



The 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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Prepared by:  
Marcin Grela

Approved by:  
Ryszard Kokoszczyński

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

## Executive summary

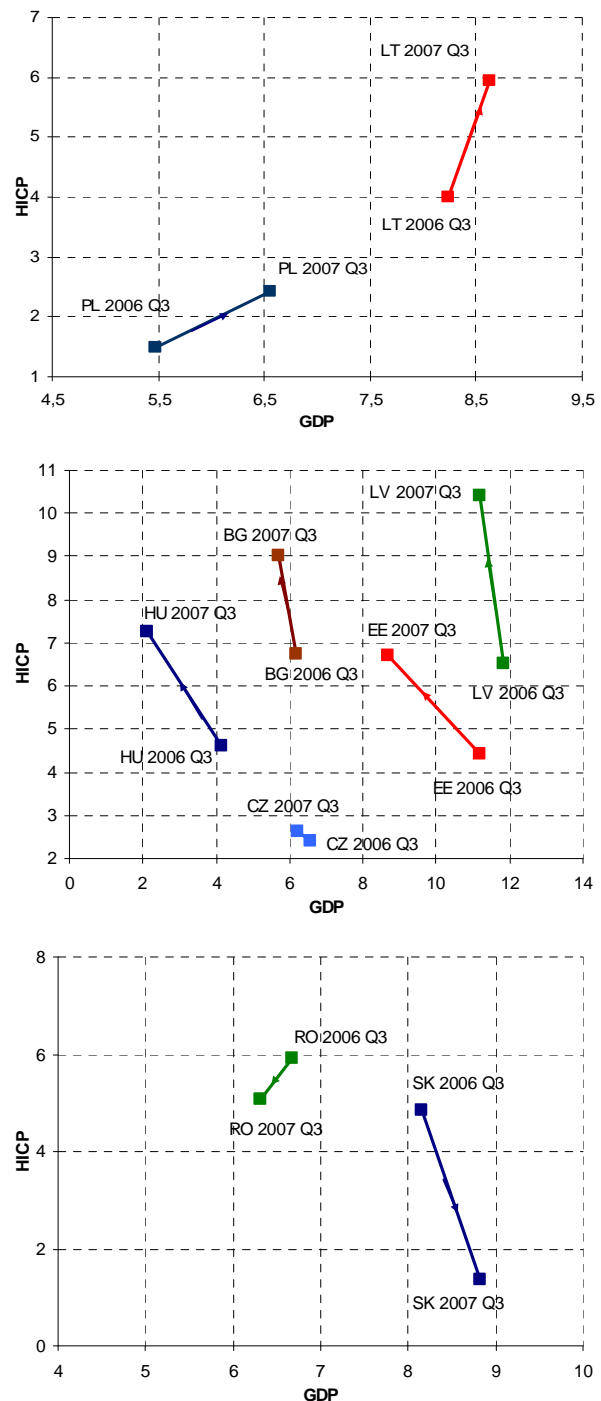
The aim of this report is to present the economic situation of the NMS-9<sup>1</sup> group in the second half of 2007. The study covers the structure of economic growth, external imbalances, inflation, monetary policy and the situation on the labour market. The macroeconomic situation of new member states was compared to the situation of the emerging economies. The report also presents the economic outlook for the Baltic states and describes the influence of the worldwide growth of food prices on inflation in NMS-9.

In 2007 Q3 the average economic growth rate in NMS-9 remained at a relatively high level and amounted to 5.9%, similarly to the previous quarter.<sup>2,3</sup> In most countries of the region the real GDP growth rate did not change significantly in 2007 Q3. Its marked increase was only reported in Lithuania, while Bulgaria, Estonia and Hungary saw a deceleration in GDP growth.

The greatest change in relation to the previous quarter in NMS-9 was the decrease in the contribution of domestic demand and the increase in the contribution of net exports to the economic growth. The improvement in the foreign trade balance resulted from an increased external demand (more dynamic economic growth in the euro area) and a concurrent weakening of domestic demand.

In the second half of 2007, the European Commission's indicators of both consumers and business sentiment in NMS-9 lowered as compared to their value in the first half of 2007. The growth rates of retail sales and manufacturing also decreased in this period as compared to the first half of 2007 and 2006.

Figure 1.1. Real GDP growth rate and HICP inflation. Change between 2006 Q3 and 2007 Q3 (average for 4 preceding quarters)



Source: Eurostat, own calculations

Between August 2007 and December 2007 the NMS-9 region reported a significant increase in average inflation. The average HICP growth rate in that period rose from 5.5% to 7.8%. Inflation increased in all the countries of the NMS-9 group. The average increase of

<sup>1</sup> NMS-9 (New Member States): Poland, the Czech Republic, Slovakia, Hungary, Estonia, Lithuania, Latvia, Bulgaria, Romania.

<sup>2</sup> All growth rates presented in the report are year-on-year growth rates.

<sup>3</sup> Weighted average for NMS-9.

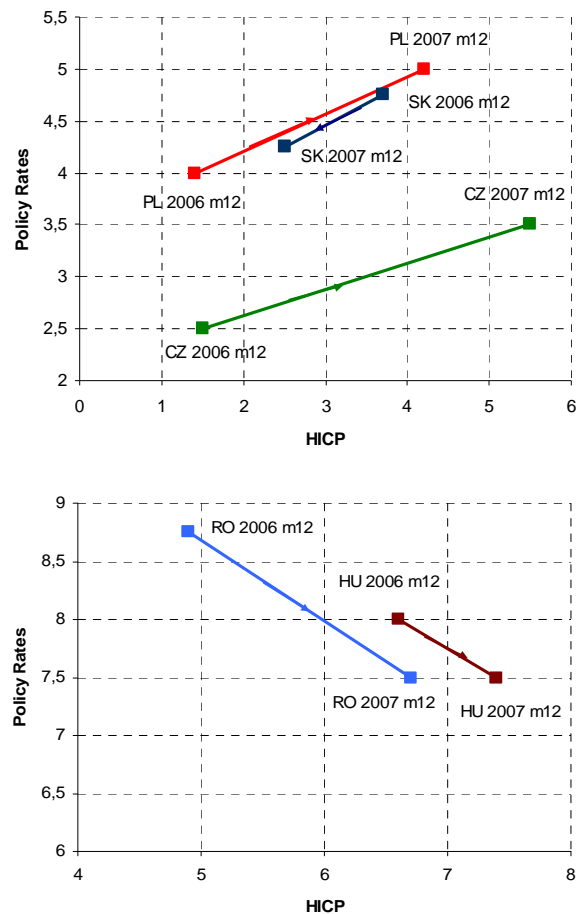
inflation in the NMS-9 group in the analysed period amounted to 2.3 percentage points and fluctuated between 0.3 percentage points in Hungary to 3.8 percentage points in Latvia. The growth of inflation primarily resulted from demand-side factors, i.e. food and energy prices.

The interest rates policy of central banks of countries implementing direct inflation targeting strategies differed from country to country in the second half of 2007. The interest rates were raised in Poland, the Czech Republic and Romania. In Slovakia they remained unchanged, while the Hungarian National Bank decided to cut them once again. In the analysed period, Poland, the Czech Republic and Romania reported an increase in their 3-month market interest rates. In Slovakia and Hungary, short-term interest rates on the inter-bank markets did not change.

In the Baltic states and Bulgaria, which have fixed exchange rate regimes in place, the 3-month market interest rates increased significantly in the second half of 2007. It was only in the case of Latvia that, after a period of rapid growth of market interest rates between June and September 2007, the value of the 3M RIGIBOR began to drop slightly in the subsequent months. Taking into account the inflation rate in the Baltic states and Bulgaria, as well as its significant increase in the second half of 2007, it is worth noticing that despite the growth in nominal interest rates, the real interest rates in those countries remain at an exceptionally low and often negative level.

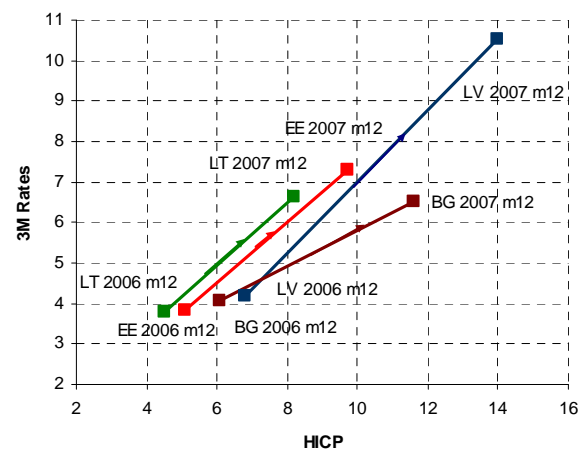
The increase in interest rates in the second half of 2007 in the NMS-9 may be partly attributed to the US mortgage market crisis. The high growth rate of granted loans observed since 2004, accompanied by a significantly lower growth rate of bank deposits, resulted in liquidity problems in domestic markets which could not be resolved in the same way as before, i.e. through increased foreign financing. As a result, market interest rates increased in the second half of 2007, especially in the Baltic states, which are the most dependent on foreign financing.

Figure 1.3. Inflation and interest rates in NMS-9 applying floating exchange rate policy between December 2006 and December 2007<sup>4</sup>.



Source: Eurostat.

Figure 1.4. Inflation and interest rates in NMS-9 applying the fixed exchange rate policy between December 2006 and December 2007.



Source: Eurostat.

<sup>4</sup> The inflation rate presented in the Figure concerns August 2007.

2007 Q3 was characterised by a significant decrease in the current account deficit in NMS-9. The deficit in this group of countries, calculated as the percentage of GDP, was 8.3% on average in 2007 Q2, as compared to 11.0% in 2007 Q2.<sup>5</sup> As in previous periods, the current account deficit in most of the countries resulted from the deficit on trade in goods (the Baltic states, Bulgaria, and Romania) and the negative balance on income (Poland, the Czech Republic, Slovakia, Hungary).

In the second half of 2007 Fitch downgraded the long-term debt rating for Latvia from A- to BBB+. In other countries the ratings did not change.

Similarly to previous periods, 2007 Q3 was also characterised by a good labour market situation in NMS-9. The high economic growth rate facilitated an increase in employment and favoured a decrease in unemployment. The growth rate of wages still remained high, which was reflected in the high growth rate of unit labour costs (ULC). Although 2007 Q3 saw a slight drop in the employment growth rate and wage growth rate as compared to the previous quarter, these values were still relatively high. The average growth rate of employment amounted to 2.2%, while wages increased by 16.3% in year-on-year terms.

The economic growth forecasts for NMS-9 prepared in 2008 did not change significantly in the recent months and at the beginning of 2008 external institutions still expected a decline of the GDP growth rate in 2008 as compared to 2006 and 2007. However, forecasts of average inflation rate grew in the corresponding period. Inflation in NMS-9, excluding Hungary, Bulgaria and Romania, is expected to grow significantly in 2008 as compared to 2007.

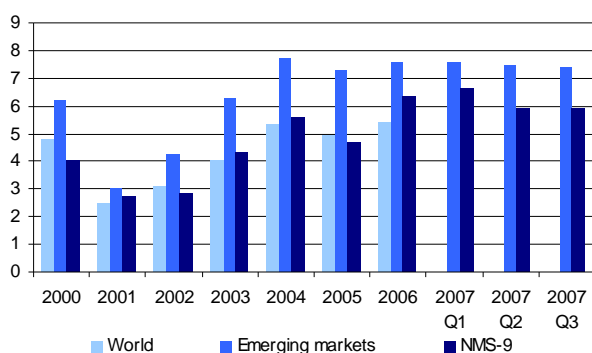
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<sup>5</sup> Arithmetic average for NMS-9.

## 1. NMS-9 economic situation as compared to emerging economies

The years 2004-2006 saw a worldwide acceleration in economic growth. In 2006, the global economy grew by 5.4%. The emerging economies grew faster in the period. The average GDP growth amounted to 6.4% in 2006 in NMS-9 group and to 7.6% in the emerging markets.<sup>6</sup> In 2007 Q3 the economic growth rate in NMS-9 remained lower than in the emerging markets and amounted to 5.9% and 7.4%, respectively.

Figure 1.1. Annual GDP growth rate



Source: IMF WEO, Eurostat, EcoWin Economic.

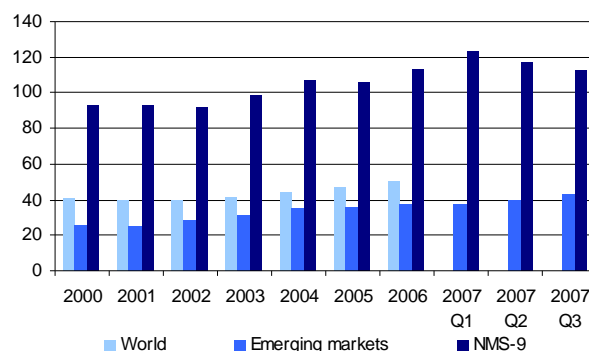
In recent years, the value of worldwide foreign trade, calculated as a percentage of the global GDP, also increased.<sup>7</sup> Starting from 2004 the total value of exports and imports of NMS-9 was higher than the total GDP value in those countries. In 2006, the foreign trade volume of the NMS-9 region represented 113.5% of the GDP, while in 2007 Q3 this figure remained at a slightly lower level (112.4%), which constitutes a decline in comparison with the previous two quarters. In comparison with the emerging economies and the world average, the NMS-9 region was characterised by the largest openness of the economies both in

<sup>6</sup> Argentina, Brazil, Chile, China, the Philippines, India, Indonesia, Malaysia, Mexico, Russia and Turkey called "Emerging" in the Figure are countries classified as the emerging countries in line with the IMF classification. They were selected as a representative comparable group for NMS-9 countries due to their significant impact on the growth of the world economy and a level of GDP per capita similar to NMS-9 countries.

<sup>7</sup> Foreign trade volume understood as the total of exports and imports.

2007 Q3 and in the previous years (see: Figure 1.2).

Figure 1.2. Foreign trade volume, percentage of GDP.<sup>8</sup>



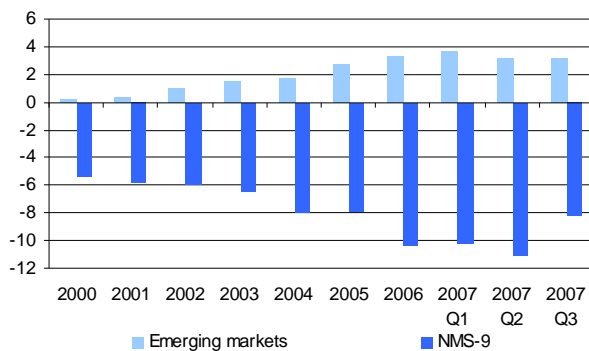
Source: IMF DOTS, Eurostat, EcoWin Economic.

The average current account deficit in the NMS-9 region amounted to 8.3% in 2007 Q3, which constitutes a decline as compared to 11.0% in Q2. Since 2000 the emerging countries have been characterised by a current account surplus, which in 2007 Q3 amounted to 3.1% of GDP.

The surplus on the current account in the group of developing countries results from the export-oriented direction of emerging economies, mostly Asian ones. In addition, some of the countries included in this group (Russia, Indonesia) are global exporters of commodities. The recent growth of the world prices of commodities has had a significant impact on the improvement of the foreign trade balance in those countries.

<sup>8</sup> In the case of the emerging countries and NMS-9, it is calculated as a relation of total amount of exports and imports of all countries in a given group to the total GDP of all countries in that group.

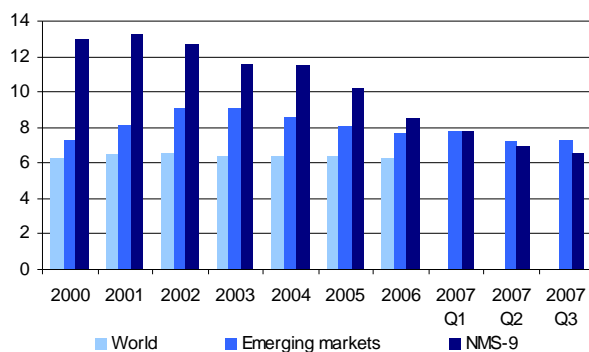
Figure 1.3. Current account balance, percentage of GDP<sup>9</sup>.



Source: IMF WEO, EcoWin Economic, Eurostat.

The economic growth acceleration had a positive impact on the improvement of the situation on the labour market in the emerging countries. In 2007 Q3, the average unemployment rate in this group of countries amounted to 7.3%, while in NMS-9 it amounted to 6.6%, as compared to 7.0% in 2007 Q2 and 8.5% in 2006. Since 2007 Q2 the unemployment rate in the NMS-9 region has been lower than in the group of the emerging economies.

Figure 1.4. Unemployment rate

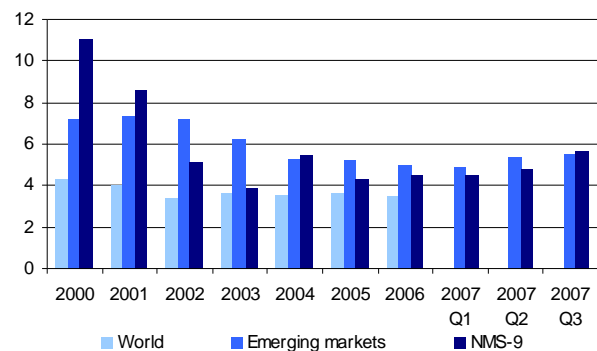


Source: ILO, Eurostat, national statistical offices.

The growth of inflation which occurred in 2007 was more noticeable in the NMS-9 group. In 2007 Q3 average inflation in those countries amounted to 5.6%, as compared to 4.8% in Q2. In the emerging countries the growth of inflation was considerably smaller. In Q3 the growth rate of consumer prices increased to 5.5%, as compared to 5.4% in 2007 Q2.

<sup>9</sup> Calculated as an arithmetic average for a given group of countries.

Figure 1.5. Average annual inflation rate



Source: IMF WEO, Eurostat.

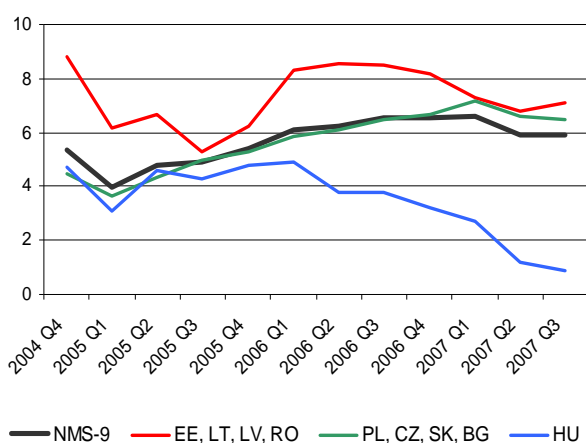
## 2. Economic growth

In 2007 Q3 the average economic growth rate in NMS-9 amounted to 5.9%, similarly to the previous quarter. In most countries of the region the real GDP growth rate did not change significantly in 2007 Q3. A marked increase was only reported in Lithuania (of 2.8 percentage points). In contrast, a considerable decline in the economic growth rate was recorded in Bulgaria (-1.9 percentage points) and Estonia (-1.2 percentage points). The GDP growth rate also continued to decline in Hungary, in 2007 Q3 it decreased to 0.9%, as compared to 1.2% in Q2.

As in previous years, the structure of economic growth was diversified across the NMS-9 group, which provided the basis for a division into the following groups:

- A. the Baltic states and Romania – since 2004 characterised by a high individual consumption growth rate and a large foreign trade deficit;
- B. Poland, the Czech Republic, Slovakia and Bulgaria – characterised by more balanced growth;
- C. Hungary – the country struggling with a growing economic slowdown related to a rapid decline in domestic demand.

Figure 2.1. Real GDP growth rate in NMS-9.



Source: Own analysis on the basis of: Eurostat, EcoWin Economic, national statistical offices.

A. The real GDP growth in the Baltic states and Romania in 2007 Q3 amounted to 7.1%, on average, as compared to 6.8% in the previous quarter. This increase resulted from an economic acceleration in Lithuania, where the GDP growth rate increased to 10.8% in the last quarter from 8.0% in 2007 Q2. A considerable decline in the economic growth rate was reported in Estonia, from 7.6% in Q2 to 6.4% in 2007 Q3. In the case of Estonia the GDP growth rate decreased by as much as 4.6 percentage points over the last three quarters.

Consumption remained the main driving force behind economic growth in those countries, but its contribution to the economic growth was lower than in the previous quarters. It amounted to 7.0 percentage points in 2007 Q3, which constitutes a decline of 3.0 percentage points as compared to Q2 and 4.4 percentage points as compared to 2007 Q1. Thus, the contribution of consumption in those countries was lower than the economic growth rate for the first time since 2006 Q1. All the countries of this group also reported a decline in the growth rate of consumption, though it was still considerably high and amounted to an average of 8.7% in Q3.

At the same time, there was also a decline in the contribution of gross investment outlays to the economic growth in this group of countries. It amounted to 3.8 percentage points in 2007 Q3, as compared to 5.1% in 2007 Q2. This resulted mainly from a decline in the investment growth rate in Estonia, where it amounted to -5.7% in Q3, as compared to 21.8% in 2007 Q2.

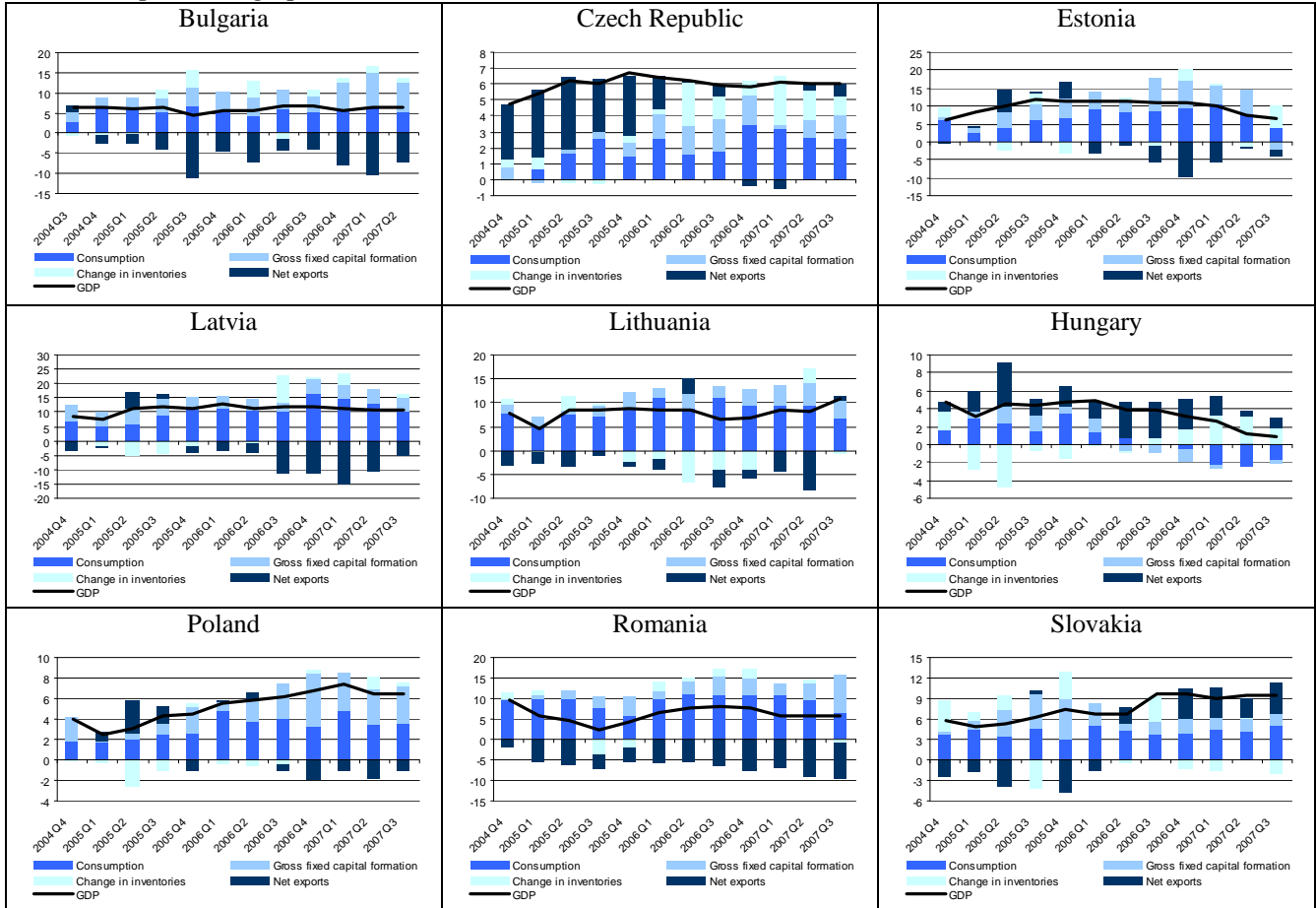
Another important change in the structure of the economic growth in the Baltic states and Romania in 2007 Q3 was the very noticeable increase in the contribution of net exports to the GDP growth rate. Although the contribution of net exports to the economic growth remained negative and amounted to -3.8 percentage points, it increased considerably in comparison with the previous quarters of 2007, when it was -8.0 and -7.2 percentage points in Q1 and Q2, respectively. Only Estonia reported a decline in the contribution of net exports to the GDP growth



rate, although it was greater than in 2006 (-2.0 percentage points in 2007 Q2 and -4.5 percentage points in 2006, respectively). In

remaining three countries its contribution increased considerably, and in Lithuania it was even positive.

Table 2.1. Decomposition of economic growth in Central and Eastern European countries, 2004-2006 (in percentage points).



Source: Eurostat, EcoWin, national statistical offices

The decrease in the foreign trade deficit in the Baltic states in 2007 Q3 as compared to the previous quarter may be attributed primarily to the weakening of domestic demand. This contributed both to a reduction in imports and to a redirection of part of production to the external market. In 2007 Q3 the competitiveness of the economies of the Baltic states did not improve. Inflation was still on the increase in the Baltic states and the real effective exchange rate (REER) was strengthening. REER strengthened by 1.5% in 2007 Q3 in Estonia, 0.6% in Lithuania and almost by 3.0% in Latvia. Also the increased activity in the euro area in 2007 Q3 (2.7% as compared to 2.5% in 2007 Q2), which is the main trading partner for NMS-9, might have contributed to the increase in external demand for goods and services produced in those countries. At the same time, the growth rate of domestic demand, both in terms of consumer and investment demand, declined in all the Baltic states. The decline in the domestic demand, observed in 2007 in the Baltic states may be partially attributed to the policy of commercial banks reducing loans granted to the private sector (see: Box 1).

Romania reported a significant decrease of the REER in 2007 Q3. Following a period of strong appreciation (of over 50% between April 2004 and July 2007), the REER declined by 5.2% in the last two months of Q3. Although the contribution of net exports to the GDP growth rate slightly improved, it remained significantly lower than in 2006. This resulted mainly from a breakdown in the investment growth rate which occurred in Q2 and then drop even lower in 2007 Q3. At the beginning of 2007 the exports growth rate in Romania amounted to 12.9%, but only 1.7% in Q3. This followed mainly from a decline in the exports of oil.

The case of Estonia, where during 2007 the GDP growth rate decreased by 5.6 percentage points, indicates that this country may be the first victim of overheating in the Baltic economies. The data concerning the Latvian economy indicate that Latvia too may soon experience a similar economic downturn. A

very tight situation in the labour market as well as increasingly high inflation is still observed in this group of countries. Although in Estonia and Latvia the growth rate of loans to the private sector decreased in the second half of 2007, it still remains at the level of over 30% in year-on-year terms, and the rapidly increasing inflation rate combined with the lack of an autonomous monetary policy results in the decline of real interest rates. These factors appear to point to the possibility of an economic downturn in the Baltic states despite the decrease of external imbalances over the last quarter.

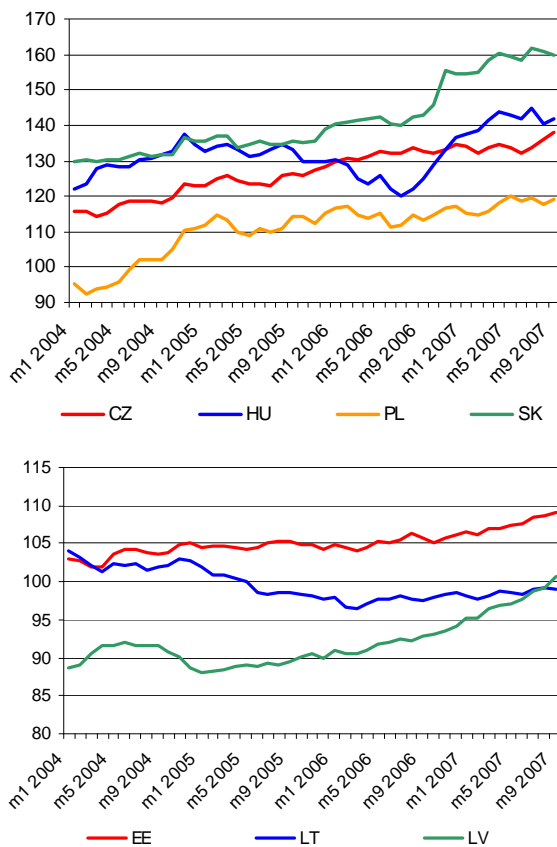
B. The average economic growth rate in Poland, Czech Republic, Slovakia and Bulgaria amounted to 6.5% in 2007 Q3, as compared to 6.6% in Q2 and 7.2% in 2007 Q1. The decline in the real GDP growth in this group of countries followed from its decline in Bulgaria, where it decreased by 1.9 percentage points, from 6.4% to 4.5%. The economic growth rate in Poland, the Czech Republic and Slovakia did not change as compared to the previous quarter. The economic growth in Poland, the Czech Republic, Bulgaria and Slovakia was more balanced and did not rely on the increase in consumption to a large extent.

The structure of economic growth in this group of countries did not change significantly as compared to the previous quarter. The contribution of total consumption and investment outlays decreased slightly. However, domestic demand, and primarily individual consumption, remained the basis of economic growth in 2007 Q3. Its contribution to the GDP growth rate amounted to 3.6 percentage points in 2007 Q3, as compared to 3.9 percentage points in 2007 Q2.

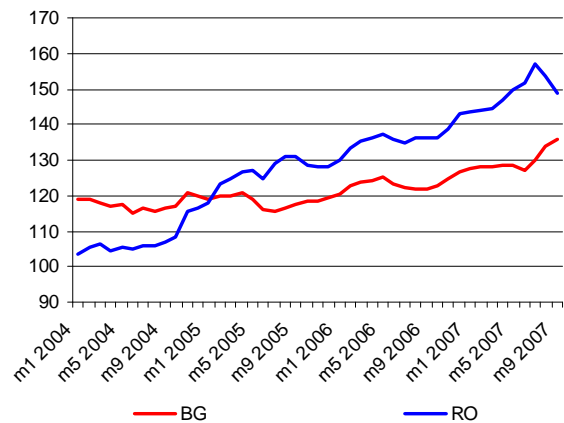
The contribution of the growth rate of investment outlays to the economic growth in this group of countries declined. It amounted to 3.0 percentage points in 2007 Q3, as compared to 3.5% in the previous quarter. The decline in the contribution of investment outlays to the GDP growth rate was related to the decline in the investment growth rate in

the Czech Republic, Poland<sup>10</sup> and Bulgaria. This was particularly visible in the case of the last two countries, where the growth rate of investment outlays declined by approx. 10 percentage points as compared to 2007 Q2. Despite such a significant slide both those countries were still characterised by the highest growth rate of investment outlays among NMS-9. In 2007 Q3 it amounted to 19.8% in Poland and 19.7% in Bulgaria. Slovakia was the only country in this group where the growth rate of investment outlays increased as compared to Q2 (from 5.9% to 6.5%).

Figure 2.2. Real effective exchange rate in NMS-9 between January 2004 and December 2007, index 2000 = 100 (increase means appreciation)



<sup>10</sup> The growth rate of investment outlays in Poland remained at a high level and amounted to 18.5% in 2007 Q4.



Source: Own analysis on the basis of IMF IFS, Eurostat, central banks.

Similarly to the Baltic states and Romania, also in this group of countries the contribution of net exports growth rate to the economic growth increased in 2007 Q3. It amounted to 0.3 percentage points as compared to -1.5 percentage points in Q2. In all the countries of the group the contribution of net exports increased in 2007 Q3. In addition, in the Czech Republic and Slovakia it was positive. These two countries were also the only ones to report a surplus in foreign trade in goods and services in Q3. In the Czech Republic this situation has been continuing since 2005 Q1. In most of the countries the increase in the contribution of net exports to the economic growth resulted from increased exports growth rate. The growth rate of exports declined only in Slovakia in the last quarter as compared to 2007 Q2 (from 18.1% down to 8.5%). This, however, was accompanied by an even more significant drop in the growth rate of imports (from 13.2% to 3.0%).

In all those four countries, the REER strengthened during 2007 Q3, similarly to the previous quarter. The appreciation was small in Poland and Slovakia (0.3% and 1.0%, respectively) and significantly higher in Bulgaria and the Czech Republic (6.8% and 4.3%, respectively). The improvement in the foreign trade balance should mostly be attributed to increased external demand and weaker domestic demand, which resulted in the growth of production for external markets.

C. In 2007 Q3, Hungary, as in previous quarters, experienced a decrease in the real

GDP growth rate. The GDP growth rate decreased from 1.2% in 2007 Q2 to 0.9% in 2007 Q3, which was at the lowest level among the countries of the region. It was the sixth consecutive quarter in which the economic growth rate in Hungary decreased.<sup>11</sup> The decrease was mainly the result of the decline in the contribution of investment outlays. In Q3 it amounted to -0.4 percentage points as compared to 0.2 percentage points in 2007 Q2. Also the contribution of the change in inventories decreased, declining from 2.9 percentage points to 1.8 percentage points in the corresponding period. The growth rate of both consumption and investment outlays in Hungary was negative in 2007 Q3. Similarly to other NMS-9 countries, the contribution of net exports to the GDP growth rate in Q3 slightly increased and amounted to 1.2 percentage points as compared to 0.6 percentage points in 2007 Q2. Net exports and the increase in inventories were therefore the only categories which had a positive contribution to the GDP growth rate in Hungary. The increase in external demand and a repeated decline in domestic demand appear to be the cause behind the improvement of export growth rate and the decline in the import growth rate in Hungary.

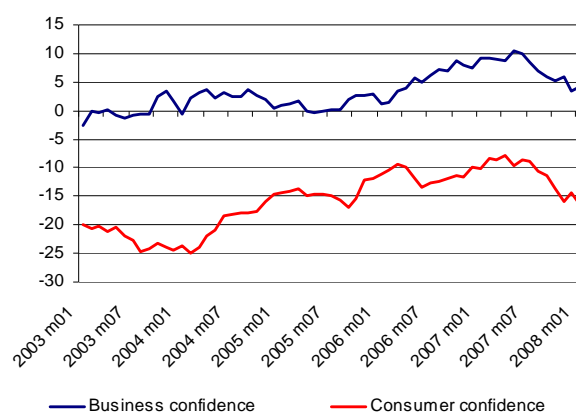
### Economic activity

In the second half of 2007 the indicators of both consumer and business expectations in NMS-9 published by the European Commission lowered as compared to their value in the first half of 2007. In December 2007 the average value of the consumer confidence index for NMS-9 amounted to -14.5, as compared to -8.8 in July 2007. The largest decline occurred in the Baltic states, the Czech Republic and Slovakia, while in Poland and Hungary its value slightly increased. The value of the business confidence index in a corresponding period also declined from 8.6 to 3.4. A decline in confidence occurred in all NMS-9, to the largest extent in the Baltic and Balkan states,

to the smallest extent – in Poland and the Czech Republic.

In January 2008 the business sentiment improved slightly, while consumer sentiment continued to deteriorate. Poland and Hungary were the only countries which saw continued deterioration both in consumer and business sentiment.

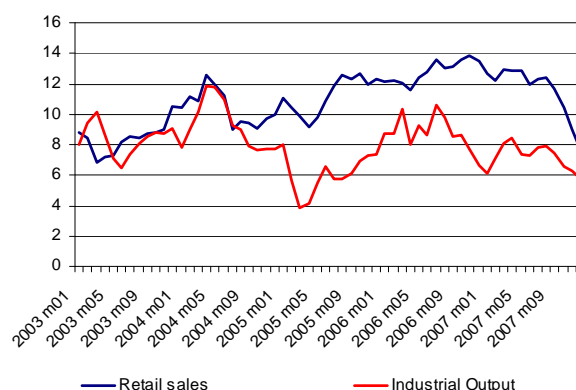
Figure 2.3. Confidence indicators for the NMS-9



Source: European Commission

The growth rate of manufacturing in NMS-9 declined in the second half of 2007 and averaged 6.6% (5.7% in 2007 Q4), as compared to 7.7% in the first half of 2007. Also the retail sales growth rate decreased in the same period. In the first half of 2007 it averaged 12.5%, while in the second half of 2007 it decreased to 9.7% (7.6% in 2007 Q4).

Figure 2.3. Growth rate of manufacturing and retail sales in NMS-9 (average for 3 consecutive months)



Source: National statistical offices, own calculations

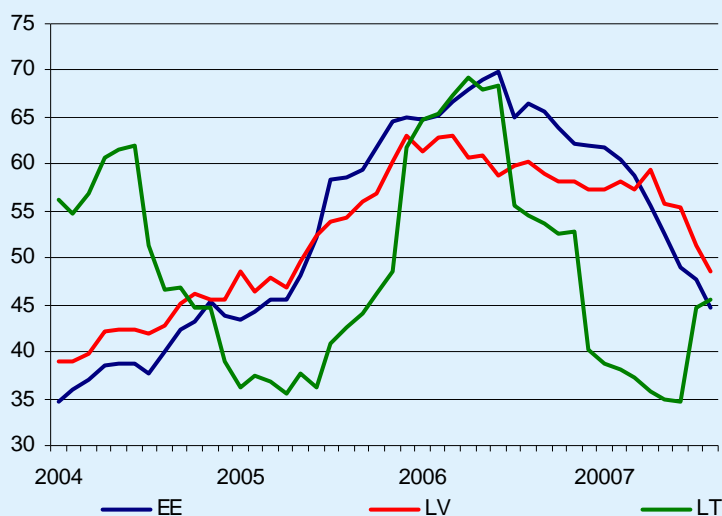
<sup>11</sup> In 2006 Q1, the real GDP growth rate in Hungary amounted to 4.9%.

### Latvia, Estonia – risk of an economic crisis, devaluation and delayed joining of EMU.

The Baltic states have recently been among the fastest developing countries, not only in the EU, but also in the world. Between 2004 and 2006, the average economic growth rate in Estonia, Lithuania and Latvia amounted to 7.5%. This fast economic growth was accompanied by fast inflation growth (the average inflation in the Baltic states in December 2007 exceeded 10% and was 14% in Latvia; the average inflation in the Baltic states in 2006 amounted to 5.5%) and the persistence of high external imbalances (the average current account deficit was nearly 16% of GDP in 2007 Q3, compared to 15% of GDP in 2006 and 10% of GDP in 2005). Additionally, the average wage was increasing too (above 24% in 2007, on average), which resulted in an acceleration of unit labour costs growth and lower competitiveness of these economies. Combined with the policy of fixed exchange rate applied by those countries, there is a risk of economic slump in the Baltic states<sup>12</sup>.

Another premise seems to be the fact that the economic growth is based exclusively on domestic, mostly consumption, demand. In the recent period this has been, in turn, accelerated by loans, both to enterprises and the private sector. In the beginning of 2006, the growth rate of loans to private sector in the Baltic states exceeded 60% in year-on-year terms, while in Estonia and Lithuania it even reached 70%.

Chart 1. Growth rate of lending to private sector in Baltic states in 2004-2007.



Source: Central banks, own calculations

<sup>12</sup> This risk mainly concerns Latvia, but also Estonia and – to a significantly smaller extent – Lithuania.

Since mid-2006 the growth rate of lending to the private sector has been falling markedly. In September 2007 it amounted to “as little” as approx. 45% in the Baltic states. In 2007 Estonia and Latvia also saw a slowdown in their economic growth rates.<sup>13</sup> Further decline of lending growth rate may therefore be conducive to the decrease in domestic demand growth rate, whereas this would imply an ever larger decrease in the economic growth rate of the Baltic states.

This decrease in the growth rate of granted loans could be partially explained by growing nominal market interest rates. Since the beginning of 2006 a three-month rate on the interbank market in Estonia and Lithuania has increased by approx. 4 percentage points, whereas in Latvia it has increased by 7 percentage points. However, the inflation increase caused the real interest rates in the Baltic states to remain negative, while the last months even brought their further decrease. The lack of liquidity of the banking sector in the Baltic states contributed to the increase in interest rates. Since 2004 the loan growth rate has significantly exceeded the bank deposits’ growth rate in the Baltic states, which led to a situation where the ratio of bank loans value to deposits amounted to 120% in Estonia to approx. 200% in Latvia<sup>14</sup> in 2007. Due to the crisis on the international financial market, the possibility of external financing of lending in the Baltic states was reduced, which consequently led to interest rate hikes.

Chart 2. Nominal market (3m) interest rates

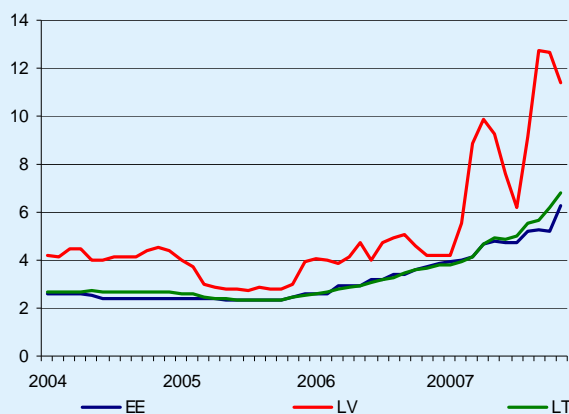
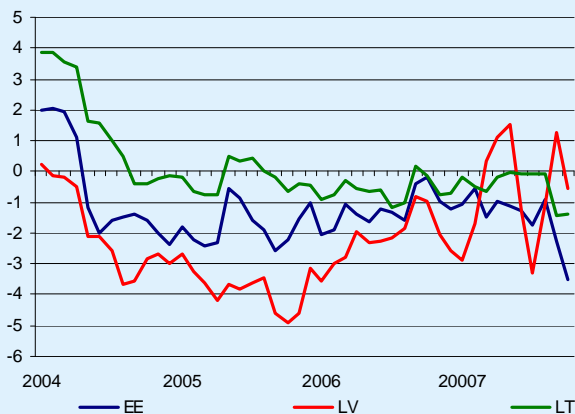


Chart 3. Real market (3m) interest rates



Source: EcoWin Financial, Eurostat, own calculations

Thus, a more serious reason for the decrease in lending growth rate is connected with the policy of commercial banks, which in the second half of 2007 markedly increased their credit policy restrictiveness. Similarly as in the case of all NMS-9 countries, the majority of the banking sector of the Baltic states is controlled by foreign investors, in this case mainly capital financial groups from Scandinavia. A vast proportion of the growing foreign debt in the Baltic states can be accounted for by loans to the banking sector obtained from parent companies, since Scandinavian banks treat the Baltic states as one of their main loan markets.

A scenario under which “parent” banks drastically cut the financing of their Baltic branches, which would lead to a sudden and deep crisis (hard landing) is hardly possible. Their financial participation in the Baltic markets is too high to allow such a policy. Instead, banks are trying to gradually increase the restrictiveness on the loan market, which aims at a gradual reduction of the lending growth rate.

<sup>13</sup> In 2007 Q3 GDP growth rate in Lithuania increased.

<sup>14</sup> See “Eastern Europe: Funding and liquidity risk has risen”, DB Research, 2007

Speculations as to the possibility of devaluation of national currencies and departure from the fixed exchange rate have recently arisen in Estonia and Latvia.<sup>15</sup> This would aim at increasing competitiveness of those economies and at boosting exports. Additionally, the economic growth would not be so strongly dependent on domestic demand and external financing sources, which would also reduce the risk of an economic crisis. The central banks officially denied such rumours. The stepping-up of exports growth rate and the improvement in current account balance over last quarters might dissuade the authorities from this idea, at least temporarily.

The overheating of the Baltic and growing external imbalances have been noticed by international financial institutions. The representatives of the European Central Bank stated that the fixed exchange rate in the Baltic states was the main reason behind the growth of external imbalances, whereas low real interest rates led to inflation increase. Therefore, the Baltic states are exposed to very large fluctuations of the business cycle, which in the long term might inhibit the real convergence process. In their opinion, fighting inflation solely by means of a fiscal policy tightening may prove too costly and hardly effective, while a more efficient method would be to abandon the fixed exchange rate policy.<sup>16</sup>

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<sup>15</sup> In 2007 rumors about devaluation spread across Latvia and Estonia. As a result, people began massively exchange kronas and lats to the euro, thus forcing the central banks to carry out currency interventions.

S. Roman, "Web rumor sparks weekend currency panic", The Baltic Times, November 28, 2007

C. Dougherty, "Latvia's hot growth fuels devaluation fears", International Herald Tribune, November 12, 2007

<sup>16</sup> "Real convergence in Central, Eastern and South-Eastern Europe", Speech by Lorenzo Bini Smaghi, Member of the Executive Board of the ECB at the ECB Conference on central, eastern and south-eastern Europe, Frankfurt, 1 October 2007

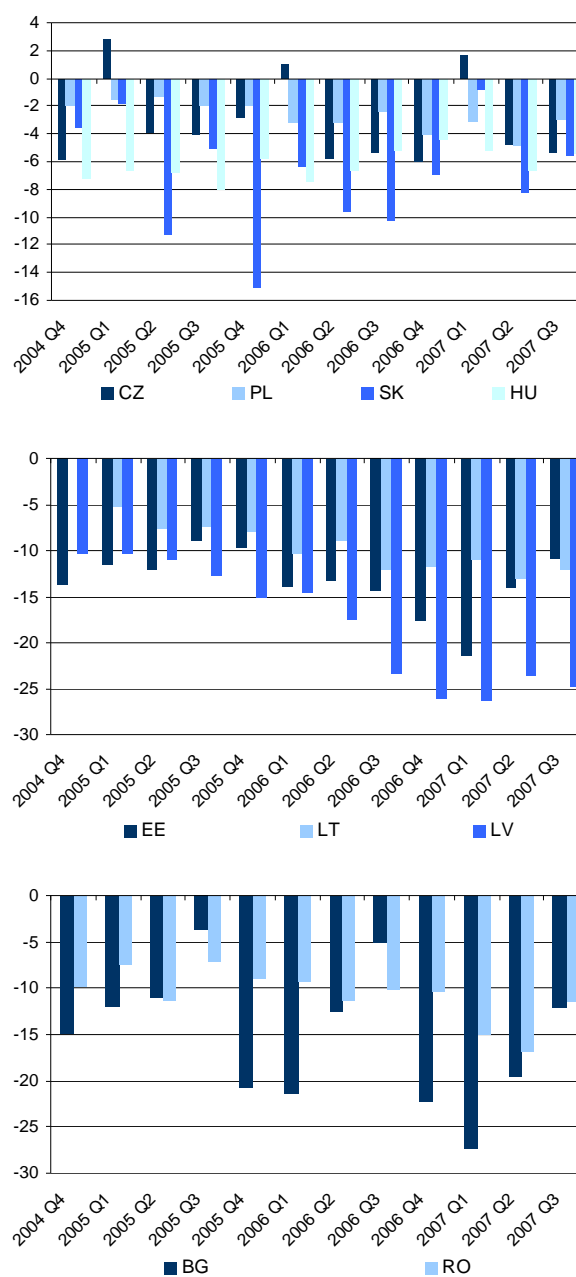
### 3. External imbalances

2007 Q3 was characterised by a significant decrease in the current account deficit of NMS-9. This deficit, calculated as the percentage of GDP for the above mentioned group of countries averaged 8.3% in 2007 Q3, compared to 11.0% in 2007 Q2. As in previous quarters, the current account deficit in the majority of the countries resulted from the deficit on trade in goods (the Czech Republic and Hungary have been an exception for several quarters now) and the negative income balance. All countries from the NMS-9 group recorded a services surplus, which did not change, either, as compared to the previous quarters. The current transfers balance in the majority of the countries (except for the Czech Republic, Slovakia and Hungary) was positive. In Poland, Romania and Lithuania it was between 2.8% and 4.5% of GDP. In other countries the balance of current transfers did not exceed 1% of GDP.

The following groups of countries have been distinguished, according to the amount and structure of their current account deficits:

- A. the Baltic states, Bulgaria, Romania – the current account deficit, despite a decrease in 2007 Q3, was still the highest in this group of countries and resulted mainly from the deficit on trade in goods;
- B. Poland, Czech Republic, Slovakia and Hungary – countries with a relatively lower deficit, which also decreased in 2007 Q3. In the case of this group of countries, the income account balance remains the main reason for the current account deficit.

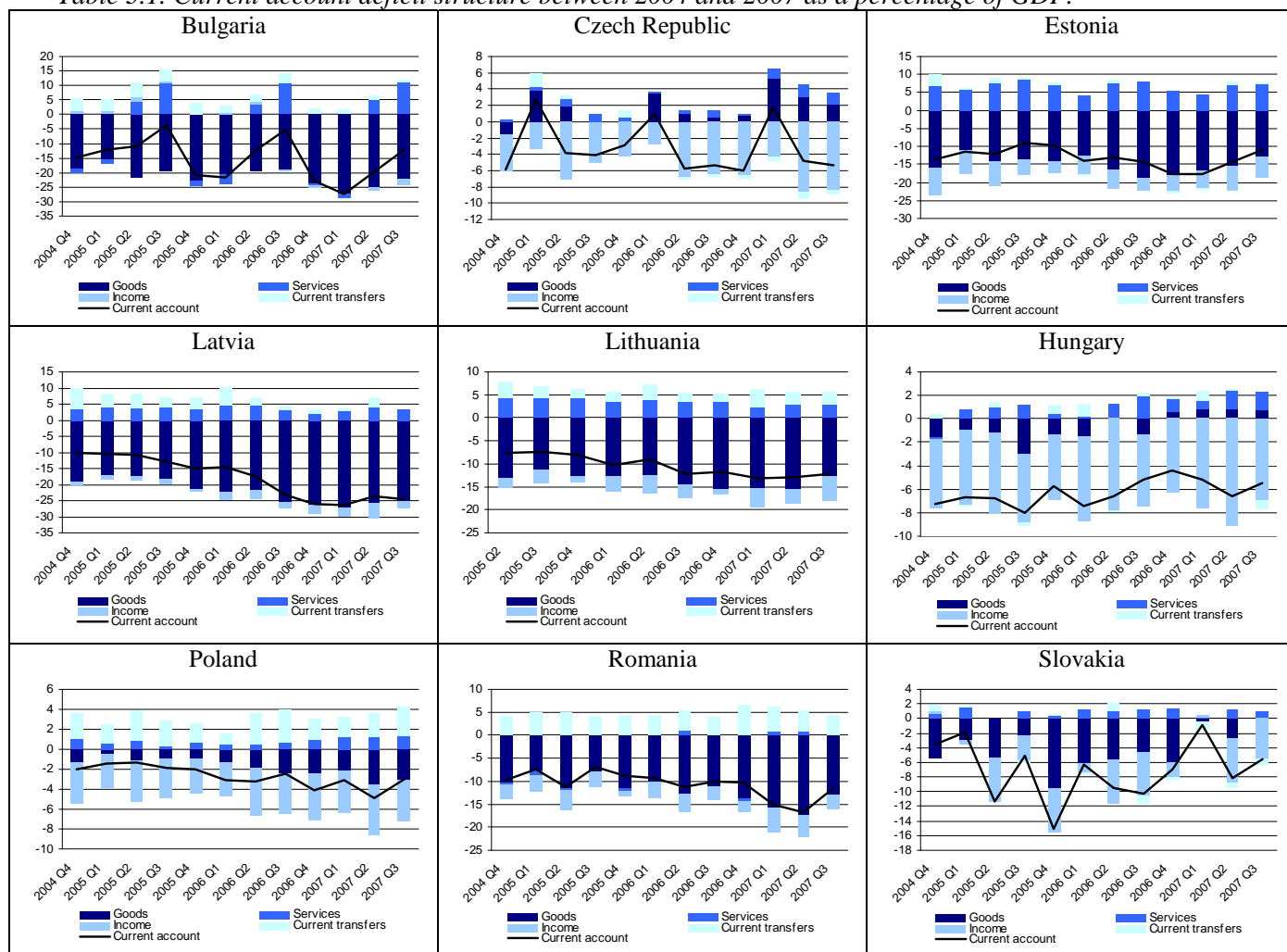
Chart 3.1. Current account balance in NMS-9 group between 2004 and 2007, in % of GDP.



Source: Own study on the basis of: Eurostat, national central banks.



Table 3.1. Current account deficit structure between 2004 and 2007 as a percentage of GDP.



Source: Own study on the basis of the Eurostat and central banks

A. The highest current account deficit was still recorded in the Baltic states, Romania and Bulgaria. In 2007 Q3, the deficit in this group of countries amounted to 14.3% of the GDP, on average, compared to 17,5% in 2007 Q2. As in previous quarters the deficit was the highest in Latvia and Bulgaria, where it amounted to 23.5% of GDP and 19.6% of GDP, respectively. In this group of countries the current account deficit resulted mainly from a large deficit on trade in goods. In 2007 Q3 it amounted to 17.2% of GDP. However, this meant a decrease of nearly 3 percentage points as compared to Q2 and the main reason for the decrease in the current account deficit was the improved balance on the commercial account. 2007 Q3 also brought an improvement in the services balance in this

group of countries compared to Q2 (5.0% and 4.1% of GDP, respectively). It was positive in all countries and in Bulgaria it increased by 6.0% of GDP. The income account deficit also decreased. It amounted to -3.6% of GDP in 2007 Q3, compared to -4.1% of GDP in 2007 Q2. On the other hand, the balance of current transfers deteriorated, dropping to 1.7% of GDP in Q3, compared to 2.5% of GDP in 2007 Q2.

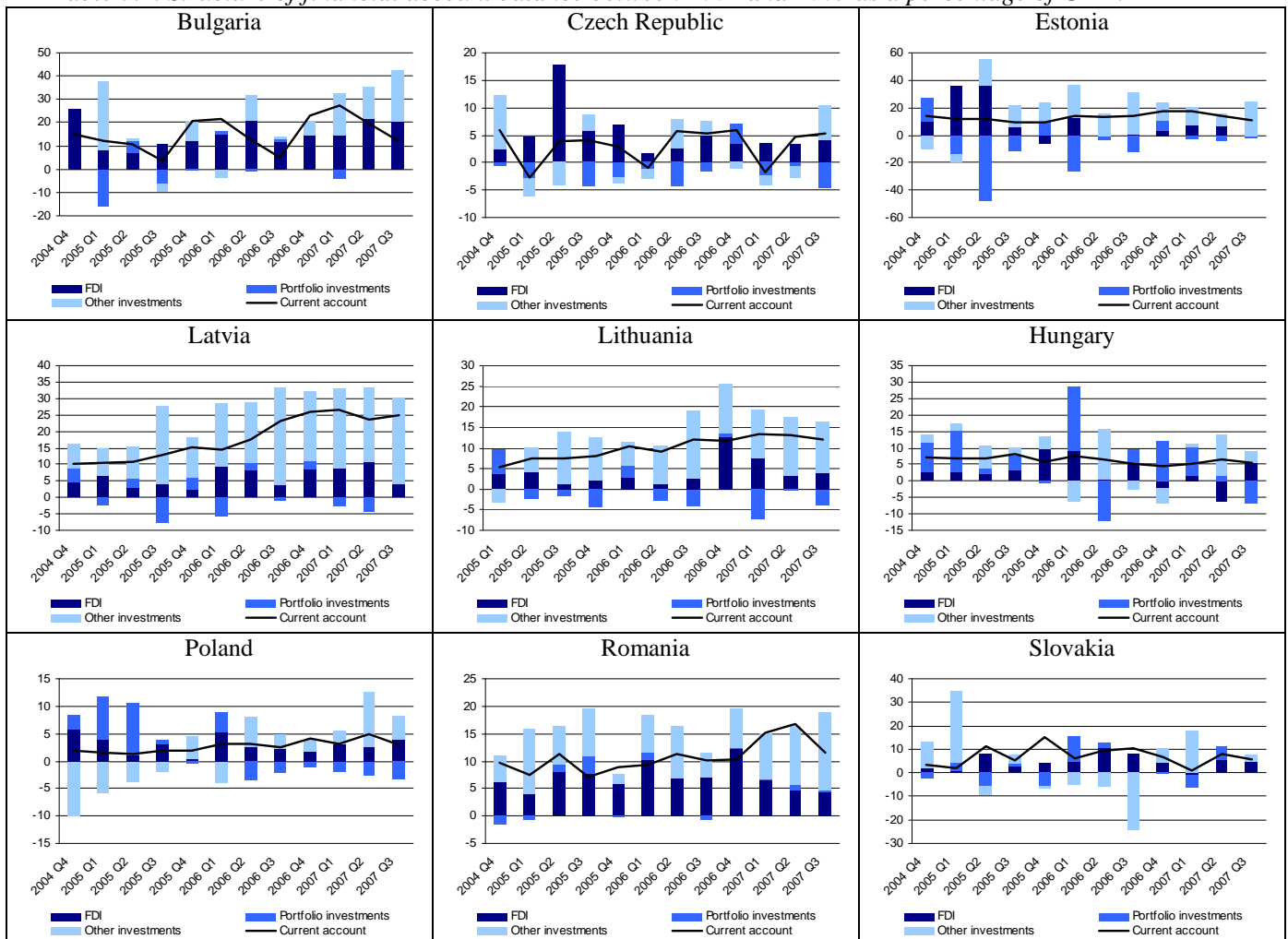
The main source of financing the current account deficit in the Baltic states, Bulgaria and Romania was other investments, including mainly loans to the banking sector. The average inflow of other investments for the above mentioned group of countries increased significantly and amounted to 19.8% of GDP in 2007 Q3, compared to 14.2% of GDP in Q2.

A lower inflow of other investments was observed only in Lithuania. Inflow of direct investments (6.3% of GDP) and outflow of portfolio investments (-0.8% of GDP) constituted a less significant impact on the changes of financial account. Only in Bulgaria the inflow of direct investments was similar to the inflow of other investments in 2007 Q3, while in the case of Estonia the outflow of direct investment could be observed.

B. The current account balance in Poland, Czech Republic, Slovakia and Hungary also improved in 2007 Q3. The average deficit in that group of countries amounted to 4.8% of GDP in 2007 Q3, compared to 6.1% of GDP

in 2007 Q2. The increase in the current account deficit was only recorded in the Czech Republic. In Poland, Slovakia and Hungary the deficit decreased in Q3. As in previous quarters, the largest part of the current account deficit was due to the deficit on the income account. However, in 2007 Q3 an improvement of the income balance was observed (-6.3% of GDP in 2007 Q3, compared to -7.2% of GDP in the previous period). The shrinking deficit in the income account and in trade in goods were responsible for the improvement of current account balance in this group of countries.

Table 3.2. Structure of financial account balance between 2004 and 2007 as a percentage of GDP.



Source: Own study on the basis of: Eurostat, central banks.

In 2007 Q3 the current account deficit in Poland, Czech Republic, Slovakia and Hungary was financed equally by the influx of foreign direct investments and other investments. They reached 4.3% and 4.2% of GDP, respectively. Compared to the previous quarter, the inflow of direct investments increased significantly (1.4% of GDP in Q2), especially in Hungary, where a significant outflow of direct investments took place in the previous quarter (-6.2% and 5.5% of GDP in 2007 Q2 and Q3, respectively). The share of other investments in financing the current account deficit decreased in comparison to the previous quarter, when it amounted to 5.1% of GDP. In 2007 Q3, an outflow of portfolio investments was observed in the amount of 3.6% of GDP.

### Long-term debt rating

In the second half of 2007 long-term debt in NMS-9 ratings remained unchanged in the majority of countries. Only in August 2007 Fitch decreased its rating for Latvia from A- to BBB+ (foreign currency) and from A to A- (domestic currency). In the case of Lithuania, a long-term perspective was changed from stable to negative. On 31 January 2008 Fitch decided to change the long-term perspective from stable to negative for Bulgaria, Estonia, Latvia and Romania.

Table 1.1. FITCH credit rating for long-term debt denominated in foreign currencies

	2002	2003	2004	2005	2006	January 2008
<b>Poland</b>	BBB+	BBB+	BBB+	BBB+	BBB+	A-
<b>Czech Republic</b>	BBB+	A-	A-	A	A	A
<b>Slovakia</b>	BBB-	BBB	A-	A	A	A
<b>Hungary</b>	A-	A-	A-	BBB+	BBB+	BBB+
<b>Estonia</b>	A-	A-	A	A	A	A
<b>Lithuania</b>	BBB	BBB	A-	A-	A	A
<b>Latvia</b>	BBB+	BBB+	A-	A-	A-	BBB+
<b>Bulgaria</b>	BB	BB+	BBB-	BBB	BBB	BBB
<b>Romania</b>	BB-	BB	BBB-	BBB-	BBB	BBB

Source: Fitch Ratings

Table 1.2. FITCH credit rating for long-term debt denominated in domestic currencies

	2002	2003	2004	2005	2006	January 2008
<b>Poland</b>	A+	A+	A	A	A	A
<b>Czech Republic</b>	A	A	A	A+	A+	A+
<b>Slovakia</b>	BBB+	A-	A+	A+	A+	A+
<b>Hungary</b>	A+	A+	A+	A-	A-	A-
<b>Estonia</b>	A+	A+	A+	A+	A+	A+
<b>Lithuania</b>	A-	A-	A	A	A+	A+
<b>Latvia</b>	A	A	A	A	A	A-
<b>Bulgaria</b>	BB+	BBB-	BBB	BBB+	BBB+	BBB+
<b>Romania</b>	BB	BB+	BBB	BBB	BBB+	BBB+

Source: Fitch Ratings

Taking into account the criticism of rating agencies which took place in the second half of 2007 in connection with the underestimation of risk on the US mortgage market, long-term debt ratings in the Central and Eastern European countries, particularly those characterised by a high current account deficit, may soon be lowered.

#### 4. Labour market

2007 Q3 was still characterised by good situation on the labour market in NMS-9. The high economic growth favoured growth of employment. The growth rate of wages remained high, which was reflected in the high growth rate of unit labour costs (ULC). The employment growth rate in 2007 Q3 averaged 2.2% in NMS-9 countries and was lower than in 2007 Q1, when it amounted to 2.5%. The average unemployment rate in NMS-9 countries was at 6.6% as at the end of the quarter and was 0.4% lower compared to the previous quarter. The average nominal wage in NMS-9 was still growing. The average wage in 2007 increased by 16.3% in Q3, in relation to the analogical period of the previous year, compared to 16.5% in 2007 Q2. The growth rate of wages remained high, which was reflected in a constantly high growth rate of unit labour costs. Average nominal growth rate of ULC in Q3 was 11.7%, compared to 12.1% in Q2. Similarly to previous periods, the high growth rate of ULC fuelled inflation pressure in some of NMS-9 countries and contributed to the deteriorated competitiveness of these economies in the international market. Just like in previous periods, changes on the labour market were not consistent across all the countries. NMS-9 economies have been grouped according to the tendencies on labour market:

- A. Slovakia – the only country with a negative ULC nominal growth rate in 2007 Q3.
- B. Romania, Lithuania and Latvia – where ULC nominal growth rate decreased in 2007 Q3.
- C. Bulgaria, the Czech Republic, Estonia, Latvia, Poland and Hungary – where employment growth rate decreased in 2007 Q3 yet, as a result of increasing wages and slowing economic growth, the ULC growth rate was on the rise.

A. The situation on the labour market in 2007 Q3, similarly as in Q2, makes Slovakia exceptional among the NMS-9 group. It was the only country where the productivity of workforce grew at a faster pace than wages in 2007 Q2. The result was a negative average nominal growth rate of ULC, which amounted to -0.3% in 2007 Q3, compared to -0.5% in Q2. Low growth rate of unit labour costs in Slovakia was exceptional among NMS-9 countries and helped maintain a low HICP growth rate in Slovakia over the past quarters, as well as contributed to the growth of the Slovak economy's competitiveness.

The negative nominal unit labour costs growth rate in Slovakia in 2007 Q2 and Q3 was the result of a decrease in employment growth rate, the lowest wage growth rate in the region and a high economic growth rate. Employment growth rate in 2007 Q3 amounted to 2.0% and was slightly higher than in Q2 (1.9%), however, compared to 2006 (3.8%) it decreased markedly. The average wage growth in 2007 Q3 was 7.1%, which was 0.1% higher than in 2007 Q2, and remained at the lowest level among NMS-9.

The reasons for the low growth rate of wages and unit labour costs were described in detail in the previous report.

B. The unit labour costs in Romania, Lithuania and Latvia decreased compared to the previous quarter. ULC growth rate in 2007 Q3 for those three countries decreased by 2.9% reaching 17.7%, on average.

The main reason for the slump in ULC growth in Romania and Lithuania was the decreasing wage growth rate. In Q3, the average annual nominal wage growth rate was 22.9% and 17.9% for Romania and Lithuania respectively, compared to 23.8% and 20.2%, respectively, in 2007 Q2. The GDP growth rate increase contributed to a labour productivity increase and a concurrent ULC growth rate drop. In Lithuania this impulse was significantly stronger than in Romania.<sup>17</sup>

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<sup>17</sup> In Lithuania, GDP in the analysed period increased by 10.8% r/r, which meant GDP growth rate increase of 2.8% compared to 2007 Q2. In Romania, GDP

A factor limiting the deceleration in ULC growth in Romania and Lithuania was the rising rate of employment growth. The average employment growth rate in the analysed group of countries amounted to 2.9% and 3.2%, respectively, in 2007 Q3 and was 0.1% and 0.4% higher, compared to the previous quarter.

The slowdown of nominal ULC growth rate in Latvia resulted from the decreasing rate of both employment growth and wage growth. The average wage growth rate in Latvia edged down from 33.4% in Q2 to 32.5% in 2007 Q3. However, it remained the highest in all NMS-9. However, the slowdown in employment growth is clear to see. In 2007 Q3 it amounted to 1.1%, compared to 3.4% in the previous quarter and 7.2% a year before. Combined with a relatively low and constantly decreasing unemployment rate in Latvia (5.1% in 2007 Q3), as well as the results of surveys carried out among Latvian entrepreneurs, in which they indicate the lack of workers as the most serious obstacle to business activity growth, the situation on the Latvian labour market may grow ever tighter in the forthcoming quarters, which may lead to further inflation rise.

C. In Bulgaria, the Czech Republic, Estonia, Poland and Hungary, the growth rate of unit labour costs stepped up in 2007 Q3. The average nominal growth rate of ULC for this group of countries amounted to 10.5% in 2007 Q3, compared to 9.5% in 2007 Q2. The highest ULC growth rate increase in the aforementioned group took place in Bulgaria, where unit labour costs growth was 3.3% faster in comparison to the previous quarter. In other countries the increase did not exceed 1%.

In most of the countries (except for Estonia) the increase in the growth rate of average wages contributed to ULC growth rate increases. ULC growth acceleration was in turn offset by the decrease in the employment growth rate. In Estonia, the main factor

conducive to the rising rate of ULC growth was the economic weakening in 2007 Q3.

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growth rate in 2007 Q3 increased only by 0.1% in relation to the previous quarter (see Chapter 2).

## 5. Inflation

Between August 2007 and December 2007 the NMS-9 reported a significant increase in inflation. The average HICP growth rate within that period increased from 5.5% to 7.8%. Inflation increased across NMS-9. The average inflation increase in NMS-9 amounted to 2.3% in the analysed period and ranged between 0.3% in Hungary and 3.8% in Latvia.

The highest inflation level, similarly as in previous quarters of 2007, was recorded in the Baltic states and Bulgaria. In December 2007, HICP growth rate in this group of countries ranged between 8.2% in Lithuania and 14.0% in Latvia. Inflation continued at a relatively high level in Hungary (despite this country's lowest increase in HICP growth rate in the region) standing at 7.4% at the end of 2007. In other countries (the Czech Republic, Poland, Romania, Slovakia), inflation rose significantly, however HICP growth rate in December 2007 was lower than in the Baltic states and Bulgaria (between 2.5% in Slovakia and 6.7% in Romania). The rising trend continued also in January 2008, which was additionally fuelled by changes in regulated prices in most of the countries.

The increase in inflation in NMS-9 was the result of global developments. HICP growth rate was primarily accelerated by demand-side factors: higher growth rate of the prices of food, particularly processed food, and also energy prices (see Table 4.1). The average contribution of food prices to inflation rise in the analysed period was 1.1 percentage point for NMS-9, with processed food<sup>18</sup> constituting 0.9 percentage point and unprocessed food 0.2 percentage point. The contribution of energy price growth rate in the corresponding period accounted for 0.8 percentage points, whereas the contribution of net inflation growth rate equalled 0.3 percentage points.

Structure of the contribution of growth in particular price categories to inflation increase

in NMS-9 region between August and December 2007 was not uniform in all countries, despite many resemblances.

In Bulgaria and Hungary, the increase of food prices growth rate resulted exclusively from the increase in processed food prices. The growth rate of unprocessed food prices in these countries decreased in December 2007 as compared to August 2007. In all the remaining countries the growth rate of both processed and unprocessed food prices and, consequently, also the contribution of the growth of these prices to overall HICP growth, increased significantly in the analogical period (see Table 5.1).

Energy prices in all countries of the group increased in the second half of 2007 and together with food prices were the second category of prices visibly influencing HICP growth rate. Slovakia and Romania were an exception here among the analysed countries. In Slovakia, the energy price growth rate did not increase significantly between August and December 2007. The growth rate of energy prices in Slovakia was only 1.2% in December 2007 and its contribution to HICP growth rate in the analysed period was just 0.1 percentage point. In Romania the energy price growth rate decreased in the analysed period (4.0% in December, compared to 5.7% in July 2007), and thus its contribution to HICP growth was negative, the only such case in NMS-9. In other countries of the region the energy price growth rate in December 2007 ranged between 7.6% in the Czech Republic and 20.2% in Latvia.

In other NMS-9 countries, except for Hungary, net inflation increased, though its significant contribution to overall HICP growth rate was only observed in Bulgaria, Romania and Slovakia.

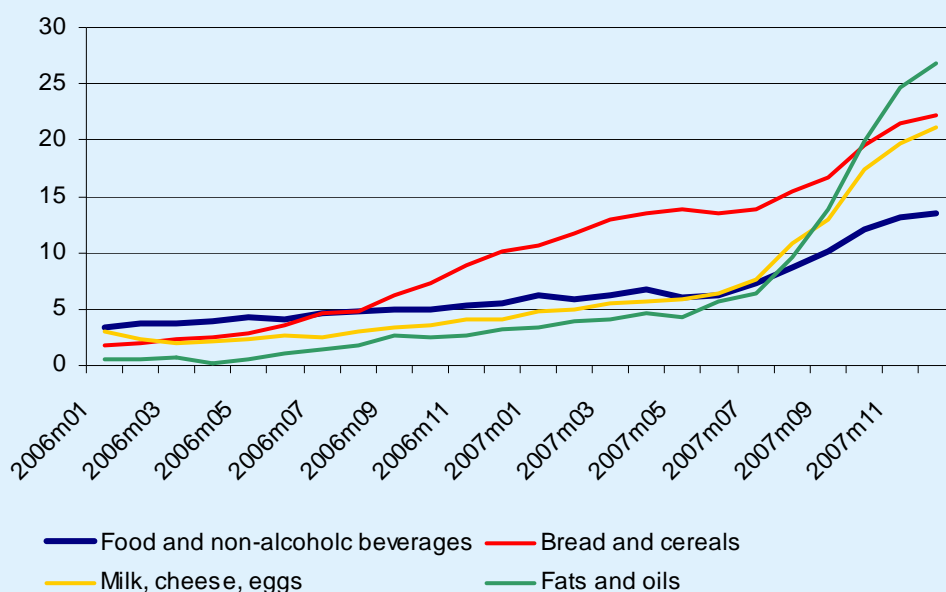
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<sup>18</sup> "Processed food" category also includes alcohol and tobacco.

### Agflation and food prices in NMS-9

In the second half of 2007 the growth rate of food prices increased significantly in the countries of Central and Eastern Europe. Between June and December 2007, the growth rate of food prices in NMS-9 increased, on average, from 6.3% to 13.5%. The rate of growth increased the most in the case of bread (by 8.7 percentage points), fruit (13.5 percentage points), dairy products (by 14.9 percentage points) and oils and fats (by 21.2 percentage points).<sup>19</sup>

Chart 1. Growth rate of food prices and selected components in NMS-9



Source: Eurostat.

The acceleration of the growth rate of food prices in the second half of 2007 was recorded in all countries from the NMS-9 group (as in other countries of the EU-27), but its scale was varied. In December 2007 the average growth rate of food prices in NMS-9 was at the level of 13.5%. It was the lowest in Slovakia (7.2%) and the highest in Bulgaria (21.1%). The highest increase of the growth rate of food prices in the second half of 2007 was also recorded in Bulgaria, where the rate increased by 13.5 percentage points. The price growth was the lowest in Hungary, where the growth rate of food prices increased by 2.5 percentage points.

Table 1. Growth rate of food prices and particular components in NMS-9 region in December 2007.

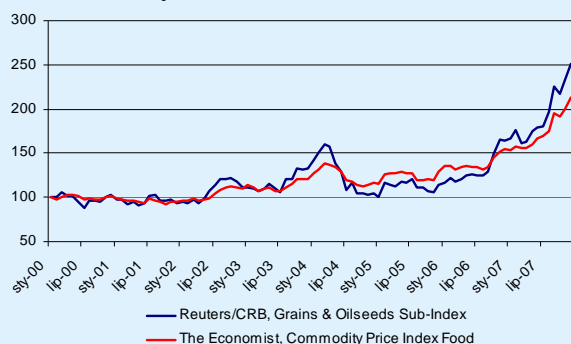
<sup>19</sup> All the data presented below refer to the Harmonised Index of Consumer Prices (HICP).

	Food and non-alcoholic beverages	Bread and cereal products	Meat	Fish	Milk, cheese, eggs	Fats and oils	Fruits	Vegetables	Sugar, jam, honey, chocolate and confectionery products	Other food products
<b>Bułgaria</b>	<b>21.1</b>	37.3	5.3	4.2	27.7	63.6	21.8	11.7	11.5	10.0
<b>Łotwa</b>	<b>19.9</b>	31.4	15.1	8.8	30.4	18.5	28.7	7.7	10.4	11.3
<b>Estonia</b>	<b>16.1</b>	21.9	12.0	3.9	33.7	29.0	20.9	6.0	5.6	5.8
<b>Litwa</b>	<b>15.3</b>	20.6	11.8	5.2	28.0	29.1	24.6	9.0	3.8	11.1
<b>Węgry</b>	<b>13.0</b>	24.1	3.4	5.8	17.6	18.7	30.4	10.9	-1.8	7.8
<b>Czechy</b>	<b>11.2</b>	20.6	3.5	2.1	21.2	21.7	15.7	-0.4	6.6	8.0
<b>Rumunia</b>	<b>9.4</b>	12.2	0.9	1.3	5.1	32.9	16.2	27.2	2.8	2.8
<b>Polska</b>	<b>7.9</b>	12.1	6.4	2.1	14.4	15.3	20.0	-2.6	-0.5	3.9
<b>Słowacja</b>	<b>7.2</b>	20.0	1.8	1.4	12.4	12.7	13.0	-1.7	-1.8	4.5

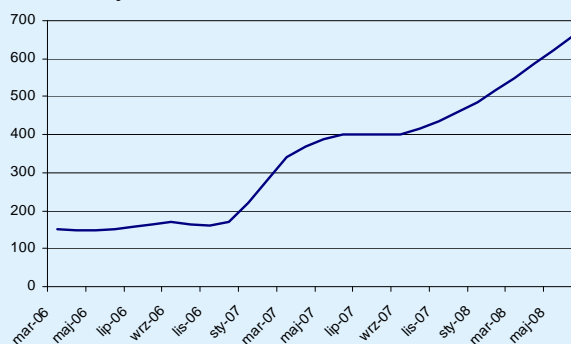
Source: Eurostat.

The fast increase of food prices in Central and Eastern Europe was not an extraordinary situation. In the second half of 2007 food prices grew all over the world. The following food price index shows that in 2007 the world food prices increased by almost 40%.

Food price index and grains & oilseeds sub-index, January 2000=100



Biofuels production forecast, thousands barrels/day



Source: EcoWin Financial

The increase in food prices in the world mainly concerned grains and oilseeds. One of the reasons behind the fast increase in the prices of these commodities is the increased output of biofuels. In the first half of 2006 the global production of biofuels amounted to approx. 150,000 barrels a day and in 2007 Q4 to 440,000 barrels a day. Further growth of production is predicted for 2008. In mid 2008 the production of biofuels in the world is to amount to approx. 660,000 barrels a day. The fast-growing production of fuels of plant origin and the fact that they are often subsidised by the state makes the production of plants for biofuels increasingly profitable. Therefore, the production of grains and oilseeds for consumption is decreasing, which results in the increase in their prices all over the world. An additional factor behind the growth of agricultural produce prices is the increase in the prices of fuels and energy, which has a direct impact on the increased costs of agricultural



production. Adverse weather conditions in 2007 also had a negative impact on the supply of agricultural products.

Another reason for the increase in food prices across the world is the increased demand for food from the developing countries (mainly China and India), related to the fast increase in wealth of those countries and the change of consumption patterns. An increasing amount of grains is used as fodder for farm animals, which at the same time decreases the supply of grains for bread and other cereal products.

The increased demand for food and the increasing risk of abnormal weather conditions, which may reduce the supply of agricultural products, seem to be the factors that will be conducive to keeping the growth rate of food prices at a high level in the future. This threat may affect the countries of the NMS-9 group to the larger extent than the developed countries, since the share of food in the inflation basket is significantly higher in the former group.

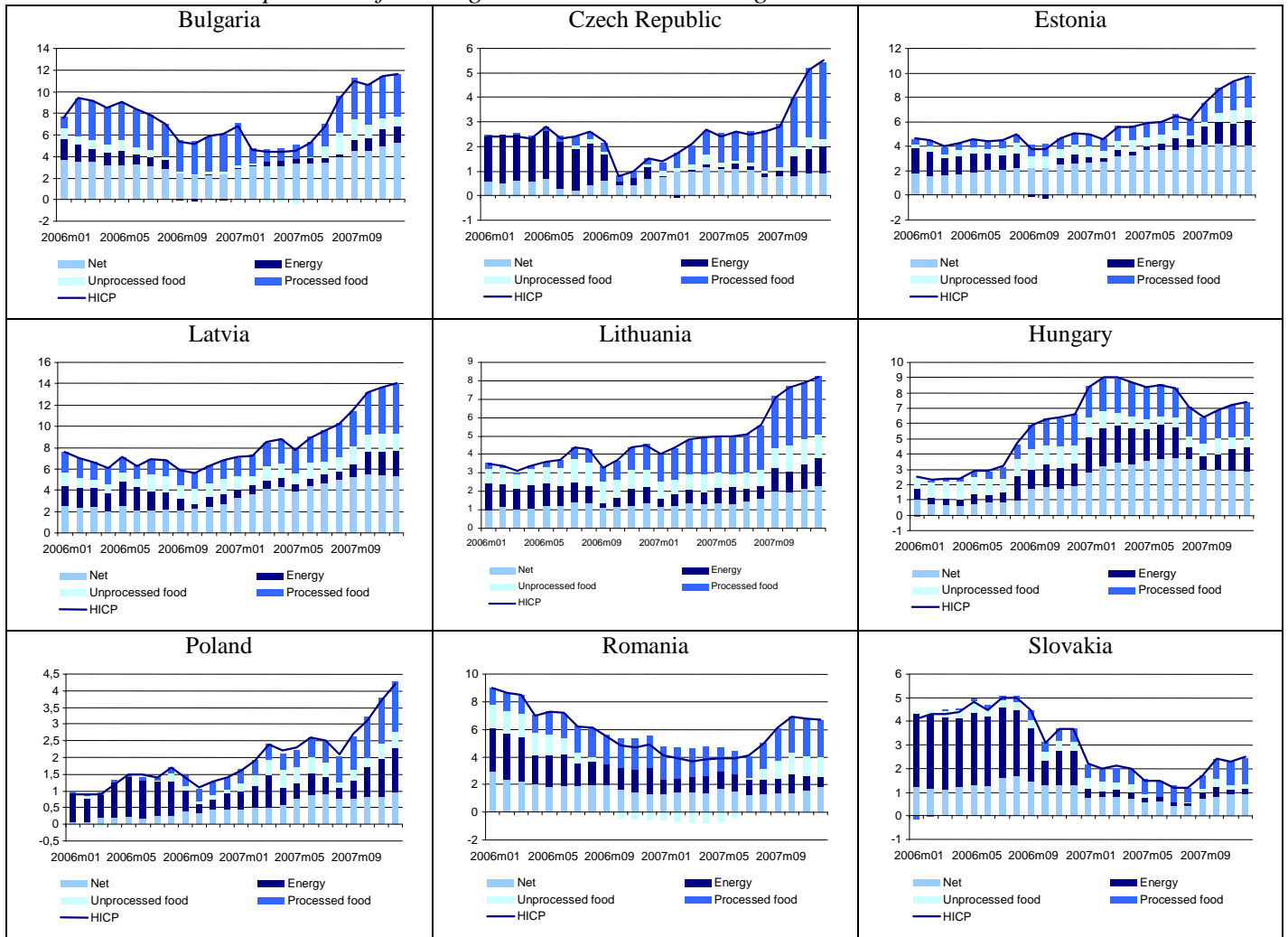
*Table 5.1. Decomposition of HICP growth rate in August – December 2007.*

Country	Price category	Contribution to inflation		Contribution to changes		Average weights in the period, in %
		Beginning of the rise in HICP growth rate – August 2007	End of the rise in the HICP growth rate – December 2007	in percentage points	in percentage of inflation change	
	<b>Total HICP</b>	<b>9.3</b>	<b>11.6</b>	<b>2.3</b>	<b>100.0</b>	<b>100.0</b>
<b>Bulgaria</b>	Energy	0.2	1.6	1.4	59.1	12.9
	Unprocessed food	2.0	0.9	-1.0	-45.0	9.7
	Processed food	3.4	3.9	0.4	19.1	19.1
	Net	4.0	5.2	1.2	53.2	58.3
	<b>Total HICP</b>	<b>2.6</b>	<b>5.5</b>	<b>2.9</b>	<b>100.0</b>	<b>100.0</b>
<b>Czech Republic</b>	Energy	0.1	1.1	1.0	32.8	14.4
	Unprocessed food	0.1	0.4	0.3	8.9	7.4
	Processed food	1.6	3.1	1.5	50.1	19.4
	Net	0.8	0.9	0.1	4.1	58.8
	<b>Total HICP</b>	<b>6.1</b>	<b>9.7</b>	<b>3.6</b>	<b>100.0</b>	<b>100.0</b>
<b>Estonia</b>	Energy	0.6	2.1	1.4	39.6	11.4
	Processed food	0.3	1.0	0.7	19.4	9.3
	Unprocessed food	1.3	2.6	1.3	35.0	19.1
	Net	4.0	4.1	0.1	3.3	60.2
	<b>Total HICP</b>	<b>5.6</b>	<b>8.2</b>	<b>2.6</b>	<b>100.0</b>	<b>100.0</b>
<b>Lithuania</b>	Energy	0.7	1.5	0.8	29.8	13.3
	Unprocessed food	0.8	1.4	0.5	20.2	11.4
	Processed food	2.4	3.1	0.7	27.1	22.0
	Net	1.6	2.3	0.7	26.6	53.2

Country	Price category	Contribution to inflation		Contribution to changes		Average weights in the period, in %
		Beginning of the rise in HICP growth rate – August 2007	End of the rise in the HICP growth rate – December 2007	in percentage points	in percentage of inflation change	
	<b>Total HICP</b>	<b>10.2</b>	<b>14.0</b>	<b>3.8</b>	<b>100.0</b>	<b>100.0</b>
<b>Latvia</b>	Energy	0.9	2.3	1.4	37.9	11.4
	Unprocessed food	1.3	1.7	0.4	11.0	11.3
	Processed food	3.2	4.7	1.5	39.3	20.5
	Net	4.9	5.3	0.4	10.5	56.8
	<b>Total HICP</b>	<b>5.0</b>	<b>6.7</b>	<b>1.7</b>	<b>100.0</b>	<b>100.0</b>
<b>Romania</b>	Energy	1.1	0.8	-0.3	-18.8	18.8
	Unprocessed food	0.8	1.4	0.6	36.2	15.8
	Processed food	1.8	2.7	0.8	49.3	27.0
	Net	1.3	1.8	0.5	29.4	38.4
	<b>Total HICP</b>	<b>2.1</b>	<b>4.2</b>	<b>2.1</b>	<b>100.0</b>	<b>100.0</b>
<b>Poland</b>	Energy	0.3	1.3	1.0	47.8	16.2
	Unprocessed food	0.1	0.5	0.4	17.2	8.8
	Processed food	0.8	1.5	0.7	33.1	18.3
	Net	0.8	1.0	0.2	8.1	56.7
	<b>Total HICP</b>	<b>1.2</b>	<b>2.5</b>	<b>1.3</b>	<b>100.0</b>	<b>100.0</b>
<b>Slovakia</b>	Energy	0.1	0.2	0.1	5.7	18.4
	Unprocessed food	0.0	0.2	0.2	12.0	7.4
	Processed food	0.6	1.1	0.5	38.0	15.0
	Net	0.4	0.9	0.5	41.0	59.2
	<b>Total HICP</b>	<b>7.1</b>	<b>7.4</b>	<b>0.3</b>	<b>100.0</b>	<b>100.0</b>
<b>Hungary</b>	Energy	0.8	1.7	0.9	287.5	13.3
	Unprocessed food	0.7	0.7	0.0	-9.5	7.1
	Processed food	1.9	2.2	0.3	98.0	19.6
	Net	3.7	2.8	-0.8	-280.0	60.0

Source: Eurostat, own calculations

Chart 5.1 Decomposition of HICP growth rate in NMS-9 region.



Source: Own summary on the basis of Eurostat data.

## 6. Monetary policy

Despite the inflation growth in all NMS-9 in the second half of 2007, the policy of central banks differed among countries implementing direct inflation targeting strategy.<sup>20</sup>

The central banks of the Czech Republic and Poland began a series of interest rate hikes in 2007, which also continued in the second half of the year. Between August and December 2007 the interest rates, both in Poland and in the Czech Republic, were increased by the total of 50 basis points. At the end of December 2007, the main interest rate of the Polish central bank was 5.0% and of the Czech central bank – 3.5%. In 2008 the central banks of Poland and the Czech Republic decided to further raise their interest rates to 5.5% and 3.75%, respectively.

Inflation projections of the central banks of Poland and the Czech Republic<sup>21</sup> of February 2008 were significantly reduced as compared to the previous projections. Both central banks forecast that the inflation in 2008 will significantly overshoot the inflation target. At the end of 2008 the inflation in the Czech Republic should exceed 5%, thus breaching the upper limit of the deviation band. According to the projection, from February 2008 on, the inflation in Poland in 2008 should be running above the upper tolerance limit for deviations. In both countries the probability of inflation overshooting the target is higher than the probability of its running below the target.

In Romania the central bank also increased the main interest rate within the same period. The main interest rate rose by 50 basis points in response to the increasing consumer demand, tensions on the labour market, persistently high external balances and the depreciation of the national

currency. In 2008 the National Bank of Romania decided to raise interest rates once again and in February 2008 the main interest rate rose to 8.0%. In Romania, despite the inflation increase in the second half of 2007, the central bank forecasts a decrease in the CPI growth rate in the projection horizon. In 2008 Q4 inflation should be running above the upper limit for deviations from the inflation target, but in 2009 it should already be consistent with the set target.

In the analysed period the National Bank of Slovakia did not decide to increase its interest rates. The main NBS interest rate has remained unchanged at the level of 4.25% since April 2007. It was despite the fact that the Slovak central bank projected a gradual inflation increase in the country. However, unlike Poland and the Czech Republic, inflation in Slovakia should be only slightly higher than the assumed inflation target in the projection horizon.

*Table 6.1. Inflation projections in countries implementing direct inflation targeting strategy.*

Country	Date of projection	Inflation at the end of 2008
Poland	February 2008	4.1
Czech Republic	February 2008	5.3
Hungary	February 2008	4.7
Slovakia	February 2008	2.8
Romania	February 2008	3.8

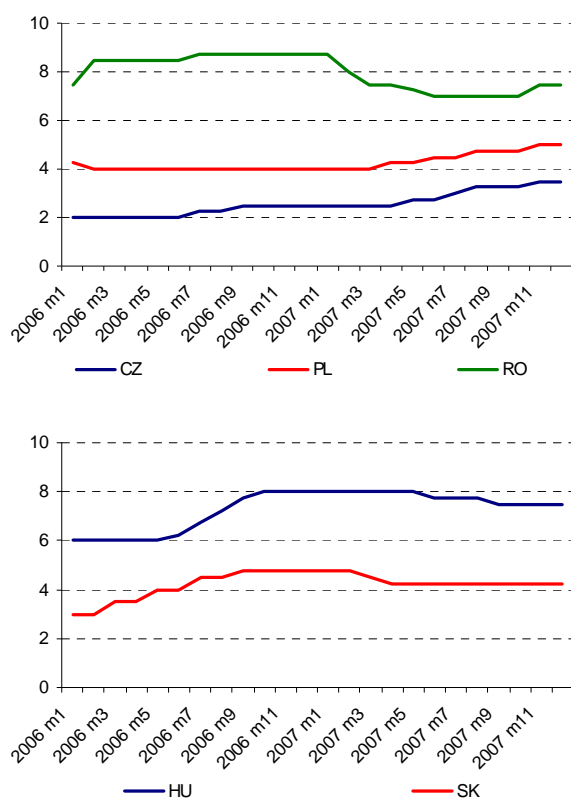
*Source: National central banks.*

From August to December 2007 the Hungarian central bank, as the only one among NMS-9, lowered the interest rate by the total of 25 basis points to the level of 7.5%. The National Bank of Hungary forecasts a gradual decrease in the growth rate of consumer prices. This decrease in Hungary will be due to the expiry of the effect connected with the one-time increase in regulated prices and increasing the rates of indirect taxes on selected goods. Despite the inflation decrease in Hungary, there are no projections indicating that in 2008 and 2009 it will fall to the level of the inflation target of 3%.

<sup>20</sup> The countries implementing the direct inflation targeting strategy include: the Czech Republic, Poland, Romania, Slovakia and Hungary.

<sup>21</sup> The projections refer to the domestic CPI.

Chart 6.1. Main interest rates in countries implementing direct inflation targeting strategy.



Source: National central banks.

The Baltic states<sup>22</sup> and Bulgaria implement the currency board regime. Between August and December 2007 market interest rates increased in all the Baltic states and also in Bulgaria.<sup>23</sup> In Latvia the highest increase was recorded in August and September, when the 3-month RIGIBOR increased to 12.7%, but it began to decrease in October and reached 10.5% at the end of 2007. In other countries (Bulgaria, Estonia, Lithuania) market interest rates rose in the whole period from August to December 2007. At the end of the year they stood at 6.5% in Bulgaria,

7.3% in Estonia and 6.7% in Lithuania. Despite a relatively high nominal interest rate, real interest rates in the group of the above mentioned countries remained at a very low level, due to high and constantly rising inflation. Such a situation was observed mainly in the Baltic states, where, apart from a few months, the interest rates have been negative since those countries' accession to the European Union.

In the second half of 2007 the market interest rates also increased in Poland, the Czech Republic and Romania. They remained unchanged in the analysed period only in Slovakia and Hungary.

The increase in interest rates in the second half of 2007 in most of the NMS-9 countries may be partly attributed to the US mortgage market crisis. The high growth rate of granted loans, observed since 2004 and accompanied by a significantly lower growth rate of bank deposits, resulted in liquidity problems in domestic markets which could not be resolved in the same way as before, i.e. through increased financing from abroad. This was due to the shortage of liquidity in global markets and more strict credit policies of large international banks. As a result, market interest rates increased in the second half of 2007, especially in the Baltic states, which depend on foreign financing the most.

<sup>22</sup> Latvia maintains a very narrow exchange rate deviation band (+/- 1%), but for the purposes of coherent analysis it was classified in the group of countries implementing the fixed exchange rate regime.

<sup>23</sup> The market interest rate was assumed as the interest level of a 3-month monetary loan on the inter-bank market.

## Statistical Annex

### 1. National Accounts

**Table 1. Gross domestic product** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007	APR 2007
Poland	5.4	6.3	6.6	6.6	7.2	6.4	6.4	6.1
Czech Republic	6.6	6.4	6.3	6.2	6.5	6.5	6.3	6.6
Slovakia	9.0	7.9	9.0	8.2	8.3	9.3	9.4	14.3
Hungary	4.5	3.5	3.9	3.7	2.7	1.2	0.9	0.8
Estonia	11.4	11.2	11.1	11.0	10.1	7.6	6.4	4.5
Lithuania	8.2	9.1	6.3	7.4	8.1	8.0	10.8	7.9
Latvia	13.1	11.1	11.9	11.7	11.2	11.0	10.9	9.6
Bulgaria	5.5	6.4	6.7	5.7	6.2	6.6	4.5	
Romania	6.9	7.8	8.3	7.7	6.0	5.6	5.7	6.6

Source: National statistical offices

**Table 2. Private consumption** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	5.0	4.4	5.2	4.7	6.9	5.1	5.2
Czech Republic	4.9	5.3	5.0	6.2	6.6	6.0	5.6
Slovakia	7.0	5.0	4.6	6.9	6.3	7.8	8.3
Hungary	3.8	2.0	1.9	0.0	0.3	-0.6	-0.8
Estonia	15.7	14.6	15.8	14.3	16.7	12.0	5.1
Lithuania	9.1	11.4	15.0	11.3	18.0	11.0	9.2
Latvia	17.2	17.9	19.7	23.7	20.4	18.4	14.4
Bulgaria	5.7	8.2	8.5	5.9	8.1	5.7	5.0
Romania	11.1	12.6	13.3	12.7	11.3	10.7	8.2

Source: National statistical offices

**Table 3. Gross fixed capital formation** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	9.0	15.9	18.0	16.6	26.2	20.8	19.8
Czech Republic	5.9	5.7	5.2	5.2	4.7	6.0	5.7
Slovakia	15.2	7.8	7.9	5.0	11.0	5.9	6.5
Hungary	9.1	-4.3	-5.1	-5.5	1.9	0.8	-1.8
Estonia	27.6	9.8	25.0	27.2	15.0	21.8	-5.7
Lithuania	17.1	16.9	13.2	21.9	24.4	18.7	15.3
Latvia	19.5	16.2	22.5	15.8	17.9	14.4	12.7
Bulgaria	17.1	16.0	11.7	23.8	35.9	24.7	19.7
Romania	11.3	14.4	17.3	18.0	17.2	19.4	32.2

Source: National statistical offices

**Table 4. Exports of goods and services** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	22.4	12.8	14.6	10.1	11.7	6.5	9.3
Czech Republic	19.3	11.4	11.3	16.0	15.4	13.5	14.8
Slovakia	17.7	18.1	23.8	22.6	23.8	20.0	9.0
Hungary	19.4	15.7	18.0	22.3	17.5	14.8	14.9
Estonia	14.2	14.6	7.1	-0.7	6.5	3.3	-2.9
Lithuania	20.5	17.2	10.1	2.9	3.5	3.2	13.0
Latvia	12.1	9.2	3.5	-3.0	8.4	8.7	11.1
Bulgaria	12.7	10.0	8.4	5.4	2.2	5.7	6.2
Romania	12.9	10.5	10.6	8.6	12.9	2.4	1.7

Source: National statistical offices

**Table 5. Imports of goods and services** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	23.7	12.7	16.6	17.5	12.8	10.8	11.4
Czech Republic	17.8	11.1	10.7	16.1	15.3	13.4	14.2
Slovakia	21.7	21.7	21.7	21.7	21.7	21.7	21.7
Hungary	18.3	10.1	12.1	17.7	13.1	13.4	14.6
Estonia	23.1	21.4	15.0	10.8	9.8	3.5	-0.4
Lithuania	23.4	11.3	16.3	6.8	10.6	14.7	9.5
Latvia	17.4	13.5	22.4	16.6	29.5	23.0	15.5
Bulgaria	20.8	12.2	14.7	14.0	13.2	10.7	9.6
Romania	21.8	19.1	24.4	25.3	23.8	20.8	22.4

Source: National statistical offices

## 2. Indices of business cycle and economic activity

**Table 6. Industrial output** in relation to the corresponding period of the previous year (in %)

	2006	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	12.0	10.4	8.9	5.4	10.8	8.3	6.4	10.8
Czech Republic	11.2	11.5	6.0	1.3	8.4	6.7	2.9	
Slovakia	9.8	18.3	5.0	12.8	14.0	13.3	5.2	
Hungary	10.3	12.0	9.5	6.0	8.6	5.6	5.3	
Estonia	7.4	8.8	2.4	3.4	8.5	4.5	-2.2	
Lithuania	7.4	12.2	13.9	0.0	6.7	3.6	7.2	8.5
Latvia	7.8	1.7	3.9	-0.5	-1.1	1.5	-5.4	
Bulgaria	6.1	14.3	8.4	8.9	11.3	7.4	4.0	
Romania	7.2	7.1	5.0	3.3	5.8	4.5	2.6	

Source: National statistical offices

**Table 7. Retail sales** in relation to the corresponding period of the previous year (in %)

	2006	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	11.9	15.0	16.1	12.2	16.3	15.1	8.1	15.9
Czech Republic	6.5	8.9	7.3	4.1	9.4	5.9	5.4	
Slovakia	6.5	5.9	5.1	1.9	2.1	2.0	5.1	
Hungary	4.4	-4.2	-3.6	-4.6	-4.1	-4.2	-4.0	
Estonia	19.0	14.0	14.6	11.8	8.9	5.5	4.7	
Lithuania	14.5	20.6	16.5	12.8	14.8	12.1	8.2	
Latvia	19.8	24.0	19.1	17.5	9.1	12.3	1.7	
Bulgaria	6.6	2.5	1.7	1.7	2.4	0.5	0.9	
Romania	24.3	23.8	33.2	31.9	17.1	19.2	20.1	

Source: National statistical offices

**Table 8. Consumer Confidence Index**

	2006	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	-12.7	-2.3	-5.3	-3.7	-4.5	-1.9	-1.3	-3.1
Czech Republic	1.9	-3.1	-1.8	-0.5	-1.9	-8.7	-12.6	-10.9
Slovakia	-9.8	1.8	0.6	-1.2	-5.7	-8.0	-4.8	-4.0
Hungary	-32.9	-45.4	-45.2	-46.8	-49.1	-50.9	-44.7	-45.1
Estonia	10.1	2.7	-1.6	-2.7	-7.5	-8.1	-7.6	-12.5
Lithuania	0.4	7.0	6.6	3.5	-1.3	-5.4	-3.7	-5.3
Latvia	-5.0	-5.2	-7.8	-9.1	-9.9	-14.8	-14.0	-18.0
Bulgaria	-31.1	-24.5	-30.2	-31.4	-30.9	-30.0	-29.5	-28.9
Romania	-22.9	-10.1	-11.4	-11.0	-12.9	-15.2	-12.6	-19.8

Source: European Commission

**Table 9. Industry Confidence Index**

	2006	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	-8.0	-0.8	-1.1	-0.8	-0.5	-0.5	-0.9	-1.4
Czech Republic	10.8	16.0	15.3	15.4	16.0	15.2	14.7	15.4
Slovakia	9.0	17.5	10.3	11.9	13.0	11.1	3.0	4.4
Hungary	-0.7	1.3	1.1	-2.4	-6.4	1.5	-2.4	-5.2
Estonia	20.1	15.4	9.5	8.0	6.1	5.2	1.1	4.0
Lithuania	5.1	8.7	9.0	4.7	2.7	9.0	4.7	5.3
Latvia	6.0	4.5	5.6	2.3	0.3	-1.1	-0.1	-1.2
Bulgaria	4.8	11.4	11.0	11.6	12.3	11.4	9.6	13.7
Romania	2.1	3.1	2.9	3.8	2.5	1.9	1.1	2.3

Source: European Commission

**Table 10. PMI in manufacturing**

	2006	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	53.9	54.5	53.6	51.6	51.6	51.9	50.8	51.9
Czech Republic	55.7	59.5	58.8	55.8	54.6	54.9	55.0	56.1
Hungary	54.0	50.5	50.6	54.2	54.8	51.0	53.8	56.9

Source: EcoWin Economic



### 3. Prices

**Table 11. CPI in relation to the corresponding period of the previous year (in %)**

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	2.6	2.3	1.5	2.3	3.0	3.6	4.0	4.3
Czech Republic	2.5	2.3	2.4	2.8	4.0	5.0	5.4	7.5
Slovakia	2.5	2.3	2.3	2.8	3.3	3.1	3.4	3.8
Hungary	8.6	8.4	8.3	6.4	6.7	7.1	7.4	7.1
Estonia	5.8	6.4	5.7	7.2	8.5	9.1	9.6	11.0
Lithuania	4.8	5.1	5.5	7.1	7.6	7.8	8.1	9.9
Latvia	8.8	9.5	10.1	11.4	13.2	13.7	14.1	15.7
Bulgaria	5.6	8.4	12.0	13.1	12.4	12.6	12.5	12.5
Romania	3.8	4.0	5.0	6.0	6.8	6.7	6.6	7.3

Source: National statistical offices

**Table 12. PPI in relation to the corresponding period of the previous year (in %)**

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	1.5	1.2	1.2	1.7	2.4	2.3	2.5	2.8
Czech Republic	2.6	2.5	2.6	2.8	4.0	5.1	5.5	6.0
Slovakia	1.3	1.3	0.5	1.6	1.8	2.0	2.8	4.4
Hungary	8.5	8.3	7.1	6.4	6.9	7.2	7.4	
Estonia	6.0	6.5	6.1	7.5	8.7	9.3	9.7	8.3
Lithuania	5.0	5.1	5.6	7.1	7.6	7.9	8.2	20.3
Latvia	8.9	9.5	10.2	11.5	13.2	13.7	14.0	10.9
Bulgaria	5.3	6.8	9.3	11.0	10.6	11.4	11.6	
Romania	3.9	4.1	5.0	6.1	6.9	6.8	6.7	

Source: National statistical offices

**Table 13. HICP in relation to the corresponding period of the previous year (in %)**

	05.2007	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007
Poland	2.3	2.6	2.5	2.1	2.7	3.1	3.7	4.2
Czech Republic	2.4	2.6	2.5	2.6	2.8	4.0	5.1	5.5
Slovakia	1.5	1.5	1.2	1.2	1.7	2.4	2.3	2.5
Hungary	8.4	8.5	8.3	7.1	6.4	6.9	7.2	7.4
Estonia	5.9	6.0	6.5	6.1	7.5	8.7	9.3	9.7
Lithuania	5.0	5.0	5.1	5.6	7.1	7.6	7.9	8.2
Latvia	7.8	8.9	9.5	10.2	11.5	13.2	13.7	14.0
Bulgaria	4.5	5.3	6.8	9.3	11.0	10.6	11.4	11.6
Romania	3.9	3.9	4.1	5.0	6.1	6.9	6.8	6.7

Source: Eurostat.

**Table 14. HICP – unprocessed food in relation to the corresponding period of the previous year (in %)**

	05.2007	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007
Poland	5.6	5.6	4.8	1.4	3.5	3.6	5.0	5.5
Czech Republic	2.5	1.7	1.8	1.3	1.7	4.7	6.2	4.8
Slovakia	2.0	-0.1	-0.5	0.5	1.3	4.8	3.3	2.6
Hungary	9.1	7.4	8.8	10.4	11.7	14.4	11.0	10.0
Estonia	7.6	6.9	6.5	3.5	4.2	7.8	10.9	11.0
Lithuania	7.2	6.6	7.8	7.3	9.1	12.3	11.4	11.9
Latvia	9.7	12.8	10.8	11.2	15.0	15.0	15.1	14.9
Bulgaria	-4.6	1.2	11.5	20.4	19.6	12.6	10.9	9.7
Romania	-4.5	-3.0	0.9	5.1	8.6	10.0	9.3	9.0

Source: Eurostat.

**Table 15. HICP – processed food (including alcohol and tobacco products)** in relation to the corresponding period of the previous year (in %)

	05.2007	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007
Poland	2.8	3.1	3.8	4.3	5.4	6.6	7.4	8.1
Czech Republic	5.9	6.1	6.3	8.5	9.0	10.8	14.5	16.0
Slovakia	4.4	4.5	4.6	4.1	3.8	5.6	6.5	7.4
Hungary	10.8	10.7	9.5	9.8	8.6	9.3	10.4	11.3
Estonia	6.4	6.2	6.7	6.8	7.8	10.7	12.3	13.4
Lithuania	8.8	9.2	9.5	10.8	12.7	14.4	14.1	14.0
Latvia	10.9	11.9	14.1	15.7	16.2	19.3	21.2	23.0
Bulgaria	6.8	7.4	10.5	17.9	19.5	19.7	20.1	20.2
Romania	6.3	5.9	5.6	6.8	8.5	9.6	10.0	9.9

Source: Eurostat.

**Table 16. HICP – energy** in relation to the corresponding period of the previous year (in %)

	05.2007	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007
Poland	2.6	3.8	3.2	2.0	3.3	5.2	7.0	8.2
Czech Republic	0.8	1.2	1.2	1.0	1.5	5.3	7.1	7.6
Slovakia	1.0	1.2	0.9	0.8	1.8	2.1	0.8	1.2
Hungary	15.8	17.2	15.2	6.1	7.2	8.0	11.2	12.6
Estonia	3.3	4.6	8.1	5.7	13.1	14.8	15.9	18.2
Lithuania	6.4	6.6	5.5	5.5	9.5	8.4	9.9	11.3
Latvia	5.6	6.2	7.4	7.6	10.6	18.0	18.9	20.2
Bulgaria	3.6	4.1	3.6	1.5	8.0	9.3	11.8	12.0
Romania	6.7	6.8	6.1	5.7	5.6	7.1	5.3	4.0

Source: Eurostat.

**Table 17. HICP (excluding energy, food, alcohol and tobacco products)** in relation to the corresponding period of the previous year (in %)

	05.2007	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007
Poland	1.4	1.6	1.6	1.4	1.4	1.5	1.5	1.7
Czech Republic	1.8	1.9	1.8	1.3	1.4	1.4	1.5	1.5
Slovakia	1.0	1.0	0.7	0.7	1.2	1.4	1.6	1.6
Hungary	5.9	6.1	6.3	6.1	4.9	4.9	4.8	4.7
Estonia	6.1	6.2	6.3	6.6	6.9	7.1	6.8	6.8
Lithuania	2.6	2.5	2.7	3.0	3.8	3.7	4.1	4.3
Latvia	6.9	7.7	8.3	8.7	9.2	9.7	9.6	9.4
Bulgaria	5.7	5.7	5.9	6.9	7.8	7.7	8.6	9.0
Romania	4.4	3.9	3.2	3.4	3.5	3.6	4.1	4.7

Source: Eurostat.

## 4. BALANCE OF PAYMENTS

**Table 18. Current account balance, as percentage of GDP.**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	-3.1	-3.2	-2.4	-4.1	-3.1	-4.9	-3.0
Czech Republic	0.9	-5.7	-5.4	-6.0	1.6	-4.9	-5.5
Slovakia	-6.3	-9.6	-10.3	-6.9	-0.9	-8.2	-5.6
Hungary	-7.4	-6.6	-5.2	-4.4	-5.2	-6.0	-5.6
Estonia	-14.0	-13.2	-14.4	-17.6	-21.3	-14.1	-10.9
Lithuania	-10.4	-9.0	-12.1	-11.6	-11.0	-13.0	-12.1
Latvia	-14.5	-17.4	-23.3	-26.1	-26.3	-23.5	-24.8
Bulgaria	-21.4	-12.5	-5.1	-22.2	-27.3	-19.6	-12.2
Romania	-9.3	-11.2	-10.1	-10.2	-15.1	-16.8	-11.4

Source: Eurostat, central banks, own calculations

**Table 19. Poland: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-3.1	-3.1	-2.4	-4.1	-3.1	-4.8	-3.0
Goods	-1.3	-1.9	-2.4	-2.4	-2.1	-3.4	-3.1
Services	0.5	0.5	0.6	0.9	1.2	1.2	1.3
Income	-3.4	-4.7	-4.0	-4.7	-4.2	-5.0	-4.1
Transfers	1.1	3.0	3.3	2.1	2.1	2.4	2.9
Capital account	0.6	0.3	0.8	0.8	0.6	0.7	1.1
Financial account	3.5	1.3	1.0	5.0	3.4	7.2	2.6
Direct investments	5.7	1.2	2.6	2.6	5.5	2.8	4.0
Portfolio investments	3.6	-3.4	-2.1	-1.3	-1.8	-2.6	-3.4
Other investments	-4.1	5.4	2.6	2.3	2.0	10.4	4.3

Source: Eurostat, central banks, own calculations

**Table 20. Czech Republic: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	2.2	-4.1	-5.0	-5.6	1.8	-4.9	-5.5
Goods	4.0	1.6	1.1	1.3	5.5	2.6	1.9
Services	1.0	1.4	1.3	0.6	1.1	1.7	1.5
Income	-2.7	-6.8	-6.3	-6.6	-4.3	-8.5	-8.4
Transfers	0.0	-0.3	-1.0	-1.0	-0.5	-0.8	-0.5
Capital account	0.3	-0.2	0.3	0.6	0.3	0.0	0.4
Financial account	-1.5	3.8	5.4	5.3	-0.5	3.4	3.9
Direct investments	1.7	2.6	4.9	3.5	4.3	3.2	4.2
Portfolio investments	-1.1	-4.4	-1.5	3.5	-2.4	-0.7	-4.5
Other investments	-1.8	5.2	2.6	-1.1	-2.8	-1.3	6.1

Source: Eurostat, central banks, own calculations

**Table 21. Slovakia: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-6.3	-9.6	-10.3	-6.9	-0.9	-8.2	-5.6
Goods	-6.2	-5.6	-4.7	-6.0	-0.4	-2.7	0.0
Services	1.2	0.9	1.3	1.4	0.3	1.3	0.9
Income	-1.2	-6.0	-5.9	-1.9	0.3	-6.0	-5.6
Transfers	-0.1	1.1	-1.1	-0.3	-1.0	-0.7	-0.9
Capital account	-0.1	0.0	-0.1	-0.1	1.0	0.3	0.1
Financial account	4.0	10.1	3.3	9.2	-5.9	6.0	8.1
Direct investments	4.8	10.0	8.0	4.4	-0.7	5.7	4.6
Portfolio investments	10.7	2.4	-0.2	-0.1	-5.5	5.6	0.2
Other investments	-4.8	-6.1	-24.3	5.6	17.9	0.0	3.0

Source: Eurostat, central banks, own calculations

**Table 22. Hungary: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-7.7	-7.4	-6.1	-5.4	-4.9	-6.0	-5.6
Goods	-2.0	-0.6	-1.8	0.0	1.2	1.5	0.8
Services	0.0	1.7	2.2	1.6	0.8	1.6	1.5
Income	-6.9	-8.4	-7.1	-7.1	-7.7	-9.3	-7.1
Transfers	1.2	0.0	0.5	0.1	0.8	0.1	-0.8
Capital account	0.1	0.2	0.9	1.3	0.2	0.1	2.4
Financial account	11.7	11.0	9.5	7.3	8.9	8.9	4.0
Direct investments	9.2	2.5	6.6	-1.7	1.1	-5.5	5.3
Portfolio investments	18.7	-9.4	4.5	10.3	6.7	0.5	-7.1
Other investments	-5.4	15.5	-2.1	-4.1	2.1	13.0	3.6

Source: Eurostat, central banks, own calculations

**Table 23. Estonia: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-14.0	-13.2	-14.4	-17.6	-17.7	-14.1	-10.9
Goods	-12.6	-16.5	-18.9	-17.8	-16.7	-15.6	-12.7
Services	4.1	7.6	7.8	5.3	4.4	7.1	7.4
Income	-5.2	-5.2	-3.5	-4.5	-5.0	-6.6	-5.7
Transfers	-0.3	1.0	0.1	-0.5	-0.4	0.9	0.2
Capital account	2.7	1.4	2.3	2.6	0.8	1.3	0.5
Financial account	12.2	10.4	11.1	18.0	21.5	11.5	14.8
Direct investments	12.5	-1.2	1.0	2.9	9.6	0.5	0.5
Portfolio investments	-27.5	-2.3	-12.8	6.7	-2.1	-4.0	-3.1
Other investments	24.2	17.3	29.0	15.2	13.0	14.7	27.0

Source: Eurostat, central banks, own calculations

**Table 24. Lithuania: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-10.4	-9.0	-12.1	-11.6	-13.2	-13.0	-12.1
Goods	-12.8	-12.4	-14.6	-15.5	-15.3	-15.7	-12.6
Services	3.5	4.0	3.5	3.5	2.3	3.1	2.9
Income	-3.2	-3.9	-2.9	-1.3	-4.1	-2.9	-5.3
Transfers	2.2	3.3	1.9	1.6	3.8	2.6	2.8
Capital account	1.4	0.7	1.0	1.6	1.1	1.5	2.2
Financial account	9.1	7.5	13.0	11.9	15.0	15.5	11.0
Direct investments	2.8	1.2	3.0	12.4	7.7	3.2	4.0
Portfolio investments	2.8	-2.4	-3.9	1.0	-7.0	-0.7	-3.8
Other investments	5.5	9.4	16.1	12.4	11.5	17.9	12.4

Source: Eurostat, central banks, own calculations

**Table 25. Latvia: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-15.9	-19.2	-24.7	-27.1	-26.4	-23.5	-24.8
Goods	-22.9	-23.4	-26.6	-27.6	-27.2	-25.8	-25.4
Services	4.6	4.5	2.8	1.8	3.0	4.0	3.7
Income	-3.0	-2.9	-2.3	-2.5	-2.7	-4.8	-3.1
Transfers	5.4	2.5	1.4	1.2	0.5	3.1	0.0
Capital account	1.7	1.3	0.8	1.0	2.0	0.8	0.6
Financial account	16.0	18.2	21.8	24.3	29.8	25.0	26.7
Direct investments	9.9	8.1	4.5	7.7	8.8	10.7	5.3
Portfolio investments	-4.9	2.8	-1.1	2.6	-2.5	-4.2	-1.3
Other investments	19.0	19.4	29.4	20.8	24.3	22.7	27.2

Source: Eurostat, central banks, own calculations

**Table 26. Bulgaria: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-20.8	-11.7	-4.8	-26.1	-27.4	-19.6	-12.2
Goods	-21.0	-19.5	-19.9	-27.6	-27.5	-25.1	-22.4
Services	-2.5	4.6	12.1	-0.4	-1.3	5.3	11.2
Income	0.4	0.7	-0.3	-0.6	0.0	-0.8	-1.8
Transfers	2.3	2.6	3.2	2.4	1.5	1.2	0.9
Capital account	0.4	0.8	0.7	0.9	0.1	0.6	0.9
Financial account	20.9	15.1	5.8	15.1	27.6	24.7	16.3
Direct investments	14.8	21.4	12.7	18.6	14.5	22.5	20.3
Portfolio investments	1.7	-0.9	2.0	0.9	-3.5	0.0	-0.1
Other investments	-3.4	9.7	-0.4	3.2	17.5	11.7	22.2

Source: Eurostat, central banks, own calculations

**Table 27. Romania: components of balance of payments, as percentage of GDP**

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Current account	-7.6	-13.1	-9.8	-10.9	-17.2	-16.4	-11.4
Goods	-9.9	-12.6	-11.2	-13.8	-17.7	-16.5	-12.5
Services	0.3	0.5	-0.1	-0.4	1.0	0.2	-0.3
Income	-3.6	-6.0	-2.9	-1.8	-5.7	-5.1	-3.1
Transfers	5.5	5.0	4.4	5.1	5.1	4.9	4.5
Capital account	0.7	-2.4	0.3	0.9	0.4	0.7	0.7
Financial account	7.5	13.3	6.9	10.6	17.5	16.5	9.0
Direct investments	11.0	5.2	7.1	11.9	9.0	6.2	5.2
Portfolio investments	0.1	-0.2	-1.1	0.4	-0.3	1.0	0.2
Other investments	5.8	9.8	2.9	7.2	10.2	11.4	13.7

Source: Eurostat, central banks, own calculations

## 5. Interest rates and exchange rates

**Table 28. Central bank interest rates** (as at the end of month)

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	4.50	4.50	4.75	4.75	4.75	5.00	5.00	5.25
Czech Republic	2.75	3.00	3.25	3.25	3.25	3.50	3.50	3.50
Slovakia	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25
Hungary	7.75	7.75	7.75	7.50	7.50	7.50	7.50	7.50
Romania	7.00	7.00	7.00	7.00	7.00	7.50	7.50	8.00

Source: Central banks, EcoWin Financial

**Table 29. Average monthly market interest rates (3M)**

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	4.71	4.81	5.03	5.10	5.21	5.56	5.68	5.65
Czech Republic	3.00	3.22	3.41	3.50	3.58	3.93	4.11	3.92
Slovakia	4.32	4.36	4.34	4.30	4.34	4.33	4.30	4.30
Hungary	7.65	7.59	7.73	7.45	7.39	7.49	7.50	7.50
Estonia	4.72	4.75	5.20	5.24	5.17	6.25	7.30	6.73
Lithuania	4.90	5.03	5.52	5.65	6.23	6.82	6.65	5.20
Latvia	7.63	6.21	9.14	12.74	12.64	11.37	10.53	8.08
Bulgaria	4.59	4.81	4.88	5.40	6.03	6.46	6.54	6.65
Romania	7.67	7.14	7.11	7.56	7.83	8.17	8.38	9.31

Source: EcoWin Financial

**Table 30. Average monthly exchange rates of national currencies to euro**

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	3.81	3.77	3.81	3.79	3.71	3.66	3.60	3.61
Czech Republic	28.55	28.36	27.86	27.57	27.34	26.73	26.32	26.05
Slovakia	34.00	33.33	33.60	33.83	33.62	33.23	33.40	33.55
Hungary	250.29	246.90	255.20	253.33	251.02	254.50	253.18	256.03
Estonia	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Lithuania	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Latvia	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
Bulgaria	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Romania	3.22	3.13	3.22	3.35	3.35	3.47	3.54	3.69

Source: Eurostat.

**Table 31. Change of national currencies exchange rate to euro** in relation to corresponding period of the previous year (in %)

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	-5.4	-5.7	-2.4	-4.4	-5.0	-4.4	-5.5	-7.0
Czech Republic	0.6	-0.3	-1.2	-2.9	-3.4	-4.6	-5.3	-6.4
Slovakia	-10.7	-13.2	-10.8	-9.8	-8.6	-7.4	-4.5	-3.5
Hungary	-8.1	-11.0	-7.0	-7.7	-6.0	-1.7	-0.3	0.8
Estonia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Lithuania	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Latvia	0.0	0.1	0.3	0.9	1.0	0.5	0.0	0.1
Bulgaria	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Romania	-9.2	-12.2	-8.6	-5.1	-4.7	-0.6	3.6	8.9

Source: Eurostat, own calculations

**Table 32. NEER** in relation to the corresponding period of the previous year (in %)

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	6.1	6.5	2.8	5.4	6.6	6.4	7.4	9.5
Czech Republic	-0.5	0.4	1.4	3.6	4.8	6.7	7.0	8.9
Slovakia	12.3	15.6	12.5	11.4	10.6	9.4	5.6	4.8
Hungary	9.5	13.2	8.2	9.5	8.3	3.9	1.9	1.2
Estonia	0.8	0.8	0.8	1.1	1.6	2.1	1.8	2.1
Lithuania	0.0	0.0	0.3	0.4	0.8	1.3	0.9	1.3
Latvia	0.1	-0.1	0.1	-0.5	-0.3	0.7	1.0	1.2
Bulgaria	-0.5	-0.3	0.1	0.4	0.8	1.3	0.8	1.5
Romania	10.2	14.4	9.4	5.9	5.9	1.9	-2.6	-6.6

Source: BIS, own calculations.

**Table 33. REER in relation to the corresponding period of the previous year (in %)**

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	6.3	6.4	1.9	5.0	6.4	6.1	7.2	9.3
Czech Republic	-0.5	0.3	1.5	3.7	5.7	8.2	8.8	10.7
Slovakia	12.4	15.5	12.3	11.6	10.6	8.7	5.2	4.3
Hungary	16.2	20.0	14.6	13.5	12.1	7.4	5.7	5.0
Estonia	3.7	4.4	3.6	5.1	6.3	6.9	7.1	7.4
Lithuania	1.8	2.1	2.9	4.2	4.4	4.7	4.5	4.9
Latvia	5.9	6.4	7.3	7.4	8.7	9.7	10.4	10.5
Bulgaria	2.2	5.3	9.2	10.3	9.5	9.7	9.1	9.7
Romania	11.5	16.3	12.0	9.1	9.6	4.7	0.1	-4.0

Source: BIS, own calculations.

## 6. Labour market

**Table 34. Employment** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	3.1	3.7	3.8	3.6	4.6	4.8	3.5
Czech Republic	1.2	1.3	1.5	1.9	1.8	1.5	1.2
Slovakia	3.7	4.5	3.8	3.5	3.1	1.9	2.0
Hungary	0.4	1.1	0.5	0.9	0.5	0.2	0.0
Estonia	6.8	6.7	6.2	5.9	1.9	1.3	1.9
Lithuania	2.7	1.9	1.3	0.9	1.6	2.8	3.2
Latvia	4.1	4.2	7.2	5.1	2.6	3.4	1.1
Bulgaria	3.6	4.3	3.3	5.9	6.6	3.6	3.6
Romania	1.0	0.8	1.2	1.6	2.7	2.8	2.9

Source: National statistical offices, own calculations

**Table 53. Unemployment rate**, as percentage of workforce

	06.2007	07.2007	08.2007	09.2007	10.2007	11.2007	12.2007	01.2008
Poland	12.4	12.2	12.0	11.6	11.3	11.2	11.4	11.7
Czech Republic	6.3	6.4	6.4	6.2	5.8	5.6	6.0	6.1
Slovakia	8.3	8.3	8.2	8.3	7.9	7.8	8.0	
Hungary	7.0	7.2	7.2	7.3	7.5	7.7		
Estonia	5.0	4.2	4.2	4.2	4.1	4.1	4.1	
Lithuania	4.1	3.9	3.9	3.9				
Latvia	5.8	5.7	5.4	5.1	4.9	4.8	4.9	5.0
Bulgaria	7.4	7.3	7.0	6.8	6.7	6.6	6.9	7.4
Romania	4.0	3.8	3.9	3.9	4.1	4.2	4.1	4.3

Source: National statistical offices

**Table 36. Nominal wages** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	4.7	4.7	5.0	5.3	7.1	8.9	9.7
Czech Republic	7.0	6.6	5.9	6.1	7.9	7.5	7.6
Slovakia	8.1	9.5	8.3	8.6	6.9	7.0	7.1
Hungary	7.4	7.1	9.0	9.4	7.1	8.9	8.8
Estonia	15.7	15.0	16.5	17.5	20.1	21.2	20.2
Lithuania	13.2	14.1	19.9	19.1	20.9	20.2	17.9
Latvia	17.8	22.3	22.8	29.0	32.4	33.4	32.5
Bulgaria	9.7	9.8	12.0	14.1	16.5	18.3	19.6
Romania	19.6	17.8	19.0	32.1	23.9	23.8	22.9

Source: National statistical offices, own calculations

**Table 37. ULC** in relation to the corresponding period of the previous year (in %)

	JAN 2006	FEB 2006	MAR 2006	APR 2006	JAN 2007	FEB 2007	MAR 2007
Poland	2.5	2.6	2.2	1.8	4.9	7.1	7.5
Czech Republic	1.6	1.5	1.1	1.8	3.3	2.6	2.8
Slovakia	3.3	4.7	5.6	6.6	4.9	7.9	7.9
Hungary	2.7	6.0	3.1	3.8	1.7	-0.5	-0.3
Estonia	11.0	10.5	11.6	12.4	12.0	14.9	15.7
Lithuania	7.6	7.0	14.9	12.7	14.4	15.0	10.3
Latvia	8.8	15.4	18.1	22.4	23.8	25.8	22.6
Bulgaria	7.8	7.8	8.7	14.4	16.9	15.3	18.6
Romania	13.7	10.8	11.8	26.1	20.6	21.1	20.1

Source: Eurostat, national statistical offices, own calculations



## 7. Public finances

**Table 38. Balance of public finance sector, as percentage of GDP**

	2000	2001	2002	2003	2004	2005	2006
Poland	-3.0	-5.1	-5.0	-6.3	-5.7	-4.3	-3.8
Czech Republic	-3.7	-5.7	-6.8	-6.6	-3.0	-3.5	-2.9
Slovakia	-12.2	-6.5	-8.2	-2.7	-2.4	-2.8	-3.7
Hungary	-2.9	-4.0	-8.9	-7.2	-6.5	-7.8	-9.2
Estonia	-0.2	-0.1	0.2	1.8	1.8	1.9	3.6
Lithuania	-3.2	-3.6	-1.9	-1.3	-1.5	-0.5	-0.6
Latvia	-2.8	-2.1	-2.3	-1.6	-1.0	-0.4	-0.3
Bulgaria	-0.6	1.6	-0.1	0.0	2.3	2.0	3.2
Romania	:	:	-2.0	-1.5	-1.5	-1.4	-1.9

Source: Eurostat.

**Table 39. Public debt, as percentage of GDP**

	2000	2001	2002	2003	2004	2005	2006
Poland	36.8	37.6	42.2	47.1	45.7	47.1	47.6
Czech Republic	18.5	25.1	28.5	30.1	30.4	30.2	30.1
Slovakia	50.4	49.0	43.4	42.4	41.4	34.2	30.4
Hungary	54.2	52.1	55.6	58.0	59.4	61.6	65.6
Estonia	5.2	4.8	3.5	5.5	5.1	4.4	4.0
Lithuania	23.7	23.1	22.4	21.2	19.4	18.6	18.2
Latvia	12.3	14.0	13.5	14.4	14.5	12.5	10.6
Bulgaria	74.3	67.3	53.6	45.9	37.9	29.2	22.8
Romania	24.7	26.0	25.0	21.5	18.8	15.8	12.4

Source: Eurostat.