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

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Summary

Economic recovery in the Central and Eastern Europe (CEE), initiated in the second half of 2013, continues, although its pace varies in individual countries.

A faster growth is achieved by economies in which no significant imbalances had built up before the crisis: Poland, Slovakia and in the recent period also the Czech Republic. GDP growth in these countries stays vivid, due to the recovery in the euro area and fiscal consolidation efforts being scaled down. GDP also grows fast in Hungary and Romania, fostered by policy measures. The weakest economic growth is observed in the Baltic states, affected by the recession in Russia, as well as in Bulgaria and Croatia. Bulgaria still suffers from the effects of bankruptcy of a large domestic bank, whereas in Croatia the economic growth is hampered by high private and public debt.

Economic recovery is driven by growing domestic demand, mainly the consumption of households. Consumption is fostered by the growth in employment and disposable income. It is associated not only with growing nominal wages and the decline in consumer prices, but also with measures undertaken by CEE governments aiming at spurring consumer demand.

Increased absorption of EU funds has also had a positive impact on economic activity over the recent years. A slowdown in public investment growth in the CEE region is expected, due to expiration of EU financial perspective for 2007-2013 (funds must be used until the end of 2015). In Poland, the Czech Republic and Slovakia a faster increase in fixed capital formation of the private sector is observed. In some CEE countries private investment is hindered by the process of deleveraging of enterprises and households.

Monetary and fiscal policy are supporting domestic demand growth. In response the deflation and the ECB asset purchase programme, central banks from the CEE region decided on further cuts in interest rates. With the abrogation of the excessive deficit procedure against the majority of the CEE countries over the recent years, the scope of fiscal consolidation has been clearly limited.

Deflationary pressure in the CEE countries is gradually fading away. The increase in commodities prices on global markets are translating into a slow increase in consumer prices in the CEE countries. Core inflation remains low, although its gradual growth is projected in 2015, which is to be supported by the closing output gaps.

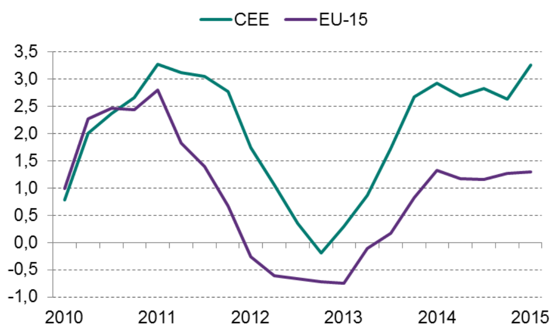
The pace of economic growth in the CEE countries is expected to be maintained in the forthcoming years. The domestic demand will remain the major growth engine, although the expected improvement in the external environment will affect the acceleration of exports. The major risk factors for growth include the negative scenarios related to resolving the crisis in Greece, mainly the uncontrolled default and the exit of this economy from the euro area, as well as the conflict in Ukraine and its aftermaths.

Countries of Central and Eastern Europe – macroeconomic outlook

Economic growth

Economic recovery in the Central and Eastern Europe (CEE), initiated in the second half of 2013, continues. In Q1 2015 GDP growth reached 3.3% y/y, i.e. it has been the fastest growth since 2008 (Figure 1.1). GDP acceleration resulted, on the one hand, from the one-off strong growth in the Czech Republic, where regulatory changes related to excise goods were first reflected in the decline in inventories in Q4 2014, followed by their growth in Q1 2015.[1] On the other hand, the increase in GDP growth in the CEE region was driven by the recovery in the Slovak export sector and the acceleration of investment in Romania, fostered by the implemented regulatory and tax changes. In the largest economies of the region, Poland and Hungary, the growth rate remained stable.

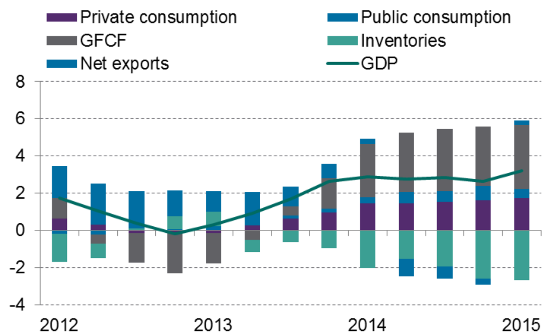
Figure 1.1. GDP in the CEE countries and EU-15 (in %, y/y)



Source: Eurostat

Individual economies of the CEE region are at various stages of recovery. Economies in which no excessive imbalances accumulated before the crisis (Poland, Slovakia and, in the recent period, also the Czech Republic) grow faster. High growth rate is also noted in Hungary and Romania, which is supported by domestic economic policies stimulating demand. On the other hand, in countries where the consequences of problems with banking sector stability continue to make a negative impact on the current economic situation, the recovery is clearly weaker. This refers mainly to Croatia, slowly recovering from recession, but also to Bulgaria. The GDP growth is also low in the Baltic states, whereas in their case it is mainly the effect of strong trade links with recession struck Russia and Finland, as well as of the uncertainty associated with the geopolitical situation.

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



Source: Eurostat

Fast growing domestic demand is the source of recovery in the CEE region (Figure 1.2). It is supported by: the beneficial impact of the decline in consumer prices and the growing demand for labour on the real income of households, accommodative monetary policy and, in some economies, also the measures of governments aimed at stimulation of demand. Over the recent period, the recovery in the CEE region has also been supported, although still to a moderate extent, by the improvement in the economic situation in the other EU countries.

[1] GDP in the Czech Republic in Q1 2015 increased by 2.5% q/q which indicated the acceleration of annual GDP growth from 1.3% in Q4 2014 to 4.0% in Q1 2015.

Since the beginning of 2014 households' consumption in the CEE countries has been on a rise. It has been fostered by: growing employment and the relatively high growth in nominal wages, as well as the improvement in income purchasing power as a result of decline in consumer prices.

Investment growth in the CEE countries reached a high level. Fast growth in gross fixed capital formation started as early as the second half of 2013. In the subsequent quarters investment growth continued to increase. However, the recovery of investment is observed only in some CEE countries.

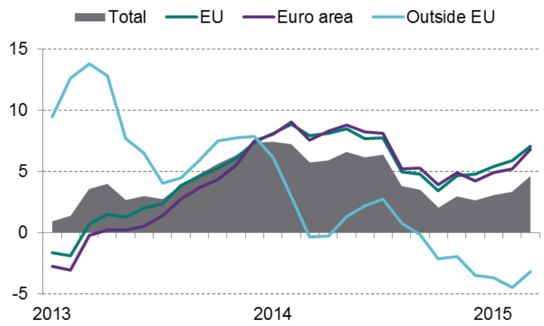
The fastest growth in investment is recorded in countries where no significant imbalances was accumulated (Poland, the Czech Republic and Slovakia) as well as in Romania. Strong investment demand in three economies of the Visegrad Group results, inter alia, from high levels of capacity utilisation, enforcing new investment after a period of weak growth in fixed capital formation. The growth rate of corporate investment in Romania clearly increased in Q1 of 2015 due to the introduction of tax changes.

In the other CEE countries the growth in fixed capital formation is slowly decreasing. Recession in Russia and the uncertainty associated with the conflict in Ukraine were reflected in the decline of investment in Latvia and Estonia. Only Lithuania managed to maintained a high growth in fixed capital formation. A visible weakening of investment growth occurred in Q4 2014 in Hungary, which was connected, on the one hand, with public investment limitation and with the completion of large projects in the automotive sector on the other.

Turbulences in the banking sector still pose a serious obstacle for investment in Croatia, Slovenia and Bulgaria. Growth in fixed capital formation is becoming clearly weaker in Bulgaria. In Croatia and Slovenia investment has been decreasing y/y. Besides hindrances in access to bank loans, in Bulgaria the growth in investment is falling also due to risks originating from strong links with the Greek economy.

Growing public investment, co-funded by the EU funds, contributed to the increase in gross fixed capital formation in 2014. It was supported by the growing consumption of funds associated with the overlapping of two financial perspectives. In connection with the approaching deadline for the disbursement of funds under the 2007-2013 perspective, a weakening of public investment growth in the region is expected. In some countries (the Czech Republic, Poland and Slovakia) private investment started to increase, due to the growing domestic demand as well as the recovery of foreign demand.

Figure 1.3. Exports of CEE countries to major trade partners (y/y, in %)



Source: Eurostat

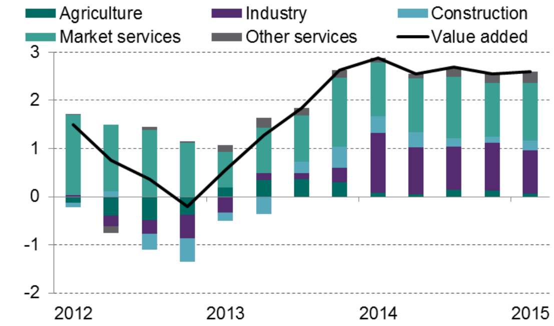
Recovery in the euro area affects the situation of the export sector in the CEE region. In Q1 2015 exports growth in the CEE countries has accelerated. This was mainly related to exports within the EU, i.e. exports to the euro area and trade among CEE countries (Figure 1.3). On the other hand, exports outside the EU continued to decrease in connection with the decline in sales to Russia and Ukraine as well as the fall in demand from large non-European economies (mainly the United States and China).

Market services and manufacturing benefits most from the recovery in the CEE countries and the euro area (Figure 1.4). The increase in value added in services, mainly in trade, transportation and logistics, is supported by the recovery of domestic demand. Only in the Baltic states activity in the services sector activity has been weakening over the recent quarters, which is associated with the slowdown in the transport and logistic sector as a result of deterioration trade between Russia and the EU[2]. On the other hand, recovery in industrial production occurred mainly in sectors strongly associated with Global Value Chains - GVCs[3] (automotive sector, production of electrical and electronic devices).

Business cycle indicators

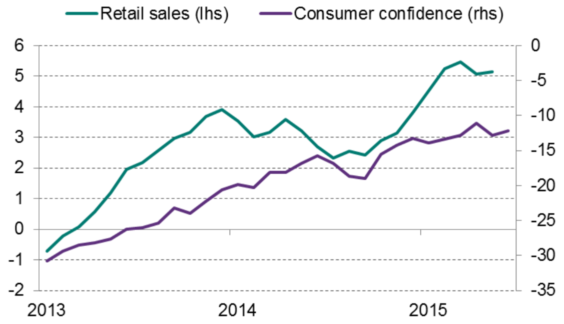
In the forthcoming months of 2015, stabilisation of consumption growth in the CEE countries is expected. In the recent months, a weakening of retail sales growth and a slowdown in consumer sentiment occurred (Figure 1.5). Consumer sentiment was improving successively following the decline in inflation and unemployment, although it deteriorated slightly in the recent period. However, business cycle indicators remain at high levels, signalling stable growth in private consumption.

Figure 1.4. Value added in the CEE countries (y/y, in pp.)



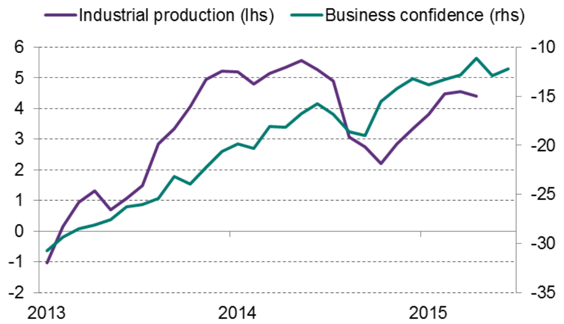
Source: Eurostat

Figure 1.5. Retail sales (in % y/y) and consumer confidence (in points) in the CEE countries



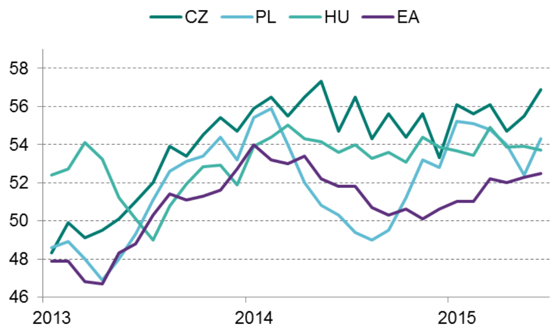
Source: Eurostat, European Commission

Figure 1.6. Industrial production (in % y/y) and business confidence (in points) in the CEE countries



Source: Eurostat, European Commission

Figure 1.7. PMI in manufacturing in the CEE countries and the euro area (in pp.)



*For Hungary, three months moving average
Source: Markit

Stabilisation of growth may be also expected in industry in the following months of 2015. Industrial production growth rate in Q2 2015 has slightly decreased, although it still remains high (Figure 1.6). Similar tendencies were observed in the case of confidence indicators in manufacturing (Figure 1.7).

[2] Re-exports, mainly of goods produced in the remaining EU countries, make c.a. 80% of the Baltic states' export to Russia. It comprises mainly goods produced in the remaining EU countries.
[3] The highest growth in industrial production in Q1 of this year was recorded in Hungary, followed by the Czech Republic, Poland, Romania and Slovakia, i.e. in countries most intensively cooperating within GVCs.

Their decline resulted mainly from the fall of forward looking subindices (inflow of new orders, expected production volume), whereas subindices describing the current situation were still increasing in most cases.

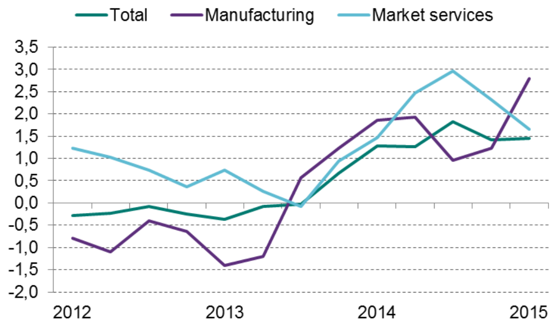
Labour market

The recovery of domestic demand and improving exports prospects are accompanied by growing employment. Since the beginning of 2014, employment has increased by almost 700 thousand people. In the recent period, the highest number of jobs, almost 2/3, has been created in trade, transport and storage services as well as in manufacturing. However, whereas the employment growth rate in services started to fall in the second half of 2014, the employment growth in industry increased, confirming the improvement in CEE industry outlook (Figure 1.8). In Hungary, public works programme played a significant role in stimulating employment[4].

The growing labour demand is reflected in the decline in unemployment rate, although the decline has slowed down in the recent months. Harmonised unemployment rate in the CEE region has been decreasing successively since the second half of 2013. However, in 2015 the magnitude of its decline slowed down (Figure 1.9), particularly in countries where the unemployment rate approached historically low levels (the Czech Republic, Estonia, Romania). This indicates that the structural factors reflected in demand and supply in the labour markets mismatches may constitute a barrier to further decline of unemployment in some CEE countries.

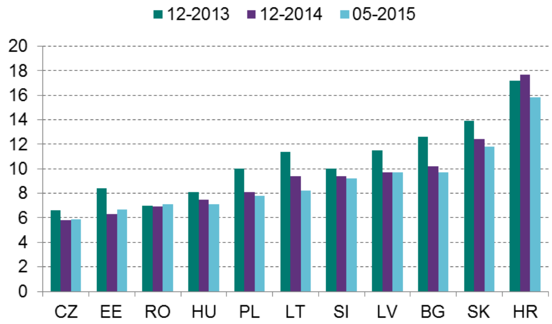
[4] According to the act on public works, the unemployed who still want to receive the benefit after the lapse of 180 days following the loss of work, are bound to participate in public works at least four hours daily. The average number of employees under this plan reached over 170 thousand by the end of 2014, whereas in 2015 an extension of the programme by further 50 thousand persons is planned.

Figure 1.8. Employment in the CEE countries (in %, y/y)



Source: Eurostat

Figure 1.9. Unemployment rate in the CEE countries (in %)

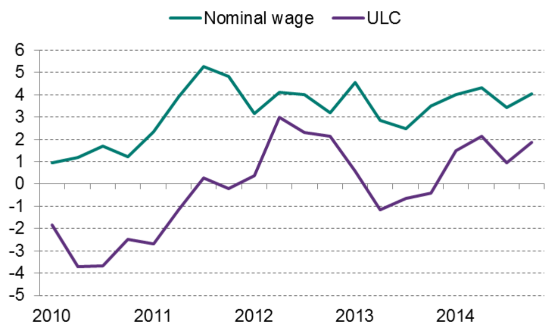


Source: Eurostat

The improvement of the situation in labour markets has led to an increase in wages growth rate (Figure 1.10). Similarly to the previous years, the fastest growth in wages is recorded in the Baltic states, where the bargaining power of employees increased due to the considerable outflow of labour force abroad over the recent years. The growth rate of wages clearly increased also in Romania and Slovakia, where minimum wage was raised. In all the aforementioned countries the annual growth in nominal wages in Q4 2014 ranged from 6 to 8%. In Poland, Bulgaria, the Czech Republic and Hungary it was approximately twice lower. In Croatia and Slovenia, where the situation in the labour markets was still clearly affected by adjustments of macroeconomic imbalances, nominal wages practically did not increase in 2014.

In most of the CEE countries, nominal wages in 2014 grew faster than labour productivity. A decline in unit labour costs (ULC) occurred only in Poland.

Figure 1.10. Nominal wages and unit labour costs in the CEE countries (in %, y/y)



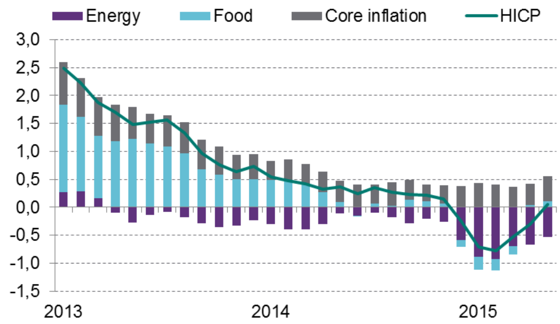
Source: Eurostat

Inflation

Deflationary pressure in the CEE countries is gradually fading away. In December 2014, a decline (y/y) in the index of consumer prices in the CEE region was recorded for the first time in history (Figure 1.11). In the first months of 2015 deflation occurred in all the countries of the region, excluding Romania. However, since March 2015 deflation in the CEE region has started to diminish. In May 2015 the HICP growth rate amounted to 0% y/y, whereas the decline in prices occurred only in Bulgaria, Poland, Slovenia, Lithuania and Slovakia, however, even in those countries deflation decreased (Figure 1.12).

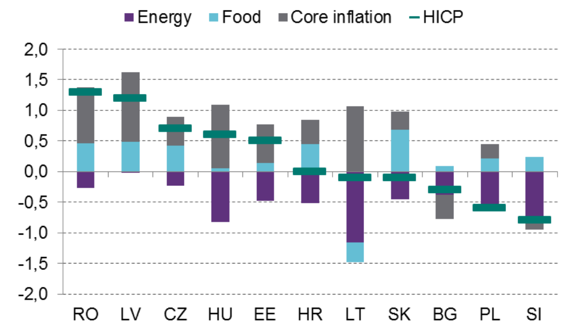
Factors affecting inflation are similar in all CEE countries. Change in inflation is determined by the developments in food and energy prices. First of all, the decline in the prices of energy commodities in global markets, observed since January 2015, fostered the reduction of energy prices in the CEE countries, including the reduction of regulated prices (electricity in Slovakia and Hungary, gas in Estonia and Lithuania). Following the growth in the prices of energy commodities in the subsequent period, prices of fuels in the CEE countries increased, which was reflected in the smaller decline in energy prices (y/y). Secondly, sanctions imposed by Russia on food imports from the EU as well as good harvests resulted in the growth in food supply in the second half of 2014, resulting in the decline of unprocessed food prices. However, the growth in the prices of food commodities as well as the expiring base effect caused that in May 2015 the prices of unprocessed food increased for the first time in 12 months.

Figure 1.11. HICP inflation and its components in the CEE countries (in %, y/y)



Source: Eurostat

Figure 1.12. HICP inflation and its components in the CEE countries - May 2015 (in %, y/y)



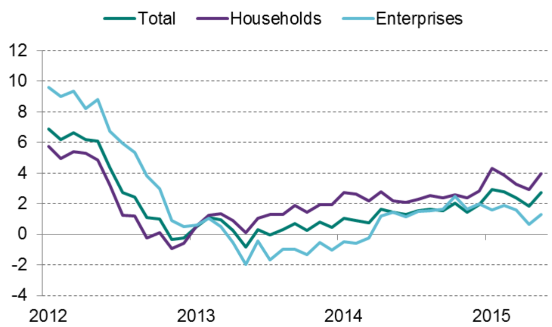
Source: Eurostat

In the first months of 2015 core inflation still remained at a low level. The low core inflation is partly the result of the continued, relatively weak demand pressure. According to the EC estimates, in the majority of the CEE countries, besides the Baltic states, the output gap remains negative. The growth in core inflation is also hampered by low commodity prices, decline in manufacturers' prices and low inflation abroad.

Lending market

In the part of the CEE region bank lending is on a rise. However, the growth in the value of granted loans is mainly related to loans for households, whereas corporate loans grow at a much slower pace (Figure 1.13). In the post-crisis years the deleveraging of private sector was one of the major factors hampering the growth in the CEE region. However, already since mid-2013 a gradual growth in bank loans for the non-financial sector has been noted. It was particularly visible in countries with a stable banking sector, i.e. Poland, Slovakia and the Czech Republic. A recovery of lending also occurred in Estonia and Lithuania. The decline in the value of loans granted stopped in Croatia, although lending in this economy is weak in connection with the ongoing deleveraging of households and the banking sector.

Figure 1.13. Bank lending to the private sector in the CEE countries (y/y, in %)

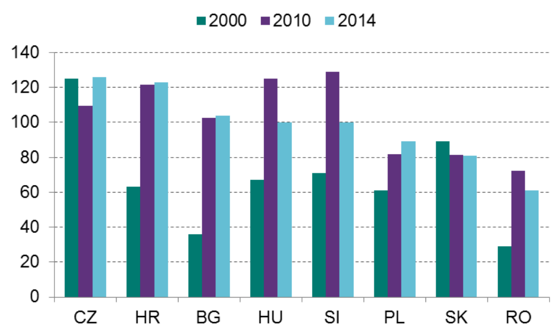


Source: Central banks

However, in some economies the value of loans continues to decline, which is due to both supply (deleveraging of banks) and demand (high level of companies and households debt). On the supply side, one of the major factors limiting lending is the poor quality of loan portfolio. The share of nonperforming loans in Bulgaria, Croatia, Romania, Slovenia and Hungary at the end of 2014 ranged from 13 to 17%. In Romania and Slovenia, as well as in Bulgaria, where a large national bank went bankrupt in mid-2014, the growth in the credit value is limited by measures aimed at the improvement of the quality of assets in the banking sector (excluding some entities and their assets from the sector). In the case of Hungary, the weakening loan supply is an effect of the low profitability of banks affects, associated, inter alia, due to obligatory foreign exchange loan conversion and reimbursement of costs associated with charging excessive fees due to too high margins and exchange rate spreads to individual clients over the last 10 years.

BIS data[5] indicate a further reduction of banks' foreign claims in the CEE countries vis-a-vis foreign banks. At the same time, a part of the capital withdrawn by foreign financial institutions was still replaced by the inflow of domestic deposits. The growth in deposits was observed in the entire region, excluding Bulgaria.

Figure 1.14. Assets of banking sector (in % GDP)



Source: CEE Banking Sector Report, Raiffeisen Research, June 2015

Commercial banks expect growth in loan demand and certain improvement regarding its supply. Surveys of the European Investment Bank regarding the conditions of banking sector[6] in the CEE countries indicate that the demand for loans has increased in the first half of 2015 and that the terms of loan granting have been eased. These tendencies

[5] Bank for International Settlements, Locational Banking Statistics

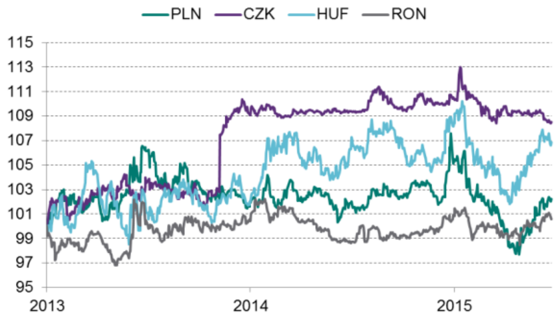
[6] CESEE Bank Lending Survey H1-2015, EIB, June 2015.

are to be sustained in the second half of 2015. Large European banking groups plan to increase their lending activity in the CEE region due to the expected higher profitability as compared with their mother countries. However, clear diversification of the region could be observed, into countries with low risk, high profitability and high growth potential (inter alia, Poland, the Czech Republic and Slovakia), and less attractive economies where banking groups do not plan large expansion (inter alia, Bulgaria, Croatia, Slovenia and Hungary).

Financial markets

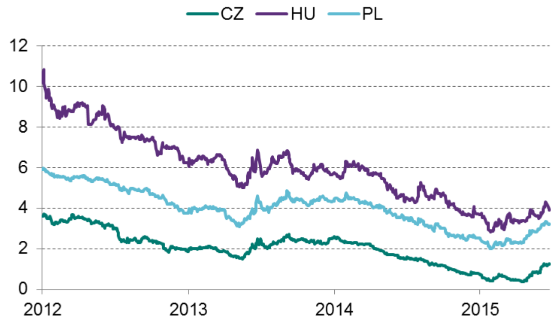
Policy actions of SNB and ECB as well as the uncertainty associated with the resolving of the crisis in Greece were the key factors affecting the developments in CEE currency markets. After the depreciation of the CEE currencies in connection with the decision of Swiss National Bank concerning abandoning the exchange rate floor in mid-January 2015, their clear strengthening against the euro could have been observed in the following months (Figure 1.15). This involved, in particular, the Polish zloty and the Hungarian forint. The Romanian leu strengthened to a lesser extent. In the case of the Czech koruna the scale of strengthening was limited by the policy of exchange rate floor (see below). The appreciation of the currencies results from launching the asset purchase programme by the ECB and the associated increased flow of capital to economies offering higher rate of return. Consequently, there was a decline in treasury bond yields to all-time lows in the CEE countries, which was supported by central banks' policy rates cuts (Figure 1.16). Increased risk in the European financial markets in April 2015 in connection with the return of the threat associated with the potential Greek default and the country's exit from the euro area (*Grexit*), as well as the appearing announcements of raising interest rates by FED, led to the weakening of the zloty and forint. At the same time, capital outflow from the treasury bond market of the CEE countries could be observed, which resulted in yields increases.

Figure 1.15. Exchange rates of CEE currencies against EUR (01.01.2013=100)



Source: Reuters

Figure 1.16. 10-year treasury bond yields (in %)

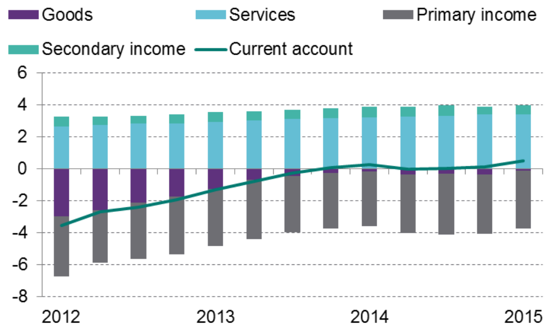


Source: Reuters

External balance

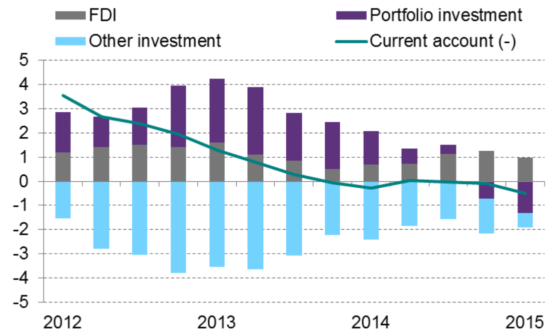
The magnitude of external imbalances in the CEE region has clearly decreased in the recent years. The current account balance in 2014 and in Q12015 was close to balancing (Figure 1.17). In none of economies of the region the current account balance exceeded the range of -4% and 6% of GDP, which would signal external imbalances under the *Macroeconomic Imbalance Procedure* (MIP). High surpluses on the current account balance were recorded in Hungary and Slovenia.

Figure 1.17. Current account balance in the CEE countries (in % of GDP, 4-quarter moving average)



Source: Eurostat

Figure 1.18. Inflow of net foreign investments to the CEE countries (in % of GDP, four-quarter moving average)



Source: Eurostat

Foreign financing in the CEE region decreased due to portfolio investment outflow (Figure 1.18). In 2014 as well as in Q1 2015, net outflow of foreign investment from all countries of the region, except Slovakia, was registered. However, this tendency was not related to foreign direct investments (FDI), which increased as compared to 2013, with the strongest growth in the Czech Republic and Slovenia. In the majority of countries, an increased inflow of FDI resulted from high reinvested earnings of foreign enterprises. On the other hand, following a period of permanent inflow, lasting from 2009, in 2014, the outflow of portfolio investment was observed. Portfolio investors withdrew their capital from almost the entire region, from the Czech Republic and Hungary in particular. This process intensified in Q4 2014, due to the expected raise of interest rates by the FED. However, already in Q1 2015 the quantitative easing in the euro area resulted in the recovery of portfolio capital inflow to the region.

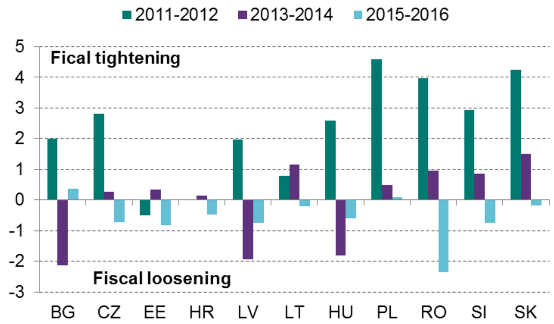
Foreign capital continued to outflow from the CEE banking sectors. The net outflow of other investment reflects the deleveraging process in the Central European banking systems. It resulted from the reduced scale of financing of local branches and subsidiaries by foreign parent banks. However, the scale of capital outflow has slowed down explicitly in Q1 2015.

Fiscal policy

With the abrogation of the *excessive deficit procedure* (EDP) against the majority of countries in the region[7] in recent years, the consolidation efforts came to a halt or their magnitude has been scaled down. Consequently, in the majority of the CEE countries the expected headline deficit in 2015 is to remain at the level close to that recorded last year, exceeding 3% of GDP only in Croatia.

[7] The EDP against Bulgaria was abrogated in 2012, against Hungary, Romania, Lithuania and Latvia – in 2013, against the Czech Republic and Slovakia – in 2014, against Poland – in 2015. Estonia remains the only country of the region so far not placed under the excessive deficit procedure. Currently only two countries are subject to the EDP: Slovenia (deadline for correction – 2015) and Croatia (2017).
In accordance with the spring fiscal notification (April 2015), the general government deficit (ESA2010) in Poland amounted to 3.2% of GDP in 2014 as compared to 4.0% of GDP in 2013. Its reduction resulted from, inter alia, changes in the functioning of the Open Pension Funds (OFEs) enacted in December 2013 (lower interest payments and lower contribution transfer to the funded pension scheme – yielding in total approximately 0.6% of GDP). While taking the decision on early EDP abrogation for Poland, the European Commission and the Council applied the systemic pension reform clause –2014 fiscal outturn corrected for its costs amounted to 2.8% of GDP. The deduction was limited to social contributions transferred to OFEs before August 2014, when provisions of pension overhaul adopted in 2013 entered into force (opt-out) and funded scheme lost its universal coverage (only 18% OFE members requested continuation of contribution transfer to OFEs).

Figure 1.19. Fiscal policy stance in the CEE countries in 2011-2016, measured by the change in the primary structural balance



BG – Bulgaria, CZ – Czech Rep., EE – Estonia, HR – Croatia, LV – Latvia, LT – Lithuania, HU – Hungary, PL – Poland, RO – Romania, SI – Slovenia, SK – Slovakia.
Source: AMECO database of the European Commission

The shift in the fiscal policy stance was geared towards supporting economic growth, through lowering the tax burden and rolling back cuts in wages in public administration, as well as in social security benefits[8].

The fiscal space, enabled by the improving economic situation, curbing the headline deficit below 3% of GDP in the previous years and lasting favourable conditions of financing borrowing needs (decline in interest payments), is to be used for fiscal policy loosening. However, its magnitude shall be moderate – on average ca. 0.8 percentage points of GDP[9] for the years 2015-2016 (Figure 1.19). Moreover, in 2016, the general government deficit – according to the spring EC forecast – is to remain below the 3%-of-GDP threshold in the CEE countries, except for Croatia and Romania. The fiscal measures on the revenue side listed in the latest updates of the Convergence/Stability Programmes (2016 round) refer mainly to combating the shadow economy and excise duties hikes. In Estonia, Romania as well as in Latvia and Hungary, a reduction of tax burden is planned[10]. On the other hand, on the expenditure side, the countries of the region do not envisage significant new austerity measures, excluding Croatia, currently under EDP (the reform of the public wage bill, reductions of certain social benefits and health sector expenditure).

Fiscal loosening will not significantly translate into increase in the public debt-to-GDP ratio. Considering the forecasts of the EC (2015-2016) and the IMF [11] (2015-2017), this ratio is expected to stabilise or decrease in the majority of countries of the region, excluding Romania, as well as Croatia and Slovenia (in case of privatisation plans failure). Only in the last two countries and in Hungary, the general government debt will exceed 60% of GDP[12]. The failure to achieve sufficient progress in the public debt reduction below this threshold (following the correction of the excessive deficit) might translate to the re-launch of the EDP against Croatia and Slovenia.

Croatia still remains the country facing the biggest fiscal challenges. In view of, inter alia, the persistent weak growth outlook, the adjustment measures undertaken (mainly expenditure-based) will be insufficient to bring fiscal outturn down below 3% of GDP before the EDP deadline (the authorities estimate that it will take place a year after the EDP

[8] In the case of some countries the increase of expenditure was geared to national defence (mainly Lithuania and Latvia – by approximately 0.3-0.5% of GDP).

[9] Measured as a change in the primary structural balance (the cyclically adjusted balance excluding impact of one-off and temporary measures), following the EC spring forecast (May 2015). The Commission applied a prudent approach to the estimates of the yield of measures aimed at limiting the tax fraud and shadow economy.

[10] Estonia – raising basic personal tax allowance, introduction of the support measure for low-income earners (tax returns); Romania – reduction of VAT, excise, reducing the tax rate on: dividends, pension and retirement benefits, real property rental, micro-enterprises and the rate of tax on special constructions; Latvia – PIT rate cut (from 24% to 23%); Hungary – reduction of rates: PIT (from 16% to 15%), VAT on unprocessed pork meat (from 27% to 5%), cut in the bank levy, raising allowance in PIT for families with at least two children.

[11] *Fiscal Monitor – Now Is The Time: Fiscal Policies For Sustainable Growth*, IMF, April 2015.

[12] The EC forecasts that the public debt-to-GDP ratio at the end of 2015 will amount to 75.0% in Hungary, 81.5% in Slovenia, and to 90.5% in Croatia.

deadline, i.e. in 2017). Another challenge will be the financing of high borrowing needs and the reduction of the public debt – the highest among the CEE countries.

Fiscal policy loosening in Romania, which can be associated with the next year's parliamentary elections[13], may undermine the effects of significant fiscal consolidation undertaken in the previous years. New fiscal code adopted by the Romanian government in March 2015 included, inter alia, reductions in: tax rates in 2016-2019 (VAT, excise, PIT, CIT), changes in social insurance contributions[14], and measures aimed at combating tax fraud. Due to the favourable state budget revenue execution, the government decided to introduce the reduced VAT rate on food already from the middle of this year, as well as to broaden its scope[15]. In its spring forecast (May 2015), the EC estimated, that owing to the measures included in the new code the fiscal position of Romania will deteriorate (deficit of 3.5% of GDP in 2016[16]), which indicates the risk of the EDP re-launching. Some of the adopted measures were reversed by the Romanian Senate[17]. Nevertheless, the government adopted in May 2015 an increase in child benefits and the proposal of faster reduction of the basic VAT rate in 2016[18].

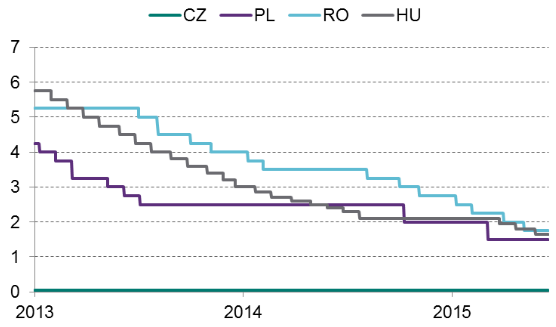
Monetary Policy

Deflation and asset purchase programme launched by the ECB (enhancing the risk of domestic currency appreciation), represented important conditions for further monetary policy easing in the CEE countries. Central banks of Poland (NBP), Romania (NBR) and Hungary (MNB) decided to cut its main policy rates to their all-time low levels (Figure 1.20). Between January and June 2015 the size of cumulative cuts amounted to, respectively: 50 bps (to 1.5%), 100 bps (to 1.75%) and 60 bps (to 1.5%). In addition, MNB decided to extend the programme supporting lending for small and medium-sized enterprises (*Funding for Growth Scheme+*), for which ca. EUR 1.6 billion was allocated. MNB decide also that the current two-week deposit facility will be replaced by a three-month, fixed interest central bank deposit as the MNB's key policy instrument from 23 September 2015 This change should encourage banks to purchase treasury bonds and develop lending. At the same time, NBR decided to decrease the rate of reserve requirement and narrow the corridor between the deposit rate and Lombard rate (from 4 to 3.5 bps). In the Czech Republic, where interest rate remains at a "technical zero" level[19], the central bank announced extension of using exchange rate as an additional monetary policy instrument (preventing the strengthening of the EUR/CZK exchange rate above the level of 27) at least until mid-2016.

[13] In the years 2015-2016 parliamentary elections will also be held in Croatia, Poland as well as in Lithuania and Slovakia.
[14] The main measures included:
- reduction of the basic VAT rate from 24% to 20% from 2016, and subsequently – to 18% from 2018, introduction of reduced VAT rate (9%) on unprocessed food products from 2016,
- abolition of the tax on special constructions and dividend taxation,
- significant reduction of excise tax on fuel and spirits,
- broadening, from 2016, the social security contribution assessment basis, alongside with introduction of its cap (set at a level of 5-fold average wage), reduction of social insurance contributions in 2018,
- reduction in PIT and CIT rate from 16% to 14% from 2019.

[15] Initially, the reduction was to cover only unprocessed food.
[16] The Romanian authorities estimated however that headline deficit will remain below 3% of GDP, taking into account the significant positive impact of improved tax collection and reduced tax evasion. It was not included in the spring EC forecast (estimates based on optimistic assumptions).
[17] The reductions of excise tax and abolition of tax on special constructions have been reversed. A reduced tax rate (5%) will be applied instead of abolition of dividend taxation.
[18] To 19%, i.e. the rate applied before the onset of the economic crisis.
[19] Since November 2012, the main policy rate of the Czech National Bank (CNB), *2W Repo rate*, has remained at a level of "technical zero", i.e. 0.05%, which hampers the implementation of conventional monetary policy.

Figure 1.20. Central banks main policy rates in the CEE region (in %)



Source: Reuters

Forecasts

Pace of economic growth in the CEE countries is expected to remain stable in the coming years. The latest forecasts of international institutions (European Commission, International Monetary Fund, OECD, World Bank) envisage that the economic growth rate in 2015-2017 will remain at the level of 2014. The economy of Poland should grow at the fastest pace, followed by Romania and Slovakia. In 2015 a high economic growth rate should be also maintained in Hungary. The EC as well as the IMF and the WB slightly revised their growth forecasts upwards. OECD upward revision was more significant.

Growth forecasts for Slovakia and Hungary have been significantly increased. It is associated with the economic policy implemented in these countries, aimed at spurring domestic demand. Fast increase in capacity utilisation will induce growth in fixed investment and, consequently, GDP in Slovenia. On the other hand, growth forecasts were decreased for Bulgaria (effect of instability in the banking sector and the political crisis as well as strong links with the Greek financial system) and for the Baltic states (strong links with the Russian economy).

Domestic demand is to remain the major growth factor. Private consumption should play a more important role than in 2014, supported by the continued, although not as rapid as before, improvement of the situation in the labour market and the increase in lending. On the other hand, the contribution of public investment to the GDP growth will decrease, especially in 2016. It is the effect of lower inflow of European Union funds due to expiring financial perspective for 2007-2013. Growth in fixed capital formation of private enterprises (already vigorously increasing in the Czech Republic, Poland and Slovakia) will partly compensate for lower public investment. The economic growth in the region will still be supported by the accommodative monetary policy and the fiscal easing.

Exports is expected to accelerate. It should mainly result from the expected recovery in the euro area. Some of the CEE countries, i.e. euro area members or euro peggers, will benefit from expected euro depreciation. At the same time, imports will grow at a similar pace to exports, due to strong domestic demand and the high import intensity of exports (especially for production associated with GVC). Accordingly, the contribution of net exports to the GDP growth will be close to neutral.

Major risk factors for growth are associated with the situation in the external environment. They comprise potential negative scenarios related to the resolution of the Greek crisis, i.e. uncontrolled default and exit of this economy from the euro area. A significant risk factor is also the conflict in Ukraine.

Inflation in the CEE countries should gradually increase in 2015-2017. Deflation pressure which has weaken already in Q2 2015 should continue to decrease in the following months, although forecasts for 2015 indicate continued low inflation (below 1%) and in some countries of the region (Bulgaria, Poland, Lithuania, Slovakia) – even deflation. Only in Romania a decline in inflation in 2015 is expected, which will result from the reduction in indirect taxes. Inflation in the CEE countries will remain relatively low in 2016.

The growth in consumer prices will mainly result from the expiring effects of low energy commodity and food prices. In addition, the closing of negative output gaps should push core inflation up. Further pressure on the growth in wages is also expected.

Bulgaria – links with Greece as a serious threat to the weakened economy

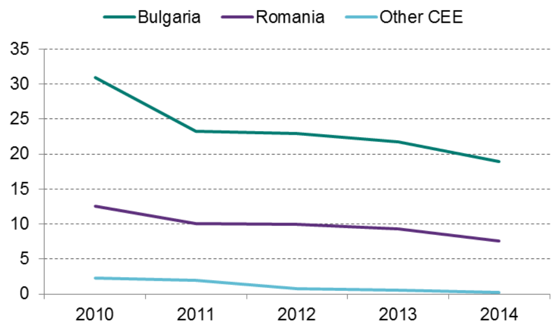
Economic growth in Bulgaria accelerated in 2014 despite unfavourable external conditions, the bankruptcy of a large national bank and the instability of the political situation. Growth was based on domestic demand, in particular household consumption, which growth rate increased at the end of last year due to improvement in consumer sentiment and decreasing unemployment. Economic growth was supported by expansive fiscal policy and increased absorption of European Union funds.

GDP growth rate increased again in Q1 2015, although – as a consequence of problems related to banking system stability – the growth structure has explicitly changed. Problems in the banking sector were reflected in increased risk aversion and limiting lending, which in turn has contributed to the slowdown in investment growth and household consumption. Economic slowdown and deflation have led to the deterioration in the general government stance[20]. Consequently, the S&P rating agency cut Bulgaria's rating to the "junk" level (BB+). The risk of the excessive deficit procedure being imposed on Bulgaria has also increased. Accordingly, the authorities decided on fiscal consolidation, which resulted in the decline of government consumption in Q1 2015. Thus, exports remained the driving force of growth. Sales to the euro area increased (to Germany and Italy in particular), as well as exports to Turkey. It fully compensated for the decline in demand from other markets, inter alia, Russia,

[20] Expenditure incurred to save banking sector stability did not officially affect the growth in deficit. In 2014 National Bank of Bulgaria provided access to liquidity to the FIB bank threatened by bankruptcy and granted guarantees to depositaries of the bankrupt CCB bank.

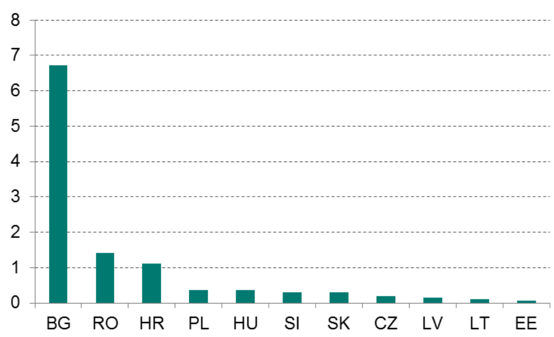
Most recent forecasts suggest a slowdown in GDP growth in 2015. The growth in household consumption will remain poor, limited, by employment stagnation, low growth in wages and lower credit supply. The consequences of CCB (*Corporate Commercial Bank*) bankruptcy will have an adverse effect on investments. In view of the required fiscal consolidation and the lapse of the programming period for the European Union funds, a reduction in government consumption and public investment is expected. At the same time, forecasts assume strong exports growth, driven by the demand from both euro area and non-EU countries (inter alia, Turkey).

Figure 2.1. Foreign claims towards Greek banks (in % GDP)



Source: BIS, IMF

Figure 2.2. Share of exports to Greece in total exports (in %)



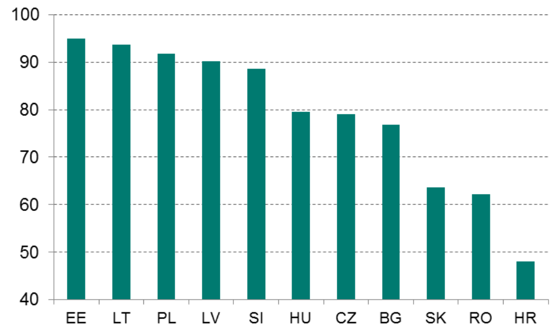
Source: Eurostat

Strong links with Greece pose a threat to the stability of Bulgarian economy. Contrary to the majority of countries in the region (besides Romania), direct economic links with Greek economy create a serious potential threat in case of its default or exit from the euro area. Greece is an important exports market for the Bulgarian economy. In 2014 almost 7% of exports were shipped to Greece (Figure 2.2). Greek investments amounted to over 7% of total foreign investments in Bulgaria. In addition, in 2014, over 20% of banking sector assets in Bulgaria belonged to Greek banks. Therefore, the Bulgarian banking system is dependent on financing by Greek parent banks. In 2014, claims vis-à-vis Greek banks amounted to 19% of Bulgaria's GDP (Figure 2.1). However, despite high exposure to Greek financial sector, foreign banks in Bulgaria have a better capitalised and have less problems with liquidity than domestic banks.

Croatia – a slight GDP growth expected after six years of recession

The magnitude of Croatia's GDP decline is decreasing. Since 2008 it has decreased by over 12%. In 2014 it only fell by 0.4%, and in Q4 2014 and Q1 2015 the annual GDP growth rate increased slightly above zero (by 0.2% and 0.1% y/y, respectively). The main reason for the weak economic recovery in Croatia is the decline in domestic demand, especially in fixed capital formation. Investment in Croatia have been negatively affected by the ongoing process of deleveraging of companies, fiscal consolidation and the weakest level of EU funds absorption among member states (Figure 3.1).

Figure 3.1. Absorption of funds from the financial perspective 2007-2013, status as at Q2 2015 (in %)

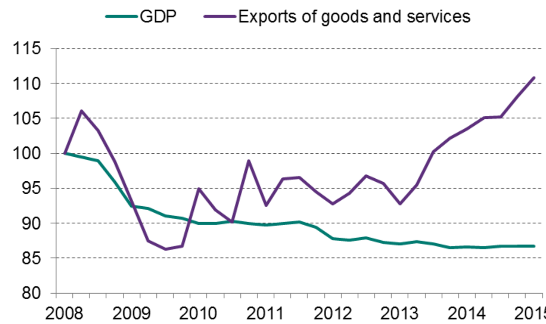


Source: EC

The only factor supporting the economic activity in Croatia are exports, although its growth rate remains low (Figure 3.2). Slow growth in exports is an effect of the continued low competitiveness of Croatian products in foreign markets, which mainly results from excessive growth in prices and wages in relation to productivity growth in the period preceding the economic crisis. In addition, one-off factors, i.e. the restructuring of the shipyard industry, negatively affected exports growth. The weakness of exports growth is also connected with structural factors, e.g. the limited level of Croatia's integration within global value chains. Product and geographical structure of the Croatian exports shows that it is characterised by goods and markets with low growth potential.

It is expected that throughout the entire 2015 Croatia's economic growth will return to a positive territory. In 2015-2016 the improvement in the business cycle of major trade partners is expected, which will be reflected in continued growth in exports, especially into EU markets. At the same time, domestic demand will remain weak. In particular, further decline in investment is expected, with only a slight increase in consumption. Weak domestic demand will continue to limit imports growth.

Figure 3.2. Croatia's GDP and exports (Q1 2008 = 100)



Source: Eurostat

The contribution of domestic demand to growth will remain insignificant. Individual consumption will slightly grow. However, the growth in consumption will still be hampered by the continuing decline in employment (Figure 3.3) and the ongoing deleveraging of households[21]. Moreover, access to bank loans remains difficult due to the limited financial flows to banks operating in

[21] In the years preceding the global financial crisis, Croats incurred debt at a rapid pace, taking advantage of the considerable inflow of foreign capital to their economy. Consequently, the debt of household sector, measured by the value of bank loans, in relation to GDP, increased from 28% in 2004 to 40% in 2008.

Croatia their foreign parent banks in the first years after the crisis.

Figure 3.3. Growth in nominal wages and employment in the economy of Croatia (in %, y/y)

Source: Croatian Bureau of Statistics

The ongoing fiscal consolidation will be another factor limiting the growth in domestic demand. Croatia belongs to the most indebted countries of the region. Public debt exceeds 80% of GDP. Since 2009 the general government deficit has continuously remained far above the 3% of GDP threshold. Consequently, since its accession to the EU in 2013, Croatia has been covered by the excessive deficit procedure. Croatia was committed to reduce the deficit to 3% of GDP by 2016, which will be associated with numerous cuts in public expenditure in the 2015-2016 (c.f. section on *Fiscal policy*).

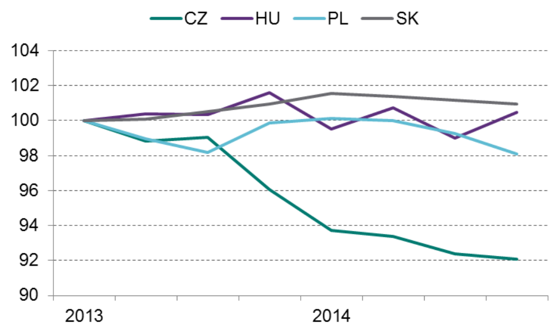
Czech Republic – unconventional monetary policy fosters economic recovery

In 2014 the economy of the Czech Republic entered the recovery stage following the two-year recession. Domestic demand, both consumptions and investments, increased, supported by expansive fiscal policy (growth in wages in the general government sector and public investment). In 2015 fiscal policy will continue to support growth in the Czech Republic. Both a growth in expenditure (further increases in wages in public sector and pensions, raising the minimum wage, maintaining high expenditure on public investment) as well as a reduction in tax burden is expected.

Growing export also contributed to growth. In 2014, it increased by almost 9%, which was the highest level among the CEE countries. Despite the relatively strong growth in exports, the contribution of net exports to the GDP growth remained negative, due to even faster growth in imports (the effect of the growing domestic demand, but also the high import intensity of Czech exports).

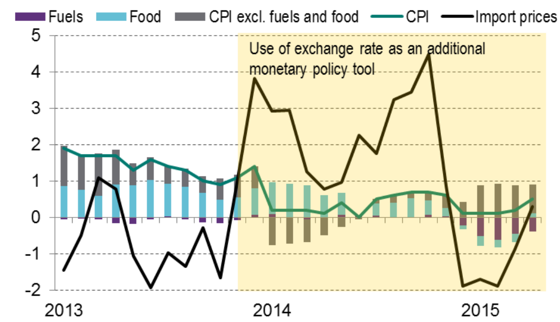
Exports growth results from increasing demand for cars produced in the Czech Republic, but also from improvement in competitiveness. The growth in production and exports of transport vehicles resulted, inter alia, from the introduction of a new production offer by the largest car producer in the Czech Republic (Skoda Auto). In addition, the weakening of the real exchange rate of the koruna was an important factor triggering exports growth. Between Q3 2013 and Q4 2014 REER deflated by ULC depreciated by 7%, whereas in Poland and in Hungary its value practically did not change, and in Slovakia REER ULC slightly strengthened (Figure 4.1). Consequently, the Czech Republic became the biggest beneficiary of exports recovery in Germany, and managed to increase its share in the European trade.

Figure 4.1. REER deflated by ULC (2013 Q1=100)



Source: Eurostat

Figure 4.2. CPI inflation and its components (in % and pp, y/y)



Source: CNB

Weakening of the exchange rate resulted mainly from unconventional measures of Czech National Bank (CNB). In November 2013, the CNB Bank Board, having no possibility of easing the monetary policy through further cuts in interest rates, decided to use exchange rate as an additional policy instrument (EUR/CZK at a level of at least 27, which meant one-off weakening of the koruna against the euro by over 5%[22]). One of the basic objectives underlying the introduction of this exchange rate floor by CNB was to avoid

[22] Details concerning the introduction of the asymmetric exchange rate target as an additional monetary policy tool can be found, inter alia, in the publication "Analysis of the economic situation in the countries of Central and Eastern Europe", 2/2014, NBP, pp. 27-28.

deflation, which was a real threat to the economy slowly recovering from recession (Figure 4.2).

Inflation still remaining at a very low level influenced the decision of CNB on the extension of the exchange rate floor at least until the second half of 2016. In addition, in case of the deflation pressure deepening, economic growth weakening or inflation expectations anchoring at a low level, CNB does not exclude further measures aimed at depreciating the koruna, although the materialisation of these risk factors seems less and less probable.

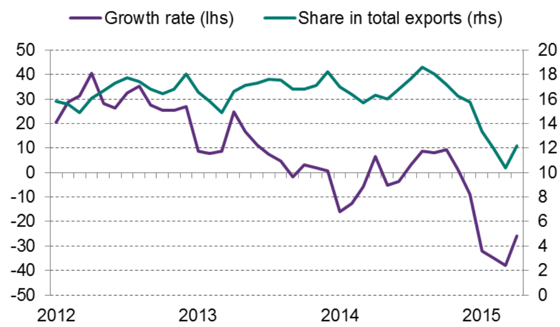
Estonia, Lithuania, Latvia – strong links with Russia weaken economic recovery

Economic growth in the Baltic states has slowed down. Although GDP growth remained among the strongest in the euro area, it was weaker than in the majority of other CEE.

The slowdown resulted from the decline in investment and falling exports. In both cases, the determining factors included: the deterioration of sentiment triggered by the conflict in Ukraine, sanctions imposed by Russia on goods imported from the EU and the recession in Russia. On the other hand, GDP growth in the Baltic states was supported by household consumption, driven by growing wages and employment.

Export to Russia weakened mainly as a consequence of recession in this economy (Figure 5.1). Despite the significant role of food in the Baltic states exports to Russia, the direct impact of sanctions turned out lower than expected, mainly due to the increased export to other EU countries (inter alia, to Sweden and Poland). The country most severely affected by the Russian sanctions was Latvia, with the highest share of food in the overall export to Russia among all the CEE countries. The depreciation of the ruble and the economic downturn in Russia were the strongest factors limiting Russian demand for goods exported by the Baltic states. Recession in Russia most severely affected Lithuania (main re-exporter of goods from other EU states). On the other hand, the relatively lower impact occurred in Estonia, where exports, due to the strongest links with Scandinavian countries, demonstrate the lowest dependence on the Russian demand. In addition, the decline in exports of goods to Russia influenced exports of services associated with transport, logistics and storage, particularly in Lithuania and Latvia, where these services represent an important part of the economy.

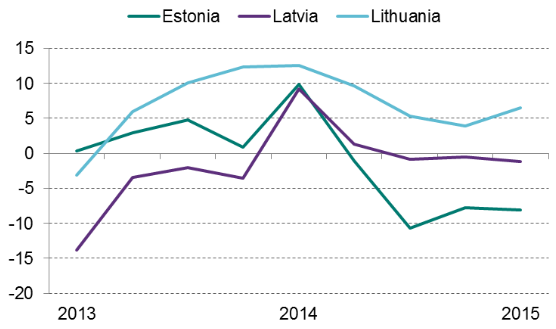
Figure 5.1. Exports of the Baltic states to Russia (current prices) – growth (in %, y/y) and share in the total export (in %)



Source: Eurostat

The decline in the Russian demand and the continuing uncertainty related to further development of the situation in Russia and Ukraine contributed to the deterioration business sentiment and to a decline in investment (Figure 5.2). The strongest decline in fixed capital formation was recorded in Estonia and Latvia. Despite the external threats, domestic factors also played a n important role. In Estonia investment in energy sector declined, in connection with the termination of modernisation oil shale extraction and shipping infrastructure. In Latvia investment in the metallurgical sector decreased, which resulted from the temporary shut-down of the largest metallurgical plant, Liepajas Metalurgs. One exception was Lithuania, where growth in fixed capital formation remained strong. It was the effect of the combination of favourable investment conditions for private companies (high level of capacity utilisation, substantial liquidity of enterprises) and the continuation of investment projects launched in previous quarters, inter alia, the construction of the *Rail Baltica*, the infrastructure of the gas terminal in Klaipeda, or the development of the power grid. However, it seems that after the termination of the aforementioned projects the growth rate of fixed capital formation in Lithuania will also decrease.

Figure 5.2. Growth in fixed capital formation (in %, y/y)



Source: Eurostat

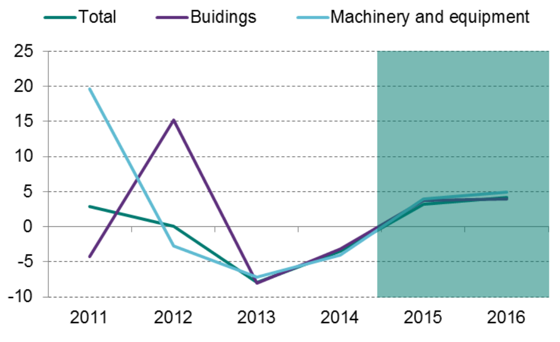
Recession in Russia and the strong depreciation of the ruble slowed down the inflow of Russian direct investment to the Baltic states. Russian direct investment has decreased in Lithuania and its inflow to Estonia has slowed down strongly. One exception was Latvia, where the inflow of Russian direct investment started to accelerate rapidly along the development of the Russian-Ukrainian conflict. It results from the fact that Latvia is partly perceived as an alternative to investment in Ukraine and from the legal solutions promoting foreign investment. The Latvian law enables non-EU nationals who invested in the Latvian capital market or purchased a real property with the defined minimum value to obtain a temporary resident visa (at the same time, in the EU). It resulted in the increased inflow of foreign investment from outside the EU to Latvia. Consequently, in view of the economic slow down in Russia, the depreciation of the ruble and a possibility of further EU sanctions against Russia, investment in Latvia is treated as a safe method of depositing capital from Russia and as an assurance of the right to stay in the territory of the EU.

The Russian-Ukrainian conflict contributed to a stronger inflow of non-residents' deposits to banks in the Baltic states. It reflected tendencies among Russian and Ukrainian entrepreneurs (and, to a lesser extent, households) to hedge capital against the effects of ruble and hryvnia depreciation in this manner.

Romania – investment slowdown comes to an end due to regulatory and tax changes

The decline in fixed capital formation in Romania was one of the major reasons for economic slowdown in 2014 (Figure 6.1). The weakening investment activity was associated with a large decline in public investment due to, inter alia, insufficient use of European Union funds[23]. Absorption of the EU funds is hampered by the non-transparent public procurement law and ineffective system of project selection, reflected in the strong fragmentation of projects. According to the IMF estimates, there are over 500 central-government investment projects with a value equivalent to 31 percent of GDP. Many projects have long implementation periods with 78 projects expected to take more than 10 years to complete[24]. The election schedule did not foster the fixed investment. In 2014, the presidential election was held[25], which made the authorities of Romania pay more attention to increasing ad hoc consumer expenditure than to continue long-term investments.

Figure 6.1. Investment according to types (in %, y/y)



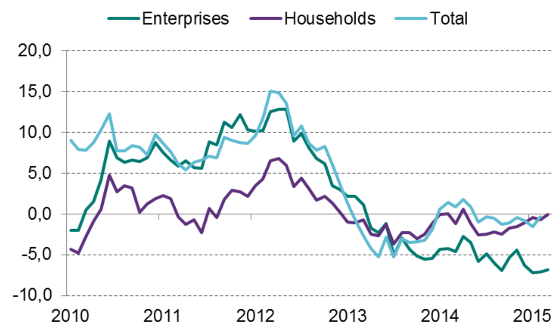
Source: European Commission, Spring 2015 Forecast

[23] According to the IMF estimates, if Romania fully used the EU funds allocated to infrastructural investment, the average annual economic growth rate would be higher by 0.5 pp in medium-term.
[24] IMF, 2015, Romania Selected Issues, IMF Country Report No. 15/80
[25] One of the candidates for the office of the president was the incumbent Prime Minister.

Weakening lending affected the decline in private companies' investment. The annual growth in lending for the non-financial sector has been decreasing since Q2 2013 (Figure 6.2). In April 2015 it amounted to -6%. Lower growth among countries in the CEE region is recorded only in Bulgaria and Slovenia, facing serious difficulties in their banking sectors.

One of the factors determining the decline in corporate lending was the ongoing deleveraging of the Romanian banking sector. In 2014 the value of foreign claims of banks operating in Romania decreased by 15%, and since 2008 this decline has reached 30%. At the same time, the banking system based on foreign financing was forced to reduce the supply of new loans.

Figure 6.2. Domestic loans (in %, y/y)



Source: NBR

The policy of banks operating in Romania focused on loan portfolio quality improvement. In April 2014 the percentage of non-performing loans exceeded 20% and it was the highest level among the CEE countries. A year later, it decreased by 6pp. The reduction of non-performing loans (through their sales, write-downs and additional provisions) was reflected not only in lower banks' profits but also in a more prudent approach to granting new loans. It affected mainly corporate loans, particularly loans denominated in foreign currency[26].

The government of Romania actively supports investment, which compensates for the not sufficient bank credit. Since the second half of 2014, the re-invested profits of enterprises have been tax exempt, if allocated for investment in fixed assets or research and development. In addition, a period of depreciation for some assets has been accelerated for tax purposes. In January 2015 the government of Romania also decided to reduce the rate of a construction tax (to 1 %). The governmental policy stimulated investments which, at the turn of 2014 and 2015, have increased in annual terms for the first time since the first half of 2012. The growth in fixed capital formation determined the acceleration of GDP growth in Romania in Q1 2015 to 4.3% y/y, i.e. to the highest level in the EU. Moreover, forecasts of external institutions indicate that in the years 2015-2016 investments will make a significant positive contribution to economic growth, contrary to the majority of other economies of the CEE, where their contribution will gradually decrease.

The government also undertakes measures supporting the growth in household consumption. In April 2015 the decision was made on cutting the VAT rate for food and non-alcoholic beverages from 24% to 9%.

[26] At the beginning of 2015, foreign exchange loans in Romania, mainly euro-denominated, still made over a half of all the corporate loans.

Slovakia – expected growth in exports and industrial production to strengthen economic growth

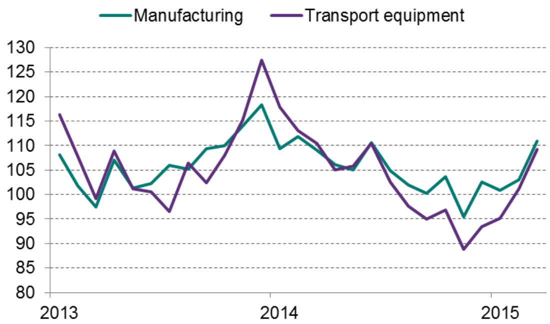
Economic growth in Slovakia in 2014 was based on domestic demand. In 2015 further growth in domestic demand is expected. It will be supported by fiscal policy. In connection with the Parliamentary election scheduled in 2016, the government announced the introduction of a number of measures to support household consumption, inter alia, raising the minimum wage, raising wages in the public sector, reducing health insurance costs, or reducing gas prices for households.

In 2014, the exports growth slowed down, which was associated both with the demand-side factors and with the appreciation of the exchange rate. The decline in sales occurred in the majority of export markets, however, it was most noticeable in non-EU countries. Exports to the Russian market have decreased by 35% y/y. However, the decline in the value of sales to the United States and to the Asian markets, mainly to China, had more impact on the slowdown of Slovak exports. Till the end of 2013 Slovak exports to those countries grew vigorously, which compensated for declines of sales to the European markets[27].

The additional factor affecting the weakening of exports was the strengthening of the euro against the CEE currencies: Poland, Hungary and above all the Czech Republic (the effect of introducing exchange rate floor). The appreciation of the euro resulted in the weakening of Slovak exporters' position on neighbouring countries' markets and did not help to benefit from the acceleration of German exports. According to NBS estimates, the growth rate of Slovakia's exports in 2014 has been lower than both the growth rate of German exports and the growth in demand on export markets, for the first time since the outbreak of the global crisis.

The slowdown in exports affected the export-oriented manufacturing sector. It was visible mainly in sectors mostly integrated with Global Value Chains (GVC), i.e. in the automotive industry and production of machinery and equipment [28] (Figure 7.1).

Figure 7.1. Industrial production (in %, y/y)



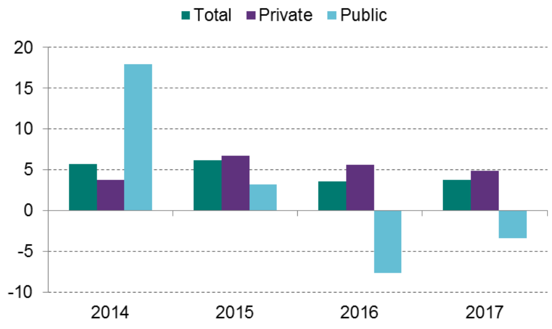
Source: Statistical Office of Slovakia

The consequence of industrial production weakening was the decrease in capacity utilisation and slow growth in private investment. Gross fixed capital formation increased in 2014 by over 5%, however, it was mainly due to public investment growing at a rate of almost 20% y/y. Private investment remained weak.

[27] A relatively strong demand from outside the EU limited the scale of economic slowdown in Slovakia in the years 2012-2013 and enabled to avoid recession, which took place, inter alia, in the neighbouring Czech Republic and Hungary.

[28] Production of computers and electronic devices in 2014 Q4 declined by 2% y/y, and in the automotive industry the slump in production amounted to 7% y/y.

Figure 7.2. Fixed capital formation (in %, y/y)



Source: NBS, Medium-term Forecast, May 2015

In Q1 2015 economic growth in Slovakia accelerated to 2.9% y/y, which resulted from the improvement in export oriented sectors. The growth in exports of goods and services increased to 6.9%. It resulted mainly from the recovery of demand for goods produced within Global Value Chains (transport vehicles in particular). The depreciation of the euro, associated with the launching asset purchase programme by the ECB, has also fostered the acceleration of exports.

Improvement in manufacturing sentiment will affect the growth in private investment. NBS forecasts indicate that the growth rate of private investment will accelerate to almost 7% in 2015, and in the following two years it will reach the level of ca. 5% (Figure 7.2). This will be associated with an increase in capacity utilisation, as well as with the easing of lending policy and a decline in the costs of corporate loans. Growing fixed capital formation in the corporate sector will make up for decline in public investment, resulting from the termination of European funds inflow under the terminated financial perspective 2007-2013.

Slovenia – recovery weakened by effects of debt crisis

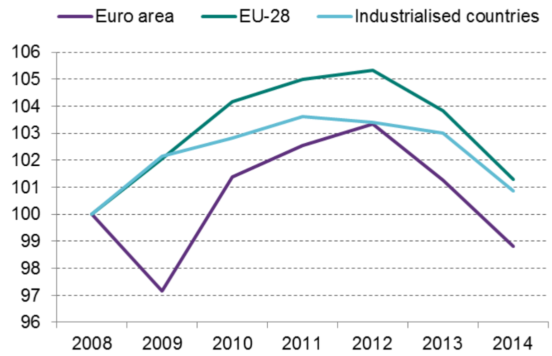
In 2014 the economy of Slovenia recovered from a two-year recession. Growing exports and high infrastructural investments, co-financed by the European Union funds, were the main factors contributing to the recovery. Following three years of decline, household consumption increased, although its growth rate was low. On the other hand, the governmental sector continued to limit consumption under the ongoing fiscal consolidation.

The acceleration of exports growth in Slovenia in the last two years was supported by the improvement in competitiveness (Figure 8.1). Increase in productivity in tradables sector was accompanied by simultaneous decline in wages. The change in the commodity structure of the Slovenian exports has also affected the growth in competitiveness due to increased share of hi-tech products.

Irrespective of the progress in the banking sector reform, the limited supply of bank loans continues to hamper the recovery. The Slovenian banking sector is under restructuring that comprises *inter alia* the transfer of "bad loans" to the institution specially created for that purpose[29] as well as mergers and privatisation of some banks. The result of these measures is the improvement in profitability of banks as well as in the quality of bank loan portfolios. However, corporate loans and loans for households continue to decrease.

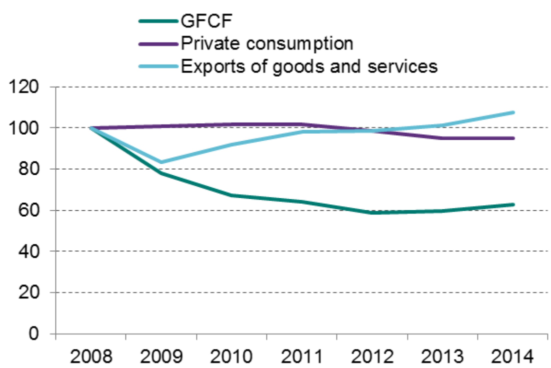
In 2015 exports and public investments will continue to act as the main drivers for economic growth in Slovenia (Figure 8.2). However, their role will gradually decrease and a decline in GDP growth rate may take place. Public investment in Slovenia, as in other CEE countries, will be limited due to termination of a period of overlapping of two EU financial perspectives. On the other hand, the growth rate of individual consumption should increase supported by employment growth and the expected growth in wages. Public consumption will decrease on the back of the continued reduction of budgetary expenditure. Acceleration of private investment is also projected due to high capacity utilisation. However, the growth in private investment will be most probably limited by the ongoing process of enterprises' deleveraging.

Figure 8.1. The real effective exchange rate deflated by ULC in the manufacturing of Slovenia relative to its trade partners (2008=100)



Source: European Commission

Figure 8.2. Private consumption, investment and export (2008=100)



Source: Eurostat

[29] Bank Asset Management Company (BAMC) repurchased the portfolio of non-repaid loans from the two biggest Slovenian banks, transferring bonds guaranteed by the State Treasury with the value of 2.9% of GDP in exchange.

Hungary – recovery strongly supported by the active policy of the state

The economic growth rate in Hungary, high as compared to the other CEE countries, is supported by the active policy of the state. These measures comprise cuts in interest rates, supporting lending for the SMEs through non-standard central bank instruments and enhancing employment in the public sector.

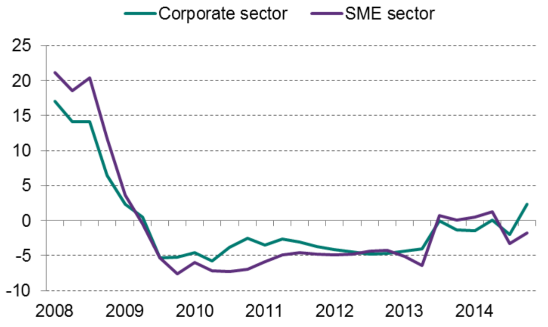
In 2015-2016 a slowdown of economic growth in Hungary is expected, mainly due to the deceleration of the rapid investment growth. The growth in fixed capital formation sharply declined from two-digit levels recorded in 2013 and in three first quarters of 2014. It resulted, on the one hand, from the reduction of public investments co-financed by the EU funds (following a period of their intensive implementation preceding the termination of the financial perspective 2007-2013) and, on the other, from the completion of large projects increasing production capacity in the automotive sector. These factors explain the projected decline in investment growth in Hungary in 2015-2016 against the high level of 2014.

At the same time, household consumption is to accelerate, due to positive effect of foreign currency loans conversion and debt relief act on households' disposable income. In June 2014 the government of Hungary committed banks to return the cumulated value of illegitimately charged interest rate and foreign exchange margins on foreign currency loans holders. The estimated value of those claims amounts to ca. EUR 2-3 billion. The claims of Hungarian households were reduced by this amount, which was reflected in the decrease of their monthly loan repayments. At the same time, the programme of foreign currency loan conversion (mainly for loans denominated in CHF and EUR), already adopted in October 2014, which entered into force in February 2015, protected Hungarian consumers against the strong weakening of the CHF/HUF exchange rate at the beginning of this year. These measures – combined with an increase in income purchasing power as a result of a decline in consumer prices – are to further support household consumption growth.

The implementation of the *Funding for Growth Scheme+* (FGS+) will not fully compensate for the decline in fixed capital formation of other private and public entities. National Bank of Hungary (MNB) continues to actively support the investment activity of small and medium-sized enterprises (Figure 9.1). In March 2015 the second stage of the FGS+ programme was launched; MNB committed itself to transfer HUF 500 billion (ca. EUR 1.6 billion) of interest-free funds to banks, to be later allocated for low interest loans (up to 2.5%) for SMEs. As opposed to the 1st stage of the FGS programme[30], launched in 2013, such loans are to be granted not only to low credit risk entities a but also to those with a medium risk. Therefore, MNB will assume 50% of potential losses due to non-repaid loans, however, it has limited its liability to 2.5% of banks' loan portfolio. The effectiveness of FGS+, particularly in the scope of triggering lending also in the segments of non-subsidised loans, may be partly limited by the deterioration of the profitability of banks in relation to costs they incur in connection with their settlement of foreign currency loan problems.

[30] According to MNB, the first stage of the programme was very successful, increasing GDP in 2013-2014 by 0.3-0.9%. The estimates of international institutions assumed a lower but also favourable impact (ca. 0.2-0.3%).

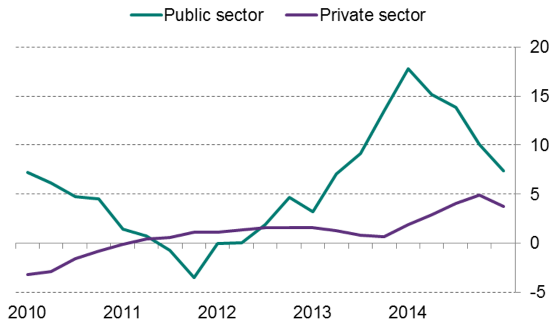
Figure 9.1. Loans for non-financial enterprises (in%, y/y)



Source: KSH

The government intends to continue the policy of active support of growth by expanding the public works programme. Since 2013 unemployment rate in Hungary went down sharply (from 11.1% in January 2013 to 7.3% in March 2015) and employment grew significantly (by 344 thousand people, i.e. 9.1% in this period) (Figure 9.2). It resulted partly from new investments in the manufacturing sector (inter alia, in the automotive sector) or SMEs investments in connection with the FGS programme. However, the public works programme, introduced in 2012 and extended in the following years, had the most significant impact on the improvement of the situation in the labour market[31]. In 2014 the range of public works was again increased. The average number of employees under this programme reached over 170 thousand (i.e. 40 thousand more than in 2013). In 2015, further extension of the scale of the programme (by approximately 50 thousand people) is planned, which, according to the government's estimates, should contribute to the decline in unemployment rate by 1 pp.

Figure 9.2. Employment (in %, y/y)



Source: KSH

Domestic demand in Hungary will be also supported by tax changes. Starting from 2016 the PIT rate will be decreased (from 16% to 15%), as well as VAT rate on pork (from 23% to 5%), benefits for families with more than two children will increase and some administrative fees will be waived. In addition, the rate of bank tax will be reduced (from 0.53% to 0.31% of assets), which may have a positive impact on lending in Hungary. The total cost of these changes to be incurred by the budget will amount to HUF 220 billion (0.8% of GDP), to be offset by a faster than expected economic growth and improved tax collection.[32].

[31] Cf. Economic policy of Hungary, in NBP, 2015, Analysis of the economic situation in the countries of Central and Eastern Europe, no. 1/2015

[32] Hungary cooperates with Austria, Bulgaria, the Czech Republic and Slovakia in fighting VAT evasion.

Statistical Annex

1. National accounts

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	0.9	1.7	1.5	1.8	1.5	1.3	2.0
Croatia	-0.9	-0.4	-0.5	-0.9	-0.3	0.2	0.1
Czech Republic	-0.9	2.0	2.2	2.1	2.3	1.3	4.0
Estonia	0.8	2.1	0.7	2.7	2.3	2.6	1.7
Lithuania	3.3	2.9	2.3	3.3	2.3	2.0	2.0
Latvia	4.1	2.4	3.4	3.3	2.7	2.6	1.5
Poland	1.6	3.4	3.6	3.4	3.4	3.5	3.5
Romania	3.5	2.8	4.0	1.8	2.9	2.7	4.1
Slovakia	0.9	2.4	2.2	2.4	2.5	2.6	2.9
Slovenia	-1.1	2.6	1.8	2.8	3.1	2.1	3.0
Hungary	-1.1	3.6	3.6	3.8	3.4	3.3	3.3

Source: Eurostat, seasonally adjusted data, constant prices of 2010, for Slovakia – seasonal non-working days adjustment.

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	-2.3	2.0	2.1	0.9	1.7	2.2	1.0
Croatia	-1.2	-0.7	-0.8	-0.8	-1.1	-0.1	0.2
Czech Republic	0.1	1.7	1.1	2.0	1.7	2.0	3.0
Estonia	4.2	4.1	4.1	3.7	4.8	4.0	2.8
Lithuania	4.7	5.6	5.6	6.4	4.2	6.4	3.8
Latvia	5.4	2.3	3.7	2.7	1.7	2.3	2.0
Poland	0.8	3.0	2.5	3.0	3.4	3.2	3.7
Romania*	1.3	4.5	5.9	3.8	3.9	4.5	4.4
Slovakia	-0.1	2.2	2.0	2.1	2.3	2.5	1.6
Slovenia	-2.7	0.3	0.8	0.5	0.6	-0.6	0.2
Hungary	0.3	1.6	1.1	1.8	1.5	1.8	2.5

Source: Eurostat, seasonally adjusted data, constant prices of 2010, for Slovakia - seasonal non-working days adjustment.

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	-0.3	2.8	4.8	5.1	4.4	3.3	2.1
Croatia	-1.3	-4.0	-2.0	-4.6	-3.6	-4.0	-0.5
Czech Republic	-3.5	4.5	2.8	5.3	5.5	4.3	3.2
Estonia	1.1	-2.8	9.8	-1.1	-10.7	-7.8	-8.1
Lithuania	12.8	8.0	12.6	9.7	5.3	4.0	6.5
Latvia	-4.3	1.3	9.2	1.3	-0.8	-0.5	-1.2
Poland	-0.2	9.2	8.4	9.7	9.7	10.0	10.0
Romania	4.9	-17.5	-7.3	-8.2	-2.1	2.7	8.0
Slovakia	-4.3	5.7	3.5	5.7	7.9	5.7	6.9
Slovenia	0.2	4.8	4.8	7.1	7.8	-0.5	-0.8
Hungary	5.8	11.7	18.3	16.6	14.6	-1.3	-3.5

Source: Eurostat, seasonally adjusted data, constant prices of 2010, for Slovakia – seasonal non-working days adjustment.

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	8.9	2.2	2.1	3.0	-2.8	5.4	12.9
Croatia	-1.2	6.3	11.6	10.1	4.9	5.7	7.1
Czech Republic	0.2	8.8	11.6	9.1	7.2	7.4	7.7
Estonia	1.8	2.9	-0.8	0.3	4.9	7.5	1.9
Lithuania	10.3	3.4	0.1	4.5	4.8	4.2	4.5
Latvia	1.0	2.2	2.2	1.8	1.9	3.0	2.9
Poland	4.6	5.7	7.3	5.9	4.6	6.3	6.8
Romania	13.5	8.1	15.2	7.2	7.7	3.9	9.0
Slovakia	4.5	4.6	11.8	4.7	1.8	0.5	4.2
Slovenia	2.9	6.3	3.8	5.0	6.8	7.0	5.5
Hungary	5.3	8.7	8.2	9.3	8.0	9.5	10.2

Source: Eurostat, seasonally adjusted data, constant prices of 2010, for Slovakia – seasonal non-working days adjustment.

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

	2013	2014	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	5.7	3.8	5.5	3.7	2.6	7.5	9.7
Croatia	-2.0	3.0	8.5	3.3	5.2	0.7	5.6
Czech Republic	0.6	9.5	10.6	11.4	7.9	8.5	9.0
Estonia	2.6	2.5	3.5	-1.5	2.8	5.3	-1.2
Lithuania	10.3	5.7	-1.1	8.8	5.3	9.6	9.0
Latvia	-1.7	1.6	1.0	2.8	-0.2	2.3	-1.1
Poland	1.2	9.1	7.6	10.8	7.9	9.1	6.7
Romania	2.4	7.7	12.0	6.5	6.6	6.6	11.6
Slovakia	2.9	5.0	12.2	6.4	1.9	-0.1	4.0
Slovenia	1.3	4.1	2.7	4.2	5.3	2.5	5.3
Hungary	5.3	10.0	9.0	10.6	11.1	9.4	7.8

Source: Eurostat, seasonally adjusted data, constant prices of 2010, for Slovakia – seasonal non-working days adjustment.

2. Business cycle and economic activity indicators

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

	09.2014	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015
Bulgaria	0.5	-0.4	0.3	1.9	1.3	2.0	3.0	2.1
Croatia	3.8	2.8	2.8	5.3	-4.9	1.8	3.4	1.2
Czech Republic	6.5	3.4	4.7	5.1	5.0	4.5	3.7	4.2
Estonia	3.8	2.3	4.6	9.8	1.6	4.4	1.3	-0.2
Lithuania	-0.1	1.4	5.0	2.8	2.0	5.3	4.0	2.8
Latvia	0.3	0.1	-2.3	-0.6	-2.1	-1.4	9.1	10.1
Poland	2.0	1.9	0.3	5.8	4.0	4.9	5.8	2.7
Romania	4.5	3.7	3.2	3.5	3.6	3.3	2.7	4.1
Slovakia	2.8	4.9	0.9	3.8	3.7	2.8	6.2	3.7
Slovenia	1.7	3.3	2.9	0.4	4.7	5.3	3.9	4.2
Hungary	5.6	1.9	5.7	5.0	8.5	6.0	8.8	6.1

Source: Eurostat

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

	09.2014	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015
Bulgaria	4.7	3.5	3.0	5.1	4.0	2.7	1.7	1.8
Croatia	1.6	1.2	2.2	2.2	3.3	2.0	0.9	-
Czech Republic	2.7	5.4	2.0	4.4	6.5	6.5	4.6	5.9
Estonia	8.3	6.0	8.8	7.8	2.6	5.2	2.7	1.7
Lithuania	5.0	5.4	5.0	5.4	3.3	4.7	4.8	3.9
Latvia	3.1	4.5	4.6	3.4	6.9	9.1	6.6	3.8
Poland	-1.1	1.8	2.3	3.2	6.9	7.6	8.6	4.9
Romania	5.4	5.4	6.9	6.4	6.4	3.2	0.6	7.4
Slovakia	4.2	5.4	3.0	4.0	0.5	0.4	0.9	0.1
Slovenia	3.6	-0.8	-0.9	-1.6	-0.1	2.4	0.1	-1.0
Hungary	4.9	5.2	5.1	6.0	7.1	5.9	5.0	5.1

Source: Eurostat

Table 8. Consumers' confidence indicator

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Bulgaria	0.8	-1.7	-2.9	-2.7	5.5	-2.4	0.8	2.7
Croatia	-2.0	5.9	-1.8	0.8	-2.6	1.5	6.4	-2.5
Czech Republic	-0.1	-3.3	-1.3	5.5	1.1	2.7	0.3	-3.4
Estonia	2.3	-2.6	-1.7	3.0	2.4	-0.3	-2.8	-4.6
Lithuania	-3.1	-6.5	1.0	3.1	0.8	1.8	4.1	1.8
Latvia	3.2	-5.6	-1.5	2.6	2.3	0.8	-1.7	0.1
Poland	-4.6	-1.0	-0.2	4.3	1.3	1.0	-2.7	1.7
Romania	3.0	0.1	-1.9	3.4	5.1	2.3	2.8	0.0
Slovakia	0.4	0.5	-3.8	3.7	0.3	4.4	-1.8	2.0
Slovenia	5.0	-3.3	7.2	1.4	-7.1	-0.2	3.2	-1.0
Hungary	0.7	-3.6	3.4	0.8	-2.2	-3.1	-1.2	2.0

Source: European Commission, CNB

Table 9. Business confidence indicator

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Bulgaria	0.0	0.4	0.8	2.5	-1.3	1.2	0.2	1.4
Croatia	29.0	16.0	16.0	16.00	10.0	10.0	10.0	
Czech Republic	3	3.4	2.4	2.2	4.1	3.6	3.9	5.2
Estonia	0.5	-1.2	-1.3	-2.1	-4.1	-3.1	-2.4	-4.9
Lithuania	-5.2	-7.9	-10.3	-10.8	-5.1	-3.6	-11.1	-13.0
Latvia	-4.2	-7.1	-6	-8.1	-7.5	-5.4	-6.2	-7.7
Poland	-11.9	-11.9	-11.2	-12.1	-11.8	-11.5	-12	-12.9
Romania	-0.1	0.6	0.7	-0.2	0.0	-0.2	1.6	-0.8
Slovakia	9.0	1.2	2.1	8.5	1.8	6.9	-1.3	5.3
Slovenia	4.3	3.6	4.6	4.3	8.1	5.0	5.5	4.5
Hungary	8.3	5.2	3.8	4.4	6.2	6.8	2.8	6.0

Source: European Commission, OeKB

Table 10. PMI in manufacturing

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Czech Republic	55.6	53.3	56.1	55.6	56.1	54.7	55.5	56.9
Poland	53.2	52.8	55.2	55.1	54.8	54	52.4	54.3
Hungary	55.6	51.0	54.3	54.9	55.5	51.2	55.1	55.1

Source: Markit Economics

3. Prices

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	-1.5	-1.9	-2.0	-2.4	-1.7	-1.1	-0.9	-0.3
Croatia	0.5	0.3	-0.1	-0.6	-0.4	0.0	-0.1	0.0
Czech Republic	0.7	0.6	0.1	-0.1	-0.1	0.1	0.5	0.7
Estonia	0.5	0.0	0.1	-0.5	-0.2	0.0	0.4	0.5
Lithuania	0.3	0.4	-0.1	-1.4	-1.5	-1.1	-0.6	-0.1
Latvia	0.7	0.9	0.3	-0.3	0.0	0.5	0.6	1.2
Poland	-0.3	-0.3	-0.6	-1.0	-1.3	-1.2	-0.9	-0.6
Romania	1.8	1.5	1.0	0.5	0.4	0.8	0.6	1.3
Slovakia	0.0	0.0	-0.1	-0.5	-0.6	-0.4	-0.1	-0.1
Slovenia	0.1	0.1	-0.1	-0.7	-0.5	-0.4	-0.7	-0.8
Hungary	-0.3	0.1	-0.8	-1.4	-1.0	-0.5	0.0	0.6

Source: Eurostat

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	-0.1	0.1	-0.5	-0.6	0.1	0.5	1.4	1.6
Croatia	-1.1	-0.4	-0.7	0.1	0.9	0.7	0.9	0.8
Czech Republic	2.4	1.7	0.2	-0.3	0.4	0.3	1.6	1.8
Estonia	1.2	0.6	1.0	0.2	0.5	0.6	1.7	1.5
Lithuania	1.6	1.6	1.2	0.6	-0.1	-0.3	0.9	0.5
Latvia	0.1	1.2	0.2	-1.5	-1.5	-0.3	-0.8	0.2
Poland	-0.5	-0.7	-1.2	-1.9	-2.0	-2.0	-1.4	-1.2
Romania	1.2	1.0	0.6	-0.1	0.0	0.6	0.9	1.9
Slovakia	-0.8	-0.5	-0.1	-0.7	-1.2	-0.8	0.4	0.3
Slovenia	0.7	0.8	0.2	0.1	0.7	1.4	1.6	1.0
Hungary	0.8	0.3	-0.5	-0.5	0.1	0.4	0.9	1.6

Source: Eurostat

Table 13. HICP – energy (in %, y/y)

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	-0.8	-3.7	-6.4	-11.0	-9.6	-4.9	-5.3	-2.9
Croatia	2.5	-0.4	-2.9	-7.0	-6.7	-3.6	-4.7	-3.5
Czech Republic	-2.3	-2.7	-4.3	-3.0	-3.8	-2.6	-2.0	-1.6
Estonia	-4.0	-3.7	-5.2	-8.2	-6.4	-4.9	-4.4	-3.5
Lithuania	-4.8	-4.9	-7.6	-15.1	-15.1	-12.3	-12.4	-8.5
Latvia	-1.0	-2.4	-4.9	-2.9	-2.3	-1.4	-0.9	-0.1
Poland	-1.2	-1.7	-3.5	-5.4	-6.3	-5.2	-4.5	-4.0
Romania	2.7	1.3	-1.7	-4.2	-3.0	-1.4	-3.5	-2.2
Slovakia	-1.6	-1.7	-2.3	-3.4	-4.0	-3.3	-2.8	-2.9
Slovenia	-0.9	-0.7	-4.3	-8.3	-7.8	-6.5	-7.2	-5.8
Hungary	-7.2	-3.8	-7.7	-10.9	-10.5	-8.5	-7.4	-5.2

Source: Eurostat

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	-2.4	-2.5	-1.6	-1.2	-0.8	-1.1	-1.0	-0.7
Croatia	0.8	0.9	1.1	0.9	0.9	0.8	0.7	0.7
Czech Republic	0.7	0.8	1.1	0.7	0.7	0.7	0.6	0.8
Estonia	1.3	0.7	0.9	1.1	1.0	1.0	0.9	1.1
Lithuania	0.9	1.0	1.1	1.3	1.4	1.5	1.7	1.9
Latvia	1.6	1.7	1.8	1.0	1.5	1.5	1.7	2.1
Poland	0.0	0.2	0.2	0.5	0.4	0.3	0.4	0.4
Romania	1.9	2.0	2.0	2.1	1.5	1.4	1.5	1.8
Slovakia	0.7	0.7	0.5	0.5	0.5	0.5	0.4	0.5
Slovenia	0.0	0.0	0.8	0.8	0.8	0.4	-0.1	-0.2
Hungary	1.3	1.2	1.1	1.2	1.5	1.5	1.8	1.9

Source: Eurostat

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	0.8	0.3	-0.9	-1.9	-1.2	-0.4	-0.6	-0.4
Croatia	-2.1	-2.2	-3.4	-5.6	-4.1	-2.7	-3.1	-2.6
Czech Republic	-0.4	-1.7	-3.7	-3.5	-3.6	-3.0	-2.6	-2.1
Estonia	-3.6	-3.0	-1.0	-3.3	-1.6	-0.4	-0.1	-2.5
Lithuania	-5.7	-7.0	-8.2	-10.5	-9.1	-9.1	-8.7	-7.9
Latvia	-0.1	-0.3	0.5	-0.1	0.0	-0.4	-1.3	-0.3
Poland	-1.5	-1.9	-3.1	-3.6	-3.1	-2.6	-2.5	-2.1
Romania	0.5	0.5	-0.4	-1.0	-0.6	0.0	-2.4	-2.2
Slovakia	-4.0	-3.0	-3.8	-3.9	-4.5	-3.3	-3.5	-3.5
Slovenia	-1.0	-0.9	-0.6	-0.6	-0.4	0.0	0.0	0.1
Hungary	-1.7	-1.2	-2.5	-4.4	-4.6	-3.4	-3.6	-1.2

Source: Eurostat

4. Balance of payments

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

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	0.4	1.0	1.4	1.2	0.8	1.2	0.1	-0.7
Croatia	0.6	1.1	0.8	0.5	0.3	0.2	0.7	1.1
Czech Republic	-1.8	-1.3	-0.5	1.0	0.4	0.4	0.6	0.8
Estonia	-2.1	-2.7	-2.1	-2.8	-2.6	-2.1	-1.2	0.0
Lithuania	0.4	1.2	1.6	1.3	0.9	1.3	0.1	-0.9
Latvia	-2.1	-2.4	-2.3	-2.5	-3.0	-3.0	-3.1	-2.4
Poland	-2.3	-1.8	-1.3	-1.1	-1.2	-1.2	-1.3	-0.6
Romania	-1.9	-1.1	-0.8	-1.0	-1.5	-1.0	-0.4	0.1
Slovakia	2.1	2.4	1.5	1.2	0.5	0.2	0.1	-0.1
Slovenia	5.0	5.6	5.6	5.2	5.0	5.4	5.8	6.0
Hungary	2.9	3.5	4.0	4.3	3.9	3.9	4.0	4.7

Source: Eurostat, central banks, calculations of EI NBP

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

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	-1.1	-0.6	-0.5	0.3	0.3	-0.1	-0.5	-1.2
Croatia	-3.0	-2.4	-2.0	-1.2	-2.1	-2.9	-3.0	-3.0
Czech Republic	1.4	0.7	-0.2	0.8	2.2	3.0	3.2	2.6
Estonia	1.4	0.6	0.7	2.0	1.0	1.8	2.9	2.7
Lithuania	-1.3	-0.7	-0.6	0.4	0.4	-0.1	-0.5	-1.4
Latvia	2.6	1.8	1.6	1.1	1.1	1.3	1.0	2.0
Poland	2.0	1.9	1.1	1.2	0.6	1.2	1.7	1.4
Romania	0.2	-0.1	0.4	-0.3	0.2	0.3	-0.3	0.2
Slovakia	0.8	2.2	1.0	1.4	1.7	0.6	0.7	0.5
Slovenia	-2.3	-2.3	-1.7	-1.2	1.8	2.4	2.4	2.2
Hungary	1.6	0.1	0.9	0.9	-0.2	1.1	0.6	-0.2

Source: Eurostat, central banks, calculations of EI NBP

Table 18. International investment position (in % of GDP, end of quarter)

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	-77.6	-75.9	-72.4	-72.8	-72.3	-69.5	-69.6	-
Croatia	-91.7	-87.4	-88.4	-91.4	-93.0	-88.5	-88.7	-89.5
Czech Republic	-44.6	-43.5	-39.6	-36.3	-36.5	-37.0	-35.5	-30.5
Estonia	-50.6	-50.1	-47.2	-48.6	-46.6	-43.8	-43.6	-41.5
Lithuania	-51.4	-49.0	-46.5	-45.9	-45.2	-43.9	-44.2	-47.1
Latvia	-67.7	-68.7	-65.1	-65.1	-63.5	-63.2	-61.2	-
Poland	-63.8	-67.2	-69.2	-69.6	-68.5	-69.3	-66.6	-68.4
Romania	-64.3	-61.6	-61.5	-58.9	-59.2	-58.1	-56.9	-55.4
Slovakia	-62.4	-63.9	-63.8	-66.7	-68.5	-68.5	-70.2	-70.6
Slovenia	-40.1	-37.7	-38.2	-47.7	-47.3	-46.2	-44.7	-
Hungary	-94.9	-93.0	-91.6	-89.7	-88.0	-82.6	-79.2	-79.8

Source: Eurostat, central banks, calculations of EI NBP

Table 19. Official reserve assets to foreign debt ratio* (in %, end of quarter)

	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1
Bulgaria	38.8	40.1	39.1	37.6	38.4	40.2	41.8	48.2
Croatia	25.9	25.8	28.1	25.9	26.6	26.0	27.2	28.7
Czech Republic	34.4	35.2	40.9	42.6	43.0	42.6	43.6	46.5
Estonia	1.1	1.2	1.3	1.5	1.7	2.0	1.9	2.2
Lithuania	22.5	23.9	24.1	22.4	24.9	25.4	28.3	3.6
Latvia	18.4	18.6	19.0	8.5	8.0	7.8	8.0	8.6
Poland	29.5	28.1	27.7	27.0	26.2	27.3	28.2	29.6
Romania	35.3	36.4	36.1	36.3	36.2	36.4	37.7	36.7
Slovakia	2.9	2.6	2.6	3.0	2.5	2.6	3.2	5.2
Slovenia	1.6	1.8	1.7	1.9	1.9	1.8	1.8	1.9
Hungary	27.0	25.6	28.3	30.1	29.5	29.7	29.2	29.4

*Official reserve assets according to central banks statements

Source: Eurostat, central banks, calculations of EI NBP

5. Financial markets and financial system

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

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Czech Republic	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Poland	2.00	2.00	2.00	2.00	1.50	1.50	1.50	1.50
Romania	2.75	2.75	2.50	2.25	2.25	2.00	1.75	1.75
Hungary	2.10	2.10	2.10	2.10	1.95	1.80	1.65	1.50

Source: Central banks, EcoWin Financial

Table 20. 3m interbank rates (average)

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Bulgaria	0.66	0.66	0.63	0.58	0.57	0.55	0.55	0.53
Croatia	0.82	0.83	0.82	0.91	0.84	0.73	0.69	0.74
Czech Republic	0.34	0.34	0.33	0.33	0.31	0.31	0.31	0.31
Estonia	0.08	0.08	0.06	0.05	0.03	0.00	-0.01	-0.01
Lithuania	0.19	0.18	0.18	0.18	0.18	0.18	0.18	0.18
Latvia	0.26	0.26	0.26	0.26	0.26	0.26	0.26	0.26
Poland	2.06	2.06	2.00	1.81	1.65	1.65	1.68	1.72
Romania	1.73	1.70	1.50	1.38	1.48	1.48	1.27	1.35
Slovakia	0.08	0.08	0.05	0.04	0.02	-0.01	-0.01	-0.01
Slovenia	0.08	0.08	0.05	0.04	0.02	-0.01	-0.01	-0.01
Hungary	2.10	2.10	2.10	2.10	1.89	1.70	1.54	1.41

Source: EcoWin Financial

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

	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015	06.2015
Croatia	7.68	7.66	7.69	7.67	7.65	7.57	7.57	7.59
Czech Republic	27.64	27.72	27.74	27.49	27.56	27.43	27.41	27.26
Poland	4.19	4.29	4.18	4.15	4.07	4.03	4.08	4.16
Romania	4.43	4.48	4.44	4.44	4.41	4.42	4.44	4.48
Hungary	306.35	315.75	310.88	303.03	299.85	303.20	309.45	315.27

Source: Eurostat

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	0.0	-0.1	-0.1	-1.9	-2.7	-4.4	-4.5	-3.1
Croatia	-1.1	-1.2	-1.3	-2.8	-3.7	-4.4	-4.4	-3.3
Czech Republic	-8.0	-3.5	-1.4	-3.9	-4.1	-5.4	-6.0	-4.5
Estonia	0.7	1.3	2.3	1.4	0.3	-2.1	-3.3	-2.2
Lithuania	0.7	1.3	2.4	1.8	0.5	-1.9	-3.2	-2.0
Latvia	0.9	1.5	2.7	2.2	0.9	-1.3	-2.6	-1.6
Poland	-1.1	-1.1	-1.6	-4.4	-3.2	-3.4	-1.6	-2.0
Romania	0.6	-0.1	-0.4	-1.3	-1.7	-3.1	-3.6	-3.8
Slovakia	-0.1	-0.2	-0.4	-1.6	-2.8	-4.6	-5.2	-3.8
Slovenia	-0.3	-0.2	-0.2	-1.4	-2.2	-3.6	-4.0	-3.0
Hungary	-5.1	-3.7	-4.2	-6.8	-2.4	-2.8	-3.4	-5.1

Source: BIS, EI NBP calculations

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	-1.9	-2.1	-2.0	-3.6	-4.1	-5.3	-5.1	-3.6
Croatia	-1.6	-1.7	-2.2	-3.7	-4.3	-4.7	-5.0	-4.0
Czech Republic	-8.2	-3.7	-1.9	-4.0	-4.4	-5.7	-6.0	-4.5
Estonia	-0.9	-0.7	0.5	-0.9	-1.8	-4.0	-4.6	-3.5
Lithuania	-0.5	0.4	1.1	-0.5	-2.5	-4.5	-5.4	-3.9
Latvia	0.3	1.2	1.9	1.1	-0.2	-2.0	-3.2	-1.8
Poland	-2.6	-2.5	-3.1	-5.8	-5.1	-5.3	-3.1	-3.6
Romania	0.9	0.1	-0.2	-1.1	-1.8	-3.0	-3.7	-3.6
Slovakia	-1.2	-1.1	-1.1	-2.4	-3.8	-5.6	-6.0	-4.8
Slovenia	-1.5	-1.4	-0.7	-2.2	-3.1	-4.5	-5.4	-4.4
Hungary	-6.5	-5.3	-5.8	-8.4	-3.9	-4.0	-4.3	-5.3

Source: BIS, EI NBP calculations

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

	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015	05.2015
Bulgaria	1.9	-7.5	-8.2	-8.5	-9.2	-9.2	-9.8	-10.7
Croatia	-0.5	-0.7	-0.8	1.7	1.0	0.9	0.8	-
Czech Republic	3.7	2.5	3.7	3.7	4.2	4.1	4.3	-
Estonia	3.3	3.1	2.6	2.3	2.6	2.7	2.6	3.0
Lithuania	-0.4	-1.5	-1.0	4.3	4.4	5.2	6.5	-
Latvia	-7.3	-7.4	-8.8	-5.2	-5.4	-5.1	-5.0	-
Poland	6.9	6.7	6.5	7.8	7.3	7.4	6.1	7.2
Romania	-3.6	-3.1	-3.7	-4.0	-4.1	-3.6	-3.7	-1.8
Slovakia	7.6	8.0	6.7	6.5	7.4	7.8	7.5	-
Slovenia	-20.8	-20.8	-13.4	-11.7	-11.8	-11.6	-12.0	-
Hungary	-3.1	-3.9	-0.2	0.8	-0.8	-6.7	-6.9	-

Source: Central banks

6. Labour market

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

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Bulgaria	0.0	0.8	-0.4	-1.0	1.0	1.0	1.4	1.9
Croatia	-0.8	-0.6	0.1	0.5	1.9	1.6	1.9	1.9
Czech Republic	0.8	1.0	0.4	0.7	0.7	0.2	0.9	1.3
Estonia	1.1	2.5	-0.1	0.4	-0.8	-0.2	1.0	1.9
Lithuania	1.6	1.5	1.2	2.1	1.9	1.0	2.9	1.7
Latvia	3.4	2.5	0.9	0.3	0.3	0.1	-2.4	-1.5
Poland	-3.8	-1.7	-0.7	-1.9	0.5	1.7	-0.5	0.3
Romania	-0.3	-0.5	-0.8	-0.5	1.0	0.4	1.4	0.8
Slovakia	0.2	-0.2	-0.4	0.5	0.1	1.1	1.7	2.6
Slovenia	-2.9	-2.6	-1.8	-0.7	-0.6	0.6	1.1	1.1
Hungary	1.1	1.8	1.4	2.7	7.1	4.9	5.4	4.5

Source: Eurostat

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

	09.2014	10.2014	11.2014	12.2014	01.2015	02.2015	03.2015	04.2015
Bulgaria	10.9	10.5	10.2	10.0	9.9	9.9	9.8	9.7
Croatia	17.6	17.8	17.7	17.4	17.1	16.7	16.2	15.8
Czech Republic	5.8	5.9	5.8	5.8	5.8	5.9	6.0	5.9
Estonia	6.9	6.6	6.4	6.3	6.1	6.2	6.7	-
Lithuania	10.3	10.1	10	9.4	9.2	9.0	8.9	8.2
Latvia	10.3	10.3	10.3	9.9	9.9	9.9	-	-
Poland	8.4	8.3	8.2	8.1	8.0	7.9	7.8	7.8
Romania	6.7	6.7	6.6	6.9	6.9	6.8	6.9	7.1
Slovakia	12.7	12.6	12.4	12.3	12.1	12.0	11.9	11.8
Slovenia	9.5	9.4	9.3	9.2	9.2	9.3	9.2	9.2
Hungary	7.3	7.3	7.3	7.5	7.4	7.3	7.1	-

Source: Eurostat

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

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Bulgaria	9.2	8.7	7.2	8.7	2.9	3.1	2.6	2.4
Croatia	1.7	-0.4	0.3	-0.2	-1.3	0.4	0.3	-0.2
Czech Republic	4.8	1.5	-1.7	-0.2	2.2	2.0	0.6	3.3
Estonia	7.9	8.6	8.0	7.6	7.8	7.4	6.2	6.8
Lithuania	6.2	5.2	6.5	5.1	3.6	5.3	3.3	6.1
Latvia	4.6	4.2	5.4	5.7	7.3	6.8	6.0	7.2
Poland	3.4	2.2	2.9	4.9	5.1	4.9	3.8	3.4
Romania	8.1	6.0	4.2	3.2	5.3	5.0	5.2	7.8
Slovakia	4.7	3.0	1.6	0.8	3.5	6.0	5.6	5.2
Slovenia	-3.8	-5.9	-0.5	2.2	2.9	2.5	2.0	0.9
Hungary	5.4	3.7	3.0	4.6	3.0	4.9	3.6	3.8

Source: Eurostat

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

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
Bulgaria	8.8	9.1	5.6	5.6	2.3	2.3	2.5	3.0
Croatia	1.8	-0.7	1.4	1.3	1.1	2.5	2.5	1.5
Czech Republic	8.0	3.9	-0.9	-0.6	0.6	0.0	-0.6	3.2
Estonia	5.3	10.2	7.3	6.6	6.2	4.5	4.9	6.0
Lithuania	3.4	1.8	3.7	4.8	5.7	4.4	6.3	6.2
Latvia	3.7	2.9	3.2	0.9	1.5	2.1	-1.5	2.4
Poland	-7.8	-8.7	-3.3	-2.5	-0.2	0.8	-1.8	-2.1
Romania	5.1	3.0	-0.8	-2.4	2.3	3.4	3.3	6.1
Slovakia	3.9	1.6	-0.2	-0.7	1.4	4.6	4.7	5.2
Slovenia	3.8	1.2	1.8	2.1	2.5	2.7	1.7	2.4
Hungary	6.6	4.4	2.4	4.1	6.5	5.7	5.7	5.1

Source: Eurostat, EI NBP calculations

7. Public finance

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

	2009	2010	2011	2012	2013	2014	2015p	2016p
Bulgaria	-4.2	-3.2	-2.0	-0.7	-0.9	-2.8	-2.9	-2.9
Croatia	no data	no data	-7.5	-5.3	-5.4	-5.7	-5.6	-5.7
Czech Republic	-5.5	-4.4	-2.7	-3.9	-1.2	-2.0	-2.0	-1.5
Estonia	-2.2	0.2	1.2	-0.2	-0.2	0.6	-0.2	-0.1
Lithuania	-9.1	-6.9	-8.9	-3.1	-2.6	-0.7	-1.5	-0.9
Latvia	-9.0	-8.1	-3.3	-0.8	-0.7	-1.4	-1.4	-1.6
Poland	-7.3	-7.6	-4.9	-3.7	-4.0	-3.2	-2.8	-2.6
Romania	-8.9	-6.6	-5.3	-2.9	-2.2	-1.5	-1.6	-3.5
Slovakia	-7.9	-7.5	-4.1	-4.2	-2.6	-2.9	-2.7	-2.5
Slovenia	-6.1	-5.6	-6.6	-4.0	-14.9	-4.9	-2.9	-2.8
Hungary	-4.6	-4.5	-5.5	-2.3	-2.5	-2.6	-2.5	-2.2

p – European Commission forecasts of May 2015

Source: Eurostat, European Commission

Table 30. Gross public debt (ESA'95) (in %, of GDP)

	2009	2010	2011	2012	2013	2014	2015p	2016p
Bulgaria	14.2	15.9	15.7	18.0	18.3	27.6	29.8	31.2
Croatia	48.0	57.0	63.7	69.2	80.6	85.0	90.5	93.9
Czech Republic	34.1	38.2	39.9	44.6	45.0	42.6	41.5	41.6
Estonia	7.0	6.5	6.0	9.7	10.1	10.6	10.3	9.8
Lithuania	29.0	36.2	37.2	39.8	38.8	40.9	41.7	37.3
Latvia	36.4	46.8	42.7	40.9	38.2	40.0	37.3	40.4
Poland	49.8	53.6	54.8	54.4	55.7	50.1	50.9	50.8
Romania	23.2	29.9	34.2	37.3	38.0	39.8	40.1	42.4
Slovakia	36.0	40.9	43.4	52.1	54.6	53.6	53.4	53.5
Slovenia	34.5	38.2	46.5	53.7	70.3	80.9	81.5	81.7
Hungary	78.2	80.9	81.0	78.5	77.3	76.9	75.0	73.5

p – European Commission forecasts of May 2015

Source: Eurostat, European Commission

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

	Year
Bulgaria	Not covered by EDP
Czech Republic	Not covered by EDP
Croatia	**2016**
Estonia	Not covered by EDP
Lithuania	Not covered by EDP
Latvia	Not covered by EDP
Poland	**EDP abrogation** (June 2015)
Romania	Not covered by EDP
Slovakia	Not covered by EDP
Slovenia	**2015**
Hungary	Not covered by EDP

Source: European Commission

8. Forecasts

Table 32. GDP growth rate forecasts (in %, y/y)

	2014	European Commission		IMF		Domestic sources	
		2015	2016	2015	2016	2015	2016
Bulgaria	1.7	1.0	1.3	1.2	1.5	-	-
Croatia	-0.4	0.3	1.2	0.5	1.0	0.4	0.9
Czech Republic	2.0	2.5	2.6	2.5	2.7	2.6	3.2
Estonia	2.1	2.3	2.9	2.5	3.4	2.2	3.1
Lithuania	2.9	2.8	3.3	2.8	3.2	2.0	3.4
Latvia	2.4	2.3	3.2	2.3	3.3	2.0	3.0
Poland	3.4	3.3	3.4	3.5	3.5	3.4	3.3
Romania	2.8	2.8	3.3	2.7	2.9	3.3	3.4
Slovakia	2.4	3.0	3.4	2.9	3.3	3.2	3.8
Slovenia	2.6	2.3	2.1	2.1	1.9	2.2	1.8
Hungary	3.6	2.8	2.2	2.7	2.3	3.3	2.5

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

	2014	European Commission		IMF		Domestic sources	
		2015	2016	2015	2016	2015	2016
Bulgaria	-1.6	-0.5	1.0	-1.0	0.6	-	-
Croatia	-0.2	0.1	1.3	-0.9	0.9	-	-
Czech Republic	0.4	0.2	1.4	-0.1	1.3	0.2	1.7
Estonia	0.5	0.2	1.9	0.4	1.7	0.5	2.8
Lithuania	0.2	-0.4	1.7	-0.3	2.0	-0.3	1.6
Latvia	0.7	0.7	2.2	0.5	1.7	0.7	-
Poland	0.0	-0.4	1.1	-0.8	1.2	-0.5	0.9
Romania	1.1	0.2	0.9	1.0	2.4	0.2	2.0
Slovakia	-0.1	-0.2	1.4	0.0	1.4	0.0	1.7
Slovenia	0.2	0.1	1.7	-0.4	0.7	-0.1	1.1
Hungary	-0.3	0.0	2.5	0.0	2.3	0.3	2.4

Table 34. Current account balance forecasts (in % of GDP)

	2014	European Commission		IMF		Domestic sources	
		2015	2016	2015	2016	2015	2016
Bulgaria	0.1	3.5	3.4	0.2	-0.8	-	-
Croatia	0.7	6.1	6.2	2.2	2.0	-	-
Czech Republic	0.6	1.3	1.2	1.6	0.9	1.1	1.5
Estonia	-1.2	-0.3	-0.5	-0.4	-0.7	1.1	-0.3
Lithuania	0.1	-0.2	-1.0	0.2	-0.8	0.0	-0.7
Latvia	-3.1	-2.3	-3.0	-2.2	-3.0	-	-
Poland	-1.3	5.5	6.2	-1.8	-2.4	0.9*	-0.2*
Romania	-0.4	-1.8	-2.2	-1.1	-1.5	-1.2	-1.4
Slovakia	0.1	1.8	0.7	0.4	0.4	1.0	1.0
Slovenia	5.8	5.4	5.6	7.1	6.5	5.8	5.9
Hungary	4.0	2.0	3.0	4.8	4.1	5.4	6.3

* - balance on current and capital account

Sources for tables 32-34: European Commission (05.2015), IMF (04.2015), Narodowy Bank Polski (03.2015), Ceska Narodni Banka (05.2015), Narodna Banka Slovenska (06.2016), Magyar Nemzeti Bank (06.2015), Comisia Naţională de Prognoză (05.2015), Banka Slovenije (04.2015), Eesti Pank (06.2015), Latvijas Banka (06.2015), Lietuvos Bankas (06.2015), Ekonomski Institut, Zagreb (01.2014).

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