inflow of portfolio capital to the CEE countries in recent years is an exception. It is primarily associated with large liquidity of the global banking sector, limited exposure to the assets of the peripheral euro area countries and curbing the lending to the CEE private sector (indirectly by the withdrawal of capital from the banking sector). Therefore, it is worthwhile to remember that in the case of the rebound in the economic situation worldwide, investors may gradually come back to the "abandoned" markets looking for higher return on investment, which would curb CEE bond purchases. It should be specifically remembered by the governments of these countries, which must not take it for granted, that low bond yields and high demand for bonds is given once and for all. Accordingly, they should take into consideration the risk of the change of a global situation while setting the assumptions of the budgetary policy.

A situation of June 2013 seems to confirm the presumptions regarding the persistence of high instability of the CEE financial markets. At that time, the risk aversion returned and foreign investors were gradually retreating from emerging economies, which effectively resulted in the rapid fall of financial assets' prices and depreciation of currency rates, also in Central European markets.

[48] Slovenia, among others, managed to carry out the bond issuance at the beginning of May 2013 although their rating was downgraded by Moody's agency to the "junk" status. Thus, already in the first half of the year, Slovenia secured the country's financial needs until the end of 2013.

Annex 2

Changes in the functioning of the mandatory funded pension schemes in the CEE countries in 2009-2013

All of the CEE countries, except for the Czech Republic[49] and Slovenia, introduced a mandatory[50] funded pension scheme (pension funds – PF; second pillar). Transfer of a part of old-age pension contributions to PF, coupled with the current pension payments from the state run PAYG schemes, requires adoption of other consolidation measures or increase in public debt to make up for the revenue loss.

The economic crisis has sparked off serious fiscal tensions across the region. Within the array of consolidation measures these countries have decided to introduce changes that will permanently or temporarily reduce fiscal costs of pension reforms. The following reasons have been crucial for the decision:

- in ESA'95 terms, in line with the Eurostat[51] regulations, the transfer of old-age pension contributions to second pillar worsens the general government budget balance, thus hampering the compliance with the Maastricht deficit rule. (3% of GDP);
- the transfer of contributions to open pension funds increases (*ceteris paribus*) borrowing needs and public debt. Nevertheless, it reduces at the same time the implicit debt, i.e. liabilities towards future pensioners[52]. The rising public debt may prompt a negative reaction of financial markets and hamper the compliance with national fiscal debt rules (Poland, Slovakia, Hungary);
- lowering rate of the contribution transferred to PF does not entail direct negative impact of reducing on the aggregated demand, unlike adjustment measures, such as tax hikes or spending cuts. It is of vital importance amidst bold fiscal adjustment coupled with subdued economic growth.

The positive impact on fiscal balance stemming from enacted changes in the functioning of funded pension scheme involved:

- diversion of a part of old-age pension contributions from open pension funds to the public schemes or suspension of its transfer;
- transfer of a part or nearly all assets accumulated in the second pillar;
- optional participation in the second pillar (Slovakia[53], Hungary).

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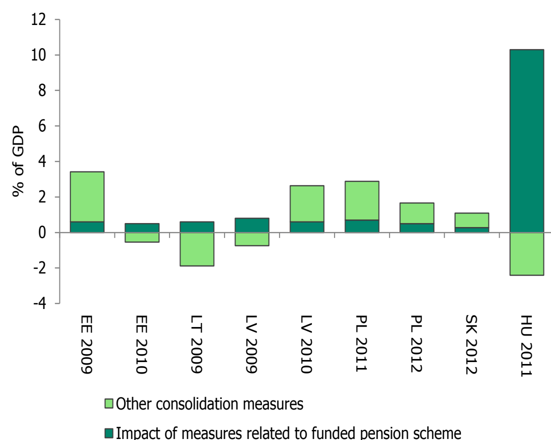
[49] The voluntary funded pension scheme was launched in the Czech Republic in 2013. A contribution transferred to pension funds combines part redirected from the first pillar (3%) and part paid directly by an insured person (2%). An option of voluntary saving for a pension in the funded scheme is available only for those that are maximum 35 years old and for the others only until the end of June this year (decision to join is irrevocable).
[50] Hungary – 1998, Poland – 1999, Bulgaria – 2000 (occupational) and 2002 (universal), Latvia – 2001, Estonia and Croatia – 2002, Lithuania – 2004, Slovakia – 2005, Romania – 2008. Lithuania is treated in this Annex as a country with mandatory; although membership in the open pension fund is voluntary, still ca. 80% of the insured have decided to join the second pillar. See A. Bitinas, *Lithuanian pension schemes*, European Bank for Research and Development, http://www.ebrd.com/downloads/research/news/LITHUANIA.pdf.
[51] Pursuant to them funded pension schemes are not treated as the general government unit. See *New decision of Eurostat on deficit and debt. Classification of funded pension schemes in case of government responsibility or guarantee*, Eurostat, 2 March 2004.
[52] See J. Jabłonowski, Ch. Müller, B. Raffelhüschen, *A fiscal outlook for Poland using Generational Accounts*, National Bank of Poland Working Papers, No. 85, Warsaw 2011.
[53] For new entrants in pension system (an amendment adopted in 2012).

Changes to the funded pension scheme and a magnitude of fiscal adjustment (measured by the change of the cyclically-adjusted primary balance).

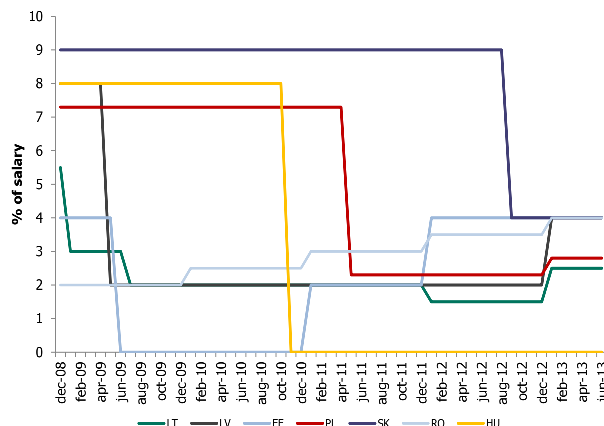


Fiscal tightening (+) / loosening (-)

EE – Estonia, LT – Lithuania LV – Latvia, PL – Poland, SK – Slovakia, HU – Hungary.

Source: Stability/Convergence Programmes of the CEE countries, AMECO database.

Old-age pension contribution rate transferred to the second pillar



LT – Lithuania, LV – Latvia, EE – Estonia, PL – Poland, SK – Slovakia, RO – Romania, HU – Hungary.

Source: Stability/Convergence Programmes of the CEE countries.

The above measures constituted a significant element of consolidation packages, especially in Hungary, where in 2011 funded pension scheme was in practice abolished (97% of its members switched back to the public pillar). In the other countries, the fiscal balance has improved by app. 0.7-1.4% of GDP annually (Romania – 0.1% of GDP).

In 2009-2013, across the region (except Bulgaria and Croatia) the contributions to the second pillar were reduced or their transfer was suspended. The Baltic States took this step already in 2009, while Poland from May 2011, and Slovakia from September 2012.

The transfers to PF were reduced or suspended on a one-off basis, except Lithuania[54]. The contribution rate was lowered by app. 70% in Poland, Lithuania and Latvia, app. 60% in Slovakia and app. 20% in Romania[55]. Estonia and Hungary decided to suspend temporarily[56] transfer of contributions to the second pillar. Ultimately, this measure became permanent in Hungary.

Changes to pension contributions transferred to open pension funds.

	Permanent	Temporary
Reduction	Latvia, Slovakia, Poland	Lithuania, Romania[57]
Suspension of contribution transfer	Hungary	Estonia

Source: Stability/Convergence Programmes of the CEE countries.

Once the fiscal situation has improved, a number of the CEE countries increased or announced the gradual increase in contributions transferred to the funded scheme[58]. In the case of Latvia, Slovakia and Poland the target level of the contribution will be lower from originally assumed; most notably in Poland (3.5% against 7.3% of a salary)[59]. It is to be achieved in Poland and Latvia[60] in 2016-2017, in

[54] In Lithuania, it has been implemented gradually. Initially, the contribution was reduced from 5.5% to 3% of the assessment base (January 2009), then further reduced to 2% (July 2009 – December 2011), and finally to 1.5% (2012).
[55] In Romania in 2009, the schedule of increases in pension contributions transferred to the second pillar (originally set by the act introducing the funded pension scheme) was postponed by one year.
[56] Estonia: July 2009–December 2011; Hungary: November 2010-December 2011.
[57] In 2009, the amount of contribution was kept at the previous year's level (2% of the salary) albeit the initial schedule provided for an increase up to 2.5%. In the following years, the contribution grew by 0.5 pp. until 6%, i.e. to the level originally provided for in the act implementing the funded pension scheme as from 2008.
[58] The process is now over in Estonia (2011-2012) and on-going in other countries (2013), except Slovakia (since 2017).
[59] Latvia – the target level of 6% comparing to 8% of a salary in early 2009 (initially, the contribution was set to increase to 10%); Slovakia - 6% and 9%, respectively.
[60] In Lithuania and Latvia, the increase in contributions transferred to open pension funds was to have been launched already in 2011, but given the public finance situation, the process has been postponed until later.

Lithuania in 2020, and in Slovakia in 2024. On the contrary, transfer to PF in Estonia will temporarily increase in 2014-2017 (from 4% to 6% of a salary) in order to offset the period of its suspension.

Some countries of the region have allowed insured persons to opt-out of the second pillar[61]. This step has involved transfer of funds accumulated in the second pillar to the general government, thus contributing to the one-off improvement of its balance. Such measure was adopted in Hungary (actually the second pillar was abolished) and in Slovakia. The changes introduced in Bulgaria at the end of 2010 have been ruled unconstitutional[62].

Transfer of assets from open pension funds to the public finance sector.

Country	Measures	Impact on the general government balance (% of GDP)
Bulgaria	Transfer of funds collected[63] in occupational pension funds (for employees entitled to early retirement) for budget revenues in the case of early retirement by an insured during 2011-2014. The change was judged at the end of May of 2011 by the Constitutional Tribunal as being unconstitutional.	+0.04 Initially estimated at ca. +0.13
Croatia	An opt-out clause since mid-October 2011 for persons in the 40-50 age group that have become members of open pension funds on the voluntary basis upon the launch of pension reform (i.e. 2002)	Negligible (<0.01)
Poland	An opt-out clause for women that attained the retirement age in 2009.	Negligible (<0.01)
Slovakia[64]	An opt-out "windows" during January-June 2008, mid-November 2008-June 2009, and September 2012 -January 2013.	2008 and 2009: +0.2 2012: +0.1 2013: +0.3
Hungary	An opt-out clause in 2009 for the insured, who reached the age of 52 before 2009. Taking a decision by an insured about staying in the second pillar until the end of February 2011 (It is connected with forfeiting entitlement to a pension from the part of PAYG pension scheme).	2009 and 2010: +0.2 2011: +9.7 2012: +0.1

Source: The NBP study based on Stability/Convergence Programmes and press releases.

Hungary is the most far-reaching case of enacted changes in the second pillar, as the largest scheme in the region after Poland (in terms of net assets-to-GDP ratio) has been actually abolished.

The insured were to decide about further memberships in a pension fund until the end of February 2011[65]. Staying in funded scheme involved forfeiting the entitlement to a pension from the first pillar, in spite of maintained obligation to pay an old-age pension contribution, and the lack of state guarantees regarding the pension payments by PF.

Eventually only ca. 3% of members decided to stay in the second pillar of pension scheme (i.e. ca. 100 thousand persons), with 1/3 in 2012 switching back to the first pillar. The assets transferred to the public finance sector amounted to app. 10.6% of GDP in 2011 with about 0.8% of GDP was paid to the insured[66]. The general government balance improved by app. 9.7% of GDP, which allowed Hungary to record a one-off budget surplus in 2011 (4.3% of GDP). The transferred assets, managed by a special state fund[67], were largely used for the debt reduction, yet the public debt-to-GDP ratio at the end of 2011 was similar to the one recorded the year before (81.4% of GDP against 81.8% of GDP). This resulted, among others, from weakening of the forint.

[61] In November 2012, the Lithuania's government adopted the changes that provided for an option of the withdrawal from open pension funds during April-September 2013. However, in the case of the withdrawal from the system, the accrued funds will remain on an individual pension account and will continue to be invested and the payment of the same will take place upon the retirement.

[62] See *Judgement No 7 of 31 May 2011 in case No 21/2010 on the record of the Constitutional Court*, Constitutional Court of the Republic of Bulgaria, http://www.constcourt.bg/Pages/Document/Default.aspx?ID=1637.

[63] By persons born in the years 1955-1959 – women and 1952-1959 – men.

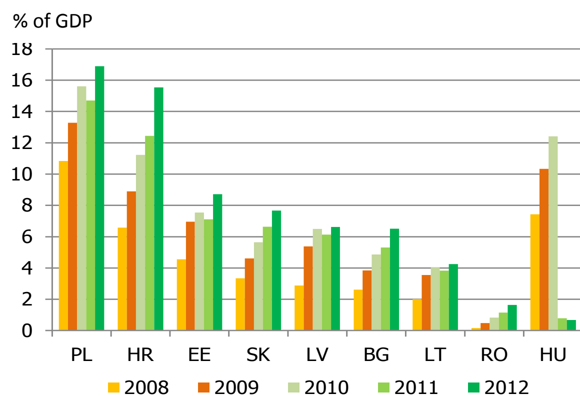
[64] In the first half of 2008 ca. 105 thousand persons (i.e. 7% of pension fund members, mainly persons in the 40-55 age bracket, decided to switch back to the state pension scheme (the so-called "pension window"). At the same time, the insured, that had not joined the PF until the mid-2006 were allowed to join the open pension fund – decision was taken by app. 21.3 thousand people. After a few months, the pension window was re-opened (mid-November 2008-June 2009). Some 62.0 thousand people returned to the first pillar (i.e. ca. 4% of open pension funds members). In the course of September 2012-January 2013, further ca. 90 thousand of the insured (ca. 6% of pension fund members) opted out.

[65] Regulations enacted at the end of 2010, also transfer of contributions to open pension funds was temporarily suspended and the participation in the funded scheme for new entrants became voluntary.

[66] The insured, that returned to state pension scheme, were to be paid profit earned by pension funds (otherwise the government was to adjust the notional account in the first pillar).

[67] Pension Reform and Debt Reduction Fund (*Nyugdíjreform és Adósságcsökkentő Alap*).

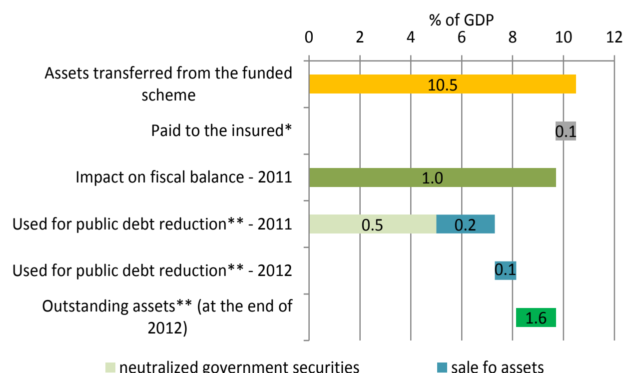
Net assets of pension funds



PL – Poland HR – Croatia, EE – Estonia, SK – Slovakia, LV – Latvia, BG – Bulgaria, LT – Lithuania, RO – Romania, HU – Hungary.

Source: Data of CEE countries financial supervision authorities.

Impact of pension reform in Hungary on fiscal balance and public debt.



* accumulated real earnings paid to the insured (transfers were made in the period of June-August 2011).
** Pension Reform and Debt Reduction Fund as at 2012 year-end, amount does not take into consideration the transfer of shares to the Hungarian National Asset Management Inc. (app. 0.5% of GDP).

Source: Hungary Convergence Programme for 2012-2015, April 2012; ÁKK data.

The above measures introduced in the CEE countries concerning the funded pension scheme will burden public finances, as a consequence of higher public share in financing pension benefits in the future. Thus, these changes may have implications for the fiscal sustainability in the long term. This impact will not be significant in the countries, where a pension scheme is actuarially balanced (notional defined contribution system – Poland and Latvia) albeit they the pension gap will be temporarily widened due to deteriorating demographic profile[68]. Other countries at the same time adopted measures concerning, among others, the increases in retirement age, phasing out of early retirement schemes, modifications of conditions and benefit formula, and pension indexation rules.

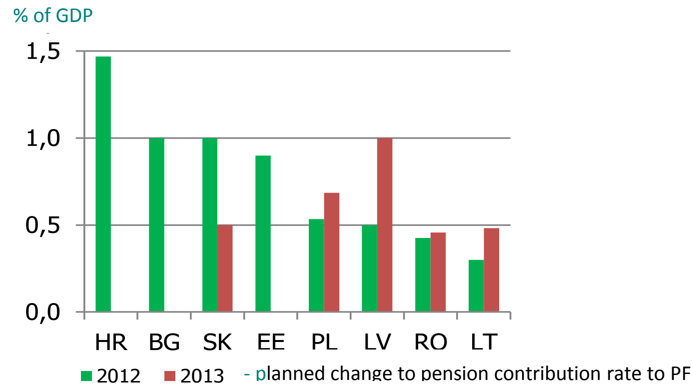
Currently, Poland is mulling over the additional changes to the second pillar. Croatia and Bulgaria, the only countries that have not reduced the contribution rate to open pension funds, are planning to increase them in the following years[69]. Possible further decisions concerning the funded scheme may be influenced by the following:

- consideration of the net costs of the pension reform (resulting from introduction of mandatory funded pension scheme) while taking a decision on imposing or lifting an excessive deficit procedure[70]. This regulation, introduced at the end of 2011 by the 'six-pack'[71], is applicable provided the headline deficit is close to the reference value (according to the EC interpretation the permissible level is ca. 3.5% of GDP). In 2012, the costs related to pension reform ranged from 0.3% to almost 1.5% of GDP[72] across the region;
- the different treatment of transfer of assets from funded scheme to the general government under ESA2010. At present, this transaction (ESA'95 – *European system of accounts*) is registered at the full amount upon the transfer of assets with the one-off positive impact on the general government balance. In May 2013, the European Parliament adopted a new edition of

[68] It is worth noticing, that according to *The 2012 Ageing report* of the European Commission (European Economy 2/2012), Poland and Latvia are in a group of few EU countries where the public spending on old age, disability and survivor's pension benefits are projected to be on a downward path in 2010-2060. Moreover, the decline in that category of spending in these two countries will be the largest one amongst the Member States. The EC report, however, has ignored the revenue side and therefore the impact of the decline in spending on the stability of pension schemes cannot be specified.
[69] Croatia – since 2014, Bulgaria is planning to increase the contribution to mandatory universal pension funds from 5% to 7% of a salary since 2017.
[70] Previously, under the amendments introduced in the Stability and Growth Pact in 2005, such deduction was possible (degressive scale) for 5 years.
[71] See *Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure* (Official Journal of the European Union L 306 of 23 November 2011).
[72] In 2013, they will be higher due to the increase in a part of the pension contribution transferred to the second pillar in Poland, Romania, Lithuania and Latvia, but lower in Slovakia (impact of reducing the rate since September 2012).

ESA (ESA2010), which stipulates that such action will not have an impact on the fiscal outturn[73]. New rules will be applicable from the fiscal notification in autumn 2014.

Pension contributions transferred to the funded scheme in 2012



HR – Croatia, BG – Bulgaria, SK – Slovakia, EE – Estonia, PL – Poland, LV – Latvia, RO – Romania, LT – Lithuania
Source: Convergence/Stability Programmes of the CEE countries, data of CEE countries financial supervision bodies.

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[73] The amount transferred from open pension funds will be registered under F.89 item "Other receivables/payables", i.e. it will not have any impact on the general government revenue at the time of the transfer. The payment of pensions in future will worsen the fiscal balance. See clause 17.148 (*Proposal for a regulation of the European Parliament and of the Council on the European system of national and regional accounts in the European Union*, COM/2010/0774 final, with amendments introduced by the European Parliament).

STATISTICAL ANNEX

1. National accounts

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

	2011	2012	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	1.8	0.8	1.2	0.8	0.7	0.6	0.4
Croatia	-0.3	-2.1	-1.3	-2.1	-2.3	-2.6	-1.5
Czech Republic	1.7	-1.2	-0.4	-1.1	-1.4	-1.6	-2.2
Estonia	7.6	3.2	4.0	2.8	3.1	3.0	1.3
Lithuania	6.0	3.6	4.3	3.1	3.8	3.1	4.1
Latvia	5.0	5.5	5.6	5.0	5.4	5.8	6.0
Poland	4.5	1.9	3.5	2.3	1.3	0.7	0.5
Romania	2.1	0.7	0.4	1.8	-0.5	1.2	2.2
Slovakia	3.3	2.0	2.9	2.3	1.9	1.0	0.8
Slovenia	-0.2	-2.2	-0.8	-2.3	-2.8	-2.8	-3.3
Hungary	1.7	-1.8	-1.3	-1.7	-1.8	-2.4	-0.3

Source: Eurostat, CSO

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

	2011	2012	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	0.2	2.5	3.5	3.7	2.3	0.6	-1.0
Croatia	0.2	-3.0	-1.6	-2.8	-3.5	-4.1	-2.9
Czech Republic	0.7	-2.6	-1.8	-2.6	-2.7	-3.4	-0.5
Estonia	4.2	4.3	4.3	2.7	5.6	4.7	3.7
Lithuania	6.1	4.0	5.9	4.5	3.2	2.5	3.3
Latvia	4.4	5.1	4.7	6.7	4.8	4.4	5.6
Poland	2.6	0.8	1.7	1.3	0.2	-0.2	0.0
Romania	1.3	1.0	1.3	2.1	-0.1	0.8	-0.1
Slovakia	-0.4	-0.6	-0.3	-0.4	-0.5	-1.1	-1.0
Slovenia	-0.2	-2.9	0.4	-2.4	-3.9	-5.5	-5.4
Hungary	0.0	-1.4	-0.4	-0.9	-2.6	-1.4	-0.9

Source: Eurostat, CSO

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

	2011	2012	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	-7.9	0.9	0.3	0.8	-0.7	3.1	5.0
Croatia	-6.0	-3.8	-2.2	-4.7	-2.6	-5.6	-2.3
Czech Republic	-0.9	-2.6	-0.5	-0.1	-3.5	-6.0	-3.9
Estonia	26.8	21.0	21.1	25.9	32.0	7.2	-6.2
Lithuania	17.2	-2.2	4.7	-0.6	-4.3	-8.2	-1.8
Latvia	28.6	16.5	35.8	17.9	5.3	10.7	-4.6
Poland	8.5	-0.8	6.8	1.4	-1.7	-4.1	-2.0
Romania	4.4	5.7	10.5	6.0	4.6	2.1	-0.8
Slovakia	5.7	-3.7	3.6	-3.1	-6.7	-8.0	-11.8
Slovenia	-10.4	-8.8	-10.6	-7.4	-7.8	-9.4	-3.0
Hungary	-5.5	-3.8	-4.0	-3.2	-3.4	-4.8	-5.0

Source: Eurostat, CSO

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

	2011	2012	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	12.8	-0.5	-3.3	3.2	-0.6	-1.5	10.8
Croatia	0.9	0.4	2.8	-4.0	-0.2	3.4	-4.9
Czech Republic	11.1	4.2	6.3	4.1	4.1	2.4	-2.1
Estonia	24.9	5.6	8.1	4.4	2.8	7.3	5.7
Lithuania	14.6	11.4	5.0	6.0	13.7	20.8	19.8
Latvia	13.1	7.9	10.0	6.5	7.7	7.4	5.3
Poland	7.7	2.8	4.3	2.5	1.2	3.2	1.3
Romania	10.5	-3.2	-2.5	-0.5	-5.1	-4.7	3.9
Slovakia	10.8	8.6	4.8	10.2	11.3	8.3	3.7
Slovenia	7.8	1.3	2.7	2.0	0.7	0.1	3.3
Hungary	8.4	2.0	2.1	4.3	2.4	-0.6	1.3

Source: Eurostat, CSO

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

	2011	2012	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	9.0	3.5	2.5	9.6	2.6	-0.4	5.6
Croatia	1.3	-2.4	-1.1	-3.8	-3.1	-1.3	-5.6
Czech Republic	7.5	2.5	3.6	3.3	0.4	2.6	-2.1
Estonia	27.0	9.1	9.3	6.2	8.6	12.3	4.9
Lithuania	13.6	7.7	5.5	4.0	9.6	11.7	10.3
Latvia	20.6	3.5	10.7	3.9	-0.4	0.7	-0.2
Poland	5.5	-1.8	2.2	-3.2	-3.2	-2.4	-1.7
Romania	11.5	-0.9	0.5	0.8	-1.1	-4.0	-1.3
Slovakia	4.5	2.8	-0.2	1.6	5.8	4.3	1.4
Slovenia	5.6	-3.4	-0.3	-1.8	-4.8	-6.4	-0.6
Hungary	6.3	0.1	0.0	1.6	-0.3	-0.8	0.9

Source: Eurostat, CSO

2. Business cycle and economic activity indicators

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

	09.2012	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013
Bulgaria	-0.8	-1.9	0.6	5.9	6.7	3.3	-0.4	0.1
Croatia	-7.0	-5.5	-4.5	-5.5	3.4	-3.9	4.1	-0.4
Czech Republic	-0.8	-3.2	-6.4	-4.6	-4.1	-1.9	-2.5	-3.4
Estonia	5.2	-1.5	1.3	5.7	5.1	1.2	7.4	2.6
Lithuania	7.0	9.5	7.8	8.8	7.6	5.8	8.6	4.4
Latvia	2.7	3.3	3.5	10.0	1.8	-1.4	-2.6	-0.7
Poland	-1.6	0.7	-1.7	-4.5	-2.3	-2.3	0.8	-0.3
Romania	3.9	2.8	2.9	4.3	3.9	5.1	7.5	8.5
Slovakia	6.1	4.7	4.7	1.2	14.2	8.3	5.0	2.7
Slovenia	-2.6	-0.3	-3.5	-1.7	-1.6	2.3	-2.4	-1.1
Hungary	0.8	-3.6	-7.0	-3.0	-1.1	-1.0	-0.7	2.8

Source: Eurostat

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

	09.2012	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013
Bulgaria	-2.8	-3.1	-3.1	-4.0	-5.4	2.0	-1.5	-0.5
Croatia	-4.9	-6.0	-4.1	-2.8	-3.4	2.5	-1.5	0.4
Czech Republic	-0.3	-1.0	-1.9	0.1	0.5	0.1	1.0	-1.0
Estonia	6.0	1.6	0.2	3.9	-0.4	-4.1	1.8	3.0
Lithuania	2.4	3.4	2.2	2.2	0.9	3.3	3.6	3.6
Latvia	7.1	6.8	4.7	8.1	6.1	6.0	7.8	6.5
Poland	-3.4	-4.1	-2.6	-3.0	2.2	4.1	1.4	2.5
Romania	7.4	1.5	3.2	-2.2	2.3	0.9	-0.7	1.3
Slovakia	-1.3	-1.3	-1.5	-2.9	-1.6	-2.0	-1.1	0.5
Slovenia	-4.2	-5.7	-5.7	-4.5	-6.1	-3.9	-5.9	-4.8
Hungary	-2.9	-3.5	-4.1	-2.9	-2.7	-1.6	-3.4	3.5

Source: Eurostat

Table 8. DG ECFIN consumers' confidence indicator

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	*-47.1*	*-43.7*	*-43.1*	*-41.0*	*-42.1*	*-42.1*	*-40.3*	*-36.4*
Croatia	*-48.7*	*-50.3*	*-52.6*	*-48.0*	*-51.0*	*-52.0*	*-49.6*	*-48.5*
Czech Republic	*-27.5*	*-27.0*	*-27.3*	*-24.9*	*-26.0*	*-20.3*	*-22.2*	*-18.4*
Estonia	*-13.5*	*-14.6*	*-8.0*	*-6.4*	*-6.5*	*-5.6*	*-4.0*	*-4.9*
Lithuania	*-18.9*	*-13.9*	*-13.0*	*-13.7*	*-14.5*	*-11.6*	*-12.1*	*-10.0*
Latvia	*-11.7*	*-11.5*	*-7.6*	*-8.3*	*-11.9*	*-10.1*	*-9.6*	*-10.7*
Poland	*-32.6*	*-29.9*	*-31.6*	*-31.7*	*-28.6*	*-30.1*	*-26.9*	*-29.6*
Romania	*-37.1*	*-35.8*	*-32.2*	*-32.0*	*-32.1*	*-33.9*	*-37.9*	*-35.2*
Slovakia	*-36.1*	*-31.1*	*-36.3*	*-36.5*	*-31.8*	*-28.7*	*-30.9*	*-27.7*
Slovenia	*-39.7*	*-37.7*	*-35.9*	*-31.3*	*-32.8*	*-28.9*	*-26.7*	*-36.5*
Hungary	*-50.1*	*-48.9*	*-47.9*	*-42.1*	*-39.0*	*-36.9*	*-37.1*	*-32.0*

Sources: European Commission, CNB

Table 9. DG ECFIN business confidence indicator

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	-11.6	-10.5	-7.6	-10.8	-10.6	-6.9	-9.6	-10.7
Croatia	5.0	5.0	5.0	-3.0	-3.0	-3.0	8.0	8.0
Czech Republic	-9.5	-12.6	-7.7	-10.2	-7.0	-8.2	-11.1	-9.8
Estonia	-4.1	-6.0	-6.9	-3.4	1.1	0.2	-4.7	-0.5
Lithuania	-13.8	-16.4	-11.4	-9.6	-7.1	-6.9	-6.6	-7.0
Latvia	-3.9	-3.9	-3.4	-2.1	-1.4	-3.9	-5.9	-3.9
Poland	-21.6	-19.5	-19.5	-19.4	-19.7	-19.9	-20.1	-17.3
Romania	-4.5	-3.5	-4.1	-3.2	-1.7	-3.4	-2.7	-3.8
Slovakia	-9.7	-18.5	-9.4	-9.6	-15.6	-1.8	0.5	-2.2
Slovenia	-17.0	-13.9	-9.7	-12.9	-9.3	-8.6	-11.8	-7.3
Hungary	-7.3	-8.6	-8.7	-5.6	-8.0	-10.0	-15.5	-7.7

Source: European Commission, OeKB

Table 10. PMI manufacturing

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Czech Republic	47.2	48.2	46.0	48.3	49.9	49.1	49.5	50.1
Poland	47.3	48.2	48.5	48.6	48.9	48.0	46.9	48.0
Hungary	50.0	52.3	48.9	55.8	53.9	55.4	51.5	47.1

Source: Markit Economics

3. Prices

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	3.0	2.7	2.8	2.6	2.2	1.6	0.9	1.0
Croatia	4.6	4.1	4.4	4.6	4.4	3.4	3.1	1.8
Czech Republic	3.6	2.8	2.4	1.8	1.8	1.5	1.7	1.2
Estonia	4.2	3.8	3.6	3.7	4.0	3.8	3.4	3.6
Lithuania	3.2	2.8	2.9	2.7	2.3	1.6	1.4	1.5
Latvia	1.6	1.5	1.6	0.6	0.3	0.3	-0.4	-0.2
Poland	3.4	2.7	2.2	1.6	1.2	1.0	0.8	0.5
Romania	5.0	4.4	4.6	5.1	4.8	4.4	4.4	4.4
Slovakia	3.9	3.5	3.4	2.5	2.2	1.9	1.7	1.8
Slovenia	3.2	2.8	3.1	2.8	2.9	2.2	1.6	1.6
Hungary	6.0	5.3	5.1	2.8	2.9	2.3	1.8	1.8

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	3.7	3.2	3.6	4.7	3.8	3.8	3.4	3.1
Croatia	5.0	4.4	5.4	5.9	5.7	5.3	5.6	6.6
Czech Republic	6.2	5.2	4.7	5.1	4.5	3.6	4.8	4.4
Estonia	5.8	5.4	5.3	5.7	5.7	4.9	4.8	5.7
Lithuania	3.4	3.4	3.5	3.1	3.1	2.3	1.7	2.6
Latvia	2.0	2.6	2.4	2.6	1.6	1.1	1.4	1.7
Poland	4.6	4.0	3.9	3.5	2.9	2.3	2.4	2.2
Romania	6.3	6.1	6.5	7.9	6.9	6.1	6.6	7.5
Slovakia	5.5	5.5	5.4	5.6	5.1	3.1	3.7	3.8
Slovenia	6.0	6.0	6.4	7.3	6.2	6.0	5.0	5.4
Hungary	10.6	10.1	9.6	8.5	7.5	6.1	5.8	5.4

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	10.7	8.7	8.6	5.5	4.9	1.2	-1.9	0.2
Croatia	14.3	13.3	13.7	12.1	10.7	7.8	4.7	-4.2
Czech Republic	7.6	5.1	3.7	2.1	2.2	2.1	1.2	-0.4
Estonia	8.6	7.2	6.4	7.9	8.8	7.8	5.9	5.2
Lithuania	4.3	2.7	2.6	3.3	1.8	-0.1	-0.4	-1.5
Latvia	7.5	5.6	6.5	1.1	0.3	-0.9	-3.0	-2.6
Poland	6.7	4.5	3.6	0.1	0.1	-0.2	-1.8	-3.0
Romania	7.4	5.5	6.2	7.4	7.9	6.4	4.8	3.3
Slovakia	4.1	3.5	3.3	-0.6	-1.1	0.0	-1.2	-1.1
Slovenia	10.4	7.1	6.6	4.7	5.9	3.8	1.0	0.9
Hungary	7.1	3.3	3.0	-4.5	-3.0	-4.2	-6.7	-6.7

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	0.7	0.9	0.9	0.9	0.7	0.6	0.4	0.1
Croatia	1.5	1.2	1.2	1.8	1.9	1.1	1.1	0.8
Czech Republic	1.5	1.3	1.1	0.5	0.4	0.5	0.4	0.1
Estonia	2.2	2.0	2.0	1.6	1.8	2.1	2.0	2.1
Lithuania	2.7	2.5	2.6	2.2	1.9	1.7	1.7	1.8
Latvia	-0.4	-0.3	-0.3	-0.8	-0.4	0.1	-0.7	-0.5
Poland	2.0	1.5	1.0	1.1	0.8	0.8	0.8	0.7
Romania	3.3	2.9	2.7	2.4	2.5	2.7	2.6	2.2
Slovakia	3.2	2.7	2.6	2.3	2.2	2.2	1.9	1.8
Slovenia	0.5	0.7	1.1	0.8	1.1	0.5	0.5	0.3
Hungary	3.4	3.5	3.5	2.3	2.4	2.5	2.5	2.6

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	6.8	5.1	4.8	1.8	2.1	0.5	-1.9	
Croatia	1.6	0.9	0.4	0.7	1.0	1.6	1.4	
Czech Republic	6.0	4.9	4.9	3.8	2.4	1.6	1.0	-0.3
Estonia	2.0	2.2	2.1	4.4	4.3	5.0	4.6	3.4
Lithuania	3.8	1.9	2.0	1.0	0.8	-2.2	-3.5	-3.2
Latvia	2.9	3.3	3.5	2.2	1.9	2.5	1.7	2.5
Poland	0.9	-0.2	-1.2	-1.3	-0.5	-0.8	-2.2	-2.5
Romania	6.4	5.6	4.8	5.7	5.4	4.5	3.0	
Slovakia	2.3	1.8	2.0	1.9	0.4	-0.7	-0.5	
Slovenia	0.8	0.7	0.4	0.4	1.1	0.8	0.5	0.2
Hungary	0.1	-2.8	-1.8	-1.0	0.6	2.1	0.5	

Source: Eurostat

4. Balance of payments

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

	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	0.6	0.0	0.1	-1.1	-2.2	-2.2	-1.3	-0.8
Croatia	-2.3	-1.0	-0.9	-1.1	-1.0	-0.6	0.0	0.6
Czech Republic	-5.2	-3.2	-2.7	-3.2	-1.5	-2.0	-2.4	-2.5
Estonia	1.9	2.1	2.0	1.9	0.8	-0.5	-1.6	-1.6
Lithuania	-2.1	-1.9	-3.7	-5.3	-3.0	-2.8	-0.5	1.2
Latvia	-0.4	-2.0	-2.1	-2.9	-3.2	-2.1	-1.7	-1.3
Poland	-5.5	-5.2	-4.9	-5.1	-4.6	-4.1	-3.5	-3.0
Romania	-4.0	-4.3	-4.5	-4.7	-4.1	-4.0	-3.9	-3.0
Slovakia	-3.1	-2.7	-1.7	-1.5	0.1	1.5	2.3	2.4
Slovenia	0.0	-0.1	0.0	-0.1	0.4	1.4	2.3	3.4
Hungary	1.0	1.0	0.8	0.7	0.9	1.4	1.6	1.6

Source: Eurostat, central banks, NBP IE calculations

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

	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	1.7	1.7	3.1	5.2	6.0	6.5	3.3	2.5
Croatia	0.7	1.3	2.4	3.0	3.0	2.2	2.6	3.0
Czech Republic	2.4	0.5	1.2	2.2	2.2	4.3	4.7	4.7
Estonia	7.8	12.0	8.1	7.1	7.3	2.9	2.6	2.5
Lithuania	4.3	3.6	3.2	3.1	0.8	1.1	1.0	1.2
Latvia	4.1	4.9	4.9	4.6	3.4	2.9	2.8	2.1
Poland	1.2	1.9	2.2	1.2	1.8	1.1	0.9	1.8
Romania	1.1	0.5	1.4	1.5	1.6	1.8	1.3	1.2
Slovakia	-0.5	0.1	1.0	1.8	2.5	2.3	2.1	1.1
Slovenia	1.9	2.3	1.8	2.3	1.8	1.2	0.5	-0.2
Hungary	1.2	0.2	0.6	1.0	0.8	2.3	2.3	1.8

Source: Eurostat, central banks, NBP IE calculations

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

	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	33.7	35.7	36.9	36.0	37.5	41.3	41.4	38.7
Croatia	24.1	24.3	24.5	24.7	25.0	25.0	25.0	25.0
Czech Republic	41.3	40.4	42.8	41.6	41.7	41.5	44.1	
Estonia	0.9	1.0	1.1	1.4	1.3	1.4	1.4	1.6
Lithuania	20.4	22.6	26.1	23.9	22.2	25.0	26.2	22.8
Latvia	18.8	19.4	16.4	17.9	16.9	17.7	18.9	18.4
Poland	29.4	31.1	31.8	28.1	31.1	28.9	29.4	
Romania	38.4	38.1	37.7	38.8	37.2	37.1	35.8	36.0
Slovakia	3.1	3.5	3.6	3.5	3.6	3.9	3.5	
Slovenia	1.8	1.8	1.8	1.7	1.8	1.9	1.8	1.6
Hungary	26.1	27.7	28.5	26.5	27.1	27.0	27.3	

Source: Eurostat, central banks, NBP IE calculations

5. Financial markets and financial system

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

	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013	06.2013
Croatia	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Czech Republic	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Poland	4.50	4.25	4.00	3.75	3.25	3.25	3.00	2.75
Romania	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Hungary	6.00	5.75	5.50	5.25	5.00	4.75	4.50	4.25

Source: Central banks, EcoWin Financial

Table 20. 3m interbank rates (average)

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	1.6	1.4	1.4	1.3	1.2	1.2	1.2	1.2
Croatia	2.4	2.0	1.4	1.3	1.1	0.9	0.8	0.9
Czech Republic	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Estonia	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Lithuania	0.8	0.7	0.7	0.5	0.5	0.5	0.6	0.7
Latvia	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Poland	4.8	4.6	4.3	4.0	3.8	3.5	3.3	2.9
Romania	5.7	5.9	6.0	6.0	5.8	5.4	4.6	4.1
Slovakia	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Slovenia	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Hungary	6.6	6.2	5.9	5.7	5.4	5.1	4.8	4.5

Source: EcoWin Financial

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Croatia	7.50	7.53	7.53	7.57	7.58	7.59	7.60	7.57
Czech Republic	24.93	25.34	25.17	25.52	25.44	25.63	25.81	25.87
Latvia	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
Poland	4.11	4.13	4.09	4.13	4.17	4.15	4.13	4.18
Romania	4.56	4.52	4.48	4.38	4.38	4.39	4.38	4.33
Hungary	281.80	282.21	286.31	293.12	292.50	302.73	298.64	292.67

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	-2.1	-2.3	-1.1	0.3	0.9	0.2	0.3	0.7
Croatia	-2.3	-2.8	-1.2	0.0	0.6	-0.6	-1.2	0.2
Czech Republic	-2.8	-2.2	0.0	0.3	-0.8	-3.7	-3.7	-1.4
Estonia	-2.7	-2.6	-1.4	0.1	0.6	-0.2	0.2	0.5
Lithuania	-2.6	-2.6	-1.8	-0.3	0.6	0.2	0.3	0.4
Latvia	-0.9	-1.6	-1.4	-0.1	0.4	-0.3	0.1	0.0
Poland	3.6	4.8	8.3	6.3	1.2	-0.3	1.4	3.7
Romania	-7.3	-6.3	-5.0	-0.7	0.1	-0.3	0.5	3.0
Slovakia	-2.4	-2.7	-1.6	0.0	0.7	0.4	0.5	0.7
Slovenia	-1.7	-1.8	-0.9	0.3	0.7	0.2	0.3	0.6
Hungary	2.8	7.0	5.4	5.2	0.3	-3.3	-0.8	1.5

Source: BIS, NBP IE calculations

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	-0.9	-1.1	0.3	2.0	1.8	0.5	0.4	0.6
Croatia	-0.2	-0.8	0.9	3.1	3.4	1.1	0.5	0.1
Czech Republic	-2.1	-1.8	0.0	0.1	-1.2	-4.0	-3.5	-1.8
Estonia	-1.2	-1.3	-0.4	1.4	2.2	1.4	1.6	2.1
Lithuania	-2.4	-2.4	-1.5	0.1	0.5	-0.3	-0.1	0.0
Latvia	-2.1	-2.6	-2.4	-1.9	-1.6	-2.1	-1.9	-1.8
Poland	4.5	5.4	8.5	6.1	0.5	-1.0	0.9	2.7
Romania	-5.5	-4.6	-2.8	2.7	3.2	2.8	4.0	6.6
Slovakia	-1.4	-1.8	-0.8	0.2	0.8	0.5	0.5	0.7
Slovenia	-1.7	-1.9	-0.7	0.3	1.0	0.2	0.2	0.1
Hungary	6.2	10.0	8.1	6.8	0.8	-3.1	-0.8	1.5

Source: BIS, NBP IE calculations

Table 24. Private sector loans (in %, y/y)

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	3.0	3.7	2.9	3.4	3.0	2.4	2.3	1.6
Croatia	-1.2	-0.9	-1.2	-2.2	-3.5	-2.5	-2.8	
Czech Republic	2.6	2.2	2.6	3.1	3.1	3.4	2.7	
Estonia	-0.9	0.4	0.3	0.8	1.4	1.6	0.9	0.3
Lithuania	-3.7	-3.7	1.5	1.1	2.0	1.4	0.5	
Latvia	-12.0	-12.0	-11.7	-11.6	-11.2	-7.8	-8.1	-5.5
Poland	4.1	1.6	1.2	2.1	2.8	2.3	1.8	0.5
Romania	4.2	2.5	1.6	0.7	0.6	0.2	-2.1	-2.4
Slovakia	2.8	3.1	3.3	3.3	3.4	2.9	2.3	
Slovenia	-4.4	-5.3	-5.5	-6.2	-6.6	-6.7	-7.1	
Hungary	-13.2	-15.0	-12.8	-7.5	-4.9	-4.5	-4.6	

Source: Central banks

6. Labour market

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

	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012
Bulgaria	-3.5	-4.0	-2.1	-1.4	-1.8	-1.2	-0.6	-0.9
Croatia	-5.5	-3.8	-1.1	-3.2	-5.0	-1.0	-0.8	-5.0
Czech Republic	0.8	0.5	0.3	-0.1	-0.6	-0.4	-0.2	-0.2
Estonia	7.1	8.1	7.9	3.4	3.7	3.5	0.6	1.5
Lithuania	-7.3	-5.5	-7.0	-7.9	1.2	1.7	2.6	0.7
Latvia	-8.6	-8.5	-9.1	-8.0	2.3	2.1	3.3	2.4
Poland	1.9	1.0	0.5	0.7	-3.1	-3.5	-3.5	-3.5
Romania	1.7	-2.4	-2.2	-0.2	-0.4	1.7	2.7	2.2
Slovakia	2.1	1.8	1.3	0.4	-0.4	-1.0	-1.0	-1.5
Slovenia	-4.0	-3.0	-1.8	-2.6	0.2	-1.5	-1.5	-0.9
Hungary	0.4	0.8	0.8	1.1	1.5	1.7	2.1	1.5

Source: Eurostat

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

	10.2012	11.2012	12.2012	01.2013	02.2013	03.2013	04.2013	05.2013
Bulgaria	12.4	12.6	12.6	12.5	12.5	12.4	12.4	12.3
Croatia	16.6	17.4	17.9	18.1	18.3	18.3	18.2	18.1
Czech Republic	7	7.2	7.2	7.2	7.1	7.2	7.2	7.2
Estonia	9.7	9.6	9.9	9.8	9.8	9.3	8.7	
Lithuania	13	13.1	13.2	13.3	12.6	12.5	12.3	12.5
Latvia	14.4	13.8	13.8	13.8	12.4	12.4	12.4	
Poland	10.3	10.3	10.4	10.4	10.6	10.6	10.7	10.8
Romania	6.9	6.8	6.7	6.7	7	7.1	7.2	7.3
Slovakia	14	14.2	14.4	14.4	14.5	14.6	14.5	14.5
Slovenia	9.5	9.5	9.3	9.4	9.6	9.7	10	10.2
Hungary	10.8	10.9	10.9	11	11.1	11.1	10.6	

Source: Eurostat

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

	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012	I 2013
Bulgaria	8.4	6.8	9.0	8.2	8.3	8.8	8.4	4.5
Croatia	1.8	2.1	1.8	2.1	0.9	0.6	0.4	1.3
Czech Republic	2.6	2.1	2.4	3.3	2.2	1.7	3.5	-0.4
Estonia	3.8	4.8	6.1	5.9	4.3	6.5	6.7	8.0
Lithuania	2.9	3.3	4.1	4.0	2.6	5.1	4.0	4.5
Latvia	5.3	5.7	5.2	3.5	4.6	3.7	3.9	5.0
Poland	4.3	5.1	4.3	3.0	3.5	3.8	2.6	3.6
Romania	2.4	10.1	9.7	4.5	7.0	7.2	7.6	8.6
Slovakia	3.2	4.7	1.7	2.9	3.4	1.3	3.8	5.2
Slovenia	2.9	2.6	0.7	-0.5	3.9	-0.7	-1.6	-3.8
Hungary	4.8	5.1	7.4	2.3	5.0	5.3	4.5	5.0

Source: Eurostat

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

	I 2011	II 2011	III 2011	IV 2011	I 2012	II 2012	III 2012	IV 2012
Bulgaria	2.4	6.1	5.1	7.7	6.9	7.4	8.0	7.7
Czech Republic	-0.2	0.5	0.6	1.6	3.7	3.4	3.1	5.2
Estonia	-6.9	-4.4	-3.5	0.1	1.8	1.4	3.3	3.6
Lithuania	-1.5	-1.0	-0.6	-0.4	-0.8	1.5	-0.1	0.8
Latvia	-2.7	-2.4	-2.6	-1.7	-1.5	-2.3	-0.3	-1.7
Poland	-2.1	-1.8	-1.6	-3.7	-3.8	1.6	-2.3	-2.3
Romania	-3.7	1.6	6.3	7.7	4.1	5.1	7.7	6.3
Slovakia	-1.5	-0.1	1.7	-1.6	0.0	1.0	-0.6	2.8
Slovenia	1.5	2.7	4.0	5.2	3.9	6.0	6.8	5.5
Hungary	-0.5	3.1	3.8	6.0	3.6	6.8	7.3	7.0

Source: Eurostat, NBP IE calculations

7. Public finance

Table 29. General government balance (ESA'95) (in %, of GDP)

	2008	2009	2010	2011	2012	2013p	2014p
Bulgaria	1.7	-4.3	-3.1	-2.0	-0.8	-1.3	-1.3
Croatia	-1.4	-4.7	-5.2	-5.7	-3.8	-4.7	-5.6
Czech Republic	-2.2	-5.8	-4.8	-3.3	-4.4	-2.9	-3.0
Estonia	-2.9	-2.0	0.2	1.2	-0.3	-0.3	0.2
Lithuania	-3.3	-9.4	-7.2	-5.5	-3.2	-2.9	-2.4
Latvia	-4.2	-9.8	-8.1	-3.6	-1.2	-1.2	-0.9
Poland	-3.7	-7.4	-7.9	-5.0	-3.9	-3.9	-4.1
Romania	-5.7	-9.0	-6.8	-5.6	-2.9	-2.6	-2.4
Slovakia	-2.1	-8.0	-7.7	-5.1	-4.3	-3.0	-3.1
Slovenia	-1.9	-6.2	-5.9	-6.4	-4.0	-5.3	-4.9
Hungary	-3.7	-4.6	-4.3	4.3	-1.9	-3.0	-3.3

p – European Commission forecasts of May 2013
Source: Eurostat, European Commission

Table 30. Sovereign debt (ESA'95) (in % of GDP)

	2008	2009	2010	2011	2012	2013p	2014p
Bulgaria	13.7	14.6	16.2	16.3	18.5	17.9	20.3
Croatia	28.9	35.7	42.2	46.7	53.7	57.9	62.5
Czech Republic	28.7	34.2	37.8	40.8	45.8	48.3	50.1
Estonia	4.5	7.2	6.7	6.2	10.1	10.2	9.6
Lithuania	15.5	29.3	37.9	38.5	40.7	40.1	39.4
Latvia	19.8	36.9	44.4	41.9	40.7	43.2	40.1
Poland	47.1	50.9	54.8	56.2	55.6	57.5	58.9
Romania	13.4	23.6	30.5	34.7	37.8	38.6	38.5
Slovakia	27.9	35.6	41.0	43.3	52.1	54.6	56.7
Slovenia	22.0	35.0	38.6	46.9	54.1	61.0	66.5
Hungary	73.0	79.8	81.8	81.4	79.2	79.7	78.9

p – European Commission forecasts of May 2013
Source: Eurostat, European Commission

Table 31. Excessive deficit correction period (EDP)

	Year
Bulgaria	Not included by EDP
Czech Republic	2013
Estonia	Not included by EDP
Lithuania	Not included by EDP*
Latvia	Not included by EDP*
Poland	2014
Romania	Not included by EDP*
Slovakia	2013
Slovenia	2015
Hungary	Not included by EDP*

Source: European Commission

8. Forecasts

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

	2012	European Commission		IMF		Domestic sources	
		2013	2014	2013	2014	2013	2014
Bulgaria	0.8	0.9	1.7	1.2	2.3	-	-
Croatia	-2.0	-1.0	0.2	-0.2	1.5	0.7	2.4
Czech Republic	-1.2	-0.4	1.6	0.3	1.6	-0.5	1.8
Estonia	2.9	3.0	4.0	2.0	4.2	3.0	4.0
Lithuania	3.7	3.1	3.6	3.0	3.3	2.8	3.5
Latvia	5.6	3.8	4.1	4.2	4.2	3.6	-
Poland	1.9	1.1	2.2	1.3	2.2	1.3	2.6
Romania	0.7	1.6	2.2	1.6	2.0	2.0	2.5
Slovakia	2.0	1.0	2.8	1.4	2.7	0.6	2.3
Slovenia	-2.3	-2.0	-0.1	-2.0	1.5	-1.9	0.5
Hungary	-1.7	0.2	1.4	0.0	1.2	0.5	1.7

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

	2012	European Commission		IMF		Domestic sources	
		2013	2014	2013	2014	2013	2014
Bulgaria	2.4	2.0	2.6	2.1	1.9	-	-
Croatia	3.4	3.1	2.0	3.2	2.3	3.2	2.3
Czech Republic	3.3	1.9	1.2	2.3	1.9	1.7	1.8
Estonia	4.3	3.6	3.1	3.3	2.7	3.6	2.4
Lithuania	3.2	2.1	2.7	2.1	2.5	2.0	2.4
Latvia	2.4	1.4	2.1	1.8	2.1	2.3	-
Poland	3.8	1.4	2.0	1.9	2.0	1.6	1.6
Romania	3.4	4.3	3.1	4.6	2.9	4.9	3.3
Slovakia	3.7	1.9	2.0	1.9	2.0	1.7	1.6
Slovenia	2.9	2.2	1.4	1.8	1.9	2.3	1.4
Hungary	5.7	2.6	3.1	3.2	3.5	2.6	2.8

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

	2012	European Commission		IMF		Domestic sources	
		2013	2014	2013	2014	2013	2014
Bulgaria	-1.1	-2.6	-3.6	-1.9	-2.1	-	-
Croatia	-0.1	0.4	0.0	0.0	-0.5	0.6	-
Czech Republic	-2.4	-2.4	-2.5	-2.1	-1.8	-1.3	-0.5
Estonia	-1.1	-2.2	-2.0	-0.8	-0.8	-2.1	-2.5
Lithuania	-0.4	-1.0	-1.5	-1.3	-1.7	-1.8	-2.1
Latvia	-1.7	-2.1	-2.6	-1.8	-1.9	-	-
Poland	-3.5	-2.5	-2.4	-3.6	-3.5	-1.2*	-0.9*
Romania	-4.0	-3.9	-3.8	-4.2	-4.5	-4.2	-4.3
Slovakia	2.3	2.5	3.3	2.2	2.7	3.6	4.4
Slovenia	2.3	4.8	4.7	2.7	2.5	4.0	4.3
Hungary	1.8	2.5	2.6	2.1	1.8	3.3	4.2

*** -** - balance on current and capital account

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