NBP

National Bank of Poland

Economic Institute
Bureau of World Economy and European Economic Integration

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

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General information on CEE countries

	Area (km^2)	Population in thousand of inhabitatnts	Population inhabitatnts per 1 km^2	GDP (EUR bn)	GDP per capita (EUR) current prices	GDP per capita (EUR) PPP adjusted
Bulgaria	110 879	7 607	69	34 118	4 500	10 100
Czech Republic	78 867	10 468	133	147 879	14 200	20 100
Estonia	45 227	1 340	30	16 073	12 000	17 100
Lithuania	65 300	2 261	35	32 203	9 600	15 300
Latvia	64 559	3 350	52	23 160	10 200	14 000
Poland	312 685	38 136	122	362 415	9 500	14 400
Romania	238 391	21 499	90	137 035	6 400	11 500
Slovakia	49 035	5 412	110	64 778	12 000	18 000
Slovenia	20 273	2 032	100	37 135	18 400	22 700
Hungary	93 028	10 031	108	105 536	10 500	15 700

source: Eurostat, CSOs

Gross domestic product growth rate (in%)

	2008	2009			2008	2009		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	y-o-y				q-o-q			
Bulgaria*	3.5	-3.5	-4.9	-5.8	-3.9	-25.8	14.5	15.9
Czech Republic	0.0	-4.4	-5.8	-4.1	-1.3	-4.8	0.1	0.8
Estonia	-9.2	-15.0	-16.1	-15.3	-4.5	-6.0	-3.4	-2.8
Lithuania	-2.2	-13.3	-19.5	-14.2	-1.2	-11.3	-7.7	6.1
Latvia	-10.3	-18.0	-18.7	-18.4	-4.7	-11.0	-0.8	-4.0
Poland	3.0	0.8	1.1	1.7	-0.1	0.1	0.5	0.5
Romania	2.9	-6.2	-8.7	-7.1	-2.8	-4.6	-1.1	-0.6
Slovakia	1.6	-5.7	-5.5	-4.8	1.2	-8.6	1.1	1.6
Slovenia	-0.8	-8.2	-9.2	-8.3	-4.0	-6.2	0.6	1.0
Hungary	-2.5	-6.7	-7.5	-7.2	-1.9	-2.6	-2.0	-1.8

y-o-y – non-seasonally adjusted, q-o-q - seasonally adjusted
* - q-o-q – non-seasonally adjusted
source: Eurostat, CSOs

EXECUTIVE SUMMARY

Central and Eastern Europe is one of the world's economic regions that has been most severely affected by the current crisis. The recession hit the CEE economies mainly as a result of the decline in global demand (as reflected in a dramatic decrease in the global trade of goods), the slowdown in lending activity and the decline in foreign capital inflows.

The trends observed in individual countries of the region were relatively similar, though their scale differed much. The diversified impact of the recession on the region's economies was mainly determined by the degree of trade openness and the share of loans in private consumption financing. Due to a relatively low significance of those factors in the Polish economy, Poland was the only CEE country which showed positive economic growth (in Q1-Q3 2009 the GDP in Poland increased by 1.2% y/y). All other countries in the region recorded a GDP fall, which amounted to 7.8% y/y on average (ranging from 4.6% in the Czech Republic to 18.6% in Latvia).

The decline in domestic demand was the major factor standing behind the GDP decrease. This affected first of all fixed capital formation, which's contribution to the GDP growth rate was negative in all countries. In a majority of the region's countries, except for Poland and the Czech Republic, also consumption expenditure declined in the first three quarters of the year. The intensification of the recession in the global economy at the beginning of 2009 resulted in a further decline in exports, which had a strong pro-growth impact on the economies of the region in pre-crisis years. Declines in exports were accompanied by declines in imports at a much larger scale in the majority of the countries of the region. As a result, the contribution of net exports to GDP growth, which was negative in previous years, became the factor that cushioned the decline in domestic demand in the CEE countries.

The worsening economic situation in the first half of 2009 led to a further deterioration of the labour markets. The increase in the unemployment rate, which had already been recorded in the second half of 2008, accelerated in all the countries in the region in 2009.

The decline in consumer price growth, which started in mid-2008, continued in the majority of the CEE countries in 2009. The annual growth rate of the harmonized index of consumer prices (HICP) in the region decreased to 2.1% in October 2009 from nearly 5% recorded in December 2008. However, disinflation trends differed significantly across the region. The Czech Republic, Estonia, Latvia and Slovakia recorded a fall in prices on annual basis in October 2009. On the other hand, inflation in Poland, Romania and Hungary turned out to be the highest among all European Union states in the same period.

The narrowing of current account deficits, observed already in the second half of 2008, accelerated in the first half of 2009. During that period, the deficit in the CEE region decreased to 1.7% of GDP compared with 7.2% of GDP in 2008. The improvement of foreign trade and income balances, i.e. categories which were responsible for the increase in external imbalances in the region in previous years, has now contributed to their significant reduction. The foreign trade balance improved considerably in all economies due to a stronger decrease in imports than exports. A surplus on the foreign trade account, observed only in the Czech Republic until the crisis erupted, has also been recorded in Slovakia and Hungary in 2009. In addition, income account balances in all these countries improved notably.

In 2009 the fiscal stance in all Central and Eastern European countries deteriorated as a result of the global economic crisis. In 2009 other countries of the region with the exception of Bulgaria and Estonia joined Hungary, against which the EU launched the excessive deficit procedure already in 2004. Fiscal prospects for 2010-2011 point to a further continuation of high fiscal imbalances in the majority of this region's countries. In addition, there is a number of risks to future fiscal developments. This includes the uncertainty as to the development in the global economy and the scale and structure of consolidation measures.

A deeper fall in the economic activity in Central and Eastern Europe in the first half of 2009 caused forecasting centres to considerably revise their growth forecasts for the region downward. However, signals of some recovery in Western European countries in the second half of the year contributed to a minor upward adjustments of those forecasts.

According to the European Commission autumn 2009 forecast, GDP in the CEE countries is going to decrease by 4.0% in 2009. However, if Poland, which is the only country to achieve a positive economic growth is excluded, the GDP fall in the region will reach 7.7%. The EC expects that in 2010 the GDP in Central and Eastern Europe will increase by 0.9% (but only by 0.1% excluding Poland). Apart from Poland, a positive economic growth is also expected in Slovakia, Slovenia, Czech Republic and Romania. The GDP in the remaining countries is expected to continue to follow the downward trend (which is expected to stop in 2011).

COUNTRIES OF CENTRAL AND EASTERN EUROPE

Economic growth

Central and Eastern Europe is one of the world's economic regions that has been most severely affected by the current crisis. The recession hit the CEE economies mainly as a result of a decline in global demand (as reflected in the dramatic decrease in the global trade of goods), the slowdown in lending activity and the decline in foreign capital inflows.

The trends observed in individual countries of the region were relatively similar, though their scale differed much. The diversified impact of the recession on the region's economies was mainly determined by the degree of trade openness and the share of loans in private consumption financing. Due to a relatively low significance of those factors in the Polish economy, Poland was the only CEE country which showed positive economic growth (in Q1-Q3 2009 the GDP in Poland increased by 1.2% y/y). All other countries in the region recorded a GDP fall, which amounted to 7.8% y/y on average (ranging from 4.6% in the Czech Republic to 18.6% in Latvia).

Figure 1.1

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

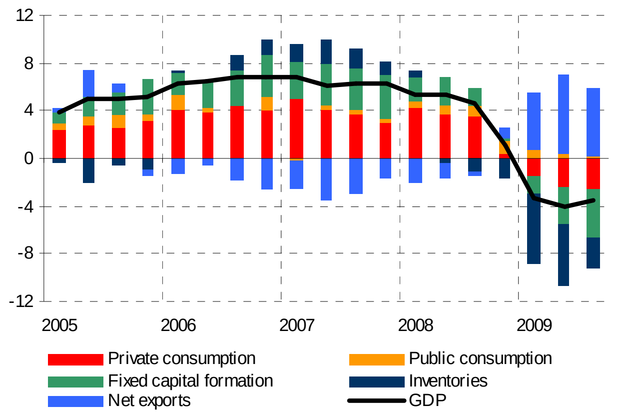


Table 1.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**6.3**	**4.1**	**-3.5**	**-4.4**	**-4.0**
Private consumption	6.3	4.7	-2.1	-4.2	-4.8
Public consumption	1.0	4.6	3.6	0.5	0.4
Fixed capital formation	15.2	6.2	-8.0	-12.6	-14.1
Exports	11.9	6.8	-18.1	-15.9	-9.5
Imports	14.6	6.8	-22.0	-22.5	-16.0

source: Ecowin Economic

The most profound decline in economic activity was recorded in Q1 2009. In that period GDP in the region decreased by 3.4% in comparison with Q4 2008 (6.1% excluding Poland). However, due to a stabilisation of demand in the global economy and a rebound in exports in Q2 2009, some of the region's countries recorded a positive quarterly GDP growth. This trend consolidated in Q3 2009, contributing to a reduction of the scale of GDP decreases on an annual basis. Nonetheless, the domestic demand remained weak.

The decline in domestic demand contributed most to the GDP decrease. The contribution of fixed capital formation to the GDP growth rate was negative in all countries. Poland and Hungary experienced a relatively low reduction in fixed investment (0.9% y/y and 5.7% y/y respectively), while in the Baltic states this decrease was nearly 40% y/y. Additionally, due to the adjustments made by business entities in response to a strong decline in the domestic and foreign demand. Inventories also decreased considerably. This has also strongly affected the GDP growth in the majority of the region's countries (except for the Baltic states).

In most of the region's countries, except for Poland and the Czech Republic, consumption expenditure also declined in the first three quarters of the 2009. The highest falls in private consumption were observed in those countries in which it stimulated the economic growth in the previous years (in the Baltic states and Romania in particular, where the decreases in household expenditure reached double-digit figures).

The collapse of domestic demand in the region was caused by a very high increase in the restrictiveness of the banks' credit policy leading to a reduction in the lending activity. The growth in loans for the private sector in 2008 amounted to over 30% y/y, while in Q3 2009 it fell to approximately 6% y/y and in the Baltic countries it was even negative. The decrease in the lending growth rate was observed in all types of loans. It was the highest in the case of loans for non-financial corporations.

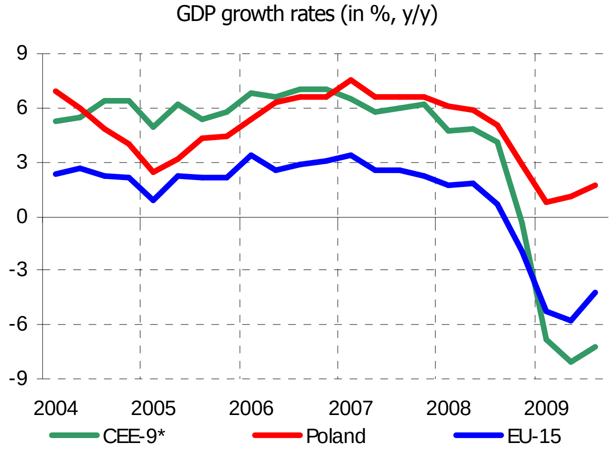
The contribution of public consumption to the GDP growth in the first three quarters of 2009 was positive in the majority of the CEE countries. However, it was lower than in the previous years due to reductions in public expenditure caused by decreasing revenues and the necessity to control the general government deficit and debt levels.

The intensification of the global crisis resulted in a further decline in exports at the beginning of 2009 which in a pre-crisis era had a strong pro-growth impact on the CEE economies. A fall in external demand strongly affected the production in the exports sectors, further contributing to the weakening of the domestic demand. Declines in exports were accompanied by declines in imports at a much larger scale in the majority of the countries in the region. As a result, the contribution of net exports to GDP growth, usually negative in previous years, became the factor that cushioned the weakening of domestic demand in the CEE region.

The fall in foreign trade volume was influenced to the greatest extent by a decrease in both domestic and external demand. The role of the exchange rate development was less significant, as demonstrated by the fact that a fall in exports in countries with a fixed exchange rate (the Baltic states, Bulgaria) was in the first half of 2009 similar to the fall in the countries whose currencies strongly depreciated at the end of 2008 and the beginning of 2009.

In a majority of CEE countries declines in the industrial production exceeded 20% y/y at the beginning of 2009. A large impact on the reduction of production in the region was a result of a strong decline in the automotive industry output (by c.a. 40%) related to a global decrease in demand for cars. Such dramatic lowering of the production level is also attributed to the policy pursued by car manufacturers which rather decided on a reduction in production in the CEE located plants, than in the Western European ones. Strong production declines were also recorded in the metallurgic industry. In addition, in some countries a decline in industrial output was related to the interruptions in the gas deliveries from Russia. The situation improved in the following quarters (Q2 and Q3) of 2009 owing to anti-crisis actions implemented in the largest European economies. In particular, this improvement was largely influenced by the introduction of government subsidies for car scrappage (especially in Germany and France) which significantly spurred the production in the automotive sector.

Figure 1.2



*- CEE excluding Poland
source: Ecowin Economic

The decrease in output in Q1 2009 was followed by the deterioration in business confidence indices, with particularly negative assessments concerning the number of export orders. The business optimism in the following quarters has been increasing mainly due a better perception of current and future trends in demand and production.

The decreasing private consumption led to a decline in retail sales in the region. The highest fall in retail sales was recorded in Q1 2009. In the Baltic countries it even amounted to 30% y/y. In the following months of 2009 decreases in retail sales growth slightly slowed down. However, at the end of Q3 they increased again as a result of a deteriorating situation on the labour market.

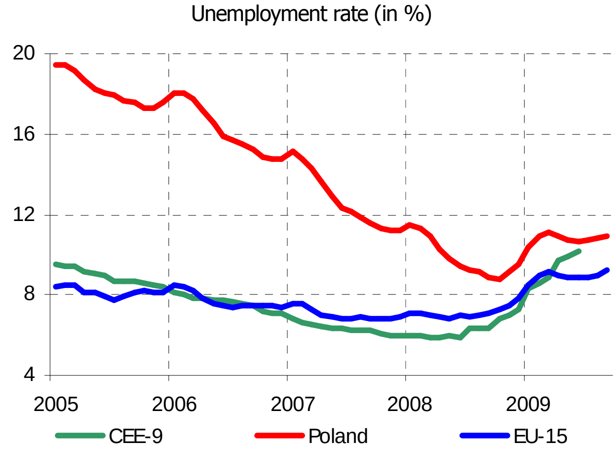
Consumer confidence in the CEE countries was deteriorating very fast in Q1 2009 (frequently to all-time lows). From Q2 consumers sentiment indices started to rise (except for Latvia and Romania). An improvement related to the assessment of the future economic situation was the main contributor to the increase in consumer optimism.

Labour market

The worsening economic situation in the first half of 2009 led to further deterioration on the labour markets. An increase in the unemployment rate, which already started in the second half of 2008, was observed in all the countries of the region. Between December 2008 and September 2009 the average unemployment rate in the region increased from 7.2% to 10.9%. Its highest growth was recorded in the Baltic countries (by more than 6 pp.) and the lowest in Bulgaria and Romania (approximately 1.5 pp.).

The rise in unemployment rate was accompanied by a decline in employment growth rate. At the end of 2008 the employment in the CEE countries grew at 0.5% y/y on the average. The number of employees in that period were still increasing in Poland, the Czech Republic, Slovakia, Bulgaria and Romania. However, in Q2 2009 the employment in the CEE region fell by 4% y/y. The highest fall was observed in the Baltic countries, in particular in Latvia (where the number of employees in Q2 fell by more than 12% y/y). Data for Q3 2009 which are still incomplete, indicate that declines in employment further deepened.

Figure 1.3



source: Ecowin Economic

Inflation and labour costs

A decline in consumer inflation which started in mid-2008, continued in the majority of the CEE countries in 2009. The annual growth rate of the harmonised index of consumer prices (HICP) in the region decreased to 2.1% in October 2009 compared with nearly 5% recorded in December 2008.

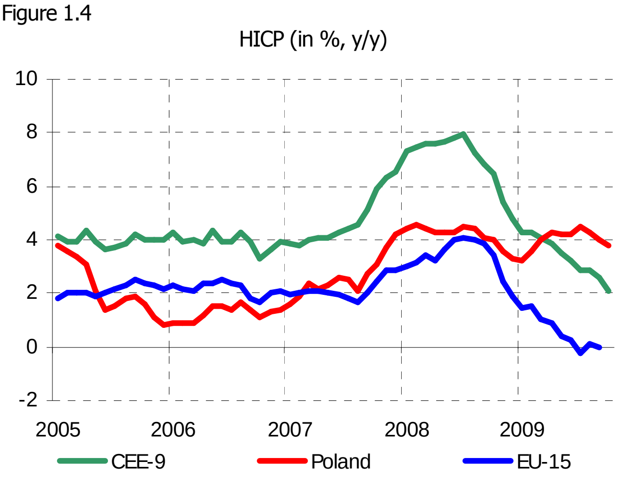
Disinflation trends differed very much in the region. Throughout 2009 up to date, inflation decreased very considerably in the Baltic states and Bulgaria. On the other hand, in Poland and Hungary the HICP growth rate was higher in October 2009 than in December 2008.

In the Czech Republic, Estonia, Latvia and Slovakia in October 2009 annual inflation fell below zero. On the other hand, Poland, Romania and Hungary showed definitely the highest inflation rate among European Union states.

The decline in inflation was temporarily restrained at the beginning of 2009 in Poland, the Czech Republic, Romania and Hungary, i.e. the countries where currencies depreciated in previous months. In addition, an increase in indirect tax rates in mid-2009 (in Poland and Hungary among others) was another factor which temporarily boosted the inflation.

The main factors which led to the decrease in inflation in 2009 were declines in energy and food prices growth rates resulting from a decrease in their prices on the global markets in the first half of 2009. Core inflation in the region also declined, however not in all countries. Weakening domestic demand caused its significant decrease in the Baltic states and Bulgaria. In Poland, Romania and Hungary core inflation did not decrease and even rose in comparison with the level observed at end of the previous year.

Figure 1.4



source: Ecowin Economic

The fall in economic activity spilled over to the labour markets, which was also reflected in a weakening growth of nominal wages. The average wage growth, c.a. 13% y/y in 2008, fell to 2.5% in Q2 2009. Incomplete data for Q3 2009 indicate a further decline of wage growth rate. On the one hand wages were still growing fast in Bulgaria (11% y/y in Q3 2009) and Romania (7% y/y in Q2), on the other, a fall of the average wages was recorded in 2009 in the Baltic countries[1].

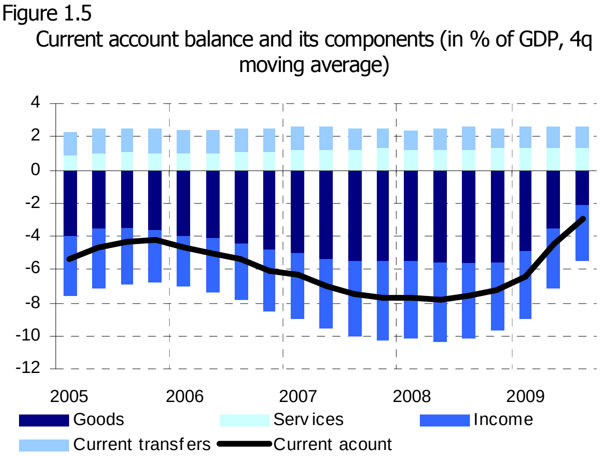
The large decrease in nominal wages in the region and a decrease in the employment growth rate did not translate into significant changes in the nominal unit labour costs (ULC) growth rate in 2009. The fall in ULC growth rates was cushioned by the decline in output observed in a majority of CEE countries.

Balance of payments

The narrowing of current account deficits observed as early as in the second half of 2008, accelerated in the first half of 2009. During that period, the deficit in the region decreased to 1.7% of GDP compared with 7.2% of GDP in 2008. The larger adjustment in current account balance was recorded in the Baltic states. The current account deficit in those countries reached 10-13% of GDP in 2008 (15-25% of GDP in 2007) and in the first half of 2009 all Baltic economies recorded current accounts surpluses. In the case of Latvia, this surplus even exceeded 14% of GDP in Q2 2009. Similar trends, although less intense, were present in other countries of the region. Those countries still experienced current account deficits, however they were significantly lower than in the previous years.

The improvement in the foreign trade and on income account, i.e. categories which in previous years were responsible for an increase in external imbalances in the region, has now contributed to their significant reduction. The foreign trade balance improved considerably in all the economies due to a stronger decrease in imports than exports. A surplus on the foreign trade account, observed only in the Czech Republic until the crisis erupted, has also been recorded in Slovakia and Hungary in 2009. In addition, all countries recorded a decrease in income account deficit. The largest decline was observed in the Baltic states (with Latvia achieving even a surplus in this category after Q2 2009). The reduction in the income account deficit was caused mainly by a decrease in reinvested profits of foreign-owned companies. The balance of services and current transfers accounts did not change significantly in 2009.

Figure 1.5

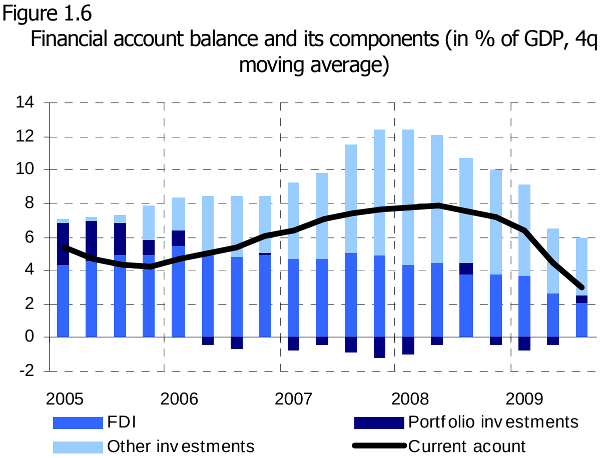


source: Ecowin Economic

The financial account also changed considerably. A decline in the inflow of foreign investments in the first half of 2009 was evident in the entire region. The inflow of foreign direct investments (FDI) decreased in all the countries mainly due to lower reinvested profits. To the greatest extent it took place in the Baltic states and to a relatively small degree in Poland and Romania. The inflow of other investments was also low compared with 2008. It resulted from the decline in trade of goods (trade loans) and the reduction in bank lending activity (loans for the banking sector). As in the case of direct investments, the decrease in the inflow of other investments was the highest in the Baltic countries.

The outbreak of the crisis and an increase in risk aversion led to a significant outflow of portfolio investments in Q4 2008 and Q1 2009. However, a respite on the financial markets which took place in Q2 2009 contributed to a return of portfolio capital to CEE markets, in particular to Poland, the Czech Republic and Slovenia.

Figure 1.6



source: Ecowin Economic

[1] A decrease in nominal wages resulted from, inter alia, reductions of salaries in the public sector.

Exchange rates and interest rates

In January and February 2009 depreciation trends for CEE currencies continued in the countries following a floating exchange rate regime (Poland, Czech Republic, Hungary, Romania). However, in the following months those currencies started to appreciate as global risk appetite increased and foreign investors became more interested in CEE financial markets. Between February and November 2009 the Polish zloty appreciated by 16% against the euro, the Czech koruna by 12% and the Hungarian forint by 13%. The Romanian leu was the only currency which did not appreciate in that period[2].

In 2009, central banks of CEE countries continued the process of easing monetary policy which started in mid-2008. The highest interest rate reduction between January and November 2009 was introduced by the Hungarian National Bank which cut the main interest rate by 350 basis points to 6.5%. The latest interest rate cut was introduced in November 2009. Other central banks also cut interest rates, however the cuts were lower and ended earlier. The National Bank of Poland cut the main interest rate by 150 basis points between January and June 2009, while the Czech National Bank (January – September 2009) and the National Bank of Romania (January – September 2009) – by 100 basis points and 225 basis points respectively.

Fiscal policy

The fiscal stance in 2009 deteriorated in all countries of the Central and Eastern Europe mainly due to the effect of automatic stabilisers of the economic situation. The European Commission forecast from November 2009 indicates that in 2009 the general government deficit of the in relation to GDP will exceed the reference value of 3% in all countries, except for Bulgaria and Estonia. The highest increase in the fiscal imbalances compared with 2008 was recorded by Lithuania (by 6.6 percentage point of GDP) and Latvia (by 4.9 percentage points of GDP), despite adjusting measures undertaken. In the case of Hungary and Estonia the deficit will increase by only 0.3 percentage points of GDP owing to public finance consolidating measures

Fiscal forecasts for 2010 and 2011 indicate that despite a projected gradual improvement of the economic situation, the public finances in CEE countries will remain bad. In the period covered by the forecast only Estonia and Bulgaria are not to record a budget deficit[3] of more than 3% of GDP. Those countries are the only countries in the region which were not covered by the Excessive Deficit Procedure. The EC expects that the amount of public debt will double in the region between 2008 and 2011. In Hungary, Latvia and Poland it will exceed the Maastricht Treaty reference value (60% of GDP) in the projected period. In addition, there is a number of risks to the future fiscal developments including the uncertainty as to the development in the global economy and the scale and structure of adjusting measures.

Forecasts

A deeper fall in the economic activity in the Central and Eastern Europe in the first half of 2009 caused forecasting centres to considerably revise downward their expectations for the region. However, signals of some recovery in the Western European countries in the second half of the year contributed to a minor upward adjustment of those forecasts in Q3 2009.

According to the EC autumn forecast, gross domestic product in the CEE countries is expected to fall by 4.0% in 2009 (by 7.7% excluding Poland). Although the expected scale of the economic slowdown in the region is similar to that projected for EU-15 states (by 4.1%), changes in individual GDP categories, in particular in domestic demand, indicate that Central and Eastern Europe is affected more severely by the crisis. According to the EC projections domestic demand in Western Europe is to drop by 3.6% and in the CEE countries it is to fall by 7.7% (and excluding Poland - by 12.5%). This disproportion is mainly a result of a stronger decrease in household consumption (by 3.8% in CEE and 1.5% in EU-15) and a deeper reduction in inventories. Public consumption is also expected to be much less significant contributor to GDP growth rate (an increase by 0.3% in CEE and by 2.1% in EU-15). The decline in fixed capital formation in CEE and EU-15 was very similar. However, the contribution of net exports was much higher in the CEE region. This is due to a greater decrease in imports in CEE (by 18.1%) than in EU-15 states (by 12.7%), while a decrease in exports was similar in both groups.

The EC expects that the GDP in the Central and Eastern Europe will increase by 0.9% in 2010 (and only by 0.1% excluding Poland). Apart from Poland, the economic growth is forecasted also for Slovakia, Slovenia, the Czech Republic and Romania. In the remaining countries GDP is expected to continue to fall (which is to stop in 2011). Rebuilding of inventories will have the greatest impact on a modest recovery in the region. Household expenditure and investments will remain at the level similar to 2009. Net exports will have much smaller, although still positive contribution to the GDP growth. Exports are expected to increase by 2.7% and imports - by 2.3%. Consequently, the growth in trade in goods in CEE countries will be slightly higher than in EU-15.

Therefore, the conclusion can be made that GDP growth prospects in the Central and Eastern European countries are not based on stable components.

The expected continuation of a lower growth of private consumption caused by a deteriorating situation on the labour market will contribute to the decline in inflation in the region in 2010. This trend will be mainly a result of a decline in the growth of consumer prices in countries with the highest inflation in 2009 (i.e. Poland, Romania and Hungary). However, a slight acceleration of inflation is expected in the countries where it was the lowest in 2009.

After the period of a decrease in the current account deficits in 2009 (and even a surplus in the Baltic countries), 2010 forecasts are not uniform. The deficit is expected to deepen in Poland and Hungary, while in other countries the current account balance should stabilise or slightly improve.

[2] In October 2009 CEE currencies depreciated for a short period of time.

[3] In this document the term budget deficit/surplus is understood as a deficit/surplus of the general government sector within the meaning of the EU methodology (ESA '95).

BULGARIA

Economic growth

The global crisis stopped the period of a relatively fast growth (at 4-6% y/y) of the Bulgarian economy which started in 2000. In the first half of 2009 the gross domestic product fell by approximately 4% and although the extent of the fall turned out to be so far the lowest among the countries of the region (excluding Poland where GDP increased), the deterioration of the current economic indicators shows that the crisis in Bulgaria continued to deepen in the second half of 2009.

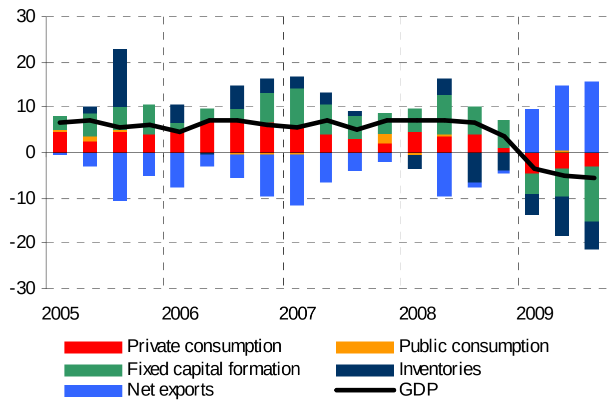
A decrease in domestic demand, fixed investment in particular, which previously was the main growth driver, was the largest contributor to the GDP decline in the first half of the year. On the other hand, a reduction of the deficit in foreign trade limited the level of GDP decrease, while in the previous year net exports negatively impacted economic growth.

A strong decline in fixed capital formation was related mainly to a distinct decrease in the inflow of foreign capital which previously contributed largely to its growth. In addition, unfavourable prospects for both the Bulgarian economy and its external environment made companies restrict capital expenditure and reduce inventories. The reduction in private consumption was mainly caused by a significant decline in bank lending activity and increasing saving propensity. The increase in the saving rate was mainly caused by deteriorating assessments of the households' financial standing and the situation on the labour market.

A fall in demand in the most important trade partners of Bulgaria, in particular a decline in the global demand for metallurgical goods, resulted in a decrease in exports by more than 16% in the first half of 2009. The collapse of domestic demand caused an even stronger decrease in imports, resulting in the reduction of the strong imbalance in the Bulgarian foreign trade and thus counteracting the GDP fall in that period.

Figure 2.1

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



source: Ecowin Economic

In Q3 2009 the situation of the Bulgarian economy deteriorated further. The GDP fell in that period by 5.8% y/y, mainly due to a decrease in private consumption. A fall in household expenditure, which was twice higher than in two previous quarters, was mainly related to a further slowdown in the bank lending activity.

Table 2.1

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

	2007	2008	Q1 2008	Q2 2009	Q3 2009
GDP	**6.2**	**6.0**	**-3.5**	**-4.9**	**-5.8**
Private consumption	5.3	4.9	-6.3	-5.6	-11.5
Public consumption	3.1	0.1	-0.4	4.2	-1.2
Fixed capital formation	21.7	20.3	-14.1	-16.3	-22.9
Exports	5.2	2.9	-17.4	-15.8	-13.2
Imports	9.9	4.9	-21.1	-24.3	-28.7

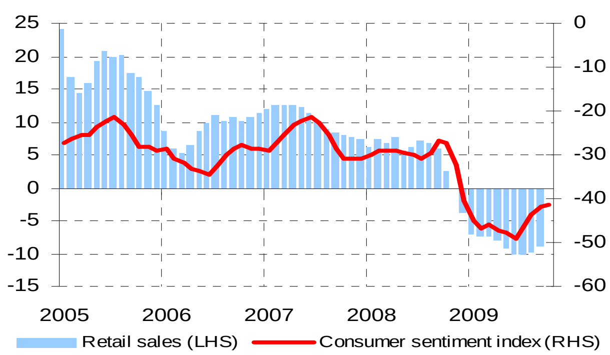
source: Ecowin Economic

At the beginning of 2009 retail sales fell below the 2007 levels, however they started to stabilize gradually from that point onwards (the scale of decreases narrowed on annual basis). Sales of food products fell the least, while the largest decreases affected durable goods.

Consumer confidence fell considerably until mid-2009, reaching its all-time low (the index has been published since 1999). However, at the beginning of the second half of 2009, it improved slightly, mainly as a result of more optimistic expectations concerning the general economic situation of the country. Inflation expectations improved, as did the assessment of prospects on the labour market.

Figure 2.2

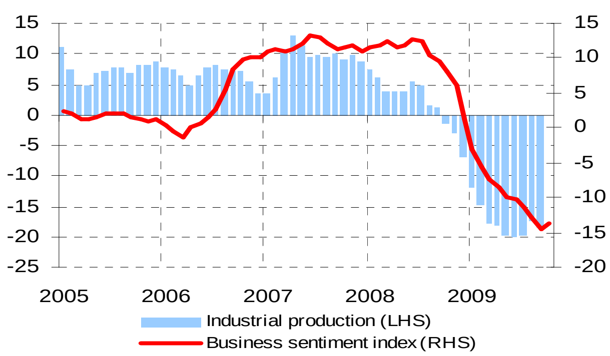
Retail sales (in %, y/y) and consumer sentiment index



source: Ecowin Economic

Figure 2.3

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



source: Ecowin Economic

The downward trend in industrial output deepened further until mid-2009 due to a strong decline in domestic demand and in exports. In June 2009 its level was 20% lower than in the same period of the previous year. Since August 2009 industrial production started to improve, but its annual growth rate still remained negative. The decrease in production was accompanied by a strong decrease in business confidence, related mainly to a fall in foreign orders and a deteriorating assessment of the general economic situation of the country. More difficult access to loans, originating mainly from abroad, also severely affected the situation of Bulgarian companies.

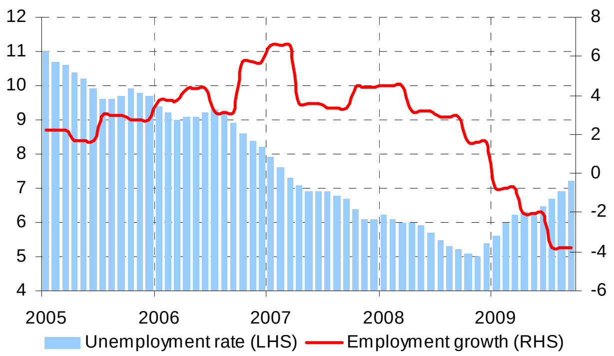
Labour market

Despite a strong reduction in the economic activity, the extent of the deterioration of the labour market has been relatively small so far. The unemployment rate increased from 6.5% in January 2009 to 7.9% in August 2009 (i.e. to the level previously recorded in 2007). The unemployment rate started to rise at the end of 2008 but this was mainly a result of seasonal factors. In 2009 the further increase in the unemployment rate was already caused by a deteriorating economic situation. In addition, the employment growth rate was negative for the first time since 2001. Analysts draw attention to the fact that adverse trends on the Bulgarian labour market will probably still deepen due to adjustments in the national industry, forced by the global crisis.

The largest decline in employment was recorded in the construction and manufacturing sector, where it amounted to 13% and 11% respectively. Relatively low decreases were observed in the transport (by 5.5%) and in the trade sector (3%).

Figure 2.4

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



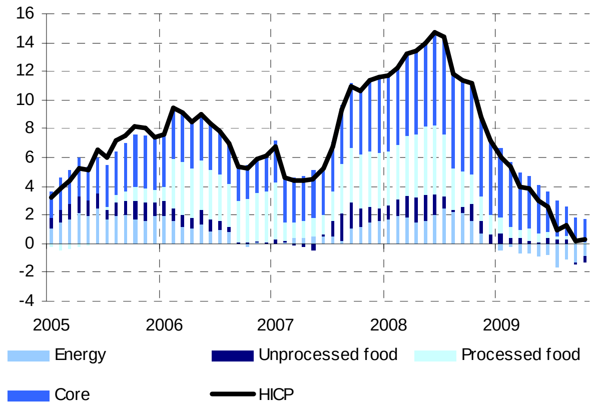
source: Ecowin Economic

Inflation and labour costs

After reaching 14% in June 2008, inflation in Bulgaria started a strong downward trend. In September 2009 the harmonized index of consumer prices fell to only 0.2% - the lowest level since 2003. However, in October 2009 this index rose slightly to 0.3%. A decrease in inflation was determined to the greatest extent by decreasing growth of food prices and deflation of energy prices. The increase in households' saving propensity contributed to a decline in core inflation.

Figure 2.5

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



source: Ecowin Economic

Inflation declined distinctly, despite further significant increases in unit labour costs (by approximately 18% y/y in the first half of 2009, i.e. by a similar figure as in the second half of 2008). An increase in unit labour costs was caused by a relatively high increase in wages (17% in the public sector and 14% in the private sector in Q2 2009) accompanied by a strong decline of GDP. The upward trend in wages continued due to an insufficient number of skilled labour force.

Table 2.2

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

	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**9.1**	**5.1**	**3.1**	**0.8**	**0.3**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.7	0.7	1.0	0.8	0.7
Restaurants and hotels	1.8	1.6	1.3	0.8	0.6
Miscellaneous	0.5	0.5	0.3	0.5	0.4
Health	0.3	0.1	0.1	0.3	0.3
Recreation and culture	0.3	0.4	0.3	0.3	0.2

source: Eurostat

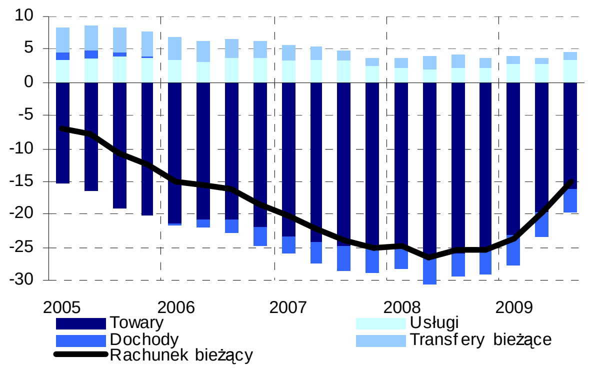
Balance of payments

In the first half of 2009 the current account deficit fell from 25% of GDP in Q4 2008 to 20% in Q2 2009. This was mainly a result of a reduction in the negative balance of trade in goods, caused by a stronger decline in imports than exports. A positive balance of trade in services and current transfers as well as a negative income balance remained at a similar level like in 2008.

The decrease in the current account deficit was accompanied by a decrease of the positive balance on the financial account. This situation was caused by the fall (by nearly half) in the inflow of direct foreign investments. A significant decrease was also recorded in other investments. The deficit on the portfolio investment account did not change considerably.

Figure 2.6

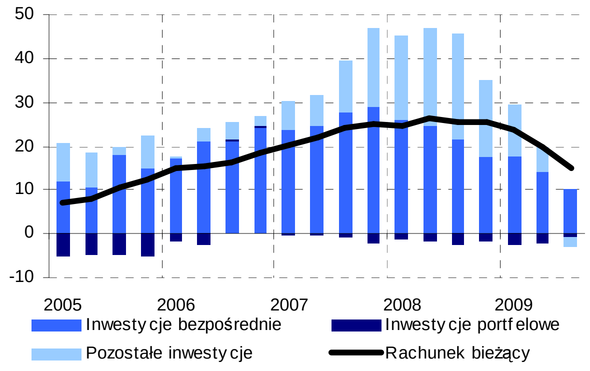
Current account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Figure 2.7

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



source: Ecowin Economic

Table 2.3

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

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-25.3**	**-25.4**	**-23.5**	**-19.7**	**-15.0**
Goods	-26.0	-25.2	-23.2	-19.5	-16.3
Services	2.3	2.3	2.7	2.7	3.5
Income	-3.5	-3.9	-4.4	-3.9	-3.2
Current transfers	2.0	1.5	1.4	1.0	1.1
Capital account	**0.8**	**0.6**	**0.1**	**0.2**	**0.2**
Financial account	**34.5**	**31.4**	**28.0**	**22.2**	**16.3**
FDIs	21.5	17.8	17.7	13.9	10.2
Portfolio investments	-2.5	-1.9	-2.6	-2.0	-0.8
Other investments	24.2	17.5	11.6	5.9	-2.1

source: Ecowin Economic

Owing to a strong inflow of foreign capital in recent years, the foreign debt of the private sector is approximately 100% of GDP. The Bulgarian National Bank estimates that short-term debt in April 2009 constituted 36% of total debt and this ratio remained relatively stable in the last several years. Fitch rating agency indicates that in the current situation of increased global risk aversion and the outflow of capital a serious problem with the renewal of short and medium term loans may arise. This will have a direct negative impact on new investments or the purchasing of raw materials.

Interest rates

Inter-bank interest rates (3M Sofibor) fell gradually after an increase to 8% at the end of 2008. As of the end of Q3 2009 the average interest rate fell to 5.1%.

Fiscal policy

In 2008 the general government sector in Bulgaria recorded a surplus of 1.8% of GDP. However, in 2009 the economic slowdown caused a significant reduction in budgetary income, in particular in the context of a continued high growth rate of expenditures (as a result of valorization of wages and benefits and an increase in investment expenditure)[4]. In order to prevent an increase in the deficit, the government made a decision to cut expenditures of individual ministries by 15%. In addition, the implementation of certain large investment projects was postponed to subsequent years. In the middle of September 2009 the government presented a program aimed at, among others, fighting the grey economy and smuggling, eliminating loopholes in the tax law and reducing public administration expenditure by further 15% in 2010. The authorities announced further expenditure cuts at the end of the year (by 10%). The European Commission expects that the Bulgaria's budget deficit will reach 0.8% of GDP in 2009.

A draft budget act for 2010 assumes a general government deficit at 0.7% of GDP against 1.2% of GDP projected by the EC. The only increase in expenditure is expected for infrastructure projects, education and environmental protection. Expenditure on pension and disability benefits as well as public sector wages will be frozen. On the income side, an increase in excise duty on alcohol and tobacco is assumed (by 43% - with funds to be used for health protection) as well as a simultaneous reduction of social insurance contributions paid by employers (by 2 percentage points). In addition, the Bulgarian government plans to perform during the year a review of the realization of budget income and expenditure, with the option to amend the budget act in mid-2010.

In its autumn forecast, the EC forecasts that in 2010 the general government deficit will increase to 1.2% of GDP (an increase by 0.4 percentage points of GDP as compared to 2009) and in 2011 it will decrease to 0.4% of GDP. The EC draws attention to the risk of exceeding those figures due to, inter alia, an uncertainty as to an effective implementation of activities aimed at limiting the increase in the budget deficit and a possibility of a stronger effect of automatic stabilizers of the economic situation in the expenditure area.

The debt of the public finance sector in the period covered by the EC forecast will be below 16.0% of GDP, which along with Estonia will be the lowest result in the entire European Union.

[4] Between January and September 2009 the income of the central budget in Bulgaria was lower by 17.9% y/y and expenditure (excluding the EU contribution) was higher by 30.5% y/y.

Forecasts

According to the external institutions forecasts (European Commission and International Monetary Fund) GDP in the second half of 2009 will continue to decrease. In 2010 a further decrease in GDP is also expected due to a continued decline in domestic demand – both the household consumption and investments. The highest risk for the household consumption is posed by increasing unemployment (research centres expect a further increase in unemployment rate in Bulgaria) and a decrease in wage growth. The maintenance of a fixed exchange rate of lev to the euro may also turn out to be a serious problem – in particular in the context of a potential devaluation in Latvia. In such a case borrowers in foreign currencies will be at risk of insolvency. In 2010 a further decline in investments is expected.

However, exports may be a factor which should stop recession trends in the Bulgarian economy. The increase in exports is expected to follow the recovery of the global economy. With further decrease in imports, in 2010 a positive contribution of net exports will be maintained.

The expected further decline in consumption will also have a negative impact on inflation. In 2010 it may be even slightly lower in comparison to the current year (even despite a projected increase in fuel prices). The current and projected inflation, which remains below the level required for the adoption of the euro (budget deficit and public debt are also compliant with nominal convergence criteria), will probably accelerate the decision of the government on Bulgaria joining the ERM 2. This would allow to achieve the goal of implementing the euro in 2013.

In the next two years a further decrease in the deficit on the current account is expected.

Table 2.4

Forecasts of main indicators

	EC	IMF
	10.2009 (04.2009)	10.2009 (04.2009)
GDP, in %, y/y		
2009	-5.9 (-1.6)	-6.5 (-2.0)
2010	-1.1 (-0.1)	-2.5 (-1.0)
2011	3.1	2.0 (2.0)
CPI, in %, y/y		
2009	2.4 (3.9)	2.7 (3.7)
2010	2.3 (3.6)	1.6 (1.3)
2011	2.9	1.9 (1.3)
Current account balance, in % of GDP, y/y		
2009	-13.7 (-18.8)	-11.4 (-12.3)
2010	-9.8 (-17.2)	-8.3 (-3.6)
2011	-7.9	-6.6 (-3.2)

CZECH REPUBLIC

Economic growth

Gross domestic product in the Czech Republic, which growth rate slowed down distinctly already in Q4 2008, decreased by 5.8% on annual basis in the first half of 2009. However, in Q2 2009 an increase on a quarterly basis (by 0.3%) occurred, which is to be a first proof that negative trends in the Czech economy have been stopped. Initial GDP estimates for Q3 2009 indicate that a slow economic recovery in the Czech Republic is to continue. GDP in Q3 2009 rose again (by 0.8% q/q and its fall decreased to 4.1% y/y).

The GDP decline in the first three quarters of 2009 resulted mainly from a decrease in gross capital formation. The decrease in fixed investments (by 7.6% in the analysed period) was accompanied by a significant fall in inventories. Despite a fall, consumption demand remained relatively strong compared with the other countries in the region. The private consumption growth rate in the first three quarters of 2009 remained positive (1.6% y/y), despite a distinct decrease in the growth of disposable income (decrease in employment, weaker wage growth and capital gains). On the other hand, credit growth rate still remained at a relatively high level (11% y/y as of the end of Q3 2009) and the savings ratio of households decreased, which explained a positive private consumption growth rate. The share of public consumption was continually positive, which was mainly related to higher expenditure of health insurance companies.

Figure 3.1

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

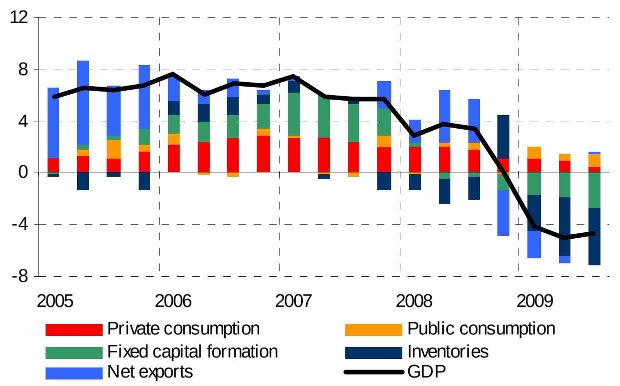


Table 3.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**6.1**	**2.7**	**-4.2**	**-5.0**	**-4.1**
Private consumption	5.2	3.4	2.3	1.8	1.0
Public consumption	0.4	1.6	4.6	3.9	5.4
Fixed capital formation	6.7	-1.1	-6.1	-7.0	-9.6
Exports	14.9	6.6	-18.5	-16.0	-8.1
Imports	14.2	5.0	-17.3	-16.2	-8.6

source: Ecowin Economic

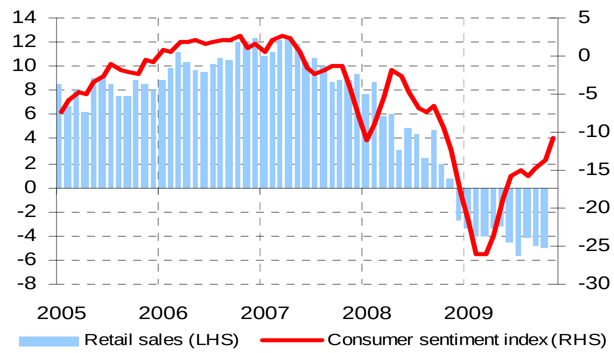
The Czech Republic and Slovakia were the only countries in the region where the contribution of net exports to the GDP growth in the first half of 2009 was negative, as well as in Q4 2008. Such fact was recorded for the first time since 2004. This resulted from the higher falls in exports than in imports (similarly to Slovakia), despite a strong depreciation of koruna in the first stage of the global crisis[5]. The main reason behind this situation were stronger, as compared with other countries in the region, trade (and capital) relationships with EU-15 states which at the beginning reacted more strongly to the crisis. A relatively strong consumption was however a factor slowing down a decline in imports. In Q3 the contribution of next exports to GDP growth was already positive (as in other CEE countries) owing to an acceleration in exports.

Despite a growth in private consumption in 2009, retail sales declines further deepened in subsequent months of 2009. On the other hand, the number of registered new cars increased (8% y/y in the first three quarters of 2009), despite president's veto in July against the act introducing subsidies for scrapping old and purchasing new cars.

In Q1 2009 the downward trend of the consumer confidence index (which started at the beginning of 2008) continued. In March 2009 the consumer sentiment indicator reached its lowest level since 1999. However, starting from Q2 2009, the consumer sentiment improved significantly owing to an increase in sub-indicators concerning a future financial situation of households and economic prospects in the Czech Republic.

Figure 3.2

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



source: Ecowin Economic

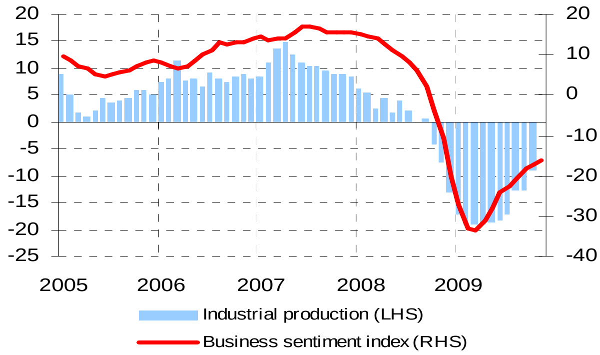
Industrial output, which started to decline already in Q4 2008, continued its downward trend in the first half of the year. Symptoms of certain stabilisation in the industry were observed as early as at the beginning of Q3 2009 mainly due to a recovery in the automotive industry (production of motor vehicles in August 2009 increased by 17% y/y). Subsidies to purchases of new cars in exchange for scrapping of old cars, introduced in numerous countries, had a positive impact on the production in this sector. Other industries did not however record a distinct increase in output.

Business confidence declined very fast at the beginning of 2009, reaching its all-time low in March 2009. Nonetheless, from Q2 2009 the business confidence started to improve. Aassessments of current trends in production and the

[5] A higher decrease in exports than in imports was mainly a result of a relatively high increase in imports of services (8% y/y in the first half of 2009), while growth of exports of services was much lower (approximately 1% y/y). The fall in exports and imports of goods was nearly identical (-21% y/y).

number of orders, both domestic and foreign ones were categories which improved most.

Figure 3.3
Industrial production (in %, y/y) and business sentiment index

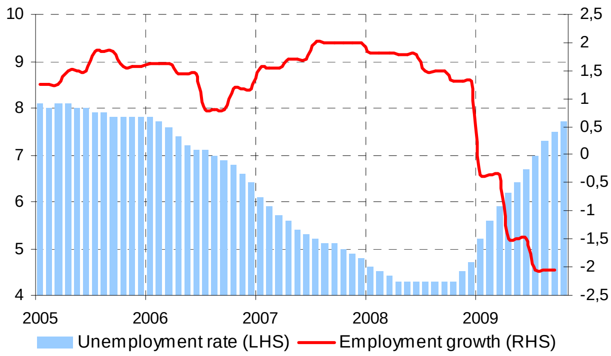


source: Ecowin Economic

Labour market

The deepening recession in the Czech economy resulted in the deterioration of the labour market. The unemployment rate which amounted to 5% in mid-2008, increased to 8.6% a year later. The employment growth also slowed down. The number of the employees, which has been increasing since mid-2004, decreased by 1.9% y/y in Q3 2009. The greatest decrease in the number of jobs was recorded in manufacturing, construction and agriculture. However, an increase in the number of the employed was recorded in the mining industry and services. In the first half of 2009 in the Czech Republic the decreasing number of the employed was partially cushioned by an increase in the number of self-employed.

Figure 3.4
Unemployment rate (in %) and employment growth rate (in %, y/y)



source: Ecowin Economic

Inflation and labour costs

In January 2009 inflation in the Czech Republic fell rapidly as a result of the evasion of the base effect related to a high increase in regulated prices in January 2008[6]. At the same time, the effect of sharp koruna depreciation appeared, which slowed the disinflation process in the forthcoming months. In the effect of higher import prices, inflation in the Czech Republic slightly increased in Q1 2009 (from 1.4% in January to 1.7% in March 2009). In the following months of 2009 the depreciation effect started to evade (as from mid-February 2009 the Czech koruna slowly appreciated), which also translated into a decrease in inflation.

Figure 3.5
HICP and its components (in pp, y/y)

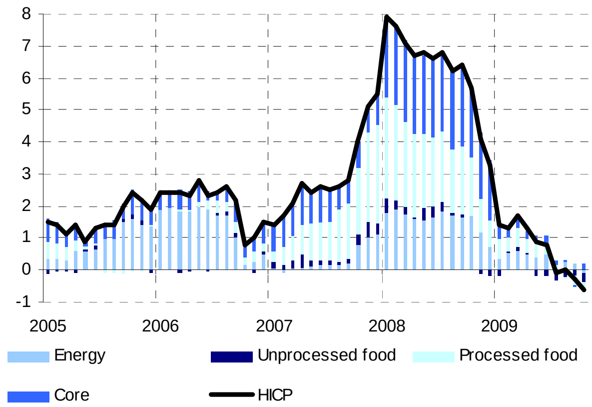


Table 3.2
HICP and its components (in pp, y/y)

	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**4.4**	**1.5**	**1.0**	**-0.1**	**-0.6**
Contribution to HICP growth rate (in pp)					
Housing	2.4	2.2	1.9	1.4	1.0
Alcoholic beverages and tobacco products	0.9	0.8	0.8	0.5	0.3
Restaurants and hotels	0.3	0.1	0.1	0.1	0.1
Miscellaneous	0.4	0.2	0.1	0.1	0.1
Education	0.0	0.0	0.0	0.0	0.0

source: Ecowin Economic

In Q3 2009 the growth of consumer prices in the Czech Republic was already negative and in October 2009 it fell to 0.6% which was one of the lowest figures in the region. In 2009 the growth of nearly all price categories slowed down. Food and transport prices (mainly fuels) had the largest contribiutions to the inflation developments in 2009[7]. Prices growth rate in both those categories were negative since the beginning of 2009 and continue to fall within the following months (to -5.1% and -3.4% y/y in October 2009 respectively). Prices of clothing and footwear, furnishings, communications, recreation and culture has also fallen in 2009. On the other hand, prices of housing and alcoholic and tobacco products were pushing inflation up. High growth rate of these price categories resulted from administrative decisions at the beginning of the year (increase in regulated prices of electricity and gas and in excise duty on tobacco products).

Wage growth rate in the first half of 2009 in the Czech Republic fell considerably in comparison with previous quarters. In Q4 2008 it amounted to over 8% y/y while in the first half of 2009 it fell to 3% y/y. The larger decline in wage growth rate was observed in the business sector than in a non-business one. However, nominal wage growth remained positive in the most sectors of the Czech economy, except for

[6] The expiry of the base effect caused a decline in inflation in January by approximately 3 p.p.

[7] In October a decrease in fuel prices slightly slowed down as a result of the expiry of the base effect related to the decrease in fuel prices in Q3 2008.

mining. In the retail trade sector they practically did not change during the last year, while the largest increase was observed in health and education.

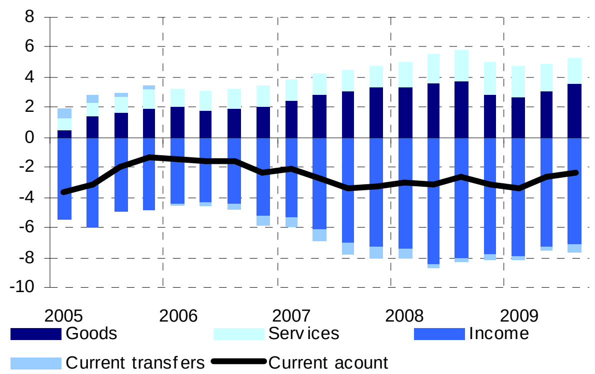
The growth rate of unit labour costs did not change in comparison with 2008. The decline in salaries growth and falling employment were compensated by a decrease in the business activity in the Czech Republic.

Balance of payments

The decrease in the current account deficit in the Czech Republic was the lowest in the entire CEE region. In Q3 2009 the deficit decreased to 2.4% of GDP compared with 3.1% of GDP in 2008. The structure of the current account balance which was, different from other CEE countries, did not change considerably in the first half of 2009. The Czech Republic still recorded a surplus in trade in goods. The surplus slightly decreased in Q1 2009 as a result of a fall in exports (of mainly machinery, equipment and motor vehicles which constituted more than half of the Czech exports). In the next two quarters of 2009 an increase in exports of those categories was recorded in response to an increased demand for cars in the developed countries (governmental plans of subsidies to purchases of new cars in EU states, mainly in Germany). Nonetheless, exports of motor vehicles in 2009 were still lower by 15% than in the same period of the previous year. The value of exports of other goods categories also fell in 2009, as did the value of imports. Between January and October 2009 Czech exports and imports declined by 22% and 25% respectively.

In the same period the surplus on the services account decreased and the current transfers deficit increased. However, the most significant change was observed on the income account. Apart from the trade balance, that change was responsible to the greatest extent for a current account deficit narrowing. The income account deficit decreased as a result of a lower value of dividends, reinvested profits of foreign-owned companies and decreasing salaries of foreigners working in the Czech Republic. Despite the improvement in 2009, this category remained the largest contributor to external imbalances in the Czech Republic.

Figure 3.6
Current account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

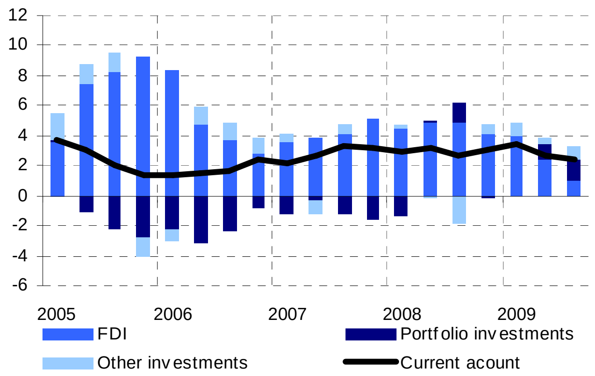
Table 3.3
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-2.6**	**-3.1**	**-3.4**	**-2.6**	**-2.4**
Goods	3.7	2.8	2.7	3.1	3.6
Services	2.0	2.2	2.1	1.9	1.7
Income	-8.1	-7.8	-8.0	-7.2	-7.2
Current transfers	-0.2	-0.3	-0.2	-0.3	-0.4
Capital account	**0.9**	**0.8**	**1.1**	**0.8**	**1.0**
Financial account	**3.9**	**4.1**	**4.5**	**3.3**	**3.0**
FDIs	4.8	4.1	3.9	2.5	1.0
Portfolio investments	1.3	-0.2	0.1	1.0	1.4
Other investments	-1.9	0.6	0.8	0.4	0.9

source: Ecowin Economic

In 2009 the inflow of foreign investments, in particular direct investments, to the Czech Republic decreased. In Q3 2009 FDI balance amounted to 1.0% of GDP compared with more than 4% of GDP in 2008. The inflow of other investments also fell. However, in the Czech Republic its contribution to the financial account was not as important as in other countries of the region (Baltic states in particular). In Q2 and Q3 2009 the net inflow of portfolio investments, negative in the previous year, increased owing to the weakening of global risk aversion. This translated to a higher inflow of capital into Czech financial markets, mainly into government bonds.

Figure 3.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Interest rates and foreign exchange rate

In 2009 the Czech National Bank (CNB) continued the process of easing the monetary policy. Since the beginning of July 2009 CNB cut the main interest rate on three occasions, by 100 b.p. in total to 1.25%. The CNB main interest rate remained at this level until December 2009.

Interest rates on the inter-bank market also decreased in 2009 in response to the CNB actions and easing tension on the global financial markets. At the beginning of the year the value of 3M Pribor amounted to more than 3.5% and in November it fell to 1.7-1.8%.

Czech koruna (CZK) after a strong depreciation in the second half of 2008 and the beginning of 2009 (between July 2008 and February 2009 the CZK depreciated by 29% against EUR and NEER by 13%), started to appreciate in the following months of 2009. The upward trend stopped temporarily only in October 2009 when CZK depreciated against EUR (by approximately 1%). However, between February and November, the Czech koruna appreciated strongly against the euro, by more than 12%.

Fiscal policy

Considerable deterioration of the Czech economy caused a material increase in the general government deficit in 2009. The European Commission expects that it will reach 6.6% of GDP compared with 2.1% in 2008. Apart from automatic stabilizers, fiscal imbalance also increased due to anti-crisis measures conducted under the National Anti-Crisis Plan (c.a. 2.0% of GDP). This included: reduction of social insurance contributions (by 2.5 pp.) and CIT rate (by 1.0 p.p.), increase in pro-development expenditure (infrastructure, research and development), support for public transport and introduction of subsidies to thermal insulation of residential buildings. The above plan also assumed reductions in expenditure of individual ministries (by approximately 0.2% of GDP).

In 2010 general government deficit is to be reduced by 1.1 pp. due to the introduction of package of tax changes and expenditure reduction introduced in October 2009. The package includes: increase in VAT rate (from 9% and 18% to 10% and 19% respectively), excise duty (engine fuels, beer, spirit and tobacco), real estate tax, postponement by one year of indexation of pension and disability benefits and reduction of expenditure on wages in the government administration (by 4%). In addition, certain anti-crisis measures were abandoned (e.g. reduction of social insurance contributions). The EC forecast for 2011 assumes a slight increase in the deficit (by 0.2 pp. of GDP) due to parliamentary election in spring 2010.

During the analysed period a fast increase in the public debt is expected (from 30% of GDP in 2008 to 44% of GDP in 2011) However, it would still remain significantly below the reference value of 60% of GDP.

In December 2009 the Czech Republic was covered by the excessive deficit procedure. General government deficit must be reduced to below 3% of GDP by 2013. Due to parliamentary election in 2010 and a temporary nature of the tax changes package and expenditure cuts of October 2009, the accomplishment of the above goal will require additional adjusting actions to be introduced.

Forecasts

In the second half of 2009 GDP growth forecasts for 2009 continued to fall due to higher than originally expected GDP decreases in Q2 2009. According to the forecasts, GDP in the Czech Republic is to fall by approximately 4% in 2009. The decline in GDP will be influenced mainly by a decrease in fixed investments and inventories. However, a majority of forecasting centres raised their growth forecasts for 2010. According to the latest available projections GDP growth rate in 2010 is to exceed 1%.

Inflation forecasts did not change as compared to the first half of 2009, despite its record low levels. The average annual inflation in the Czech Republic in 2009 may exceed slightly 1% and remain at a similar level in the next year. A slight decrease in projected inflation has been observed in recent months, which may be related to the depreciation of Czech koruna[8]

A decreasing deficit in the current account (both in the Czech Republic and the entire region) in the first half of 2009 influenced its projected decline in subsequent years.

Table 3.4

Forecasts of main indicators

	ČNB	EC	OECD	IMF
	11.2009 (11.2008)	10.2009 (04.2009)	11.2009 (06.2009)	10.2009 (04.2009)
GDP, in %, y/y				
2009	-4.4 (-2.4)	-4.8 (-2.7)	-4.4 (-4.2)	-4.3 (-3.5)
2010	1.4 (1.4)	0.8 (0.3)	2.0 (1.4)	1.3 (0.1)
2011	2.2	2.3	2.8	2.5 (2.5)
CPI, in %, y/y				
2009	0.1 (0.9)	0.6 (1.1)	1.1 (1.6)	1.0 (1.0)
2010	2.4 (2.0)	1.5 (1.6)	1.4 (0.3)	1.1 (1.6)
2011	2.1	1.8	2.0	2.0 (2.0)
Current account balance, in % of GDP, y/y				
2009	-1.1 (-2.1)	-2.5 (-3.2)	1.0 (-1.4)	-2.1 (-2.7)
2010	-0.8 (-1.6)	-1.4 (-3.3)	0.3 (1.0)	-2.2 (-3.0)
2011	-0.8	-0.8	0.3	-2.5 (-2.7)

ČNB - Česká Národní Banka

[8] In Q2 and Q3 2009 inflation forecasts for 2009 were slightly revised downward.

ESTONIA

Economic growth

Similarly to other Baltic states, Estonia recorded a double-digit decrease in real GDP in the first half of 2009. In Q1 GDP fell by 15% y/y and in Q2 2009 – by 16.1% y/y. The economic growth started to decline in Estonia already at the beginning of 2007 and the global financial turmoil further deepened the crisis in the second half of 2008 and in 2009.

In the pre-crisis years, when economic growth in Estonia amounted to 10% y/y, the growth was based mainly on a strong domestic demand, both consumption and investments. On the other hand, net exports negatively influenced GDP growth. In 2008 the structure of economic growth in Estonia changed. Such changes even strengthen in 2009. A fall in the economic activity in recent quarters was caused mainly by a decreasing domestic demand (consumption and investments). The growth rate of private consumption and fixed capital formation on annual basis in the first three quarters of 2009 amounted to -19% and -35% respectively. In addition, a weakening domestic demand contributed to a significant fall in imports growth and thus the share of net exports in the GDP growth since the beginning of 2008 is positive (for the first time since the beginning of 2004), despite a decrease in exports.

Figure 4.1

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

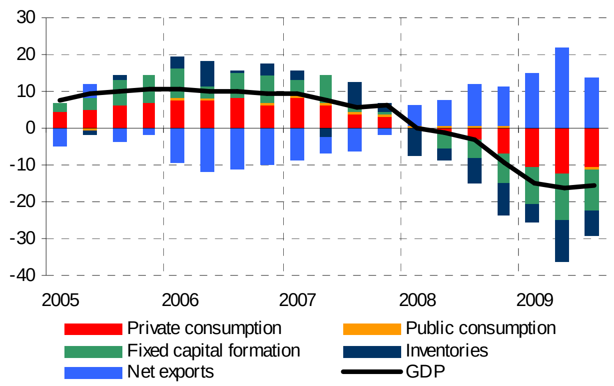


Table 4.1

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

	2007	2008	Q1 2009	Q2 2009	Q32009
GDP	**6.3**	**-3.6**	**-15.0**	**-16.1**	**-15.6**
Private consumption	7.8	-4.0	-17.7	-20.8	-20.0
Public consumption	3.9	4.4	-0.4	0.3	-1.0
Fixed capital formation	4.8	-7.6	-27.3	-38.8	-37.0
Exports	0.0	-1.1	-16.5	-11.1	-9.6
Imports	4.2	-7.9	-27.4	-30.9	-26.6

source: Ecowin Economic

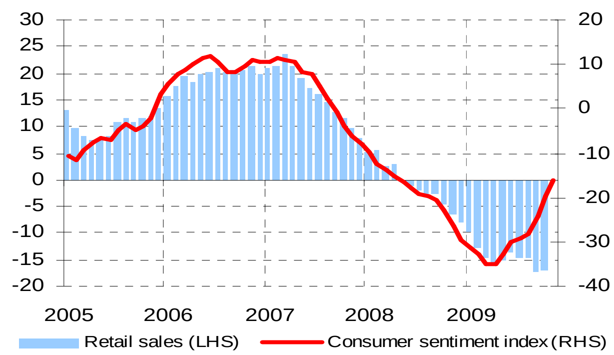
Declining consumption also affected the retail sales volume. After a strong decline in Q1 2009, the annual growth of retail sales did not change in subsequent months and it oscillated around -15% y/y. In September and October this growth fell again due to a high decrease in sales of consumer durable goods (mainly computer hardware and electronic equipment which were nearly 50% lower than in the previous year).

The annual growth rate of industrial production in Estonia has been negative since Q2 2008 and in mid-2009 the falls exceeded 30%. In the second half of 2009 decreases in industrial production slightly diminished (due to, inter alia, the base effect), however they were still the highest in the entire CEE region. The decline in production was recorded in all industry sectors, with the largest decreases affecting intermediate and capital goods.

Consumer and business confidence indicators in Estonia had been gradually decreasing since the beginning of 2007 until Q1 2009. Then the trend reversed and the sentiment of both consumers and manufacturers started to improve considerably. In the case of consumer sentiment, this was mainly a result of an improved assessment of a future financial situation of households and a future economic situation in the country. Business entities positively evaluated the projected value of future production and employment[9].

Figure 4.2

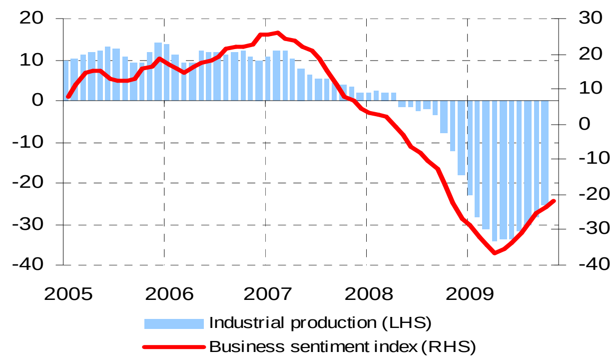
Retail sales (in %, y/y) and consumer sentiment index



source: Ecowin Economic

Figure 4.3

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



source: Ecowin Economic

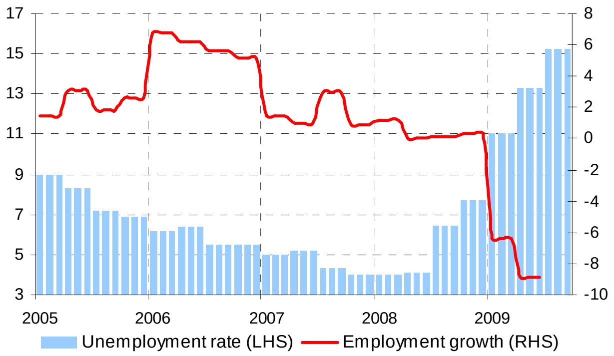
Labour market

The deepening economic crisis had a significant impact on a deteriorating situation on the labour market. The unemployment rate in Q3 2009 increased to 14.6%, compared to 4% in Q2 2008. Such a high unemployment rate has not been observed in Estonia since 2000. A fall in the number of the employed in the Estonian economy also fell in a record pace. In Q2 and Q3 2009 the employment

[9] A fall in the value of the same sub-indices, both in the case of consumer and business confidence indices, was responsible for a decrease in confidence in previous quarters.

decreased by nearly 10% y/y. The highest decrease in the number of employees in that period was recorded in construction (32%) and manufacturing (17.5%), while employment in the mining industry slightly increased. During the analysed period, employment in the entire services sector fell by 3% y/y, mainly due to a decrease in employment in trade and public administration. On the other hand, the number of jobs in the financial intermediation sector and real estate services increased.

Figure 4.4
Unemployment rate (in %) and employment growth rate (in %, y/y)

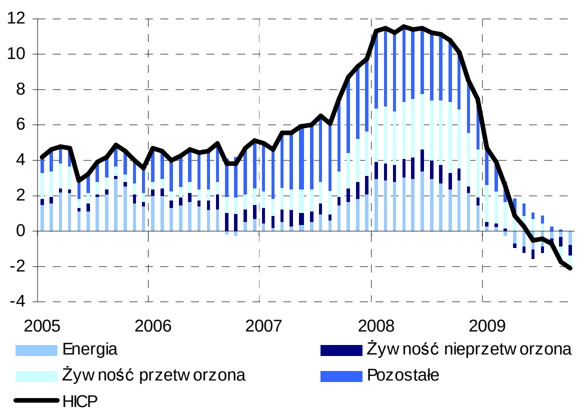


source: Ecowin Economic

Inflation and labour costs

Inflation measured by the harmonised index of consumer prices (HICP) in Estonia in the first half of 2009 continued a downward trend which started in the second half of 2008. The HICP growth, which was one of the highest in the region in 2008 (10.6%), fell into negative figures in June 2009 and in October it amounted to -2.1% y/y. That meant, that inflation in Estonia was the lowest in the CEE region and one of the lowest in the entire EU[10]. A slight and short-lived increase in inflation was recorded only in July 2009 (to -0.4% compared to -0.5% in June) and it resulted from an increase in VAT rate from 18% to 20%. This increase was however amortised by the expiry of the base effect related to an increase in excise duty for tobacco products 12 months earlier.

Figure 4.5
HICP and its components (in pp, y/y)



Food and fuel prices which started to decrease practically from the beginning of the year had the strongest impact on the decline in inflation. In addition, weakening domestic demand caused a fast decrease in core inflation which between January and September 2009 fell from 2.1% to 0.0%.

Similarly to other Baltic states, the growth of nominal wages in Estonia collapsed in the first half in 2009. A strong decline in average wage growth rate was recorded already in Q4 2008 when it fell to 6.9% y/y compared to 16% in three previous quarters. In 2009 the it fell below 0% and in Q3 it amounted to -5.9% y/y. This decrease was caused to a large extent by a decision of the Estonian government to reduce salaries in the public sector by 10% at the beginning of 2009.

A considerable decline in wage growth, combined with a decline in employment, caused a downward trend in the growth of the unit labour costs. Despite its extent being limited due to a deepening recession in the economy, the ULC growth in Estonia was one of the lowest in the region and in Q3 2009 it was already negative.

Table 4.2
HICP and its components (in pp, y/y)

	Q4 2008	Q1 2008	Q2 2008	Q3 2009	Oct-09
HICP	**8.7**	**3.7**	**0.2**	**-0.9**	**-2.1**
Contribution to HICP growth rate (in pp)					
Miscellaneous	0.4	0.5	0.4	0.4	0.4
Clothing and footwear	0.3	0.1	0.2	0.1	0.1
Household equipment	0.3	0.2	0.1	0.1	0.1
Health	0.2	0.2	0.2	0.1	0.1
Alcoholic beverages and tobacco products	2.1	1.7	1.5	0.5	0.1

source: Ecowin Economic

Balance of payments

Current account deficit in Estonia gradually decreased since mid-2007, when it constituted nearly 20% of GDP. In Q2 2009 it fell to 2.2% of GDP[11]. In Q3 2009 the balance on the current account showed a surplus (0.8% of GDP) for the first time since 1993. A decline in deficit was caused mainly by improving foreign trade balance. The deficit in the trade in goods declined in the last eight quarters from 19% of GDP to nearly 6% of GDP. Other categories (income, services and current transfers) also contributed to the improvement of external imbalances in Estonia in recent quarters, however their contribution was definitely lower than in the case of trade in goods.

Tendencies in foreign trade of Estonia were similar to those observed in other Baltic states. In the first eight months of 2009 both exports and imports continued to decline (-27% y/y and -35% y/y respectively). An increase in trade in goods (exports and imports) was recorded only for mineral goods and fuels. A collapse of domestic demand contributed to a decline in imports of mainly durable goods, i.e. machinery and equipment and motor vehicles. Exports decreased in almost all categories of goods (except for fuels and other mineral goods). The most significant decline in exports was

[10] Except for Ireland and Portugal.

[11] Data refer to the 4Q moving average. In the first half of 2009 alone the current account in Estonia recorded a surplus of 2% of GDP.

observed in exports of metals and metal goods as well as in motor vehicles.

Figure 4.6
Current account balance and its components (in % of GDP, 4q moving average)

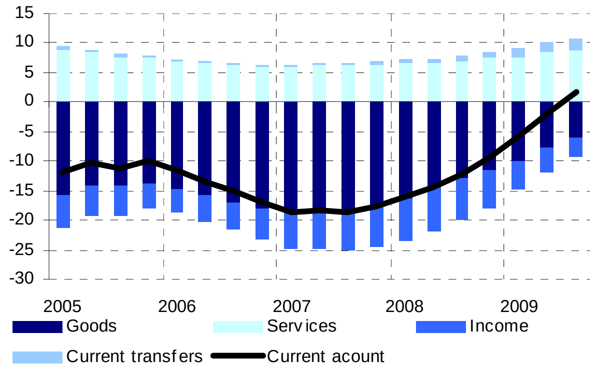
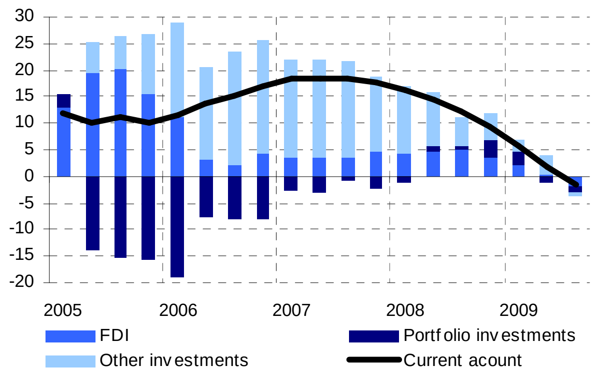


Table 4.3
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-12.1**	**-9.4**	**-5.8**	**-2.2**	**0.8**
Goods	-12.9	-11.7	-10.0	-7.7	-5.9
Services	6.9	7.4	7.7	8.2	9.0
Income	-6.9	-6.3	-4.8	-4.2	-4.2
Current transfers	0.9	1.2	1.4	1.6	1.8
Capital account	**0.7**	**0.7**	**0.6**	**0.6**	**0.9**
Financial account	**11.1**	**12.0**	**6.9**	**3.0**	**-1.8**
FDIs	4.9	3.7	2.1	0.3	-2.0
Portfolio investments	0.9	3.1	2.4	-1.0	-1.2
Other investments	5.4	4.9	2.3	3.6	0.9

source: Ecowin Economic

Figure 4.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

In 2009 the inflow of foreign investments continued to decrease, however it still fully covered the deficit on the current account. In particular, an inflow of FDIs stopped. At the end of 2008 FDI net inflow amounted to almost 4% of GDP. In Q3 2009 an outflow of 1.8% of GDP was observed. Inflows of portfolio investments and other investment also declined due to a continued investors' aversion to Estonian financial markets, in particular the inter-bank lending market[12]. A decrease in the inflow of other investments (mainly trade credits and credits for the banking sector) was not as strong as in Lithuania or Latvia and in the first quarters of 2009 it was still positive.

Interest rates

3-month interest rates on the inter-bank market in Estonia decreased regularly in 2009. At the beginning of the year 3M Talibor was nearly 8% and in November 2009 it fell to 3.5%, i.e. the lowest level since 2006. Slight, temporary increases in interest rates occurred in February and June due to rumours of a potential devaluation in Latvia which would cause similar actions in other Baltic countries. A considerable decrease in inflation in the second half of 2008, and first of all in 2009, led to the situation when in 2009, for the first time since 2004, real 3-month interest rates in Estonia were positive.

A nominal effective exchange rate in Estonia in 2009 was very stable and practically did not change. In turn, a fast decrease in the prices growth caused a slight weakening of the CPI deflated REER (by 1.5% between January-October 2009).

Fiscal policy

A considerable decrease in GDP contributed to the deterioration of the fiscal stance in Estonia. In 2008 the general government deficit amounted to 2.7% of GDP, compared to surpluses in five preceding years (2.1% of GDP on average). Despite the expected deep decline of GDP, the European Commission estimates that in 2009 the negative fiscal balance will increase only slightly (by 0.3 p.p. of GDP to 3.0% of GDP), mainly owing to consolidation actions (both permanent and one-off) with the total value of 8% of GDP. Those actions related to both income (increases in income taxes, VAT, social contribution, higher dividends) and expenditure (current expenditure cuts including: government administration wages, illness benefits, pension and disability benefits). In addition, between mid-2009 and December 2010 a transfer of contributions to the funded pension system (4% of a salary) was suspended for persons born before 1983 who decided to join the funded pension system. In 2011 the share of those contributions will be reduced (to 2% of a salary).

According to the EC forecast, Estonia will be one of EU countries with the lowest budget deficit – in 2010 it will be 3.2% of GDP and in 2011 – 3.0% of GDP. The EC stresses that due to uncertainty as to the future macroeconomic developments, a permanent reduction of the general government deficit to below 3% of GDP will require an increased effectiveness of expenditures, an increased control and identification of the new sources of income. The Estonian government declares that the general government deficit will be maintained below the reference value, so that in 2011 euro can be adopted.

A positive general government balance before the crisis allowed Estonia to partially limit borrowing requirements in 2008 and 2009. This limited a growth of public debt.

[12] In Q2 2009 an inflow of other investments to Estonia was observed as a result of banks withdrawing from reverse repo operations.

However, due to a significant decline of GDP, the public debt is expected to increase by 8.6 pp. of GDP to 13.2% of GDP between 2008 and 2011.

Forecasts

Deteriorating situation of the Estonian economy in 2009 caused further decline in economic growth rate expectations. Most of the forecasts suggest that Estonian GDP may shrink by c.a. 14% in 2009. It is also expected that GDP growth rate will remain negative in 2010. Possible recovery is expected not earlier than in 2 years. Only the Bank of Estonia indicates in its forecasts a possibility of economic growth already in 2010. A decline in real GDP in Estonia in the coming years is estimated to be a result of a weak in domestic demand (both consumption and investments). Net exports is expected to continue compensating the declines in domestic demand in the forthcoming years.

Weakening domestic demand is the main reason responsible for a decline in inflation in 2009 and 2010. According to projections, consumer prices level should not change in 2009. However, a majority of forecasting institutions predicts deflation in 2010. The inflation in Estonia is to be the lowest in the region both in the current and next year.

An improvement in the current account balance in the first half of 2009 caused a significant verification of forecasts for the current and next year. The latest forecasts already show a surplus on the current account in the 2009 (as much as 6.3% of GDP - Bank of Estonia) and 2010.

Table 4.4

Forecasts of main indicators

	EP	EC	OECD	IMF
	10.2009 (04.2008)	10.2009 (04.2009)	11.2009 (06.2009)	10.2009 (04.2009)
GDP, in %, y/y				
2009	-14.2 (-12.3)	-13.7 (-10.3)	-14.4 (-13.9)	-14.0 (-10.0)
2010	1.4 (0.2)	-0.1 (-0.8)	-0.8 (-0.7)	-2.6 (-1.0)
2011	4.7 (4.7)	4.2	3.9	1.4 (2.3)
CPI, in %, y/y				
2009	0.1 (-0.5)	0.2 (0.6)	0.0 (-0.5)	0.0 (0.8)
2010	-0.4 (-2.9)	0.5 (0.5)	0.1 (-0.5)	-0.3 (-1.3)
2011	1.7 (-0.8)	2.1	0.4	0.5 (-0.4)
Current account balance, in % of GDP, y/y				
2009	6.3 (2.7)	3.9 (-1.1)		1.9 (-6.5)
2010	0.4 (-1.7)	1.3 (-3.1)		2.0 (-5.4)
2011	-5.3 (-4.9)	-0.3		-1.1 (-6.8)

EP - Eesti Pank

LITHUANIA

Economic growth

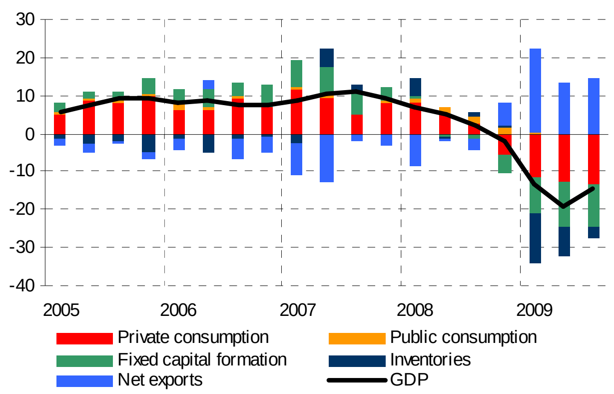
For the first 3 quarters of 2008 Lithuanian economy successfully resisted strong economic slowdown observed in other Baltic states. However, in Q4 2008 first signs of unavoidable crisis aroused. Finally, in the first half of 2009 the Lithuanian economy collapsed sharing the fate of Estonia and Latvia. Gross domestic product in the first half of 2009 decreased by 16.5% (a highest decrease since gaining the independence). A higher decline in GDP growth in Lithuania, in comparison with other Baltic states, resulted from a high base at the beginning of 2008 (when Lithuania still recorded a relatively high economic growth, Latvia and Estonia already experienced a slowdown in the economic activity). The information on the scale of GDP decline in the first half of 2009 contributed to significant deterioration of growth forecasts for Lithuania. Forecasts published in Q4 2009 expect a decrease in GDP by 17-18.5% in 2009 and by 3.5%-4% in 2010, while at the beginning of 2009 they expected a decline in the economic activity by only 3% in 2009.

Similarly to other Baltic states, GDP decline in the first half of 2009 was mainly a result of a decrease in domestic demand. Consumption fell by 17.5% y/y and investments by 39% y/y. A large, largest in the CEE region, fall in credit growth rate (-3% y/y in August 2009 compared to 18% y/y in December 2008) was a major contribution to the weakening domestic expenditure. At the same time, a decrease in imports by more than 30%, i.e. twice as much as a decrease in exports, caused the highest ever positive contribution of net exports to GDP growth.

In Q3 2009 GDP rose on quarterly basis. Preliminary estimates of the Lithuanian Statistical Bureau indicate that the growth amounted to 6.1% q/q. On annual basis Lithuanian economy was still shrinking (-14.2% y/y). The improvement in the economy in Q3 2009 is mainly a result of reconstruction of inventories and further improvement of the trade balance. Consumption demand and investments continued to decline.

Figure 5.1

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



Retail sales and industrial production reflected a collapse in the domestic demand in the first half of 2009. Retail sales in April 2009 fell by 30% y/y (the largest decrease among CEE countries). In the following months the extent of declines slowly decreased (mainly due to base effect). In September and October the retail trade turnover further deteriorated. Throughout this period the growth rate of retail sales in Lithuania oscillated between -25% and -30%.

Table 5.1

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

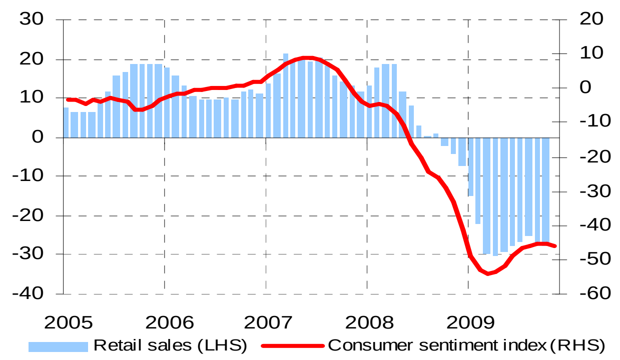
	2007	2008	Q1 2008	Q2 2008	Q3 2009
GDP	**8.9**	**3.0**	**-13.3**	**-19.5**	**-14.2**
Private consumption	12.3	5.9	-15.7	-17.5	-19.0
Public consumption	3.3	4.1	2.4	-0.2	-1.5
Fixed capital formation	20.8	-6.4	-38.5	-40.9	-41.4
Exports	4.3	11.5	-13.1	-23.4	-17.4
Imports	11.6	10.3	-33.7	-33.2	-31.3

source: Ecowin Economic

A downward trend of consumer confidence and manufacturers confidence indices which started at the beginning of 2007, stopped in Q2 2009. The consumer sentiment improved mainly due to expectations of the improvement of the economic situation in the country.

Figure 5.2

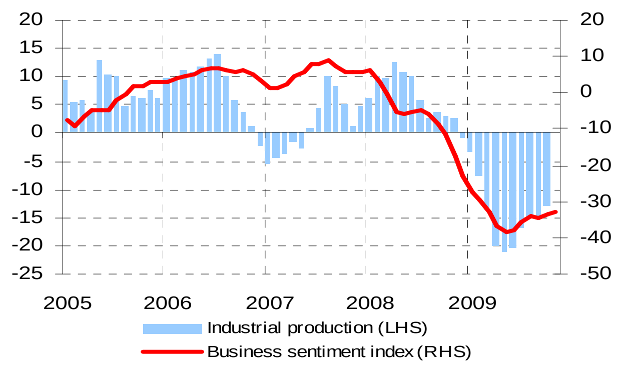
Retail sales (in %, y/y) and consumer sentiment index



source: Ecowin Economic

Figure 5.3

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



source: Ecowin Economic

In the first half of 2009 Lithuanian manufacturing sector experienced rapid falls in production. The highest decreases in the first months of 2009 were observed especially in the production of capital and intermediate goods. In the second half of 2009 the downward trend weakened due to slight recovery in the above mention sectors.

Business sentiment indicators followed a similar trend. After a fast decrease in the first half of the year, it improved in subsequent months. Trends in the production volume and discontinuation of a decline in the number of orders, mainly on the domestic market, had the most significant influence on the improvement of sentiment in recent months.

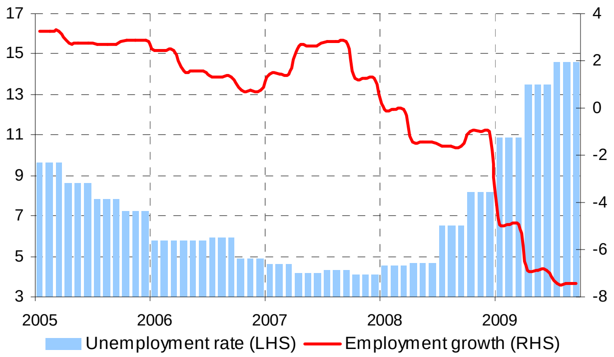
Labour market

The situation on the Lithuanian labour market was similar to what was observed in other Baltic states. Unemployment rate in 2009 continued to rise at a fast pace (13.8% in Q3 2009 compared with 4.5% in Q2 2008) and reached its highest level since 2003.

Employment growth rate in Lithuania also decreased significantly. The number of employees has been falling since Q2 2008. In Q2 2009 it decreased by 7% y/y. The largest fall in employment was observed in manufacturing, construction (29% y/y/ each) and trade (16%).

Figure 5.4

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



source: Ecowin Economic

Inflation and labour costs

An unification of the Lithuanian VAT rate at the beginning of 2009 (to 19% compared two previous rates of 15% and 18%) caused consumer inflation increase by 1 pp. in January 2009. Since then, HICP annual growth rate in Lithuania experienced a rapid and continued slide down. In October 2009 it amounted to 1%, which is 8.5 pp. less than in January.

In September inflation rose slightly as a result of significant increases in prices of education and clothing and footwear. However, it was only a very short-lasting incident which did not influenced the general trend.

Similarly to other countries of the region, a decrease in inflation was explained mainly be decreases in prices of food and fuels but core inflation also experienced significant downfall. In Q1 2009 it remained at a relatively high level (3.5%) due to a strong consumption compared with other Baltic countries and the above mentioned increase in VAT rates. The decrease in core inflation accelerated considerably in Q2 2009 when consumption expenditure collapsed dramatically.

Figure 5.5

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

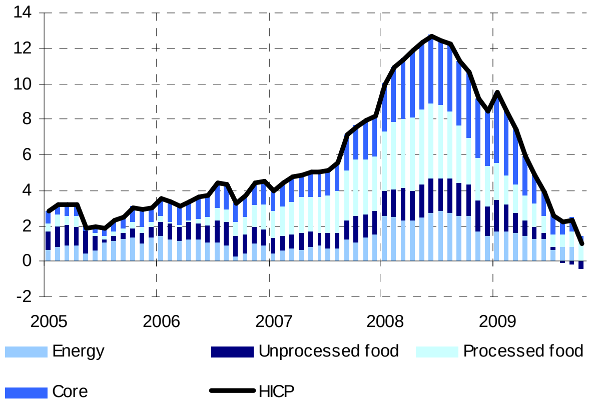


Table 5.2

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

	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**9.5**	**8.5**	**4.9**	**2.4**	**1.0**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	1.1	1.0	1.0	1.1	1.5
Health	0.6	1.2	1.0	0.9	0.9
Education	0.1	0.1	0.1	0.2	0.2
Miscellaneous	0.4	0.4	0.3	0.2	0.2
Housing	2.7	2.7	2.2	1.3	0.0

source: Ecowin Economic

A deteriorating situation in the Lithuanian economy, a decrease in employment and reductions of wages in the public sector (by 12% at the beginning of 2009) caused a decrease in nominal wages in the entire economy. A downward trend in nominal wage growth rate was observed already in 2008 but at the end of the year it remained at a double-digit level (13.2% y/y in Q4 2008). In 2009 the trend continued. As a result, in Q3 2009 average nominal wage was almost 8% lower than a year earlier.

A decline in nominal wages and the number of the employed contributed to a slower growth in unit labour costs. However, it was stopped by a collapse of the business activity in Lithuania and consequently the ULC growth rate fell only slightly in the first half of 2009 and was still one of the highest among the CEE countries.

Balance of payments

Current account deficit in Lithuania, similarly to other Baltic countries, decreased considerably within the last quarters (from 12% of GDP in 2008 to nearly zero in Q3 2009). The largest contributors to the deficit reduction was trade in goods. Foreign trade deficit during first 3 quarters of 2009 decreased by 7.6% p.p. of GDP. Income account deficit also decreased and surpluses on the services and current transfers account increased.

In mid-2009 exports and imports fell by 32% y/y and 43% y/y respectively, while the annual growth of those categories was positive even until the end of 2008. Exports of fuels and lubricants, which constituted more than 20% of total exports, recorded a very high decrease (more than 44% y/y). It resulted from a decline in imports of crude oil (caused on the one hand by a decrease in global crude oil prices and on the other, by a reduced demand for fuels in Lithuania and in countries supplied by the Możejki refinery) which decreased to a similar extent in the analysed period. As far as imports are concerned, the highest decrease was recorded in the passenger car segment (by more than 70% y/y) and in the electronic equipment and computer hardware segment (more than 50% y/y).

Figure 5.6
Current account balance and its components (in % of GDP, 4q moving average)

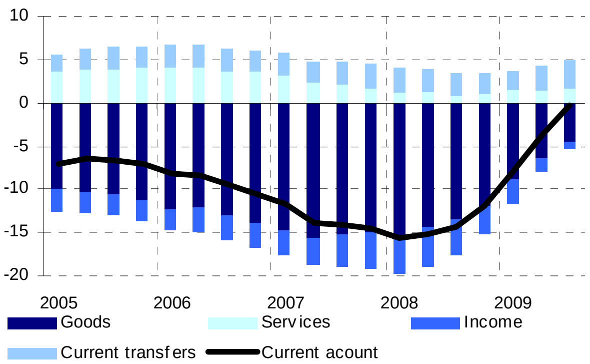


Figure 5.7
Financial account balance and its components (in % of GDP, 4q moving average)

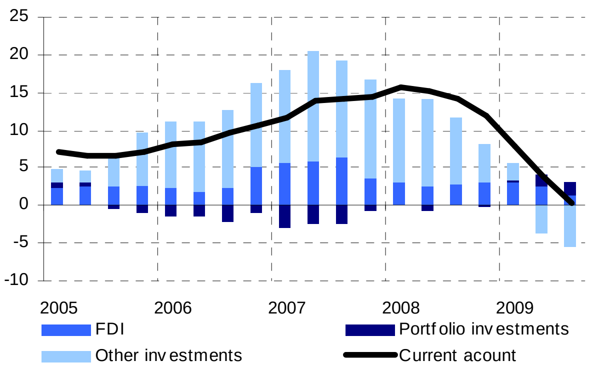


Table 5.3
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-14.2**	**-11.9**	**-8.0**	**-4.0**	**-0.3**
Goods	-13.5	-12.0	-8.8	-6.4	-4.4
Services	0.8	1.1	1.4	1.4	1.6
Income	-4.1	-3.3	-2.8	-1.9	-0.8
Current transfers	2.6	2.3	2.3	2.9	3.4
Capital account	**0.8**	**0.8**	**0.8**	**0.6**	**1.0**
Financial account	**12.4**	**10.3**	**6.7**	**2.4**	**-1.0**
FDIs	2.8	3.1	3.0	3.1	1.1
Portfolio investments	0.0	-0.3	0.4	1.6	1.8
Other investments	8.8	5.0	2.3	-3.5	-4.3

source: Ecowin Economic

Opposite to the other Baltic states, a lower inflow of foreign capital to Lithuania in the first half of 2009 was caused almost solely by deterioration of the other investments balance. At the end of 2008 Lithuania recorded an other investments surplus, which in Q2 2009 it turned into a deficit. In the same period the balance of direct investments did not change substantially and the net inflow of portfolio investment even increased compared to 2008. A decline in the other investments inflow was especially visible in the banking sector. Lack of foreign financing led to the fastest in the region decrease in the lending growth rate.

The situation on financial account slightly changed in Q3 2009. The inflow of capital continued to diminish, the deficit of other investments increased, however a decline in the inflow of direct investments had the greatest influence on the balance deterioration. This was attributable mainly to a lower level of reinvested earnings by foreign owned companies.

In Q3 2009 for the first time in the Lithuania history the balance on the financial account (calculated as 4q moving average) was negative.

Interest rates

Nominal interest rates on the Lithuanian inter-bank market fell in the first months of 2009. 3-month Vilibor fell from nearly 10% in January to 7% in May 2009. In May and June 2009 interest rates increased abruptly (to 8.5% in June) as a result of investor concerns related to poor results of the Lithuanian economy and a threat of devaluation in Latvia, which, in their opinion would also affect other Baltic countries. In the second half of the year the risk of devaluation decreased as consequently interest rates did (to 5% at the beginning of December 2009). Despite a decrease in nominal rates on the inter-bank market, real rates (which were negative in 2008) increased due to a fast drop in inflation.

A nominal effective exchange rate in 2009 was very stable and practically did not change since the beginning of the year. However, due to a faster than in other countries decline in inflation, the real effective exchange rate decreased.

Fiscal policy

According to the European Commission, the deficit of the general government sector in Lithuania in 2009 is to amount to 9.8% of GDP as compared to 3.2% of GDP in 2008. The deterioration of the fiscal stance was caused by a deep fall in GDP. Despite the undertaken adjusting measures, in the next two years the general government deficit is to still exceed 9%. Consolidation measures adopted at the end of 2008 and in 2009 covered, among others, increases of tax rates (including two increases of VAT rate, from 18% to 21% in total) and social insurance contributions, reduction of expenditure on public administration (the employment was reduced in 2009 by 7%, salaries were also reduced by around 15%). In addition, contributions transferred to the private pension funds were temporarily reduced (from 5.5% to 3.0% of a salary) in 2009 and 2010. The total scale of adjusting actions in 2009 amounted to approximately 7.5% of GDP.

At the end of October 2009 an agreement was reached with trade unions, entrepreneurs' and pensioners' organisations which provides for a reduction of general government deficit to below 3% of GDP. The above goal is to be reached as a result of, 10% wage reduction in the public sector, closing down some state institutions and increasing social insurance contributions by 2 pp. In addition, the agreement provided for the introduction of a stimulus package by reducing CIT rate from 20% to 15%, strengthening public and private partnership, accelerating the absorption of the EU funds and reducing bureaucracy. In addition, the 2010 budget act provides for a reduction of expenditure on maternity benefits (by approximately 15%) as well as retirement and disability pensions (by approximately 5%) and another reduction of the employment in the government administration (by 5%). In order to improve the stability of public finance in a long term and to support the competitiveness of the economy, the government also announced a reform of the educational system, healthcare sector and the pension system.

In July 2009 Lithuania was covered by the excessive deficit procedure. The budget balance should be reduced below -3% of GDP by 2011. The Lithuanian government estimates that the deficit of the government sector could be reduced below the reference amount in 2012.

A significant decrease in GDP and an increase in the budget deficit will cause more than a threefold increase in the public debt - from 15.6% of GDP in 2008 to 49.4% in 2011.

Forecasts

A surprising, very fast decline in GDP that occurred already in 2009 caused a very strong downward adjustment of economic growth forecasts for Lithuania in 2009. However it did not considerably impact forecasts for 2010. According to international institutions and the Bank of Lithuania, GDP should fall by approximately 17-19% in 2009. In 2010, real GDP will also decrease by approximately 3-5%.

The main reason for the GDP decrease projected for the current and the next year is the domestic demand collapse, while the contribution of net exports is to remain positive.

A decreasing domestic demand will probably also contribute to a further decline in inflation. The Bank of Lithuania and the European Commission even expect deflation in 2010.

A current account surplus which arose in the first half of 2009 is expected to be maintained throughout the second half of 2009 and in 2010.

Table 5.4

Forecasts of main indicators

	LB	EC	IMF
	11.2009 (05.2008)	10.2009 (04.2009)	10.2009 (04.2009)
GDP, in %, y/y			
2009	-15.2 (-15.6)	-18.1 (-11.0)	-18.5 (-10.0)
2010	-1.5 (-4.5)	-3.9 (-4.7)	-4.0 (-3.2)
2011		2.5	3.0 (3.0)
CPI, in %, y/y			
2009	3.9 (3.9)	3.9 (3.6)	3.5 (5.1)
2010	-0.8 (-2.1)	-0.7 (-0.4)	-2.9 (0.6)
2011		1.0	0.5 (-0.7)
Current account balance, in % of GDP, y/y			
2009	0.0 (0.9)	0.1 (-1.9)	1.0 (-4.0)
2010	0.6 (4.2)	0.3 (0.7)	0.5 (-5.3)
2011		-0.4	0.0 (-5.5)

LB – Lietuvos Bankas

LATVIA

Economic growth

In the first 3 quarters of 2009 Latvia experienced the strongest GDP decline among Central and Eastern European economies. In that period GDP contracted by 18.6% y/y, compared with 4.6% contraction in 2008.

Deepening crisis in the Latvian economy in 2009 resulted mainly from a decline in domestic demand. Due to a collapse of the bank lending activity (starting from July 2009 the annual growth of loans for the private sector is negative) and a deteriorating situation on the labour market (a fall in the number of the employed and nominal wages), household consumption fell in the analysed period of 2009 by more than 23% y/y. This was the highest number in the CEE region and had the strongest impact on GDP decrease in Latvia. Declining fixed capital formation (a decline by 37% in the first half of 2009) and a fall in public consumption (by 7%), due to serious cuts in public sector, had also a negative impact on the economic growth rate.

A deepening disproportion between a fall in exports and imports (strongly influenced by a collapse in domestic demand) led to an increase in the contribution of net exports to GDP growth. In 2009 it was the only national accounts category which counteracted the declines in domestic demand in Latvia.

Figure 6.1

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

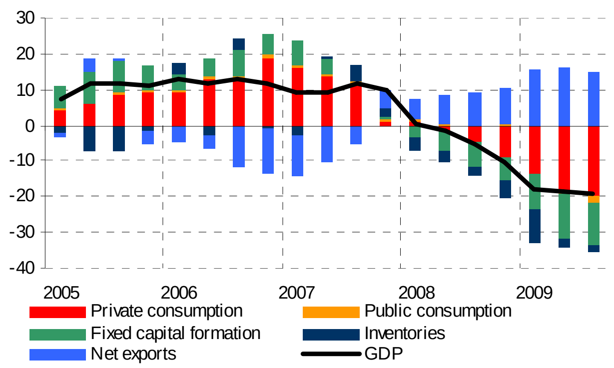


Table 6.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**10.0**	**-4.6**	**-18.0**	**-18.7**	**-19.0**
Private consumption	14.8	-11.1	-17.9	-24.9	-28.1
Public consumption	3.7	1.5	-1.2	-6.9	-12.4
Fixed capital formation	7.5	-13.2	-34.1	-38.1	-39.4
Exports	10.0	-1.3	-16.4	-17.9	-14.7
Imports	14.7	-13.6	-34.3	-39.3	-35.4

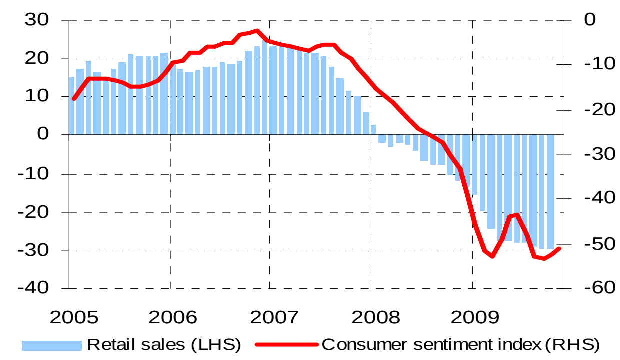
source: Ecowin Economic

A decline in retail sales growth rate, which was evident in Latvia since 2007 (retail sales growth rate was negative since the beginning of 2008), further deepened in 2009, especially in the first quarter. Following a decline in retail sales in Latvia to nearly -30% y/y in April 2009, in the subsequent months the downward trend stopped. However, no improvement has been noticed.

A different situation occurred in the case of indicator of consumer sentiment. After a period of increase in Q2 2009, in Q3 they fell to the levels observed at the beginning of the year. A development of the index in 2009 was mainly affected by a change in the current and expected financial situation of households and a change in their savings over the next 12 months.

Figure 6.2

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

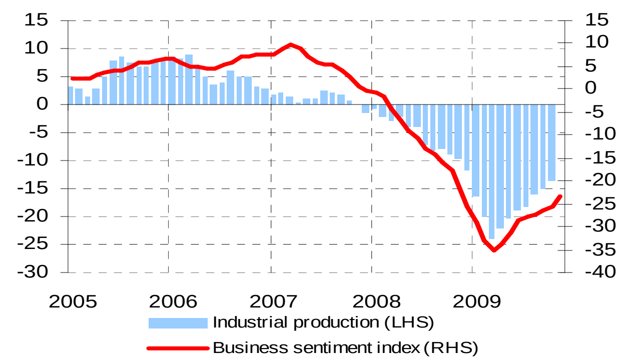


source: Ecowin Economic

The industrial output growth rate in Q1 2009 was also decreasing (to -24% y/y). The value of industrial production fell in all sectors, with the greatest decreases in the manufacture of textiles, machinery and equipment and vehicles (a decrease of more than 50% y/y). Since Q2 2009 the industrial output started to increase (however its annual growth still remained negative, -15% y/y in September). The greatest improvement in the analysed period was recorded in manufacturing, in particular in the manufacture of textiles and wood products.

Figure 6.3

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



source: Ecowin Economic

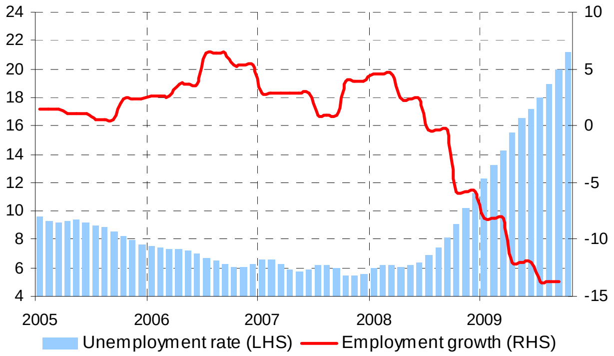
In Q1 2009 business sentiment indicators in Latvia continued their downward trend observed in two previous years, reaching their all-time lows. Since Q2 2009 the business optimism started to increase mainly owing to sub-indices depicting current and expected trends in production and an expected increase in employment over the next 12 months.

Labour market

The crisis in the Latvian economy also affected the labour market. In the last four quarters the unemployment rate increased dramatically and in October 2009 it reached 14.1% compared with less than 5% in mid-2008.

The pace of employment decline, which was the highest in the region, also increased in 2009. In Q3 2009 the number of the employed fell by more than 15% y/y in comparison with nearly 5% increase at the beginning of 2008. Employment fell in all sectors of the economy. The highest decline was recorded in construction (-35% y/y), public administration[13] (-20%) and manufacturing (-14%). The decrease in the number of the employed in Latvia was also accompanied by a reduction in the average number of working hours[14].

Figure 6.4
Unemployment rate (in %) and employment growth rate (in %, y/y)

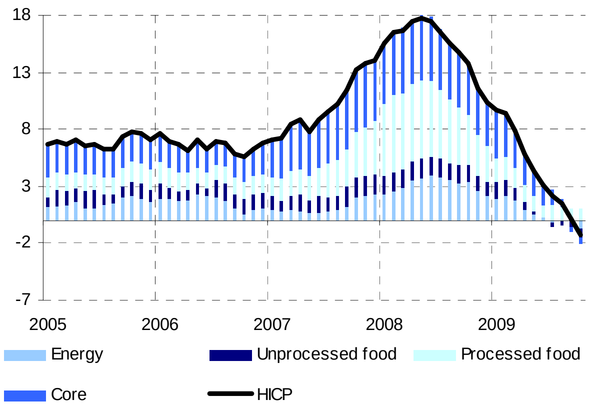


source: Ecowin Economic

Inflation and labour costs

A decline in inflation in Latvia in 2009 was the highest in the region. Between January and September 2009 the annual growth rate of the harmonised index of consumer prices fell from 9.7% to -1.2%. Due to such a significant decline, inflation in Latvia fell to the lowest (apart from Estonia) level among CEE countries, from the highest level in the region in 2008.

Figure 6.5
HICP and its components (in pp, y/y)



In 2009 the growth of nearly all price categories slowed down[15]. Prices of food, housing (mainly electricity, gas and heating) and fuels were main factors behind a decline in inflation. A decrease in core inflation (from 4.2% in January to -0.6% in October 2006) was mainly related to a collapse of consumption in Latvia in 2009.

Table 6.2
HICP and its components (in pp, y/y)

	Q4 2009	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**11.9**	**9.0**	**4.5**	**1.2**	**-1.2**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	2.0	1.3	1.3	1.5	1.5
Health	0.5	0.7	1.1	0.9	0.9
Miscellaneous	0.5	0.4	0.3	0.2	0.2
Education	0.3	0.3	0.3	0.3	0.1
Recreation and culture	0.5	0.5	0.4	0.3	0.1

source: Ecowin Economic

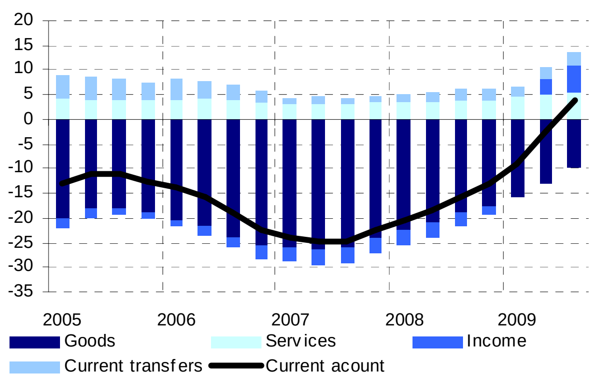
An upward trend in nominal wages in Latvia reversed in the first half of 2009. While in 2008 wages still grew at more than 20% a year, in Q3 2009 they decreased by 6.4%. The above decrease was caused mainly by reductions of wages in the public sector which in Q3 fell by nearly 13% on the average (17% in the general government sector).

A decline in wages growth combined with a decrease in the employment triggered a further, very fast decrease in unit labour costs which was not "compensated" by a fall in the productivity. In 2008 the ULC growth rate was still the highest in the region and in Q3 2009 it fell below 0%, becoming the lowest among CEE countries.

Balance of payments

A decrease in the current account deficit in Latvia in recent quarters was the highest in the CEE region. Current account deficit, which reached as much as 25% of GDP in mid-2007, decreased to 2.2% of GDP in Q2 2009[16]. Decreasing deficit in trade in goods and a surplus in the income account were the main factors behind the decline in deficit.

Figure 6.6
Current account balance and its components (in % of GDP, 4q moving average)



The value of Latvian foreign trade in 2009 decreased significantly. This was related both to exports (-26.5% y/y in the first three quarters of 2009), and in particular to imports (-41.1%). The largest decreases were recorded in exports of

[13] A decrease in the public administration is a part of the savings plan related to granting international aid to Latvia.
[14] In Q2 2009 the number of full-time employees fell by more than 25%. The largest decreases were recorded in construction (by 50%) and manufacturing (by 33%).
[15] Since March, the growth of prices related to health protection increased due to the introduction of administrative charges for certain hospital services.

[16] Those figures refer to the 4Q moving average. Taking into account data that were not adjusted for seasonality, the balance on the current account in Latvia in Q2 2009 showed a surplus of 14% of GDP.

metals, iron and steel in particular, and wood products, which constitute the most important groups of goods in Latvian exports. At the same time, a weakening domestic demand contributed to a decline in imports, in particular of machinery and equipment and vehicles.

Figure 6.7

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

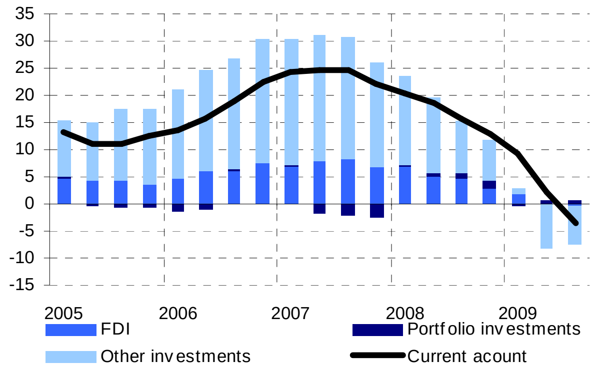


Table 6.3

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

	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
Current account	**-18.5**	**-15.2**	**-12.6**	**-8.8**	**-2.1**
Goods	-20.3	-18.3	-17.0	-15.3	-12.8
Services	3.5	3.6	4.0	4.7	5.1
Income	-3.4	-3.0	-1.9	-0.5	3.0
Current transfers	1.7	2.4	2.2	2.3	2.6
Capital account	**0.8**	**0.9**	**0.6**	**0.6**	**0.9**
Financial account	**17.0**	**13.9**	**13.1**	**8.0**	**0.8**
FDIs	4.9	4.4	3.4	2.0	0.3
Portfolio investments	0.8	1.2	0.7	-0.9	0.1
Other investments	13.8	9.7	7.3	1.0	-8.3

source: Ecowin Economic

At the same time, the inflow of foreign capital decreased. An inflow of other investments, which were the basic source of financing for deficit on the current account in Latvia since 2005, suffered the most. In Q2 2008 their outflow of 8.2% of GDP was even recorded. A decline in the inflow of other investments was mainly due to: a decrease in foreign trade volume (smaller inflow of trade credits) and reduction in the bank credit (smaller inflow of foreign loans to the banking sector).

Similarly to other Baltic countries, in recent years the Latvian economy has been highly dependent on the inflow of foreign capital. An insufficient inflow of foreign capital led to the destabilisation of the financial sector in Latvia, making it necessary to apply for aid to the International Monetary Fund[17]. Disbursement of loan tranches was dependent on stabilisation of the public sector (in particular limiting general government deficit for 2009-2010)[18]. The international aid granted to Latvia so far did not contribute significantly to the improvement of the economic situation in the first half of the 2009. However, taking into account the fact that payments were made mainly in Q2 2009, its effects are yet to be seen.

Interest rates

The information on a potential devaluation in Latvia and negotiations with IMF on further loan tranches disbursement had a significant impact on the interest rates on the Latvian inter-bank market. It led to a fast and temporary increase in interest rates on the inter-bank market which expired in subsequent months. Such situation occurred in March, June and October, reflecting harsh negotiations of the Latvian government with IMF on disbursing additional loan tranches, especially the problem of the fiscal policy tightening. The speculations on the potential Latvian lat. devaluation also had an impact on interest rate developments. In March 2009 3M Rgibor increased to 12.5% from 9.5% in February. In June the highest increase in interest rates was recorded when 3-month inter-bank rate temporarily reached nearly 30% as compared to 13% in May as a result of unsuccessful auction of treasury bonds. Another increase in interest rates in October 2009 was lower (14% in mid-October compared with 12% at the end of September). In the following months a decline in short-term interest rates in Latvia was observed to nearly 10% at the beginning of December 2009.

Real interest rates also increased as a result of an increase in nominal rates and a fast decline in inflation. In 2009 both nominal and real interest rates on the Latvian inter-bank market were the highest in the CEE region and the entire EU[19].

In 2009 effective exchange rates in Latvia were similar to rates in other Baltic countries. NEER did not practically change since the beginning of the year, while CPI deflated REER depreciated as a result of a fast decline in inflation.

Fiscal policy

In face of a considerable decrease in GDP, problems with financing the current account deficit and excessively expansive fiscal policy before the crisis, at the end of 2008 Latvia applied to the European Union and the International Monetary Fund for a financial aid. Financial support of EUR 7,5 billion was granted on the condition of, inter alia, introducing adjusting actions resulting in keeping the budget deficit below 5% of GDP in 2009 and 3% of GDP in 2011. The deterioration of the economic situation in 2009 which turned out to be worse than originally expected and in the end the above requirements were loosen. General government deficit should not exceed 10% of GDP in 2009 and 8.5% of GDP in 2010.

Activities undertaken by Latvia at the end of 2008 and in 2009 to prevent an increase in the general government deficit include increases in taxes[20] (VAT – from 5% and 18% to 10% and 21%, excise duty, tax on games, reduction of

[17] IMF which in December 2008 decided to grant a loan to Latvia of EUR 1.7 billion. The programme was also supported by the European Union (EUR 3.1 billion), World Bank (EUR 0.4 billion) as well as Scandinavian countries, Poland, Czech Republic and Estonia (in total EUR 2.3 billion). In the coming three years, Latvia will receive EUR 7.5 billion in total as aid to stabilise its economy.

[18] Delays in the accomplishment of this goal caused a postponement of the drawdown of a loan tranche (EUR 195 million) from March to August 2009. In 2009 Latvia received from IMF and EU EUR 1.4 billion in total.

[19] At the beginning of December 2009 nominal interest rates in Latvia fell to the lower level than in Romania.

[20] PIT rate was decreased (from 25% to 23%).

the tax-exempt amount), increase in proceeds from dividends and significant expenditure cuts. In 2009 reductions covered: expenditure on public sector wages (twice by 15% and 20%), maternity benefits as well as pension and disability benefits (by 10%, in the case of working beneficiaries by 70%) and family allowances if parents work (by 50%). In May 2009 the amount of a contribution transferred to the capital portion of the pension system was reduced (from 8% to 2% of a salary in 2009 and 2010. In 2011 this contribution is to be 4% and starting in 2012 – 6%).

The European Commission expects that in 2009 the general government deficit will amount to 9% of GDP and in 2010 and 2011 – approximately 12% of GDP. The above estimates do not take into account a draft budget act for 2010 which was prepared under the assumption that conditions for granting the international aid to Latvia are satisfied (actions reducing the deficit by 4.2 p.p. of GDP). The 2010 draft budget act provides for, inter alia, introduction of real estate tax, elimination of certain tax relieves and further reduction of employment in the public administration. The government does not exclude the necessity to introduce additional changes in respect of income as part of the 2010 draft budget act.

In July 2009 Latvia was covered by the excessive deficit procedure. The deficit is to be adjusted below 3% of GDP by 2012, which will require serious adjustments in subsequent years (approximately 2.75% of GDP annually).

The EC projects more than threefold increase in Latvian public debt from 19.5% in 2008 to 60.4% in 2011. The figures may increase due to, among others, the risk related to the situation on the domestic financial market.

Forecasts

October and November forecasts still show that in 2009 and 2010 Latvia will be the country most seriously affected by the global crisis. GDP is expected to fall by 18% in 2009 and further 4% in 2010. A decline in domestic demand, individual consumption in particular, will remain the main cause of a recession. In the recent couple of months, forecasts for real GDP growth, in particular for 2009, worsened significantly due to a higher than expected decrease in GDP in the first half of the year.

Similar to other Baltic countries, a further strong decline in inflation is expected in Latvia in 2009 and 2010. In 2010 Latvia is to experience the largest decrease in prices in the region.

In recent months forecasts for the current account balance have changed considerably. Due to a fast-growing surplus on the current account in the first half of the year, latest forecasts show a high surplus in 2009 and 2010 (approximately 4.5-7.5% of GDP in 2009 and 2010) instead of deficit previously forecasted deficit.

Table 6.4

Forecasts of main indicators

	MF	EC	IMF
	10.2009	10.2009 (04.2009)	10.2009 (04.2009)
GDP, in %, y/y			
2009	-18.0	-18.0 (-13.1)	-18.0 (-12.0)
2010	-4.0	-4.0 (-3.2)	-4.0 (-2.0)
2011	2.0	2.0	1.5 (1.4)
CPI, in %, y/y			
2009	3.5	3.5 (4.6)	3.1 (3.3)
2010	-3.7	-3.7 (-0.7)	-3.5 (-3.5)
2011	-2.8	-1.2	-2.5 (-0.8)
Current account balance, in % of GDP, y/y			
2009	6.3	6.8 (-1.5)	4.5 (-6.7)
2010	8.8	5.4 (-1.9)	6.4 (-5.5)
2011	8.4	3.4	5.1 (-5.5)

MF – Ministerstwo Finansów Republiki Łotewskiej

Box 1

Changes in external imbalances structure

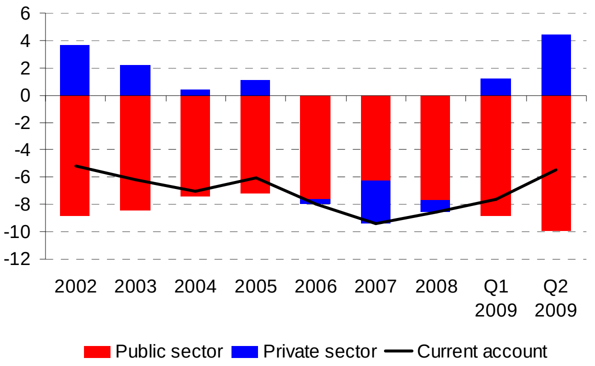
Between 2005 and 2007 Central and Eastern European (CEE) countries experienced a very high increase in external imbalances. The current account deficit (4Q moving average) widened from approximately 4% of GDP in 2005 to nearly 8% of GDP two years later. This trend reversed in mid-2008 as a result of crisis escalation.

One of the symptoms of the global economic crisis was a decrease in external imbalances. This situation was also present in CEE countries. In Q2 2009 the current account deficit in CEE countries decreased to 4.6% of GDP. The highest fall in deficit was recorded in the Baltic states. Since the end of 2007 until the first half of 2009 the deficit decreased from nearly 19% of GDP to 3% of GDP.

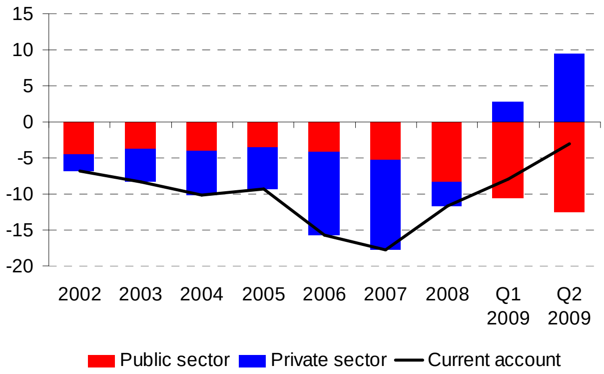
A common feature of CEE countries (excluding Baltic states) was the fact, that in most of them imbalances were generated by the public sector. The private sector did not generate external deficit and in the case of numerous countries it even produced surpluses[21]. A different situation was in the Baltic countries. In Estonia, Lithuania and Latvia external imbalances were generated by both the private and public sectors. In addition, between 2005 and 2007, i.e. the period of the highest increase in current account deficits in those countries, this increase appeared to result from growing private sector imbalances. The public sector deficit was quite stable and all the time lower than the average for the entire region.

External imbalances structure

CEE countries



Baltic states



source: Eurostat, EcoWin Economic, own calculations

In the second half of 2008 and in particular at the beginning of 2009 the fall in external imbalances in the region was also accompanied by a change in their structure. A narrowing of current account deficits was caused solely by their decrease in the private sector. In addition, apart from Bulgaria and Romania, the deficit in this sector was replaced by a surplus in Q1 2009. However, a deteriorating fiscal stance (a fast increase in public sector deficits) resulted in a majority of the countries in the region in an increased share of imbalances generated by public sector. Hungary was an exemption due to its policy of tightening the public finance implemented since 2006. A decrease in Hungarian external imbalances was noticeable in both the private and public sectors.

The change in external imbalances structure was particularly evident in the Baltic countries. The contribution of the public sector imbalances to current account deficit formation increased twofold (from 5.3% of GDP to 10.7% of GDP on the average) between 2007 and 2009. At the same time, the share of the private sector generated deficit fell by more than 15 pp. of GDP (from -13% to 3% of GDP in the analysed period). Thus, the structure of the formation of external imbalances in the Baltic countries resembled the structure observed currently and in previous years, in other countries of the region.

[21] The current account balance was treated as the difference between savings and investments, both in the public and private sector.

Struktura salda na rachunku obrotów bieżących (in % of GDP)

		2002	2003	2004	2005	2006	2007	2008	Q1 2009	Q2 2009
Bulgaria	Current account	-2.4	-5.5	-6.6	-12.4	-18.4	-25.2	-25.4	-23.5	-19.7
	Public sector	-3.6	-3.1	-1.3	-2.3	-1.2	-4.7	-3.8	-5.3	-9.9
	Private sector	1.2	-2.4	-5.2	-10.1	-17.2	-20.5	-21.5	-18.2	-9.8
Czech Republic	Current account	-5.5	-6.2	-5.3	-1.3	-2.4	-3.2	-3.1	-3.4	-2.7
	Public sector	-10.6	-11.1	-7.8	-8.5	-7.6	-5.4	-6.9	-7.9	-9.0
	Private sector	5.1	4.9	2.5	7.1	5.2	2.2	3.8	4.5	6.3
Estonia	Current account	-10.6	-11.3	-11.3	-10.0	-16.9	-17.8	-9.4	-5.8	-2.2
	Public sector	-5.0	-2.7	-2.1	-2.3	-2.4	-2.6	-8.1	-10.1	-11.8
	Private sector	-5.6	-8.6	-9.2	-7.6	-14.5	-15.2	-1.3	4.3	9.6
Lithuania	Current account	-5.1	-6.8	-7.7	-7.1	-10.6	-14.5	-11.9	-8.0	-4.0
	Public sector	-4.7	-4.3	-5.0	-4.0	-4.6	-6.2	-8.2	-10.3	-12.3
	Private sector	-0.4	-2.5	-2.7	-3.1	-6.1	-8.3	-3.8	2.4	8.3
Latvia	Current account	-6.6	-8.1	-12.9	-12.5	-22.5	-22.3	-13.0	-9.1	-2.2
	Public sector	-3.5	-3.9	-4.1	-3.5	-5.1	-6.0	-8.9	-11.3	-13.1
	Private sector	-3.1	-4.2	-8.8	-9.0	-17.4	-16.3	-4.1	2.1	10.9
Poland	Current account	-2.8	-2.5	-4.0	-1.2	-2.7	-4.7	-5.0	-4.0	-2.9
	Public sector	-8.4	-9.6	-9.1	-7.5	-7.5	-6.1	-8.1	-9.5	-10.3
	Private sector	5.6	7.0	5.2	6.3	4.8	1.4	3.1	5.5	7.4
Romania	Current account	-3.4	-5.9	-8.3	-8.6	-10.4	-13.5	-11.8	-10.1	-7.3
	Public sector	-5.3	-5.0	-4.3	-5.0	-7.4	-8.1	-11.1	-12.0	-12.8
	Private sector	1.9	-0.9	-4.1	-3.6	-3.0	-5.4	-0.7	1.9	5.5
Slovakia	Current account	-6.9	-5.4	-6.7	-6.4	-7.0	-4.7	-5.8	-6.2	-5.0
	Public sector	-11.5	-5.4	-4.8	-4.9	-5.7	-3.7	-4.3	-4.6	-5.8
	Private sector	4.7	0.0	-2.0	-1.5	-1.3	-1.0	-1.5	-1.7	0.8
Slovenia	Current account	1.1	-0.8	-2.7	-1.7	-2.5	-4.8	-6.2	-5.6	-3.9
	Public sector	-5.4	-5.9	-5.7	-4.6	-5.0	-4.2	-6.1	-7.4	-9.1
	Private sector	6.5	5.1	3.0	2.9	2.5	-0.6	0.0	1.7	5.2
Hungary	Current account	-7.0	-7.9	-8.3	-7.2	-7.4	-6.8	-7.1	-6.5	-4.7
	Public sector	-13.9	-10.6	-10.0	-11.9	-13.9	-8.5	-6.4	-6.9	-7.1
	Private sector	7.0	2.6	1.7	4.7	6.5	1.7	-0.7	0.4	2.4

source: own calculations based on Eurostat, EcoWin Economic data

POLAND

Economic growth

Poland was the only country of Central and Eastern Europe and also European Union, which recorded a positive economic growth in the first three quarters of 2009. The continuation of the economic growth under strong external recession trends surrounding the Polish economy was determined on one hand by a lower exposure to external shocks (as reflected by a lower share of foreign trade in GDP in comparison with other countries of the region) and on the other, by a lower importance of loans in financing household consumption (mitigating effects of a strong reduction in the lending activity).

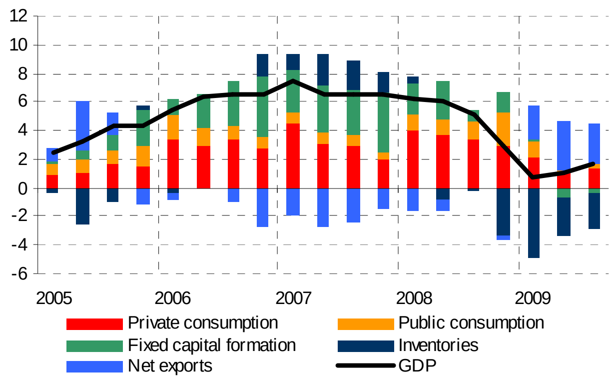
The continuation of the economic growth was surprising also to international institutions. In the first half of the year unanimously forecast a decrease in gross domestic product in Poland in 2009.

Nonetheless, Poland recorded a considerable decrease in GDP growth in comparison with the same period of 2008. Between January and September 2009 gross domestic product increased in Poland by 1.2% (compared with a 5.8% increase in Q1-3 of the previous year).

The most considerable slowdown in the economic activity was recorded in Q1 2009. During that period GDP increased by only 0.8% y/y, which was the lowest result since 2002[22]. However, in subsequent quarters the economic growth accelerated.

Figure 7.1

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



GDP growth decline was influenced by all main categories of domestic demand. Especially a decrease in capital formation had a strong adverse impact on GDP. This was a result of a decline in both fixed capital formation and inventories. However, a decrease in investments in Poland was definitely lower than in other CEE countries. A fall in investments in the enterprise sector and construction was partially compensated by an increase in capital expenditures of the general government sector. The process of adjusting to the low economic activity also contributed to a deep reduction in companies' inventories, causing a highly negative contribution of the change in inventories to GDP growth.

Table 7.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**6.8**	**5.0**	**0.8**	**1.1**	**1.7**
Private consumption	4.9	5.9	3.3	1.7	2.2
Public consumption	3.7	7.5	5.7	0.9	1.5
Fixed capital formation	17.6	8.2	1.0	-3.0	-1.5
Exports	9.1	7.1	-13.3	-13.9	-9.5
Imports	13.7	8.0	-17.2	-19.9	-14.9

source: Ecowin Economic

A growth in private consumption was the highest in the region. It was also very important for maintaining positive GDP growth in Poland. Household expenditure has been increasing despite a deteriorating situation on the labour market, a decline in disposable income growth and restricted access to loans.

The most important driver of the economic growth in the first three quarters of the year was, similarly to other countries of the region, net exports. Its positive contribution to GDP growth resulted from stronger decline in imports than in exports. Such situation took place despite a higher weakening in domestic, rather than foreign, demand. A strong decline in imports was related on one hand to the satisfaction of current demand by reducing inventories and on the other to reduced competitiveness of imported goods and services caused by a strong zloty depreciation. A decrease in exports was lower owing to their structure, under which consumption goods, demonstrating a lower volatility of demand growth, are of greater importance. In addition, subsidies to purchases of new cars introduced in some EU countries had a positive impact on the exports growth. A certain recovery of the economic activity in Western European countries also contributed to a decrease in exports and imports declines in Q3 2009. On a quarterly basis, an increase in imports in Q3 2009 (by 4.8%) turned out to be stronger than an increase in exports (by 2.3%), mainly due to an increase in demand of the exports sector and zloty appreciation.

Weakening consumption demand was reflected in a decline of retail sales growth. Between January-September 2009 it increased by merely 1.9% y/y in real terms (compared with an 11.5% increase in 2008). Nonetheless, Poland is the only country in the region which records an increase in sales in 2009. However, in October 2009 retail sales rose by only 0.7% y/y, which may indicate that a low growth of consumption expenditure is to continue also in Q4 2009. A deepening decline in sales of cars and consumer durable goods were the main contributors to the growth decrease at the beginning of Q4 2009. However, the annual growth in sales of food and non-durables remained at a relatively high level.

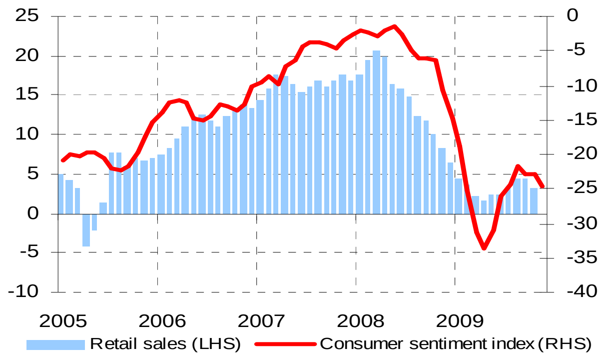
The NBP sentiment survey shows however an improvement in expectations concerning future changes in the financial situation of households as well as changes in the overall economic situation of the country. Households also better

[22] On a quarterly basis a negative economic growth was recorded in Q4 2008 when GDP fell by 0.1% in comparison with Q3 2008.

perceive possibilities of making important purchases in the next 12 months.

Figure 7.2

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

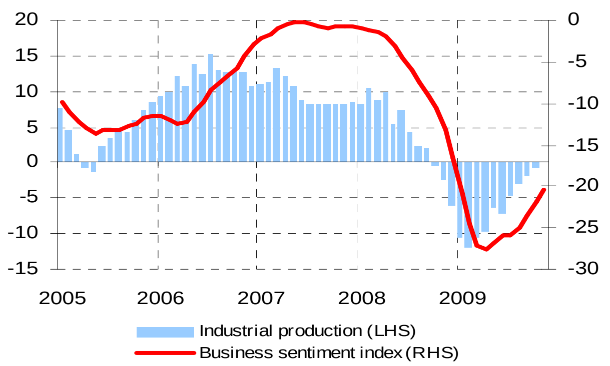


source: Ecowin Economic

Much lower decrease in industrial output also indicates a lower impact of the deteriorating external demand on the Poland's economic situation. Even if declines in export production were similar to declines in other countries (as indicated by exports data), an increase in production for the domestic market in Poland highly compensated decreases in external demand. Between January and September 2009, industrial production in Poland decreased by 16.0% y/y. A progressing recovery on Poland's most important export markets was accompanied by weakening production declines (in Q3 industrial output was lower by 2.3% in comparison with the previous year). At the beginning of the year the largest decreases in production were recorded in sectors export oriented sectors. On the other hand, monthly changes in industrial output in September and October 2009 also demonstrated the highest improvement in those sectors. Apart from external demand, rebuilding of inventories also contributed to the increase in production.

Figure 7.3

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



source: Ecowin Economic

Results of NBP survey on show that in Q3 2009 signals of an improvement in the economic situation in the business sector, which started to appear in Q2 2009, strengthened. However, the investment activity still oscillates around its all-time lows. A low demand and exchange rate fluctuations remained the main problem of the business sector (despite a significant improvement). A certain improvement was recorded in employment plans, however the number of companies which intend to reduce the number of employees is still higher than those intending to increase employment.

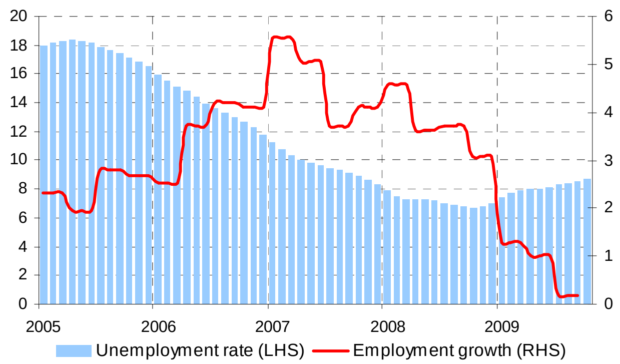
Labour market

The decline in economic growth was reflected in the situation on the labour market which started to deteriorate from Q4 2008. The unemployment rate in Poland reached its peak in March 2009 - 11.2%. In subsequent months, it decreased again, mainly owing to seasonal factors. However, at the beginning of Q4 2009 the unemployment rate grew again to 11.1%. At the same time, higher employment reductions (in October 2009 employment fell by 2.4% y/y) may indicate that in the nearest future the situation on the labour market is to further deteriorate.

In 2009 (until October 2009) employment fell by 107 thousand people in total. The highest decrease in employment was recorded in manufacturing (due to a decline in employment in the automotive, metal and machinery industry) and in trade and transport services. Decreasing demand for labour was also reflected in the reduction of the number of hours worked.

Figure 7.4

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



source: Ecowin Economic

Inflation and labour costs

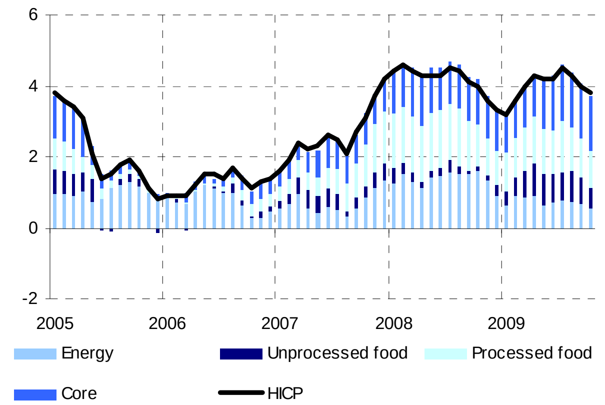
Inflation in Poland in 2009 is one of the highest in the region, alongside Romania and Hungary. Until July 2009 (when HICP reached its 2009 peak) it followed an upward trend, mainly due to increases in regulated prices, including prices of energy and housing. At the same time, prices of tobacco products and alcoholic beverages grew due to an increase in excise duty rates. Other factors which contributed to the high inflation included: strong zloty depreciation in the second half of 2008 and at the beginning of 2009 and a growth of prices of services related to a relatively strong consumer demand.

Since August 2009 a downward trend in inflation has been however observed. In October 2009 HICP fell to 3.8% as a result of a decrease in the annual growth of prices of food and fuels as well as lower prices of natural gas for households introduced in June 2009. Zloty appreciation additionally contributed to a decrease in prices of imported goods.

A stabilisation of core inflation in the second half of 2009, after its significant increase in previous months, may indicate that the existing weakening of demand did not fully neutralise an increase in regulated prices, excise duty rates and effects of the earlier depreciations of the exchange rate.

Figure 7.5

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



In 2009 wage growth in the enterprise sector slowed down considerably. Between Q1 and Q3 2009 the nominal wagess growth rate amounted to 4.7% (compared with 10.2% in Q1-Q3 2008), while real growth amounted to 1.2% (5.6%). The increase in wages resulted mainly from a higher employment reduction in the group of employees with lowest qualifications and thus lower paid. In case of employees with relatively higher qualifications and salaries reductions were lower.

The decline in wage growth in the first three quarters of 2009 was stronger than a decrease in the labour productivity, causing a fall in the growth of unit labour costs in Poland. In Q3 2009 it was 1.9% y/y in comparison with 8.8% y/y in 2008.

Table 7.2

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

	Q4 2009	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**3.6**	**3.6**	**4.2**	**4.3**	**3.8**
Contribution to HICP growth rate (in pp)					
Housing	1.8	1.8	1.6	1.3	1.0
Food and non-alcoholic beverages	0.7	0.9	1.2	1.1	0.8
Alcoholic beverages and tobacco products	0.7	0.8	0.9	1.0	0.8
Miscellaneous	0.3	0.3	0.5	0.7	0.7
Recreation and culture	0.0	0.1	0.2	0.2	0.2

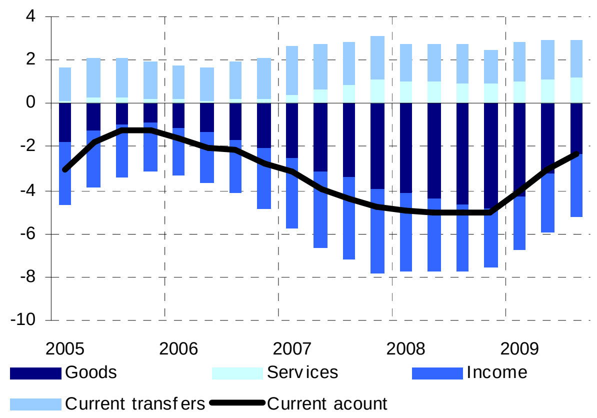
source: Ecowin Economic

Balance of payments

Current account deficit decreased strongly in the first half of 2009, mainly due to a significant limitation of the deficit in trade in goods. It was related to a decrease in Polish imports (by 30.9% y/y), higher than in exports (by 23.5% y/y). Income deficit also decreased significantly (by 13.2% y/y). Consequently, after Q2 2009 current account deficit in relation to GDP decreased to 2.9%, which means an improvement against 2008 by 2.1 pp.

Figure 7.6

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



It seems that the decrease in exports was lower than the decrease in imports due to structural factors – a lower share in exports of intermediate goods (53% in 2008, while their share in imports was 63%) and a higher share of consumer goods (34% versus 20%). In addition, the structure of car exports is dominated by small models for which demand strongly increased after some EU countries introduced subsidies to purchases of new cars. The downward trend in exports was also mitigated by an increase in production under new investment projects (as demonstrated by a strong growth in production and exports of computers).

Table 7.3

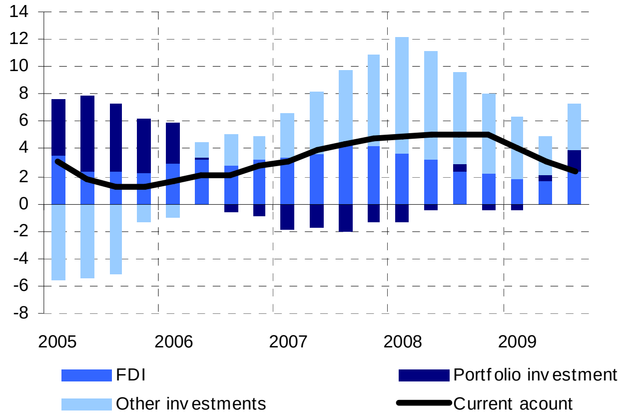
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-5.0**	**-5.0**	**-4.0**	**-2.9**	**-2.0**
Goods	-4.6	-4.9	-4.3	-3.2	-2.2
Services	1.0	1.0	1.1	1.1	1.3
Income	-3.1	-2.6	-2.5	-2.7	-2.8
Current transfers	1.7	1.5	1.7	1.8	1.7
Capital account	**0.5**	**0.3**	**0.1**	**0.1**	**0.1**
Financial account	**9.4**	**7.4**	**5.3**	**4.4**	**6.4**
FDIs	2.3	2.2	1.8	1.7	1.8
Portfolio investments	0.6	-0.5	-0.5	0.4	1.6
Other investments	6.7	5.9	4.6	2.8	3.5

source: Ecowin Economic

In the first half of 2009, a significant decline in current account deficit was accompanied by a considerably lower inflow of capital to Poland in the form of credits (including trade credits) and loans than in the same period of 2008 (a decrease by 87.9%). The value of direct investments in Poland in the first two quarters of 2009 was lower by 43.7% than a year ago (versus a decrease by more than 50% y/y in the second half of 2008). The inflow of FDIs was relatively strong mainly thanks to high reinvested profits, reflecting good financial results of Polish companies. As far as foreign portfolio investments are concerned, a nearly twofold increase in their balance was recorded as a result of a high demand of non-residents for debt treasury securities.

Figure 7.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Fiscal policy

The European Commission estimates that the general government deficit in Poland will grow from 3.6% of GDP in 2008 to 6.4% of GDP in 2009. The increase in the fiscal imbalance was caused by the automatic stabilisers of the economic situation and the introduction of tax changes in 2009 (mainly reduction of PIT rates).

In July 2009 an amendment to the budget act was adopted which increased the deficit of the state budget by PLN 9.0 billion. The income projection was revised and expenditure (mainly current and property expenditure) was cut. In addition, expenditure on the road construction (approximately PLN 9.9 billion) were moved from the state budget to the National Road Fund, however this change does not affect the general government deficit under EU methodology. Despite adjusting actions undertaken for the state budget, due to the deterioration of the situation of local governments and social insurance funds, the deficit of the general government sector in 2009 is to increase (from 3.9% of GDP to 6.6% of GDP).

The EC expects further increase in the Poland's fiscal deficit in subsequent years. In 2010 it is to reach 7.5% of GDP due to, inter alia, an increase in social transfers and expenditure on public debt servicing. In addition, the draft budget act for 2010 does not provide for activities consolidating the public finance. The general government deficit is expected to remain in 2011 at a high level (7.6% of GDP).

In July 2009 Poland was covered by the excessive deficit procedure. The deadline to reduce the public finance deficit to below 3% of GDP was set for 2012. The EU Council also recommended that necessary fiscal adjustments should start in 2010 and the average annual reduction of the structural deficit by 2012 be not less than 1.25 pp. of GDP. The Council indicated, inter alia, the need to enhance control and improve the effectiveness of expenditure as well as to conduct reforms of the pension and social security system. In January 2010 the government is to present in the Convergence Programme Revision a plan of reducing the budget deficit.

In the period covered by the forecast, the public debt in relation to GDP will increase in Poland considerably and will exceed 60% of GDP (61.3% of GDP in 2011 versus 47.2% in 2008). The EC indicates a risk for debt forecasts due to a high volatility of the exchange rate.

Interest rates and foreign exchange rate

After three consecutive interest rate cuts in Q1 2009 (by 125 basis points in total), in June 2009 the Monetary Policy Council cut the reference rate again by 25 basis points to 3.50% and maintained interest rates at the same level in subsequent months. The interest rate cut in June 2009 was followed by a reduction of inter-bank market rates. 3M Wibor decreased from the average level of 4.60% in June 2009 to 4.09% in November 2009.

Until mid-February 2009 the nominal PLN exchange rate had been following a depreciation trend against US dollar and euro which started in July 2008. The PLN depreciation was caused mainly by global factors, including a continued high risk aversion leading to the outflow of foreign capital from emerging markets. Since February 2009 PLN exchange rate started to gradually stabilise, however it still underwent changes within a relatively broad volatility band. Factors contributing to a high volatility of the PLN exchange rate include first of all: negative information from the Poland's external environment (including downgrades of Latvia and Estonia ratings by Standard & Poors) and expectations of deterioration of the public finance situation in individual countries in 2010. Since August 2009 zloty started to appreciate in particular as a result of a decrease in risk aversion as well as positive macroeconomic data indicating a gradual recovery in the global economy.

Forecasts

According to European Commission forecasts, Poland will be the only country to record the economic growth in 2009. In 2010 and 2011 the economic growth in Poland will be also one of the highest in the region.

In subsequent months of 2009 economic growth forecasts for Poland were revised upward. According to the October projection of the National Bank of Poland, in 2009 GDP will increase by 1.3% (versus 0.4% increase assumed in June 2009 projection). NBP expects that in 2010 the economic growth will accelerate to 1.8% mainly owing to a rebound of investment demand and rebounding of inventories. On the other hand the growth of private consumption is likely to remain at a low level due to expected worsening of negative trends on the labour market. A recovery in foreign demand is expected to be accompanied by an increase in trade of goods. A faster increase in imports (driven by an increase in investment demand and in demand of the exports sector for intermediate goods) than in exports will cause deterioration of the trade balance, thus affecting adversely the GDP growth. For this reason the deficit on the current account is expected to deepen in relation to GDP (from the expected 1.0% in 2009 to 3.4% in 2010).

The NBP projection indicates a gradual decline in inflation until Q3 2010. The consumption price growth in the next year will be materially influenced by a decreasing growth of food and energy commodities prices caused by the PLN appreciation and a lack of a distinct upward trend for energy and agricultural raw materials on global markets. Core inflation will also gradually decrease in line with a fading pressure from the labour market and continued low growth of import prices. The expected limitation of the possibility to further reduce labour costs by companies together with first distinct signals of a recovery on the labour market will stop a further decrease in all inflation categories in 2011.

Table 7.4

Forecasts of main indicators

	NBP	EC	OECD	IMF
	10.2009 (02.2009)	10.2009 (05.2009)	11.2009 (06.2009)	10.2009 (04.2009)
GDP, in %, y/y				
2009	1.3 (0.4)	1.2 (-1.4)	1.4 (-0.4)	1.0 (-0.7)
2010	1.8 (1.4)	1.8 (0.8)	2.5 (0.6)	2.2 (1.3)
2011	3.2 (3.4)	3.2	3.1	4.0 (4.0)
CPI, in %, y/y				
2009	3.4 (3.2)	3.9 (2.6)	2.9 (3.5)	3.4 (2.1)
2010	1.5 (2.1)	1.9 (1.9)	2.1 (1.8)	2.6 (2.6)
2011	2.1 (2.0)	2.0	1.8	2.7 (2.7)
Current account balance, in % of GDP, y/y				
2009	-1.0 (-5.1)	-1.9 (-4.7)	-1.7 (-3.5)	-2.2 (-4.5)
2010	-3.4 (-5.0)	-2.8 (-3.7)	-2.3 (-3.3)	-3.1 (-3.9)
2011	-4.7 (-4.6)	-3.2	-2.5	-3.3 (-3.8)

NBP – Narodowy Bank Polski

ROMANIA

Economic growth

In March 2009 Romania received a financial rescue package of EUR 20 billion from the International Monetary Fund, which limited to a certain extent the GDP decline that occurred in the first half of 2009. However, the prospects of the Romanian economy are still exposed to a high risk, in particular because the political situation destabilised (after a collapse of the government in October 2009).

In the first three quarters of 2008 Romania was still the fastest growing economy in the region. But starting from Q4 2008 the global crisis severely hit the Romanian economy. In the first three quarters of 2009 the gross domestic product fell by 7.4%.

In the first half of 2009 all categories of domestic demand declined (except for public consumption). Private consumption decreased due to a fast growing unemployment and a slowdown in the lending activity. In July 2009 the growth in loans for households, which was 70% in the previous year, fell to 10%. In addition, the strong depreciation of the Romanian leu contributed to an increase in debt of households which took loans in foreign currencies (those constitute approximately half of total loans).

Figure 8.1

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

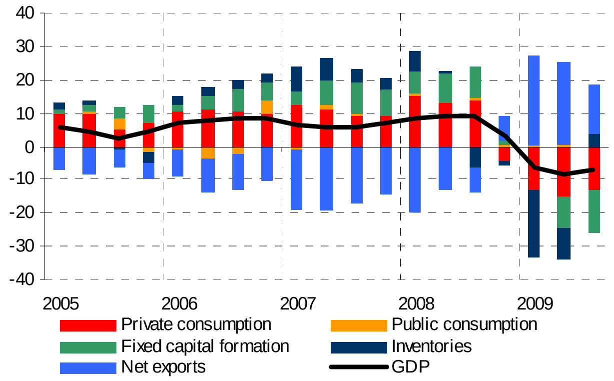


Table 7.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**6.2**	**7.1**	**-6.2**	**-8.7**	**-7.1**
Private consumption	11.7	9.2	-12.3	-15.0	-14.3
Public consumption	1.2	3.1	3.0	1.0	-0.4
Fixed capital formation	28.9	19.3	-0.3	-25.6	-28.6
Exports	7.8	18.9	-20.8	-12.0	1.9
Import	27.8	17.1	-33.3	-27.9	-15.5

source: Ecowin Economic

Due to a lower openness of the Romanian economy in comparison to the majority of the region's countries, the decline in external demand affected capital expenditures of companies with a certain delay. The growth of fixed capital formation already fell significantly at the end of 2008, however it decreased by ¼ as late as in Q2 2009. This situation was caused by a decrease in external demand and an increasing debt of Romanian companies.

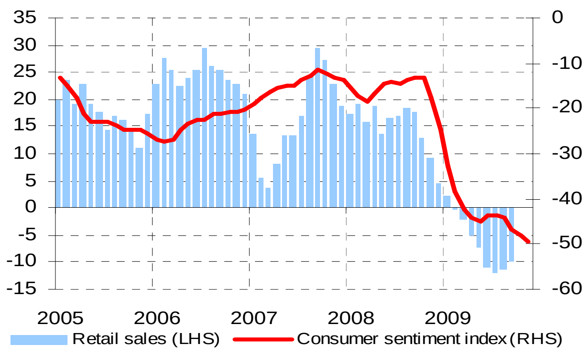
The decrease in consumption and investment demand was also reflected in a strong decline in imports (to much greater extent than in exports) and consequently net exports mitigated to a certain extent a strong fall in GDP. The only GDP category showing growth in the first half of the year was public consumption. However, due to its low importance and reduction of public expenditure by the Romanian government (in order to meet requirements concerning the financial aid from IMF), its influence on the overall GDP growth turned out to be marginal.

An increase in exports in Q3 2009 (Romania was the only country to record a positive annual growth in exports) made the GDP decrease slightly lower than in the first half of 2009. Nonetheless, a continued strong decline in consumption expenditure and a deepening decrease in investments might indicate an intensification of the crisis in the Romanian economy.

Retail sales in Romania started to decline slightly later than in the majority of other CEE countries. The greatest decreases in retail sales were recorded in mid-2009 (by 15% in June 2009 y/y) and it was due to more restrictive lending conditions, a decrease in salaries growth and a deteriorating situation on the labour market. In addition, the decrease in demand for imported goods, in particular durable goods, was due to the increase in their prices, caused by a strong leu depreciation (which was more than 20% against euro between August 2008 and January 2009).

Figure 8.2

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

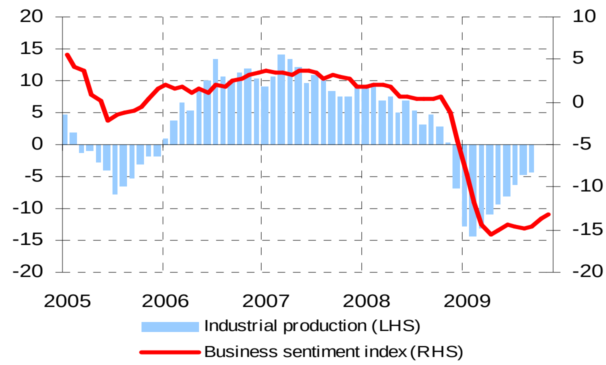


source: Ecowin Economic

The decline in retail sales was accompanied by a considerable deterioration in consumer confidence. Consumer confidence indicators have dramatically deteriorated since the beginning of the current crisis. As opposed to a majority of other countries, the consumer confidence index still decreased in the second half of 2009, reaching in September 2009 the lowest level since 2001, i.e. since it is published. It continues to fall mainly due to increasingly pessimistic expectations about the general economic situation of the country and the labour market. Taking into account forecasts indicating further potential increases in unemployment, consumer confidence can be expected to deteriorate further in the coming months.

After a strong decline in Q1 2009, the industrial output started to stabilise, owing to a certain improvement in external demand. The improvement in expectations concerning export orders and the adoption of the IMF anti-crisis programme were also reflected by a moderate increase in the business confidence. However, its still low level is strongly affected by a negative assessment of inventories and expectations about future prices. In addition, a growing dependence of companies on short-term financing has a negative impact on business sentiment. In the current bad financial situation of banks, companies fear problems with the roll-over of debt. Foreign banks declared that they will remain on the Romanian market and increase capital adequacy ratios from 8% to 10% during the term of the IMF rescue programme. This, however, did not contribute to an increase in lending, but increased the market's confidence that foreign banks will not withdraw from Romania.

Figure 8.3
Industrial production (in %, y/y) and business sentiment index

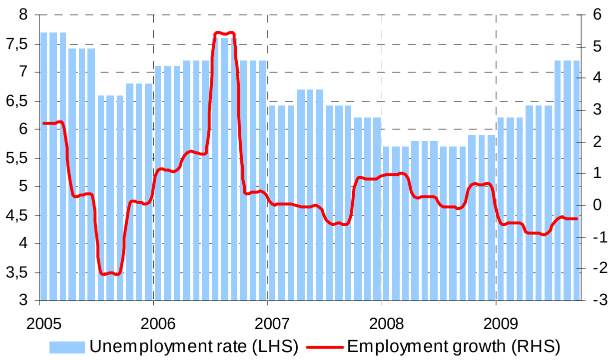


source: Ecowin Economic

Labour market

In September 2009 the unemployment rate in Romania increased to 7% - the highest level since 2004 (exceeding twice the average 2008 level). Taking into account the high impact of seasonal factors, the unemployment rate can be expected to continue to increase at the end of 2009 and at the beginning of 2010. The European Commission forecasts that it will increase to 9% at the end of 2009 and will remain at a similar level in the next two years.

Figure 8.4
Unemployment rate (in %) and employment growth rate (in %, y/y)



source: Ecowin Economic

This forecast is supported by the pessimistic sentiment of Romanian entrepreneurs and the introduction of limitations in employment in the public sector, imposed by the IMF. In addition, market tensions are intensified by work emigrants returning from other European Union countries.

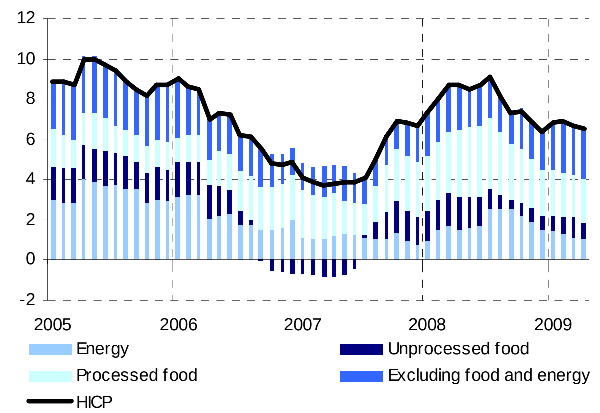
In comparison to September 2008, the highest decrease in employment was recorded in the industry and construction sector (by 16% y/y). On the other hand, the lowest decrease in employment was recorded in the hotel, trade, restaurants and in transport sectors (by 3% y/y). It seems that leu depreciation caused an increased interest in Romania as a travel target and that Romanian drivers replace more expensive drivers in richer European Union countries.

Inflation and labour costs

The decline in domestic demand, reduction of labour costs and energy prices caused the inflation downward trend to continue in the first three quarters of 2009. In October 2009 inflation measured by HICP fell to 4.9%, however it still remains the highest among European Union countries. The high inflation is mainly caused by a relatively high growth of food prices, costs of household keeping as well as alcohol and tobacco products.

The reduction of salaries in the public and private sector considerably affected the growth of unit labour costs in comparison with the previous year. According to Bank of Romania estimates, the growth rate of those costs, which in Q4 2008 was still at approximately 20%, fell in Q1 2009 to approximately 10% and in Q2 2009 it was less than 3%. The Bank of Romania expects that inflation will still decrease and at the end of this year it will be below the upper limit of the inflation target (3.5% +/-1%).

Figure 8.5
HICP and its components (in pp, y/y)



source: Ecowin Economic

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

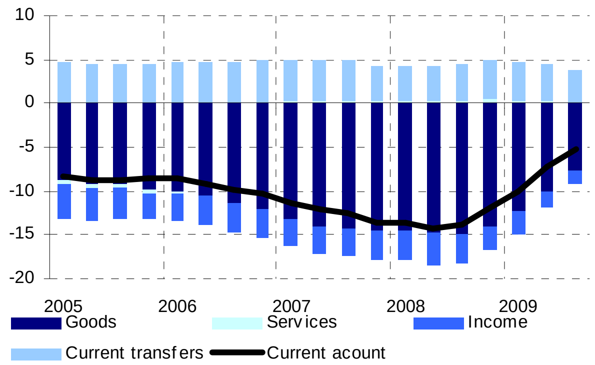
	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
HICP	**8.2**	**6.9**	**6.8**	**6.1**	**4.9**
Contribution to HICP growth rate (in pp)					
Food and non-alcoholic beverages	3.3	2.4	2.2	1.5	1.0
Housing	2.2	2.2	2.0	1.6	0.6
Alcoholic beverages and tobacco products	0.6	0.7	0.9	1.3	1.4
Communication	0.5	0.3	0.6	0.6	0.9
Recreation and culture	0.1	0.1	0.2	0.2	0.2

source: Eurostat

Balance of payments

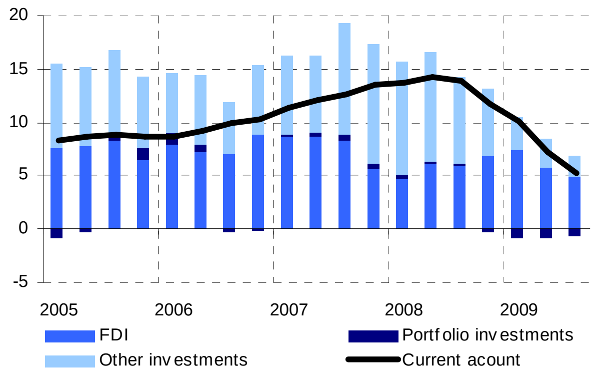
A high increase in consumption expenditure, stimulated by an easy access to loans and an expansive fiscal policy, led to a high deficit on the current account in the previous years. As in the case of other countries of the region, this deficit decreased in 2009. The greatest change consisted in the decrease of the negative balance of trade in goods. This was the result of a strong decline in imports (caused by depreciation of the Romanian currency in addition to a decrease in domestic demand) and a slightly lower decrease in exports. Due to the reduction in reinvested profits of foreign companies (caused by lower profits), the income deficit also decreased to a level recorded before 2007.

Figure 7.6
Current account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Figure 8.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

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

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-13.8**	**-11.8**	**-10.1**	**-7.3**	**-5.3**
Goods	-15.0	-14.0	-12.2	-10.0	-7.7
Services	0.2	0.5	0.3	0.2	0.1
Income	-3.3	-2.7	-2.7	-1.7	-1.5
Current transfers	4.3	4.4	4.4	4.3	3.8
Capital account	**0.6**	**0.5**	**0.4**	**0.3**	**0.4**
Financial account	**13.7**	**12.6**	**10.9**	**7.6**	**5.2**
FDIs	6.1	6.8	7.4	5.7	4.9
Portfolio investments	0.1	-0.4	-0.9	-0.8	-0.6
Other investments	8.1	6.4	3.1	2.8	2.0

source: Ecowin Economic

The current account deficit in the first three quarters of 2009 was financed mostly by an inflow of direct foreign investments, which in Q1 2009 still remained at a level similar to 2008 and decreased slightly only in Q2 and Q3. However, the role of other investments in financing the imbalance on the current account declined. Since Q4 2008 an outflow of portfolio investments from Romania has been also observed.

Interest rates and foreign exchange rate

After a series of interest rate increases introduced in 2008 in order to prevent economic overheating, the Bank of Romania eased the monetary policy in 2009. In order to limit an adverse impact of the recession on the economy, the basic interest rate was reduced by 225 basis points in total - to 8% since the end of September 2009.

Following a strong depreciation of the leu against the euro between August 2008 and January 2009, the exchange rate of the Romanian currency stabilised. This was a result of an increasing risk appetite of foreign investors. However, a further depreciation trend could be observed since May 2009. Another leu depreciation was related mainly to a downgrade of the rating by Fitch and the political instability.

Fiscal policy

A high structural deficit in the years preceding the crisis, high foreign debt and outflow of foreign capital forced Romania to request a financial aid from international institutions at the beginning of 2009. Romania received approximately EUR 20 billion[23], conditional, among others, on developing a programme of public finance consolidation. Activities undertaken to limit the government sector deficit include the reduction of current expenditure (including salaries in the public sector) and expenditure on retirement and disability pensions, as well as an increase of direct taxes.

The European Commission forecasts that in 2009 the budget deficit will increase to 7.8% of GDP (from 5.5% of GDP in 2008). Due to a high political uncertainty (change of the government in October 2009, presidential election in November 2009) those forecasts bear a high risk. It is expected that in subsequent years the deficit of the public finance sector will decrease, however it will still exceed 3% of GDP (6.8% of GDP in 2010, 5.9% of GDP in 2011).

Since July 2009 the EU launched the excessive deficit procedure against Romania. However, in order to reduce the budget deficit to below 3% of GDP by 2011, further adjusting measures will be necessary.

The debt of the government sector will increase in the period covered by the forecast (from 13.6% of GDP in 2008 to 31.3% of GDP in 2011). However, it will still be one of the lowest in the European Union.

Forecasts

During the last six months prospects for the Romanian economy deteriorated considerably. The decline in GDP in 2009 is expected to be two times higher than projected by

[23] From IMF, EU, World Bank and other institutions.

international institutions in spring 2009. This forecast is a result of worse than expected results for the first half of 2009 on one hand, and on the other hand decreases in the economic activity are expected to deepen in the second half of 2009. The European Commission and the IMF forecast unanimously that the GDP downward trend will stop in 2010 . The highest risks relate to private consumption, a deteriorating situation on the labour market and an increase in household debt caused by an increase in the value of loans denominated in foreign currencies.

It is expected that the agreement on IMF aid will contribute to a reduction in public expenditure both in 2009 and 2010. After a strong decline in 2009, the downward trend in investment is expected to reverse in 2010. However, due to the fact that capital expenditures in Romania are determined by domestic demand to a greater extent than in other countries of the region, their growth will be relatively small.

The IMF positively assesses government activities undertaken so far, which should contribute to an improvement in the perception of Romania by foreign investors. If, however, the temporary government is not able to meet the budget goals, it may not receive the third IMF aid tranche of nearly EUR 1.5 billion. Those funds would be mainly used for debt servicing. According to the Bank of Romania, this country needs for this purpose EUR 5 billion by the end of 2009.

The Bank of Romania expects a decrease in inflation, which should be caused to a considerable extent by a production level below the potential production level and a lower growth of prices of agricultural raw materials. However, an increase of excise duties for tobacco products in January 2010 will probably increase inflation. The Bank of Romania raised its inflation forecast as of the end of 2010 from 0.2% (August 2009) to 4.5% (November 2009).

The IMF projects that the current account deficit will continue to decrease and it will be 5.6% of GDP in 2010.

Table 8.4

Forecasts of main indicators

	CNP	EC	IMF
	11.2009 (06.2009)	10.2009 (04.2009)	10.2009 (04.2009)
GDP, in %, y/y			
2009	-7.7 (-4.0)	-8.0 (-4.0)	-8.5 (-4.1)
2010	0.5 (0.1)	0.5 (0.0)	0.5 (0.0)
2011	2.4 (2.4)	2.6	4.6 (5.0)
CPI, in %, y/y			
2009	5.6 (5.8)	5.7 (5.8)	5.5 (5.9)
2010	3.7 (3.5)	3.5 (3.5)	3.6 (3.9)
2011	3.2 (3.2)	3.4	3.1 (3.5)
Current account balance, in % of GDP, y/y			
2009	-4.6 (-10.9)	-5.5 (-7.4)	-5.5 (-7.5)
2010	-5.1 (-9.8)	-5.5 (-6.1)	-5.6 (-6.5)
2011	-5.3 (-9.2)	-5.7	-6.0 (-6.3)

CNP - Comisia Naţională de Prognoz

SLOVAKIA

Economic growth

In the first half of 2009 the Slovak economy recorded a GDP decrease for the first time since 1999. In the first half of 2009 GDP decreased by 5.5% y/y versus an increase of 6.4% in 2008. A particularly deep decline in the economic activity occurred in Q1 2009 when GDP fell by 11% in comparison with the previous quarter. This was a result of a simultaneous decrease in domestic demand (a fall in consumption, investments and inventories) and a collapse of external demand. A decreasing demand from main trade partners and the fact that the Slovak economy is highly dependent on the external demand, led to the highest decrease in exports in the region and a negative contribution of net exports to GDP growth.

In Q2 and Q3 2009 the GDP growth in Slovakia accelerated. On a quarterly basis, GDP in Slovakia grew at the highest rate not only in the region but also in all European Union countries (by 1.1% and 1.6% respectively in Q2 and Q3 2009). Recession in the Slovak economy was stopped owing to effects of counter-cyclical programmes implemented both in the country and abroad. On one hand, the introduction of fiscal stimuli by the Slovak government[24] prevented a high decrease in consumption despite a deteriorating situation on the labour market (a decrease in employment and salaries growth). On the other hand – subsidies to purchases of new cars introduced in some Western European countries increased the foreign demand for cars manufactured in Slovakia. With a simultaneous further decrease in imports, net exports had a positive impact on the economic growth in Q2 and Q3 2009.

Figure 9.1

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

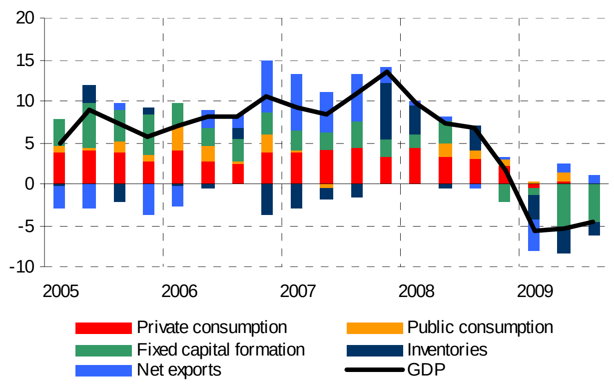


Table 9.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**10.4**	**6.4**	**-5.6**	**-5.3**	**-4.8**
Private consumption	7.1	6.1	-1.2	0.7	-0.3
Public consumption	-1.3	4.3	1.2	5.9	-0.8
Fixed capital formation	8.7	6.8	-4.1	-17.6	-11.4
Exports	13.8	3.2	-25.3	-20.5	-15.0
Imports	8.9	3.3	-23.2	-21.9	-17.0

source: Ecowin Economic

However, in Q2 and Q3 2009 the growth of fixed capital formation collapsed, contributing to a great extent to the GDP decreases in that period. A decline in fixed investments in Q2 2009 affected all sectors of the economy. Paradoxically, despite programmes supporting purchases of new vehicles, a decrease in this category was the highest.

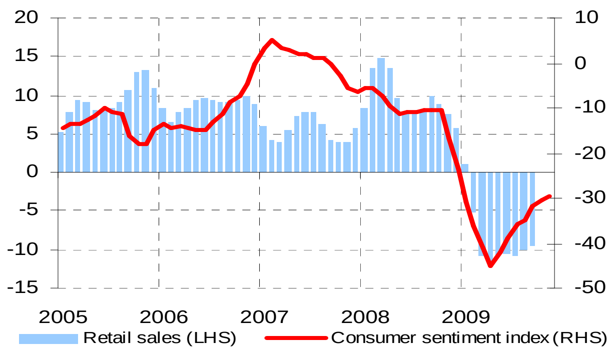
The decrease in household consumption was accompanied by a decrease in retail sales[25]. In Q1 2009 retail sales were lower by 11% in comparison with the previous year. In the next two quarters of 2009 the decrease in retail sales did not substantially change. A high fall in retail trade turnover in 2009 related mainly to fuels and consumer durable goods.

Owing to the premium for a purchase of a new car and for scrapping of an old car (amounting to EUR 2 thousand per vehicle), implemented by the Slovak government at the beginning of March 2009, the number of registered new cars in Slovakia increased by nearly 20% in the first three quarters of 2009 (the second biggest growth in Europe behind Germany)[26]. In Q1 2009 it declined by 18.5%.

Consumer confidence indices in Q1 2009 also deteriorated very fast, continuing the trend started in the second half of 2008. At the end of Q1 2009 the value of the EC consumer confidence index of was the lowest in 10 years. However, since Q2 2009 Slovak consumer sentiment started to improve considerably. First of all, consumers started to assess more optimistically the prospect of the economy development and their own financial situation over the next 12 months.

Figure 9.2

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



source: Ecowin Economic

In Q1 2009 industrial production in Slovakia declined considerably, mainly due to decreasing activity in automotive, metallurgical and chemical sectors. In the following months the downward trend slowed down (-5% y/y in September versus -23% y/y in February 2009) as a result of an increase in production in the pharmaceutical, chemical and electronic industry. In the second half of 2009 car production also increased but it was still much lower than in the corresponding period of the previous year.

The indicator of business sentiment in Q1 2009, just as the consumer one, continued the downward trend observed

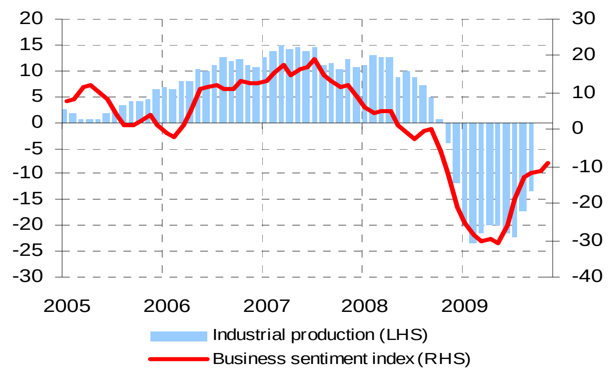
[24] Including a programme of subsidies to purchases of new cars.

[25] Excluding motor vehicles.

[26] According to the Association of European Automobile Constructors (ACEA).

already in the second half of 2008. It reached the lowest level since the EC index started being published. The optimism of business entities started to improve slightly later than in the case of consumers. A significant increase in the business sentiment index was observed in Q3 2009 mainly as a result of the improvement of the current production value and the expected increase in production prices in the following months.

Figure 9.3
Industrial production (in %, y/y) and business sentiment index

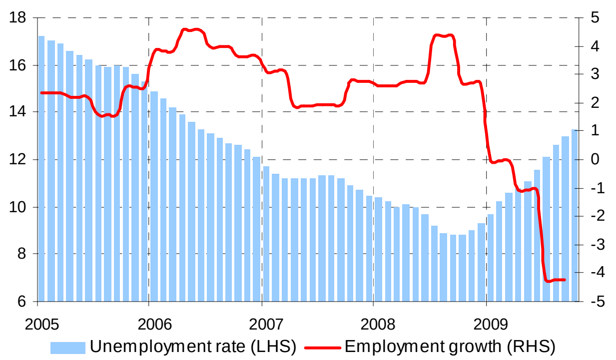


source: Ecowin Economic

Labour market

Since the unemployment rate reached its all-time low in Q3 2008 – 7.4%, it has been rising constatntly. In September and October 2009 it already reached 12.5%, i.e. the highest level since 2005. Since the beginning of 2009 the increase in the unemployment rate has been accompanied by a decrease in the number of jobs. In Q1 2009 this decrease was quite low (-0.1% y/y), however it deepened significantly in Q2 (-1.1% y/y) and in particular in Q3 2009 (-4,3% y/y). The decline in employment affected a majority of Slovak economy sectors, in particular the manufacturing, catering, hotel industry and trade. In other services employment did not change considerably. Opposite to other countries of the regions, employment in construction rose in 2009.

Figure 9.4
Unemployment rate (in %) and employment growth rate (in %, y/y)



source: Ecowin Economic

Inflation and labour costs

A decrease in inflation, which started in Slovakia in the second half of 2008, continued in 2009. The annual HICP growth fell to -0.1% in October 2009 compared with 2.7% in January. Despite concerns, the euro adoption did not reverse a downward trend in inflation in Slovakia and on contrary – it contributed to its faster decrease in comparison with the neighbouring countries[27]. A decline in inflation resulted mainly from a falling prices of food and energy. Food prices has been falling since March (unprocessed food from the beginning of 2009). A decrease in prices of energy commodities led to a decrease in energy prices. A declining trend was strengthened in September 2009 in the result of the expiry of the base effect related to an increase in prices of residential heating a year ago. A deteriorating situation on the labour market and falling consumption in 2009 caused a decrease in core inflation which fell from 3.1% in January to 1.1% in September 2009.

Figure 9.5
HICP and its components (in pp, y/y)

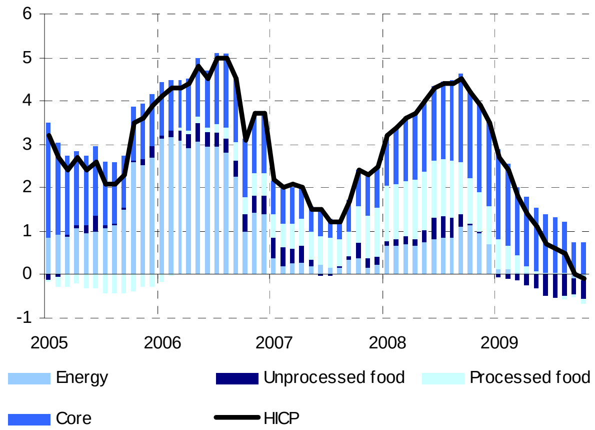


Table 8.2
HICP and its components (in pp, y/y)

	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**3.9**	**2.3**	**1.1**	**0.4**	**-0.1**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.4	0.5	0.5	0.5	0.5
Housing	1.4	1.1	0.9	0.7	0.4
Health	0.4	0.4	0.4	0.4	0.4
Restaurants and hotels	0.6	0.6	0.5	0.4	0.2
Miscellaneous	0.2	0.3	0.2	0.2	0.1

source: Ecowin Economic

A deteriorating situation in the economy and in particular on the labour market caused slower wage growth in Slovakia in the first half of 2009. In the first two quarters of 2009 it was 1.7% and 0.9% respectively compared with 3.5% in 2008 [28]. The decrease in wage growth rate in the first half of 2009 affected all sectors of the economy but in most of them wages were still increasing (with the exception of energy distribution sector).

[27] At the beginning of 2009 inflation in Poland, Czech Republic, Hungary and Romania increased due to a strong depreciation of currencies of those countries and an increase in prices of imported goods and services. In the case of Slovakia, the stability of the exchange rate in the period immediately preceding its accession protected the economy against an increase in prices caused by those reasons.

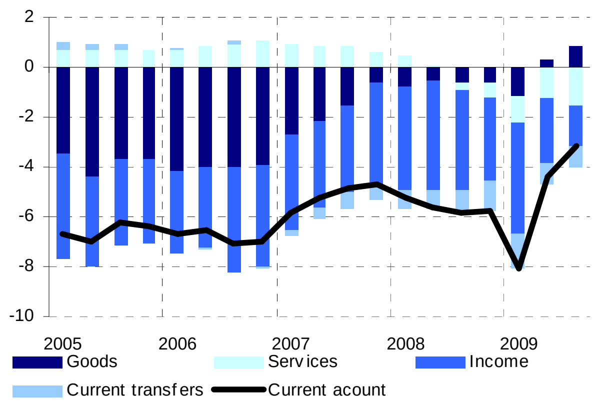
[28] In Q4 2008 the annual salaries growth in Slovakia decreased slightly (-0.2%).

Balance of payments

A decrease in the current account deficit which occurred in a majority of the region's countries already at the beginning of 2009, became evident in Slovakia already in Q2 2009. In Q1 2009 the current account deficit (4q moving average) widened to 8.1% of GDP from 5.8% of GDP at the end of 2008. The deteriorating current account balance was mainly caused by growing foreign trade deficit as exports fell stronger. In Q1 2009 the highest decreases were recorded in exports of cars and electronic equipment which in the previous years constituted more than half of Slovak exports. In Q1 2009 the negative balance on both income and current transfers account slightly decreased.

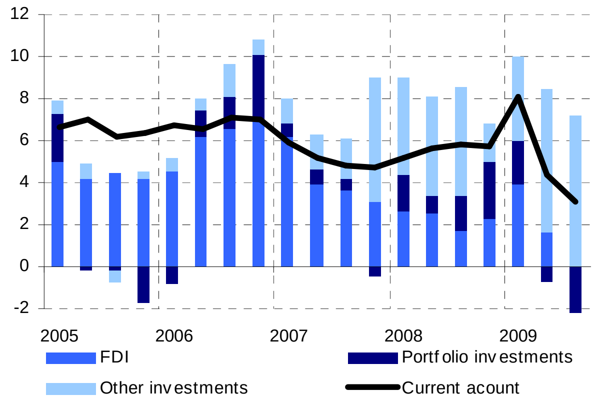
In Q2 and Q3 2009 the current account deficit narrowed considerably (to -3.1% of GDP in Q3 2009). This improvement was caused mainly by an increase in trade in goods balance, which in Q3 already showed a surplus. This situation was a result of larger falls in imports than in the previous quarter while exports showed some improvement. Improving foreign trade performance resulted mostly from an increased car exports in relation to the introduction of subsidies to purchases of new vehicles in Western European countries, especially in Germany - the main Slovakian trade partner. At the same time income account deficit also narrowed. However, it was still the largest contributor to current account deficit in Slovakia. In 2009 the deficit on the services account increased (due to a deteriorating balance of financial and tourist services), while the deficit on current transfers account slightly decreased.

Figure 9.6
Current account balance and its components (in % of GDP, 4q moving average)



An inflow of foreign investments to Slovakia in the first half of 2009 did not change significantly compared with Q4 2008. A significant decrease was observed already in Q3 2009. After a temporary increase in the inflow of direct investments in Q1 2009, in the next two quarters it fell, however to much smaller extent than in other countries of the region. In Q2 2009 an inflow of other investments increased unexpectedly reaching its record levels recorded at the brink of 2007 and 2008. Those were mainly short-term loans. In Q3 2009 Slovakia, similarly to other CEE states, already recorded a very high outflow of other investments. Opposite to other countries of the region, the inflow of portfolio investments has been consistently decreasing throughout 2009.

Figure 9.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Table 9.3
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-5.8**	**-5.8**	**-8.1**	**-4.4**	**-3.1**
Goods	-0.6	-0.6	-1.1	0.3	0.9
Services	-0.3	-0.6	-1.1	-1.2	-1.5
Income	-4.0	-3.3	-4.5	-2.6	-1.6
Current transfers	-0.9	-1.2	-1.4	-0.9	-0.8
Capital account	**1.3**	**1.8**	**2.4**	**1.7**	**2.2**
Financial account	**6.0**	**6.8**	**10.0**	**7.7**	**4.7**
FDIs	1.8	2.3	3.9	1.6	0.0
Portfolio investments	1.6	2.7	2.1	-0.7	-2.7
Other investments	5.2	1.8	4.0	6.8	7.2

source: Ecowin Economic

Fiscal policy

An increase in the general government deficit in Slovakia (from 2.3% of GDP in 2008 to 6.3% of GDP in 2009) projected by the European Commission is mainly an effect of automatic stabilisers of the economic situation. The measures taken by Slovakian authorities at the end of 2008 and in 2009, aimed at mitigating effects of the economic crisis (including subsidies to employee salaries, subsidies to a purchase of a new car) did not increase the deficit. They were financed by resources moved from other expenditure categories.

According to the EC forecast, in the following years the general government deficit is to decrease (to 6.0% of GDP in 2010 and 5.5% of GDP in 2011), but it will still exceed 3% of GDP. The government expects to introduce in 2010 an increase in excise duty on alcohol and cigarettes, eliminate loopholes in tax law, freeze certain tax relieves and reduce current expenditure (including mergers of some ministries).

In December 2009 Slovakia was covered by the excessive deficit procedure. The negative budget balance should be reduced by 2013. The EC indicates the need to consolidate public finance in order to permanently decrease the fiscal imbalance.

The EC expects that the public debt in Slovakia will increase between 2008 and 2011 by 15.0 percentage points, however it will remain far below 60% of GDP (42.7% of GDP in 2011).

Forecasts

A very fast decrease in GDP growth in the first half of 2009 (in particular in Q1 2009) contributed to further decreases in forecasts for the economic growth rate in Slovakia in 2009. A majority of forecasts expects a decline in GDP in 2009 by at least 5%. In the first half of 2009 forecasts assumed two times lower decreases. At the same time, projections show that the economic crisis in Slovakia reached its peak in Q1 2009. In the following quarters GDP should slowly increase on a quarterly basis. For this reason, forecasts for the economic growth in 2010 were raised considerably. IMF even projects an increase in GDP by 3.7% - the highest figure in the region.

According to the EC and NBS forecasts, a fall in GDP in 2009 is to result mainly from deteriorating domestic demand, especially investment demand, although the contribution of net exports is also to be negative. Strengthening of domestic demand in the following years is to constitute the basis for the growth of the Slovak economy.

It is expected that in Q4 2009 inflation will reach its minimum and then will increase to approximately 2% together with an improving growth of the economic activity.

According to the EC and NBS forecasts, the current account deficit will slightly decrease in the second half of 2009 and in 2010, however this change will not be as high as in the majority of the CEE countries.

Table 9.4

Forecasts of main indicators

	NBS	EC	OECD	IMF
	09.2009 (03.2008)	10.2009 (04.2009)	11.2009 (06.2009)	10.2009 (04.2009)
GDP, in %, y/y				
2009	-5.6 (-2.4)	-5.8 (-2.6)	-5.8 (-5.0)	-4.7 (-2.1)
2010	2.9 (2.0)	1.9 (0.7)	2.0 (3.1)	3.7 (1.9)
2011	4.2 (3.2)	2.6	4.2	5.2 (5.2)
CPI, in %, y/y				
2009	1.0 (1.7)	1.1 (2.0)	1.0 (1.8)	1.5 (1.7)
2010	1.8 (2.0)	1.9 (2.4)	1.7 (1.8)	2.3 (2.3)
2011	2.4 (2.9)	2.5	2.4	2.7 (2.7)
Current account balance, in % of GDP, y/y				
2009	-5.8 (-7.3)	-5.8 (-7.5)	-3.8 (-6.9)	-8.0 (-5.7)
2010	-5.0 (-6.4)	-5.3 (-7.1)	-3.1 (-6.2)	-7.8 (-5.0)
2011	-2.9 (-5.6)	-5.0	-2.8	-7.0 (-4.5)

NBS - Národná Banka Slovenska

SLOVENIA

Economic growth

The extent of an economic slowdown in Slovenia in 2009 is one of the highest (along with the Baltic states) among Central and Eastern European countries. This situation arose despite the fact that the Slovenian government earmarked relatively the highest amount of funds out of all CEE countries to anti-crisis activities (15% of GDP).

In the first three quarters of 2009 gross domestic product fell by 8.6% in comparison with the same period of the previous year. Such a deep decrease in GDP resulted mainly from a strong decline in foreign demand. Owing to this decline exports fell by nearly 20% in Q1-Q3 2009. Due to a relatively low potential of the Slovenian economy and its pro-export nature, a decrease in external demand contributed very fast (faster than in a majority of other CEE countries) to a deep decline in domestic demand, in particular fixed capital formation.

In the first three quarters of 2009 fixed capital formation decreased by nearly ¼ in comparison with the previous year. The decline in investments was caused by not only a reduction in foreign and domestic demand but also continued negative trends on the real estate market (which started in mid-2008). Deteriorating prospects for external and domestic demand also caused Slovenian companies to strongly reduce their inventories, which also had a significantly adverse impact on GDP growth in 2009.

Figure 10.1

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

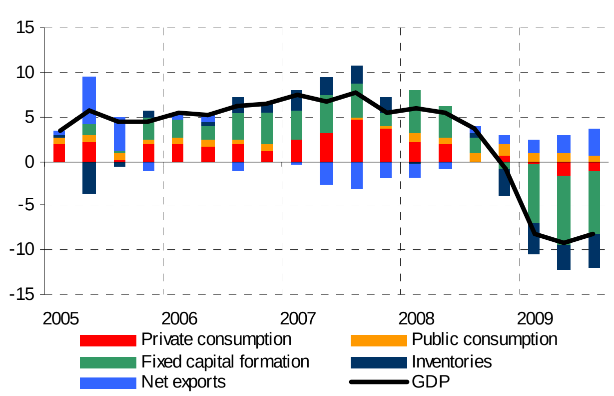


Table 10.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	6.8	3.5	-8.2	-9.2	-8.3
Private consumption	5.3	2.2	-1.0	-3.1	-2.1
Public consumption	2.5	3.7	4.8	4.9	4.3
Fixed capital formation	11.9	6.2	-22.2	-25.5	-23.8
Exports	13.8	3.3	-19.5	-21.3	-16.3
Imports	15.7	3.5	-20.9	-23.4	-19.6

source: Ecowin Economic

The deterioration of the situation of Slovenian companies resulted in a reduction of employment and a considerable decrease in wage growth rate. In addition, a slowdown in the lending activity, which in the years directly preceding the crisis played an important function in increasing consumption expenditure, contributed to a decrease in household consumption. On the other hand activities undertaken by the Slovenian government with the aim to mitigate effects of the crisis contributed to an increase in public expenditure.

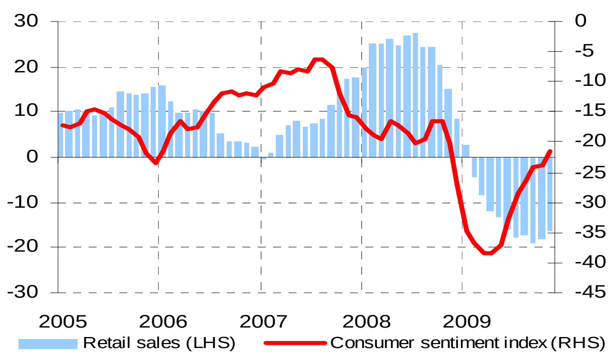
A strong decline in exports sector demand for imported intermediate goods and in domestic demand (both consumption and investment) was reflected in a deep decrease in imports (higher than in the case of exports). For this reason, an improvement in trade balance contributed to a decrease in GDP decline.

Despite the fact that on an annual basis the GDP decrease in Slovenia was still very deep in Q3 2009, on a quarterly basis it increased for the second consecutive time (by 1.0% versus an increase by 0.6% in Q2 2009). This may indicate that recession trends in the Slovenian economy have weakened. A quarterly GDP increase was a result of an increase in exports due to an increasing demand in euro zone countries. The above increase was accompanied by smaller declines in fixed capital formation (a slight increase was even recorded in the case of investments in machinery and equipment) and household consumption.

A decrease in household expenditure was demonstrated in particular by a strong decrease in retail sales. In the first three quarters of 2009 retail sales decreased by 10.7% in comparison with the previous year. During that period the highest decreases were recorded for sales of cars (by more than 25% y/y) and durable goods (by more than 20% y/y). On the other hand, a decrease in sales of food was relatively small (by 3.5% y/y). During the current crisis retail sales dropped to the lowest level in September 2009. However, October 2009 data show that the downward trend may have reversed. This is because on a monthly basis, retail sales increased by 1.2% - the highest increase in sales in the last thirteen months. Nonetheless, retail sales were still lower by more than 13% in comparison with October 2008

Figure 10.2

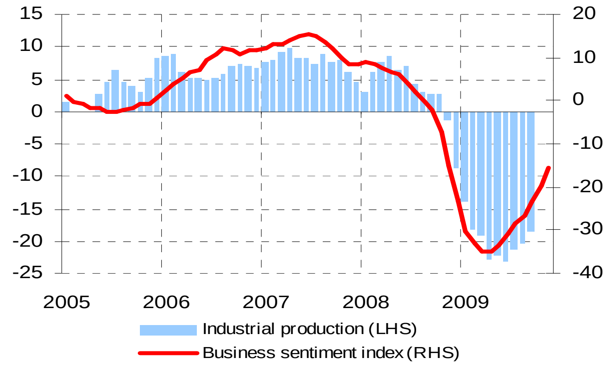
Retail sales (in %, y/y) and consumer sentiment index



source: Ecowin Economic

Stabilisation of retail sales may however turn out to be a long process. Admittedly, the EC consumer confidence index started to improve after reaching its all-time low in January 2009 (the index has been published since 1996), but the percentage of household planning a purchase of durable goods over the next 12 months did not change significantly. At the beginning of Q4 2009 an increase in the consumer sentiment index was affected to the greatest extent by an improvement in the assessment of economic prospects for the country and an expected improvement of the situation on the labour market. Expectations concerning the financial situation of households improved to a lesser extent, which may limit consumption expenditure in the nearest future.

Figure 10.3
Industrial production (in %, y/y) and business sentiment index



source: Ecowin Economic

In the first three quarters of 2009 industrial output of Slovenia decreased by more than 20% in comparison with the previous year. The highest decrease (by approximately 30%) was recorded in the manufacture of consumer durable goods. Relatively strong declines in production occurred also in the case of intermediate goods and capital goods. A decrease in the manufacture of other consumer goods turned out to be relatively lowest.

An increase in industrial production on a monthly basis has been observed since May 2009 and it contributes to a limitation of declines on an annual basis (in September 2009 the production was lower by 16% in comparison with the previous year). The reversal of the production downward trend was mainly a result of stabilisation of production in export oriented sectors caused by a certain improvement in demand in other euro zone countries (resulting from, inter alia, subsidies to purchases of new cars introduced in some Western European countries). In Q3 2009 the production of the automotive industry was nearly 6% lower in comparison with the previous year, while in the first half of 2009 its decrease was three times higher[29]. The production of the pharmaceutical sector, highly export oriented, remained relatively stable. A certain increase in foreign orders was accompanied by a further decline in domestic. For this reason, the deepest decreases are recorded in sectors whose production is addressed mainly to the Slovenian market. Therefore, the utilisation of production capacities remained at a very low level (72.4% in September 2009).

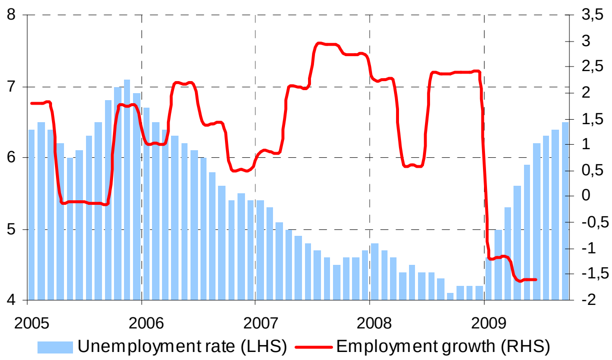
An increase in export orders has been since Q2 2009 the main driver for the improvement of the business confidence index in Slovenia which at the beginning of the year fell to its all-time low. Since September 2009 the number of companies expecting an increased number of export orders has been higher than the number of companies expecting its decrease (in November sub-index of expected export orders increased to the highest level since September 2008). Even though generally Slovenian companies assess much better prospects than their current situation, a majority of them still declare a reduction in employment.

Labour market

An increase in unemployment turned out to be lower than indicated by government forecasts from the first half of 2009 and lower than implied by the scale of a decrease in the business activity. On one hand, this was a result of anti-crisis activities of the Slovenian government whose priority was to minimise negative effects of the crisis on the labour market (compare with Analysis of the situation in CEE countries, May 2009) [30]. On the other hand, it resulted from a different than expected reaction of companies at the beginning of the crisis. The reaction of companies to a decrease in orders was to reduce working time rather than to reduce employment. During that time the employment decreased fastest in the manufacturing, while the reaction of the public sector was much weaker. An increase in the number of the self-employed also contributed to reduced unemployment.

The number of jobs in Slovenia started to decrease already in November 2008. During the last twelve months (from November 2008 to October 2009) number of employed decreased by more than 34 thousand. This was reflected in an increase in the unemployment rate which reached 9.4% in Q3 2009 (the highest rate in three years). Although it has not changed since July 2009, a further increase in the unemployment rate is expected in the following months.

Figure 10.4
Unemployment rate (in %) and employment growth rate (in %, y/y)



source: Ecowin Economic

Inflation and labour costs

For the most part of 2009 inflation in Slovenia has been decreasing very fast. If in mid-2008 it was one of the highest in the euro zone (7.0% in June 2008), since mid-2009 HICP has been oscillating around zero.

A decrease in energy prices had a strong negative impact on inflation. The decline in the current inflation rate was also accompanied by a decrease in core inflation, as reflected by a

[29] Slovenian Renault factory which manufactures small and relatively cheap car models was one of the greatest beneficiaries of the programme of subsidies to new cars among CEE countries. Although this program has been terminated in Germany, positive trends may remain due to a similar programme operating in France (until 2011).

[30] According to estimates of the Ministry of Labour, the introduction in February 2009 of subsidies to full time work contributed to saving 20 thousand jobs.

quite high decrease in consumption demand. This decrease occurred despite the fact that in the current year the impact of tax rates on inflation was the highest since 2002[31]. However, in recent months the extent of that decrease was limited considerably mainly owing to an increase in prices of utility services.

Figure 10.5

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

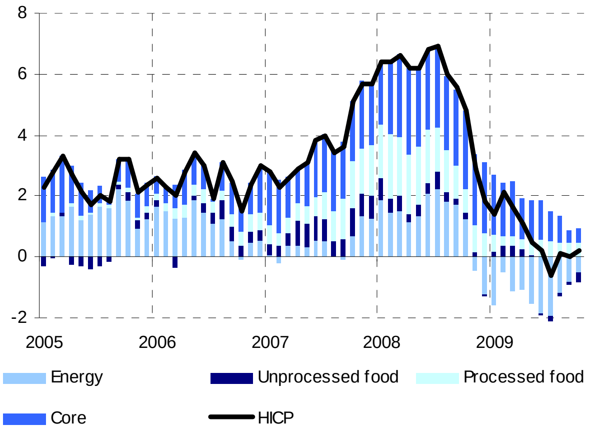


Table 10.2

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

	Q4 2009	Q1 2009	Q2 2009	Q3 2009	Oct-09
HICP	**3.2**	**1.7**	**0.6**	**-0.2**	**0.2**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.1	0.1	0.3	0.4	0.4
Restaurants and hotels	0.8	0.7	0.5	0.4	0.4
Miscellaneous	0.3	0.3	0.3	0.4	0.4
Recreation and culture	0.3	0.2	0.3	0.2	0.2
Household equipment	0.4	0.4	0.3	0.2	0.1

source: Ecowin Economic

The decrease in core inflation was facilitated by slower wage growth. The average net wage between January and August 2009 increased by 4.1% - i.e. two times slower than in the same period of the previous year (with a very strong disproportion between the growth of wages in the public and private sector[32]). The annual wage growth demonstrates a weakening trend. In August 2009 salaries increased by merely 1.0% y/y. The increase in the public sector wages will continue to be reduced as indicated by an agreement reached in October 2009 between the government and trade unions[33].

[31] It is estimated that in the first three quarters of 2009 it caused an increase in inflation by 1 p.p. (0.7 p.p. liquid fuels, 0.2 p.p. tobacco and 0.1 p.p. alcohol). At the same time, other regulated prices also increased.

[32] While salaries in the private sector increased by 1.9% between January and August 2009, in the public sector they increased by 9.7% - i.e. even more than in the same period of the previous year.

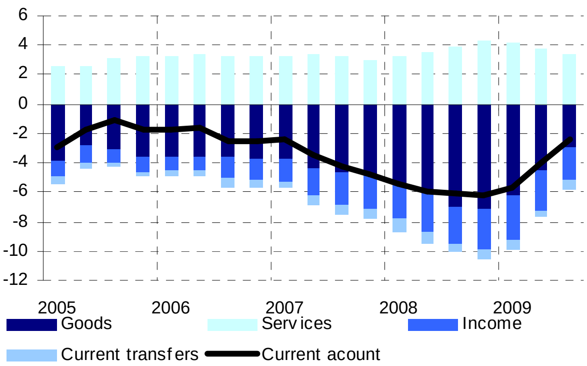
[33] The introduction of the system of pay rises in the public sector was aimed at reducing a strong disproportion between wages in the private and public sector. An increase of wages in the public sector will be slightly limited. Even if it was originally expected that in 2010 an increase in salaries will amount to 10.3%. Currently they are expected to increase by 3.1%.

Balance of payments

Although on an annual basis Slovenia still recorded a current account deficit in Q3 2009, this deficit decreased in comparison with the previous year. Taking into account two last quarters (Q2 and Q3 2009), a surplus was recorded in the current account (a similar situation, i.e. two consecutive quarters with a positive current account balance, occurred in 2005). The greatest influence on the improvement of the current account balance was exerted by a significant reduction of deficit in trade in goods which resulted from a stronger decrease in imports than in exports. In the first three quarters of 2009 exports fell by 22.4% y/y, while imports decreased by 29.4%. Both exports volume and prices were decreasing much less than imports volume and prices. Foreign trade turnover is starting to stabilise, as may be demonstrated by increases in both exports and imports.

Figure 10.6

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



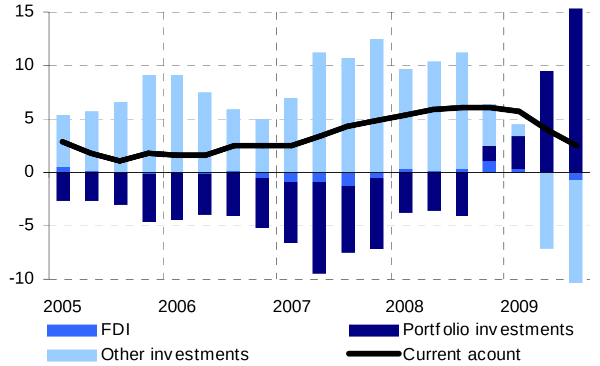
A decrease in a services surplus (related to, inter alia, a decrease in income from tourism) was accompanied by a reduction in income deficit (due to reduced activity of foreign investors). In the first three quarters of 2009 a negative income balance decreased by 36% in comparison with the same period of 2008. This was determined on one hand by clearly lower income of non-residents working in Slovenia and on the other hand by gradually increasing remittances from Slovenians working abroad.

In the second half of 2008 a financial account surplus further increased due to an increasing net inflow of direct and portfolio investments. In the first three quarters of 2009 the surplus unexpectedly into a deficit. This situation was caused by a rapid outflow of FDIs and other investments which was not compensated by a record high inflow of portfolio investments[34]. Withdrawal of capital in respect of other investments was a result of, similarly to other CEE countries, a decrease in liabilities of the Slovenian banking sector in respect of loans received and deposits accepted from non-residents.

[34] The inflow of portfolio investments in the first three quarters of 2009 is impressive due to the fact that between 2002 and 2007 Slovenia was a net debtor of foreign countries.

Figure 10.7

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



source: Ecowin Economic

Table 10.3

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

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-6.1**	**-6.2**	**-5.6**	**-3.9**	**-1.9**
Goods	-7.0	-7.1	-6.2	-4.5	-2.9
Services	4.0	4.3	4.2	3.8	3.7
Income	-2.5	-2.8	-3.0	-2.7	-2.1
Current transfers	-0.5	-0.6	-0.6	-0.5	-0.6
Capital account	**-0.1**	**-0.1**	**-0.1**	**0.0**	**0.0**
Financial account	**7.6**	**6.6**	**5.1**	**3.0**	**1.2**
FDIs	0.4	1.0	0.4	-0.1	-0.7
Portfolio investments	-4.0	1.5	3.1	9.5	15.8
Other investments	10.9	3.8	1.1	-7.0	-14.5

source: Ecowin Economic

Fiscal policy

The effects of automatic stabilisers of the economic situation and implemented anti-crisis activities (approximately 2.0% of GDP) contributed to an increase in the general government deficit in Slovenia in 2009. According to the European Commission autumn forecast it will increase from 1.8% of GDP in 2008 to 6.3% of GDP in 2009. In the following years the negative budget balance is to stabilise at 7.0% of GDP.

In 2010 Slovenia plans to increase excise duty rates on fuels and electricity as a part of anti-crisis package implemented in 2009. The government announced an introduction of a fiscal expenditure rule and appointment of an independent budget council in order to reduce the fiscal imbalance in the following years.

In December 2009 Slovenia was covered by the excessive deficit procedure. The deficit of the public finance sector should be reduced by 2013. The EC indicates that this country should mitigate the risk to a long-term stability of the public finance sector.

Public debt in Slovenia will double during the projected period, from 22.5% of GDP in 2008 to 48.2% of GDP in 2011. Apart from fiscal imbalance, an increase in debt will be also caused by government's financial support for the banking system (approximately 4.5% of GDP in 2009).

Forecasts

The Slovenian Institute of Macroeconomic Analysis and Development (IMAD) estimates in its forecast published at the end of September 2009 that GDP fall in 2009 will amount to 7.3%. In 2010 the economy is expected to grow at 1.0%. Forecasts of external institutions are more optimistic. For instance, November OECD forecast estimates that Slovenian GDP will increase next year by 2.7%. Regardless of the economic growth rate, all research centres agree that the main driver for recovery should be exports, as demand in Western European countries is to increase. The downward trend of domestic demand is expected to continue - both in the case of household consumption (which is expected to increase not earlier than in the second half of 2010) and investments. Further decrease in wage growth and expected deterioration of the situation on the labour market will adversely influence an increase in household expenditure (according to IMAD forecast, the average annual unemployment rate in 2010 will increase to 10.6%). The Slovenian economy will continue to be supported by anti-crisis activities of the government which intends to earmark 10% of GDP for this purpose in 2010.

A very slow stabilisation of consumption will have a negative impact on the increase in inflation. According to the European Commission, the average annual HICP in Slovenia is to amount to 1.7% in 2010 compared with 0.9% in 2009. A higher increase in exports than in imports will contribute to further reduction of the current account deficit which in 2010 will amount to 0.2% of GDP.

Table 10.4

Forecasts of main indicators

	IMAD	EC	OECD	IMF
	09.2009 (03.2009)	10.2009 (04.2009)	11.2009 (06.2009)	10.2009 (04.2009)
GDP, in %, y/y				
2009	-7.3 (-4.0)	-7.4 (-3.4)	-7.9 (-5.8)	-4.7 (-2.7)
2010	1.0 (0.9)	1.3 (0.7)	2.7 (0.7)	0.6 (1.4)
2011	2.5 (2.7)	2.0	3.0	3.8 (3.7)
CPI, in %, y/y				
2009	1.9 (1.4)	0.9 (0.7)	0.7 (-5.8)	0.5 (0.5)
2010	2.0 (2.2)	1.7 (2.0)	1.1 (1.6)	2.1 (2.1)
2011	2.7 (3.0)	2.0	2.7	2.3 (2.3)
Current account balance, in % of GDP, y/y				
2009	-0.2 (-2.2)	-0.8 (-4.6)		-3.0 (-4.0)
2010	0.0 (-3.5)	-0.2 (-4.4)		-4.7 (-5.0)
2011	0.1 (-3.9)	-0.6		-5.0 (-5.4)

IMAD - Institute of Macroeconomic Analysis and Development

HUNGARY

Economic growth

A decrease in gross domestic product in Hungary deepened further in the first three quarters of 2009. All categories of expenditure, with the exception of public consumption, contributed to that situation. During that period Hungarian GDP decreased by 7.1% y/y, after posting a decline of 2.5% in Q4 2008. The scale of the current slowdown in economic activity may be therefore compared only to that observed in the initial period of the transformation. Q3 2009 was already the sixth quarter with a quarterly fall in GDP (this decrease was slightly lower than in the preceding quarters of 2009).

Figure 11.1

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

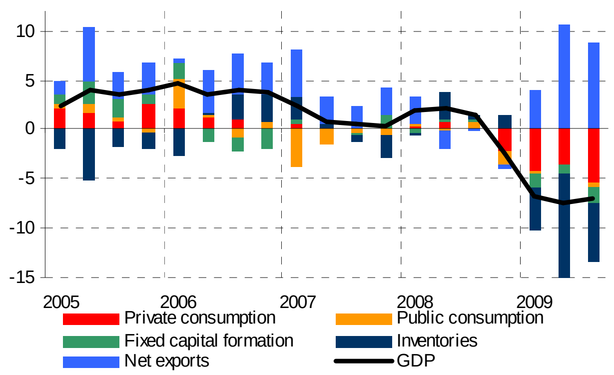


Table 10.1

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

	2007	2008	Q1 2009	Q2 2009	Q3 2009
GDP	**1.1**	**0.6**	**-6.7**	**-7.5**	**-7.1**
Private consumption	0.7	-0.5	-7.3	-6.6	-9.8
Public consumption	-7.4	0.7	-0.2	1.8	-3.1
Fixed capital formation	1.5	-2.6	-6.9	-3.3	-6.8
Exports	15.9	4.8	-18.6	-14.0	-6.9
Imports	13.1	4.7	-22.0	-22.6	-14.6

source: Ecowin Economic

In Q2 2009 the decline in individual consumption slowed down slightly. This is because increase in indirect tax rates in the second half of 2009 contributed to acceleration in household expenditures at the end of Q2 2009 (as indicated by retail sales data). However, for the same reason, decrease in household expenditures deepened in Q3 2009. A similar situation occurred in the case of investments. Between Q1 and Q2 2009 their decrease decelerated as investments rose public sector. However, fixed capital formation still decreased in the private sector. In Q3 the decline in fixed capital formation re-accelerated.

Another factor that contributed to decline in GDP was large drawdown in inventories (particularly in Q2 2009). A deep adjustment of this category resulted from a rapid deterioration in demand prospects, both for domestic and foreign demand. In addition, a limited availability of loans for Hungarian companies might have added to a decline in industrial output, as demand could be satisfied with depleting inventories. Additional factors behind reduction in inventories were a significant decline in natural gas supplies at the beginning of the year and an increase in export demand for car components.

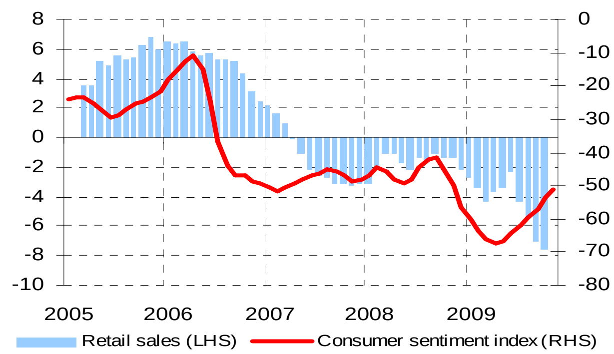
The decrease in domestic demand was partly compensated by an improvement in the external balance. Similarly to other CEE countries, a exports declined less than imports. An increase in external demand caused fall in exports and imports (due to increasing demand of the export sector) to decelerate steadily from quarter to quarter.

Public consumption was the only expenditure category that recorded an increase, which was due to an increase in social expenditure and non-budgetary, i.a. R&D, expenditure.

In the first three quarters of 2009, retail sales fell by 4.4% y/y and to be lower by 7.3% in September 2009 compared to a year before.. Sales in durable goods posted a particularly strong decline (7.7% in the first three quarters of 2009 and 11.2% y/y in September). Car sales in the first three quarters of 2009 decreased by 38.9%. Nonetheless, in Q2 2009 there was a reverse of a downward trend in the indices of consumer confidence. Since that time the CE index has been increasing steadily but it is still below its long-run average levels.

Figure 11.2

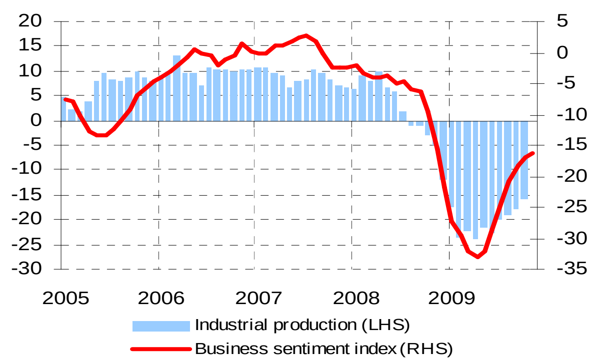
Retail sales (in %, y/y) and consumer sentiment index



source: Ecowin Economic

Figure 11.3

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



source: Ecowin Economic

The pace of decrease in industrial output slowed down slightly in Q2 and Q3 2009 to record a strong increase in September 2009 (3.7% m/m). It was, however, still below 21.9% compared to a year before. Even though the decrease in industrial output was mainly due to decline in activity in the export sector, in 2009 the output of domestic goods was deepening as well. Since the elevated external demand for vehicles (related to scrappage schemes in several EU countries) was satisfied with inventories reduction, it had a limited impact on the increase in production. Nonetheless, business sentiment indices indicate an expected improvement in the Hungarian industry sector.

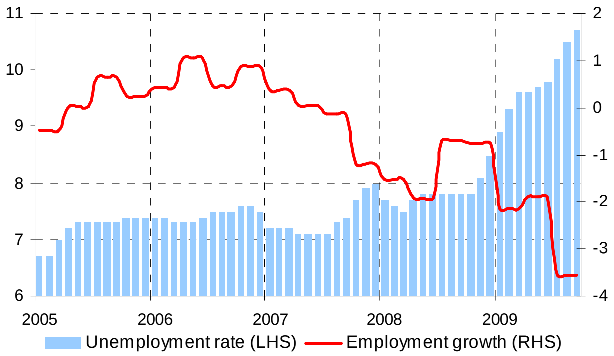
Labour market

The number of the unemployed in the Hungarian economy is currently at the highest level since mid-90s. In addition, the unemployment period has been extending in the current episode. However, the situation in the labour market has been deteriorating less rapidly than envisaged, as employers preferred to cut working hours rather than payrolls and municipalities embarked on public works projects. The unemployment rate increased from 8.4% in January 2009 to 10.5% in October 2009.

The pace of job shedding accelerated in 2009. The number of the employed on an annual basis has been negative since mid-2007 and in Q3 2009 it fell to more than -3%. The highest decrease in the number of the employed was recorded in particular in the automotive industry (-23% y/y) and manufacturing (-12% y/y).

Figure 10.4

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



source: Ecowin Economic

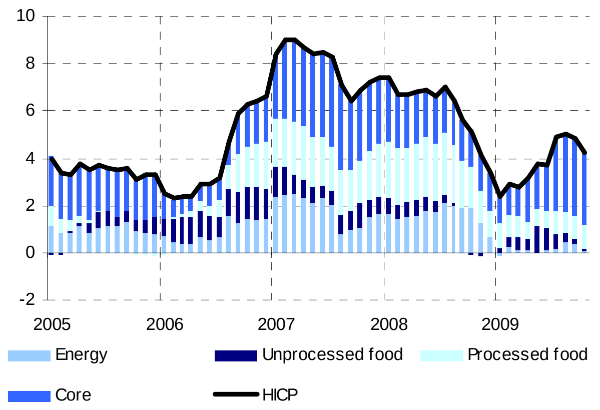
Inflation and labour costs

In the first three quarters of 2009 the pace of price growth re-accelerated. the HICP inflation having increased from 2.4% y/y in January 2009 to 5.0% y/y in August 2009, fell in the following months (to 4.2% y/y in October 2009). The stronger than forecast rise in inflation rate was caused mainly by one-off factors. The main reason behind a rapid acceleration in price growth was the exchange rate pass-through caused by a severe depreciation of the forint in Q4 2008 and Q1 2009. Another factor behind a substantial increase in inflation in mid-2009 was a hike of indirect tax rates in mid-2009[35].

[35] Excluding changes of indirect taxes, HICP inflation fell from 3.6% y/y in June 2009 to 1.1% y/y in September 2009 and it remained negative on a monthly basis. This may result from the fact that shops did not transfer fully the changes of tax rates to final prices in fear of lower takings.

Figure 11.5

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



source: Eurostat

Acceleration in price growth in the first three quarters of 2009 was broad-based. It was particularly strong for alcoholic beverages (due to an increase in excise duty at the beginning of the year), utility and transport services, and imported goods, mainly clothing. The hike of indirect tax rates in July 2009 contributed to acceleration in price growth of all categories of goods and services, except for education.

Table 11.2

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

	Q4 2008	Q1 2008	Q2 2008	Q3 2009	Oct-09
HICP	**4.2**	**2.7**	**3.6**	**4.9**	**4.2**
Contribution to HICP growth rate (in pp)					
Alcoholic beverages and tobacco products	0.4	0.4	0.5	0.8	0.8
Housing	2.0	1.4	1.2	1.1	0.7
Restaurants and hotels	0.5	0.4	0.4	0.5	0.5
Recreation and culture	0.2	0.2	0.2	0.4	0.4
Food and non-alcoholic beverages	0.9	0.9	1.1	0.6	0.4

source: Ecowin Economic

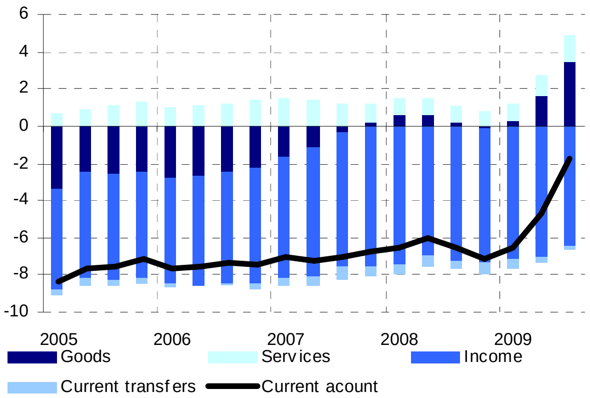
Following an increase in Q1 2009, the growth of nominal wages was decelerating in the following quarters and was slower than the HICP inflation. The low growth of wages in the economy was caused by reduction in salaries in the public sector as a part of the fiscal consolidation programme. The wage growth in the private sector remained relatively stable (4.7% y/y on average in the first three quarters of 2009) which resulted from laying off less experienced employees. Wages were reduced either by cuts in working hours or bonuses.

Unit labour costs increased in Q2 2009. The increase in unit labour costs was due to the a fall in production and to lesser extent by an increase in salaries.

Balance of payments

Current account deficit decreased in the second half of 2008 due to, i.a. deficit in goods, which resulted from exports falling faster than imports. An additional factor behind the widening current account deficit was a deficit in foreign investments which was higher than in the first half of the previous year. Deterioration in deficit in income and balance in goods and services was partly offset by improvement in surplus in services.

Figure 11.6
Current account balance and its components (in % of GDP, 4q moving average)



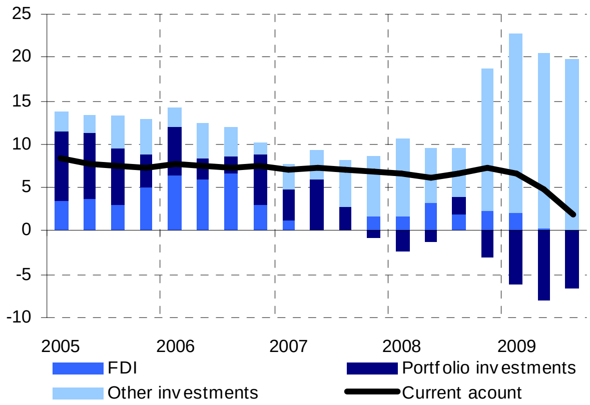
source: Ecowin Economic

The current account deficit in relation to the GDP narrowed significantly in the first half of 2009 (from 7.1% after Q4 2008 to 4.4% after Q2 2009). This was due to i.a. an improvement in the balance of trade in goods which turned positive after recording a deficit in the second half of the previous year. In Q2 2009 the value of exports (in EUR) decreased by 25% from a year before, while imports fell by 32%. Compared to the previous quarter the decrease in exports slowed down, while fall in imports accelerated slightly. At the same time, surplus in services balance improved. The current account deficit narrowed due to a fall in the income account deficit, mainly as result of decrease in non-resident FDI income and worse company earnings compared to a year before. Another factor behind an improvement in current account deficit

In the second half of 2009, financial account surplus widened was recorded in compared with its level in two preceding quarters. This was due to an increase in liabilities of the government sector in respect of loans granted by the International Monetary Fund, European Union and World Bank. With regard to other categories, there was an increase in FDI inflows and decrease in portfolio investments. In the entire 2009 FDI inflows covered only about one third of the current account deficit.

In Q1 2009, the surplus wound down considerably due to decrease in other investments and direct investments inflows and a continued outflows of portfolio investments. In Q2 2009 the financial account balance turned negative, mostly due to falling capital flows related to additional loan tranches granted to Hungary as part of a rescue plan. In addition, the balance of direct investments turned negative after profit reinvestment in Hungary fell considerably. However, due to an improving sentiment in the international financial markets, the portfolio investment outflows diminished. In the first half of 2009 a relatively low surplus compared to a year before was recorded on the financial account. As of the end of Q2 2009, the FDI covered only 9% of the current account deficit (4-quarter floating average).

Figure 11.7
Financial account balance and its components (in % of GDP, 4q moving average)



source: Ecowin Economic

Table 11.3
Balance of payments, balance (in % of GDP, 4q moving average)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Current account	**-6.5**	**-7.2**	**-6.5**	**-4.7**	**-1.8**
Goods	0.2	-0.1	0.3	1.6	3.5
Services	0.9	0.8	0.9	1.1	1.3
Income	-7.2	-7.3	-7.2	-7.0	-6.5
Current transfers	-0.4	-0.6	-0.5	-0.4	-0.2
Capital account	**0.5**	**1.0**	**1.3**	**1.6**	**1.9**
Financial account	**9.4**	**15.6**	**16.5**	**12.5**	**13.1**
FDIs	1.8	2.4	2.2	0.3	0.2
Portfolio investments	2.0	-3.0	-6.2	-7.9	-6.6
Other investments	5.5	16.3	20.4	20.1	19.6

source: Ecowin Economic

Interest rates and foreign exchange rate

Since Q2 2009 sentiment in international financial markets have been improving along with falling risk aversion. For this reason, the demand for Hungarian treasury bonds increased after a sudden collapse in Q4 2008 and Q1 2009.

At the same time, declining volatility of the forint allowed to lower the reference rate by the Bank of Hungary from 9.5% in January 2009 to 6.5% in October 2009.

Both the increase in risk appetite and the reference rate cut triggered a decline in treasury bond yields, which fell by 459 b.p. to 7.62% between March and November 2009. The fall in Hungarian treasury bond yields was accompanied with appreciation of the forint against the euro.

Fiscal policy

Hungary is another country of the region which was forced to request financing from international organisations as a result of, i.a. a significant general government deficit and deteriorating economic situation at the end of 2008. This aid was granted on the condition that Hungary undertakes a wide range of measures to reduce the deficit of the general government sector. Changes adopted in 2008 and 2009 included: gradual raising of the retirement age, changes in the pension and disability benefits indexation, abolition of the 13th pension, reducing the amount of healthcare benefits, wage freeze in the public sector (for two years; along with elimination of the 13th salary), reduction of social security benefits (i.a. scholarships, subsidies) and a municipality reform. In mid-2009 there was a hike in VAT rates and an increase in excise duty (from 20% to 25% and by 5-6 p.p., respectively). As well as these, PIT rate (from 18% and 36% to 17% and 32%) along with social insurance contributions (from 32% to 27%) are scheduled to be lowered in 2010.

According to the EC forecast, the general government deficit will increase slightly in 2009 from a year before and it will amount to 4.1% of GDP (compared with 3.9% estimated by the Hungarian government). In the following years the sector balance will remain around the level recorded in 2009, i.e. approximately -4% of GDP. This implies that it will still exceed the Maastricht Treaty reference value. The EC also expressed its doubts over the viability of certain actions related to the fiscal consolidation in Hungary (including wage freeze in the public sector, healthcare expenditure cuts, education and reduction in subsidizing municipalities).

The excessive deficit procedure was launched against Hungary in May 2004. Due to a difficult economic situation the date of adjusting the general government deficit was postponed in July 2009 by another two years, i.e. to 2011.

In the forecast period, Hungary's public debt is set to increase from 72.9% of GDP in 2008 to 79.1% in 2011, the highest level in the region.

Forecasts

In Q2 and Q3 2009 the economic growth forecasts for 2009 were revised downward for Hungary and then, raised slightly back in Q4 2009. Forecasts for 2010 remained stable and they still project that the recession will continue in 2010. The key factor behind the prolonged recession is subdued household expenditure stemming from fiscal policy measures aiming at reducing consumption, further deterioration in the labour market and a decreasing availability of loans. The last factor will be equally important for investments in the private sector, which will be dampened as a result of restructuring in the automobile industry.

The Hungarian economy still experiences a low demand inflation pressure. However, due to a higher than previously envisaged cost pressure, further hikes in indirect tax rates at the beginning of 2010 and resulting increase in inflation expectations, elevated inflation is expected in the first half of 2010. For these reasons, some inflation forecasts for 2009 and 2010 have been revised upwards.

Table 11.4

Forecasts of main indicators

	MNB	EC	OECD	IMF
	11.2009 (05.2009)	10.2009 (04.2009)	11.2009 (06.2008)	10.2008 (04.2008)
GDP, in %, y/y				
2009	-6.7 (-6.7)	-6.5 (-6.3)	-6.9 (-6.2)	-6.7 (-3.3)
2010	-0.6 (-0.9)	-0.5 (-0.3)	-1.0 (0.4)	-0.9 (-0.4)
2011	3.4 (3.4)	3.1	3.1	3.2 (2.5)
CPI, in %, y/y				
2009	4.2 (4.5)	4.3 (4.4)	4.5 (4.5)	4.5 (3.8)
2010	3.9 (4.3)	4.0 (4.1)	4.0 (4.1)	4.1 (2.8)
2011	1.9 (1.9)	2.5	3.0	2.5 (3.0)
Current account balance, in % of GDP, y/y				
2009	-0.5 (-4.1)	-1.3 (-5.0)	-1.6 (-4.0)	-3.0 (-3.9)
2010	-1.5 (-4.0)	-1.7 (-4.8)	-1.8 (-3.2)	-3.3 (-3.4)
2011	-1.4 (-3.3)	-1.8	-2.6	-3.4 (-3.1)

MNB – Magyar Nemzeti Bank

Box 2

Impact of fixed exchange rate system on imbalances in the Baltic states

When adopting the fixed exchange rate system under ERM II, the Baltic countries assessed their chances of the euro zone accession too optimistically. As a result of low interest rates, in particular in view of over-liquidity on the global market, those countries experienced credit booms with all their negative consequences, including a high increase in external imbalances. Effects of the increase in imbalances emerged in particular at the outbreak of the global crisis and led to a very deep decrease in the economic activity in those countries which is expected to be suffered for many years. At the same time, the situation observed in the Baltic countries in recent years revealed weaknesses of ERM II in respect of a lack of appropriate supervision over the countries covered by that mechanism.

Reasons for an increase in imbalances in the post-accession period

Between 2004 and 2008 a very fast increase in the current account deficits was observed in the Baltic countries. At the end of 2007 and the beginning of 2008 the current account deficit in those countries ranged from 15% of GDP in Lithuania to 25% of GDP in Latvia.

One of the reasons for an increase in the current account deficits was a fixed exchange rate regime adopted by the Baltic countries. The fixed exchange rate regime was implemented in those countries already since 1991 when they regained independence. However, during the post-accession period, its impact on the widening external imbalances was the highest.

After their accession to the European Union, the Baltic countries joined ERM II very fast - Estonia and Lithuania as early as in June 2004, while Latvia - in May 2005. At the same time, those countries undertook a unilateral obligation to narrow the exchange rate criterion. Estonia and Lithuania adopted the currency board system, while Latvia narrowed the fluctuation band to +/-1% around the central parity. By adopting the fixed exchange rate regime, the Baltic countries abandoned an autonomous monetary policy and thus accepted the adoption of interest rates applicable in the euro zone. As it turned out, far too low in the case of economies where the real convergence process was very fast.

The adoption of the fixed exchange rate regime resulted in a very fast increase in the lending activity in the Baltic countries. The loan volume increased in all countries of the region, which to a certain extent is a natural component of the catching up process, however, in the case of the Baltic states this process was much more intense than in other countries of the region. In 2006 and 2007 the growth in credit to private sector in the Baltic states amounted to approximately 50-70% y/y, while in other countries of the region it was twice lower. The value of loans in relation to GDP between 2004 and 2008 in the Baltic states increased more than twofold (from nearly 50% to 100% of GDP in Estonia and Latvia and from 25% to 60% in Lithuania). In addition, the absence of foreign exchange risk encouraged to take on liabilities in foreign currencies (euro) due to even lower costs of a loan. The share of loans denominated in foreign currencies oscillated between 65% in Lithuania and nearly 90% in Latvia.

Credit boom in the Baltic countries (and also in other countries of the region) between 2004 and 2007 was also facilitated by the situation on global financial markets. A high liquidity, low interest rates in developed economies, low risk aversion and lax supervisory standards, also in the euro zone, contributed to a higher inflow of capital to Central and Eastern European countries. An additional driver for the increase in loan volume in the Baltic countries was the above mentioned low level of real interest rates which for the most of the analysed period were negative in the Baltic countries. Consequently, an easy access to cheap credit led to an unprecedented credit boom in the region together with all its consequences (see figure 1) such as:

- a fast increase in domestic demand, mainly consumption[36],
- an increase in inflation[37],
- bubbles in the capital markets and real estate market[38],
- an increase in imports,
- a decrease in exports competitiveness due to increasing prices and labour costs[39],

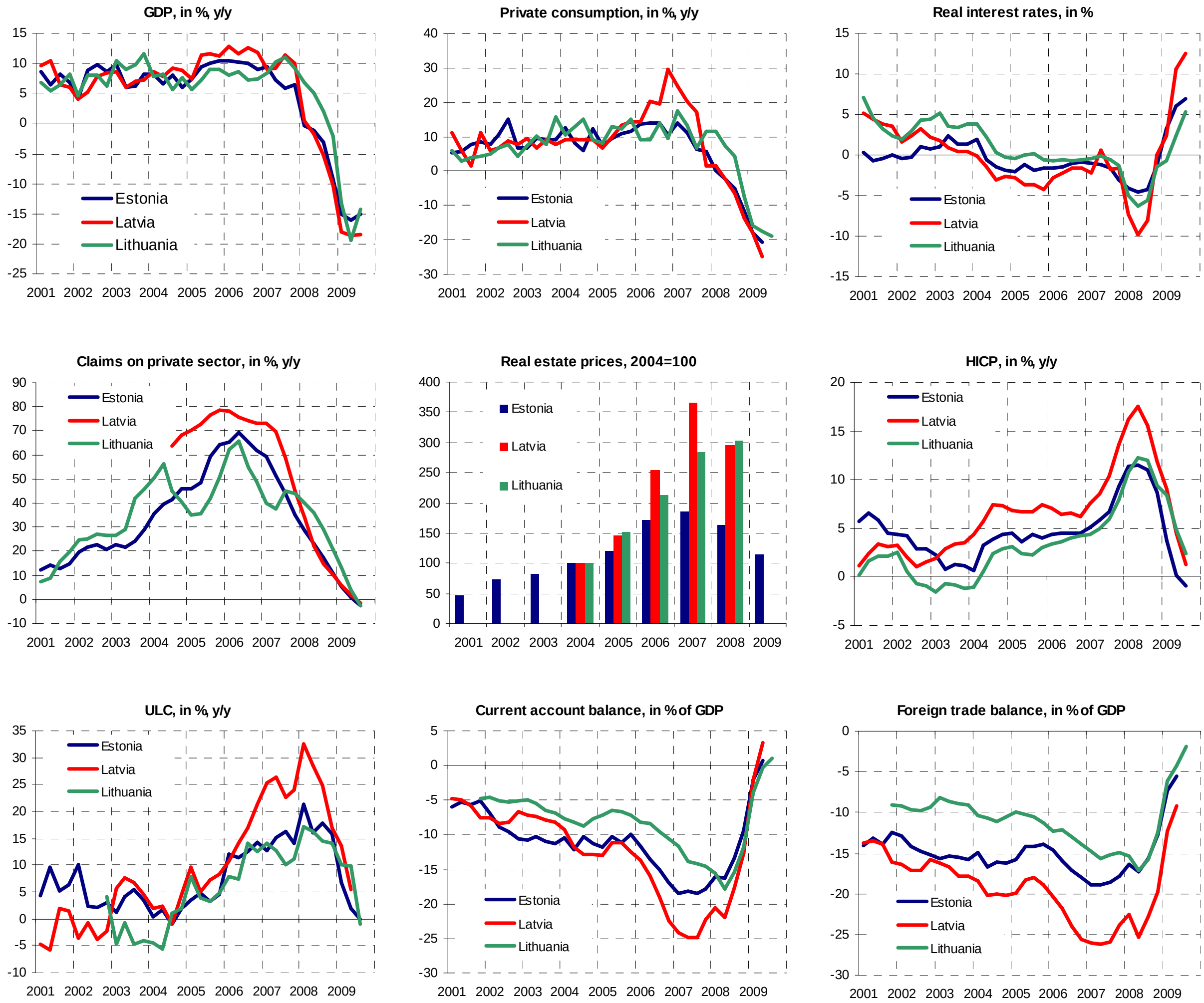
[36] The average annual growth in private consumption between 2004 and 2007 in the Baltic countries far exceeded 10% and at the end of 2006 it increased to almost 30% y/y in Latvia.

[37] An increase in inflation, to two-digit figures, caused further decreases in real interest rates which in the absence of a fully autonomous monetary policy led paradoxically to even lower costs of credit and to an increase in the lending growth even during the economic overheating.

[38] For instance, between 2004 and 2007 prices of 1 m^2 of a flat increased 2.5 times in Tallinn and 3.5 times in Riga.

- deepening current account deficit,
- an increase in foreign debt[40].

Figure 1. Credit boom in the Baltic states



Source: Eurostat, EcoWin Economic, central banks, CSOs

Consequences of external imbalances in the face of global crisis

A very fast economic growth, driven mainly by consumption, high inflation and wage growth, increasing current account deficit and rapid credit growth based on an inflow of foreign capital constituted a clear signal of economies' overheating. This problem was also perceived by commercial banks which in mid-2007 decided to tighten their credit policies[41] in fear of a sudden economic collapse[42] in the Baltic countries. Then it turned out how much Baltic economies were dependent on the inflow of foreign capital. Consumption growth fell very fast, resulting in a distinct economic slowdown in those countries.

Escalation of the global crisis in 2008 additionally deepened the economic slowdown in the Baltic states (see figure 1). The impact of the crisis on the Baltic economies was transmitted mainly through

[39] Despite the Baltic countries succeeding in avoiding nominal currency appreciation that occurred in other countries of the region between 2004 and 2008, the exports growth in those countries was one of the lowest in the region. One of the reasons for this situation was strong appreciation of the real exchange rate resulting from an increase in unit labour costs. Their average annual growth between 2004 and 2008 was approximately 8% and was more than five times higher than in the euro zone.

[40] The fast increase in lending was not however accompanied by an equally fast increase in deposits, which made banks (mostly branches of foreign banks, mainly Scandinavian) borrow money abroad and consequently led to an increase in the external debt. The value of foreign debt between 2004 and 2008 increased by 150-200% and in the case of Estonia and Latvia it distinctly exceeded the GDP value.

[41] The loan growth started to decrease significantly since mid-2007 despite record low real interest rate, reaching -10% in Latvia.

[42] Banks feared, inter alia, a situation that occurred in Portugal before its accession to the euro zone, where credit boom led to a long-lasting recession.

the financial channel. The bankruptcy of Lehman Brothers caused a very fast increase in risk aversion, leading to capital flight from emerging markets. CEE countries were not an exemption. External imbalances growing in previous years, dependence on the external financing and an increase in foreign debt in the Baltic countries was perceived as an important factor increasing investors risk. As a result, a sudden stop of capital inflow, especially to the banking sector, accelerated and deepened trends observed in the Baltic economies since mid-2007. The lending growth rate declined faster and faster (to -2% y/y on the average in Q3 2009), leading to, inter alia, further decreases in prices on the real estate market. Domestic demand also collapsed, resulting in the largest economic crisis in those countries since the beginning of the 1990s.

The importance of trade channel in transmitting global crisis effects was smaller, albeit also important. Similarly to other countries of the region, the Baltic countries suffered from the decreasing foreign trade volume. A declining foreign demand and difficult access to trade loans led to a decrease in exports in the Baltic countries. However, at the same time the decrease in domestic demand caused an even larger decline in imports, which consequently translated into a positive contribution of the foreign trade balance to the GDP growth in recent quarters.

The impact of the crisis on the Baltic economies revealed weaknesses of ERM II. Experiences of the last year showed that consent to abandon an autonomous monetary policy can not be taken too easy. The Baltic case showed, that a lack of sufficient control by Eurosystem over the condition of economies covered by ERM II, creates a risk of a loss of confidence not only in respect of economies covered by it but also in respect of the functioning of the entire mechanism.

Future of the fixed exchange rate regime in the Baltic countries

A deteriorating economic situation in the Baltic states in 2009 started discussions on the possibility of devaluating their currencies or even abandonment of fixed exchange rate regime. Those speculations usually referred to Latvia where effects of the crisis were most evident.

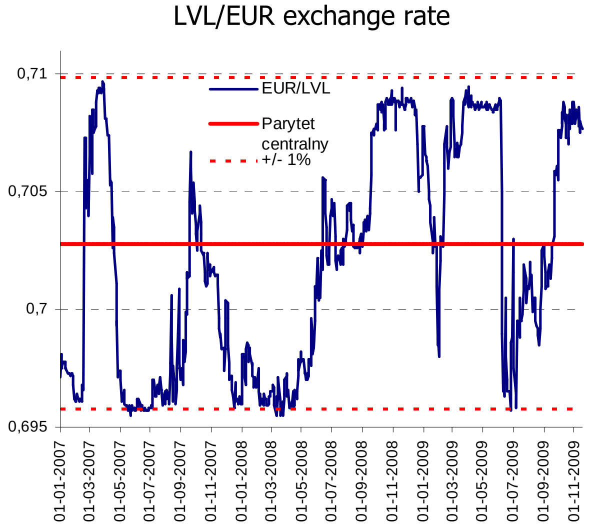
Discussions on the devaluation of the central parity or freeing the exchange rate in Latvia occurred during negotiations with IMF and other international institutions on terms of disbursement of subsequent tranches of the loan granted to Latvia in December 2008. [43]

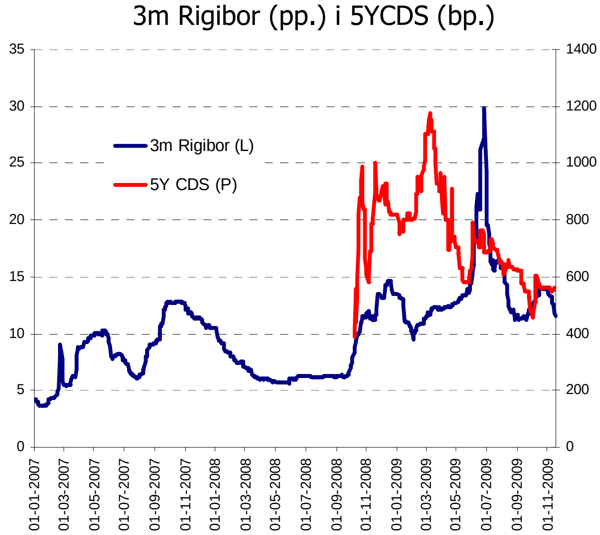
First voices for devaluation in Latvia appeared already in December 2008 when IMF demanded very radical budget cuts (reduction of general government deficit in 2009 to 5% of GDP versus projected nearly 10% of GDP). Proposals to reduce budget expenditure led to a collapse of the government in February 2009, which further decreased the confidence in the Latvian economy. This situation deteriorated even further in March 2009 when IMF concluded that Latvia did not introduce required reforms in order to reduce the deficit and decided to froze the disbursement of the first loan tranche. As a result, the lat exchange rate remained all the time at the upper limit of fluctuations band, for Latvian treasury bonds yield increased significantly as did CDS rates and interest rates on the inter-bank market. The issue of devaluation in Latvia returned in June 2009 after an unsuccessful treasury bond issuance. This caused a panic on financial markets (an increase in the bond yield and the inter-bank interest rate to 30%). Some investors even suggested the repetition of the Argentinian crisis. However, tensions on financial markets subsided very fast as Latvia managed to meet EU and IMF conditions (reduction of budget expenditure by 10%, i.e. approximately LVL 500 million) and receive d subsequent loan tranches (EUR 1.7 billion from EU and EUR 0.2 billion previously frozen in August 2009). In October 2009 the issue of potential devaluation in Latvia resurfaced. The Latvian government negotiated a disbursement of another loan tranche and it did not want to agree to the level of further budget cuts in 2010. Simultaneously, a draft act was proposed which would limit liabilities of borrowers[44]. Those steps were interpreted by some economists as a signal of devaluation. Those speculations ended after IMF approved a disbursement of subsequent loan tranches. Tensions on the financial market also subsided. However, the devaluation risk in Latvia is still present and depends on the situation in the real economy, on financial markets and in the public finance sector in subsequent quarters.

[43] Dramatically deteriorating situation of the financial sector (mainly banks) in Latvia forced its government to apply for IMF aid. In December 2008 IMF granted to Latvia a loan of EUR 1.7 billion and taking into account the aid received from EU and a group of European countries, the value of the loan granted to Latvia was EUR 7.5 billion.

[44] The value of mortgage loan borrowers' liabilities would be limited to the value of the property in the case of inability to repay the loan. This proposal brought about objection of commercial banks, in particular Swedish banks which dominate on the Latvian market, because as a result of a burst of the property market bubble, property prices fell by as much as 70%.

Figure 2. Developments on the Latvian financial markets





Source: EcoWin Financial

A potential devaluation in Latvia poses risks not only for this country but also for the entire region, in particular for Lithuania and Estonia. It is highly likely that devaluation in Latvia would force similar steps in other Baltic countries. It would also lead to a decrease in investor confidence which would bring damage to the entire region of the Central and Eastern Europe.

The main argument against a change of the exchange rate regime or devaluation of Baltic currencies is a very high share of loans denominated in foreign currencies. In the case of Baltic countries such loans constitute approximately 80% of total debt of households and companies. A currency weakening (depreciation or devaluation) would lead to a significant burden for households and business entities which are already in a very bad situation due to the highest in the region decline in the economic activity. It would also be another shock for the banking system. Since the end of 2007 the number of non-performing loans has been increasing very fast and their share rose from less than 1% as of the end of 2007 to more than 10% in Lithuania and Latvia in mid-2009.

On the other hand, arguments in favour of a change of the exchange rate regime in the Baltic countries are also put forward. One of them are high costs of its maintenance during a strong depreciation pressure. According to European Commission's estimates, the cost of defense of the exchange rate of its currency by the Bank of Latvia amounted to approximately 25% of its foreign exchange reserves in the first half of 2009. Another argument is an increase in the competitiveness of exports of those countries. This argument lost its importance in recent months because due to a fast decrease in inflation and labour costs in 2009. Real exchange rates already started to weaken, thus the competitiveness of the Baltic countries increased.

It seems that governments of the Baltic countries treat the abandonment of the fixed exchange rate regime as the last resort. A change of the exchange rate regime would induce deterioration of the already very poor financial situation of households and business entities. On the other hand, its positive impact on the economy would not be certain. In addition, it would involve a high risk of leaving ERM II and lost of the central banks credibility. This would induce a serious a risk of a delay in euro implementation. Taking into account the current economic situation of the Baltic economies, those concerns relate mainly to Estonia where public finance suffered least as a result of the crisis and this country still hopes to accede to the euro zone in 2011.

Statistical annex

1. National accounts

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

	2007	2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	6.8	5.0	5.1	3.0	0.8	1.1	1.7
Czech Republic	6.5	2.7	3.9	0.0	-4.4	-5.8	-4.1
Slovakia	10.4	6.5	7.1	2.5	-5.6	-5.3	-4.9
Slovenia	6.1	3.6	3.9	-0.8	-8.3	-9.3	-8.3
Hungary	1.3	0.8	1.4	-2.5	-6.7	-7.5	-7.2
Estonia	7.1	-3.5	-3.2	-9.2	-15.0	-16.1	-15.6
Lithuania	8.8	3.0	2.1	-2.2	-13.3	-19.5	-14.2
Latvia	10.3	-4.2	-5.2	-10.3	-18.0	-18.7	-19.0
Bulgaria	6.2	6.1	6.8	3.5	-3.5	-4.9	-5.8
Romania	6.0	7.4	9.2	2.9	-6.2	-8.7	-7.1
EU-15	2.9	0.5	0.3	-2.0	-5.0	-5.0	-4.3

Source: CSOs

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

	2007	2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	4.9	5.9	5.7	5.7	3.3	1.7	2.2
Czech Republic	5.7	3.4	3.3	3.4	1.8	1.4	1.0
Slovakia	7.1	6.2	6.0	4.7	-1.2	0.7	-0.3
Slovenia	3.1	2.2	0.6	1.1	0.2	-2.6	-2.1
Hungary	-0.3	-0.4	0.2	-4.1	-7.3	-6.6	-9.8
Estonia	8.9	-4.7	-4.9	-11.7	-17.7	-20.8	-20.0
Lithuania	11.5	4.0	4.4	-7.4	-15.7	-17.5	-19.0
Latvia	14.0	-5.2	-6.5	-13.7	-17.8	-24.7	-27.9
Bulgaria	5.3	4.7	5.9	1.8	-6.0	-5.0	-4.7
Romania	10.4	9.3	14.6	-3.7	-10.5	-13.2	-12.7
EU-15	1.9	0.4	0.1	-0.9	-2.1	-1.8	1.9

Source: CSOs

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

	2007	2008	III 2008	IV 2008	I 2009	II 2009	II 2009
Poland	17.6	8.2	4.0	4.5	1.0	-3.0	-1.5
Czech Republic	6.1	-1.0	-0.5	-3.5	-7.5	-7.2	-9.6
Slovakia	8.2	7.0	7.3	1.4	-4.1	-17.6	-11.4
Slovenia	17.6	6.6	4.5	-5.3	-22.5	-27.3	-23.8
Hungary	0.7	-2.8	-1.5	-2.7	-6.9	-3.3	-6.8
Estonia	7.8	-11.5	-13.2	-21.3	-27.3	-38.8	-37.0
Lithuania	15.8	-5.9	-5.6	-16.1	-38.5	-40.9	-41.4
Latvia	8.4	-15.1	-19.3	-17.1	-34.1	-38.1	-39.4
Bulgaria	21.7	20.6	22.3	15.8	-14.1	-16.3	-36.5
Romania	28.9	22.6	24.3	2.8	-0.3	-25.6	-28.6
EU-15	4.9	-1.1	-1.4	-6.0	-11.4	-12.5	-0.5

Source: CSOs

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

	2007	2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	9.1	7.1	9.5	-3.2	-13.3	-13.9	-9.5
Czech Republic	14.5	6.9	8.4	-9.6	-19.9	-18.1	-8.8
Slovakia	16.0	3.6	2.7	-7.8	-25.3	-20.5	-15.0
Slovenia	13.1	3.4	4.2	-6.2	-20.8	-21.3	-16.3
Hungary	14.2	5.2	3.6	-8.2	-18.6	-14.0	-6.9
Estonia	1.5	-0.6	5.0	-1.3	-16.5	-11.1	-9.6
Lithuania	4.7	12.1	12.6	10.5	-13.1	-23.4	-17.4
Latvia	11.1	-1.2	-2.1	-6.1	-16.4	-17.9	-14.7
Bulgaria	5.2	3.0	3.8	-6.0	-17.4	-15.8	-6.7
Romania	8.8	19.8	22.0	1.6	-19.6	-12.2	1.6
EU-15	4.4	1.1	1.2	-6.0	-15.5	-16.8	-13.6

Source: CSOs

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

	2007	2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	13.7	8.0	9.1	-2.5	-17.2	-19.9	-14.9
Czech Republic	13.7	5.4	4.6	-6.8	-18.5	-17.9	-8.7
Slovakia	10.4	3.8	3.6	-6.7	-23.2	-21.9	-17.0
Slovenia	14.3	3.8	3.0	-6.6	-22.1	-24.8	-19.6
Hungary	12.1	5.1	3.5	-8.7	-22.0	-22.6	-14.6
Estonia	2.8	-8.6	-7.0	-11.5	-27.4	-30.9	-26.6
Lithuania	9.1	10.6	13.4	-0.7	-33.7	-33.2	-31.3
Latvia	15.0	-13.5	-15.1	-20.7	-34.3	-39.3	-35.4
Bulgaria	9.9	5.1	4.2	-3.2	-21.1	-24.3	-23.4
Romania	26.1	18.7	20.7	-10.2	-31.4	-26.9	-15.3
EU-15	4.3	0.9	0.6	-4.3	-13.0	-14.8	-17.9

Source: CSOs

2. Indices of business cycle and economic activity

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

	2007	2008	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	9.7	3.0	-5.2	-4.4	-4.5	0.1	-1.2	-1.2
Czech Republic	8.3	-1.5	-21.3	-11.8	-18.2	-8.4	-11.9	-7.3
Slovakia	13.1	3.3	-24.0	-17.7	-21.4	-6.4	-5.8	-6.4
Slovenia	7.1	-1.9	-19.8	-23.2	-20.4	-18.2	-16.3	
Hungary	8.3	0.1	-22.4	-19.0	-19.0	-19.5	-15.2	
Estonia	6.8	-6.2	-31.9	-29.0	-28.6	-26.3	-27.6	-23.1
Lithuania	4.1	5.7	-19.4	-16.1	-15.6	-13.9	-15.4	-8.9
Latvia	0.4	-6.8	-19.0	-18.4	-17.6	-12.4	-15.3	
Bulgaria	9.2	1.1	-23.9	-24.2	-23.8	-23.1	-28.2	
Romania	5.4	2.8	-10.1	-4.5	-4.1	-5.7	-3.1	-2.7
EU-15	3.1	-3.9	-12.4	-9.4	-7.9	-12.4	-13.9	

Source: CSOs

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

	2007	2008	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	14.6	9.7	-0.5	-0.7	3.6	3.1	0.7	0.7
Czech Republic	7.8	3.2	-7.5	-4.9	-4.9	-3.5	-7.6	
Slovakia	5.4	9.5	-12.0	-10.7	-10.2	-9.6	-9.2	-10.3
Slovenia	9.6	10.6	-17.4	-13.1	-15.1	-15.0	-18.4	
Hungary	-2.8	-1.8	-3.9	-2.3	-6.6	-7.2	-7.3	
Estonia	15.2	-2.3	-16.2	-10.8	-17.2	-16.5	-17.8	-16.5
Lithuania	17.7	5.0	-28.6	-25.1	-26.9	-22.8	-31.8	-28.7
Latvia	19.9	-6.9	-26.7	-29.2	-29.4	-29.8	-30.9	-29.1
Bulgaria	4.9	3.7	-10.4	-10.5	-9.2	-9.7	-8.3	
Romania	16.4	13.7	-11.8	-17.8	-12.9	-11.7	-12.7	
EU-15	0.6	0.0	-2.9	-0.9	-0.9	-1.2	-1.7	-0.5

Source: CSOs

Table 8. DG ECFIN consumer sentiment index

	2007	2008	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	-5.0	-6.5	-20.8	-24.5	-20.1	-24.3	-24.6	-25.4
Czech Republic	-2.2	-8.6	-14.1	-16.9	-16.6	-10.8	-14.0	-7.9
Slovakia	-0.2	-13.1	-36.0	-34.7	-34.3	-26.2	-30.9	-31.5
Slovenia	-9.8	-20.4	-24.9	-27.4	-27.4	-18.0	-25.8	-21.0
Hungary	-48.3	-47.9	-61.0	-60.6	-57.1	-53.9	-48.9	-50.6
Estonia	2.8	-20.6	-29.8	-29.4	-25.1	-18.4	-15.0	-14.2
Lithuania	4.6	-22.1	-44.5	-45.3	-48.4	-42.1	-46.4	-48.6
Latvia	-7.8	-27.2	-50.3	-54.9	-53.8	-51.1	-52.6	-49.2
Bulgaria	-26.4	-31.6	-48.6	-42.2	-40.3	-42.6	-41.4	-42.3
Romania	-14.3	-17.7	-41.2	-45.3	-45.9	-49.3	-48.5	-49.8

Source: EC

Table 9. DG ECFIN business sentiment index

	2007	2008	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	-0.7	-7.9	-26.0	-25.8	-23.4	-21.7	-20.4	-19.1
Czech Republic	15.4	1.4	-21.8	-20.8	-19.0	-14.3	-17.9	-16.8
Slovakia	14.2	-4.2	-16.5	-9.9	-11.4	-13.3	-8.7	-5.6
Slovenia	12.3	-3.5	-27.7	-28.2	-23.6	-18.1	-16.9	-11.7
Hungary	0.3	-9.3	-24.6	-20.2	-17.3	-17.2	-15.9	-15.7
Estonia	15.1	-11.0	-33.3	-27.5	-24.1	-23.9	-22.5	-19.8
Lithuania	5.7	-9.5	-29.0	-28.7	-24.2	-29.8	-23.2	-17.9
Latvia	4.8	-14.1	-27.7	-26.7	-27.5	-25.6	-23.1	-21.8
Bulgaria	11.7	8.9	-10.4	-13.6	-14.9	-14.8	-11.7	-12.5
Romania	3.0	-0.4	-14.3	-15.4	-14.8	-13.6	-12.7	-13.2

Source: EC

Table 10. PMI manufacturing index

	2007	2008	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	52.9	47.0	43.0	46.5	48.2	48.2	48.8	52.4
Czech Republic	56.8				47.0	47.5	49.8	50.6
Hungary	53.6	49.8	46.3	49.5	46.1	49.1	48.3	47.5

Source: EcoWin Economic

3. Prices

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	3.6	4.0	3.6	3.5	3.6	3.7	3.4	3.1
Czech Republic	2.3	1.8	1.3	1.2	0.3	0.2	0.0	-0.2
Slovakia	2.5	2.1	1.9	1.8	1.7	1.3	0.6	0.4
Slovenia	1.8	1.1	0.7	0.3	-0.6	0.0	-0.1	0.0
Hungary	2.9	3.4	3.8	3.7	5.1	5.0	4.9	4.7
Estonia	2.0	0.3	-0.3	-0.9	-0.7	-0.9	-1.6	-2.2
Lithuania	7.7	6.3	5.2	4.2	3.0	2.6	2.7	1.3
Latvia	8.3	6.2	4.7	3.4	2.5	1.8	0.5	-0.9
Bulgaria	4.9	4.8	3.9	3.7	1.6	1.3	0.2	-0.3
Romania	6.7	6.5	6.0	5.9	5.1	5.0	4.9	4.3

Source: CSOs

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	4.0	3.5	1.9	1.8	0.6	1.0	0.6	
Czech Republic	-2.0	-2.5	-3.8	-4.4	-4.9	-5.2	-5.4	-4.6
Slovakia	0.5	-0.8	-2.6	-3.2	-4.3	-4.7	-5.2	-5.8
Slovenia	0.8	0.2	-0.7	-0.7	-1.3	-1.7	-1.6	-1.4
Hungary	4.6	2.5	1.8	2.1	-0.5	-0.8	-1.2	-2.8
Estonia	3.0	1.1	0.0	-0.7	-2.2	-2.2	-1.8	-3.2
Lithuania	-2.7	-4.1	-4.6	-7.5	-9.6	-11.9	-12.1	-12.8
Latvia	8.5	2.5	-0.7	-3.3	-3.9	-5.2	-5.4	-10.2
Bulgaria	-1.1	-2.3	-3.2	-5.1	-9.0	-9.8	-7.8	-8.3
Romania	3.8	3.0	2.5	1.2	-0.7	-1.0	-0.1	
EU-15	-2.5	-4.5	-5.9	-6.8	-8.5	-7.2	-7.3	-6.0

Source: CSOs

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	4.0	3.5	1.9	1.8	0.6	1.0	0.6	1.6
Czech Republic	-2.0	-2.6	-3.8	-4.4	-4.9	-5.2	-5.4	-4.6
Slovakia	0.6	-0.8	-2.6	-3.2	-4.3	-4.7	-5.2	-5.8
Slovenia	0.8	0.2	-0.7	-0.7	-1.3	-1.7	-1.6	-1.5
Hungary	4.6	2.5	1.8	2.1	-0.5	-0.8	-1.2	-2.8
Estonia	3.0	1.1	0.0	-0.7	-2.2	-2.2	-1.8	-3.2
Lithuania	-2.4	-4.1	-4.6	-7.5	-9.6	-12.0	-12.1	-12.8
Latvia	8.5	2.5	-0.7	-3.3	-3.9	-5.2	-5.4	-10.2
Bulgaria	-1.1	-2.3	-3.2	-5.1	-9.0	-9.8	-7.8	-8.3
Romania	3.8	3.0	2.5	1.2	-0.7	-1.0	-0.1	0.1
EU-15	-2.5	-4.5	-5.9	-6.8	-8.5	-7.2	-7.3	-6.0

Source: Eurostat

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	7.9	9.9	8.9	8.1	8.1	9.1	7.4	6.0
Czech Republic	1.6	0.7	-2.5	-2.7	-4.7	-3.1	-2.3	-3.8
Slovakia	-1.7	-3.6	-4.4	-6.8	-7.3	-7.0	-5.3	-6.2
Slovenia	4.8	3.3	0.6	-1.3	-3.4	-1.5	-1.7	-3.9
Hungary	6.5	6.0	15.1	12.0	8.0	5.3	3.0	2.5
Estonia	1.7	-2.7	-3.6	-5.4	-3.9	-4.6	-5.7	-5.8
Lithuania	10.1	7.5	5.9	3.0	1.3	-0.4	-1.3	-3.4
Latvia	9.7	5.4	2.5	0.1	-3.2	-3.8	-5.9	-7.2
Bulgaria	3.8	2.0	1.4	4.2	3.3	3.7	-0.4	-4.9
Romania	5.7	4.8	4.2	3.8	5.2	2.9	2.3	0.9

Source: Eurostat

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	5.9	6.2	6.2	6.0	7.0	5.9	5.4	5.1
Czech Republic	3.1	2.3	2.1	1.9	0.4	-0.4	-1.7	-1.8
Slovakia	2.5	0.8	0.4	0.0	-0.1	-0.4	-0.5	-0.6
Slovenia	2.1	1.9	3.1	3.5	3.2	3.0	2.9	2.9
Hungary	4.6	3.4	3.5	3.6	4.9	4.3	4.7	4.8
Estonia	7.5	5.4	4.4	3.4	2.4	-0.5	-4.2	-3.5
Lithuania	7.3	6.5	6.0	4.4	3.6	3.3	3.9	5.1
Latvia	9.1	7.6	6.9	5.8	6.5	5.8	5.3	5.2
Bulgaria	3.1	4.7	3.4	2.4	1.3	0.8	0.5	0.7
Romania	8.0	8.2	7.8	7.2	6.6	6.2	7.1	6.3

Source: Eurostat

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	6.6	7.0	5.1	5.7	6.0	5.8	5.5	4.3
Czech Republic	4.5	3.7	3.1	3.5	0.6	1.7	1.6	-0.7
Slovakia	0.5	0.6	0.2	0.5	0.5	0.6	-0.8	-1.1
Slovenia	-6.9	-6.5	-9.4	-11.2	-11.9	-7.3	-4.9	-3.2
Hungary	1.0	1.1	-0.3	0.9	1.3	3.1	2.7	0.2
Estonia	-2.0	-5.2	-7.1	-8.0	-6.8	-3.2	-2.7	-6.3
Lithuania	12.6	11.3	10.3	10.1	5.1	6.8	6.6	0.4
Latvia	15.3	8.5	4.8	2.0	-1.5	0.3	0.2	-6.4
Bulgaria	-5.3	-4.9	-6.5	-6.0	-12.4	-8.2	-10.1	-6.6
Romania	7.0	6.1	4.8	5.2	0.1	0.9	0.8	1.3

Source: Eurostat

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

	03.2009	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009
Poland	2.0	2.1	2.5	2.7	2.8	2.7	2.7	2.7
Czech Republic	0.6	0.4	0.4	0.4	0.2	0.1	-0.1	0.3
Slovakia	2.4	2.4	2.2	2.0	1.9	1.7	1.1	1.1
Slovenia	3.0	2.3	2.2	2.2	1.6	1.4	0.7	0.8
Hungary	2.1	3.1	3.2	3.2	5.3	5.6	5.5	5.2
Estonia	2.0	1.3	1.2	0.7	0.7	0.4	0.1	0.0
Lithuania	5.6	4.1	3.0	2.5	2.1	1.4	1.5	0.5
Latvia	5.8	4.8	3.8	3.0	2.4	1.3	-0.6	-1.1
Bulgaria	6.7	6.1	5.5	4.7	4.2	3.5	2.9	2.6
Romania	6.1	6.1	5.9	6.1	6.4	7.0	6.6	5.7

Source: Eurostat

4. Balance of payments

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	-4.7	-5.0	-5.0	-5.0	-5.0	-4.0	-2.9	-2.0
Czech Republic	-3.2	-3.0	-3.2	-2.6	-3.1	-3.4	-2.7	-2.4
Slovakia	-4.7	-5.2	-5.7	-5.8	-5.8	-6.2	-4.9	-3.4
Slovenia	-4.8	-5.5	-5.9	-6.1	-6.2	-5.6	-3.9	-1.9
Hungary	-6.8	-6.5	-6.0	-6.5	-7.1	-6.5	-4.7	
Estonia	-17.8	-16.1	-14.5	-12.1	-9.4	-5.8	-2.2	0.8
Lithuania	-14.5	-15.6	-15.1	-14.3	-11.9	-8.0	-4.0	-0.3
Latvia	-22.3	-20.5	-18.6	-15.6	-13.0	-9.1	-2.2	
Bulgaria	-25.2	-24.7	-26.5	-25.3	-25.4	-23.5	-19.7	-15.0
Romania	-13.5	-13.7	-14.3	-13.8	-11.8	-10.1	-7.3	-5.3
EU-15	-0.1	-0.3	-0.6	-0.9	-1.3	-1.4	0.0	

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-4610	-4392	-5069	-4020	-4812	-95	-859	-503
Goods	-4028	-3560	-4687	-4496	-4983	-764	-360	-840
Services	1421	567	875	645	1378	819	941	1057
Income	-3481	-2376	-3045	-2159	-1996	-1607	-3100	-2094
Current transfers	1478	977	1788	1990	789	1457	1660	1374
Capital account	718	807	166	37	153	51	3	81
Financial account	9444	11120	9987	3521	2287	2820	5831	9166
FDIs	2364	3144	1991	883	1968	1379	1534	699
Portfolio investments	941	-950	727	1463	-3144	-765	3850	5036
Other investments	6952	8716	7295	1402	3977	3306	517	3224

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-1489	1185	-2251	-1249	-2296	839	-1053	-779
Goods	1005	1679	1597	1140	-268	1477	2011	1780
Services	341	872	891	810	714	631	486	504
Income	-2653	-1410	-4823	-2899	-2494	-1406	-3515	-2607
Current transfers	-183	45	85	-300	-247	137	-36	-456
Capital account	502	272	515	77	372	565	170	222
Financial account	1690	-623	2704	1941	2100	-224	935	1329
FDIs	2301	842	2141	1720	1354	486	-68	-357
Portfolio investments	472	-510	1583	351	-1732	-38	2782	936
Other investments	-1008	-801	-947	-11	2689	-527	-1629	777

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-1048	-302	-1123	-1414	-1034	-553	-223	-347
Goods	-138	25	-219	-87	-145	-235	430	413
Services	30	-70	-101	-45	-208	-242	-369	-212
Income	-902	-52	-668	-1066	-415	-21	-196	-387
Current transfers	-38	-204	-136	-216	-266	-55	-89	-161
Capital account	228	139	402	222	585	253	147	-147
Financial account	746	203	958	2088	1331	176	856	-1032
FDIs	407	-197	329	643	765	161	-487	327
Portfolio investments	-358	573	167	703	376	241	-814	574
Other investments	2413	-173	462	742	190	-225	2157	-1933

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-692	-425	-486	-642	-733	-206	190	75
Goods	-664	-489	-668	-751	-743	-128	7	-145
Services	167	334	475	487	314	263	318	415
Income	-135	-150	-259	-394	-236	-212	-150	-152
Current transfers	-60	-120	-33	16	-69	-129	16	-43
Capital account	-8	-8	3	-8	-30	-5	40	-4
Financial account	990	443	738	640	618	-119	-72	-17
FDIs	56	114	-142	128	281	-129	-303	-93
Portfolio investments	-806	305	-1152	165	1257	873	1150	2325
Other investments	1665	75	1947	340	-947	-953	-977	-2254

Source: Eurostat, central banks, own calculations

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

	III 2007	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009
Current account	-1588	-1535	-1550	-1550	-2239	-2268	-562	476
Goods	160	344	101	101	-429	-90	717	1398
Services	151	56	296	296	504	-3	126	417
Income	-1909	-1645	-1898	-1898	-2231	-1924	-1257	-1469
Current transfers	10	-290	-50	-50	-83	-251	-147	130
Capital account	236	44	122	122	129	739	300	415
Financial account	1355	3396	2513	2513	2727	7916	3729	-2050
FDIs	775	338	905	905	-54	1310	31	-872
Portfolio investments	-339	185	899	899	1405	-5664	-2918	-531
Other investments	918	2873	710	710	1375	12269	6616	-648

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-671	-618	-404	-281	-202	-12	168	157
Goods	-684	-497	-483	-448	-451	-178	-73	-129
Services	219	231	328	342	293	230	353	402
Income	-265	-351	-290	-223	-150	-85	-167	-193
Current transfers	59	-1	40	48	107	21	55	77
Capital account	36	44	23	13	39	17	16	48
Financial account	344	710	534	226	466	-155	-86	-472
FDIs	319	282	83	114	117	11	-203	-207
Portfolio investments	11	105	155	-122	364	-17	-375	-138
Other investments	37	273	297	272	-55	-159	471	-129

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-1067	-1340	-1292	-849	-361	26	-11	267
Goods	-1167	-1270	-1030	-849	-716	-143	-195	-190
Services	105	43	36	76	198	113	39	105
Income	-234	-336	-456	-297	29	-157	-148	42
Current transfers	228	222	158	221	128	212	293	310
Capital account	19	136	63	25	40	124	4	126
Financial account	1070	987	1192	713	453	-277	-165	-283
FDIs	134	169	166	428	252	80	157	-172
Portfolio investments	520	-194	-271	-39	416	13	78	10
Other investments	985	273	1518	38	-207	-644	-236	-130

Source: Eurostat, central banks, own calculations

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

	III 2007	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009
Current account	-1365	-1080	-901	-898	-758	-458	60	680
Goods	-1402	-1236	-1041	-1056	-1055	-927	-495	-289
Services	204	187	201	251	226	239	299	292
Income	-168	-136	-151	-281	-98	164	169	442
Current transfers	0	105	90	188	170	66	86	235
Capital account	6	130	31	21	28	66	14	74
Financial account	1433	728	1046	708	789	544	-194	-882
FDIs	331	205	367	266	227	-158	29	-119
Portfolio investments	0	0	0	0	0	0	0	0
Other investments	1468	568	493	689	509	61	-987	-1325

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-2666	-1972	-2429	-1257	-2995	-1413	-1140	438
Goods	-2305	-1770	-2477	-2009	-2341	-1145	-1250	-835
Services	-207	-241	220	979	-187	-95	251	1212
Income	-262	-96	-519	-283	-432	-291	-350	-24
Current transfers	109	135	347	56	-35	119	210	85
Capital account	77	174	0	8	23	18	8	24
Financial account	4034	2223	2680	2410	3392	1144	712	334
FDIs	2475	805	1949	1864	1445	817	671	538
Portfolio investments	-296	29	-264	-298	-107	-238	-40	105
Other investments	2032	1532	2124	2292	7	-443	200	-489

Source: Eurostat, central banks, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Current account	-5520	-3372	-5642	-4030	-3114	-858	-1451	-1003
Goods	-5595	-4167	-5145	-5288	-4511	-1499	-1702	-1567
Services	-59	142	221	6	289	-61	14	-147
Income	-954	-570	-2049	-826	-238	-517	-671	-419
Current transfers	371	140	172	57	252	14	42	205
Capital account	1088	1222	1331	2078	1345	1218	908	1130
Financial account	4854	2976	5997	4651	3583	416	1146	1126
FDIs	1232	1090	3453	2369	2395	1734	929	834
Portfolio investments	-104	321	2	-59	-826	-276	114	266
Other investments	4077	1873	2469	2442	1934	-2719	1917	1230

Source: Eurostat, central banks, own calculations

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

	III 2007	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009
Poland	27.2	27.8	26.9	28.1	29.0	23.9	26.7	23.2
Czech Republic	48.7	45.9	44.2	38.9	40.5	46.0	50.3	48.0
Slovakia	51.9	48.7	46.8	42.1	40.6	43.7	2.2	1.7
Slovenia	2.5	2.1	2.1	1.8	1.8	1.8	1.6	1.4
Hungary	17.2	16.4	15.9	15.3	14.7	19.7	22.1	21.1
Estonia	13.8	12.6	12.7	13.9	13.1	14.8	14.3	14.9
Lithuania	26.1	25.8	21.8	21.1	19.5	20.7	19.3	19.4
Latvia	15.6	14.8	15.4	14.5	14.7	13.1	11.7	10.0
Bulgaria	44.9	41.2	40.0	39.4	40.5	34.4	32.2	32.5
Romania	49.8	46.4	44.5	40.3	39.8	39.2	39.2	38.9

Source: Eurostat, central banks, own calculations

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

	2004	2005	2006	2007	2008	11.2009
Poland	BBB+	BBB+	BBB+	A-	A-	A-
Czech Republic	A-	A	A	A	A+	A+
Slovakia	A-	A	A	A	A+	A+
Slovenia	AA-	AA-	AA	AA	AA	AA
Hungary	A-	BBB+	BBB+	BBB+	BBB	BBB
Estonia	A	A	A	A	A-	BBB+
Lithuania	A-	A-	A	A	BBB+	BBB
Latvia	A-	A-	A-	BBB+	BBB-	BB+
Bulgaria	BBB-	BBB	BBB	BBB	BBB-	BBB-
Romania	BBB-	BBB-	BBB	BBB	BB+	BB+

Source: FitchRatings

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

	2004	2005	2006	2007	2008	11.2009
Poland	A	A	A	A	A	A
Czech Republic	A	A+	A+	A+	AA-	AA-
Slovakia	A+	A+	A+	A+	A+	A+
Slovenia	AA	AA	AA	AA	AA	AA
Hungary	A+	A-	A-	A-	BBB+	BBB+
Estonia	A+	A+	A+	A+	A	A-
Lithuania	A	A	A+	A+	A-	BBB+
Latvia	A	A	A	A-	BBB	BBB-
Bulgaria	BBB	BBB+	BBB+	BBB+	BBB	BBB
Romania	BBB	BBB	BBB+	BBB+	BBB-	BBB-

Source: FitchRatings

5. Interest rates and exchange rates

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

	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50
Czech Republic	1.75	1.50	1.50	1.50	1.25	1.25	1.25	1.25
Hungary	9.50	9.50	9.50	8.50	8.00	7.50	7.00	6.50
Romania	10.00	9.50	9.50	9.00	8.50	8.00	8.00	8.00
Euro area	1.25	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Source: Central banks, EcoWin Financial

Table 33. 3m interbank rates (average)

	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	4.2	4.5	4.6	4.3	4.2	4.2	4.2	4.2
Czech Republic	2.5	2.3	2.2	2.1	1.9	1.9	1.9	1.8
Slovakia	1.4	1.3	1.1	0.9	0.8	0.8	0.7	0.7
Slovenia	1.4	1.3	1.2	1.0	0.9	0.8	0.7	0.7
Hungary	9.7	9.7	9.7	9.4	8.3	7.9	7.2	6.8
Estonia	6.5	6.3	6.2	6.2	5.8	5.6	5.4	4.5
Lithuania	6.9	6.8	8.1	8.4	8.0	7.1	6.6	5.4
Latvia	12.4	13.4	20.9	16.9	13.1	11.6	13.5	11.9
Bulgaria	6.0	6.0	5.9	5.7	5.3	5.1	4.8	4.8
Romania	14.2	11.5	10.5	9.5	9.3	9.3	10.3	10.4

Source: EcoWin Financial

Table 34. Exchange rates against EUR (average)

	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	4.40	4.41	4.50	4.29	4.12	4.15	4.21	4.16
Czech Republic	26.68	26.71	26.48	25.78	25.61	25.33	25.87	25.80
Hungary	293.67	281.67	280.37	271.88	269.44	271.38	268.24	270.82
Estonia	15.64	15.64	15.64	15.64	15.64	15.64	15.64	15.64
Lithuania	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Latvia	0.71	0.71	0.70	0.70	0.70	0.70	0.71	0.71
Bulgaria	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Romania	4.19	4.16	4.21	4.21	4.21	4.24	4.28	4.28

Source: Eurostat

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

	04.2009	05.2009	06.2009	07.2009	08.2009	09.2009	10.2009	11.2009
Poland	28.0	29.5	33.5	31.8	25.4	23.4	17.5	11.5
Czech Republic	6.6	6.5	9.1	9.6	5.5	3.7	4.5	2.5
Hungary	16.0	13.9	15.7	17.4	14.3	12.8	2.9	2.3
Romania	15.3	13.9	15.2	18.1	19.6	17.0	14.5	13.5

Source: Eurostat, own calculations

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

	03.2009	04.2009	05.2009	06.2009	07.2009	082.2009	09.2009	10.2009
Poland	-23.0	-22.5	-22.8	-24.7	-23.7	-19.2	-17.1	-12.3
Czech Republic	-6.8	-6.5	-5.8	-7.6	-8.1	-3.8	-1.0	-0.7
Slovakia	10.4	9.0	6.1	3.1	3.1	3.4	3.6	4.7
Slovenia	1.4	0.7	0.9	1.3	1.3	1.8	2.1	2.5
Hungary	-14.0	-14.3	-12.0	-12.9	-14.2	-11.2	-9.3	0.7
Estonia	3.1	2.1	2.3	2.8	2.6	2.9	3.3	4.1
Lithuania	4.6	3.6	3.9	4.5	4.4	4.5	4.8	5.2
Latvia	2.5	1.6	1.8	4.2	4.3	4.3	4.3	4.3
Bulgaria	2.2	0.7	1.3	2.1	2.1	3.3	4.0	4.2
Romania	-11.5	-12.9	-11.4	-11.8	-13.5	-14.2	-11.8	-9.7

Source: BIS, own calculations

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

	03.2009	04.2009	05.2009	06.2009	07.2009	082.2009	09.2009	10.2009
Poland	-21.0	-20.2	-20.3	-22.1	-20.6	-16.2	-14.1	-9.1
Czech Republic	-5.8	-5.8	-5.1	-6.8	-7.9	-4.0	-1.2	-0.7
Slovakia	11.7	10.0	7.1	4.3	4.5	4.2	3.9	4.7
Slovenia	1.7	0.5	0.7	1.0	0.5	1.2	1.7	2.0
Hungary	-12.6	-12.5	-9.3	-10.0	-9.8	-7.1	-5.1	5.1
Estonia	2.9	0.3	0.5	0.7	1.2	1.1	1.0	1.4
Lithuania	9.9	7.5	7.6	7.5	6.4	5.9	6.7	5.6
Latvia	9.5	8.8	4.8	6.2	5.8	4.9	3.8	2.7
Bulgaria	5.3	3.8	4.2	4.9	3.1	3.7	3.4	3.2
Romania	-6.9	-8.5	-6.9	-7.3	-9.4	-10.5	-7.9	-6.2

Source: BIS, own calculations

6. Labour market

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	4.2	4.6	3.5	3.6	3.0	1.3	1.0	
Czech Republic	2.2	1.9	1.8	1.5	1.3	-0.2	-1.3	-1.9
Slovakia	2.8	2.8	2.9	4.5	2.8	-0.1	-1.1	-4.3
Slovenia	3.7	3.5	3.1	3.0	2.3	-0.2	-2.1	-3.1
Hungary	-1.1	-1.6	-1.9	-0.6	-0.7	-2.1	-1.8	-3.6
Estonia	0.5	1.5	-0.3	-0.2	-0.2	-6.8	-9.7	-9.4
Lithuania	1.8	0.2	-1.2	-1.4	-1.2	-5.1	-6.7	-7.4
Latvia	4.3	4.9	3.1	0.2	-5.5	-8.0	-12.5	-15.8
Bulgaria	3.0	2.3	2.0	1.8	1.1	-1.8	-4.9	-7.2
Romania	4.6	4.9	3.7	3.1	1.7	-0.8	-2.1	-4.0

Source: CSOs, own calculations

Table 39. Unemployment rate (in %)

	03.2008	04.2008	05.2008	06.2008	07.2009	08.2009	09.2009	10.2009
Poland	11.1	10.9	10.7	10.6	10.7	10.8	10.9	11.1
Czech Republic	7.7	7.9	7.9	8.0	8.4	8.5	8.6	8.5
Slovakia	10.3	10.9	11.4	11.8	12.1	12.1	12.5	12.4
Slovenia	8.4	8.8	8.9	9.1	9.4	9.4	9.4	
Hungary	9.9	9.8	9.6	9.7	9.9	10.3	10.4	
Estonia	11.4	13.5	13.5	13.5	14.6	14.6	14.6	
Lithuania	11.9	13.6	13.6	13.6	13.8	13.8	13.8	
Latvia	10.7	11.0	11.3	11.5	11.8	12.3	13.2	14.1
Bulgaria	6.9	7.0	7.1	7.3	7.6	7.9	8.0	8.2
Romania	5.6	5.7	5.8	6.0	6.3	6.6	6.9	7.1
EU-15	8.7	8.8	9.0	9.1	9.2	9.3	9.4	9.4

Source: CSOs

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	8.9	10.1	11.6	9.8	6.8	6.8	4.4	4.9
Czech Republic	6.6	10.2	8.0	7.8	8.3	2.7	2.8	4.8
Slovakia	4.5	5.8	4.8	3.5	-0.2	1.7	0.9	1.3
Slovenia	6.7	7.8	8.6	9.9	7.1	5.5	4.6	2.3
Hungary	-1.7	-0.9	0.9	-1.4	-0.5	0.2	2.5	
Estonia	20.2	19.5	15.2	14.8	6.9	-1.5	-4.4	-5.9
Lithuania	18.5	23.8	22.5	19.0	13.0	1.9	-2.9	-7.7
Latvia	29.7	28.3	23.9	21.0	12.1	3.6	-0.8	-6.4
Bulgaria	23.2	24.4	24.2	22.6	20.1	16.2	15.4	11.4
Romania	22.7	27.7	25.8	24.7	19.9	17.1	9.2	6.8

Source: CSOs, own calculations

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

	IV 2007	I 2008	II 2008	III 2008	IV 2008	I 2009	II 2009	III 2009
Poland	6.6	8.7	9.4	8.6	6.8	7.2	4.3	
Czech Republic	2.9	7.7	5.4	5.4	9.4	6.9	7.2	7.6
Slovakia	-7.0	-0.7	-0.2	1.4	0.1	7.3	5.3	1.8
Slovenia	5.0	5.5	6.3	8.9	10.2	13.6	11.8	7.5
Hungary	-3.3	-4.2	-3.0	-2.8	1.1	4.8	8.2	
Estonia	16.2	20.8	16.0	17.9	16.4	6.7	1.9	0.3
Lithuania	11.5	16.9	16.1	14.4	13.8	10.1	9.8	-0.9
Latvia	24.0	32.8	28.9	25.3	16.9	13.6	5.4	-3.2
Bulgaria	20.9	22.3	20.7	18.9	18.4	18.9	18.1	12.8
Romania	18.9	21.8	18.5	17.3	18.1	21.5	13.1	6.7

Source: Eurostat, CSOs, own calculations

7. Public finance

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

	2001	2002	2003	2004	2005	2006	2007	2008
Poland	-5.1	-5.0	-6.3	-5.7	-4.3	-3.9	-1.9	-3.9
Czech Republic	-5.7	-6.8	-6.6	-3.0	-3.6	-2.6	-0.6	-1.5
Slovakia	-6.5	-8.2	-2.7	-2.3	-2.8	-3.5	-1.9	-2.2
Slovenia	-4.0	-2.5	-2.7	-2.2	-1.4	-1.3	0.5	-0.9
Hungary	-4.0	-8.9	-7.2	-6.4	-7.8	-9.2	-4.9	-3.4
Estonia	-0.1	0.3	1.7	1.7	1.5	2.9	2.7	-3.0
Lithuania	-3.6	-1.9	-1.3	-1.5	-0.5	-0.4	-1.0	-3.2
Latvia	-2.1	-2.3	-1.6	-1.0	-0.4	-0.5	-0.4	-4.0
Bulgaria		-0.8	-0.3	1.6	1.9	3.0	0.1	1.5
Romania	-3.5	-2.0	-1.5	-1.2	-1.2	-2.2	-2.5	-5.4
EU-15	-1.2	-2.3	-3.0	-2.8	-2.4	-1.3	-0.8	-1.8

Source: Eurostat

Table 43. Public debt (in % of GDP)

	2001	2002	2003	2004	2005	2006	2007	2008
Poland	37.6	42.2	47.1	45.7	47.1	47.7	44.9	47.1
Czech Republic	25.1	28.5	30.1	30.4	29.8	29.6	28.9	29.8
Slovakia	48.9	43.4	42.4	41.4	34.2	30.4	29.4	27.6
Slovenia	26.8	28.0	27.5	27.2	27.0	26.7	23.4	22.8
Hungary	52.1	55.7	58.0	59.4	61.7	65.6	65.8	73.0
Estonia	4.8	5.7	5.6	5.0	4.5	4.3	3.5	4.8
Lithuania	23.1	22.3	21.1	19.4	18.4	18.0	17.0	15.6
Latvia	14.0	13.5	14.6	14.9	12.4	10.7	9.0	19.5
Bulgaria	67.3	53.6	45.9	37.9	29.2	22.7	18.2	14.1
Romania	26.0	25.0	21.5	18.8	15.8	12.4	12.7	13.6
EU-15	62.2	61.6	63.0	63.2	64.1	62.8	60.4	62.5

Source: Eurostat