



The National Bank of Poland

Economic Institute
World Economy and European Economic Integration Bureau

Analysis of economic situation in countries of Central and Eastern Europe

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

Executive summary

In 2007 the average economic growth rate in NMS-9 remained at a relatively high level (respectively 6.2% as compared to 6.6% in 2006). On the other hand, the growth rates reported by particular economies of the region were not uniform. The Baltic states and Hungary saw their economies slow down significantly. In other NMS-9 countries the GDP remained broadly unchanged in 2007 or showed a slight increase vis-à-vis the corresponding figures of 2006. In 2008 Q1 economic growth moderated in the majority of the NMS-9 countries.

In the Baltic states considerable decrease in internal demand coincided with a material downturn in lending. Banks strengthened their supervisory standards not only on account of "overheating" of the economies of the region but also in effect of worldwide lending crisis and ensuing global increase in risk aversion.

Across Poland, the Czech Republic and Slovakia high growth prevailed in 2007 both in consumption and investment. Meanwhile, consumption remained on a steady slowdown in Hungary as investment demand showed a very weak growth.

Since early 2008, the expectations indices both among consumers and business communities across all the analyzed region continued the fall commenced in the second half of 2007. The said tendency reflected primarily the global conditions: growing commodity prices on global markets and worsening sentiment on financial markets.

In 2008 to date, high inflation prevailed across all the CEE region. The largest inflation growth occurred in Bulgaria, Lithuania and Latvia in the analyzed period. The high level of inflation was still due to high food and energy prices, but their contribution to inflation growth rate in the NMS-9 countries between January and May 2008 was lower than in the second half of 2007.

Net inflation (excluding food and energy prices) in the majority of NMS-9 countries (with the exception of Hungary) followed a rising trend in the first five months of 2008.

Following the slowdown in 2007 Q4, the average nominal wage growth for all the CEE region regained its momentum in 2008 Q1.

In the wake of slower wage growth in 2007 Q4, unit labour costs on average slightly declined in the analyzed region.

As regards balance of payments, weaker demand in the Baltic economies contributed to the improvement in their current account balance. At the same time Romania and Bulgaria posted a marked increase in their current account deficits.

The labour market situation in 2008 Q1 remained positive in most countries of the analyzed region, fuelled by the relatively high rate of economic growth.

2007 brought about the improvement in the balance of the public finance sector in most NMS-9 countries. On the other hand, as forecast by the European Commission, over the coming years the figure is going to deteriorate across most of the region (with the exception of the Czech Republic, Slovakia and Hungary).

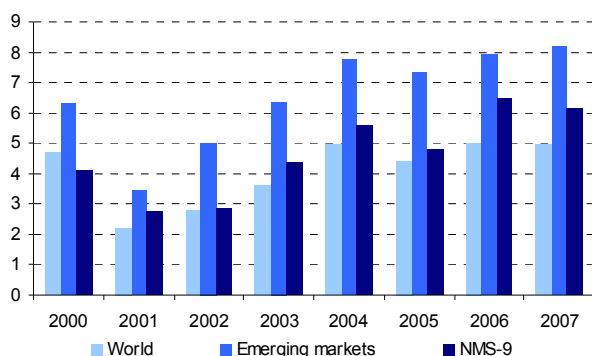
In 2008 central banks tightened their monetary policies in most countries implementing direct inflation target policy. Central banks in Poland, the Czech Republic, Hungary and Romania decided to raise their interest rates. The National Bank of Slovakia proved to be the only one that kept them unchanged. In the analysed period, Poland, the Czech Republic, Hungary and Romania also reported an increase in their 3-month market interest rates. In Slovakia, short-term interest rates on the inter-bank markets did not change. 3-month interest rates in the Baltic countries declined in 2008, having grown rapidly in the second half of 2007.

The current forecast of economic growth for the CEE region for 2008 and 2009 declined as against those of the end-2007. Meanwhile, according to the most updated inflation forecast, inflation will rise more markedly in 2008 only to fall in 2009.

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

The year 2007 saw the continuation of a high worldwide economic growth. The global economic growth amounted to 4.9% as compared to 5.0% in 2006. The emerging economies grew faster in the period¹. The GDP growth gained momentum in those countries from 7.9% in 2006 to 8.2% in 2007.

Figure 1.1. Annual GDP growth rate



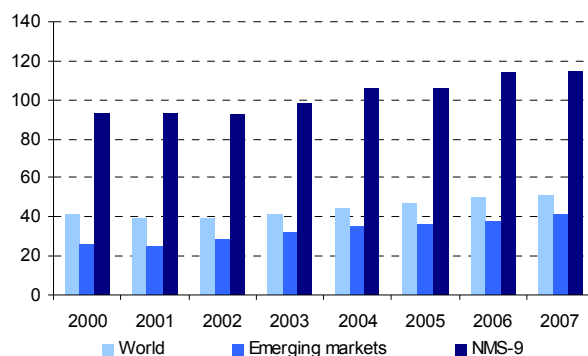
Source: IMF WEO, Eurostat, EcoWin Economic.

Beginning from 2003 the volume of global foreign trade as percentage of global GDP has followed a rising trend². In 2007 the value of global trade represented 51.4% of GDP, as against 50.1% of GDP posted in 2006. In the group of emerging economies the value of worldwide foreign trade in relation to the GDP has also increased to stand at 41.4% in 2007. As in previous years, in 2007 the NMS-9 region showed a very large openness of its economies. 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 value represented 113.7% of the GDP, whereas in 2007 this figure grew to 114.8%.

¹ Argentina, Brazil, Chile, China, the Philippines India, Indonesia, Malaysia, Mexico, Russia, Turkey referred to in the charts as 'Emerging' - according to IMF classification these countries fall under the category of emerging countries. They have been chosen as a representative comparative group for NMS-9 countries on account of their significant impact on the development of global economy and similar level of GDP per capita to NMS-9.

² The foreign trade value is understood as the joint value of exports and imports.

Figure 1.2. Foreign trade volume, percentage of GDP³.



Source: IMF DOTS, Eurostat, EcoWin Economic.

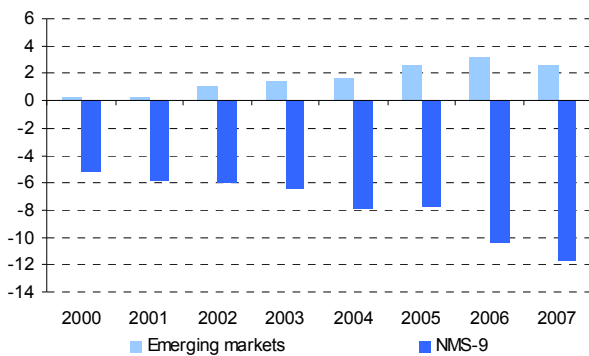
In 2007 the average current account deficit⁴ in the NMS-9 region amounted to 11.7%, rising from 10.4% reported in 2006. This high and increasing deficit resulted primarily from the worsening of the current account balance reported in the Baltic and Balkan countries (-17.3% and -14.6% of the GDP in 2007 and 2006 respectively, on the average). In the group of countries including Poland, the Czech Republic, Slovakia and Hungary the current account deficit was much lower; in addition it decreased in 2007 (-4.3% and -5.4% of the GDP in 2007 and 2006 respectively). Meanwhile, in 2007 as in the preceding years the group of emerging countries reported the current account surplus of 2.6% of the GDP, however, representing a decline of 0.7 pp against the corresponding figure for 2006.

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

³ For the emerging group and NMS-9 calculated as the total value of exports and imports of all countries included in a given group vis-à-vis the joint GDP of all the countries within this group.

⁴ The arithmetic average for NMS-9 countries.

Figure 1.3. Current account balance, percentage of GDP⁵.



Source: IMF WEO, EcoWin Economic, Eurostat.

The continuation of high economic growth in those countries had a positive impact on the improvement of the situation on the labour market in the emerging countries. In 2007, the average unemployment rate amounted to 6.6% in the emerging countries and to 7.3% in NMS-9, as compared to 8.0% and 8.5% respectively in 2006. The global unemployment rate also fell from 6.3% to 6.0% over the corresponding period.

Figure 1.4 Unemployment rate

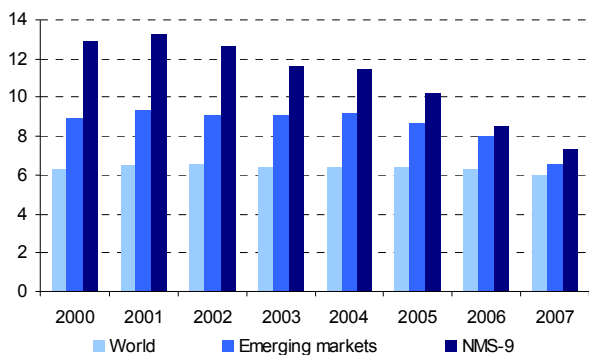
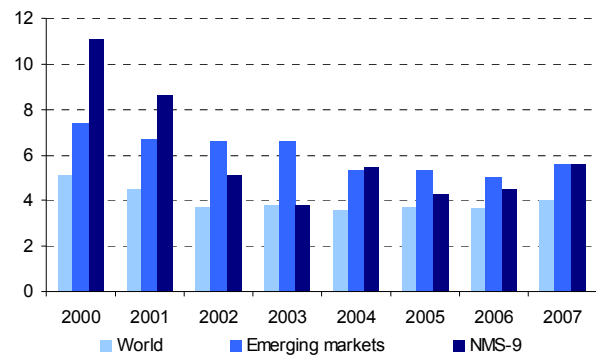


Figure: ILO, Eurostat, National Statistical Offices.

The year 2007 was marked by worldwide inflation growth, which stood at 4.0% in comparison to 3.7% in 2006. The growth of inflation which occurred in 2007 was more noticeable in the NMS-9 group. The average inflation in NMS-9 amounted to 5.6% as compared to 4.5% in the preceding year. Inflation grew more slowly in the emerging countries. Consumer prices growth accelerated

to 5.6% in 2007 as compared to 5.0% in 2006.

Figure 1.5. Average inflation



Source: IMF WEO, Eurostat.

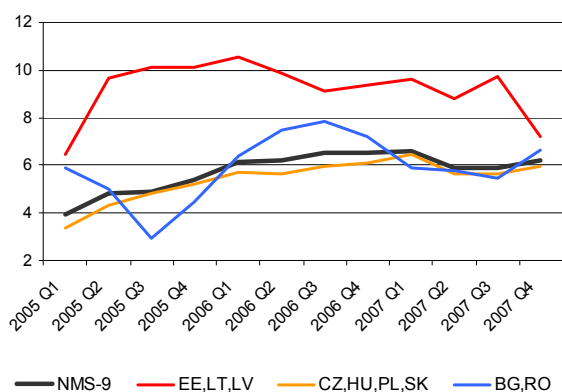
⁵ Calculated as the arithmetic average for the given group of countries.

2. Economic growth

The annual economic growth rate in NMS-9 averaged 6.2% in 2007 Q4, i.e. went up from 5.9% in the previous quarter. The higher GDP growth in the region was primarily attributable to a dynamic GDP growth in Slovakia, which was up by 4.9 pp in 2007 Q4 over the corresponding figures of 2007 Q3. Whereas the GDP growth gained momentum also in the Czech Republic, Bulgaria and Romania, it decelerated in the remaining countries of the region. The Baltic states reported a marked decline of 2.6 pp, on the average. A slight decrease in economic growth in relation to 2007 Q3 was observed in Poland and in Hungary.

Whereas the GDP growth in Poland remained broadly unchanged in 2008 Q1 in comparison with 2007, it decreased in the Czech Republic and Slovakia. Also the Baltic states followed a declining path; by contrast Hungary and Romania posted a rapid economic growth in 2008 Q1.

Figure 2.1. GDP growth rate in NMS-9



Source: Eurostat, EcoWin Economic, own calculations

The GDP growth rate in the group of countries including Poland, the Czech Republic, Slovakia and Hungary averaged 6.0% in 2007 Q4, i.e. was up by 0.4 pp over the corresponding figures of 2007 Q3, fuelled by the economic acceleration undergoing in the Czech Republic and in Slovakia. The GDP growth in the Czech Republic went up to 6.6% in 2007 Q4 from 6.0% in 2007 Q3, only to contract to 5.4% in 2008 Q1. The economic growth in Slovakia rose from 9.4% in 2007 Q3

to 14.3% in 2007 Q4. Slovakia posted the GDP growth following the rise in excise duties on tobacco - starting from the beginning of 2008 - and subsequently the accumulation by tobacco companies of their inventories. In other words the growth was triggered by a one-time factor, which can as well inhibit the GDP expansion in the oncoming quarters. Data for 2008 Q1 confirm this picture with the GDP growth in Slovakia developing at 8.7%.

Both in Poland and in Hungary the GDP growth decreased marginally in 2007 Q4 as compared with the preceding quarter. In Poland this figure declined from 6.5% in 2007 Q3 to 6.4% in 2007 Q4. In 2008 Q1 the economic growth in Poland further edged down to stand at 6.1%. **Hungary remained the slowest developing economy from the countries in the NMS-9 region.** The GDP growth declined from 0.9% in 2007 Q3 to 0.8% in 2007 Q4. It was already the sixth consecutive quarter in which the economic growth rate in Hungary decreased. In 2008 Q1 the GDP in Hungary rebounded and accelerated to 1.6% y/y, fuelled by net exports.

The economic growth in the analysed countries continued to be driven mainly by internal demand. In 2007 Q4 however, an increasing part of the GDP growth was financed by investment outlays. It amounted to 2.6 pp, up from 1.6 pp in the third quarter. In contrast to the previous quarters of 2007, it surpassed the contribution of total consumption, which in 2007 Q4 fell to 2.0 pp from 2.3 pp in 2007 Q3. Fixed capital formation pursued a rising trend in the Czech Republic, Slovakia and Hungary. An opposite situation was observed only in Poland, but Poland in 2007 Q4 continued to boast the highest investment growth in the above-mentioned group of countries (16.4%). A drop in the contribution of consumption to economic growth in 2007 Q4 was due to its slowdown in Poland and Slovakia.

The contribution of net exports to economic growth in the analysed group of countries remained positive and slightly increased in 2007 Q4. It amounted to 1.6 percentage points,

compared with 1.1 pp in the previous quarter⁶. Whereas contribution of net exports increased in Poland and the Czech Republic, in Hungary it did not change in comparison with 2007 Q3, while it decreased significantly in Slovakia.

In 2008 Q1 the GDP growth in these countries decreased to 5.4%, which was driven by the drop in the contribution of fixed capital formation and net exports.

The economic growth in **the Baltic states** in 2007 Q4 dropped to 6.9% from 9.4% in Q3. In 2008 Q1 the GDP growth further dropped to 3.4%. In 2007 Q4 the GDP growth in Lithuania and Latvia stood at 8.0%, down by respectively 2.9 pp and 2.8 pp in comparison with the previous quarter. **Estonia was the slowest developing country in this group (4.8%), its GDP growth in the fourth quarter decreased by 1.6 pp. The economic growth in Estonia in 2007 Q4 dropped by 6.2 pp in comparison with 2006 Q4. The first estimates of GDP dynamics in 2008 Q1 indicate a continued economic slowdown in the Baltic countries. The GDP in 2008 Q1 increased in Latvia by 3.6%, in Lithuania by 6.9% , and in Estonia merely by 0.1%.**

The internal demand, though weaker in 2007 Q4, remained the main factor driving economic growth, particularly in Estonia and Lithuania. **Internal demand slowed down most markedly in Latvia.** Its overall contribution to GDP growth decreased from 16.1 pp in 2007 Q3 to 4.6 pp in 2007 Q4. This drop was partially compensated by the increase in net exports, which contribution in the corresponding period grew from -5.3 pp to 3.7 pp. The contribution of consumption to economic growth in the Baltic states as a whole declined from 7.0 pp in 2007 Q3 to 4.4 pp in 2007 Q4. The contribution of investment in this period declined from 2.1 pp to 1.3 pp. The fixed capital formation growth rate dropped in Lithuania and Latvia, while in Estonia it grew in comparison with 2007 Q3, when it was negative.

⁶ A positive contribution of net exports was due to an improvement in the foreign trade balance, although in the above-mentioned group of countries it remained negative.

In 2007 Q4 the contribution of net exports to economic growth in the Baltic states further increased. On the average it amounted to +1.3 pp against -2.1 pp in 2007 Q3 and -8.7 pp in 2007 Q1. This situation was due to a bigger contribution of net exports to economic growth in Latvia and Estonia. In 2007 Q4 exports gained momentum in Estonia and Latvia, along with a slowdown in imports. In the case of Lithuania both the growth of exports and imports declined seriously.

The foreign trade balance improved primarily because of the fall in domestic demand. Imports growth slowed down and some part of production shifted towards exports due to domestic slowdown. Although the economic activity in the euro area lost its momentum, the Swedish and Russian economies, which are among the main economic partners of the Baltic states reported a rebound, unwinding the negative tendency.

The GDP growth in the Baltic states further declined in 2008 Q1 as internal demand lost momentum (with the exception of Latvia, where the contribution of both consumption and investment increased in 2008 Q1). Contrary to the previous two quarters the contribution of net exports to economic growth in all the Baltic states declined.

The real GDP growth in **the Balkan states (Bulgaria and Romania)** increased in 2007 Q4. It amounted to 6.9% in Bulgaria and 6.6% in Romania against respectively 4.5% and 5.7% in the previous quarter.

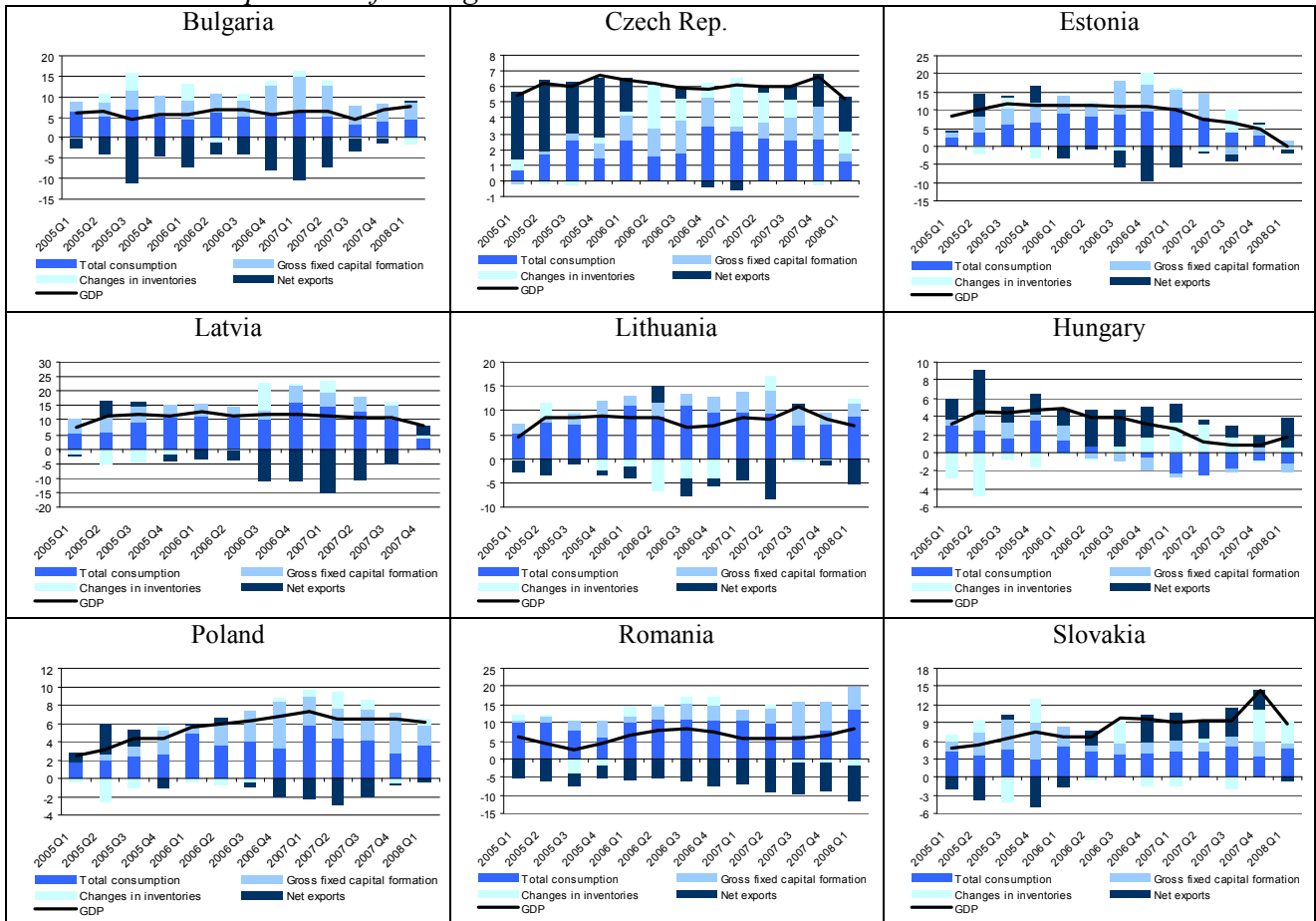
In the Balkan states, as in other countries of the region, the economic growth was mainly driven by internal demand. The contribution of consumption to economic growth increased in 2007 Q4 for both countries and amounted to 4.1 pp in Bulgaria and 8.1 pp in Romania. On the other hand the investment demand weakened somewhat, and its contribution fell from 4.6 pp in 2007 Q3 to 4.4 pp in Bulgaria and from 9.2 pp in 2007 Q3 to 7.6 pp in Romania. **Both these countries, and in particular Romania (as well as Poland), recorded the highest growth of fixed capital**

formation among NMS-9 countries in 2007 Q4 (14% in Bulgaria and 28% in Romania).

In Bulgaria and Romania in 2007 Q4 the contribution of foreign trade balance to economic growth was still negative, but a certain increase was observed. It amounted to -1.4 pp in Bulgaria and -7.6 pp in Romania, up

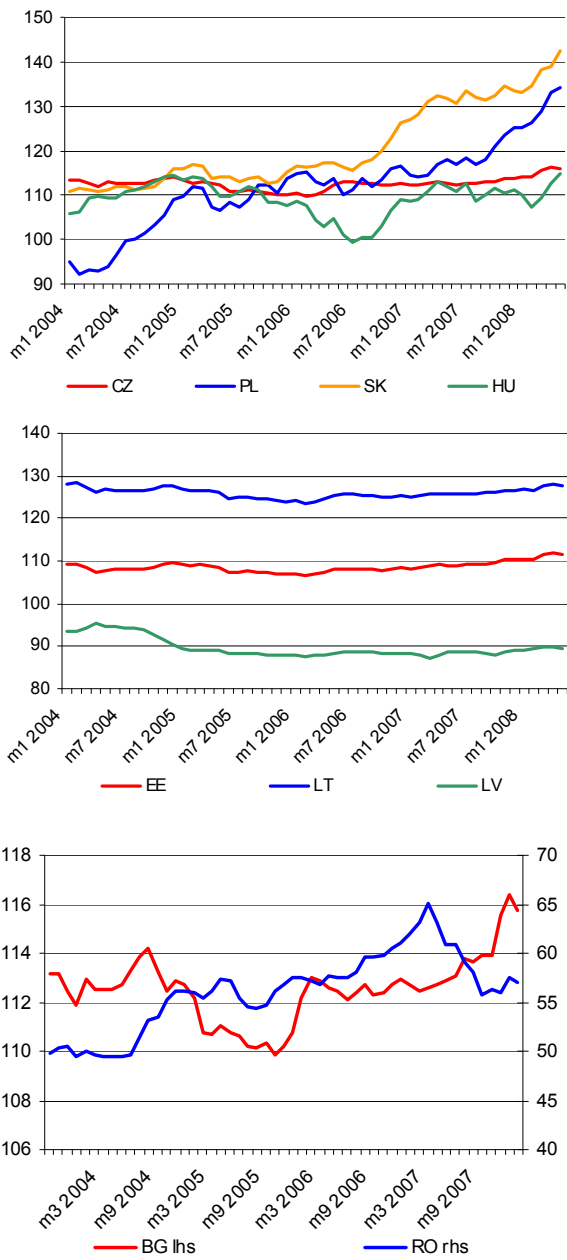
from respectively -3.2 pp and -8.8 pp in the previous quarter. In the case of Bulgaria, this increase was due to the fall in the growth of imports, while in Romania a significant increase in the growth of exports was observed.

Table 2.1. Decomposition of GDP growth in NMS-9.



Source, CSO, Eurostat

Figure 2.2 Real effective exchange rate in NMS-9, index 2000=100 (increase means appreciation)



Source: BIS

Box 1.

Comparison of investment levels in 'old' and 'new' EU countries

Since EU entry in 2004, most NMS-9 countries experienced an increase in investment outlays expressed as percentage of GDP. Whereas in 2003 it averaged 21.5% of GDP, in 2007 it amounted to nearly 25% of GDP. The biggest increase in investment outlays to GDP took place in Romania, Bulgaria, Lithuania and Latvia. In turn, in the Czech Republic and Hungary the contribution of investments to GDP slightly decreased in the analyzed period.

In the old EU countries the contribution of investment outlays to GDP grew between 2003 and 2007 but this increase was smaller than that reported in the new Member States. In 2003 investments in EU-15 countries accounted for 19.5% of GDP as against 21% of GDP in 2007.

Table 1. Gross fixed capital formation in EU countries in 2000-2007 (percentage of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007
Austria	22,8	22,1	20,4	21,3	20,7	20,4	20,6	20,7
Belgium	20,8	20,4	19,2	18,8	19,6	20,3	20,7	21,4
Denmark	20,2	19,8	19,6	19,3	19,3	19,7	21,6	22,8
Finland	19,4	19,5	17,9	18,1	18,2	18,9	19,3	20,3
France	19,5	19,5	18,8	18,8	19,3	19,8	20,4	21,0
Greece	21,6	21,5	22,4	24,3	24,4	23,4	25,8	25,7
Spain	25,8	26,0	26,3	27,2	28,0	29,3	30,4	31,1
Netherlands	21,9	21,1	20,0	19,5	18,8	19,0	19,7	19,9
Ireland	23,4	22,6	21,7	22,3	23,6	26,0	26,3	25,3
Luxembourg	20,8	22,6	22,6	21,6	20,8	20,0	18,4	19,4
Germany	21,5	20,0	18,3	17,9	17,5	17,4	18,0	18,5
Portugal	27,1	26,5	25,0	22,9	22,6	22,2	21,6	21,7
Sweden	17,6	17,5	16,8	16,3	16,4	17,4	18,1	18,9
UK	17,4	17,1	17,1	16,7	17,1	17,2	17,8	18,2
Italy	20,3	20,3	20,9	20,4	20,5	20,7	21,0	21,1
EU-15	20,5	20,1	19,5	19,4	19,6	19,9	20,5	21,0
Bulgaria	15,7	18,2	18,2	19,3	20,5	24,2	25,9	29,8
Cyprus	17,0	16,7	18,1	17,6	18,7	19,5	20,3	20,8
Czech Rep.	28,0	28,0	27,5	26,7	25,8	25,0	24,6	24,1
Estonia	26,0	26,7	29,8	31,7	31,4	30,6	34,1	31,9
Lithuania	18,8	20,1	20,3	21,2	22,3	22,8	24,8	26,6
Latvia	24,2	24,9	23,8	24,4	27,5	30,6	32,6	31,6
Malta	22,9	20,6	16,3	19,6	19,3	19,5	19,5	18,7
Poland	23,7	20,7	18,7	18,2	18,1	18,2	19,7	22,3
Romania	18,9	20,7	21,3	21,4	21,8	23,1	25,6	30,5
Slovakia	25,8	28,6	27,4	24,8	24,0	26,5	26,3	25,7
Slovenia	26,2	24,9	23,4	24,1	25,4	25,5	26,1	28,7
Hungary	23,0	23,0	23,0	22,1	22,4	22,7	21,7	20,9
EU-12	23,5	22,5	21,8	21,5	21,6	22,0	23,0	24,8
EU-27	20,7	20,2	19,6	19,5	19,7	20,0	20,7	21,2

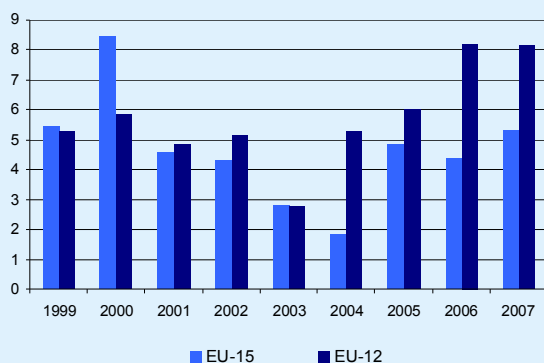
Source: Eurostat

A more rapid increase in the investment rate in the new EU countries after 2004 may be attributable to the increased inflow of foreign direct investment (FDI) to EU-12 countries after their entry to the EU as well as good economic climate in these countries.

In 2007 the inflow of FDI increased to nearly EUR 70 bn, up from EUR 14 bn in 2003 (respectively 8.2% and 2.7% of GDP). In comparison with the four previous years the volume of FDI inflows in 2004-2007 increased in all new member states, in particular in Hungary, Bulgaria and Romania, where this category grew more than four times over the analyzed period. It seems therefore that EU entry increased the investment attractiveness of NMS-9 countries. The period 2004-2007 featured very good economic climate all over the world. The average yearly growth of global GDP in this period was about 5%, while the volume of trade grew on the average by 8.6% a year. Those developments in parallel with offshoring trends - the tendency to transfer production to countries with low manufacturing costs - led to the growth of world capital transfers. In this period the inflow of global FDI increased two and a half times (from USD 560 bn in 2003 to USD 1300 bn in 2006), from which the NMS-9 countries benefited as well.

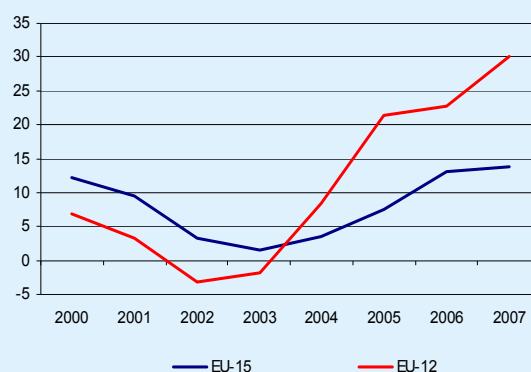
A good economic climate was another factor affecting investment growth in the new Member States. Whereby enterprises increased their profits and could allocate more funds to investment. Additionally the new EU Member States experienced a marked development of credits for enterprises. Their growth increased from -1.8% in 2003 to 30% in 2007. The level of credits for enterprises in relation to the GDP increased in this period from 16.4% to 20.6%, yet it was still twice lower than in the 'old' EU countries.

Figure 1. FDI inflow as percentage of GDP



Source: UNCTAD, Eurostat, Central Banks

Figure 2. Loans to enterprises, yoy, in %



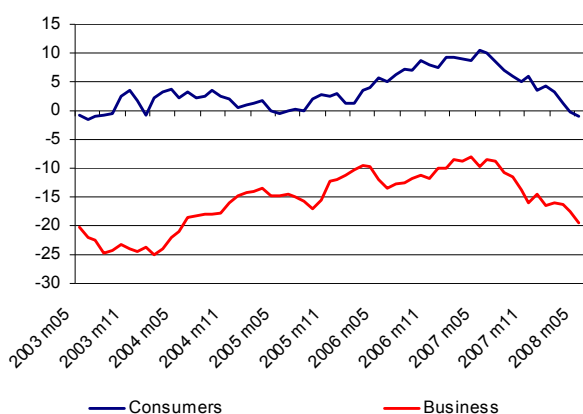
Source: EcoWin Economic, Eurostat, Central Banks

Economic climate

Over the first five months of 2008 the indices of sentiments among both consumers and business corporates in the CEE region pursued a steady decline (see chart 2.3), mainly on account of worsening sentiment in global economy. In May 2008 the average level of consumer confidence for the analyzed group of countries was -19.6 down from -8.8 and -14.5 respectively in July 2007 and December 2007. The biggest decline took place in the Baltic states, in Slovakia and in Hungary. Poland was the only state where consumer sentiment improved between 2007 and 2008.

The business confidence index for the whole group of countries also fell from 3.4 in December 2007 to -1.0 in May 2008. In fact confidence deteriorated across the region, only in Bulgaria did business sentiment improve.

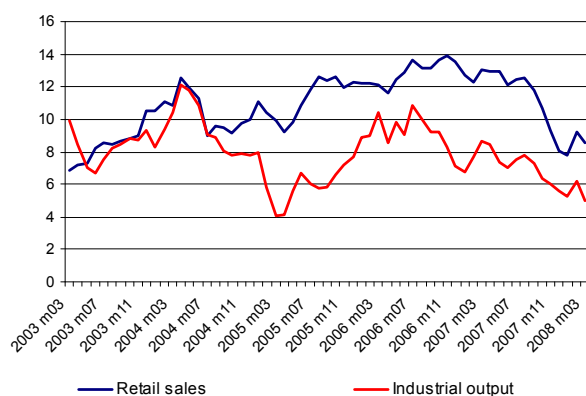
Figure 2.3. Economic confidence indices in NMS-9



Source: European Commission

The growth rate of industrial output in NMS-9 countries fell in 2008 Q1 and averaged 4.9% against 6.0% in 2007 Q4. At the same time the growth in retail sales accelerated. In 2008 Q1 it averaged 8.5%, up from 8.0% in 2007 Q4. The acceleration in the growth of retail sales took place in Slovakia, Lithuania, Poland and Bulgaria.

Figure 2.4. Industrial output and retail sales growth rates In NMS-9 (3 months average)



Source: EcoWin Economic, own calculations

Forecasts

According to the forecasts of external institutions (see table 2.2 and 2.3) the economic growth rate in the CEE region will fall in 2008 and 2009 in comparison with 2007. Only in Hungary will the GDP growth slightly accelerate in 2008-2009. The latest economic growth forecasts for 2008 and 2009 are lower than those from end-2007. **The biggest negative difference with respect to**

GDP growth forecasts is noted in the case of the Baltic states.

The greatest threats to economic growth in NMS-9 countries include:

- Economic slowdown across the euro area. NMS-9 countries tend to maintain highly open economies and are therefore vulnerable to a decline in external demand.
- The continued liquidity crisis in financial markets coupled with high dependence on external financing (particularly in the Baltic and Balkan states) may lead to further reduction in lending and weaken both consumption and investment.
- The fixed exchange rate regime and lack of possibility of monetary policy reaction in the Baltic states and Bulgaria in the context of adverse external environment may lead to the deepening and prolongation of economic slowdown in these countries.

Table 2.2. GDP growth rate forecasts

	IMF			European Commission	
	2007	2008	2009	2008	2009
Czech Rep.	6,5	4,2	4,7	4,7	5,0
Poland	6,6	4,9	4,5	5,3	5,0
Slovakia	10,4	6,6	5,6	7,0	6,2
Hungary	1,3	1,8	2,5	1,9	3,2
Estonia	7,1	3,0	3,7	2,7	4,3
Lithuania	8,8	6,5	5,5	6,1	3,7
Latvia	10,3	3,6	0,5	3,8	2,5
Bulgaria	6,2	5,5	4,8	5,8	5,6
Romania	6,0	5,4	4,7	6,2	5,1

Source: IMF, European Commission

Table 2.3. GDP growth rate forecasts.

	2007	2008	2009
Czech Rep.	6,5	4,5	4,8
Poland	6,6	5,9	5,0
Slovakia	10,4	7,3	6,1
Hungary	1,3	2,0	3,1

Source: OECD Economic Outlook (June 2008)

Latvia – on the way to stagflation

A scenario of a possible economic slump in the Baltic states has been contemplated by economists for a while. There are at least several grounds for such reasoning:

- High external imbalances (deficit at the current account balance in 2006-2007 stood at 10 to even 30% of GDP).
- The fixed exchange rate regime and ensuing lack of fully autonomous monetary policy brought an enormous rise in inflation and appreciation of real exchange rates.
- A highly negative level of real interest rates (caused by high inflation) led to expansive growth of lending and growth of the foreign debt of the banking sector.

Considering the economic growth in 2006 and at the beginning of 2007 there were no signs of economic slowdown of the Baltic economies. First symptoms appeared in 2007 Q2 in Estonia, when the GDP dynamics dropped by 2.5 percentage points. In the other Baltic states the GDP growth rate was still running above 10% and was the highest among NMS-9 countries.

In 2007 Q4 an economic slowdown took place in all the Baltic states. The GDP growth declined on the average by 2.5 percentage points. The GDP ebbed most in Latvia, where it dropped by nearly 3 percentage points. Preliminary estimates of GDP growth show that in 2008 Q1 another fall took place by 4.4 percentage points to 3.6%.

The breakdown of economic growth in Latvia in 2007 Q4 shows a rapid decline in internal demand. Its overall contribution to GDP growth fell from 16.1 pp in 2007 Q3 to 4.6 pp in 2007 Q4, i.e. by as much as 11.5 pp. In contrast to the previous quarters, the main factor driving economic growth in Latvia was net exports. This growth stemmed from slump in imports, apparently an additional factor reflecting economic slowdown in Latvia.

At the same time inflation in Latvia keeps growing. In April 2008 it stood at nearly 18% and was by far the highest in the CEE region.

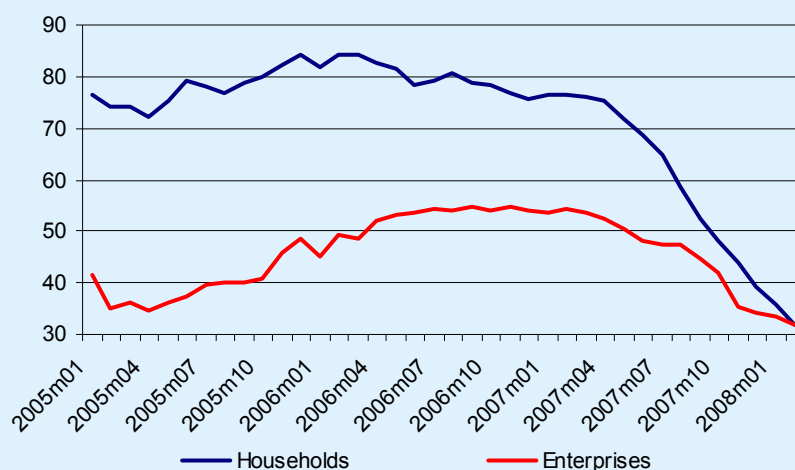
Table 1. *Decomposition of GDP growth in Latvia.*

	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4
GDP	13,1	11,1	11,9	11,7	11,2	11,0	10,9	8,0
Total consumption	11,1	11,0	10,3	16,5	14,5	13,2	10,4	3,7
Gross fixe capital formation	4,9	3,7	2,9	5,2	5,0	4,6	4,6	0,2
Changes in inventories	-0,4	-0,5	9,5	0,8	4,2	0,2	1,1	0,7
Net exports	-3,0	-3,4	-11,0	-11,4	-15,0	-10,5	-5,3	3,7

Source: Eurostat, own calculations

Economic growth in Latvia, similarly as in other Baltic states was to a large extent fuelled by household and corporate lending. The economic activity slowdown in 2007 Q4 may be therefore partly attributable to the deceleration in the growth of granted credits. In 2006 and in the first half of 2007 it stood at ca. 80% y/y in the case of households and 40-50% in the case of enterprises while in 2008 Q1 it declined to ca. 30% y/y. Credit slump reflects the tightening of banking supervisory standards in the context of the overheating Latvian economy and a crisis in global financial markets.

Figure 1. Credit to private sector growth rate, yoy, in %



Source: EcoWin Economic, own calculations

Economic slowdown may also hit the fiscal situation in Latvia. The budget for 2008 adopted in October 2007 envisaged a surplus of 1% of GDP but this target is unlikely be met. Estimating the level of tax income, an assumption was made of economic growth at the level of 7.5%, while the latest forecasts show this pace to stand at the level of ca. 3-4%. The fall in income may be also accompanied by the growth in expenditure. High inflation leads to the increase in wage pressure on the part of public sector employees, there is also a pressure to increase disability benefits, pensions and other social benefits.

International Monetary Fund forecasts for Latvia from April 2008 indicate a very significant decline in economic growth in 2008 and 2009, coupled with high inflation (the highest among NMS-9 countries). In 2009 and 2010 Latvia will be the slowest developing country in the region and at the same time the price growth there will be the quickest.

Table 2. INF forecasts for Latvia

	2006	2007	2008	2009	2010	2011	2012	2013
GDP	11,9	10,2	3,6	0,5	0,3	1,3	2,2	3,0
CPI average	6,5	10,1	15,3	9,2	6,7	4,4	3,7	3,1
CPI end of period	6,8	14,1	11,8	7,9	5,6	4,1	3,4	3,1
CA/GDP	-22,3	-23,3	-15,0	-10,5	-6,8	-5,3	-4,8	-4,8

Source: Word Economic Outlook, April 2008

According to the IMF there are at least several factors, which in the coming years may inhibit lending in the Baltic states, including Latvia. They are the following:

- ***Impact of the subprime crisis in the US.*** The direct impact of the crisis on the Baltic states does not seem too big, since the Scandinavian banks, who are the main players in the Baltic markets were not significantly exposed (at least according to the present state of knowledge) to instruments on the mortgage loans market in the US. Much more serious seems to be the indirect impact, through the aversion to risk and consequently more cautious financing of the emerging economies.
- ***Decline in the competitiveness of the economy.*** A very rapid rise in wages (reaching as much as 30% y/y in Latvia) surpassing by far the labour productivity growth has brought in recent years a fall in the competitiveness of this economy in the international market, and consequently worse earnings of enterprises. Should this trend persist in the labour market, foreign investors may lose motivation and the inflow of future investments may decline.
- ***A dwindling inflow of petrodollars.*** The growing prices of raw materials in the world markets and growing profits from trade in these materials resulted in recent years in a big inflow of investment from countries-exporters of raw materials to emerging economies, including NMS-9 countries. Should the prices of raw materials grow at a more moderate pace, the inflow of funds from this source may very quickly decrease, thus reducing the inflow of external financing in Latvia.⁷

The economic situation in 2007 Q4 and in the first half of 2008 as well as the external centres' forecasts indicate that the **risk of „stagflation” in Latvia is beginning to increase.** This scenario is even more likely to come true in the context of the fixed exchange rate and easing of fiscal policies.

Estonia is exposed to similar risks. According to the estimate data, the GDP growth in Estonia developed only at 0.1% in 2008 Q1, vis-à-vis the two-digit figure posted a year before. At the same time inflation reached 11.6 % in April 2008, i.e. the highest level recorded since the early 1990s.

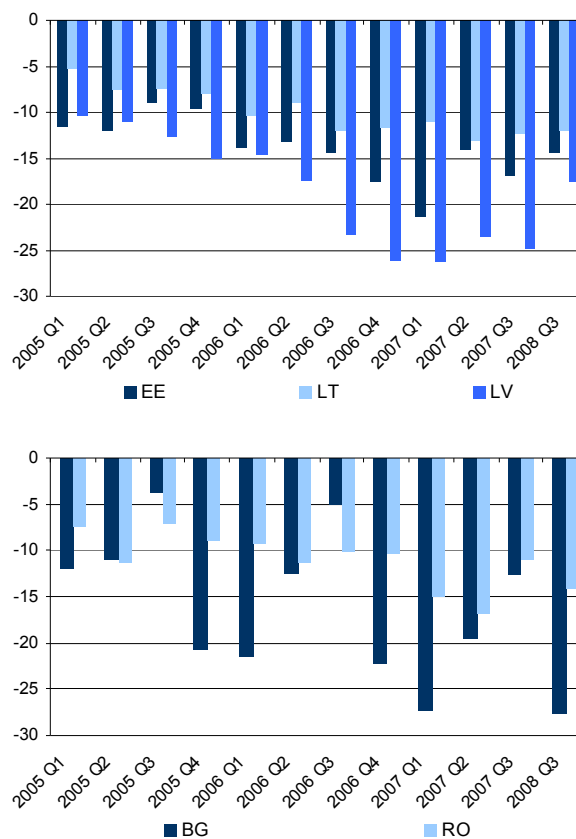
⁷ Since oil prices showed a significant growth in the first half of 2008, and their growth does not seem to be anticipated in the forecasts for the remaining part of the year, the weight of this argument has weakened.

3. External imbalances

In 2007 Q4 the average current account deficit in NMS-9 countries increased to 11.4% of GDP, up from 10.8% of GDP in 2007 Q3. The increase in deficit resulted mainly from a significant deterioration of current account balance in Bulgaria and Romania. The deficit rose also in Poland, though to a much smaller extent than in the Balkan countries. In the other countries of the region the current account balance improved. As in the previous quarters the current account deficit in most of the countries resulted from the deficit in trade in goods⁸ and the negative income balance. With the exception of the Balkan countries all other NMS-9 countries recorded a surplus in foreign trade in services. The current transfers balance in the majority of countries (except Slovakia) was also positive, though it exceeded 2% of GDP only in Lithuania, Latvia and Rumania.

The highest current account deficit continued to be recorded in the Baltic states, as well as in Romania and Bulgaria. In 2007 Q4, the deficit in this group of countries averaged 17.2% of the GDP, up from 15.6% in 2007 Q3. The increase in the current account deficit in this group of countries results from the deteriorating balance in the Balkan countries (in particular in Bulgaria, where the deficit reached 27.7% of GDP in 2007 Q4). **At the same time in all the Baltic states the current account deficit declined in relation to GDP**, which resulted in the first place from the rapid decline in the imports of goods in Latvia and Estonia (see chapter 1).

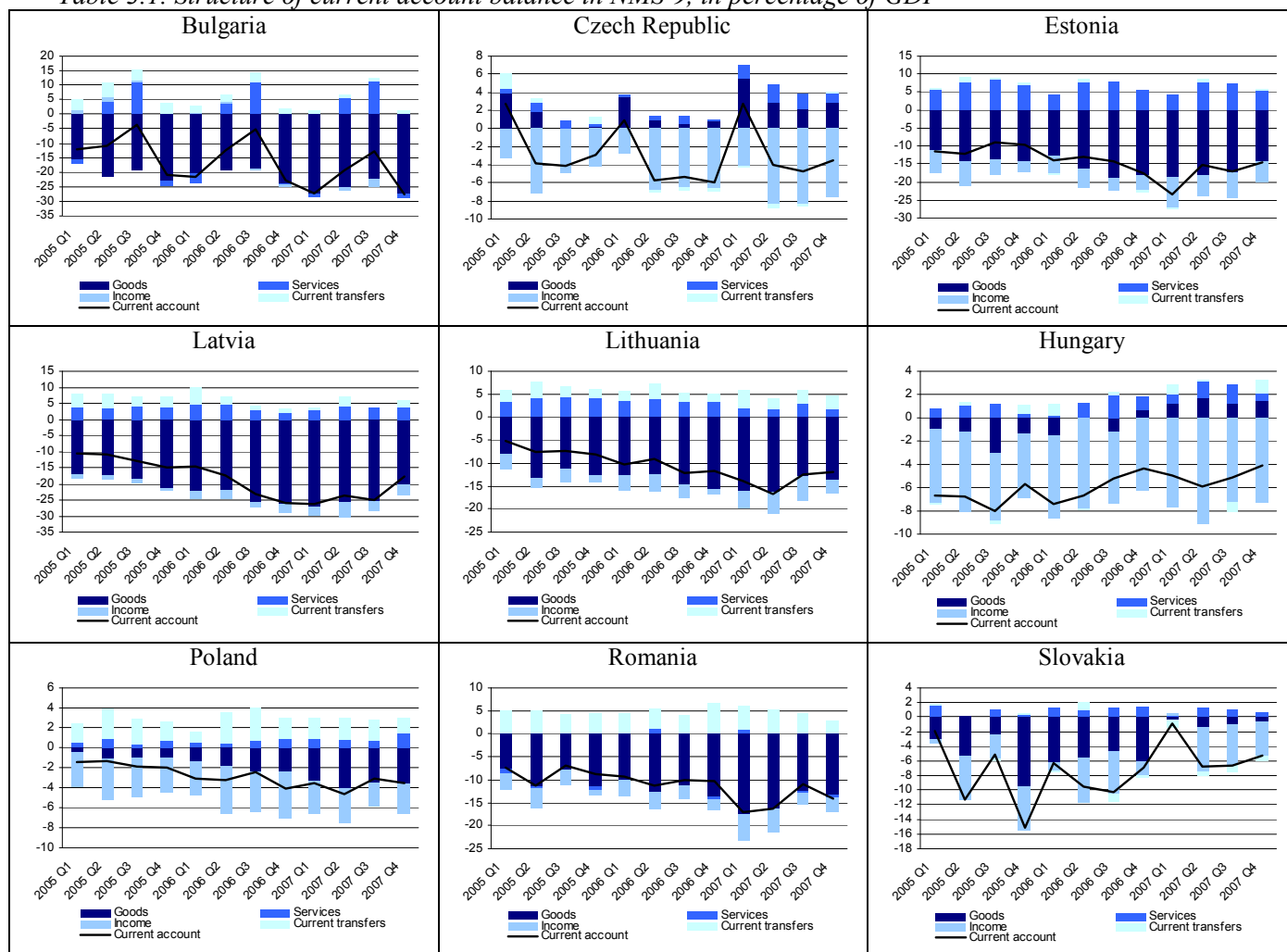
Figure 3.1. Current account balance In NMS-9, as percentage of GDP



Source: Eurostat, Central Banks, own calculations

⁸ For the last several quarters the Czech Republic and Hungary have constituted an exception.

Table 3.1. Structure of current account balance in NMS-9, in percentage of GDP



Source: Eurostat, Central Banks, own calculations

In the group of Baltic and Balkan countries the current account deficit resulted mainly from a large deficit on trade in goods. In 2007 Q4 it amounted to 17.9% of GDP, an improvement from 18.1% in the previous quarter. In 2007 Q4 the balance on services deteriorated in comparison with 2007 Q3 (respectively 5.0% and 1.8% of GDP), which constituted the most important factor in the increase of current account deficit. The most rapid decline took place in Bulgaria, where the services balance was -1.4% of GDP compared to 11.4% of GDP in 2007 Q3. The balance on income and the current transfers balance, on the other hand, improved in this group of countries (see table 3.1).

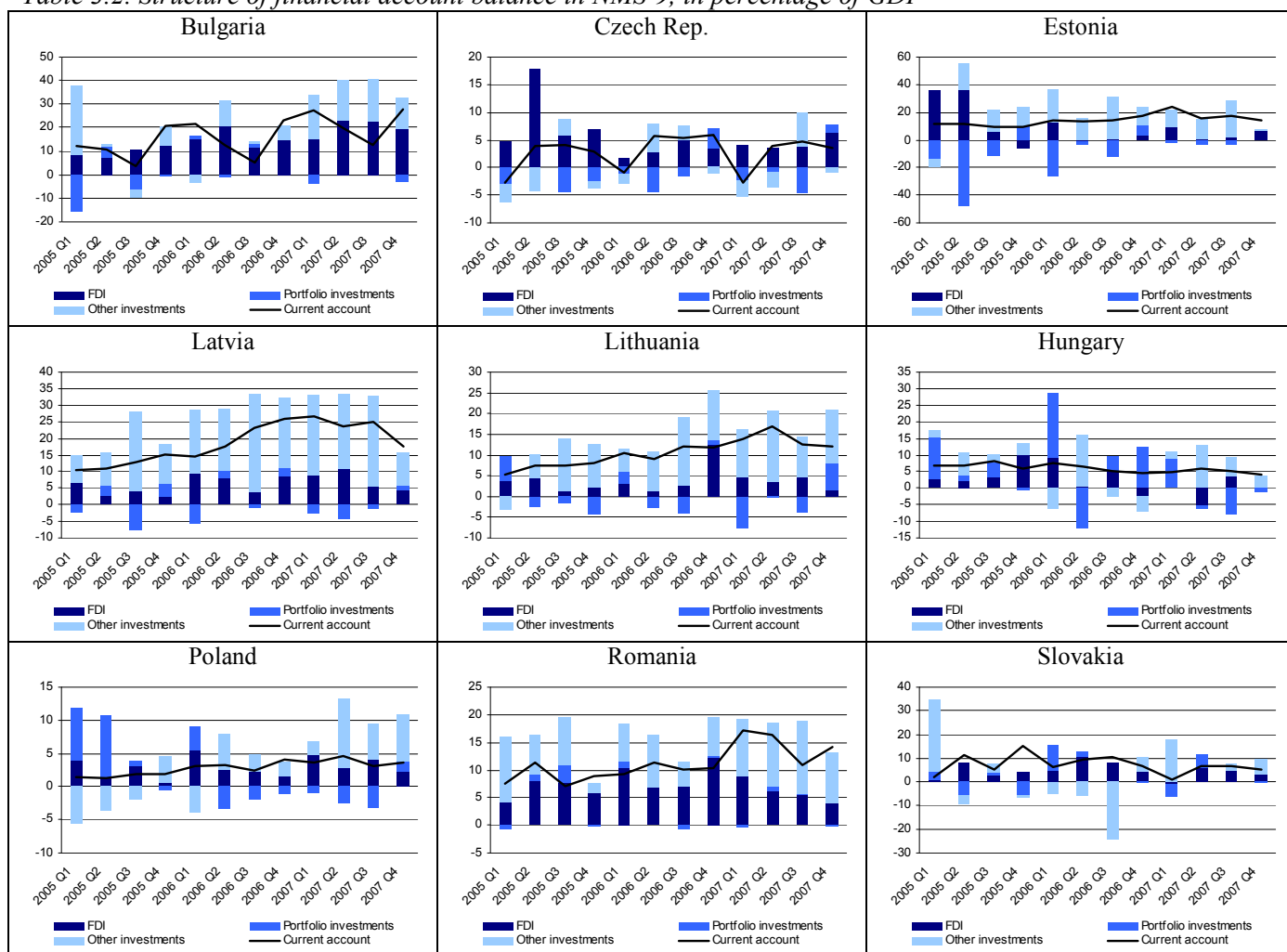
From a financing perspective the current account deficit in the Baltic states, Bulgaria and Romania was primarily covered by

other investments, including mainly loans to the banking sector. Turbulence on financial markets and liquidity problems towards the end of 2007 **markedly dampened the inflow of investments to this group of countries, and to the Baltic countries in particular.** The average inflow of other investment to the above mentioned group amounted to 9% of GDP in 2007 Q4, down from 19% of GDP in 2007 Q3. The inflow of FDI has also declined somewhat, while the balance of portfolio investments improved (see table 3.2).

2007 Q4 brought about the improvement in the current account balance for the whole group comprising **Poland, the Czech Republic, Slovakia and Hungary**. Within this group the current account deficit averaged 4.1% of the GDP in 2007 Q4, down from 4.9% of the GDP in 2007 Q3. Poland proved to be the only country in this group that saw its current account deficit deteriorate. In all the remaining countries the deficit declined in 2007 Q4.

Nonetheless it was the Czech Republic as well as Poland that recorded the lowest economic deficit in the NMS-9 group. As in the preceding quarters the income account deficit accounted for most of the current account deficit. On the other hand 2007 Q3 saw the said balance improve (see table 3.1). Since deficit declined both on income account and on trade in goods, the current account deficit improved in the analysed group of countries.

Table 3.2. Structure of financial account balance in NMS-9, in percentage of GDP



Source: Eurostat, Central Banks, own calculations

In 2007 Q4 the current account deficit in the above mentioned group of countries as well as in the Baltic countries was financed mainly with the inflow of other investments, which amounted to 4.0 % of GDP. On the other hand the FDI inflow in 2007 Q4 amounted to 3.0% of GDP. Both of those balances declined in comparison with 2007 Q3 when they stood at 5.1% and 4.0% of GDP respectively. Similarly as in the Baltic states the portfolio investment balance improved and stood at 0.4% in 2007 Q4 up from -3.9% in 2007 Q3.

Long-term debt rating

Table 3.3. Long-term foreign currency debt rating

	2003	2004	2005	2006	2007	May 2008
Poland	BBB+	BBB+	BBB+	BBB+	A-	A-
Czech Rep.	A-	A-	A	A	A	A+
Slovakia	BBB	A-	A	A	A	A
Hungary	A-	A-	BBB+	BBB+	BBB+	BBB+
Estonia	A-	A	A	A	A	A
Lithuania	BBB	A-	A-	A	A	A
Latvia	BBB+	A-	A-	A-	BBB+	BBB+
Bulgaria	BB+	BBB-	BBB	BBB	BBB	BBB
Romania	BB	BBB-	BBB-	BBB	BBB	BBB

Source: FitchRatings

Table 3.3. Long-term domestic currency debt rating

	2003	2004	2005	2006	2007	Maj 2008
Poland	A+	A	A	A	A	A
Czech Rep.	A	A	A+	A+	A+	AA-
Slovakia	A-	A+	A+	A+	A+	A+
Hungary	A+	A+	A-	A-	A-	A-
Estonia	A+	A+	A+	A+	A+	A+
Lithuania	A-	A	A	A+	A+	A+
Latvia	A	A	A	A	A-	A-
Bulgaria	BBB-	BBB	BBB+	BBB+	BBB+	BBB+
Romania	BB+	BBB	BBB	BBB+	BBB+	BBB+

Source: FitchRatings

In 2008 ratings for long-term debt remained stable in the majority of countries. Only in the case of the Czech Republic the Fitch agency upgraded the rating from A to A+ (foreign currency) and from A+ to AA- (domestic currency). **On the other hand long-term debt outlook deteriorated in Bulgaria, Estonia, Latvia and Romania.** On 31 January 2008 the Fitch agency decided to change the

long-term outlook for these countries from stable to negative.

Forecasts

Current account balance forecasts for NMS-9 countries show the figure decline in relation to GDP in most countries (see tables 3.3 and 3.4). Only in Poland and in Romania the current account deficit is growing. The forecasted weakening of domestic demand in the Baltic countries may have a dampening effect on imports in these countries and thus improve the current account balance.

Table 3.5. Current account balance forecast for NMS-9, in percentage of GDP

	2007	IMF			European Commission	
		2008	2009	2008	2009	
Czech Rep.	-2,7	-3,0	-2,8	-2,9	-2,6	
Poland	-3,7	-5,0	-5,7	-4,6	-5,5	
Slovakia	-5,7	-5,0	-4,7	-4,0	-3,1	
Hungary	-4,9	-5,5	-5,1	-4,4	-3,9	
Estonia	-17,3	-11,2	-11,2	-11,2	-9,3	
Lithuania	-13,7	-10,5	-8,8	-12,3	-11,2	
Latvia	-22,9	-15,0	-10,5	-17,7	-15,5	
Bulgaria	-21,5	-21,9	-18,9	-21,2	-20,9	
Romania	-14,1	-14,5	-13,0	-16,1	-16,2	

Source: IMF, European Commission

Table 3.6. Current account balance forecast for NMS-9, in percentage of GDP

	2007	2008	2009
Czech Rep.	-2,7	-2,8	-1,8
Poland	-3,7	-4,5	-5,6
Slovakia	-5,7	-4,3	-3,1
Hungary	-4,9	-4,4	-4,1

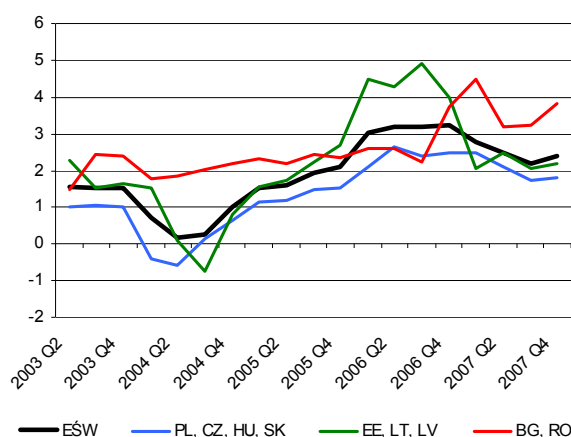
Źródło: OECD Economic Outlook (June 2008)

4. Labour market

The situation on the labour market in 2007 Q4 in NMS-9 countries as a whole **was still good**. High economic growth supported growth in employment. The average employment growth in the NMS-9 region in 2007 Q4 stood at 2.4% in comparison with 2.2% in 2007 Q3. The growth in employment accelerated in 2007 Q4 in Poland, Slovakia, Romania and in Latvia, while decelerated in Bulgaria, Estonia and Lithuania but still remained positive. **Hungary was the only country in the region which experienced a decline in employment in this period** (employment dropped from -0.2 % in 2007 Q2 to -1.6 % in 2008 Q1). In 2008 Q1 in the majority of the countries in the region ⁹ (with the exception of Hungary) the growth of employment accelerated again.

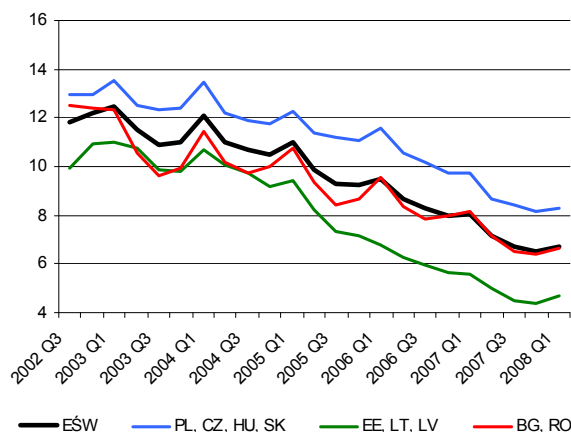
In the last quarter of 2007 the rate of unemployment in NMS-9 countries dropped from 6.7% to 6.5%. Yet, not all the countries of the region recorded a decline in unemployment. In Bulgaria, Romania, Lithuania and Hungary the rate of unemployment increased. In 2008 Q1 the rate of unemployment in most countries in the region increased slightly and for the region as a whole it averaged 6.7%. The growth of unemployment in winter was due to limited employment in certain sectors, e.g. construction, and was not a surprise.

Figure 4.1. Employment growth rate



Source: EcoWin Economic, own calculations

Figure 4.2. Unemployment rate



Source: EcoWin Economic

⁹ Due to the lack of data for all countries for 2008 Q1, the analysis is not comprehensive.

5. Inflation and labour costs¹⁰

Between January and May 2008 the average HICP inflation in NMS-9 grew from 8.8% to 9.5%. The highest rise in the analysed period took place in Lithuania, Latvia and Bulgaria where it reached between 2.1 to 2.3 percentage points.

The highest inflation level, similarly as in 2007, was recorded in the Baltic states and Bulgaria. In May 2008 the HICP growth in this group of countries markedly exceeded 10% and ranged between 11.4% in Estonia and 17.7% in Latvia. Such a high inflation in these countries has not been recorded since the beginning of the 1990s. High inflation in May 2008 also prevailed in Romania (8.5%), the Czech Republic (6.8%) and Hungary (6.9%). In those last two countries the high level of inflation in 2008 reflects the rise in administered prices and indirect taxes at the beginning of 2008. **A relatively lowest HICP growth was observed in Poland (4.3%) and in Slovakia (4.0%).**

Inflation continued at high levels driven by high food and energy prices, but their contribution to inflation growth rate between January and May 2008 was in the NMS-9 countries much lower than in the 2nd half of 2007 (see table 4.1). It amounted to 0.5 pp on average against 1.9 pp in the 2nd half of 2007.

The energy price hikes significantly contributed to inflation growth between January and May 2008 only in Latvia and in Romania. In other countries the contribution of energy prices to HICP growth was small and in the Czech Republic and in Bulgaria it turned even negative.

The contribution of food prices to inflation growth in NMS-9 was also smaller than in the 2nd half of 2007, in particular with regard to unprocessed food. The biggest contribution of food prices to inflation growth took place in Lithuania, Latvia, Bulgaria and Romania, i.e. in countries where inflation increased the most in the period under review. The food prices growth in this group of countries accelerated

further in 2008, while in the other countries of the region it stopped and even fell. In other words a different path of food prices was responsible for a different path of inflation in NMS-9 countries (see table 5.1).

Core inflation (excluding food and energy prices) in the majority of NMS-9 countries (apart from Hungary) in the analyzed period followed a rising trend. On the average it increased for NMS-9 countries by 0.3 pp in the period from January to May 2008.

Wages and unit labour costs

The nominal wage growth in 2007 Q4 slightly decelerated, yet remained high. The growth of average wage in 2007 Q4 stood at 14.1% against 14.9% in 2007 Q3. In 2008 Q1 the wage growth again increased to 15.8%, mainly due to the wage increase in Poland, the Czech Republic and Slovakia.

Whereas nominal wages grew at a slower pace, economy expanded rapidly in 2007 Q4. Consequently unit labour costs (ULC), while moderated its rise, remained high. The ULC growth in the fourth quarter amounted to 10.5% in comparison with 11.7% in 2007 Q3.

Slovakia was the only country in the region where the ULC growth was negative. It amounted to -3.0 percentage points in 2007 Q4, as compared to -0.3% in the previous quarter. This decrease was due mainly to the acceleration of economic growth¹¹.

As it appears no second round effects have so far occurred in the CEE region. Most countries reported wage growth already in early 2006, i.e. much earlier than inflation growth which was fuelled there by rising food and energy prices. Furthermore wage growth stabilized or even fell in the second half of 2007 in some countries (the Czech Republic, Hungary, Estonia).

¹⁰ All data describe HICP inflation.

¹¹ However, it was due to one-off factors related to increase in inventories. (see chapter 2). Leaving this effect apart would put the ULC growth in Slovakia in 2007 Q4 at 1%, i.e. still at a lowest level among NMS-9 countries.

Table 5.1. Decomposition of HICP inflation, January-May 2008 in NMS-9

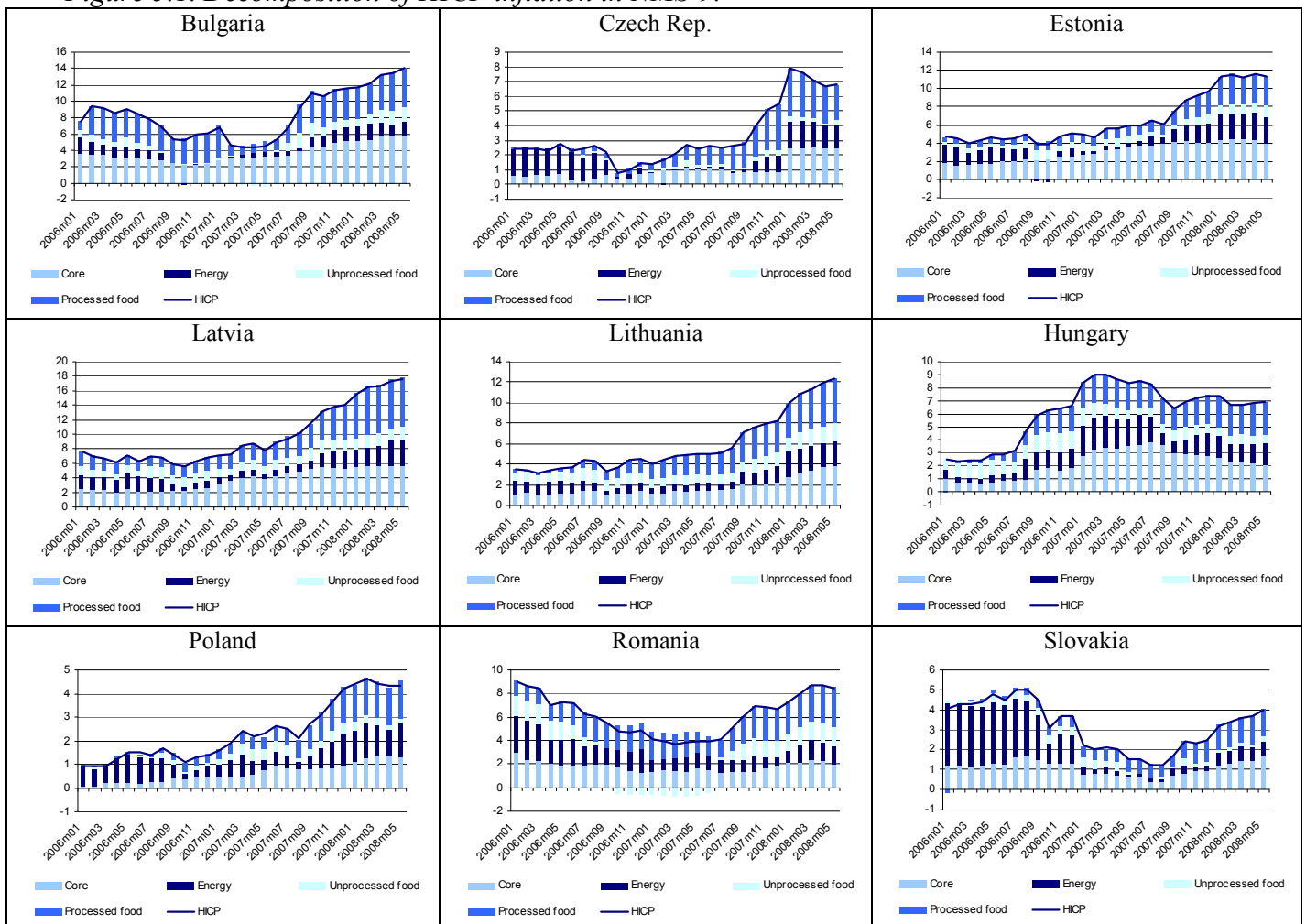
Country	Price category	Contribution to inflation level		Contribution to inflation change		Weights, in per cent
		01..2007	05.2007	in pp.	in percentage of inflation change	
Czech Rep.	HICP	7,9	6,8	-1,1	100,0	100,0
	Energy	1,8	1,6	-0,2	22,3	14,4
	Unprocessed food	0,4	0,3	-0,1	6,1	7,4
	Processed food	3,2	2,3	-0,9	77,4	19,4
	Core	2,5	2,5	0,0	0,0	58,8
Poland	HICP	4,4	4,3	-0,1	100,0	100,0
	Energy	1,3	1,4	0,2	-161,9	16,2
	Unprocessed food	0,4	0,2	-0,3	273,2	8,8
	Processed food	1,5	1,6	0,1	-73,1	18,3
	Core	1,1	1,3	0,2	-170,1	56,7
Slovakia	HICP	3,2	4,0	0,8	100,0	100,0
	Energy	0,7	0,8	0,1	11,5	13,3
	Unprocessed food	0,1	0,3	0,1	18,6	7,1
	Processed food	1,2	1,3	0,1	11,2	19,6
	Core	1,2	1,7	0,5	59,2	60,0
Hungary	HICP	7,4	6,9	-0,5	100,0	100,0
	Energy	1,6	1,8	0,1	-23,9	18,8
	Unprocessed food	0,7	0,6	0,0	10,0	15,8
	Processed food	2,4	2,5	0,1	-19,6	27,0
	Core	2,6	2,0	-0,6	120,0	38,4
Estonia	HICP	11,3	11,4	0,1	100,0	100,0
	Energy	3,0	3,0	0,0	11,4	11,4
	Unprocessed food	0,9	1,2	0,3	288,4	9,3
	Processed food	3,1	3,2	0,2	152,9	19,1
	Core	4,3	3,9	-0,4	-361,2	60,2
Lithuania	HICP	10,0	12,3	2,3	100,0	100,0
	Energy	2,5	2,5	0,0	-1,2	11,4
	Unprocessed food	1,4	1,8	0,4	15,4	11,3
	Processed food	3,3	4,3	0,9	40,2	20,5
	Core	2,7	3,8	1,1	46,3	56,8
Latvia	HICP	15,6	17,7	2,1	100,0	100,0
	Energy	2,3	3,6	1,3	60,9	13,3
	Unprocessed food	1,6	1,8	0,3	12,4	11,4
	Processed food	6,3	6,8	0,5	23,4	22,0
	Core	5,5	5,7	0,2	8,1	53,2

Source: Eurostat, own calculations

Country	Price category	Contribution to inflation level		Contribution to inflation change		Weights, in per cent
		01..2007	05.2007	in pp.	in percentage of inflation change	
Bulgaria	HICP	11,7	14,0	2,3	100,0	100,0
	Energy	1,7	1,6	-0,1	-4,5	12,9
	Unprocessed food	0,9	1,8	0,8	35,8	9,7
	Processed food	3,8	4,7	1,0	41,6	19,1
	Core	5,2	5,9	0,7	30,4	58,3
Romania	HICP	7,3	8,5	1,2	100,0	100,0
	Energy	1,0	1,6	0,6	48,6	18,4
	Unprocessed food	1,5	1,6	0,1	11,8	7,4
	Processed food	2,8	3,4	0,7	56,3	15,0
	Core	2,1	2,0	-0,2	-12,8	59,2
Average	HICP	8,8	9,5	0,8	100,0	100,0
	Energy	1,8	2,0	0,2	26,4	13,3
	Unprocessed food	0,9	1,1	0,2	22,9	7,1
	Processed food	3,1	3,4	0,3	36,7	19,6
	Core	3,0	3,2	0,2	20,6	60,0

Source: Eurostat, own calculations

Figure 5.1. Decomposition of HICP inflation in NMS-9.



Source: Eurostat, own calculations

Forecasts

Inflation forecasts from April and May 2008 anticipate its growth in 2008 in comparison with 2007 in all NMS-9 countries (excluding Hungary). In turn, in 2009 inflation should decrease across the region. Only OECD forecasts for Poland anticipate a significant rise in inflation in 2009 in comparison with 2008. In comparison with forecasts from the end of 2007 the anticipated inflation in NMS-9 in 2008 and 2009 rose markedly. The main upside risk to price stability seems to derive from the continued rise in food prices and energy commodities. Additionally, mainly in the Baltic countries there is a risk of rise in inflationary expectations and triggering of price/wage spiral.

Table 5.2. Average annual inflation forecasts for NMS-9.

	2007	European Commission*			
		IMF		2008	2009
		2008	2009	2008	2009
Czech Rep.	2,8	6,0	3,5	6,2	2,7
Poland	2,5	4,1	3,8	4,3	3,4
Slovakia	2,8	3,6	3,8	3,8	3,2
Hungary	8,0	5,9	3,5	6,3	3,7
Estonia	6,6	9,8	4,7	9,5	5,1
Lithuania	5,8	8,3	6,1	10,1	7,2
Latvia	10,1	15,3	9,2	15,8	8,5
Bulgaria	8,4	9,7	6,0	9,9	5,9
Romania	4,8	7,0	5,1	7,6	4,8

* HICP

Source: IMF, European Commission

Table 5.3 . Average annual inflation forecasts

	2007	2008	2009
Czech Rep.	2,8	6,8	2,9
Poland	2,5	4,5	5,5
Slovakia	2,8	4,0	3,6
Hungary	8,0	6,3	3,7

Source: OECD Economic Outlook (June 2008)

6. Monetary policy

In four of the five countries of the NMS-9 region, which implement direct inflation targeting strategies¹² in the period between January and June 2008 a tightening of the monetary policy took place.

The central banks of the Czech Republic, Poland and Romania began a series of interest rate hikes in 2007, which also continued in 2008.

The National Bank of the Czech Republic (CNB) decided in February 2008 to raise interest rates by 25 basis points to the level of 3.75% and since then interest rates in the Czech Republic have remained stable. The May inflation projection for the Czech Republic anticipated a higher level of inflation than in February. The CPI dynamics in the Czech Republic at the end of 2008 is anticipated to be running at the level of 5.3%, yet after the base effects related to the rises in administered prices and indirect taxes subsided, the inflation in 2009 should drop to the level of 2.0% at the end of that year.¹³

The interest rates of the National Bank of Poland in the period from January to June 2008 were risen on four occasions by 25 basis points, from 5.0% to 6.0%.

Interest rates in Romania increased the most in the analysed group of countries in 2008. The NBR's reference rate rose by 225 basis points, from 7.5% in January to 9.75% in June 2008 as a response to a rising consumer demand, tensions in the labour market, continued high external imbalances as well as the depreciation of the domestic currency. In Romania, despite the inflation increase in 2008, 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 fluctuation band of the inflation target, at the end of 2009

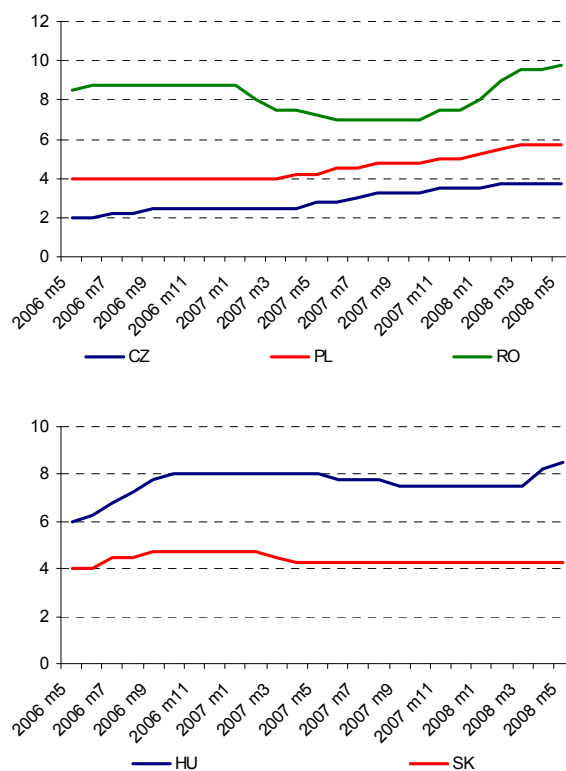
¹² The countries implementing the direct inflation targeting strategy include: the Czech Republic, Poland, Romania, Slovakia and Hungary.

¹³ On 8 March 2007 the CNB took the decision to lower the inflationary target from 3% to 2% since January 2010.

Q1 it should already be consistent with the target.

The National Bank of Hungary (MNB) after a series of interest rate reductions in 2007 decided to raise them in 2008. The main MNB interest rate rose in the period from January to June 2008 from 7.5% to 8.5%. The MNB justified its decision by a slower drop of inflation than earlier envisaged, as well as a move to prevent the anchoring of high inflationary expectations and the materialisation of second round effects.

Figure 6.1. Main policy rates in inflation targeting countries



Source: Central banks

Slovakia was the only country in this group where the central bank did not decide to raise interest rates. The basic interest rate in Slovakia has showed no change since April 2007 and stands at 4.25%. Despite the rise in inflation in 2008 the National Bank of Slovakia (NBS) did not raise interest rates, claiming that this rise is due to factors on the supply side, not demand side. The recently held projection of the NBS has not changed significantly in comparison with the February

projection and still forecasts inflation to be running above the inflationary target in 2008 and 2009.

Table 6.1. Central banks' inflation forecasts in inflation targeting countries

Country	Date of projection	Inflation at the end of the year	
		2008	2009
Poland	June 08	4,2	3,5
Czech Rep.	May 08	5,3	2,0
Hungary	May 08	5,5	3,4
Slovakia	May 08	2,8	3,1
Romania	May 08	6,0	3,5

Source: Central Banks

After a period of rise in short-term interest rates in the Baltic states in the 2nd half of 2007, they decreased at the beginning of 2008. In the period from December 2007 to May 2008 the 3-month interbank rates decreased from 7.3 % to 6.5% in Estonia, from 6.6% to 5,2 % in Lithuania and from 10,5% to 6.0 % in Latvia. The decrease in interest rates coupled with rising inflation led to a situation when real interest rates in the Baltic states are negative. In May the 3-month real interbank interest rate stood at -4.4% in Estonia, -6.3 in Lithuania and -9.9 in Latvia. The fall in nominal interest rates in the Baltic markets may indicate an improvement of liquidity in interbank market, which in turn may be the result of a more restrictive credit policy carried out by banks, as well as the recovery from liquidity crisis on the global market and greater inflow of funds from abroad.

In turn, in Bulgaria in the analysed period of 2008, no decreases in interbank interest rates could be observed. In May 2008 the average monthly 3-month Sofibor rose to 6.9% up from 6.5% in December 2007.

The market interest rates in the period from January to May 2008 rose also in Poland, the Czech Republic, Romania and in Hungary. In the case of the first three countries it was related, among others to the present and forecast level of central bank interest rates. In Hungary, the rise in interest rates was also due to the rise in political instability (see Box 3). They remained unchanged in the analysed period only in Slovakia.

Hungary – the reactions of the financial market

Since the beginning of 2007 the Hungarian economy has been coping with a severe dampening of economic growth, high inflation and external imbalance. Additionally, since the beginning of 2008, tension has been mounting on the Hungarian political stage, which increased fears about the continuation of reforms in the public finances sector. It found its reflection in the rise in the country risk rating and the depreciation of the forint. The MNB decided at the end of February 2008 to free the exchange rate and leave the +/- 15% band around the central parity, which entailed the postponement of the perspective of entering the euro area. At the same time, since mid-2007, there has been a clear rise in the aversion to risk on the global financial market due to the deepening crisis on the American market.

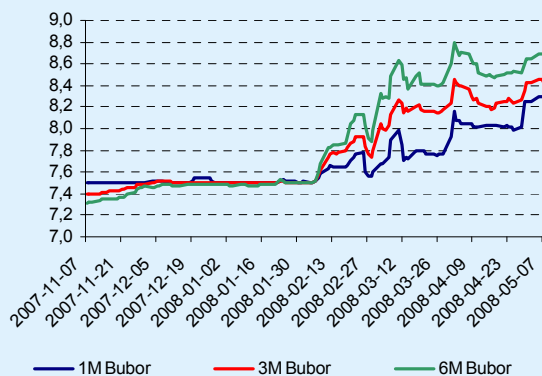
At the turn of February and March 2008, deteriorating data about the Hungarian economy, including a higher inflation than expected and doubts about meeting the inflationary target in 2009, brought about a massive sale of Hungarian bonds. Aversion towards the government bonds also rose in the wake of the referendum results, whereby people refused their support to the projects of curbing public spending (among others the subsidies to education and health service), which ended in the ruling coalition falling apart.

Figure 1. HUF/EUR spot exchange rate



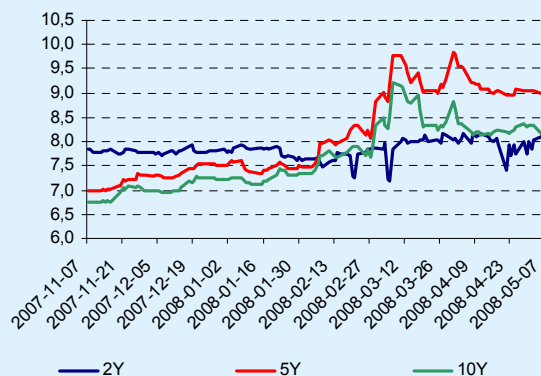
Source: EcoWin Economic

Figure 2. Interbank interest rates In Hungary



Source: EcoWin Economic

Figure 3. Government bonds yields In Hungary



Source: EcoWin Economic

Due to the rise in investment risk in Hungary since mid-February interbank interest rates have been rising as well as government bonds yields. From the beginning of February till the end of March 2008 the value of 3M BUDBOR increased from 7.5% to 8.5%. The five-year bonds yield increased from 8% to 9.8% in the period from 15 February to 10 March.

The rise in investment risk in 2008 Q1 could be seen in all NMS-9 countries, yet in Hungary, as well as in the Baltic states this increase was the biggest. Credit Default Swap increased by ca. 150 basis points there (see table 4).

In April and May 2008 the situation on the bond market stabilised. In consequence five and ten year Hungarian treasury bonds increased their yields. On the other hand interest rates in Hungary were on a rise. This rise was due to the reaction of the National Bank of Hungary (MNB) to the persisting high inflation. In April 2008 the MNB changed its stance to a more restrictive one and after a series of interest rate reductions since the beginning of 2007 it decided to raise them. In April and May 2008 the main interest rate rose by 0.75 percentage points to the level of 8.50%.

Figure 4.. Credit Default Swap for 5Y (green) and 10y (white) government bonds in selected NMS-9



Source: Bloomberg

The persisting high inflation (HICP growth y/y in May 2008 amounted to 6.9% and the CPI growth to 7.0%) will most probably make the MNB raise again the interest rates, which in turn will translate to the level of interest rates on the financial market. The further tightening of monetary policy may therefore prolong the period of economic slowdown in Hungary.

The example of Hungary as an economy with negative macroeconomic indices and unstable economic policy shows that the reaction of financial markets in the period of strong global turbulence was much more radical here in comparison with other countries of the region with better fundamentals.

Statistical annex

1. National accounts

Table 1. Gross Domestic Product in relation to the corresponding period of previous year, in%

	2006	2007	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	6,2	6,6	7,3	6,5	6,5	6,4	6,1
Czech Rep.	6,4	6,5	6,5	6,5	6,3	6,6	5,2
Slovakia	8,5	10,4	8,3	9,3	9,4	14,3	8,7
Hungary	3,9	1,3	2,7	1,2	0,9	0,8	1,7
Estonia	11,2	7,1	10,1	7,6	6,4	4,8	0,1
Lithuania	7,7	8,8	8,1	8,0	10,8	8,0	6,9
Latvia	12,2	10,3	11,2	11,0	10,9	8,0	3,3
Bulgaria	6,3	6,2	5,5	7,3	4,9	6,9	
Romania	7,9	6,0	6,1	5,7	5,7	6,6	8,2

Source: EcoWin Economic

Table 2. Private consumption in relation to the corresponding period of previous year, in%

	2006	2007	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	4,9	5,2	6,9	5,0	5,1	3,6	5,6
Czech Rep.	5,4	5,7	6,8	6,3	5,7	4,2	2,7
Slovakia	5,9	7,1	6,3	7,8	8,3	5,9	8,4
Hungary	1,9	-0,3	0,3	-0,6	-0,8	-0,2	0,4
Estonia	15,1	8,9	16,7	12,0	5,1	3,3	-0,4
Lithuania	11,8	11,5	18,0	11,0	9,2	9,4	12,2
Latvia	21,4	14,0	20,4	18,4	14,4	0,0	2,3
Bulgaria	9,5	5,3	7,0	5,4	4,9	3,4	
Romania	12,6	10,4	11,5	11,5	9,4	9,2	14,5

Source: EcoWin Economic

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

	2006	2007	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	15,6	19,3	23,8	19,0	18,3	15,2	15,7
Czech Rep.	5,5	6,1	5,3	5,2	5,5	7,5	2,0
Slovakia	8,1	8,2	11,0	5,9	6,5	8,9	2,4
Hungary	-2,5	0,7	1,9	0,8	-1,8	2,6	-5,4
Estonia	22,4	7,8	15,0	21,8	-5,7	5,6	5,2
Lithuania	17,4	15,8	24,4	18,7	15,3	8,4	10,7
Latvia	16,4	8,4	17,9	14,4	12,7	2,6	5,1
Bulgaria	14,7	21,7	35,9	24,7	19,7	14,0	
Romania	19,3	28,9	23,5	28,4	32,2	28,0	33,2

Source: EcoWin Economic

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

	2006	2007	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	14,6	8,4	10,2	7,2	8,2	8,2	13,4
Czech Rep.	14,4	14,5	16,1	14,5	15,7	13,2	12,3
Slovakia	21,0	16,0	22,7	18,1	8,5	16,0	12,2
Hungary	19,0	14,2	17,5	14,8	15,0	10,4	13,9
Estonia	8,3	1,5	6,5	3,3	-2,9	-0,2	-5,4
Lithuania	12,2	4,7	3,5	3,2	13,0	1,1	8,5
Latvia	6,5	11,1	8,4	8,7	11,1	17,1	6,5
Bulgaria	8,7	5,2	3,7	5,3	5,4	6,0	
Romania	10,6	8,8	12,0	3,5	4,8	14,9	24,6

Source: EcoWin Economic

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

	2006	2007	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	17,4	12,4	15,4	13,8	12,9	8,2	13,7
Czech Rep.	13,8	13,7	15,9	14,3	15,2	10,9	10,8
Slovakia	17,7	10,4	14,5	13,2	3,0	11,6	12,9
Hungary	14,7	12,1	13,1	13,4	13,6	9,1	10,2
Estonia	17,1	2,8	9,8	3,5	-0,4	-0,7	-3,8
Lithuania	13,8	9,1	10,6	14,7	9,5	2,5	14,5
Latvia	19,3	15,0	29,5	23,0	15,5	-1,8	-1,6
Bulgaria	14,0	9,9	14,7	11,1	9,3	5,7	
Romania	22,4	26,1	28,5	22,7	24,7	28,6	35,2

Source: EcoWin Economic

2. Indices of business cycle and economic activity

Table 6. Industrial output in relation to the corresponding period of previous year, in%

	2006	2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008
Poland	12,0	9,7	8,4	6,4	10,6	15,0	1,0	14,9
Czech Rep.	11,2	8,3	6,7	2,9	9,1	11,3	-2,1	
Slovakia	9,8	13,1	13,3	5,2	8,8	14,0	-1,4	
Hungary	10,3	8,3	5,6	5,3	6,6	13,0	1,7	
Estonia	7,4	6,8	6,1	0,5	4,0	3,9	-10,7	
Lithuania	7,4	4,1	3,6	7,2	6,5	11,4	4,5	15,7
Latvia	7,8	0,4	1,0	-5,1	0,7	-4,2	-5,7	
Bulgaria	6,1	9,2	9,0	5,0	8,2	5,4	-2,0	
Romania	7,2	5,4	4,5	2,6	6,0	7,6	3,0	

Source: EcoWin Economic, National statistical offices

Table 7. Retail sales in relation to the corresponding period of previous year, in%

	2006	2007	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008
Poland	11,9	14,6	16,3	15,1	8,1	16,1	19,2	11,7
Czech Rep.	6,5	7,8	9,4	5,9	5,4	4,0	6,3	-2,9
Slovakia	6,5	5,4	4,8	4,7	7,7	15,6	16,6	10,5
Hungary	4,4	-2,8	-3,6	-4,3	-4,0	-3,0	-2,6	-3,7
Estonia	19,0	15,2	-4,1	5,9	4,7	-0,9	4,9	-4,6
Lithuania	14,5	17,7	9,4	11,9	8,0	21,6	27,7	12,4
Latvia	19,8	19,9	14,8	11,0	1,4	-0,6	1,0	-3,4
Bulgaria	6,6	4,9	9,1	2,1	2,3	4,8	11,2	4,0
Romania	24,3	16,4	3,9	19,2	20,1	13,2	24,4	11,2

Source: EcoWin Economic, National statistical offices

Table 8. Consumer confidence index

	2006	2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	-12,7	-5,0	-1,3	-3,1	-2,1	-2,0	-0,3	-1,0
Czech Rep.	1,9	-2,2	-12,6	-10,9	-1,9	-1,4	-1,3	-5,9
Slovakia	-9,8	-0,2	-4,8	-4,0	-8,1	-8,8	-10,8	-14,0
Hungary	-32,9	-48,3	-44,7	-45,1	-45,1	-49,4	-52,2	-49,5
Estonia	10,1	2,8	-7,6	-12,5	-15,4	-14,1	-16,7	-19,2
Lithuania	0,4	4,6	-3,7	-5,3	-4,6	-6,6	-11,1	-14,9
Latvia	-5,0	-7,8	-14,0	-18,0	-17,7	-17,7	-21,9	-22,9
Bulgaria	-31,1	-26,4	-29,5	-28,9	-27,7	-30,1	-29,3	-29,5
Romania	-22,9	-14,3	-12,6	-19,8	-20,4	-15,7	-13,8	

Source: European Commission

Table 9. Business confidence index

	2006	2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	-8,0	-0,7	-0,9	-1,4	-1,3	-1,5	-3,5	-4,5
Czech Rep.	10,8	15,4	14,7	15,4	14,1	12,2	11,6	9,8
Slovakia	9,0	14,2	3,0	4,4	5,8	5,2	4,0	-6,0
Hungary	-0,7	0,3	-2,4	-5,2	-2,8	-4,2	-5,3	-1,9
Estonia	20,1	15,1	1,1	4,0	2,4	-0,4	-3,9	-5,5
Lithuania	5,1	5,7	4,7	5,3	-1,7	-5,2	-9,4	-3,6
Latvia	6,0	4,8	-0,1	-1,2	-3,5	-7,6	-9,5	-10,1
Bulgaria	4,8	11,7	9,6	13,7	12,3	11,0	11,7	13,2
Romania	2,1	3,0	1,1	2,3	3,0	0,9	1,5	-0,6

Source: European Commission

Table 10. PMI manufacturing index

	2006	2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	53,9	52,9	50,8	51,9	53,1	52,4	50,6	49,3
Czech Rep.	55,7	56,8	55,0	56,1	56,5	57,4	54,1	51,8
Hungary	54,0	53,6	53,8	56,9	50,6	52,5	52,7	51,6

Source: EcoWin Economic

3. Prices

Table 11. CPI in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	3,0	3,6	4,0	4,0	4,2	4,1	4,0	4,4
Czech Rep.	4,0	5,0	5,4	7,5	7,5	7,1	6,8	6,8
Slovakia	3,3	3,1	3,4	3,8	4,0	4,2	4,3	4,6
Hungary	6,7	7,1	7,4	7,1	6,9	6,7	6,6	7,0
Estonia	8,5	9,1	9,6	11,0	11,3	10,9	11,4	11,3
Lithuania	7,6	7,8	8,1	9,9	10,8	11,3	11,7	12,0
Latvia	13,2	13,7	14,1	15,7	16,7	16,7	17,4	17,9
Bulgaria	12,4	12,6	12,5	12,5	13,2	14,2	14,6	15,0
Romania	6,8	6,7	6,6	7,3	8,0	8,6	8,6	8,5

Source: EcoWin Economic

Table 12. PPI in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	2,0	2,5	2,3	2,9	3,2	2,9	2,5	
Czech Rep.	4,4	5,4	5,3	6,0	5,6	5,4	4,8	5,1
Slovakia	1,8	2,0	2,8	4,4	5,1	5,3	5,8	
Hungary	-1,4	0,4	1,6	4,3	4,9	5,7	6,5	
Estonia	9,1	8,6	8,7	8,3	8,3	8,0	7,2	
Lithuania	13,4	17,2	19,4	21,8	22,3	20,8	19,7	20,7
Latvia	15,9	13,9	13,1	11,0	11,4	10,5	12,1	
Bulgaria	11,3	13,2	11,3	12,9	13,9	15,4	13,6	
Romania	8,2	9,2	10,5	13,0	14,7	15,6	15,5	

Source: EcoWin Economic

Table 13. HICP in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	3,1	3,7	4,2	4,4	4,6	4,4	4,3	4,3
Czech Rep.	4,0	5,1	5,5	7,9	7,6	7,1	6,7	6,8
Slovakia	2,4	2,3	2,5	3,2	3,4	3,6	3,7	4,0
Hungary	6,9	7,2	7,4	7,4	6,7	6,7	6,8	6,9
Estonia	8,7	9,3	9,7	11,3	11,5	11,2	11,6	11,4
Lithuania	7,6	7,9	8,2	10,0	10,9	11,4	11,9	12,3
Latvia	13,2	13,7	14,0	15,6	16,5	16,6	17,4	17,7
Bulgaria	10,6	11,4	11,6	11,7	12,2	13,2	13,4	14,0
Romania	6,9	6,8	6,7	7,3	8,0	8,7	8,7	8,5

Source: Eurostat

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

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	3,6	5,0	5,5	5,1	3,8	3,0	2,3	2,0
Czech Rep.	4,7	6,2	4,8	5,6	4,1	3,3	1,0	4,7
Slovakia	4,8	3,3	2,6	1,7	1,6	2,5	1,8	3,7
Hungary	14,4	11,0	10,0	9,7	8,6	9,3	9,1	9,0
Estonia	7,8	10,9	11,0	10,0	10,8	10,5	10,6	13,1
Lithuania	12,3	11,4	11,9	12,4	13,9	15,9	14,3	15,5
Latvia	15,0	15,1	14,9	13,7	14,0	14,3	14,0	16,0
Bulgaria	12,6	10,9	9,7	9,7	12,3	16,2	17,6	18,2
Romania	10,0	9,3	9,0	9,3	9,4	10,2	10,4	10,2

Source: Eurostat

Table 15. HICP - processed food in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	6,6	7,4	8,1	8,4	8,5	8,5	8,7	8,8
Czech Rep.	10,8	14,5	16,0	16,4	15,4	13,7	13,4	12,0
Slovakia	5,6	6,5	7,4	8,3	8,6	8,6	9,3	8,9
Hungary	9,3	10,4	11,3	12,1	12,1	11,5	12,4	12,6
Estonia	10,7	12,3	13,4	16,1	16,8	15,9	16,9	16,9
Lithuania	14,4	14,1	14,0	15,2	17,3	17,7	19,0	19,4
Latvia	19,3	21,2	23,0	31,0	33,6	33,0	33,3	33,4
Bulgaria	19,7	20,1	20,2	19,7	19,8	22,0	23,5	24,7
Romania	9,6	10,0	9,9	10,2	10,7	11,3	12,1	12,7

Source: Eurostat

Table 16. HICP - energy in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	3,3	5,2	7,0	8,2	7,8	9,3	8,1	8,8
Czech Rep.	5,3	7,1	7,6	12,6	13,0	12,1	11,0	10,9
Slovakia	2,1	0,8	1,2	3,6	3,7	3,8	3,6	4,1
Hungary	8,0	11,2	12,6	12,3	10,7	11,5	11,8	13,2
Estonia	14,8	15,9	18,2	26,2	25,0	24,6	26,9	26,3
Lithuania	8,4	9,9	11,3	19,1	18,4	17,3	17,5	18,9
Latvia	18,0	18,9	20,2	20,5	22,9	25,0	31,1	31,7
Bulgaria	9,3	11,8	12,0	13,5	14,7	13,6	11,3	12,7
Romania	5,6	7,1	5,3	4,0	5,3	8,1	9,1	8,4

Source: Eurostat

Table 17. HICP - excluding food and energy in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	1,5	1,5	1,7	2,0	2,3	2,4	2,4	2,3
Czech Rep.	1,4	1,5	1,5	4,2	4,2	4,3	4,2	4,2
Slovakia	1,4	1,6	1,6	2,0	2,2	2,5	2,5	2,8
Hungary	4,9	4,8	4,7	4,4	3,8	3,7	3,6	3,4
Estonia	7,1	6,8	6,8	7,1	7,4	7,4	7,2	6,5
Lithuania	3,7	4,1	4,3	5,1	5,8	6,5	7,1	7,1
Latvia	9,7	9,6	9,4	9,7	9,9	9,9	10,0	10,0
Bulgaria	7,7	8,6	9,0	8,9	9,2	9,8	9,9	10,1
Romania	3,6	4,1	4,7	5,5	5,6	6,1	5,9	5,1

Source: Eurostat

4. Balance of payments

Table 18. Current account balance in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Poland	-3,1	-3,2	-2,4	-4,1	-3,1	-4,9	-3,1	-3,6
Czech Rep.	0,9	-5,7	-5,4	-6,0	1,6	-4,8	-4,7	-3,5
Slovakia	-6,3	-9,6	-10,3	-6,9	-0,9	-8,2	-6,6	-5,3
Hungary	-7,4	-6,6	-5,2	-4,4	-5,2	-6,6	-5,2	-4,1
Estonia	-14,0	-13,2	-14,4	-17,6	-21,3	-14,1	-17,0	-14,5
Lithuania	-10,4	-9,0	-12,1	-11,6	-11,0	-13,0	-12,4	-12,0
Latvia	-14,5	-17,4	-23,3	-26,1	-26,3	-23,5	-24,8	-17,7
Bulgaria	-21,4	-12,5	-5,1	-22,2	-27,3	-19,6	-12,7	-27,7
Romania	-9,3	-11,2	-10,1	-10,2	-15,1	-16,8	-11,0	-14,2

Source: Eurostat, Central Bank, own calculations

Table 19. Poland, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-3,1	-3,2	-2,4	-4,1	-3,6	-4,7	-3,1	-3,6
Goods	-1,3	-1,9	-2,4	-2,4	-3,4	-4,1	-3,5	-3,6
Services	0,5	0,5	0,6	0,9	0,9	0,7	0,6	1,4
Income	-3,4	-4,8	-4,0	-4,7	-3,3	-3,5	-2,4	-3,0
Current transfers	1,1	3,0	3,4	2,1	2,1	2,2	2,2	1,6
Capital account	0,6	0,3	0,8	0,8	0,6	0,7	1,1	1,8
Financial account	3,5	1,3	1,0	5,0	3,4	7,1	3,9	5,4
FDI	5,4	2,6	2,3	1,7	4,7	2,8	4,1	2,2
Portfolio investments	3,6	-3,5	-2,0	-1,0	-0,9	-2,6	-3,2	1,6
Other investments	-4,0	5,3	2,6	2,1	2,0	10,4	5,4	7,0

Source: Eurostat, Central Bank, own calculations

Table 20. Czech Republic, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	0,9	-5,7	-5,4	-6,0	2,7	-4,0	-4,7	-3,5
Goods	3,5	0,9	0,6	0,8	5,6	2,9	2,1	2,9
Services	0,2	0,4	0,8	0,1	1,5	2,0	1,7	1,1
Income	-2,8	-6,8	-6,4	-6,6	-4,1	-8,3	-8,3	-7,6
Current transfers	0,0	-0,3	-0,3	-0,3	-0,2	-0,5	-0,3	0,1
Capital account	0,3	-0,2	0,3	0,6	0,3	0,0	0,4	1,5
Financial account	-0,8	3,3	4,5	5,2	-0,8	2,2	3,6	4,6
FDI	1,8	2,6	5,0	3,5	4,2	3,5	3,8	6,3
Portfolio investments	-1,1	-4,4	-1,5	3,5	-2,4	-0,7	-4,5	1,4
Other investments	-1,9	5,2	2,6	-1,2	-2,9	-2,8	6,2	-0,9

Source: Eurostat, Central Bank, own calculations

Table 21. Slovakia, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-6,3	-9,6	-10,3	-6,9	-0,9	-6,8	-6,6	-5,3
Goods	-6,2	-5,6	-4,7	-6,0	-0,4	-1,4	-1,0	-0,7
Services	1,2	0,9	1,3	1,4	0,3	1,3	0,9	0,7
Income	-1,2	-6,0	-5,9	-1,9	0,3	-5,9	-5,6	-4,6
Current transfers	-0,1	1,1	-1,1	-0,3	-1,0	-0,7	-0,9	-0,7
Capital account	-0,1	0,0	-0,1	-0,1	1,0	0,3	0,1	1,1
Financial account	4,0	10,1	3,3	9,2	-5,9	6,0	8,1	7,0
FDI	4,9	10,2	8,0	4,4	-0,7	5,7	4,6	3,4
Portfolio investments	10,8	2,3	-0,2	-0,2	-5,5	5,6	0,2	-0,3
Other investments	-4,9	-6,2	-24,3	5,9	17,9	0,0	3,0	6,5

Source: Eurostat, Central Bank, own calculations

Table 22. Hungary, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-7,4	-6,6	-5,2	-4,4	-4,9	-5,9	-5,2	-4,1
Goods	-1,5	0,0	-1,3	0,6	1,2	1,7	1,2	1,4
Services	0,2	1,3	1,9	1,1	0,8	1,4	1,6	0,6
Income	-7,2	-7,8	-6,1	-6,3	-7,7	-9,2	-7,3	-7,3
Current transfers	1,0	-0,1	0,4	0,1	0,8	0,1	-0,8	1,1
Capital account	0,1	0,2	0,9	1,3	0,2	0,1	2,4	1,3
Financial account	11,2	10,5	8,9	6,8	8,9	9,0	4,2	4,8
FDI	9,0	0,5	5,1	-2,3	0,2	-5,4	3,6	0,2
Portfolio investments	19,4	-11,8	4,5	12,3	8,6	-0,8	-8,1	-1,1
Other investments	-6,2	15,5	-2,6	-4,8	2,1	13,0	5,7	3,5

Source: Eurostat, Central Bank, own calculations

Table 23. Estonia, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-14,0	-13,2	-14,4	-17,6	-23,4	-15,3	-17,0	-14,5
Goods	-12,6	-16,5	-18,9	-17,8	-18,5	-18,0	-17,3	-14,4
Services	4,1	7,6	7,8	5,3	4,2	7,7	7,4	5,3
Income	-5,2	-5,2	-3,5	-4,5	-8,7	-6,0	-7,0	-5,7
Current transfers	-0,3	1,0	0,1	-0,5	-0,4	1,0	0,0	0,3
Capital account	2,7	1,4	2,3	2,6	0,8	1,3	0,5	3,5
Financial account	12,2	10,4	11,1	18,0	21,3	11,4	15,6	11,6
FDI	12,7	-1,0	0,6	2,9	9,2	0,4	1,7	6,9
Portfolio investments	-26,2	-2,5	-12,1	7,7	-2,2	-4,0	-3,4	-0,3
Other investments	23,7	15,7	30,0	13,1	13,3	14,9	26,9	0,6

Source: Eurostat, Central Bank, own calculations

Table 24. Lithuania, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-10,4	-9,0	-12,1	-11,6	-14,0	-16,8	-12,4	-12,0
Goods	-12,8	-12,4	-14,6	-15,5	-16,0	-16,4	-13,0	-13,7
Services	3,5	4,0	3,5	3,5	2,1	1,7	3,0	1,7
Income	-3,2	-3,9	-2,9	-1,3	-4,0	-4,7	-5,3	-3,0
Current transfers	2,2	3,3	1,9	1,6	3,9	2,6	2,9	2,9
Capital account	1,4	0,7	1,0	1,6	1,1	1,7	2,3	1,8
Financial account	9,1	7,5	13,0	11,9	11,9	15,4	8,9	13,6
FDI	2,8	1,2	2,7	12,5	4,8	3,4	4,6	1,6
Portfolio investments	3,2	-2,7	-4,1	1,0	-7,5	-0,3	-3,8	6,5
Other investments	5,5	9,4	16,3	12,0	11,6	17,2	9,7	12,8

Source: Eurostat, Central Bank, own calculations

Table 25. Latvia, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-14,5	-17,4	-23,3	-26,1	-26,4	-23,5	-24,8	-17,7
Goods	-22,3	-21,8	-25,6	-26,2	-27,2	-25,8	-25,4	-20,3
Services	4,7	4,7	2,8	1,9	3,0	4,0	3,7	3,8
Income	-2,2	-2,8	-1,9	-2,9	-2,7	-4,8	-3,1	-3,4
Current transfers	5,3	2,4	1,4	1,2	0,4	3,1	0,0	2,3
Capital account	1,7	1,4	0,8	1,0	2,1	0,8	0,6	4,6
Financial account	16,2	18,4	22,0	24,4	30,0	25,2	26,9	14,3
FDI	9,4	8,0	3,8	8,5	8,8	10,7	5,3	4,5
Portfolio investments	-5,6	2,6	-1,1	2,5	-2,5	-4,2	-1,3	1,4
Other investments	19,2	18,2	29,3	21,1	24,2	22,7	27,2	9,6

Source: Eurostat, Central Bank, own calculations

Table 26. Bulgaria, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-21,4	-12,5	-5,1	-22,8	-27,3	-19,5	-12,7	-27,7
Goods	-20,6	-19,3	-18,9	-24,0	-27,3	-25,1	-22,3	-27,5
Services	-3,5	3,5	10,9	-0,3	-1,0	5,5	11,4	-1,4
Income	0,4	0,7	-0,3	-0,5	-0,2	-1,2	-2,7	-0,1
Current transfers	2,3	2,6	3,2	2,1	1,2	1,2	0,9	1,3
Capital account	0,4	0,8	0,7	0,9	0,5	0,6	0,9	2,5
Financial account	30,0	21,7	11,7	19,8	29,0	27,0	14,5	27,7
FDI	15,0	20,5	11,6	14,7	15,7	23,0	22,3	19,9
Portfolio investments	1,4	-1,3	1,7	0,0	-4,1	-0,4	-0,1	-3,2
Other investments	-3,5	11,2	0,7	6,1	18,3	16,8	18,2	13,2

Source: Eurostat, Central Bank, own calculations

Table 27. Romania, components of balance of payment in percentage of GDP

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Current account	-9,3	-11,2	-10,1	-10,2	-17,1	-16,3	-11,0	-14,2
Goods	-9,9	-12,6	-11,2	-13,6	-17,6	-16,4	-12,5	-13,5
Services	0,1	1,0	0,2	-0,9	1,0	0,2	-0,3	-0,4
Income	-3,7	-4,0	-2,9	-2,4	-5,6	-5,0	-2,8	-3,0
Current transfers	4,2	4,4	3,8	6,6	5,1	4,9	4,3	2,8
Capital account	0,7	-2,4	0,3	0,9	0,4	0,7	0,5	0,9
Financial account	7,5	13,3	6,8	10,6	17,7	16,1	9,4	12,7
FDI	10,3	6,8	7,0	12,3	9,0	6,1	5,5	4,1
Portfolio investments	1,2	0,1	-0,9	0,2	-0,3	1,0	0,2	-0,2
Other investments	6,8	9,5	4,6	7,0	10,1	11,3	13,4	9,0

Source: Eurostat, Central Bank, own calculations

5. Interest rates and exchange rates

Table 28. Central bank main policy rates as at the end of the month

	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008	06.2008
Poland	5,00	5,00	5,25	5,50	5,75	5,75	5,75	6,00
Czech Rep.	3,50	3,50	3,50	3,75	3,75	3,75	3,75	3,75
Slovakia	4,25	4,25	4,25	4,25	4,25	4,25	4,25	4,25
Hungary	7,50	7,50	7,50	7,50	7,50	8,25	8,50	8,50
Romania	7,50	7,50	8,00	9,00	9,50	9,50	9,75	9,75

Source: Central Banks, EcoWin Financial

Table 29. Interbank interest rates, average, 3M

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	5,21	5,56	5,68	5,65	5,94	6,15	6,34	6,48
Czech Rep.	3,58	3,93	4,11	3,92	3,96	4,10	4,13	4,16
Slovakia	4,34	4,33	4,30	4,30	4,28	4,28	4,30	4,36
Hungary	7,39	7,49	7,50	7,50	7,80	8,23	8,43	8,71
Estonia	5,17	6,25	7,30	6,73	6,60	6,35	6,32	6,47
Lithuania	6,23	6,82	6,65	5,20	4,83	4,95	5,07	5,19
Latvia	12,64	11,37	10,53	8,08	7,09	6,00	5,78	6,04
Bulgaria	6,03	6,46	6,54	6,65	6,65	6,72	6,82	6,89
Romania	7,83	8,17	8,38	9,31	10,70	10,96	11,87	

Source: EcoWin Financial

Table 30. Exchange rates of national currencies toward euro, monthly averages

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	3,64	3,61	3,59	3,62	3,53	3,54	3,44	3,40
Czech Rep.	26,97	26,26	26,63	26,07	25,23	25,21	25,06	25,10
Slovakia	33,33	33,16	33,58	33,78	32,53	32,50	32,37	31,47
Hungary	251,41	253,00	253,73	259,46	264,15	259,94	253,75	247,69
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	3,34	3,49	3,61	3,72	3,73	3,72	3,64	3,66

Source: Eurostat

Table 31. Exchange rates of national currencies toward euro in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	-6,1	-5,2	-6,2	-7,7	-9,9	-9,0	-9,8	-10,0
Czech Rep.	-4,4	-6,1	-3,1	-7,4	-10,8	-10,2	-10,5	-11,1
Slovakia	-8,2	-6,7	-2,5	-3,8	-5,5	-3,9	-3,3	-6,7
Hungary	-3,4	-1,3	0,8	0,9	3,7	4,0	3,2	-0,3
Romania	-5,2	1,5	6,6	9,2	9,9	10,4	9,3	11,4

Source: Eurostat, own calculations

Table 32. NEER in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	6,6	6,4	7,4	9,5	10,7	12,6	13,7	13,7
Czech Rep.	4,8	6,7	7,0	8,9	13,1	14,0	14,6	14,9
Slovakia	10,6	9,4	5,6	4,8	4,9	5,4	4,8	8,3
Hungary	8,3	3,9	1,9	1,2	-1,7	-1,4	-0,5	2,8
Estonia	1,6	2,1	1,8	2,1	1,7	2,3	2,4	2,2
Lithuania	0,8	1,3	0,9	1,3	1,0	1,6	1,8	1,6
Latvia	-0,3	0,7	1,0	1,2	1,5	2,5	3,0	2,7
Bulgaria	0,8	1,3	0,8	1,5	1,4	3,1	2,4	1,0
Romania	5,9	1,9	-2,6	-6,6	-6,0	-7,5	-5,6	-7,9

Source: BIS, own calculations

Table 33. REER in relation to the corresponding period of previous year, in%

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	6,0	6,1	7,5	9,8	10,8	12,4	13,6	13,6
Czech Rep.	5,8	8,3	9,0	12,8	16,9	17,2	17,5	17,9
Slovakia	10,6	8,7	5,1	4,4	4,6	5,2	4,7	8,2
Hungary	12,1	7,4	5,7	4,5	1,0	1,0	1,9	5,2
Estonia	6,3	6,9	7,0	7,5	7,1	8,1	8,7	8,5
Lithuania	4,4	4,7	4,5	6,2	6,6	7,6	8,1	7,9
Latvia	8,7	9,7	10,3	11,7	12,8	11,9	13,1	12,7
Bulgaria	9,5	9,7	9,0	9,6	9,8	14,4	14,3	12,7
Romania	9,6	4,7	0,0	-3,6	-2,5	-3,6	-1,6	-4,0

Source: BIS, own calculations

6. Labour market

Table 34. Employment in relation to the corresponding period of previous year, in%

	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	3,7	3,8	3,6	4,2	4,2	4,4	4,6	5,5
Czech Rep.	1,3	1,5	1,9	1,8	1,5	1,4	1,4	
Slovakia	4,5	3,8	3,5	3,1	1,9	2,0	2,8	
Hungary	1,1	0,5	0,9	0,5	0,1	-0,2	-1,2	-1,6
Estonia	6,7	6,2	5,9	1,9	1,3	1,9	0,5	1,5
Lithuania	1,9	1,3	0,9	1,6	2,8	3,2	1,8	
Latvia	4,2	7,2	5,1	2,6	3,4	1,1	4,3	4,9
Bulgaria	4,3	3,3	5,9	4,9	3,0	2,1	1,6	3,3
Romania	0,8	1,2	1,6	2,3	2,8	2,9	3,0	2,3

Source: EcoWin Economic, own calculations

Table 35. Unemployment rate as percentage of labour force

	10.2007	11.2007	12.2007	01.2008	02.2008	03.2008	04.2008	05.2008
Poland	11,3	11,2	11,4	11,7	11,5	11,1	10,5	
Czech Rep.	5,8	5,6	6,0	6,1	5,9	5,6	5,2	5,0
Slovakia	7,9	7,8	8,0	8,1	7,8	7,6	7,4	
Hungary	7,5	7,7	8,1	8,0	8,0	7,7		
Estonia	4,1	4,1	4,1	4,2	4,2	4,2		
Lithuania	4,2	4,2	4,2	4,9	4,9	4,9		
Latvia	4,9	4,8	4,9	5,0	5,0	4,9	4,8	4,8
Bulgaria	6,7	6,6	6,9	7,4	7,3	6,8	6,5	
Romania	4,1	4,2	4,1	4,3	4,3	4,2	3,9	3,8

Source: EcoWin Economic

Table 36. Nominal wages in relation to the corresponding period of previous year, in%

	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007	I 2008
Poland	4,7	5,0	5,3	7,8	8,9	9,8	10,0	11,5
Czech Rep.	6,6	5,9	6,1	7,9	7,4	7,5	6,8	
Slovakia	9,5	8,3	8,6	6,9	7,0	7,1	8,5	
Hungary	7,1	9,0	9,4	7,1	8,9	8,8	7,3	6,5
Estonia	15,0	16,5	17,5	20,4	21,6	20,2	20,3	19,4
Lithuania	14,1	19,9	19,1	20,9	20,2	17,9	18,5	23,8
Latvia	21,8	22,8	29,3	31,6	32,2	32,9	29,9	28,1
Bulgaria	17,8	19,0	32,1	17,6	19,6	21,7	23,2	24,4
Romania	9,8	12,0	14,1	20,0	23,5	24,1	22,7	24,4

Source: EcoWin Economic, own calculations

Table 37. ULC in relation to the corresponding period of previous year, in%

	I 2006	II 2006	III 2006	IV 2006	I 2007	II 2007	III 2007	IV 2007
Poland	2,5	2,6	2,2	1,8	4,3	7,3	6,8	7,0
Czech Rep.	1,6	1,5	1,1	1,8	3,6	2,9	2,8	1,5
Slovakia	2,7	6,0	3,1	3,8	1,0	-0,6	-0,3	-3,0
Hungary	3,3	4,7	5,6	6,6	4,9	7,9	7,9	5,4
Estonia	11,0	10,5	11,6	12,4	12,0	14,9	15,7	15,8
Lithuania	7,6	7,0	14,9	12,7	11,3	12,0	10,2	12,3
Latvia	8,8	14,9	18,1	22,7	26,7	28,8	22,7	21,3
Bulgaria	7,8	7,8	8,7	14,4	18,4	16,7	19,2	21,5
Romania	13,7	10,8	11,8	26,1	20,8	21,1	20,1	13,3

Source: Eurostat, EcoWin Economic, own calculations

7. Public finance

Table 38. General government balance as percentage of GDP

	2000	2001	2002	2003	2004	2005	2006	2007
Poland	-3,0	-5,1	-5,0	-6,3	-5,7	-4,3	-3,8	-2,0
Czech Rep.	-3,7	-5,7	-6,8	-6,6	-3,0	-3,6	-2,7	-1,6
Slovakia	-12,2	-6,5	-8,2	-2,7	-2,4	-2,8	-3,6	-2,2
Hungary	-2,9	-4,0	-8,9	-7,2	-6,5	-7,8	-9,2	-5,5
Estonia	-0,2	-0,1	0,4	1,8	1,6	1,8	3,4	2,8
Lithuania	-3,2	-3,6	-1,9	-1,3	-1,5	-0,5	-0,5	-1,2
Latvia	-2,8	-2,1	-2,3	-1,6	-1,0	-0,4	-0,2	0,0
Bulgaria	:	0,4	-1,0	-0,5	1,4	1,8	3,0	3,4
Romania	-4,4	-3,5	-2,0	-1,5	-1,2	-1,2	-2,2	-2,5

Source: Eurostat

Table 39. Public debt as percentage of GDP

	2000	2001	2002	2003	2004	2005	2006	2007
Poland	36,8	37,6	42,2	47,1	45,7	47,1	47,6	45,2
Czech Rep.	18,5	25,1	28,5	30,1	30,4	29,7	29,4	28,7
Slovakia	50,4	49,0	43,4	42,4	41,4	34,2	30,4	29,4
Hungary	54,3	52,1	55,7	58,0	59,4	61,6	65,6	66,0
Estonia	5,2	4,8	5,6	5,5	5,1	4,5	4,2	3,4
Lithuania	23,7	23,1	22,4	21,2	19,4	18,6	18,2	17,3
Latvia	12,3	14,0	13,5	14,6	14,9	12,4	10,7	9,7
Bulgaria	74,3	67,3	53,6	45,9	37,9	29,2	22,7	18,2
Romania	24,7	26,0	25,0	21,5	18,8	15,8	12,4	13,0

Source: Eurostat