Developments in Selected CESEE Countries: Heterogeneous Growth Performance, Improving Fiscal and External Accounts[1,2,3]

1 Introduction

External environment worsens in fall and early winter 2011 before stabilizing from the turn of the year

Changes in the international environment continued to impact strongly on economic developments in Central, Eastern and Southeastern Europe (CESEE) throughout the review period (October 2011 to April 2012). The intensification of the sovereign debt crisis in some euro area countries in the latter part of 2011, followed by stabilization thereafter, has been particularly relevant for both real and financial sector developments in the CESEE region.

Consequently, in the fall of 2011, the risk assessment of the CESEE region deteriorated markedly. Sovereign CDS premiums and Eurobond spreads increased and some currencies weakened. Although the magnitude of the increases varied across CESEE countries, given differences in underlying vulnerability, spreads generally widened considerably (but much less so than for peripheral euro area countries). Hungary was most affected in the region, as greater domestic policy uncertainty amplified the volatility in international markets. Since the turn of the year, spreads have moderated again to close to their level of September 2011, while currencies have moved sideways or have strengthened again, recovering the ground lost in the last months of 2011.

External demand also softened considerably during the latter part of 2011 before stabilizing from the turn of the year. This has had an impact on the demand for exports from CESEE countries (see below for a more detailed discussion). As a consequence, growth projections for 2012 for the advanced economies, in particular for the euro area, were revised downward, which will also have an effect on growth developments in the CESEE region.[4]

Concerns about cross-border deleveraging affecting CESEE mounted in late 2011, have abated since then, and remain a risk factor looking ahead

Increased funding pressures and higher capital requirements prescribed by the European Banking Authority (EBA) raised serious concerns in the latter part of 2011 about deleveraging, in particular cross-border deleveraging by European banks. Such deleveraging would affect the CESEE region and lead to a credit crunch there, as the lion's share of credit in these countries is provided by Western European banks, either through subsidiaries or via direct cross-border lending. However, the ECB's long-term refinancing operations, which had a positive impact on the liquidity conditions of euro area banks as well as their CESEE subsidiaries – these account for most of the banks active in the CESEE region– as well as parent banks' plans to reach EBA requirements with only marginal reductions on the asset side of their balance sheets have allayed these concerns more recently, at least for the time being.

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[2] *Cutoff date: April 11, 2012 (April 23, 2012, for fiscal data). This report focuses primarily on data releases and developments from October 2011 up to the cutoff date, while selectively recalling earlier developments wherever needed to put recent developments into perspective.*

[3] *This report covers Slovakia, Slovenia, the Czech Republic, Bulgaria, Hungary, Poland, and Romania, as well as Croatia, Turkey and Russia.*

[4] *For details, see the chapter on the CESEE forecast in this issue of the FEEI.*

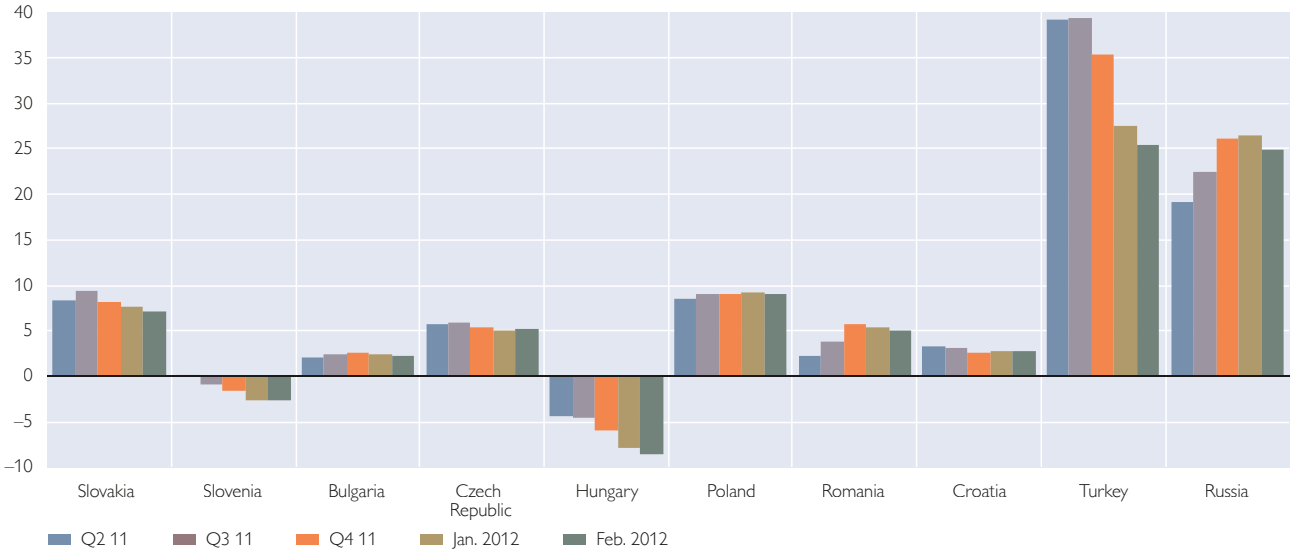
Recent data also suggest that there has been no deleveraging for the region as a whole so far. Exchange rate-adjusted BIS data for the third quarter of 2011 show that European banking groups broadly kept their overall exposure to CESEE unchanged, with some declines in foreign claims only in very few countries (in particular Hungary and to a lesser extent also Slovenia).[5]

The latest figures on the development of the outstanding credit stock point in the same direction as the BIS data. There was no broad-based decline in credit growth during the review period. In some countries, credit growth actually accelerated in the fourth quarter of 2011 (e.g. in Russia, to a lesser extent also in Romania). Some other countries have reported moderating credit dynamics. The decline in growth rates, however, has been mostly moderate. Where it was more substantial, like in Hungary and Turkey, the development was often related to country-specific factors, e.g. the possibility of an early repayment of foreign currency mortgage loans as well as the impact of a high bank tax in Hungary and the tightening of liquidity by the central bank in order to rein in previously very buoyant credit dynamics in Turkey. Developments in the first two months of 2012 show no fundamental trend changes compared to the final quarter of 2011. Credit growth declined further in Hungary and Turkey, but remained broadly unchanged in the rest of the region. It can be noted, however, that credit dynamics no longer accelerated in any country under observation. Still, deleveraging remains a risk, as long as fragilities in the Western European banking system have not been fully addressed.

Chart 1

Growth of Credit to the Private Sector

%, year on year, adjusted for exchange rate changes



Note: Turkey: not adjusted.

Source: National central banks.

[5] *Data for the fourth quarter, however, indicate that a moderate reduction foreign claims took place.*

While there has been no general deleveraging, lending conditions have tightened in the CESEE region. The Emerging Markets Bank Lending Conditions Survey of the Institute of International Finance (IIF), for example, reported that lending conditions in emerging Europe deteriorated considerably (and more strongly than in any other emerging market region) in the second half of 2011. In the first quarter of 2012, however, overall lending conditions deteriorated further only marginally, given the stabilizing funding environment of parent banks.

Real economy keeps up comparatively well in the region as a whole, with substantial differences among individual countries

In quarter-on-quarter terms, GDP growth picked up noticeably in the third quarter of 2011 and remained fairly strong also in the final quarter of 2011. However, these regional figures mask substantial differences across countries.

Growth in the region was boosted by bumper harvests in Russia, Romania, and Hungary, but also by the generally good performance of Russia and Turkey, the two largest economies in the region. These two economies are much less tightly interconnected with the euro area than most other CESEE countries and are viewed by financial markets as distinctive from the other CESEE countries. Moreover, growth in Russia benefited from rising oil prices. Apart from those two countries, Slovakia and Poland were also nearly unaffected by the economic downturn in Western Europe. Both countries have been growing at quarter-on-quarter rates of about 1% for several quarters, with industry and also construction (in Poland) delivering important growth contributions.

Slovenia, the Czech Republic and Croatia, on the other hand, reported anemic or negative growth for several quarters, as domestic economic weaknesses were amplified by the deterioration in the international environment. The same is true for Hungary, where the good performance of agriculture, however, kept GDP growth in positive territory. In Romania, the good growth reading in the third quarter was mainly due to agriculture, and the downturn in the fourth quarter was at least in part attributable to base effects.

Notable growth contributions of domestic demand only in the faster-growing countries

The development of GDP components underlines the dichotomy of growth developments in the CESEE region. Dynamics in the economically weaker countries

Table 1

Real GDP growth

	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Period-on-period change in % (seasonally and working-day adjusted)							
Slovakia	4.2	3.3	0.9	0.8	0.8	0.8	0.8	0.9
Slovenia	1.4	–0.2	0.4	0.7	–0.3	–0.1	–0.4	–0.7
Bulgaria	0.4	1.7	0.8	0.4	0.5	0.5	0.2	0.3
Czech Republic	2.7	1.7	0.7	0.6	0.5	0.3	–0.1	–0.1
Hungary	1.3	1.7	0.7	0.2	0.7	0.1	0.4	0.3
Poland	3.9	4.3	1.3	0.9	1.1	1.2	1.0	1.1
Romania	–1.7	2.5	–0.8	0.9	1.1	0.2	1.1	–0.2
Croatia	–1.2	–0.0	0.4	–0.2	0.0	0.4	0.1	–0.2
Turkey	9.2	8.5	1.1	3.6	1.4	1.3	1.7	0.6
Russia	4.3	4.3	0.3	2.3	0.9	–0.0	1.8	1.9
CESEE average[1]	4.5	4.6	0.6	2.0	1.0	0.5	1.4	1.1
Euro area	1.9	1.5	0.4	0.3	0.7	0.1	0.1	–0.3

Source: Eurostat, national statistical offices.

[1] Average weighted with GDP at PPP.

of the region were to a substantial extent driven by foreign demand, which delivered the only positive growth contributions in the final quarter of 2011. Weak domestic demand and the consequent subdued development of imports played a key role in promoting net exports.

In the faster-growing countries of the region, it was domestic demand that contributed more notably to growth. Private consumption was especially robust in Russia and Turkey, while capital formation provided stronger growth impulses in Slovakia and Poland. Both Russia and Turkey benefited from animated credit growth, somewhat improving labor market conditions and rising real wages. Investments in Slovakia were stimulated by rising capacity utilization, while a booming construction sector in the run-up to the 2012 European football championship had a positive impact in Poland. In most of the other countries, the consolidation of public finances, subdued labor markets as well as – in a few instances – ongoing efforts by households (in Slovenia also by the corporate sector) to reduce leverage hampered stronger domestic demand growth.

Sentiment and high-frequency activity indicators weaken in the second half of 2011, but improve somewhat in the first months of this year

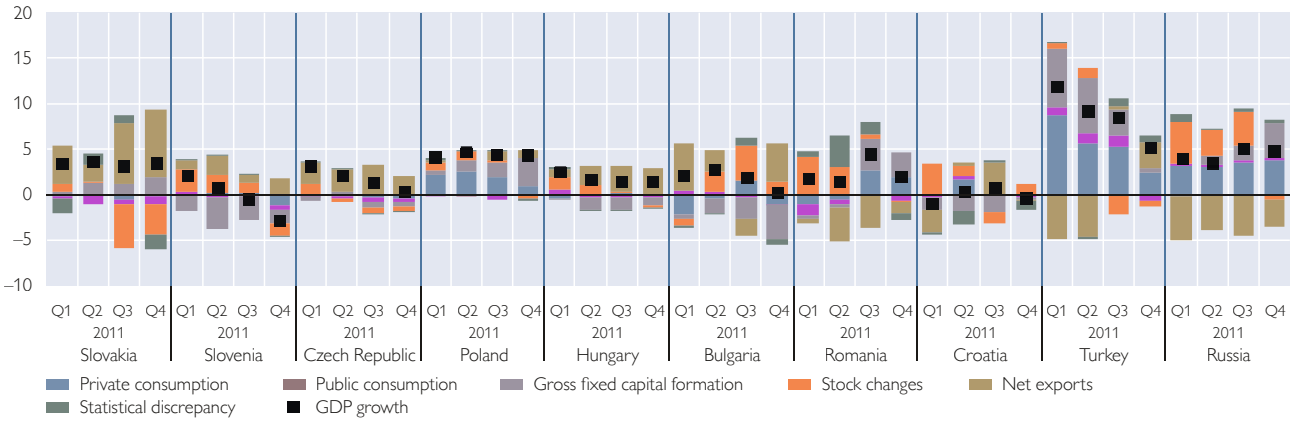
Sentiment indicators worsened in the latter part of 2011, while they have improved somewhat since the beginning of 2012. The economic sentiment indicator of the European Commission (which is available for EU Member States only), for example, reached a two-year low in December 2011. The average reading for the region was 89.2 points, nearly 5 points below the August reading and clearly below the long-run average of 100. By March 2012, the indicator had picked up again to 94.4 points.

The growth of industrial output declined moderately but steadily from 5.4% in August 2011 to 3.5% in February 2012. The decline was strongly influenced by developments in Turkey, where industrial dynamics decelerated more substantially than in the other countries, not least given a base effect after the very brisk performance in 2010. Russia, too, reported below-average growth rates of industrial production, with the performance of the extractive branches and of the production and distribution of electricity, gas and water weighing on the overall rate. Recently, however, the dynamics have picked up somewhat in Russia, a phenomenon that has

Chart 2

GDP Growth and Its Main Components

Percentage points, dots in %



Source: Eurostat, national statistical offices.

also been observed in Poland and Slovakia. Recent developments in retail sales have been heterogeneous across the region, with comparatively strong readings in Russia and Romania, while outturns in Bulgaria and Slovakia were particularly subdued. At the current juncture, a positive momentum, as in industrial production, cannot be observed yet.

Against this background, economic growth in CESEE is expected to pick up gradually during the course of 2012, but it will remain markedly below 2011 readings.[6]

Lower inflation rates in many countries

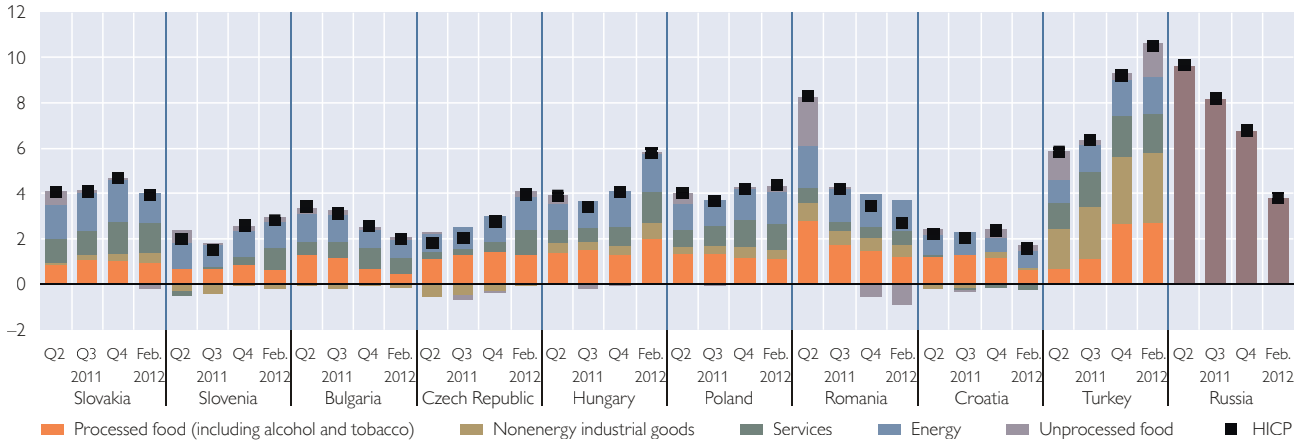
The average inflation rate in the ten CESEE countries covered here declined from around 6% in the third quarter of 2011 to around 5% in February 2012. This development was mostly driven by disinflation in Russia, but price dynamics moderated in Bulgaria and Romania as well. These countries benefited from the favorable development of food prices in the wake of bountiful harvests. The fact that food accounts for a large share of these countries' basket of goods further amplified the effect on the consumer price index. Croatia is currently recording the lowest inflation among the ten countries (about 1½% year on year in January and February 2012), largely due to weak domestic demand, which also pushed core inflation into negative territory in this country.

Some countries in the region, however, reported rising inflation rates, namely Turkey, Slovenia, Hungary and the Czech Republic. In the latter two, inflationary developments were strongly influenced by indirect tax hikes that took effect in January 2012. The value added tax rate was raised from 25% to 27% in Hungary, and the lower VAT rate in the Czech Republic went up from 10% to 14%. Moreover, energy price increases were higher than the regional average in both countries, also because of the depreciation especially of the Hungarian forint since mid-2011. Currency depreciation apparently had an influence on inflation developments in Turkey too. However, price dynamics in the country accelerated among all

Chart 3

HICP Inflation and Its Main Drivers

Percentage points, contribution to year-on-year change in HICP; HICP in %



Source: Eurostat.

Note: CPI for Russia. No breakdown according to COICOP available.

[6] *For the detailed OeNB-Bank of Finland forecast for CESEE, see this issue.*

subcategories amidst an environment of decelerating, but still strong domestic demand as well as higher food and energy prices.

Against this background, the Hungarian central bank raised its key interest rate, and the central bank of Turkey further tightened its policy stance in the review period. Furthermore, the Polish central bank adopted a tightening bias in April. Conversely, monetary policy was loosened slightly in Romania and Russia (for further details, see the respective country chapters).

Further external adjustment in the second half of 2011

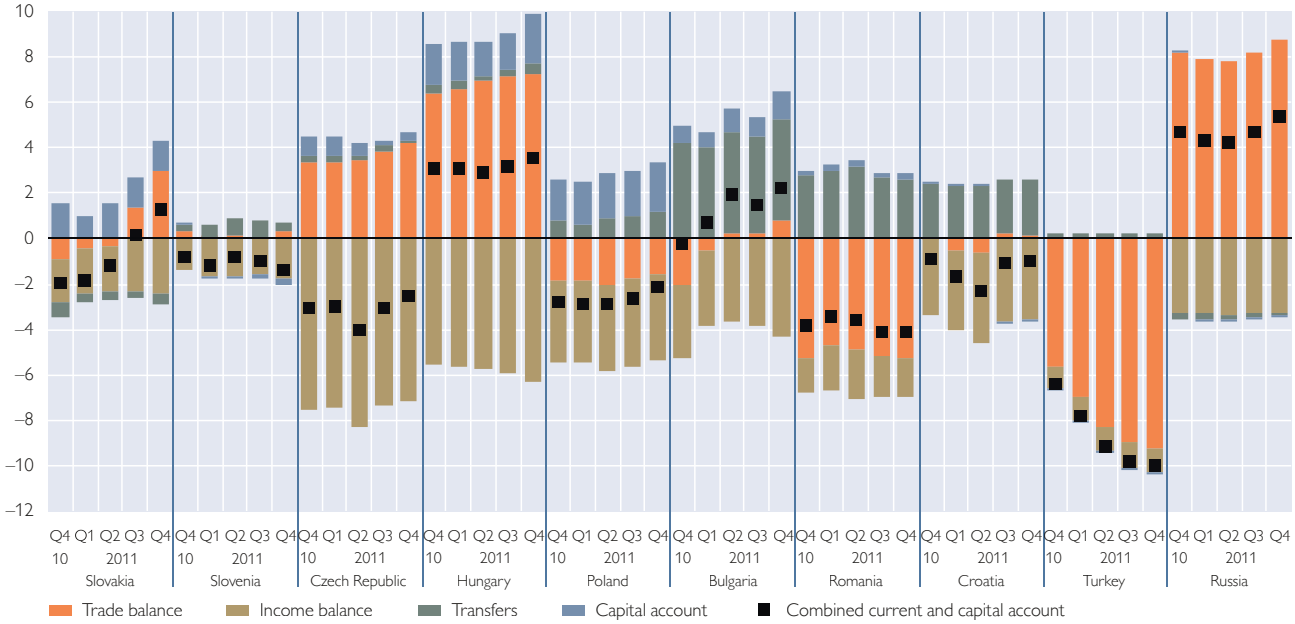
Current account positions in the CESEE region had improved substantially during the global financial crisis. This process came to a temporary halt in the first half of 2011. During the review period, however, external positions again improved in many CESEE countries. The average current account balance in the region turned from a deficit of 0.8% of GDP in the second quarter of 2011 into a slight surplus of 0.1% of GDP in the fourth quarter of 2011 (four-quarter moving sums). This trend was driven strongly by developments in Russia, which were in turn fueled by oil price movements, but it was also notable in Croatia, the Czech Republic and Slovakia, with the adjustment reaching 2.5 percentage points of GDP in Slovakia (measured from the second quarter of 2011 to the fourth quarter of 2011). Better outcomes in the trade balance were mostly responsible for this development, with a lower gap in the income balance playing a role in the Czech Republic too.

At first sight, the improved trade performance seems somewhat counterintuitive, as the international environment of the CESEE region clearly deteriorated in the review period. It needs to be borne in mind, however, that trade linkages with the euro area countries affected most strongly by the debt crisis are rather weak. In

Chart 4

Combined Current and Capital Account Balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

fact, Germany is by far the most important trading partner for the region, and the economic dynamics there remained comparatively solid until autumn 2011. Furthermore, and despite a clear deceleration, world trade also continued to expand at a rather robust 5.8% in 2011, and the international price competitiveness of the CESEE countries benefited from pronounced exchange rate deprecations in the second half of 2011. Apart from that, weak domestic demand as a dampening factor for imports influenced the trade performance in some countries.

Outflows of other investments weigh on the financial account

Net capital flows to the ten CESEE countries as a whole decelerated from 2.8% of GDP in the second quarter of 2011 (four-quarter moving sum), but remained positive in the latter part of the year despite the worsening of external developments and amounted to 0.9% of GDP in the fourth quarter of 2011 (four-quarter moving sum). Lower net inflows were mostly due to the changing dynamics of net flows of other investments, but also of portfolio investment flows. Developments in the regional aggregate were strongly influenced by Russia, which recorded capital outflows comparable to those in the crisis year 2008.

At the country level, capital inflows decreased substantially in Croatia, the Czech Republic, Poland and Romania (reflecting in part falling external financing needs), while they picked up somewhat only in Slovakia and Hungary. FDI inflows increased in Slovakia, Poland, Croatia and Bulgaria, but overall FDI inflows to the region remain rather low compared to precrisis developments. The FDI coverage ratio of countries with current account deficits was generally high and increasing (to around 80% or higher), with the exception of Romania and Turkey (34% and 17%, respectively).

Fiscal balances benefited from relatively strong economic dynamics in the first half of 2011, from ongoing consolidation efforts and – in Russia – from oil price developments

During the observation period, fiscal balances in CESEE continued to improve. The average deficit of the region contracted from –4.5% of GDP in 2010 to –0.7% of GDP in 2011. This reading is about 1.5% of GDP below the projections of early 2011, partly due to fairly good growth dynamics throughout the first half of the year. Accordingly, the decline in the cyclically adjusted deficit figures was somewhat less pronounced (from –3.6% of GDP in 2010 to –1.6% of GDP in 2012).

The regional average was strongly driven by developments in Russia. Against the background of solid economic dynamics and buoyant oil prices, the country turned its budget deficit into a surplus, with consolidation efforts amounting to 5% of GDP. The improvement, however, was in part also driven by the withdrawal of some anticrisis stimulus measures that had been introduced in 2008 to 2009.

Slovenia and Croatia were the only CESEE countries under review here to report a higher budget gap in 2011 compared to 2010, as both countries could not benefit tangibly from the stronger international momentum in the first half of 2011 and as consolidation efforts were stalling last year. In both countries, new administrations took over in early 2012 and started to renew fiscal consolidation efforts.

Excessive deficit procedures: Current state and outlook

All seven CESEE EU Member States covered here remained under the excessive deficit procedure (EDP) during the review period. In Hungary, the EDP was stepped up in early 2012. The deadlines for the correction of excessive deficits have remained unchanged: 2011 for Bulgaria, 2012 for Poland and Romania and 2013 for the Czech Republic, Slovakia and Slovenia. In early summer, the European Commission will review the progress toward reaching these deadlines, based on the final deficit figures for 2011 as checked by Eurostat and on the convergence program updates the Member States will provide to the Commission until end-April. The

Council will then decide about the Commission recommendations, presumably around mid-year. Given that Bulgaria lowered its deficit to clearly below 3% of GDP in 2011 and seems to be on track to retain moderate deficits in 2012 and beyond, it is expected that the EDP for Bulgaria will be lifted.

Some further progress with EU enlargement

During the review period, two important events related to EU enlargement took place: In December 2011, the EU and Croatia signed the accession treaty with Croatia; subsequently, the referendum on EU accession in Croatia brought a positive result. The accession treaty is expected to be ratified in the first half of 2013, so that Croatia will become an EU Member State on July 1, 2013. Furthermore, in March 2012, Serbia was granted EU candidate country status.

2 Slovakia: Export-Driven Growth in the Second Half of 2011, Fiscal Consolidation Challenges Ahead

Output growth in the second half of 2011 still driven by net exports and investment despite deterioration in external environment

After posting solid growth in 2010, the Slovak economy was again among the most dynamic EU economies in 2011, with annual growth coming to 3.3%. In the second half of 2011, output continued to advance broadly at the first-half pace, but the dynamics of its components changed considerably. In the second half of 2011, growth was driven by net exports, while domestic demand started to contribute negatively to growth. Even though both export and import growth slowed down considerably in the last two quarters, the dynamics of import growth decelerated much more than that of exports and even turned negative, so that the overall contribution of external demand to output growth almost doubled. This development was supported by new investments in automobile production lines. Household consumption as well as public consumption growth remained negative, with the former being dragged down by unfavorable labor market developments.

Current account improves considerably, inflation spikes

The current account improved substantially, turning positive in 2011 owing to an improvement in all of its components except the income balance, most notably a 3.5% of GDP surplus in the trade balance. The income balance continued to deteriorate in the second half of 2011, mainly due to the reinvestment of most earnings of foreign-owned companies. These reinvestments contributed to renewed net FDI inflows amounting to 1.7% of GDP in 2011 as a whole, after FDI inflows had temporarily dropped in the second quarter.

Average annual HICP inflation picked up to 4.1% in 2011. In the first half of 2011, higher global energy and food prices, a higher VAT rate (increase by 1 percentage point to 20%) and excise taxes fueled inflation. Regulated energy prices and transport prices pushed up inflation in the second half, and, to a lesser extent, in January and February 2012, when the HICP reached 4.1% and 4.0% year on year, respectively.

Labor market remains anemic

The labor market does not reflect recent economic growth. The employment rate rose at a declining pace throughout 2011 and still has not reached precrisis levels. The previous decline of the unemployment rate reversed in the second half of the year, when unemployment expanded by 0.8 percentage points to 14% in the fourth quarter. Unit labor costs in manufacturing increased by 2.3% in 2011, partly owing to a base effect from the previous year, with labor costs outpacing productivity growth, in particular in the second half of the year.

New government faces fiscal consolidation challenges

Subject to the excessive deficit procedure since 2009, Slovakia has committed itself to bringing the public deficit down to below 3% of GDP by 2013. At 4.8%, the deficit came in slightly lower than expected (4.9%, including a +0.8 percentage point methodological revision by Eurostat) in 2011, down from 7.7% in 2010. For 2012, a deficit of 4.6% is budgeted, with the consolidation measures comprising a public wage bill freeze (except for judges, prosecutors and teachers), a cut in goods and services spending (by 0.5% nominally) and a bank levy. However, the new single-party government which came out of the early elections in March 2012 will have to introduce further measures to meet the 2013 target in a sustainable manner. So far, the reintroduction of a progressive income tax, an increase of the just enacted bank levy and various changes to the pension system are being tentatively explored. Additionally, in late 2011, a new law on fiscal responsibility was adopted that imposes a constitutional limit on the public debt-to-GDP ratio of 60%, which is to decline gradually to 50% by 2028 (the public debt stood at 43.3% of GDP in 2011).

Table 2

Main Economic Indicators: Slovakia

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–4.9	4.2	3.3	4.0	3.7	3.4	3.5	3.0	3.4
Private consumption	0.2	–0.7	–0.4	–0.7	0.0	–0.2	–0.1	–0.8	–0.3
Public consumption	6.1	1.1	–3.5	2.1	–2.7	–1.7	–5.1	–3.3	–3.7
Gross fixed capital formation	–19.7	12.4	5.7	13.4	15.1	1.6	6.4	5.9	8.4
Exports of goods and services	–15.9	16.5	10.8	16.2	15.8	16.8	13.1	6.8	7.5
Imports of goods and services	–18.1	16.3	4.5	20.0	15.5	11.4	10.9	–1.8	–1.0
	Contribution to GDP growth in percentage points								
Domestic demand	–7.2	4.2	–1.5	6.4	3.7	0.8	0.4	–4.5	–2.4
Net exports of goods and services	2.3	0.0	5.1	–2.5	–0.0	4.2	1.9	6.6	7.4
Exports of goods and services	–13.3	11.7	8.8	10.9	12.0	13.4	10.6	5.2	6.5
Imports of goods and services	–15.6	11.7	3.7	13.4	12.1	9.2	8.7	–1.4	–0.9
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	7.3	–1.7	–0.7	0.2	–0.5	0.5	–0.7	–0.5	–2.0
Unit labor costs in manufacturing (nominal, per hour)	1.7	–16.5	2.3	–10.1	–8.1	–3.8	1.8	4.9	6.3
Labor productivity in manufacturing (real, per hour)	4.0	19.2	4.2	13.0	11.9	7.9	4.2	4.4	0.9
Labor costs in manufacturing (nominal, per hour)	4.9	0.5	6.7	1.6	2.9	3.7	6.1	9.4	7.2
Producer price index (PPI) in industry	–6.6	0.1	4.4	1.9	1.8	5.3	5.1	3.7	3.6
Consumer price index (here: HICP)	0.9	0.7	4.1	1.0	1.1	3.5	4.1	4.1	4.7
EUR per 1 SKK, + = SKK appreciation	3.8	3.8	3.8	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	12.1	14.4	13.6	14.2	13.9	13.9	13.2	13.2	14.0
Employment rate (%, 15–64 years)	60.2	58.8	59.5	59.2	59.3	59.0	59.6	59.9	59.5
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
SKK per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.2	4.4	0.7	3.5	4.4	2.8	3.9	5.0	0.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–1.4	1.3	–3.8	–1.6	1.3	0.3	2.5	–5.5	–3.8
Domestic credit of the banking system	23.0	9.2	9.4	12.0	9.2	4.2	3.8	4.4	9.4
of which: claims on the private sector	6.0	3.2	6.9	1.9	3.2	4.6	6.8	7.5	6.9
claims on households	3.5	4.2	3.9	3.8	4.2	4.3	4.5	4.3	3.9
claims on enterprises	2.4	–1.0	2.9	–1.9	–1.0	0.3	2.4	3.2	2.9
claims on the public sector (net)	17.0	6.0	2.5	10.2	6.0	–0.4	–3.0	–3.1	2.5
Other assets (net) of the banking system	–18.4	–6.1	–4.9	–7.0	–6.1	–1.7	–2.4	6.1	–4.9
	% of GDP, ESA 95								
General government revenues	33.5	32.4	32.6	. .	. .	. .	. .	. .	. .
General government expenditures	41.5	40.1	37.4	. .	. .	. .	. .	. .	. .
General government balance	–8.0	–7.7	–4.8	. .	. .	. .	. .	. .	. .
Primary balance	–6.6	–6.3	–3.2	. .	. .	. .	. .	. .	. .
Gross public debt	35.6	41.1	43.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–16.8	22.8	15.6	23.9	23.0	25.9	16.9	13.8	8.1
Merchandise imports	–20.0	25.5	10.9	32.7	29.0	25.3	17.4	4.6	0.6
	% of GDP (based on EUR), period total								
Trade balance	1.5	0.2	3.5	–1.9	–1.2	2.9	2.1	4.3	4.7
Services balance	–1.6	–1.1	–0.5	–0.9	–0.6	–0.8	–0.9	–0.7	0.2
Income balance (factor services balance)	–1.4	–1.9	–2.4	–1.2	–1.9	–2.5	–2.4	–2.3	–2.5
Current transfers	–1.1	–0.6	–0.5	–1.3	–0.7	1.4	–0.8	–1.1	–1.4
Current account balance	–2.6	–3.5	0.1	–5.3	–4.4	1.0	–1.9	0.2	1.0
Capital account balance	0.7	1.5	1.3	1.8	1.9	0.3	2.3	1.1	1.3
Foreign direct investment (net)	–1.0	0.2	1.7	–2.3	1.1	1.7	–1.6	1.4	5.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	72.2	74.9	76.7	75.2	74.9	77.7	78.2	78.0	76.7
Gross official reserves (excluding gold)[1]	0.8	0.8	1.0	0.8	0.8	0.9	0.9	0.9	1.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	EUR million, period total								
GDP at current prices	62,795	65,744	69,058	17,445	16,855	15,853	17,192	18,258	17,756

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Given Slovakia's adoption of the euro, the concept of the calculation of international reserves changed as of the beginning of 2009. In particular, reserves no longer include foreign assets in euro or claims on euro area residents.*

3 Slovenia: New Government Commits to Fiscal Consolidation as Recession Looms

Economy slides into recession in the second half of 2011

Following economic growth of 1.4% year on year during the first half of 2011, the economy progressively slid into recession during the last two quarters. While the decline in investment moderated in the fourth quarter as negative trends in construction eased somewhat, changes in inventories sharply reduced GDP growth, unlike in the past several quarters, when they had made a large positive contribution. Domestic consumption contracted in the second half of the year, reflecting spending restraint in the public sector, poor labor market conditions, decelerating real wage growth and weak consumer confidence. Credit conditions tightened further in the second half of 2011, as net losses, funding pressures and recapitalization needs faced by Slovenian banks increased. At the same time, credit demand was constrained by the weak economic environment, high unemployment and income uncertainty, declining collateral value (house prices), lackluster investment activity and the high indebtedness of nonfinancial corporations. Export growth continued to slow in the second half of 2011, as did import growth, but net exports still contributed positively to the overall GDP growth rate.

Inflation picks up from lows seen in mid-2011 but remains under control

HICP inflation accelerated from the lows seen in July and August 2011 and reached 2.8% in February 2012. The acceleration since August 2011 was almost entirely attributable to core inflation, which increased from 0.1% to 1.8% in February 2012. On a positive note, both headline and core inflation in Slovenia was lower than the euro area average between early 2011 and January 2012, and the February spike in inflation was overwhelmingly attributable to energy price increases and a base effect. While the weakness of domestic consumption has likely mitigated demand-pull inflation, the growth rate of unit labor costs in the whole economy turned slightly positive in the final quarter of 2011 following negative annual unit labor cost growth since the beginning of 2010. However, the underlying trend may be more benign, as the developments in the fourth quarter were mainly due to a cyclical decline of productivity that outpaced the decline of labor costs.

New government promises fiscal consolidation, growth promotion, and privatization

Following parliamentary elections in early December 2011, a new center-right government was confirmed by parliament in mid-February 2012. So far the new government has indicated that the consolidation of public finances, the stimulation of economic growth and job creation rank high on its priority list. As a first step to tackle uncertainties around the 2012 budget, the government has sent to parliament a supplementary budget for 2012 to reduce the central government budget deficit to 3% of GDP.[7] The measures concentrate on reorganizing and streamlining the public sector, lowering wage costs and achieving savings in the social security and education systems as well as in subsidies and public investments. Also, the government signaled that it was not ready to provide fresh money (around EUR 300 million to EUR 400 million by mid-2012 as prescribed by the European Banking Authority) for the recapitalization of the country's biggest bank, NLB, but instead planned to reduce its stake in the bank from 55% to 25%. To revive the economy, the government intends to gradually reduce the tax burden, increase tax breaks for investment and R&D, cut red tape further for enterprises, accelerate privatization and attract foreign investors.

[7] *The 2012 budget was initially approved in November 2010 under substantially different economic assumptions.*

Table 3

Main Economic Indicators: Slovenia

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–8.0	1.4	–0.2	1.7	2.3	2.1	0.7	–0.5	–2.8
Private consumption	–0.1	–0.7	–0.3	–1.1	0.8	0.1	0.4	0.4	–1.9
Public consumption	2.9	1.5	–0.9	1.3	1.6	1.2	–1.3	–0.9	–2.6
Gross fixed capital formation	–23.3	–8.3	–10.7	–9.9	–7.2	–8.1	–15.1	–12.0	–6.9
Exports of goods and services	–17.2	9.5	6.8	11.4	8.3	10.9	8.3	5.5	3.0
Imports of goods and services	–19.6	7.2	4.7	5.9	7.8	9.6	5.0	4.4	0.3
	Contribution to GDP growth in percentage points								
Domestic demand	–10.3	–0.1	–1.6	–1.5	1.9	1.1	–1.5	–1.4	–4.4
Net exports of goods and services	2.3	1.5	1.4	3.2	0.3	0.9	2.2	0.8	1.8
Exports of goods and services	–11.5	5.6	4.5	6.6	5.0	7.0	5.4	3.6	2.0
Imports of goods and services	–13.8	4.1	3.0	3.4	4.7	6.1	3.2	2.8	0.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	8.9	–0.7	–0.4	0.0	–1.3	–1.1	–0.6	–0.7	1.0
Unit labor costs in manufacturing (nominal, per hour)	25.1	–0.5	0.3	–1.1	–1.8	–4.5	0.8	0.8	4.4
Labor productivity in manufacturing (real, per hour)	–15.9	3.9	1.6	4.4	6.0	7.2	2.3	–0.8	–1.9
Labor costs in manufacturing (nominal, per hour)	5.7	3.2	1.9	3.3	4.0	2.3	3.1	–0.1	2.4
Producer price index (PPI) in industry	–1.4	2.0	4.6	3.2	3.8	5.7	4.8	4.1	3.6
Consumer price index (here: HICP)	0.9	2.1	2.1	2.3	2.0	2.2	2.0	1.5	2.6
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.0	7.4	8.4	7.2	7.9	8.7	7.8	8.0	8.9
Employment rate (%, 15–64 years)	67.5	66.2	64.4	66.3	65.7	63.7	64.4	65.1	64.4
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
SIT per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.4	1.6	3.0	1.9	1.6	0.5	1.4	2.9	3.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	6.6	–4.0	7.2	–4.8	–4.0	–0.6	4.8	7.8	7.2
Domestic credit of the banking system	2.1	6.7	–3.2	8.4	6.7	2.3	0.1	–2.7	–3.2
of which: claims on the private sector	4.7	2.8	–3.9	3.1	2.8	1.1	0.2	–1.5	–3.9
claims on households	2.7	3.9	0.8	4.0	3.9	3.0	2.3	1.6	0.8
claims on enterprises	2.0	–1.1	–4.6	–0.9	–1.1	–1.9	–2.2	–3.0	–4.6
claims on the public sector (net)	–2.6	3.9	0.7	5.2	3.9	1.1	–0.0	–1.2	0.7
Other assets (net) of the banking system	–5.3	–1.2	–1.1	–1.7	–1.2	–1.1	–3.6	–2.2	–1.1
	% of GDP, ESA 95								
General government revenues	43.2	44.2	44.5	. .	. .	. .	. .	. .	. .
General government expenditures	49.3	50.2	50.9	. .	. .	. .	. .	. .	. .
General government balance	–6.1	–6.0	–6.4	. .	. .	. .	. .	. .	. .
Primary balance	–4.7	–4.4	–4.5	. .	. .	. .	. .	. .	. .
Gross public debt	35.3	38.8	47.6	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–19.4	13.8	12.5	17.5	14.9	19.2	13.7	10.2	7.6
Merchandise imports	–25.7	16.2	12.4	16.6	18.9	21.2	13.1	11.0	5.8
	% of GDP (based on EUR), period total								
Trade balance	–2.0	–3.4	–3.7	–2.6	–5.7	–3.7	–3.0	–3.2	–5.1
Services balance	3.3	3.7	4.0	3.8	3.5	3.8	4.3	3.9	4.0
Income balance (factor services balance)	–2.2	–1.4	–1.8	–2.2	–1.1	–1.7	–1.5	–2.1	–1.8
Current transfers	–0.4	0.3	0.4	0.1	2.2	0.6	0.3	–0.0	0.8
Current account balance	–1.3	–0.8	–1.1	–0.9	–1.0	–1.1	0.1	–1.4	–2.0
Capital account balance	–0.0	0.0	–0.3	0.2	–0.6	–0.1	–0.1	–0.1	–0.9
Foreign direct investment (net)	–1.8	0.9	2.1	0.6	3.7	0.6	2.6	2.1	3.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	114.1	114.9	116.6	118.1	114.9	120.1	118.6	119.6	116.6
Gross official reserves (excluding gold)[1]	1.9	2.0	1.8	1.9	2.0	1.8	1.8	1.8	1.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.4	0.4	0.3	0.4	0.4	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	35,311	35,416	35,639	9,178	8,967	8,362	9,223	9,183	8,870

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Given Slovenia's adoption of the euro, the concept of the calculation of international reserves changed as of the beginning of 2007. In particular, reserves no longer include foreign assets in euro or claims on euro area residents.*

4 Bulgaria: Slowing Economic Activity, Vanishing Macroeconomic Imbalances and Sound Fiscal Developments

Sluggish domestic demand and deteriorating external conditions weigh on fragile recovery

GDP growth in Bulgaria lost momentum in the second half of 2011 and came to 0.3% in the fourth quarter, bringing annual average growth in 2011 to 1.7%. Growth in 2011 was primarily driven by net exports and the rebuilding of inventories, while domestic demand components still imposed a drag on GDP growth. Private consumption stayed depressed in 2011 due to adverse labor market conditions, weak consumer confidence, shrinking lending to households and fiscal austerity measures. At the same time, gross fixed investment continued to decline given weak demand conditions and persistently low business confidence. Net exports continued to contribute positively to economic growth, but somewhat less so than in the first half of 2011.

Macroeconomic imbalances have been corrected

The still favorable development of net exports was also reflected in the current account, which posted a surplus of about 1.8% of GDP in the second half of 2011. The bulk of improvement, compared to the second half of 2010, came from the goods and services balance and the increase in current transfers, while the deficit in the income balance widened somewhat. The country's gross external debt-to-GDP ratio fell below 100% on the back of the amortization and repayment of external debt by the private sector (primarily corporates and banks).

Weak domestic demand also left its footprint on the development of prices. A negative contribution of prices for nonenergy industrial goods, together with declining food and energy prices, supported a continued disinflation process in the second half of 2011. Annual HICP inflation had steadily decreased from its peak of 4.6% in March 2011 to 2% in December. Since then, it has more or less stayed at this level, in spite of the significant rise in automotive fuel prices and administered prices at the beginning of 2012.

Continuing job reduction, positive unit labor cost growth in manufacturing

Notwithstanding the acceleration of economic activity in the first half of 2011, the annual employment rate contracted to 58.5% and the unemployment rate increased to 11.3% until the end of the year. Continuing job reduction, together with an increase in minimum wages in 2011, led to a further widening of labor costs. Labor productivity gains, which continued to decline, were no longer able to compensate for the wage increases, and the growth of unit labor costs in the manufacturing sector thus turned positive again in the second half of 2011 (for the first time since 2009).

Mixed financial sector developments

In contrast to lending to households, credit to enterprises started to show positive dynamics in the second half of 2011. However, overall lending to the private sector grew only meagerly. This cautious revival of credit activity is backed by the steady growth of bank deposits, which augmented by more than 9% in real terms in the second half of 2011 (nearly twice as much as a year before).

Sound fiscal developments: EDP exit in 2012 still on track

Bulgaria is still subject to an EU Council decision on the existence of an excessive deficit which had to be corrected in 2011. The general government deficit for 2011 is 2.1% of GDP and thus clearly below the 2.5% target in the 2011 convergence program. The budget adopted for 2012 stipulates a general government deficit of 1.35% of GDP in 2012. The exit from the EDP in 2012 is thus still on track. However, it should be noted that some of the economic assumptions underlying the 2012 budget (2012 GDP growth of close to 3%) are on the optimistic side.

Table 4

Main Economic Indicators: Bulgaria

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–5.5	0.4	1.7	0.8	3.1	2.0	2.7	1.9	0.3
Private consumption	–7.6	0.1	–0.6	–1.3	2.5	–3.0	–0.6	2.9	–1.6
Public consumption	–6.5	1.9	0.5	–0.7	4.7	2.7	2.4	–2.4	–0.2
Gross fixed capital formation	–17.6	–18.3	–9.7	–24.3	–1.6	–2.4	–6.6	–12.4	–14.4
Exports of goods and services	–11.2	14.7	12.8	21.0	14.5	25.6	13.0	4.6	13.4
Imports of goods and services	–21.0	2.4	8.5	3.1	8.4	13.6	8.1	9.0	4.5
	Contribution to GDP growth in percentage points								
Domestic demand	–15.5	–5.2	–0.6	–7.4	1.1	–2.8	0.5	2.8	–3.5
Net exports of goods and services	10.0	5.6	2.3	9.6	1.7	5.2	2.4	–1.8	4.2
Exports of goods and services	–6.5	7.0	7.3	11.2	6.3	13.9	7.3	3.1	6.8
Imports of goods and services	–16.5	1.4	5.1	1.6	4.6	8.7	5.0	4.9	2.6
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	13.3	6.1	1.0	2.5	3.1	–3.5	0.7	2.9	4.8
Unit labor costs in manufacturing (nominal, per hour)	23.6	–5.2	0.3	–5.4	–4.8	–7.2	3.1	1.2	5.1
Labor productivity in manufacturing (real, per hour)	–9.2	12.2	6.8	13.5	10.9	12.8	5.8	6.1	3.4
Labor costs in manufacturing (nominal, per hour)	11.8	6.2	7.5	7.4	5.5	4.7	9.1	7.4	8.7
Producer price index (PPI) in industry	–6.3	8.5	9.5	10.3	11.3	13.2	10.3	8.4	6.1
Consumer price index (here: HICP)	2.5	3.0	3.4	3.3	4.0	4.5	3.4	3.1	2.5
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.9	10.3	11.3	9.6	11.3	12.1	11.3	10.3	11.5
Employment rate (%, 15–64 years)	62.6	59.7	58.5	60.6	59.0	57.3	58.2	59.9	58.7
Key interest rate per annum (%)[1]	. .	. .	. .	. .	. .	. .	. .	. .	. .
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.2	6.4	12.3	8.4	6.4	7.4	8.0	10.3	12.3
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.7	5.0	7.9	4.8	5.0	4.5	6.2	8.5	7.9
Domestic credit of the banking system	6.6	5.1	7.3	7.0	5.1	5.7	3.8	4.5	7.3
of which: claims on the private sector	4.1	1.5	3.9	1.7	1.5	2.0	2.7	2.8	3.9
claims on households	2.3	–0.3	–0.2	0.3	–0.3	–0.3	–0.2	–0.1	–0.2
claims on enterprises	1.8	1.8	4.1	1.4	1.8	2.3	2.9	2.9	4.1
claims on the public sector (net)	2.5	3.7	3.4	5.3	3.7	3.7	1.1	1.6	3.4
Other assets (net) of the banking system	–4.1	–3.7	–3.0	–3.4	–3.7	–2.8	–2.0	–2.7	–3.0
	% of GDP, ESA 95								
General government revenues	36.3	34.3	33.1	. .	. .	. .	. .	. .	. .
General government expenditures	40.6	37.4	35.2	. .	. .	. .	. .	. .	. .
General government balance	–4.3	–3.1	–2.1	. .	. .	. .	. .	. .	. .
Primary balance	–3.6	–2.5	–1.5	. .	. .	. .	. .	. .	. .
Gross public debt	14.6	16.3	16.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–23.0	32.9	30.0	44.5	32.7	57.7	28.1	22.6	19.7
Merchandise imports	–33.3	15.4	21.2	18.1	28.9	35.5	18.9	22.0	12.4
	% of GDP (based on EUR), period total								
Trade balance	–11.9	–7.7	–5.1	–2.0	–10.2	–2.5	–7.3	–2.0	–8.6
Services balance	3.7	5.6	5.9	14.8	1.1	1.7	5.0	14.0	1.6
Income balance (factor services balance)	–3.4	–3.1	–4.3	–3.8	–2.1	–4.5	–4.6	–4.4	–3.6
Current transfers	2.7	4.2	4.4	4.0	2.9	4.2	7.0	3.1	3.5
Current account balance	–8.9	–1.0	0.9	13.0	–8.3	–1.1	0.1	10.7	–7.2
Capital account balance	1.4	0.8	1.3	1.8	1.4	0.2	0.5	1.2	3.1
Foreign direct investment (net)	7.2	2.9	3.1	2.8	4.4	–1.1	0.9	2.8	9.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	108.3	102.8	91.9	104.3	102.8	98.4	95.9	93.3	91.9
Gross official reserves (excluding gold)	34.2	32.2	30.6	32.7	32.2	29.5	29.0	29.7	30.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.4	6.5	5.6	6.8	6.5	5.8	5.6	5.6	5.6
	EUR million, period total								
GDP at current prices	34,933	36,052	38,483	9,973	10,240	8,166	9,605	10,760	9,953

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Not available in a currency board regime.*

5 Czech Republic: Fiscal Austerity Drags Domestic Demand Down

Output growth decelerates, being driven by external demand; domestic demand negative

Growth in the Czech economy moderated further in the second half of 2011 (and was slightly negative in quarter-on-quarter terms in both quarters), bringing annual 2011 growth down to 1.7%.

In the review period, all components of domestic demand contributed negatively to growth. Net exports were thus the only positive growth contributor alongside a considerable deceleration of both imports and exports in 2011, with imports declining somewhat faster. Public consumption fell due to austerity measures, which, together with a subdued labor market, restrained private consumption. Gross fixed investment suffered from declining economic sentiment and a reduction in public investment.

The current account deficit decreased from 3.9% of GDP in 2010 to 2.9% of GDP in 2011, mainly due to an improvement in the trade balance, which, however, slowed down in the second half of the year. The surplus in the trade balance was overcompensated by a deficit in the income balance mainly due to FDI earnings (which were only partly reinvested in the country). Net FDI continued to cover about two-thirds of the current account deficit. However, FDI inflows apart from reinvested earnings were meager; declines in equity capital in some corporations and outflows of other capital in the third quarter even led to a temporary net FDI outflow.

Inflation picks up, koruna depreciates temporarily

Annual average HICP inflation reached 2.1% in 2011, picking up mainly in the last quarter owing to an early pass-through of the 4 percentage point VAT rate hike effective from 2012, higher administered prices (rents and energy) as well as food and fuel prices, combined with a weaker koruna. This development continued into 2012 (HICP rise by 4% year on year in February) and has also been reflected by the monetary policy-relevant inflation measure (CPI adjusted for first-round effects of changes to indirect taxes), which remains in the upper bound of Česka narodni banka's (CNB's) inflation target of 2% ±1 percentage point. The CNB has kept its policy rate constant at 0.75% since May 2010 in light of the lack of demand pressures and of a weakening economy.

The Czech koruna depreciated against the euro in the last quarter of 2011 due to global risk aversion and slowing output, but regained much of the losses, so that at the end of March 2012 it was 0.1% stronger than at the end of September 2011.

Consolidation in line with plans, further measures under way

Under the EDP commitment to bring the public deficit down to below 3% of GDP by 2013, the 2011 deficit target was set at 4.6% of GDP. The actual deficit in 2011 was considerably lower at 3.1% of GDP, mainly because public investment declined more than envisaged (–0.7% of GDP). For 2012, consolidation measures comprise an increase in excise taxes, a hike of the lower VAT rate from 10% to 14%, a freeze in public salaries (except for teachers and physicians) and lower public investment. The government is determined to stick to the planned 2012 deficit (3.5% of GDP) even if growth should be lower than expected. It would introduce further measures and has in fact already frozen some public expenditure. The government also plans to boost both VAT rates by 1 percentage point each (to 15% and 21%) rather than unifying the rate. Moreover, government will introduce a temporary additional personal income tax rate and will index pensions more slowly in 2013. However, these measures have yet to be adopted by the parliament, provided elections are not held early.

Table 5

Main Economic Indicators: Czech Republic

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–4.7	2.7	1.7	3.0	3.3	3.1	2.1	1.3	0.3
Private consumption	–0.4	0.6	–0.5	0.6	0.9	–0.2	–0.4	–0.6	–0.7
Public consumption	3.8	0.6	–1.4	0.6	–1.0	–0.1	–1.1	–2.5	–1.7
Gross fixed capital formation	–11.5	0.1	–1.2	3.8	4.6	–2.1	1.4	–2.1	–1.7
Exports of goods and services	–10.0	16.4	11.0	15.8	16.4	19.2	12.9	8.5	4.4
Imports of goods and services	–11.6	16.0	7.5	19.7	15.7	16.9	10.0	3.5	1.4
	Contribution to GDP growth in percentage points								
Domestic demand	–5.5	1.8	–0.9	4.5	2.3	0.7	–0.4	–2.0	–1.8
Net exports of goods and services	0.8	0.9	2.6	–1.5	1.0	2.4	2.5	3.4	2.1
Exports of goods and services	–6.5	9.8	7.4	9.4	10.2	12.8	8.7	5.7	3.1
Imports of goods and services	–7.2	8.9	4.9	10.9	9.2	10.5	6.3	2.3	1.0
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	1.9	–0.3	0.1	2.4	0.2	–0.0	0.6	–0.3	0.4
Unit labor costs in manufacturing (nominal, per hour)	11.6	–7.5	. .	–2.0	–16.3	–9.8	–3.8	4.1	. .
Labor productivity in manufacturing (real, per hour)	–5.5	9.5	7.2	6.6	23.8	15.0	10.0	1.9	3.4
Labor costs in manufacturing (nominal, per hour)	5.5	1.1	. .	4.5	3.7	3.7	5.8	6.1	. .
Producer price index (PPI) in industry	–1.5	0.1	3.7	2.0	1.9	3.2	3.1	3.7	4.9
Consumer price index (here: HICP)	0.6	1.2	2.1	1.6	2.0	1.9	1.8	2.0	2.8
EUR per 1 CZK, + = CZK appreciation	–5.7	4.6	2.9	2.7	4.6	6.2	5.2	2.2	–2.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.7	7.4	6.8	7.1	7.0	7.3	6.8	6.6	6.5
Employment rate (%, 15–64 years)	65.4	65.0	65.7	65.4	65.5	65.0	65.7	66.1	66.1
Key interest rate per annum (%)	1.5	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
CZK per 1 EUR	26.5	25.3	24.6	24.9	24.8	24.4	24.3	24.4	25.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	0.2	1.9	2.8	3.9	1.9	1.3	–0.8	1.8	2.8
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.0	0.4	–0.8	4.6	0.4	–3.3	–5.7	–4.8	–0.8
Domestic credit of the banking system	4.6	4.0	7.9	3.1	4.0	5.4	5.7	10.2	7.9
of which: claims on the private sector	0.3	2.1	4.1	0.4	2.1	3.2	3.9	4.5	4.1
claims on households	3.8	2.7	2.2	3.0	2.7	2.6	2.5	2.2	2.2
claims on enterprises	–3.5	–0.6	1.9	–2.6	–0.6	0.6	1.4	2.3	1.9
claims on the public sector (net)	4.3	1.9	3.7	2.7	1.9	2.2	1.8	5.7	3.7
Other assets (net) of the banking system	–5.4	–2.6	–4.3	–3.8	–2.6	–0.8	–0.8	–3.5	–4.3
	% of GDP, ESA 95								
General government revenues	39.1	39.3	40.3	. .	. .	. .	. .	. .	. .
General government expenditures	44.9	44.1	43.4	. .	. .	. .	. .	. .	. .
General government balance	–5.8	–4.8	–3.1	. .	. .	. .	. .	. .	. .
Primary balance	–4.5	–3.4	–1.7	. .	. .	. .	. .	. .	. .
Gross public debt	34.4	38.1	41.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–16.3	21.3	15.7	21.3	21.9	27.8	18.3	11.7	6.8
Merchandise imports	–19.2	24.1	14.0	27.8	25.6	28.6	17.6	9.3	3.7
	% of GDP (based on EUR), period total								
Trade balance	2.3	1.4	2.5	–0.5	0.4	3.8	3.0	0.8	2.3
Services balance	2.0	2.0	1.7	1.6	1.7	1.6	2.1	1.9	1.3
Income balance (factor services balance)	–6.7	–7.6	–7.2	–12.0	–5.9	–3.2	–11.6	–8.5	–5.0
Current transfers	–0.0	0.2	0.1	–0.2	0.2	0.4	0.6	–0.3	–0.4
Current account balance	–2.4	–3.9	–2.9	–11.1	–3.5	2.6	–5.9	–6.0	–1.7
Capital account balance	1.4	0.9	0.4	1.5	0.6	0.1	–0.0	0.3	1.1
Foreign direct investment (net)	1.0	2.5	2.0	3.9	1.3	1.5	3.6	–0.4	3.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	43.7	47.2	46.9	47.7	47.2	46.0	46.7	47.6	46.9
Gross official reserves (excluding gold)	20.2	21.0	19.9	21.6	21.0	19.4	19.1	19.2	19.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.3	3.9	3.4	4.2	3.9	3.4	3.3	3.3	3.4
	EUR million, period total								
GDP at current prices	141,602	149,401	154,882	38,477	39,794	36,254	39,529	39,591	39,508

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

6 Hungary: Some Moves to Unlock Precautionary International Financial Assistance

Policy issues delay negotiations with EU and IMF, but fiscal consolidation is under way

One of the most important events over the past half year was the surprise application by the Hungarian authorities for precautionary financial assistance from the IMF and the EU in mid-November 2011. However, preparatory negotiations came to a halt soon after they had started, as the Hungarian government refused requests to reconsider planned constitutional legislation concerning major economic issues. Following the downgrade of Hungary's foreign currency debt rating to junk status and financial market tensions in late 2011 and early 2012, the government struck a more conciliatory tone from early January 2012 and signaled its readiness to reconsider some controversial issues (independence of the central bank and the data protection authorities, measures affecting the judiciary). It remains to be seen whether the intended changes are sufficient to unlock negotiations.

In late January 2012, the EU Council established that Hungary had failed to take sustainable action to bring the budget deficit below 3% of GDP in 2011.[8] Moreover, in the Council's view, the reference value would again be respected only thanks to one-off measures in 2012, and would possibly be missed in 2013. In mid-March 2012, the Council also suspended around 0.5% of GDP cohesion fund appropriations from 2013 if Hungary does not make – by mid-September 2012[9] – the necessary fiscal effort to meet the deficit target of 2.5% of GDP in 2012 and does not take structural measures to ensure that the deficit in 2013 remains well below 3%.

Inflation jumps in early 2012 following indirect tax hikes and weaker exchange rate

After climbing gradually during the second half of 2011, inflation accelerated sharply to 5.8% in February 2012. The increase reflected indirect tax hikes that took effect in early 2012 and a weaker exchange rate. In November and December 2011, the MNB raised its policy rate in two steps by 50 basis points each to 7% in response to a worsening of Hungary's risk perception and inflation outlook. Taking into account the improvement in risk perception since early January and trusting the government's commitment to fiscal consolidation and its readiness to conclude an agreement with the IMF and the EU, the MNB kept the policy rate steady during the first quarter of 2012.

GDP growth surprisingly strong in the fourth quarter, but slowdown expected

GDP grew by 1.4% in the final quarter of 2011, bringing annual average growth to 1.7%. However, growth in the second half of 2011 was to a substantial extent driven by agriculture, which rebounded from a weak 2010 base. Domestic demand contracted markedly during the second half of 2011, mostly on account of the ongoing decline of investment spending, but consumption activity also contracted. Consumption was depressed by poor labor market conditions, income uncertainty, increased debt servicing costs, a sharp deterioration of consumer confidence and fiscal austerity. Investment activity continued to suffer from weak demand conditions, uncertainties regarding the policy environment and a steep decline in business confidence. Tight credit conditions adversely affected both consumption and investment activity. In this respect, the MNB's new two-year lending facility (along with the broadening of acceptable securities in its open market operations) may support lending activity in the coming period.

[8] *The surplus in 2011 is mainly due to substantial one-off revenues (see Recent Economic Developments, FEEI Q4/2011).*

[9] *However, the Council may lift the suspension of cohesion funds in June 2012 if Hungary has applied the necessary corrective measures by then.*

Table 6

Main Economic Indicators: Hungary

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–6.8	1.3	1.7	1.8	1.9	2.5	1.5	1.4	1.4
Private consumption	–6.2	–2.2	0.0	0.6	–0.7	–0.6	0.2	0.3	0.1
Public consumption	–0.6	–2.1	–0.4	1.0	–5.3	2.5	–1.3	–1.5	–1.0
Gross fixed capital formation	–11.0	–9.7	–5.4	–6.8	–12.9	–1.5	–7.6	–7.5	–4.4
Exports of goods and services	–10.2	14.3	8.4	14.0	12.7	14.1	8.6	6.7	4.9
Imports of goods and services	–14.8	12.8	6.3	13.9	11.6	14.2	6.7	3.8	1.7
	Contribution to GDP growth in percentage points								
Domestic demand	–10.4	–0.5	–0.5	0.9	0.6	1.5	–0.5	–1.3	–1.5
Net exports of goods and services	3.6	1.8	2.2	0.8	1.3	0.9	2.1	2.8	2.9
Exports of goods and services	–8.4	11.1	7.3	10.8	10.0	12.4	7.4	5.7	4.2
Imports of goods and services	–12.0	9.3	5.1	10.0	8.7	11.5	5.3	3.0	1.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.7	–3.5	4.3	–2.7	–3.9	2.6	5.2	6.2	3.4
Unit labor costs in manufacturing (nominal, per hour)	9.2	–9.6	4.4	–8.8	–2.7	–0.6	8.1	7.5	2.9
Labor productivity in manufacturing (real, per hour)	–4.8	10.2	1.3	10.3	5.2	6.8	–2.2	–1.9	2.9
Labor costs in manufacturing (nominal, per hour)	3.2	0.0	5.8	0.6	2.4	6.1	5.7	5.5	5.9
Producer price index (PPI) in industry	4.6	6.3	2.6	10.5	9.8	5.2	0.0	–0.4	5.6
Consumer price index (here: HICP)	4.0	4.7	3.9	3.6	4.3	4.3	3.9	3.4	4.1
EUR per 1 HUF, + = HUF appreciation	–10.3	1.9	–1.4	–3.9	–1.8	–1.4	3.1	2.7	–9.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	10.1	11.2	11.0	10.9	10.9	11.7	10.9	10.8	10.7
Employment rate (%, 15–64 years)	55.4	55.4	55.8	56.0	55.8	54.6	55.8	56.4	56.5
Key interest rate per annum (%)	8.6	5.5	6.0	5.3	5.4	5.9	6.0	6.0	6.3
HUF per 1 EUR	280.5	275.4	279.3	282.4	275.7	272.5	266.4	275.0	303.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.4	3.0	5.9	2.6	3.0	1.5	-1.0	5.3	5.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	13.4	4.2	17.6	3.4	4.2	4.6	4.8	16.7	17.6
Domestic credit of the banking system	–3.3	6.4	–3.1	6.2	6.4	–1.5	–10.1	–6.5	–3.1
of which: claims on the private sector	–3.7	3.7	–0.6	1.1	3.7	–2.3	–7.4	1.6	–0.6
claims on households	0.8	4.6	–0.5	3.4	4.6	0.8	–2.2	2.1	–0.5
claims on enterprises	–4.6	–0.9	0.4	–2.3	–0.9	–3.1	–5.3	0.0	0.4
claims on the public sector (net)	0.4	2.7	–2.6	5.1	2.7	0.8	–2.6	–8.1	–2.6
Other assets (net) of the banking system	–5.7	–7.7	–8.5	–7.0	–7.7	–1.6	4.3	–4.9	–8.5
	% of GDP, ESA 95								
General government revenues	46.9	45.2	52.9	. .	. .	. .	. .	. .	. .
General government expenditures	51.5	49.4	48.6	. .	. .	. .	. .	. .	. .
General government balance	–4.6	–4.2	4.3	. .	. .	. .	. .	. .	. .
Primary balance	0.1	–0.1	8.3	. .	. .	. .	. .	. .	. .
Gross public debt	79.8	81.4	80.6	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–20.4	20.3	11.6	21.7	20.4	23.6	12.9	8.9	3.0
Merchandise imports	–24.9	19.5	10.9	22.5	20.7	21.7	12.7	7.5	3.6
	% of GDP (based on EUR), period total								
Trade balance	2.6	3.3	4.0	2.3	3.3	5.8	4.1	3.2	3.1
Services balance	2.2	3.0	3.2	3.8	2.2	2.0	4.2	3.8	2.7
Income balance (factor services balance)	–5.3	–5.5	–6.3	–5.4	–4.8	–6.2	–6.8	–6.1	–6.0
Current transfers	0.5	0.4	0.5	0.6	0.1	–0.1	0.3	0.8	0.9
Current account balance	–0.2	1.2	1.4	1.2	0.8	1.5	1.9	1.7	0.6
Capital account balance	1.2	1.8	2.1	2.1	0.8	2.0	1.2	2.7	2.7
Foreign direct investment (net)	0.1	0.7	–0.1	1.8	3.7	–0.9	–2.4	–2.0	4.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	149.7	142.4	130.6	144.3	142.4	143.0	141.6	137.0	130.6
Gross official reserves (excluding gold)	33.4	34.6	37.4	34.9	34.6	36.4	37.0	38.0	37.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.5	5.2	5.3	5.4	5.2	5.3	5.3	5.5	5.3
	EUR million, period total								
GDP at current prices	91,625	97,069	100,709	24,159	26,890	22,903	25,781	26,145	25,880

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

7 Poland: Monetary Policy Council Adopts Tightening Bias

Fixed investment grows at double-digit rate, external balance is supported by currency depreciation

Poland posted annual GDP growth of 4.3% in 2011, with substantial contributions by both exports and domestic demand. Private consumption and (contrary to 2010) gross fixed capital formation made a roughly equally large contribution, with the contribution of private consumption falling and that of gross fixed capital formation rising in the course of the year. Private consumption growth remained clearly below GDP growth; higher labor force participation, low employment growth and low real average wage growth were its main pillars. The higher activity rate caused the unemployment rate to remain at about 10%. Fiscal consolidation measures (e.g. hikes in indirect tax rates and the freeze of the nominal wage fund in large parts of the public sector) dampened real wage growth and took their toll on consumption. The deceleration of employment growth and some worsening of confidence further weakened consumption growth toward the end of the year.

Fixed investment grew by 8.5% in 2011 and by nearly 11% in the fourth quarter of 2011, after it had stagnated in 2010. The take-off of investment caused employment in the enterprise sector to grow particularly strongly. Sizeable public investment, the availability of EU funds (including cofinancing), the stable and robust profitability and liquidity positions of enterprises, faster growth of corporate loans and still high growth of housing loans were factors that drove investment.

Export growth outpaced import growth in 2011, leading to a positive growth contribution of net exports and a lower current account deficit (fully covered by the capital account surplus and net FDI inflows). These results reflected mainly developments in the second half of 2011, when strong real currency depreciation (deflated by unit labor costs in the manufacturing sector) not only contained import growth, but also stimulated foreign sales and new export orders despite weak foreign demand.

Inflation remains above the upper end of the tolerance band, leading to hawkish Monetary Policy Council stance

After the złoty had depreciated against the euro from PLN 4.0 in July to PLN 4.5 per euro in December, it recovered to PLN 4.1 in March 2012. The previous depreciation further exacerbated the impact of rising international energy prices. Thus, after decelerating from June to September 2011, annual inflation peaked in December (4.5% HICP) and November 4.8% (CPI). However, also core inflation rose to a peak in December 2011, which resulted from sustained above-average rises of prices for processed food (including alcohol and tobacco) and from increases of tax rates and administered prices (linked to fiscal consolidation). After decelerating to 4.1% (HICP and CPI) in January 2012, inflation rebounded to 4.4% (HICP) and 4.3% (CPI) in February, following a boost in excise tax rates on tobacco products.

With headline inflation above the upper end of the 1 percentage point tolerance band around the inflation target (2.5% CPI) and the expectation of a mild slowdown, which increases the probability of inflation remaining above the target in the medium term, the Polish monetary policy council (MPC) in early April announced that it would consider tightening in the near future, unless signs of considerable weakening appear.

Fiscal policy aims at preventing an excessive deficit in 2012, in line with EDP timelines

Consolidation measures helped lower the fiscal deficit to 5.1% of GDP in 2011 from 7.8% in 2010. For 2012, the Commission projected the deficit in January at 3.3% of GDP, based on the revised 2012 Budget Law adopted by the new government in December. With a deficit of close to 3% and a debt ratio below 60%, the cost of a systemic pension reform can be taken into account when assessing the correction of an excessive deficit. As the direct net cost of such a reform was estimated at 0.6% of GDP in 2012, the Commission considered that no further policy steps were needed at present.

Table 7

Main Economic Indicators: Poland

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	1.6	3.9	4.3	4.9	4.2	4.1	4.6	4.3	4.4
Private consumption	2.0	3.2	3.1	4.4	3.0	3.2	4.0	3.0	2.0
Public consumption	2.1	4.1	–1.3	6.2	6.5	–0.1	–1.3	–4.5	0.4
Gross fixed capital formation	–1.2	–0.2	8.3	2.8	2.0	4.0	7.0	8.5	10.4
Exports of goods and services	–6.8	12.1	7.5	10.5	9.9	9.2	4.6	8.6	7.7
Imports of goods and services	–12.4	13.9	5.8	12.5	13.4	8.5	4.3	5.3	5.2
	Contribution to GDP growth in percentage points								
Domestic demand	–1.1	4.6	3.7	5.7	5.6	3.9	4.6	3.0	3.5
Net exports of goods and services	2.7	–0.7	0.7	–0.8	–1.4	0.3	0.1	1.3	0.9
Exports of goods and services	–2.7	4.8	3.2	4.3	3.7	3.9	2.0	3.7	3.1
Imports of goods and services	–5.5	5.5	2.5	5.2	5.1	3.6	1.9	2.4	2.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.4	1.9	1.0	0.9	2.6	0.9	0.8	1.7	0.4
Unit labor costs in manufacturing (nominal, per hour)	0.5	–9.2	0.6	–8.6	–6.3	0.5	1.6	2.3	–2.0
Labor productivity in manufacturing (real, per hour)	4.2	11.3	4.0	12.5	7.3	2.6	4.4	1.3	7.6
Labor costs in manufacturing (nominal, per hour)	4.6	1.3	4.6	2.8	0.6	3.1	6.0	3.7	5.5
Producer price index (PPI) in industry	3.9	2.3	7.5	4.2	5.2	7.7	7.1	7.1	8.2
Consumer price index (here: HICP)	4.0	2.7	3.9	2.1	2.7	3.6	4.0	3.7	4.2
EUR per 1 PLN, + = PLN appreciation	–18.8	8.4	–3.0	4.7	5.3	1.2	1.4	–3.4	–10.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.3	9.7	9.8	9.2	9.4	10.2	9.6	9.5	9.9
Employment rate (%, 15–64 years)	59.4	59.3	59.7	60.0	59.6	58.9	59.7	60.2	59.9
Key interest rate per annum (%)	3.8	3.5	4.2	3.5	3.5	3.7	4.2	4.5	4.5
PLN per 1 EUR	4.3	4.0	4.1	4.0	4.0	3.9	4.0	4.2	4.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.1	8.8	12.5	8.9	8.8	10.9	7.2	10.2	12.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	3.2	3.0	6.4	5.2	3.0	2.1	–3.7	2.5	6.4
Domestic credit of the banking system	9.2	10.3	14.0	9.9	10.3	12.3	8.1	14.1	14.0
of which: claims on the private sector	6.7	8.0	13.1	7.0	8.0	9.7	8.5	13.5	13.1
claims on households	6.8	8.3	7.4	7.5	8.3	7.9	5.9	9.0	7.4
claims on enterprises	–0.2	–0.2	5.7	–0.5	–0.2	1.8	2.6	4.5	5.7
claims on the public sector (net)	2.5	2.3	0.9	3.0	2.3	2.6	–0.5	0.6	0.9
Other assets (net) of the banking system	–4.3	–4.5	–7.9	–6.2	–4.5	–3.5	2.9	–6.4	–7.9
	% of GDP, ESA 95								
General government revenues	37.2	37.5	38.5	. .	. .	. .	. .	. .	. .
General government expenditures	44.6	45.3	43.6	. .	. .	. .	. .	. .	. .
General government balance	–7.4	–7.8	–5.1	. .	. .	. .	. .	. .	. .
Primary balance	–4.7	–5.2	–2.4	. .	. .	. .	. .	. .	. .
Gross public debt	50.9	54.8	56.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–15.8	22.9	11.3	23.1	20.7	16.8	12.0	10.0	7.2
Merchandise imports	–24.4	25.0	11.5	25.2	25.5	17.5	16.0	8.6	5.1
	% of GDP (based on EUR), period total								
Trade balance	–1.7	–2.5	–2.7	–2.8	–3.3	–2.1	–3.4	–2.5	–2.9
Services balance	1.1	0.7	1.2	0.4	0.6	1.1	1.6	1.3	0.7
Income balance (factor services balance)	–3.8	–3.6	–3.9	–4.0	–3.4	–3.3	–4.4	–4.4	–3.5
Current transfers	0.5	0.8	1.2	0.4	–0.1	0.8	2.5	0.8	0.5
Current account balance	–3.9	–4.6	–4.3	–5.9	–6.3	–3.5	–3.6	–4.9	–5.1
Capital account balance	1.6	1.8	2.2	1.5	2.8	1.9	1.5	1.6	3.7
Foreign direct investment (net)	1.9	0.7	1.8	–0.5	–0.1	2.1	–0.1	3.4	1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	62.4	66.6	67.4	67.3	66.6	67.8	68.4	66.8	67.4
Gross official reserves (excluding gold)	16.9	18.8	19.4	20.1	18.8	19.8	19.5	18.8	19.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.1	5.1	5.0	5.6	5.1	5.3	5.2	4.9	5.0
	EUR million, period total								
GDP at current prices	311,335	354,642	369,621	87,549	100,184	88,503	93,332	90,593	97,194

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

8 Romania: Nascent Recovery Challenged by Weaker External Environment

Bumper harvest and strengthening domestic demand counter dwindling external demand in the second half of 2011

The Romanian economy continued to recover moderately in the second half of 2011, bringing full-year growth to 2.5%. In particular in the third quarter, exceptionally good agricultural output drove up GDP growth decisively. As the positive effects of the harvest tapered off and external demand slowed down, GDP shrank slightly in quarter-on-quarter terms in the final quarter, yielding a year-on-year growth rate of +1.9%. While the contribution of net exports to GDP growth was negative in the second half of 2011, domestic demand strengthened. Supported by real wage growth, private consumption started to grow again, while gross fixed capital formation expanded relatively briskly from a low base, partly reflecting a revival of construction activity.

Disinflation allows the central bank to cut its policy rate

Annual inflation declined continuously and reached the central bank's target range (3% ±1 percentage point) already at the end of the third quarter 2011, earlier than the Banca Naţională României (BNR) had originally expected. In February 2012, inflation fell further to 2.7% year on year. Favorable food price developments thanks to the good harvest were not the sole drivers of disinflation, as core inflation came down as well. Amidst receding inflationary pressures, the BNR cut its key policy rate in four steps and by a total of 100 basis points to 5.25% from November 2011 through March 2012.

Persistent current account deficit, signs of deterioration in the second half of 2011

In 2011, the current account deficit increased slightly to 4.2% of GDP, whereas net FDI inflows decreased to cover only a third of the current account gap. Some signs of deterioration in the current account position were seen in the second half of 2011. Most importantly, slowing external demand, recovering domestic demand and rising unit labor costs in the manufacturing sector weighed on the trade deficit. In contrast to the first half of 2011, merchandise import growth exceeded merchandise export growth in the second half of 2011. Moreover, the surplus in the current transfers balance declined year on year in the second half of 2011, which was also in contrast to the first half of the year (mainly due to lower remittances from abroad). Only the services and income balances improved slightly year on year in the second half of 2011.

Reform agenda meets with public protests, but precautionary support program on track

The precautionary IMF/EU program stayed on track, as overall policy implementation remained satisfactory. Yet, January's public protests against the health sector reform plan highlighted challenges in the design and in the implementation of complex reform measures and finally triggered a government reshuffle. The new government confirmed its commitment to the economic program under the precautionary IMF/EU arrangement. In line with the program, the government is targeting a budget deficit of 1.9% of GDP in cash terms in 2012, following a deficit of 4.2% of GDP in 2011 (corresponding to 5.2% in ESA 95 terms), below the program target of 4.4% of GDP. However, ahead of parliamentary elections in November 2012, risks of policy reversals may increase, in particular as suggested by recent statements by politicians about forthcoming public sector wage hikes. In March 2012, the IMF completed the fourth review under the program and made an additional amount of EUR 500 million available for disbursement. Romania currently has access to EUR 2 billion under the IMF precautionary Stand-By Arrangement. Moreover, up to EUR 1.4 billion could be activated through precautionary EU medium-term financial assistance. While Romania does not intend to draw on these funds, the IMF/EU support program continues to be an important anchor.

Table 8

Main Economic Indicators: Romania

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–6.6	–1.7	2.5	–2.2	–1.0	1.7	1.4	4.4	1.9
Private consumption	–10.3	–0.4	1.3	–0.3	0.1	–1.3	–0.7	3.6	2.7
Public consumption	2.9	–4.1	–3.6	–2.1	–3.9	–6.7	–2.8	–0.7	–4.0
Gross fixed capital formation	–28.1	–2.1	6.2	–4.8	6.0	–2.1	–1.4	11.4	10.3
Exports of goods and services	–6.2	15.1	10.5	12.6	18.7	21.8	8.2	9.2	3.8
Imports of goods and services	–21.4	12.7	11.5	8.9	13.1	16.9	10.6	12.8	5.7
	Contribution to GDP growth in percentage points								
Domestic demand	–13.6	–1.6	3.2	–2.4	1.0	1.6	1.7	6.6	4.2
Net exports of goods and services	7.0	–0.0	–0.8	–0.3	0.1	–0.5	–3.7	–3.6	–1.3
Exports of goods and services	–1.9	4.3	3.5	4.1	5.2	11.0	3.6	3.5	1.3
Imports of goods and services	–8.9	4.3	4.3	4.4	5.0	11.4	7.3	7.0	2.5
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	3.1	7.5	1.9	7.9	7.7	1.0	2.6	4.1	0.2
Unit labor costs in manufacturing (nominal, per hour)	1.5	–8.3	4.3	–5.8	–4.0	–5.0	7.1	5.3	11.0
Labor productivity in manufacturing (real, per hour)	13.3	15.9	2.9	14.0	11.8	10.7	1.2	2.5	–1.7
Labor costs in manufacturing (nominal, per hour)	14.1	6.7	7.7	7.4	7.4	5.2	8.3	7.9	9.2
Producer price index (PPI) in industry	1.9	6.3	8.9	7.2	8.5	10.7	8.7	8.7	7.6
Consumer price index (here: HICP)	5.6	6.1	5.8	7.5	7.8	7.5	8.3	4.2	3.4
EUR per 1 RON, + = RON appreciation	–13.1	0.7	–0.7	–0.7	–0.5	–2.6	1.1	–0.1	–1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.2	7.6	7.7	7.2	7.6	7.8	7.5	7.5	8.0
Employment rate (%, 15–64 years)	58.6	58.8	58.5	60.2	57.9	58.0	58.8	59.1	57.9
Key interest rate per annum (%)	9.1	6.5	6.2	6.3	6.3	6.3	6.3	6.3	6.1
RON per 1 EUR	4.2	4.2	4.2	4.3	4.3	4.2	4.1	4.3	4.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	9.0	6.9	6.6	6.5	6.9	3.3	2.5	6.8	6.6
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	5.0	0.8	–1.4	4.3	0.8	–7.1	–1.8	0.7	–1.4
Domestic credit of the banking system	12.6	13.8	11.4	12.2	13.8	12.2	3.1	12.7	11.4
of which: claims on the private sector	1.2	5.2	6.8	5.1	5.2	2.6	1.7	7.1	6.8
claims on households	0.6	1.0	1.1	1.7	1.0	–0.2	–1.2	0.9	1.1
claims on enterprises	0.6	4.2	5.7	3.4	4.2	2.8	2.9	6.1	5.7
claims on the public sector (net)	11.4	8.6	4.7	7.1	8.6	9.5	1.4	5.7	4.7
Other assets (net) of the banking system	–8.7	–7.7	–3.4	–10.0	–7.7	–1.8	1.3	–6.6	–3.4
	% of GDP, ESA 95								
General government revenues	32.1	33.4	32.5	. .	. .	. .	. .	. .	. .
General government expenditures	41.1	40.2	37.7	. .	. .	. .	. .	. .	. .
General government balance	–9.0	–6.8	–5.2	. .	. .	. .	. .	. .	. .
Primary balance	–7.5	–5.3	–3.7	. .	. .	. .	. .	. .	. .
Gross public debt	23.6	30.5	33.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–13.8	28.5	20.5	27.6	32.8	39.8	18.3	18.0	10.1
Merchandise imports	–31.9	20.4	21.4	17.4	22.8	30.9	21.1	21.5	14.2
	% of GDP (based on EUR), period total								
Trade balance	–5.8	–4.8	–5.5	–3.6	–4.0	–4.0	–8.0	–4.9	–5.2
Services balance	–0.2	–0.4	0.3	–0.2	0.0	–0.1	0.3	–0.1	0.7
Income balance (factor services balance)	–1.6	–1.6	–1.7	–2.5	–0.7	–2.8	–3.1	–1.3	–0.4
Current transfers	3.5	2.8	2.6	3.8	2.9	3.0	3.0	1.9	2.7
Current account balance	–4.2	–4.0	–4.4	–2.5	–1.8	–3.9	–7.8	–4.4	–2.2
Capital account balance	0.5	0.2	0.3	0.2	0.2	0.4	0.2	0.1	0.4
Foreign direct investment (net)	3.1	1.9	1.4	3.4	–0.5	1.9	1.4	1.6	0.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	68.7	74.7	72.3	74.5	74.7	75.5	76.4	74.7	72.3
Gross official reserves (excluding gold)	23.9	26.2	24.4	26.7	26.2	26.1	26.7	25.4	24.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.8	7.7	6.7	8.1	7.7	7.4	7.5	7.0	6.7
	EUR million, period total								
GDP at current prices	118,189	123,737	136,192	33,629	38,539	24,905	31,551	37,318	42,417

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

9 Croatia: Renewed Fiscal Consolidation Efforts ahead of EU Entry in Mid-2013

Domestic demand continues to weigh on economic growth

Against the background of a gradual slowdown of global economic activity, economic conditions remained weak in the latter half of 2011. As a result, GDP stagnated in the full year 2011. Domestic demand stayed anemic. Private and public consumption continued to be subdued, given adverse labor market conditions, ongoing household debt restructuring and fiscal constraints. At the same time, investment activity remained depressed due to persistently low business confidence, moderate FDI inflows and limited fiscal leeway. In turn, net exports contributed positively to economic growth, as imports contracted faster than exports, a pattern also seen in 2009 during the height of the global financial crisis.

Current account position improves in the second half of 2011, external debt ratio stabilizes

Weak domestic demand and a good tourism season helped Croatia's current account position improve in the second half of 2011. Given the related lower financing needs and accelerating net FDI inflows, Croatia's gross external debt stabilized in 2011, even falling marginally to 99.7% of GDP as at end-2011. Rising foreign debt levels of the public and banking sectors were by far compensated by the decreasing foreign indebtedness of the corporate sector.

Despite downward pressures on the kuna since summer 2011 due to changing net capital inflows related to foreign debt repayments of the corporate sector and subsequent interventions of the central bank, the country's foreign exchange reserves stayed broadly stable at 24.4% of GDP at the end of 2011. In early 2012, Hrvatska narodna banka (HNB) continued to intervene (three times) to support the kuna. In April 2012, the HNB decided to reduce the mandatory reserve requirements from 15% to 13.5% to promote economic activity and improve the country's balance of payments via more favorable private sector credit terms.

Despite good liquidity conditions, the inflationary environment remained benign in 2011, when consumer price inflation averaged a moderate 2.3%, given sluggish domestic demand. Inflationary pressures remained low at the start of 2012, but a VAT increase as of March will probably lead to an uptick of inflation in the coming months.

2012 budget prepares the ground for fiscal consolidation

Given stagnating economic activity and underperforming budget revenues, public finances remained under pressure in 2011, with the general government budget deficit climbing to 5.5% of GDP. Based on (rather optimistic) economic growth projections of 0.8%, the 2012 budget targets a deficit of 3.8% of GDP. It contains several consolidation measures of the new administration that took office in early 2012. The most important measures on the revenue side comprise the increase of the general VAT rate from 23% to 25% as of March 1, 2012, and the reduction of health insurance contributions from 15% to 13% as of May 1, 2012. Expenditure-side measures (of some 2% of GDP) envisage major expenditure cuts mainly in the areas of employee compensation in the public sector and state subsidies.

According to Croatia's 2012 Pre-Accession Economic Programme, the budget deficit is forecast to fall to 3.3% of GDP in 2013 (Croatia's EU entry is scheduled for July 1, 2013) and 2.6% of GDP in 2014, mainly driven by consolidation measures on the expenditure side.

Given the rising budget deficit in 2011 and the assumption of state guarantees issued for shipyard debt amounting to some 3.5% of GDP, Croatia's public debt rose to 45.8% of GDP (excluding state guarantees of some 18% of GDP) by end-2011.

Table 9

Main Economic Indicators: Croatia

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–6.0	–1.2	–0.0	0.3	–0.6	–1.0	0.4	0.7	–0.4
Private consumption	–8.2	–0.8	0.2	1.9	1.1	–0.0	0.6	0.0	0.1
Public consumption	0.0	–0.9	–0.2	–1.0	0.7	–1.0	1.8	–0.4	–1.4
Gross fixed capital formation	–11.8	–11.3	–7.2	–9.5	–8.0	–6.7	–7.3	–8.4	–6.1
Exports of goods and services	–17.3	6.0	2.2	4.1	10.8	–3.7	5.1	7.1	–3.5
Imports of goods and services	–20.4	–1.3	1.0	3.4	1.1	3.7	3.5	0.1	–3.0
	Contribution to GDP growth in percentage points								
Domestic demand	–9.0	–3.8	–0.5	–0.0	–3.8	1.7	0.0	–3.0	–0.3
Net exports of goods and services	3.0	2.6	0.4	0.7	3.1	–2.5	0.4	3.5	–0.1
Exports of goods and services	–7.2	2.1	0.8	1.9	3.6	–1.1	1.8	3.5	–1.3
Imports of goods and services	–10.2	–0.5	0.4	1.2	0.4	1.4	1.4	0.0	–1.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit wage costs in manufacturing (nominal, per hour)	12.4	2.0	. .	–0.1	3.8	4.6	–1.2	2.9	–0.5
Labor productivity in manufacturing (real, per hour)	–3.6	–3.2	. .	–2.1	–6.8	–4.6	2.8	1.6	5.5
Gross wages in manufacturing (nominal, per hour)	7.9	–1.0	. .	–2.1	–3.3	–0.3	1.6	4.6	5.0
Producer price index (PPI) in industry	–0.4	4.3	6.4	3.8	5.1	6.3	6.5	6.3	6.4
Consumer price index (here: CPI)	2.4	1.0	2.3	1.1	1.5	2.2	2.3	2.0	2.4
EUR per 1 HRK, + = HRK appreciation	–1.6	0.7	–2.0	1.0	–1.2	–1.6	–1.9	–2.8	–1.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.3	12.1	13.9	11.8	12.5	14.7	13.8	12.6	14.3
Employment rate (%, 15–64 years)	56.6	54.0	52.4	53.9	53.6	52.4	52.3	53.2	51.5
Key interest rate per annum (%)	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.3	7.3	7.4	7.3	7.4	7.4	7.4	7.5	7.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	–0.9	4.4	3.5	3.8	4.4	3.3	3.5	3.7	3.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.5	–0.4	–4.5	6.6	–0.4	–0.5	–2.4	–5.2	–4.5
Domestic credit of the banking system	–0.5	8.6	11.4	0.4	8.6	6.6	8.3	12.0	11.4
of which: claims on the private sector	–0.6	7.0	5.7	5.3	7.0	6.2	6.8	6.8	5.7
claims on households	–1.6	2.1	0.5	0.9	2.1	1.4	1.7	1.7	0.5
claims on enterprises	1.0	4.9	5.2	4.3	4.9	4.8	5.1	5.1	5.2
claims on the public sector (net)	0.1	1.6	5.7	–4.9	1.6	0.4	1.5	5.2	5.7
Other assets (net) of the banking system	–1.8	–3.7	–3.4	–3.1	–3.7	–2.8	–2.4	–3.1	–3.4
	% of GDP, ESA 95								
General government revenues	36.4	35.0	34.3	. .	. .	. .	. .	. .	. .
General government expenditures	40.5	39.9	39.8	. .	. .	. .	. .	. .	. .
General government balance	–4.1	–4.9	–5.5	. .	. .	. .	. .	. .	. .
Primary balance	–2.4	–2.9	–3.3	. .	. .	. .	. .	. .	. .
Gross public debt	35.1	41.2	45.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–21.3	18.1	8.0	18.5	26.1	10.3	11.1	13.7	–1.9
Merchandise imports	–26.8	–0.2	7.2	6.3	4.3	13.8	11.1	5.4	–0.2
	% of GDP (based on EUR), period total								
Trade balance	–16.2	–13.0	–13.9	–13.8	–13.1	–14.4	–14.5	–13.1	–13.5
Services balance	12.9	13.0	14.0	31.0	4.2	1.6	13.8	33.5	4.0
Income balance (factor services balance)	–3.9	–3.4	–3.5	–4.0	–2.5	–4.8	–4.8	–2.8	–1.8
Current transfers	2.3	2.4	2.4	2.1	2.6	2.2	2.4	2.2	3.0
Current account balance	–5.0	–1.0	–1.0	15.3	–8.9	–15.5	–3.1	19.8	–8.3
Capital account balance	0.1	0.1	–0.0	0.1	–0.0	–0.0	–0.0	–0.0	–0.0
Foreign direct investment (net)	3.3	0.9	2.2	2.2	–2.8	0.4	2.2	4.3	1.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	99.9	101.2	99.7	99.2	101.2	103.5	103.1	101.4	99.7
Gross official reserves (excluding gold)	22.7	23.2	24.4	24.3	23.2	24.9	24.9	24.7	24.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.0	7.2	7.2	7.6	7.2	7.6	7.4	7.3	7.2
	EUR million, period total								
GDP at current prices	45,669	45,911	45,865	12,557	11,182	10,638	11,544	12,536	11,147

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

11 Turkey: Economy Slows Down, but Imbalances Are Corrected only Slowly

Domestic demand slows down notably …

2011 brought strong GDP growth for the second year in a row, even though some momentum was lost in the second half due to sharply slowing domestic demand dynamics. The year-on-year growth rate of private consumption halved from the third to the fourth quarter while public consumption growth turned negative in the final quarter. Gross fixed capital formation growth declined noticeably to a meager 2.4% in the fourth quarter after having expanded at double-digit rates in the previous three quarters. Capacity utilization fell continuously from October 2011 to a low of 72.9% in February 2012. Labor force participation dropped at the end of 2011, helping the unemployment rate to decline further in the last two quarters of 2011.

The cooling of domestic demand has eased immediate overheating concerns and also induced some external rebalancing. In the final quarter of 2011, imports declined in year on year terms, while export dynamics strengthened, thus yielding a sizeable positive GDP contribution of net exports. This robust export performance despite current weakness in the euro area is partly related to the ongoing diversification of trading partners toward partners in the Middle East.

… but vulnerabilities remain elevated

Nevertheless, external imbalances continue to pose risks. The current account deficit soared to 10% of GDP for 2011 as a whole, even though it started to shrink in the second half of 2011 and remained on a downward path in the first two months of 2012. Still, not only the size, but also the financing of the current account deficit remain a concern. Combined FDI and portfolio investment flows covered less than 50% of the current account deficit during the second half of 2011.

Persistently high inflation rates constitute another risk factor. Year-end inflation rose to 10.4% in 2011, marking the second-largest deviation from target (2011: 5.5%) since the introduction of the inflation targeting regime in 2002. In its January MPC meeting, the Central Bank of the Republic of Turkey postponed reaching the 2012 target of 5% to mid-2013, citing temporary factors such as high food and energy prices as the main reasons for the deviation. After a small further increase in January, inflation remained stable at 10.4% in February 2012.

Monetary policy remains oriented toward financial stability

The central bank continued its tightening stance by wielding an unorthodox policy mix in the form of strong liquidity management. Frequent adjustments of the interest rate corridor and minimum reserve requirements have rendered the one-week repo funding rate (currently at 5.75%) less important; funding at this rate was even temporarily suspended for several trading days ("exceptional day" measures) in 2012. Consequently, credit growth to the private sector slowed considerably from a level of 43% year on year in August 2011 to 27% year on year in February 2012. Further, following a continuous and sizeable depreciation until September 2011 (by 26% in nominal terms against the euro from September 2010), the lira appreciated again in the final quarter of 2011. This appreciation trend continued in the first quarter of 2012, lifting the lira to a level of 2.38 TRY/EUR.

Robust economic growth in the first two quarters of 2011 led to a doubling of the primary budget surplus last year compared to 2010. Revenues were also boosted by a tax amnesty. Likewise, the headline budget deficit fell in 2011 and came in below target. Based on an optimistic GDP growth forecast of 4%, the government expects to meet the 2012 target of 1.5% of GDP and predicts public debt to fall further from 39.7% of GDP in 2011 to 37%.

Table 11

Main Economic Indicators: Turkey

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–4.8	9.2	8.5	5.3	9.3	11.9	9.1	8.4	5.2
Private consumption	–2.3	6.7	7.7	6.8	8.9	11.9	8.2	7.8	3.4
Public consumption	7.8	2.0	4.5	–0.9	3.1	7.0	9.0	10.3	–4.3
Gross fixed capital formation	–19.0	30.5	18.3	30.7	42.7	33.9	28.7	14.6	2.4
Exports of goods and services	–5.0	3.4	6.5	–1.6	4.2	8.7	0.5	10.2	6.7
Imports of goods and services	–14.3	20.7	10.6	16.3	25.4	26.9	18.9	6.8	–5.1
	Contribution to GDP growth in percentage points								
Domestic demand	–7.7	13.8	9.4	8.9	13.8	16.6	13.9	7.2	1.7
Net exports of goods and services	2.5	–4.0	–1.3	–3.9	–5.1	–4.8	–4.6	0.5	2.9
Exports of goods and services	–1.1	0.8	1.4	–0.4	1.0	1.8	0.1	2.1	1.5
Imports of goods and services	–3.6	4.8	2.7	3.6	6.1	6.6	4.8	1.7	–1.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit wage costs in manufacturing (nominal, per hour)	11.0	1.3	6.8	5.1	5.3	1.7	7.5	8.2	10.1
Labor productivity in manufacturing (real, per hour)	–0.3	9.8	2.9	7.1	7.9	7.4	1.9	3.0	–0.0
Gross wages in manufacturing (nominal, per hour)	10.0	11.8	10.1	12.5	13.6	9.1	9.5	11.4	10.1
Producer price index (PPI) in industry	1.0	6.2	12.3	6.6	6.7	10.1	10.0	13.8	15.3
Consumer price index (here: HICP)	6.3	8.6	6.5	8.4	7.4	4.3	5.9	6.4	9.2
EUR per 1 TRY, + = TRY appreciation	–11.8	8.3	–14.5	9.6	10.8	–3.3	–13.2	–20.2	–19.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	12.9	10.9	9.0	10.3	10.0	10.6	8.7	8.4	8.3
Employment rate (%, 15–64 years)	44.2	46.3	48.4	47.5	46.5	46.1	49.2	49.9	48.4
Key interest rate per annum (%)[1]	9.2	6.8	6.1	7.0	6.9	6.3	6.3	5.9	5.8
TRY per 1 EUR	2.16	2.00	2.34	1.96	1.99	2.16	2.26	2.45	2.48
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.0	18.6	15.2	15.9	18.6	20.4	20.7	22.1	15.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–1.2	–7.5	0.6	–6.8	–7.5	–3.1	–1.6	–1.1	0.6
Domestic credit of the banking system	21.5	30.2	19.0	28.3	30.2	26.6	26.2	26.5	19.0
of which: claims on the private sector	9.9	27.9	25.0	23.8	27.9	29.0	30.3	31.8	25.0
claims on households	2.7	8.4	8.4	7.2	8.4	9.3	10.5	10.2	8.4
claims on enterprises	7.1	19.5	16.6	16.6	19.5	19.7	19.8	21.5	16.6
claims on the public sector (net)	11.6	2.4	–6.0	4.5	2.4	–2.4	–4.1	–5.3	–6.0
Other assets (net) of the banking system	–7.2	–4.2	–4.4	–5.5	–4.2	–3.1	–3.8	–3.2	–4.4
	% of GDP, ESA 95								
General government revenues	32.7	33.1	32.6	. .	. .	. .	. .	. .	. .
General government expenditures	39.4	36.6	35.0	. .	. .	. .	. .	. .	. .
General government balance	–6.7	–3.5	–2.4	. .	. .	. .	. .	. .	. .
Primary balance	–1.8	1.4	2.4	. .	. .	. .	. .	. .	. .
Gross public debt	45.5	43.2	39.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–17.7	16.1	13.0	16.5	18.8	20.4	3.6	17.0	12.4
Merchandise imports	–26.7	39.4	24.8	36.9	49.2	48.1	27.8	21.5	9.4
	% of GDP (based on EUR), period total								
Trade balance	–4.0	–7.7	–11.6	–8.5	–9.3	–11.3	–12.9	–11.6	–10.5
Services balance	2.7	2.1	2.3	3.9	1.8	0.8	2.0	4.4	2.0
Income balance (factor services balance)	–1.3	–1.0	–1.0	–0.8	–1.0	–1.5	–0.8	–0.9	–0.8
Current transfers	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Current account balance	–2.3	–6.4	–10.0	–5.2	–8.4	–11.8	–11.5	–7.9	–9.0
Capital account balance	–0.0	–0.0	–0.0	–0.0	–0.0	–0.0	–0.0	–0.0	–0.0
Foreign direct investment (net)	1.1	1.0	1.7	1.0	1.7	1.8	1.1	2.1	2.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	20.4	39.7	42.8	40.2	39.7	37.4	38.0	41.2	42.8
Gross official reserves (excluding gold)	11.1	11.0	10.9	11.0	11.0	10.7	11.3	11.5	10.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.4	4.9	4.0	5.0	4.9	4.5	4.5	4.4	4.0
	EUR million, period total								
GDP at current prices	440,371	551,485	553,666	151,327	148,656	133,385	139,729	143,327	137,225

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Until April 2010: overnight borrowing rate; from May 2010: 1-week repo (lending) rate.*

12 Russia: Growth Higher than Expected, Inflation Drops to Lowest Post-Soviet Level

Russian growth benefits from rising oil prices and a bountiful harvest

As in 2010, Russian GDP grew in 2011, expanding by 4.3%. Benefiting from rising oil prices, which on average were 40% higher (in U.S. dollars) than in 2010, and from a good harvest, as opposed to the heat-wave-induced bad harvest of the previous year, Russia in 2011 again reached and exceeded its precrisis output level. Growth accelerated in the second half of 2011. Even more than in 2010, the recovery was driven by domestic demand. The strongest contributions were delivered by the continued replenishment of inventories, private consumption and gross fixed investment; once again, the expansion of real imports outpaced export growth by a wide margin.

Inflation at end 2011 falls to its lowest post-USSR annual level

CPI inflation declined to 6.1% in December 2011, its lowest year-end level since the Soviet era. In February 2012, inflation fell further to 3.8%. The sharp decrease by about 3 percentage points in the course of the second half of 2011 pertains to a combination of factors: Food price growth slowed down substantially on the back of a bountiful harvest in 2011. Money supply growth decelerated due to increased capital outflows and a federal budget surplus (as opposed to a deficit in 2010), which meant that the government did not have to dip into its Reserve Fund and thus avoided any monetization of budget finance. The further decline of inflation in early 2012, however, was mostly due to the deferral of municipal tariff hikes to July of the election year 2012, a measure that does not appear to be sustainable in the medium term.

The Central Bank of Russia halts its monetary tightening exercise

With receding inflationary pressure accompanied by a renewed deterioration of the external economic environment in the fall of 2011, the Central Bank of Russia (CBR) halted its monetary tightening exercise. In December 2011, the refinancing rate was lowered again from 8.25% to 8.0%, while the overnight deposit rate was lifted from 3.75% to 4.0%. Moving in the direction of its long-term goal of inflation targeting, the CBR at end-December widened the ruble's fluctuation band relative to its U.S. dollar/euro currency basket from five rubles to six rubles. Over the six months to end-February 2012, the ruble's real-effective exchange rate appreciated by 3.0%.

Economic recovery supported by expanding bank credit and rising oil prices

The economic recovery, particularly private consumption, is being supported by banks' expanding credit activity. As of end-February 2012, credit to the private sector had grown by 22.4% year-on-year in real terms. Bank deposits also increased (15.7%), supported by hikes of deposit rates. The share of nonperforming loans (NPLs) in total loans declined from 19.7% to 17.2% over the year 2011. Buoyant oil prices, strong private-sector domestic demand and a gradual withdrawal of the anticrisis fiscal stimulus helped turn the general government budget balance into a surplus in 2011. Due to the improvement of the terms of trade, the current account surplus increased to 5.4% of GDP in 2011.

Uncertainty pushes private capital outflows to their highest level since 2008

However, private capital outflows rose to EUR 60.5 billion in 2011 (of which in the fourth quarter: EUR 28 billion) and were unrelenting in January and February 2012 (estimated at EUR 17.2 billion). These are the highest levels since the crisis year of 2008. The surge, particularly in recent months, can be largely explained by the appearance of political uncertainty in Russia and, to some extent, also by liquidity transfers of Russian subsidiaries to their Western parent banks. Although it increased in absolute terms, Russian gross external debt slightly declined to 31.6% of GDP at end-2011.

Table 10

Main Economic Indicators: Russia

	2009	2010	2011	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11
	Year-on-year change of the period total in %								
GDP at constant prices	–7.8	4.3	4.3	3.8	4.9	4.0	3.4	5.0	4.8
Private consumption	–5.1	5.1	6.7	6.8	6.2	6.0	6.0	7.1	7.6
Public consumption	–0.6	–1.4	1.5	–1.6	–2.8	1.7	1.5	1.5	1.4
Gross fixed capital formation	–14.4	5.8	8.0	5.1	11.2	–0.6	4.9	7.9	13.2
Exports of goods and services	–4.7	7.0	0.4	2.2	4.3	–0.4	2.0	–1.5	1.4
Imports of goods and services	–30.4	25.8	20.3	35.1	29.8	28.7	23.7	17.9	14.9
	Contribution to GDP growth in percentage points								
Domestic demand	–13.1	7.0	7.9	9.5	9.4	7.9	7.1	9.1	7.3
Net exports of goods and services	5.2	–2.0	–3.9	–5.2	–4.0	–4.8	–3.8	–4.4	–2.9
Exports of goods and services	–1.5	2.3	0.1	0.7	1.4	–0.1	0.7	–0.5	0.5
Imports of goods and services	–6.7	4.3	4.1	5.9	5.3	4.7	4.5	3.9	3.3
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit labor costs in industry (nominal, per person)	4.8	2.2	9.3	5.7	8.7	9.0	10.2	8.6	9.4
Labor productivity in industry (real, per person)	0.3	11.8	4.1	8.7	7.8	4.9	4.1	4.7	3.0
Average gross earnings in industry (nominal, per person)	4.8	14.7	13.8	14.9	17.1	14.4	14.7	13.7	12.7
Producer price index (PPI) in industry	–6.6	12.3	19.0	8.3	14.4	21.4	19.3	18.6	16.6
Consumer price index (here: CPI)	11.8	6.9	8.6	6.2	8.1	9.6	9.6	8.2	6.8
EUR per 1 RUB, + = RUB appreciation	–17.5	9.6	–1.5	13.3	4.4	3.3	–4.4	–3.9	–0.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.4	7.5	6.6	6.8	6.9	7.5	6.6	6.2	6.3
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	11.4	8.0	8.1	7.8	7.8	7.8	8.2	8.3	8.2
RUB per 1 EUR	44.1	40.3	40.9	39.5	41.7	40.0	40.3	41.2	42.1
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	17.3	24.6	21.1	25.4	24.6	22.4	19.0	20.5	21.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	10.7	5.8	9.4	11.1	5.8	6.3	3.8	11.2	9.4
Domestic credit of the banking system	19.4	22.1	19.9	20.4	22.1	18.4	15.3	17.0	19.9
of which: claims on the private sector	2.9	12.4	24.4	8.8	12.4	15.2	16.5	23.7	24.4
claims on households	–2.8	3.1	6.4	1.9	3.1	3.5	4.5	5.8	6.4
claims on enterprises	5.6	9.3	18.0	6.9	9.3	11.6	12.1	17.9	18.0
claims on the public sector (net)	16.5	9.7	–4.6	11.6	9.7	3.2	–1.3	–6.6	–4.6
Other assets (net) of the banking system	–12.8	–3.3	–8.1	–6.1	–3.3	–2.2	–0.1	–7.8	–8.1
	% of GDP, ESA 95								
General government revenues	35.0	34.8	38.2	. .	. .	. .	. .	. .	. .
General government expenditures	41.4	38.3	36.6	. .	. .	. .	. .	. .	. .
General government balance	–6.3	–3.5	1.6	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	8.3	8.6	9.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–32.4	39.8	24.2	31.2	28.5	24.1	20.9	22.0	29.2
Merchandise imports	–31.3	37.4	23.7	54.5	37.9	44.0	26.0	13.8	19.3
	% of GDP (based on EUR), period total								
Trade balance	9.0	10.2	10.7	7.6	8.6	12.1	10.9	9.1	10.9
Services balance	–1.6	–2.0	–1.9	–2.5	–2.0	–1.6	–1.8	–2.3	–2.0
Income balance (factor services balance)	–3.3	–3.3	–3.2	–3.2	–3.3	–2.5	–4.5	–2.9	–3.1
Current transfers	–0.2	–0.2	–0.2	–0.4	–0.4	–0.2	0.1	–0.3	–0.2
Current account balance	3.9	4.7	5.4	1.4	3.0	7.8	4.7	3.6	5.7
Capital account balance	–0.9	0.0	–0.0	–0.0	–0.0	0.0	–0.0	–0.0	–0.0
Foreign direct investment (net)	–0.6	–0.6	–0.8	–0.8	–0.5	–0.2	–1.5	0.2	–1.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	36.9	32.6	31.6	33.0	32.6	30.4	30.4	30.6	31.6
Gross official reserves (excluding gold)	32.9	29.6	26.3	31.7	29.6	27.7	27.3	27.4	26.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	19.2	16.3	14.2	17.9	16.3	15.1	14.6	14.8	14.2
	EUR million, period total								
GDP at current prices	879,525	1,121,860	1,333,135	299,627	311,910	291,975	323,641	350,066	36,7453

Source: Bloomberg, national statistical offices, national central banks, wiiw, OeNB.

Box 1

Ukraine: Widening External Imbalances, IMF Program off Track for More than a Year

Ukraine recorded strong GDP growth (5.2%) in 2011, which was mainly driven by private consumption. Moreover, in the second half of 2011, the growth of gross fixed capital formation accelerated considerably, supported by infrastructure investments for the 2012 European football championship. Real exports, however, were hit by declining external demand and fell year on year in the second half of 2011. With real imports still growing, net exports continued to contribute negatively to GDP growth.

Inflation continued its downward trend and dropped to 3% in February 2012. Against the background of disinflation, the central bank cut its refinancing rate by 25 basis points to 7.5% in March.

Domestic demand-led growth was accompanied by widening external imbalances. In 2011, the current account deficit increased to 5.5% of GDP from 2.2% of GDP in 2010. Net FDI inflows covered 75% of the current account deficit.

In the second half of 2011, official foreign exchange reserves shrank markedly due to stepped-up interventions to support the hryvnia's peg to the U.S. dollar. Exchange rate pressures had been triggered by households' depreciation expectations, increasing risk aversion in international financial markets and causing concerns about Ukraine's external accounts to resurface. The pressure on the currency apparently eased in early 2012.

Ukraine's Stand-By Arrangement with the IMF, concluded in July 2010, has already been off track for more than a year. So far, the IMF has disbursed only two tranches amounting to EUR 2.6 billion of a total of EUR 11.6 billion. Ukrainian authorities remained reluctant to raise gas prices for households, a key condition of the IMF to continue the program. Negotiations with Russia to reduce gas import prices, which the Ukrainian authorities see as an alternative to raising domestic gas prices, have so far been inconclusive. Recently, the Ukrainian administration has hinted at being ready to consider changes in domestic gas prices.

Box 2

Western Balkans: Growth Slows while External Adjustment Remains a Challenge

In annual average terms, GDP growth in most Western Balkan countries[1] picked up somewhat in 2011, with annual real GDP growth rates ranging from 1.6% in Serbia to 3.2% in FYR Macedonia and an estimated 5% in Kosovo[2]. However, the growth pattern in all countries of the region changed substantially during the course of the year. Relatively strong dynamics in the first half of 2011 were followed by a slowdown in economic activity in the second half, mainly reflecting spillovers from a deteriorating international environment. A more detailed analysis is hampered by data gaps. Neither demand components are available for all countries covered here, nor are quarterly GDP data available.

In broad terms, the following main trends are discernible. Private consumption grew in all countries in 2011 (no data are available for Serbia[3]). A similar picture can be seen as for gross fixed capital formation (except in Montenegro, where investment contracted). The contribution of net exports to GDP growth fell and turned negative in several countries.

The labor market situation continued to be weak in all Western Balkan countries. Unemployment remained particularly high in Bosnia and Herzegovina (44%), FYR Macedonia (31%) and Serbia (22%) in 2011.

[1] *The Western Balkan region comprises the EU candidate countries FYR of Macedonia and Montenegro, as well as the potential candidate countries Albania, Bosnia and Herzegovina, Kosovo, and Serbia. Developments in Croatia are covered in the country section of this report.*

[2] *The figure for Kosovo is based on an IMF estimate.*

[3] *In the case of Serbia, retail sales data indicate a considerable contraction in 2011.*

All Western Balkan countries recorded current account deficits in 2011. While the deficit was small and fairly stable in FYR Macedonia, deficits in the other countries remained elevated, mostly around 10% of GDP, and on the rise in Serbia as well as in Bosnia and Herzegovina. In Montenegro, the deficit amounted to 19% of GDP, which constituted an improvement compared to 2010 (25%), though. Net FDI inflows covered between half and two-thirds of current account deficits in most countries, only in Bosnia and Herzegovina was the coverage rate considerably lower, while it was above 100% in FYR Macedonia. Overall, coverage rates did not change substantially from 2010 to 2011.

Private sector credit growth picked up in 2011 in almost all countries, reaching between 5% and 15% (in Bosnia and Herzegovina it turned positive in 2011). In contrast, credit to the private sector continued to contract in Montenegro (2011: –11%). In total, the private sector credit stock in Montenegro fell by about 30% from 2009 to 2011. However, credit quality improved in Montenegro, contrary to the other Western Balkan countries, where the share of nonperforming loans increased further. In all countries covered here, it reached levels between 12% and 19% in 2011 (except in Kosovo, where IMF estimates point to a share of bad loans of 6% in total outstanding loans).[4]

Annual average inflation rates tended to rise in 2011 in most countries (except for Serbia and Albania). They ranged between 3% and 4% for Montenegro, FYR Macedonia, Albania and Bosnia and Herzegovina, to 7% and above in Serbia and in Kosovo. In most countries, inflation peaked in the spring of 2011 and eased a bit thereafter, while it started to rise again in early 2012. The central banks of Serbia and of Albania reduced policy rates in 2011 (the other countries have little or no space for monetary policy due to fixed pegs, currency board arrangement or the use of the euro).

All countries posted general government deficits in 2011 of between about 1% and 5% of GDP. Deficit ratios stayed broadly stable compared to 2010, even though revenue developments were somewhat below plan in several countries.

The IMF has continued to be an important policy anchor for some Western Balkan countries. The completion of the first review of the precautionary Stand-By Arrangement Serbia received in September 2011 has been delayed due to unresolved issues about the 2012 budget, while the overall policy performance of the Serbian authorities was found to be largely appropriate. Kosovo has recently applied for a new Stand-By Arrangement, and at staff level, recently agreement was reached on a twenty-month agreement (of an amount of about EUR 107 million). FYR Macedonia continues to have a precautionary credit line agreement with the IMF. Finally, the Stand-By Arrangement of Bosnia and Herzegovina with the IMF is nearing completion and will expire in June 2012.

[4] *It should be noted that cross-country comparisons of NPL data are hampered by differences in classification rules.*