Developments in Selected CESEE Countries:

Economic Recovery Increasingly Driven by Domestic Demand[1,2]

1 Regional Overview

Economic recovery proceeds but risks increased as of late

Economic conditions in Central, Eastern and Southeastern Europe (CESEE) started to recover in early 2013 and continued to do so throughout the review period. The CESEE economies thus developed very much in line with the euro area and other countries in Eastern Europe (e.g. in the Baltics) as well as other emerging market regions, where growth also picked up slightly in the second half of 2013. Most of the CESEE region covered in this report benefited from improving sentiment in Europe, more benign economic activity in the euro area and an incipient recovery of domestic demand. Only Turkey and more importantly Croatia lagged behind. Yet the recovery thus remains uneven and continues to be fragile. One risk at the current juncture relates to the future impact on emerging markets of the U.S. Fed's tapering of quantitative easing. Against this backdrop, especially Russia and Turkey have already been experiencing capital outflows and currency depreciation since mid-2013. These developments were exacerbated by rising political risks that climaxed in the context of the geopolitical tensions around Crimea. A further escalation of the conflict, including full-fledged economic and financial sanctions on the part of the EU vis-à-vis Russia, could severely affect economic conditions in the region. So far, however, the impact on the CESEE countries has been contained and limited to Russia. The region has relatively limited direct export linkages with Ukraine, and gas exports from Russia so far seem to run smoothly. Furthermore, the impact on CESEE financial markets has remained limited so far and also restricted to the Russian economy, which seems to have been affected substantially already, though (negative rating outlooks, weaker currency, deteriorating sentiment).

Accelerating economic momentum…

Following slow but steady improvements throughout 2013, quarterly year-on-year growth in the CESEE region averaged 0.7% and 0.8% in the third and fourth quarter, respectively. From this perspective, growth accelerated in all countries of the region, except for Croatia and Turkey. Slovenia, the Czech Republic and Romania even reported growth rates of above 1% in the final quarter of 2013. When looking at annual year-on-year growth rates, the pick-up in economic activity becomes even more apparent. Again with the exception of Croatia and Turkey, all countries displayed a clear upward growth trend.

A somewhat more positive economic momentum can also be observed for developments in 2013 as a whole. Growth picked up somewhat, or was at least less negative than in 2012, in most countries.

…as domestic demand is starting to pick up

The improvement was underpinned by strengthened domestic demand. Gross capital formation in particular performed well as fixed investments increased and the inventory cycle started to turn. This is especially true for the EU Member States of the region, many of which reported substantial increases in this area.

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[2] *Cutoff date: April 9, 2014. This report focuses primarily on data releases and developments from October 2013 up to the cutoff date and covers Slovakia, Slovenia, the Czech Republic, Croatia, Bulgaria, Hungary, Poland and Romania, as well as Turkey and Russia. For statistical information on selected economic indicators for CESEE countries not covered in this section (Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, Serbia and Ukraine), see the Statistical Annex in this issue.*

Table 1

Real GDP Growth

	2012	2013	Q1 13	Q2 13	Q3 13	Q4 13
	Period-on-period change in %					
Slovakia	1.8	0.9	0.3	0.3	0.3	0.4
Slovenia	–2.5	–1.1	0.1	0.2	0.4	1.2
Bulgaria	0.6	0.9	0.3	0.2	0.5	0.3
Croatia	–1.9	–1.0	0.0	–0.3	–0.2	–0.4
Czech Republic	–1.0	–0.9	–1.3	0.3	0.3	1.8
Hungary	–1.7	1.1	1.1	0.3	0.8	0.5
Poland	2.0	1.6	0.4	0.6	0.7	0.5
Romania	0.5	3.5	0.6	0.8	1.6	1.5
Turkey	2.5	4.0	1.6	2.1	0.9	0.5
Russia	3.4	1.3	0.2	0.4	0.6	0.9
CESEE average[1]	2.3	1.8	0.5	0.8	0.7	0.8
Euro area	–0.7	–0.4	–0.2	0.3	0.1	0.2

Source: Eurostat, national statistical offices.

[1] *Average weighted with GDP at PPP.*

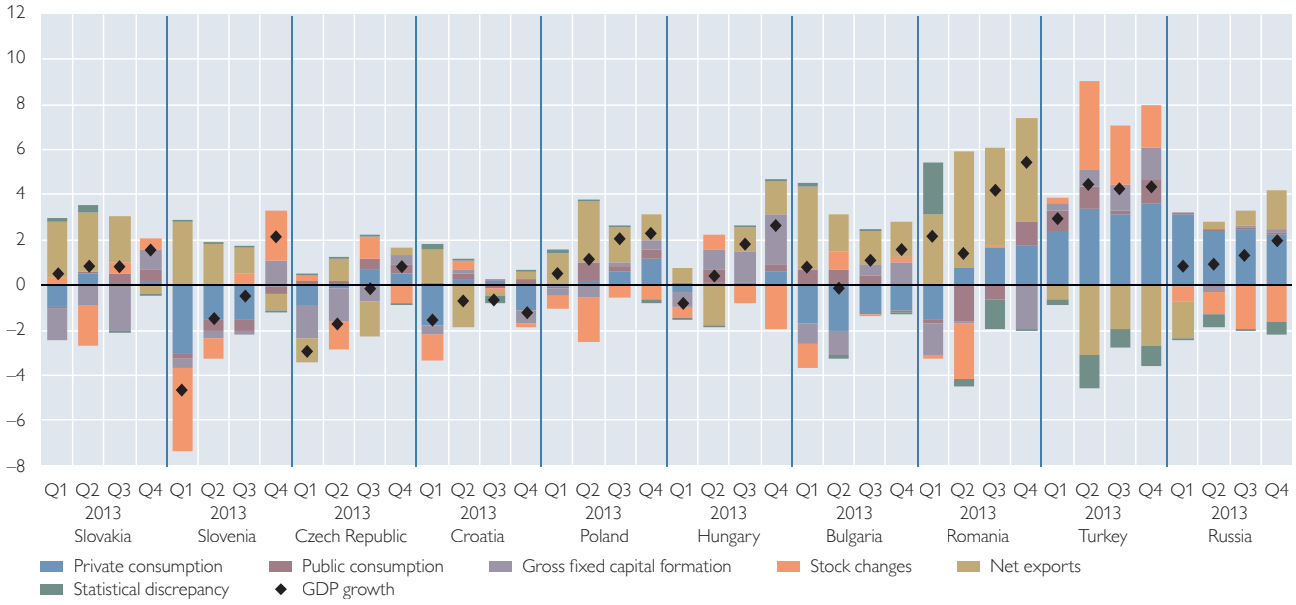
Evidently, unmet investment needs could finally be addressed after two years of stagnating capital formation or even disinvestment.

Several pieces of evidence can explain this development: Improving forecasts of external economic activity might have prompted exporters across the region to start modernizing and expanding production in anticipation of future business opportunities. Furthermore, the end of the EU's multiannual financial framework 2007–2013 encouraged public investment as countries sought support for as many

Chart 1

GDP Growth and Its Main Components

Percentage points, GDP growth in %



Source: Eurostat, national statistical offices.

EU-funded projects as possible in order to increase the absorption rate of the funds allocated.

The export-oriented industrial sector of the region generally developed very positively as well, with the exception of Russia and Croatia. In the other CESEE countries, industrial production increased from around –0.5% on average in January 2013 to around 6.5% on average in January 2014. Romania even registered double-digit growth rates. This was mirrored by value added in industry, which started to contribute positively to growth in nearly all countries under observation. Against this backdrop, capacity utilization was on the rise, reaching up to 75% or 80% in the first quarter of 2014 in most countries. The increase was especially strong in Poland, Hungary and Slovakia but also in Slovenia.

However, the most important factor for the pick-up in capital formation was probably improving sentiment in the region as well as throughout Europe. The Economic Sentiment Indicator (ESI) of the European Commission for example rose to 100.5 points on average in March 2014, the highest reading since mid-2011 and in line with its long-term average, having increased by more than 8 points since early 2011. The improvement was rather broad based among all sectors of the economy, but driven above all by construction and consumer sentiment. This general picture is, in principle, confirmed by manufacturing PMI data (which, however, are only available for a few countries). The index has been showing a clear upward trend in Poland, the Czech Republic and Turkey since spring 2013 and currently stands clearly above 50, indicating an expansion. The more recent slight decrease of the index in March might be related to the developments in Ukraine, the effects of which have not yet been observed in the ESI. The PMI for Russia decreased notably in the past months, from 51.8 in October 2013 to 48.3 in March 2014.

Private consumption developed less favorably than investment. However, against the background of increasingly positive sentiment and a cautious improvement of labor market conditions, some recovery can also be observed in this area. Consumption growth was slightly positive and no longer dampened economic momentum in any country but Bulgaria and Croatia.

Seasonally adjusted unemployment rates surpassed their peaks in early 2013 and have trended downward somewhat since then in all countries but Bulgaria. In some cases, however, the improvement was only marginal and unemployment rates remained especially high in Slovakia, Bulgaria and Croatia. Meanwhile, a broad-based turn in employment growth is yet to emerge. Still, employment increased somewhat in Slovakia, the Czech Republic, Hungary, Poland and Turkey. In the latter country, employment growth moderated markedly. A strong decrease of inflation supported real wage developments throughout the region. Real wage growth was positive in most countries and in some cases even accelerated significantly.

Net exports lose some of their importance for economic activity

Net exports continued to drive economic growth only in a few CESEE countries (especially in Croatia, Russia and Hungary). Export activity started to accelerate in early 2013 and continued to rebound in the review period in all countries but Croatia and Turkey. However, given increasing domestic demand and the associated pick-up in imports, the contribution of net exports to GDP growth generally lost some of its recent importance. In the fourth quarter, for example, net exports negatively impacted on economic momentum for the first

time since mid-2011 in Slovakia and even for the first time since the outbreak of the crisis in Slovenia. In many countries, the growth contribution of the external sector nevertheless remained an important backbone for economic activity.

Besides the acceleration of international demand, the robust export performance also reflects gains in competitiveness. Growth of unit labor costs (ULC) in manufacturing (measured in euro) has been broadly favorable in the countries under observation already for several quarters. Only Slovenia and Croatia lost some competitive edge against the backdrop of deteriorating productivity. The other countries benefited from productivity advances as well as from some depreciation of local currencies against the euro and mostly reported declining unit labor costs.

No notable momentum in the financial sector

The incipient economic recovery has so far not been accompanied by improvements in financial sector activity. Growth of domestic credit to the private sector remained anemic during the review period throughout most of CESEE, with annual growth rates (adjusted for exchange rate changes) often only at around 2% or below and even showing a downward trend in several cases. This is especially true for Slovenia, where the transfer of nonperforming assets into a bad bank in December caused the credit stock to shrink. Several other countries, particularly Hungary but also Croatia and as of late (though to a lesser extent) Romania, have faced a deleveraging of households and/or corporations, which was attributable not only to the weak economic momentum, but also in part related to domestic banking sector problems (including sectoral taxes, high NPL burdens, partly due to foreign currency loans going bad against the backdrop of currency depreciation, and/or governance problems in a few countries). Rising credit growth was still reported for Slovakia, Poland and Turkey.

It is not completely clear why credit growth has not yet started to accelerate more notably. The pick-up in domestic demand that we currently see in many countries should in general be accompanied by an increasing demand for credit, and there is actually some evidence that credit demand is rising. For example, the Emerging Markets Bank Lending Conditions Survey of the Institute of International Finance (IIF) for the fourth quarter of 2013[3] reports that loan demand continued to improve across all loan categories. Demand for consumer credit was particularly strong, reflecting policy rate cuts and a recovery in private consumption in the region, at least in Central Europe. Furthermore, overall bank lending conditions remained broadly stable in the second half of 2013 after having improved somewhat in late 2012 and early 2013.

On the other hand, the survey also finds that credit standards were tightened across all loan categories and that local and international funding conditions continued to deteriorate. The deterioration in the fourth quarter, however, was less pronounced than in the third quarter given policy rate cuts and a limited impact of international financial market volatility on domestic assets.

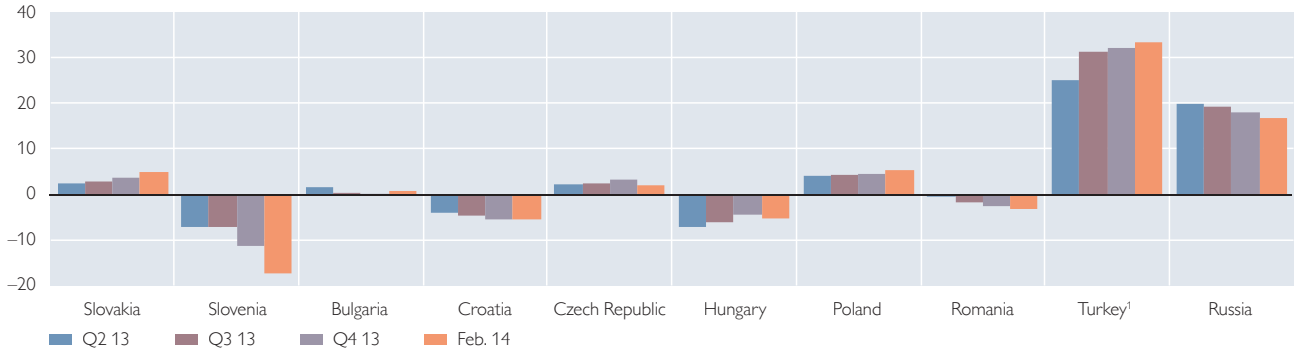
Nevertheless, access to both domestic and foreign sources of financing seems to be guaranteed. Deposit growth outpaced credit growth in the second half of 2013 and the credit expansion was fully covered by higher deposits in all countries except Turkey and Russia. Furthermore, the consolidated exposures of BIS-reporting banks remained broadly stable in the third quarter of 2013 (more recent data were not available at the time of writing) after having declined by

[3] *www.iif.com/download.php?id=uDX7O/1A/SA=*

Chart 2

Growth of Credit to the Private Sector

%, year on year, adjusted for exchange rate changes



Source: National central banks.

[1] Nonadjusted.

some EUR 10 billion in the second quarter. Declining exposures between the second and the third quarter were reported especially for Croatia, Slovenia and Hungary, countries where a higher deleveraging pressure has been impacting negatively on banking sector flows already for several quarters. A substantial increase, on the contrary, was reported for Poland (by EUR 2 billion).

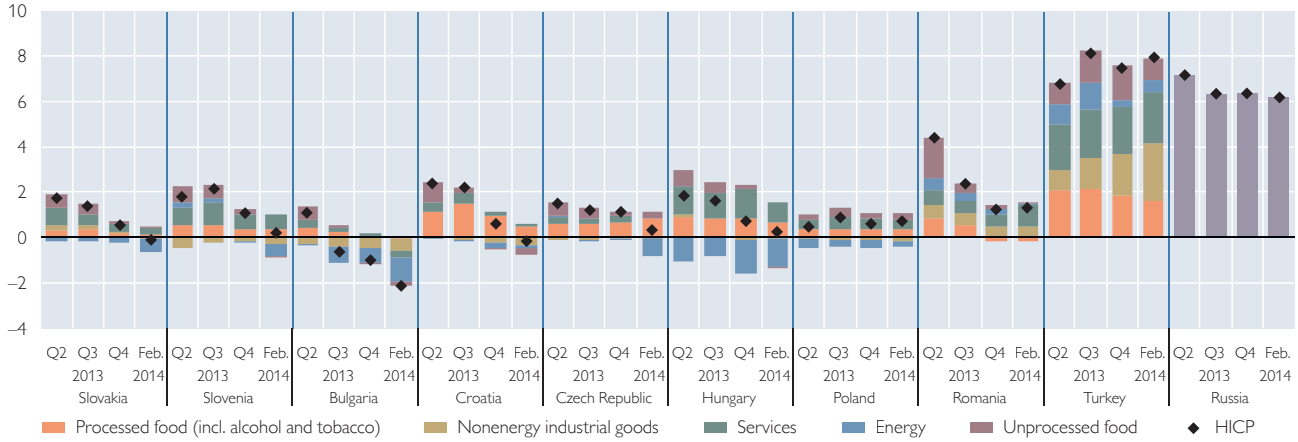
Strong disinflationary tendencies in most countries of the region

Strong disinflationary trends can be observed in most countries of the region during the review period (see chart 3). Disinflation was most pronounced in Croatia and Slovenia (more than 2 percentage points from the third quarter of 2013 until February 2014) followed by Bulgaria, Hungary and Slovakia (around 1.5 percentage points in the same period). In February, prices even started to shrink in Croatia and Slovakia. Bulgaria has been experiencing deflation since August 2013 and currently reports the lowest inflation rate by far in the EU.

Chart 3

HICP Inflation and Its Main Drivers

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



Source: Eurostat.

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

Somewhat higher and more stable inflation rates were reported for Turkey and Russia. Price developments in those countries, however, have to be assessed against the backdrop of strong currency depreciation since mid-2013 (in both countries close to 20% against the euro).

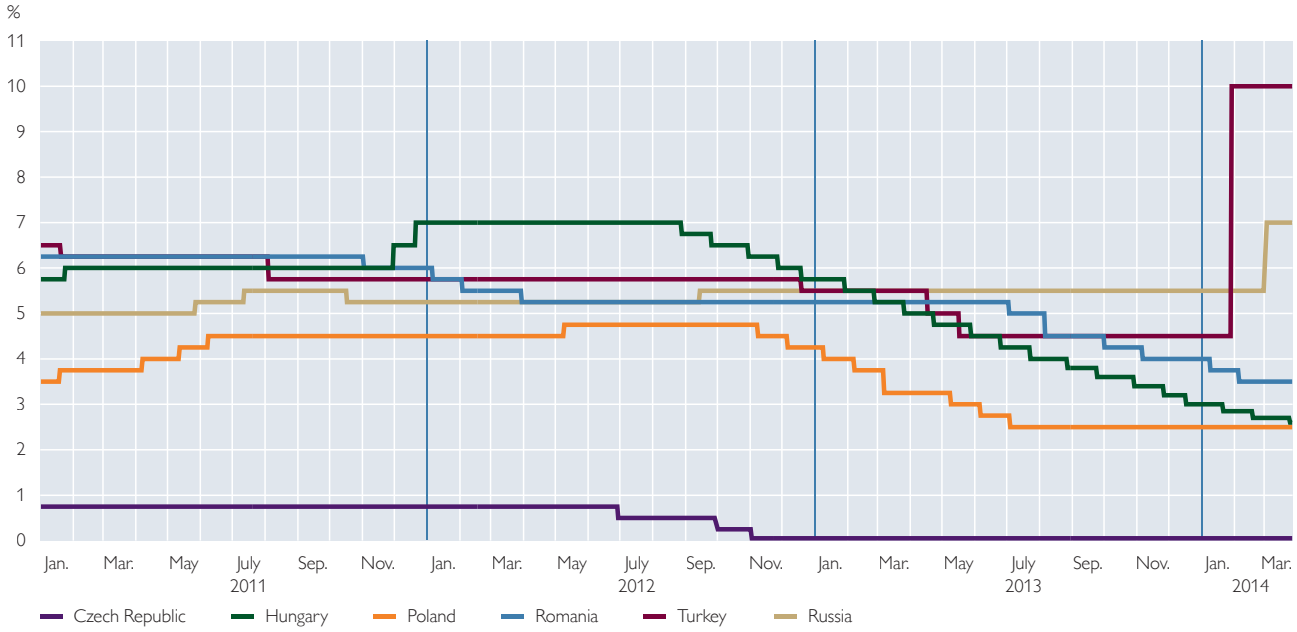
Energy prices played an important role in explaining disinflation. In February, they no longer contributed to driving up prices in any country but Turkey. Price pressures from the other components of the HICP were easing as well, most notably with regard to food prices. This is especially true for Hungary, Bulgaria, Romania and Croatia, where food prices soared in 2012 on account of draughts. The ensuing base effect combined with a good harvest in 2013 led to deflation in this area in late 2013 and early 2014. In some countries, adjustments of administered prices (e.g. Czech Republic, Bulgaria, Hungary) and base effects after tax rises in the past (e.g. Czech Republic) further dampened price growth. Core inflation rates decreased less than headline inflation rates but nonetheless also demonstrated a clear downward trend (Bulgaria again reported core deflation). Uncertainty with regard to the employment situation, fiscal austerity, and subdued domestic credit dampened demand. In combination with existing excess capacities, this tempered wage demands and deprived retailers and producers of pricing power.

Monetary policy continues to be accommodative…

Against the backdrop of substantial disinflation, many central banks of the region continued to pursue a policy of monetary accommodation (see chart 4). The Hungarian central bank and the Romanian central bank cut their policy rates by a total of 100 basis points from mid-October to early April, lowering them to 2.6% and 3.5% respectively. The Czech Republic's policy rate has been standing at "technically zero" since October 2012. In November 2013, the Czech central bank decided to use the exchange rate as an additional instrument for easing monetary

Chart 4

Policy Rate Developments in CESEE



Source: National central banks.

conditions and to keep the exchange rate of the koruna against the euro at a level of close to 27 CZK per EUR. The two euro area countries, Slovenia and Slovakia, implemented the ECB's interest rate decision of November 2013.

…except for Russia and Turkey

Running counter to developments in Central Europe, Turkey and Russia increased their policy rates strongly, owing to substantial currency depreciation in the observation period. The Turkish lira lost some 6.5% against the euro between early October 2013 and early April 2014, while the Russian ruble depreciated by some 11% in the same period (see chart 5). This development was on the one hand related to broader global factors, especially the announced and finally executed tapering of quantitative easing by the U.S. Fed that put pressure on emerging markets worldwide. On the other hand, domestic political uncertainty adversely impacted on exchange rates (mass protests and corruption allegations in Turkey together with elections ahead, the conflict around Crimea in Russia). Both the Turkish lira and the Russian ruble traded at historical lows in the first quarter of 2014. Foreign currency interventions and decisive policy rate rises from 4.5% to 10% in Turkey (one-week repo rate) and from 5.5% to 7% in Russia, however, helped stabilize markets and the currencies have since recovered some of their losses.

Further external adjustment in many countries of the region

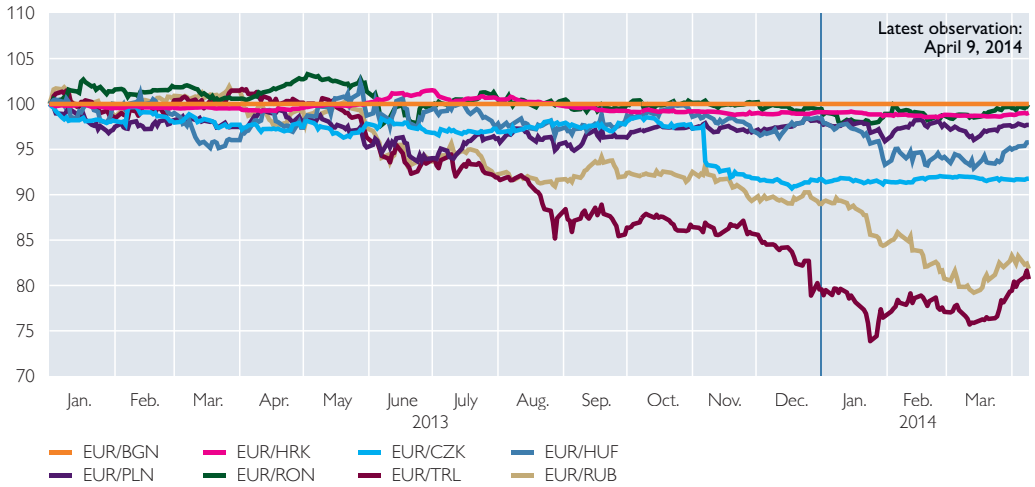
The combined current and capital account for the region as a whole continued to be broadly balanced in the review period. On the country level, two opposing trends were at work, however: While current account surpluses improved further in most EU Member States of the country sample, external balances deteriorated somewhat in Russia and Turkey. In Russia, it was especially higher net outflows from investment income that negatively impacted on the external accounts. In Turkey, strong consumption and investment dynamics drove the trade balance deeper into the reds despite a weakening currency.

All of the EU Member States of the region reported (sometimes substantial) current account surpluses. In many cases, surpluses even increased further during

Chart 5

Exchange Rate Developments versus the Euro

1.1.2013 = 100; increases indicate appreciation

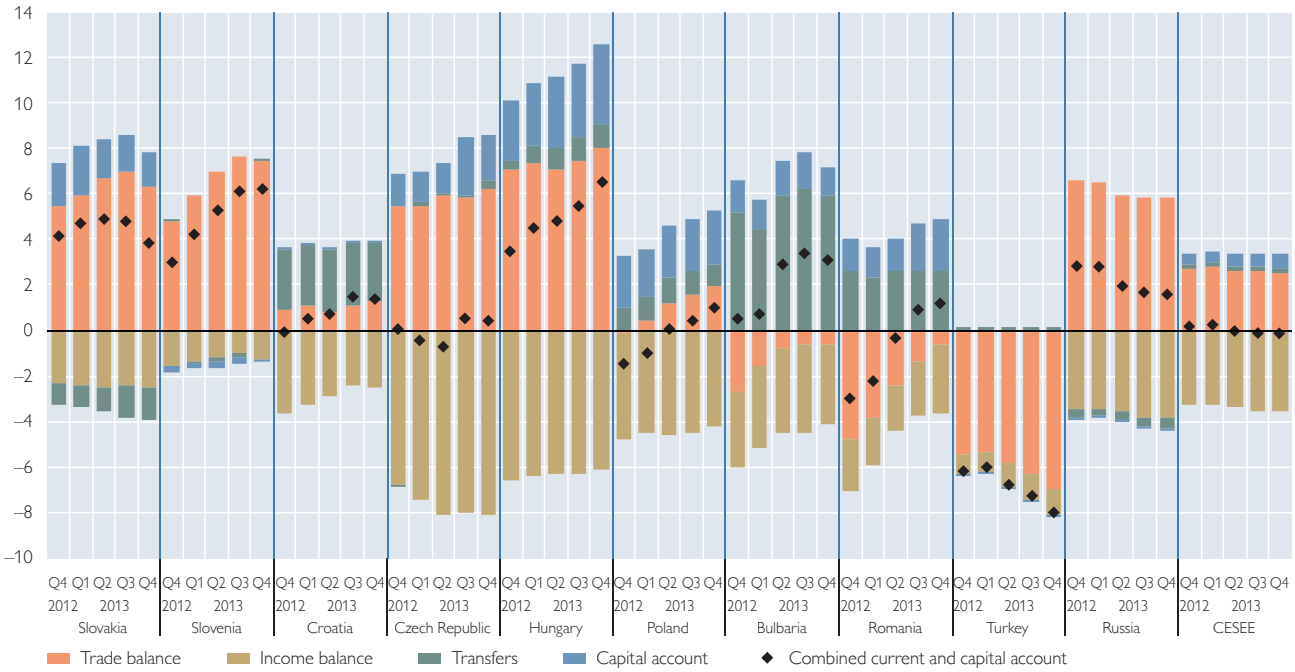


Source: Thomson Reuters.

Chart 6

Combined Current and Capital Account Balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

the review period as a recovery of economic conditions in major export markets and partly lower import prices (e.g. for food, commodities and energy) had a positive impact on trade balances. Furthermore, the improvement of the capital account that was observed in e.g. the Czech Republic and Romania is likely to reflect the higher number of EU co-financed investment projects that were implemented as the deadline for the multiannual financial framework ending 2013 drew nearer.

Lower but still positive capital flows to the region

Net capital flows to the ten CESEE countries as a whole decelerated markedly from 5.9% of GDP in the second quarter of 2013 to 2.6% of GDP in the fourth quarter of 2013 (four-quarter moving sums) (see chart 7). The deterioration was driven mostly by lower net portfolio inflows, while net FDI flows were somewhat lower (but still slightly positive) too. At the same time, net outflows of other investments moderated, indicating an easing of deleveraging pressure in the observation period.

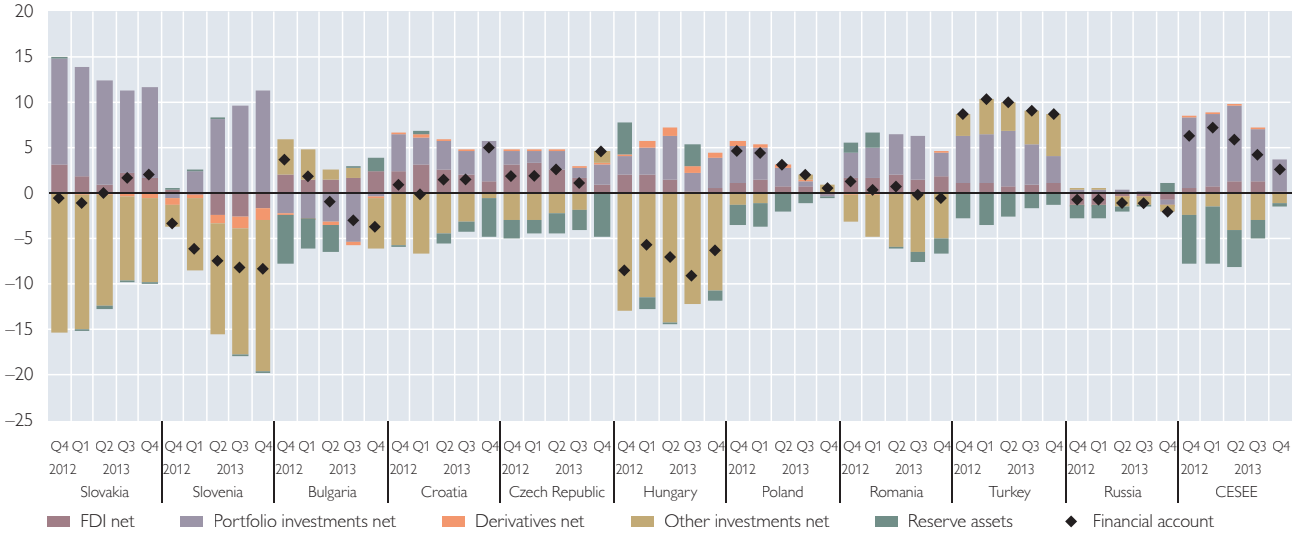
On the country level, the development was very much driven by three markets: Poland, Russia and Turkey. The net portfolio position (based on four-quarter moving sums) of those three countries deteriorated by more than EUR 42 billion between the second and the fourth quarter of 2013. 80% of this sum originated from Russia and Turkey against the backdrop of political uncertainty and tapering. In Poland, bond repayments weighted on portfolio investments.

Among the other countries, a stronger deterioration in the financial account was observed only in Bulgaria, where a substantial outflow of other investments was reported for the final quarter of 2013. In the rest of the region, financial

Chart 7

Financial Account Balance

% of GDP, four-quarter moving sum



Source: National central banks.

account balances were roughly stable or even improved somewhat during the review period (e.g. Czech Republic, Croatia and Slovakia).

Somewhat higher budget deficits in most countries in 2013

Most countries under observation reported somewhat higher budget deficits in 2013 than they did in 2012, contrary to plans to reduce the fiscal deficits as outlined in the EU Stability and Convergence Programs in April 2013. The deterioration was mainly related to weak domestic demand especially in the first half of 2013 that caused revenues to underperform. The increase in the budgetary gap was most pronounced in Slovenia, where one-off factors, including those related to bank recapitalization, drove up the deficit from –4% of GDP in 2012 to –14.7% of GDP in 2013. Only Romania, Slovakia and the Czech Republic reported lower budgetary shortfalls than in 2012.

Slovakia and the Czech Republic are also the two countries in the region which had committed to reduce their deficits to below 3% of GDP under the excessive deficit procedure (EDP) by 2013. With shortfalls of 2.8% and 1.5% of GDP, this goal was clearly met, and the EDP should officially be abrogated in early summer. With that, Slovenia, Poland and Croatia remain the only CESEE EU countries still subject to an excessive deficit procedure. In the case of Slovenia, the target date for a correction had to be extended by two years, from 2013 to 2015, due to unexpected adverse economic developments, including a double-dip recession, weakening labor markets and large macroeconomic imbalances. In the case of Poland, the deadline was extended to 2015, following an initial extension from 2012 to 2014. After having deteriorated to 4.3% of GDP in 2013, the fiscal deficit is projected to turn into a surplus of some 5% of GDP in 2014, given a one-off transfer of assets. In January 2014, the EU Council found Croatia to run an excessive deficit in the evaluation round following the latter's EU accession. The deadline for a correction was set at 2016.

Box 1

Ukraine: Challenging Political and Macroeconomic Environment

In November 2013, public protests were triggered by the Ukrainian government's decision to suspend the process of preparations for an EU association agreement (including a deep and comprehensive free trade agreement) that the EU stood ready to sign at the Eastern Partnership summit scheduled for end-November 2013 in Vilnius. Initially peaceful protests were forcefully dissolved by the police, which prompted even larger demonstrations. Over the subsequent three months, protests and actions by authorities turned more and more violent. On February 22, president Yanukovich disappeared and parliament voted to remove the president from power. Subsequently, an interim president and a new government were approved by parliament, pending presidential elections that were set for May 25. The regime change was followed by a conflict with Russia, also because of Russian support for the secession of Crimea from Ukraine. Russia subsequently suspended the support package it had agreed in December with Yanukovich, i.e. its planned purchase of USD 15 billion Ukrainian eurobonds and a gas price discount. Moreover, pro-Russian activists started to occupy official buildings in some cities of Eastern Ukraine.

The political crisis and the conflict with Russia came at a time of rather adverse macroeconomic conditions for Ukraine: In 2013, the economy was stagnating the second year in a row. The 2013 fiscal deficit stood at 4.5% of GDP and, on top of this, the 2013 deficit of the state-owned gas company Naftogaz reached nearly 2% of GDP. Furthermore, Ukraine's current account deficit climbed to 8.9% of GDP. High external debt service requirements and a low level of official foreign currency reserves added to the high level of external vulnerability.

The National Bank of Ukraine (NBU) pursued a relatively tight de facto peg against the USD from early 2009 until early 2014. Exchange rate risks materialized in the first quarter of 2014. The NBU ran down its foreign currency reserves to keep the exchange rate stable, as the hryvnia repeatedly came under pressure. As pressures further intensified in January and February this year, the NBU finally let the exchange rate float. Though administrative restrictions on foreign currency transactions were broadened during the time of the protests, foreign currency reserves declined further (to USD 15.1 billion in March 2014, covering less than two months of imports). After heavy interventions in January and February, the NBU stopped intervening on the foreign exchange market to support the hryvnia in March, while the currency continued to weaken. At the end of March, the central bank started to reduce capital controls introduced in February. From the end of 2013 to mid-April 2014 the currency lost more than 30% against the USD. Against this backdrop and pointing to the exchange rate pass-through on inflation, the NBU raised the discount rate by 300 basis points to 9.5% in mid-April.

The depreciation of the hryvnia will negatively impact credit quality, though the share of foreign currency loans to total loans in the household sector declined from 69% at end-2010 to 35% at end-2013 due to central bank restrictions. Yet, the remaining stock of foreign currency loans in the household sector is still considerable.

Given the economy's high external financing needs the new government requested support from the IMF. On March 27, the IMF announced a staff-level agreement with Ukraine on a two-year USD 14 to 18 billion Stand-By Arrangement. This forms part of a broader support package by the international community, which is set to total USD 27 billion over the next two years. The exact contribution of the IMF will be determined once all bilateral and multilateral support is accounted for. The economic program under the arrangement inter alia comprises a flexible exchange rate policy and the introduction of inflation targeting, financial sector reforms, fiscal adjustment, and an increase in retail gas and heating tariffs.

Box 2

Western Balkans: Emerging from Recession

The growth performance across the Western Balkan countries improved considerably in 2013 compared to 2012 with the exception of Albania. In Bosnia and Herzegovina, Montenegro, FYR Macedonia and Serbia, real GDP growth figures moved into positive territory. As most CESEE countries covered in this report, Western Balkan countries benefited from booming exports, particularly Serbia, while at the same time import growth decelerated in most cases, leading to positive contributions of net exports to GDP growth. Domestic demand generally remained weak, suppressed by persistently high unemployment rates, low or declining real wage growth and restrictive lending conditions. Albania's real GDP declined in the first three quarters of 2013 but turned positive in the final quarter of 2013.

With unemployment rates (annual averages, based on Labour Force Surveys) between 15.6% (Albania) and 31% (Kosovo), labor markets continue to be one of the main concerns in the region. However, Bosnia and Herzegovina, FYR Macedonia and Serbia recorded slightly declining unemployment rates in 2013 compared to 2012. Particularly in the case of Albania, the labor market was affected by a sizable number of migrants returning home from the crisis-hit countries Greece and Italy. These developments were also reflected in the inflow of remittances: According to the World Bank, remittances to Albania declined by 2 percentage points of GDP in the first half of 2013.

In 2013 stronger export and weaker import growth generally narrowed the trade gap leading to a smaller current account deficit particularly in Serbia. Only in Albania did the shortfall of the current account increase somewhat in 2013 (to around 10.5% of GDP). With 15% of GDP, the current account deficit is still at an elevated level in Montenegro (2012: –18.7% of GDP) while FYR Macedonia recorded the smallest current account deficit in the region with 1.9% of GDP. In 2013, net FDI inflows increased in all countries compared to 2012 but in Montenegro.

Credit growth to the nonbank private sector continued to be weak or even negative in most Western Balkan countries. Noticeably, in Montenegro credit growth was positive in 2013 (+5.2%) after years of contraction. However, in the last quarter of 2013, credit growth declined by almost 2% again. Elevated and still increasing levels of nonperforming loans pose one of the greatest challenges for financial stability to the region. In 2013, Albania and Serbia reached NPL ratios of more than 20%. With about 8% to 10% Kosovo and FYR Macedonia showed the lowest NPL levels. In all Western Balkan countries efforts to tackle the problem of high NPL levels are underway.

Not only in the CESEE countries but also in the Western Balkans, inflation slowed down in the course of 2013 and in early 2014. In Serbia, inflation dropped from double-digit rates in the first and second quarter of 2013 to 2.0% in the final quarter of 2013 and stayed low in the first months of 2014, thus reaching the lower bound of the inflation target with 4% ±1.5 percentage points of the Serbian central bank. In Albania, the lower bound of the inflation target (3% ±1 percentage point) was reached as well. Bosnia and Herzegovina has experienced accelerating deflation since August 2013 (price decrease of 1.6% in February 2014). In Montenegro, inflation was also very low in recent months (fourth quarter of 2013: 0.2%, January and February 2014: –0.5% and –0.6%, respectively). Low inflation rates were largely driven by a sharp drop of food and beverage prices as well as clothing prices but were also due to low price increases of imported goods. The Serbian central bank continued its monetary easing cycle and cut the key policy rate in three steps, from 11% in June 2013 to 9.5% in December 2013. Albania also cut its key interest rate in three steps (from 3.5% in October 2013 to 2.75% in February 2014).

Regarding the fiscal stance, developments were uneven across the region. Comparing 2013 with 2012, budget deficits are expected to deteriorate significantly in Albania and Kosovo and modestly Bosnia and Herzegovina. In the other countries, deficits remained broadly unchanged or even decreased somewhat (Serbia). Public debt levels are increasing in

all countries but in Bosnia and Herzegovina. The increase will be particularly pronounced in Albania, bringing the debt level to 70% of GDP (2012: about 60% of GDP).

Over the last months, progress was made on the way to EU membership. Most importantly, Serbia started official EU accession negotiations in January 2014, and Albania can be expected to become an EU candidate country in the near future. In contrast, some internal problems in Bosnia and Herzegovina were an obstacle for the disbursement of EU funds, leading to a cut of IPA (Instrument for Pre-Accession Assistance) for the year 2013 by 50%. In February 2014, the IMF granted Bosnia and Herzegovina more time in order to meet reform commitments under the sixth review of the Stand-By Arrangement (SBA). In early 2014, the IMF approved a 36-month arrangement of about EUR 330 million under the Extended Fund Facility for supporting the reform program in Albania and concluded the second post-program monitoring with FYR Macedonia. In Kosovo, the fifth SBA review took place at the end of 2013. There are no financial arrangements with Montenegro and Serbia.

2 Slovakia: Temporary Slowdown in 2013 but Back to Faster Speed in 2014

Turning point to a more balanced growth composition

Despite an improving momentum in the second half of the year, Slovakia's GDP growth declined to 0.9% in 2013. Net exports remained the main growth driver. After a significant expansion of car production in 2012, the car industry – a key sector in the economy – is getting close to its maximum capacity. Thanks to a rise in real disposable income and consumer confidence, private consumption was showing signs of recovery. Positive growth rates have been reported since the second quarter of 2013. Public consumption growth turned positive after two years of decline due to slower consolidation. Gross fixed capital formation decreased substantially in 2013, but finally started to increase in late 2013 after seven negative quarters. As many new sections of motorways are planned for 2014, government investment is expected to grow further this year. Taking these factors into account, a more balanced growth composition is expected for 2014.

Trade surplus hits record high in 2013

The current account surplus peaked at 2.4% of GDP in 2013. This was mainly due to a record high surplus in the trade balance (6.1% of the GDP) while the service balance delivered a slightly positive contribution too. Although inflows strengthened in the second half of 2013, at 1.8% of GDP net FDI in 2013 was markedly lower than a year before.

Significant decrease in inflation but no risk for long-lasting deflation

The significant decrease in inflation was caused mainly by a continued fall of energy and commodity prices as well as weak demand. The HICP is currently among the lowest in the European Union and entered negative territory in February 2014 (–0.1% year on year). However, because of a brightening economic outlook in Slovakia, deflation is not expected to be persistent. A slow rise of the price level is projected over the coming months.

Labor market remains comparatively weak

The employment rate has been stagnating at close to 60%, and with 14.3% in the last quarter of 2013, the unemployment rate remains one of the highest in the EU. Despite a slight decrease in unemployment in early 2014, GDP growth is not yet sufficiently high to kick-start a substantial turn in the labor market. On a positive note, robust growth in manufacturing production and an unchanged labor market situation suggest improving labor productivity in manufacturing (with 11.2% in the fourth quarter of 2014 and a growing trend).

Revenue-based fiscal consolidation

The budget deficit in 2013 decreased to below 3% of GDP. Thus, Slovakia met its commitment within the excessive deficit procedure to remove its excessive deficit in 2013. This achievement was mainly fueled by one-off measures (e.g. sale of emergency oil reserves or a levy on business operations in regulated industries). However, higher-than-budgeted revenue elements (e.g. VAT collection) as well as lower-than-budgeted expenditures (e.g. public investments) also contributed to the better outcome.

In 2013, the gross public debt level increased to 55.4% of GDP. Hence, it exceeded not only the first threshold (set at 50% of GDP) but also the threshold of 53% of GDP defined under the constitutional Fiscal Responsibility Act. At this stage, the regulation demands for additional fiscal policy sanctions (e.g. the salaries of the cabinet members had to be frozen in the 2014 budget). Forecasts for 2014 suggest debt levels to rise further to slightly above the next threshold at 57% of GDP, which is close to the Maastricht level, even though some one-off measures will be undertaken in 2014. The planned sale of telecom shares and use of this extra revenue for debt reduction would decrease the debt level by approximately 0.2% of GDP.

Table 2

Main Economic Indicators: Slovakia

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	3.0	1.8	0.9	1.9	0.4	0.5	0.8	0.9	1.5
Private consumption	–0.5	–0.2	–0.1	–0.4	–0.8	–1.6	0.9	0.1	0.3
Public consumption	–4.3	–1.1	1.4	–1.1	–0.9	–0.3	0.4	2.8	2.5
Gross fixed capital formation	14.2	–10.5	–4.3	–6.6	–10.9	–7.9	–4.8	–9.8	4.0
Exports of goods and services	12.2	9.9	4.5	13.3	8.2	4.9	4.4	1.9	6.6
Imports of goods and services	9.7	3.3	2.9	7.0	4.5	2.5	1.9	–0.4	7.4
	Contribution to GDP growth in percentage points								
Domestic demand	1.0	–4.1	–0.8	–3.4	–3.1	–2.0	–2.1	–1.2	2.1
Net exports of goods and services	2.0	5.9	1.7	5.2	3.6	2.5	2.6	2.1	–0.4
Exports of goods and services	9.8	8.8	4.3	11.0	7.6	4.7	4.4	1.7	6.6
Imports of goods and services	–7.8	–2.9	–2.6	–5.8	–4.0	–2.3	–1.7	0.3	–7.0
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	0.7	1.0	–1,0	0.5	2.2	0.1	–1.1	–1.5	–1.4
Unit labor costs in manufacturing (nominal, per hour)	2.6	–6.6	–2.4	–11.4	–4.0	1.6	–0.5	–3.1	–7.0
Labor productivity in manufacturing (real, per hour)	2.7	12.6	7.9	15.5	10.8	7.1	6.1	7.4	11.1
Labor costs in manufacturing (nominal, per hour)	5.4	5.1	5.3	2.3	6.4	8.8	5.6	4.1	3.3
Producer price index (PPI) in industry	4.5	1.9	–1.0	1.8	2.0	0.5	–0.7	–1.5	–2.3
Consumer price index (here: HICP)	4.1	3.7	1.5	3.8	3.6	2.2	1.7	1.4	0.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	13.7	14.0	14.3	13.7	14.5	14.6	14.1	14.1	14.3
Employment rate (%, 15–64 years)	59.3	59.7	59.9	60.1	59.4	59.8	59.8	60.0	59.8
Key interest rate per annum (%)	1.2	0.9	0.5	0.8	0.8	0.8	0.6	0.5	0.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	0.7	6.6	5.9	1.9	6.6	5.5	6.1	5.6	5.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–3.8	–3.1	0.5	2.7	–3.1	0.4	–5.9	–6.5	0.5
Domestic credit of the banking system	9.4	–7.1	0.7	–4.5	–7.1	–10.9	–7.0	–2.2	0.7
of which: claims on the private sector	6.9	–0.1	5.1	0.5	–0.1	1.8	2.8	3.4	5.1
claims on households	3.9	3.9	4.1	3.7	3.9	3.9	4.1	4.1	4.1
claims on enterprises	2.9	–4.0	1.0	–3.2	–4.0	–2.1	–1.3	–0.7	1.0
claims on the public sector (net)	2.5	–6.9	–4.4	–5.1	–6.9	–12.7	–9.8	–5.6	–4.4
Other assets (net) of the banking system	–4.9	16.7	4.6	3.8	16.7	16.0	19.0	14.3	4.6
	% of GDP, ESA 95								
General government revenues	34.1	33.7	35.9	. .	. .	. .	. .	. .	. .
General government expenditures	38.9	38.2	38.7	. .	. .	. .	. .	. .	. .
General government balance	–4.8	–4.5	–2.8	. .	. .	. .	. .	. .	. .
Primary balance	–3.2	–2.7	–0.8	. .	. .	. .	. .	. .	. .
Gross public debt	43.6	52.7	55.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	46.2	44.8	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	27.0	28.3	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	1.5	5.0	6.1	3.9	5.3	7.8	9.1	4.6	3.4
Services balance	–0.5	0.4	0.2	0.5	0.5	–0.3	0.2	0.9	–0.1
Income balance (factor services balance)	–4.2	–2.3	–2.5	–2.4	–2.4	–2.6	–2.4	–2.3	–2.5
Current transfers	–0.5	–0.9	–1.5	–1.2	–1.1	–0.6	–1.6	–2.0	–1.7
Current account balance	–3.8	2.2	2.4	0.8	2.3	4.4	5.3	1.2	–1.0
Capital account balance	1.3	1.9	1.4	1.5	3.0	1.0	1.3	0.8	2.6
Foreign direct investment (net)	2.9	3.2	1.8	–0.2	7.7	–0.9	–3.3	5.0	5.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	76.7	75.6	82.7	73.3	75.6	80.8	84.5	86.2	82.7
Gross official reserves (excluding gold)	1.0	0.9	0.9	0.9	0.9	1.0	1.2	0.9	0.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
	EUR million, period total								
GDP at current prices	68,974	71,096	72,134	18,782	18,119	16,710	18,036	18,996	18,393

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

3 Slovenia: Banking Sector Stabilization Provides Respite for Continuing Reforms

Government finally took action in mid-December 2013 to stabilize the banking sector

In mid-December 2013, the government recapitalized the three largest state-owned banks and two banks under orderly liquidation with the amount of EUR 3.2 billion (9.1% of GDP). Subsequently, the two largest banks transferred NPLs worth EUR 3.3 billion to the bank asset management company (at a discount of 69%). The third-largest bank is expected to transfer further EUR 1.1 billion worth NPLs at a discount of around 53% once the European Commission approves its restructuring plan. As a result, the share of NPLs in banks' credit portfolios is estimated to have fallen from 21% to around 12%. Out of five further private banks with a potential future capital shortfall, three foreign-owned subsidiaries have already made up for the deficit. The fourth bank was given until end-April to find private investors, otherwise the government would provide the necessary capital backstop. The deadline for the fifth domestic bank has been extended until end-2014. As a further element of the consolidation of the banking sector, the government has committed itself to fully privatize the second and third largest bank by end-2014 and reduce its stake in the biggest bank to a blocking minority in the medium term. In order to prevent a further accumulation of NPLs a new legislative framework for corporate restructuring was put into place in December 2013. This is aimed at preventive restructuring of viable companies with an unsustainable debt overhang already at an early stage and at improving the efficiency of insolvency proceedings.

Economy rebounded in Q4 2013

After two years of negative annual growth rates, GDP grew by 2.1% year on year in the final quarter of 2013. The rebound was primarily attributable to the turnaround in domestic demand. Investments expanded for the first time since 2008, and the decline in consumption moderated as well. Nonetheless, the biggest contribution to domestic demand growth stemmed from the moderation of destocking. Export growth held up well, mirroring improved export expectations in the preceding quarters. However, the strong acceleration of import growth caused net real exports to reduce the overall GDP growth rate for the first time since late 2008. Given stubbornly high unemployment, declining real wages, weak consumer confidence, the ongoing steep decline in credit to the private sector and the need for continued fiscal restraint, the growth outlook remains weak.

Achievement of a durable correction of the excessive deficit by 2015 still at risk

Slovenia recorded a budget deficit of 14.7% of GDP in 2013, boosted by one-off measures, mostly the costs of bank recapitalization (deficit of 3.7% excluding one-offs). The deficit is expected to decrease to 3.9% in 2014 (or 3.3% excluding further bank recap) and to 3.3% in 2015. The structural balance is estimated to improve by only around 0.7 percentage points over 2013–2014 and to worsen again by 0.5 percentage points in 2015. This falls short of the June 2013 EU Council Recommendation to Slovenia, so that the country may miss the 2015 deadline for correcting its excessive deficit. On a separate note, according to the latest assessment by the European Commission, Slovenia "continues to experience excessive macroeconomic imbalances which require specific monitoring and continuing strong policy action." More specifically, weak corporate governance, the high level of state involvement in the economy, losses in cost competitiveness, corporate debt overhang and the increase in government debt call for very close monitoring. Bank restructuring, privatization and enhanced supervision require further determined action as well.

Table 3

Main Economic Indicators: Slovenia

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	0.7	–2.5	–1.1	–3.0	–3.3	–4.6	–1.4	–0.5	2.1
Private consumption	0.8	–4.8	–2.7	–6.8	–5.8	–5.3	–2.7	–2.8	0.0
Public consumption	–1.6	–1.3	–2.0	–1.8	–2.4	–1.4	–2.4	–2.4	–1.9
Gross fixed capital formation	–5.5	–8.2	0.2	–7.3	–12.3	–2.3	–1.7	–1.1	5.9
Exports of goods and services	7.0	0.6	2.9	0.1	0.8	1.5	2.2	4.0	3.7
Imports of goods and services	5.6	–4.7	1.3	–7.1	–6.0	–2.3	–0.3	2.8	4.9
	Contribution to GDP growth in percentage points								
Domestic demand	–0.3	–6.3	–2.4	–8.2	–8.3	–7.4	–3.3	–1.7	2.9
Net exports of goods and services	1.0	3.8	1.3	5.1	5.0	2.8	1.8	1.1	–0.7
Exports of goods and services	4.7	0.4	2.2	0.1	0.6	1.2	1.6	3.0	2.9
Imports of goods and services	–3.6	3.4	–0.9	5.0	4.4	1.6	0.2	–1.9	–3.6
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–0.9	1.0	–1.2	0.4	1.1	–0.6	–0.6	–0.8	–2.9
Unit labor costs in manufacturing (nominal, per hour)	0.3	4.8	2.4	4.0	5.2	7.3	–3.5	2.1	4.0
Labor productivity in manufacturing (real, per hour)	1.5	–1.8	–1.8	–1.1	–3.3	–2.7	–2.2	–2.5	0.4
Labor costs in manufacturing (nominal, per hour)	1.9	2.9	0.6	2.8	1.7	4.4	–5.7	–0.5	4.4
Producer price index (PPI) in industry	4.6	0.9	0.0	0.6	0.6	0.7	0.2	–0.2	–0.6
Consumer price index (here: HICP)	2.1	2.8	1.9	3.2	3.0	2.7	1.8	2.2	1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.4	9.0	10.3	9.3	9.7	11.2	10.5	9.5	9.8
Employment rate (%, 15–64 years)	64.4	64.1	63.3	64.3	64.2	62.4	63.0	64.5	63.2
Key interest rate per annum (%)	1.2	0.9	0.5	0.8	0.8	0.8	0.6	0.5	0.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.0	–0.7	0.2	0.4	–0.7	0.6	–0.8	0.6	0.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	6.5	3.9	19.8	–5.4	3.9	10.5	19.0	18.8	19.8
Domestic credit of the banking system	–3.1	–2.7	–13.8	7.5	–2.7	–8.1	–15.9	–18.3	–13.8
of which: claims on the private sector	–3.8	–7.2	–22.9	–5.2	–7.2	–9.9	–10.3	–10.4	–22.9
claims on households	0.8	–0.8	–1.5	–0.6	–0.8	–1.1	–1.1	–1.2	–1.5
claims on enterprises	–4.6	–6.4	–21.4	–4.6	–6.4	–8.9	–9.1	–9.2	–21.4
claims on the public sector (net)	0.7	4.5	9.1	12.7	4.5	1.8	–5.6	–7.8	9.1
Other assets (net) of the banking system	–0.4	–2.0	–5.8	–1.7	–2.0	–1.7	–3.9	0.1	–5.8
	% of GDP, ESA 95								
General government revenues	43.5	44.4	44.7	. .	. .	. .	. .	. .	. .
General government expenditures	49.9	48.4	59.4	. .	. .	. .	. .	. .	. .
General government balance	–6.4	–4.0	–14.7	. .	. .	. .	. .	. .	. .
Primary balance	–4.5	–1.8	–12.1	. .	. .	. .	. .	. .	. .
Gross public debt	47.1	54.4	71.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	85.1	83.7	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	30.6	30.4	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–2.6	–0.3	1.8	0.7	0.3	1.6	2.6	2.7	0.2
Services balance	4.1	5.1	5.7	5.8	4.7	6.2	6.0	6.3	4.3
Income balance (factor services balance)	–1.4	–1.6	–1.2	–2.2	–0.5	–0.9	–1.3	–1.3	–1.4
Current transfers	0.4	0.1	0.1	–0.8	1.0	–1.0	0.2	–0.9	1.8
Current account balance	0.4	3.3	6.3	3.5	5.5	6.0	7.6	6.7	4.9
Capital account balance	–0.2	–0.3	–0.1	–0.3	–0.6	–0.1	–0.4	–0.3	0.4
Foreign direct investment (net)	1.8	0.5	–1.6	0.9	–1.9	–0.8	–7.4	–0.2	2.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	110.9	115.7	112.2	114.2	115.7	116.1	116.1	113.7	112.2
Gross official reserves (excluding gold)	1.8	1.7	1.6	1.7	1.7	1.5	1.6	1.8	1.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	36,150	35,319	35,275	9,049	8,717	8,124	9,044	9,141	8,966

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

4 Bulgaria: Signs of an Economic Turnaround amid Continuing Deflation Trends

Moderate economic expansion in the second half of 2013…

After sluggish economic performance in the first half of 2013, real GDP expanded (year on year) by 1.3% in the second half of the year. Net exports (spurred by continuing strong export growth) remained the main growth driver, but investment also contributed positively to GDP growth for the first time since the third quarter of 2012. As a result, domestic demand ceased to put a strain on GDP growth. Unless suppressed by the continuing decline in private consumption whose downward trend has recently moderated, however, domestic demand would be even more supportive. From a production-side perspective, the turnaround was decisively supported by gross value added in industry, while activities linked to household consumption contributed negatively. The turnaround seems to have carried on in 2014 as both business and consumer sentiment indicators have shown a clear improvement since end-2013 (though they are still fairly below the levels recorded before 2009).

…but legacies of the crisis still weigh on the recovery

Despite these promising developments, credit conditions have remained tight. Although lending to households did not shrink in the second half of 2013 (for the first time since early 2010), we see a continuation of near-zero growth of credit to private nonbanks (not least on the back of elevated NPL ratios of more than 14%). Labor market conditions have continued to be challenging too. The unemployment rate stood at more than 13% at the end of 2013, and the share of long-term unemployment has increased to nearly 60%, making the country susceptible to hysteresis effects.

Continuing deflationary tendencies given the rollback of electricity tariffs and subdued domestic demand

Deflation has continued in the review period, and the annual HICP reached its hitherto strongest drop of –2.1% in February 2014. This prolonged price decline can mainly be explained by receding costs of housing and utilities (due to last year's rollback of electricity tariffs), transport and healthcare. Another reason is a negative base effect coming from food prices that increased strongly in 2012 while the harvest in 2013 was abundant.

The expansion of unit labor costs also clearly lost momentum in the second half of 2013. This can be traced back to labor productivity gains returning to more vigorous levels and labor costs either advancing at a similar rate (in manufacturing) or at a significantly smaller rate (in the total economy) than in the first half of the year.

Respectable surplus in the current account balance

Export growth continued to outperform import growth in the second half of 2013 (not least due to improving ULC conditions) because of subdued domestic demand. As a result, the current account balance improved substantially and recorded a surplus of nearly 2% of GDP by the end of 2013 (the largest surplus in the last decade).

Budgetary target clearly met in 2013

Despite a comparatively strong expansion in public consumption in 2013, the general government budget deficit widened from 0.8% of GDP in 2012 to only 1.5% of GDP in 2013, which is fairly below the deficit target of 2% (as defined by the new Socialist-led government in 2013). Several changes in social legislation of 2013 will only materialize in 2014 (such as the increase in minimum wages by nearly 10%). At the same time, the 2014 budget counts on a sharp rise in tax revenue (up by nearly 9% against 2013). It thus remains to be seen whether the government will be able to keep the budget deficit at 1.8% of GDP in 2014.

Table 4

Main Economic Indicators: Bulgaria

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	1.8	0.6	0.9	0.6	0.4	0.9	–0.1	1.1	1.6
Private consumption	1.5	3.7	–2.3	3.8	2.1	–2.3	–3.0	–2.2	–1.7
Public consumption	1.6	–0.5	2.5	0.0	0.0	4.0	4.3	3.7	–0.7
Gross fixed capital formation	–6.5	4.8	–0.1	2.9	–1.5	–9.8	–1.2	1.8	5.4
Exports of goods and services	12.3	–0.4	8.9	–0.8	–1.3	11.9	4.6	9.5	10.2
Imports of goods and services	8.8	3.3	5.7	2.4	–0.9	5.7	2.0	8.4	6.7
	Contribution to GDP growth in percentage points								
Domestic demand	0.0	3.1	–1.1	2.2	0.8	–2.8	–1.7	–0.5	0.0
Net exports of goods and services	1.8	–2.5	2.0	–2.1	–0.2	3.7	1.7	1.5	1.6
Exports of goods and services	7.1	–0.3	6.0	–0.6	–0.8	8.0	3.1	6.9	6.0
Imports of goods and services	–5.2	–2.2	–3.9	–1.5	0.6	–4.3	–1.5	–5.4	–4.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.2	4.4	5.4	5.1	5.1	7.7	7.9	3.8	1.9
Unit labor costs in manufacturing (nominal, per hour)	–1.3	3.2	2.0	3.0	3.8	0.0	5.1	3.4	0.0
Labor productivity in manufacturing (real, per hour)	4.5	2.5	2.3	1.8	1.9	5.0	–1.1	0.9	5.0
Labor costs in manufacturing (nominal, per hour)	3.5	5.7	4.6	4.8	5.8	5.0	4.0	4.4	5.0
Producer price index (PPI) in industry	9.3	4.4	–1.5	5.0	5.8	1.7	–0.9	–3.1	–3.6
Consumer price index (here: HICP)	3.4	2.4	0.4	3.0	2.8	2.1	1.1	–0.7	–1.0
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)	11.4	12.4	13.0	11.6	12.5	13.8	13.0	12.1	13.2
Employment rate (%, 15–64 years)	58.4	58.8	59.5	60.6	59.4	57.7	59.5	61.1	59.6
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)	12.2	8.4	8.9	8.7	8.4	8.9	7.7	8.1	8.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	7.9	7.5	4.9	10.1	7.5	5.7	6.2	3.3	4.9
Domestic credit of the banking system	7.3	2.4	3.2	1.7	2.4	3.9	1.2	4.0	3.2
of which: claims on the private sector	3.9	2.6	0.3	3.7	2.6	2.0	0.6	0.2	0.3
claims on households	–0.2	–0.3	0.0	–0.5	–0.3	–0.4	–0.3	–0.2	0.0
claims on enterprises	4.1	3.0	0.3	4.2	3.0	2.4	0.8	0.4	0.3
claims on the public sector (net)	3.4	–0.2	3.0	–2.0	–0.2	1.9	0.7	3.8	3.0
Other assets (net) of the banking system	–3.0	–1.4	0.8	–3.1	–1.4	–0.8	0.3	0.7	0.8
	% of GDP, ESA 95								
General government revenues	33.6	35.0	37.2	. .	. .	. .	. .	. .	. .
General government expenditures	35.6	35.8	38.7	. .	. .	. .	. .	. .	. .
General government balance	–2.0	–0.8	–1.5	. .	. .	. .	. .	. .	. .
Primary balance	–1.3	0.1	–0.7	. .	. .	. .	. .	. .	. .
Gross public debt	16.3	18.4	18.9	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	107.9	106.6	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	25.5	24.4	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–5.6	–8.7	–5.9	–4.8	–7.7	–5.3	–8.0	–3.6	–6.6
Services balance	6.0	6.0	5.3	13.5	2.2	1.0	4.6	13.4	1.2
Income balance (factor services balance)	–4.7	–3.3	–3.5	–4.0	–3.6	–4.2	–3.1	–4.6	–2.2
Current transfers	4.4	5.2	6.0	3.5	4.5	3.6	12.0	4.8	3.5
Current account balance	0.1	–0.8	1.9	8.3	–4.6	–4.9	5.5	10.0	–4.1
Capital account balance	1.3	1.4	1.2	1.5	3.0	0.2	1.3	1.5	1.5
Foreign direct investment (net)	3.1	2.0	2.4	3.5	–3.1	4.2	2.2	3.8	–0.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	94.3	94.6	93.5	96.2	94.6	94.3	93.8	93.9	93.5
Gross official reserves (excluding gold)	30.6	34.9	33.3	35.2	34.9	32.1	33.4	34.3	33.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.6	6.0	5.7	6.0	6.0	5.6	5.8	5.9	5.7
	EUR million, period total								
GDP at current prices	38,505	39,927	39,940	11,066	10,863	8,389	9,809	10,768	10,974

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

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

5 Croatia: Another Year of Recession Passed

Economic contraction caused by weak household consumption and investments

Although some indicators in the first half of 2013 raised hopes for an end of recession, the Croatian economy continued to contract in the second half of the year. Overall, the loss of GDP amounted to 1.0% in 2013. The contraction was driven by a decline of investments and household consumption, related to the adverse labor market situation as well as negative credit growth rates. The only positive contribution stemmed from government consumption. The contribution of net exports accounted for almost zero, as negative export developments were compensated by declining imports in line with subdued domestic demand. On the production side, the biggest declines were registered in manufacturing and construction.

Current account posts surplus for the first time

In 2013, the current account was positive for the first time, posting a surplus of 1.3% of GDP. This development was driven by an increase in the service balance (due to an increase in tourism revenues) and a narrowing of the income deficit as profits of foreign companies plunged. However, the deficit of the goods balance amounted to 14.4% of GDP, which is a slight deterioration compared to 2012, caused by falling exports. On the financing side, net FDI dropped by around 50% year on year to 1.3% of GDP. By contrast, net portfolio investments increased slightly to 4.3% of GDP. Gross external debt rose to 105.3% of GDP, thus aggravating Croatia's fragile position further. Due to the movements in international capital markets Hrvatska narodna banka (HNB) had to intervene in the foreign exchange market in January 2014 to counter depreciation pressures on the dinar.

Credit contraction decelerates, economy falls into deflation in early 2014

As in 2012, credit growth was negative but the contraction of credit to the private sector decelerated to 1.0% (compared to 4.1% in 2012). The share of nonperforming loans in total loans continued to rise in the second half of 2013, amounting to 11.6% at the year's end. Accordingly, the pre-tax return on assets dropped to 0.3% for the whole year (compared to 0.9% in 2012). With the exception of the tourism-months, inflation decreased over the whole year with prices increasing only 0.5% year on year by the end of 2013. In February 2014, the economy fell into deflation with a price level decrease of 0.2% on a year-to-year basis. The disinflationary development was mainly driven by declining prices of energy and unprocessed food, whereas core inflation started to decrease from October onward but remained in positive territory until February 2014, with a rate of 0.4% on a yearly basis.

European Commission opens excessive deficit procedure in response to deteriorating fiscal situation

Croatia reported a somewhat declining, though still elevated fiscal deficit of 4.9% of GDP in 2013. Gross public debt crossed the 60%-of-GDP ceiling and amounted to 67.1% at the end of 2013. As expected the EU opened an excessive deficit procedure (EDP) in January, demanding Croatia to push the budget deficit below 3% of GDP until 2016. The rating agencies reacted to the worsening fiscal situation by lowering Croatia's sovereign rating from "BB+" to "BB" (S&P in January 2014) and revising the outlook from "stable" to "negative" (Fitch in February 2014; Moody's in March 2014), respectively.

Table 5

Main Economic Indicators: Croatia

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	–0.2	–1.9	–1.0	–1.8	–2.2	–1.5	–0.7	–0.6	–1.2
Private consumption	0.4	–3.0	–1.0	–3.6	–4.2	–2.8	0.4	0.3	–1.8
Public consumption	–1.4	–0.8	0.5	–0.3	–2.0	0.3	1.4	–0.9	1.2
Gross fixed capital formation	–3.4	–4.7	–1.0	–4.8	–4.6	–2.3	0.9	0.3	–3.3
Exports of goods and services	1.7	0.9	–1.8	0.6	4.3	–4.3	1.4	–1.3	–3.8
Imports of goods and services	2.1	–2.5	–1.7	–4.6	–2.2	–6.5	5.5	–1.6	–4.4
	Contribution to GDP growth in percentage points								
Domestic demand	–0.1	–3.3	–1.0	–4.8	–4.5	–3.0	1.1	–0.5	–1.6
Net exports of goods and services	–0.1	1.4	–0.1	2.2	2.5	1.5	–1.8	–0.2	0.4
Exports of goods and services	0.7	0.4	–0.8	0.3	1.6	–1.4	0.6	–0.8	–1.5
Imports of goods and services	–0.8	1.1	0.7	1.9	0.9	2.9	–2.4	0.6	1.9
	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)	1.0	2.0	3.4	–3.3	2.9	0.3	4.3	8.2	1.6
Labor productivity in manufacturing (real, per hour)	1.6	2.0	–1.4	6.0	1.1	6.8	–3.0	–6.1	–1.5
Gross wages in manufacturing (nominal, per hour)	2.4	3.6	2.4	2.5	4.1	7.1	1.2	1.6	0.1
Producer price index (PPI) in industry	6.4	7.0	0.5	7.9	7.3	4.1	1.1	–0.6	–2.7
Consumer price index (here: CPI)	2.2	3.3	2.3	4.1	4.4	4.2	2.4	2.2	0.6
EUR per 1 HRK, + = HRK appreciation	–2.0	–1.1	–0.8	–0.1	–0.4	–0.4	–0.4	–1.0	–1.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	13.9	16.3	17.6	15.0	18.5	18.4	17.0	16.9	18.0
Employment rate (%, 15–64 years)	52.4	50.7	49.2	52.5	48.7	47.5	49.8	50.2	49.1
Key interest rate per annum (%)	6.0	7.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.4	7.5	7.6	7.5	7.5	7.6	7.6	7.5	7.6
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	1.6	3.2	2.9	2.1	3.2	4.4	3.4	5.1	2.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–4.2	6.3	5.7	1.7	6.3	7.8	4.8	5.5	5.7
Domestic credit of the banking system	8.8	–0.8	–3.0	3.7	–0.8	–0.5	–1.5	0.4	–3.0
of which: claims on the private sector	4.9	–4.1	–1.0	–0.5	–4.1	–4.2	–3.2	–1.0	–1.0
claims on households	0.5	–0.7	–0.9	–1.0	–0.7	–0.6	–1.4	–0.2	–0.9
claims on enterprises	4.4	–3.4	–0.2	0.5	–3.4	–3.6	–1.8	–0.8	–0.2
claims on the public sector (net)	3.9	3.3	–2.0	4.3	3.3	3.7	1.6	1.4	–2.0
Other assets (net) of the banking system	–3.0	–2.4	0.3	–3.3	–2.4	–2.9	0.2	–0.8	0.3
	% of GDP, ESA 95								
General government revenues	40.3	40.8	41.0	. .	. .	. .	. .	. .	. .
General government expenditures	48.1	45.7	45.9	. .	. .	. .	. .	. .	. .
General government balance	–7.8	–5.0	–4.9	. .	. .	. .	. .	. .	. .
Primary balance	–5.2	–2.0	–1.9	. .	. .	. .	. .	. .	. .
Gross public debt	52.0	55.9	67.1	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	91.8	91.1	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	41.3	41.0	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–13.9	–13.8	–14.4	–12.4	–11.6	–15.3	–17.9	–13.2	–11.4
Services balance	14.0	14.7	15.7	36.0	3.9	1.9	15.3	38.3	4.3
Income balance (factor services balance)	–3.6	–3.7	–2.5	–4.0	–1.2	–3.4	–2.9	–2.4	–1.6
Current transfers	2.6	2.6	2.5	2.3	2.7	2.8	3.2	2.3	1.9
Current account balance	–0.9	–0.1	1.3	22.0	–6.2	–14.0	–2.3	25.0	–6.8
Capital account balance	0.1	0.1	0.1	0.0	0.3	–0.1	0.1	0.1	0.1
Foreign direct investment (net)	2.4	2.5	1.3	1.8	3.3	5.9	–0.5	–0.3	0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	103.9	102.7	105.3	104.7	102.7	102.8	105.0	103.1	105.3
Gross official reserves (excluding gold)	25.3	25.7	29.8	26.1	25.7	25.8	28.0	26.9	29.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.2	7.2	8.5	7.3	7.2	7.3	7.9	7.6	8.5
	EUR million, period total								
GDP at current prices	44,187	43,693	43,318	11,919	10,975	9,976	10,901	11,769	10,671

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

6 Czech Republic: On a Broadly Favorable, Though Still Delicate Growth Trajectory

Strong boost in the final quarter of 2013 against the backdrop of ČNB foreign exchange interventions

Following a protracted recession, the Czech economy seems to be gathering steam. The hitherto frail recovery was given a surprisingly strong boost in the last quarter of 2013. In the third quarter the rather large negative growth contribution of net exports was overcompensated by the positive impact of stock changes and to some extent public consumption. Gross fixed capital formation and private consumption played only a negligible role. In contrast, the strong GDP growth in the last quarter was driven by net exports, to a lesser degree by private consumption and, most notably, by strong gross fixed capital formation. Apart from improving sentiment indicators and the recuperating euro area, a major stimulus to GDP growth was provided by the ČNB . In early November the ČNB decided to weaken the koruna by approximately 5% against the euro and to keep the new level of about 27 CZK/EUR at least until early 2015. The intervention not only helped exporters but also encouraged investment and consumption in the fourth quarter in anticipation of higher import prices.

The labor market has been improving at a very gradual pace. The average employment rate increased to somewhat above 68% in the second half of 2013. The unemployment rate decreased in parallel, but very moderately, and averaged 6.9%.

Current account slides into a nondramatic deficit

The historical surpluses of the trade balance recorded in the first half of 2013 declined to about 3.5% of GDP in the second semester on the back of invigorated imports. The negative income balance stemmed mainly from FDI as a result of dividend payments to nonresidents. The cumulative current account balance deteriorated and posted a deficit of approximately 2.5% of GDP. Overall net FDI in the second half of 2013 was slightly negative (–0.2% of GDP).

Exchange rate intervention interrupted the disinflationary trend

HICP annual inflation slowed further down between July and December 2013 and stood just above the lower tolerance boundary of ČNB's target (2% ± 1 percentage point). A noteworthy positive contribution to inflation was delivered just by food, alcohol and tobacco and fuel and energy prices. Despite low inflation in the last quarter (1.1%) monthly figures unveil that the weakened exchange rate in the wake of ČNB's intervention fed through to prices rather quickly. Annual HICP inflation rose from 0.8% in October to 1.5% in December, interrupting the long-term disinflationary trend. However, inflation dived again in the first two months of 2014 (0.3%) owing to a fall in administered energy prices in combination with base effects on the back of past increases in indirect taxes. Against the backdrop of not yet completely averted deflation risk and exhausted standard monetary policy measures (the policy rate has remained at "technical zero" since November 2012) the ČNB has not ruled out a further extension of the intervention period.

New government expected to stick to fiscal discipline

In line with the EDP commitment to remove the excessive budget deficit by 2013, the latter came in at 1.5% of GDP in 2013, rendering an abrogation of the EDP likely. The new center-left coalition government which emerged from the early election at end of October was appointed only in late January 2014. Despite the pledge of the new administration to ramp up spending particularly on infrastructure projects and due to the envisaged increase in public sector wages, the budget deficit is expected to hover around 3% of GDP in the foreseeable future.

Table 6

Main Economic Indicators: Czech Republic

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	1.8	–1.0	–0.9	–1.5	–1.1	–2.9	–1.7	–0.1	0.8
Private consumption	0.5	–2.1	0.1	–2.2	–2.8	–1.7	–0.2	1.3	1.0
Public consumption	–2.7	–1.9	1.6	–1.5	–1.0	1.1	0.8	2.6	1.9
Gross fixed capital formation	0.4	–4.5	–3.5	–5.0	–6.9	–6.8	–6.6	–3.2	1.7
Exports of goods and services	9.5	4.5	0.2	3.9	3.6	–5.3	0.5	2.8	2.8
Imports of goods and services	7.0	2.3	0.6	–0.4	3.1	–4.5	–0.9	5.2	2.5
	Contribution to GDP growth in percentage points								
Domestic demand	–0.1	–2.7	–0.6	–4.6	–1.5	–1.9	–2.7	1.4	0.5
Net exports of goods and services	1.9	1.7	–0.3	3.1	0.4	–1.0	1.0	–1.5	0.3
Exports of goods and services	6.4	3.3	0.1	2.8	2.6	–4.4	0.4	2.1	2.2
Imports of goods and services	–4.4	–1.6	–0.4	0.3	–2.1	3.4	0.6	–3.7	–1.8
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	0.1	2.0	. .	1.1	1.5	–0.4	–0.4	0.4	. .
Unit labor costs in manufacturing (nominal, per hour)	–3.3	2.5	. .	3.0	2.9	1.4	1.3	2.0	. .
Labor productivity in manufacturing (real, per hour)	6.6	–0.6	. .	–0.6	–5.5	–0.2	–2.3	–6.5	. .
Labor costs in manufacturing (nominal, per hour)	3.2	2.0	. .	2.3	–2.8	1.2	–1.0	–4.7	. .
Producer price index (PPI) in industry	3.7	2.4	0.7	2.2	0.9	0.8	0.2	0.3	1.4
Consumer price index (here: HICP)	2.1	3.5	1.4	3.4	2.9	1.7	1.5	1.2	1.1
EUR per 1 CZK, + = CZK appreciation	2.9	–2.2	–3.2	–2.7	0.4	–1.9	–2.2	–3.0	–5.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.8	7.1	7.0	7.0	7.2	7.5	6.8	7.0	6.8
Employment rate (%, 15–64 years)	65.7	66.6	67.7	67.1	67.0	66.8	67.8	68.0	68.3
Key interest rate per annum (%)	0.8	0.5	0.1	0.5	0.1	0.1	0.1	0.1	0.1
CZK per 1 EUR	24.6	25.1	26.0	25.1	25.2	25.6	25.8	25.9	26.7
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	2.8	4.8	5.8	4.0	4.8	5.1	4.6	5.8	5.8
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–0.8	5.4	5.6	5.1	5.4	6.1	3.7	4.2	5.6
Domestic credit of the banking system	7.9	1.5	3.5	3.0	1.5	2.7	1.7	3.1	3.5
of which: claims on the private sector	4.1	1.9	2.8	2.4	1.9	2.5	1.8	2.1	2.8
claims on households	2.2	1.6	1.4	1.7	1.6	1.5	1.5	1.7	1.4
claims on enterprises	1.9	0.3	1.3	0.7	0.3	1.0	0.3	0.4	1.3
claims on the public sector (net)	3.7	–0.4	0.8	0.7	–0.4	0.2	–0.1	0.9	0.8
Other assets (net) of the banking system	–4.3	–2.1	–3.3	–4.1	–2.1	–3.7	–0.9	–1.5	–3.3
	% of GDP, ESA 95								
General government revenues	40.0	40.3	40.9	. .	. .	. .	. .	. .	. .
General government expenditures	43.2	44.5	42.4	. .	. .	. .	. .	. .	. .
General government balance	–3.2	–4.2	–1.5	. .	. .	. .	. .	. .	. .
Primary balance	–1.8	–2.7	–0.1	. .	. .	. .	. .	. .	. .
Gross public debt	41.4	46.2	46.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	38.5	40.0	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	30.0	32.4	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	2.4	3.9	4.9	3.4	2.2	5.9	6.4	3.6	3.6
Services balance	1.5	1.6	1.4	1.8	1.2	1.6	1.4	1.0	1.4
Income balance (factor services balance)	–6.7	–6.8	–8.0	–9.0	–7.2	–7.3	–8.6	–8.7	–7.5
Current transfers	0.1	–0.1	0.4	–0.5	0.6	0.9	–0.6	–0.3	1.5
Current account balance	–2.7	–1.3	–1.4	–4.3	–3.2	1.1	–1.4	–4.3	–1.0
Capital account balance	0.4	1.4	1.9	0.7	4.5	0.0	0.0	5.5	2.0
Foreign direct investment (net)	1.2	3.2	0.9	2.7	3.4	3.0	1.0	–0.6	0.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	46.8	50.8	54.0	50.3	50.8	51.1	52.1	50.7	54.0
Gross official reserves (excluding gold)	19.7	21.9	27.1	20.3	21.9	22.5	21.9	22.3	27.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.4	3.6	4.4	3.3	3.6	3.7	3.6	3.7	4.4
	EUR million, period total								
GDP at current prices	155,452	152,911	149,441	38,605	39,849	35,115	37,492	38,034	38,800

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

7 Hungary: Loose Monetary Policy Supports Cyclical Recovery

GDP growth solidifies

GDP growth accelerated further in the second half of 2013, reaching 2.7% year on year in the fourth quarter. The structure of growth became more balanced as domestic demand continued to recover. Investment growth picked up sharply on the back of accelerated absorption of EU funds and easing lending conditions, reflecting key interest rate cuts and the Funding for Growth Scheme (FGS) for SMEs. Private consumption was supported by the sharp fall in inflation, wage increases, accelerating employment growth and decreasing unemployment. Public sector wage increases and the purchase of goods and services fueled government consumption. Export growth accelerated sharply reflecting strong external demand, improving cost competitiveness and new export capacities going on line. As import growth picked up less strongly, the contribution of net real exports became positive again.

Budget deficit to remain narrowly below 3%

The budget deficit amounted to 2.2% of GDP in 2013, well below the 2.7% target. The Commission expects the deficit to be at or slightly below 3% in 2014–2015, given additional spending measures, rising interest expenditure and only modest private consumption growth in nominal terms. The structural balance is set to worsen substantially in 2014 (from –1.1% to –2.4% of GDP) and to improve only marginally in 2015 (–2.3%) Thus it will fail to approach the medium-term objective of –1.7%, and government debt will likewise remain stuck slightly below 80% of GDP. In the assessment of the European Commission, "Hungary continues to experience macroeconomic imbalances, which require monitoring and decisive policy action." The highly negative net international investment position, high public and private sector debt levels, a fragile financial sector (including the high share of NPLs and foreign currency loans and an adverse operating environment) and deteriorating export performance are among the major risk factors.

Speed of rate cutting slowed, Funding for Growth Scheme prolonged

Referring to substantial spare capacity and sustainably low inflation, the MNB continued to reduce its policy rate during the reference period (albeit in smaller steps) despite increasing financial market volatility, bringing it to 2.6% by end-March. Disinflation has been supported by a third wave of utility price cuts effective from November 1, 2013, low imported inflation and the negative output gap. The reduction in the interest rate differential has, however, made Hungarian asset prices and the currency more susceptible to changes in global investor sentiment, as suggested by the underperformance of the local government bond market and the forint compared to some of the regional peers during the first quarter of 2014.

Monetary easing has continued through the FGS as well. The MNB decided in September 2013 to prolong (until end-2014) and expand the volume (to a total of close to 10% of GDP) and the coverage of the scheme. According to first indications, however, the utilization of the first new tranche lags behind expectations. The MNB expects a strengthening of loan demand from the second quarter of 2014 in line with the usual seasonality of investments and better knowledge about new EU funding opportunities for the 2014–2020 program period.

As to the issue of households' foreign currency loans, the government has so far refrained from a new round of rescue measures (apart from the parliament-initiated extension of the exchange rate cap scheme to delinquent borrowers and to larger loan contracts). The exact design of any new support measures will be known only after the Supreme Court delivers its verdict on the general legal framework for foreign currency loans and on potential possibilities for interference with private contracts.

Table 7

Main Economic Indicators: Hungary

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	1.6	–1.7	1.1	–1.7	–2.7	–0.8	0.5	1.8	2.7
Private consumption	0.4	–1.6	0.2	–4.0	–0.9	–0.5	0.2	0.1	1.1
Public consumption	0.0	–1.2	1.3	–1.7	0.3	0.5	2.8	0.1	1.7
Gross fixed capital formation	–5.9	–3.7	5.9	–0.9	–6.7	–5.2	5.4	8.3	10.4
Exports of goods and services	8.4	1.7	5.3	2.1	–1.5	2.2	3.6	6.4	8.8
Imports of goods and services	6.4	–0.1	5.3	–0.6	–0.9	1.7	6.0	5.8	7.6
	Contribution to GDP growth in percentage points								
Domestic demand	–0.5	–3.3	0.7	–4.1	–2.1	–1.3	2.2	0.8	1.2
Net exports of goods and services	2.1	1.6	0.4	2.4	–0.6	0.6	–1.8	1.1	1.5
Exports of goods and services	7.2	1.5	5.0	1.9	–1.4	2.2	3.5	6.0	7.9
Imports of goods and services	–5.1	0.1	–4.6	0.5	0.8	–1.5	–5.2	–4.9	–6.5
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.2	2.9	4.0	2.9	2.9	3.6	4.9	3.3	4.1
Unit labor costs in manufacturing (nominal, per hour)	4.5	6.5	1.3	5.2	9.7	4.8	1.2	0.4	–1.2
Labor productivity in manufacturing (real, per hour)	1.4	0.8	1.6	2.4	–1.9	–1.6	1.2	2.1	4.5
Labor costs in manufacturing (nominal, per hour)	6.0	7.4	2.8	7.7	7.6	3.2	2.4	2.5	3.2
Producer price index (PPI) in industry	4.2	4.2	0.6	4.5	–1.5	0.6	–0.1	1.6	0.3
Consumer price index (here: HICP)	3.9	5.7	1.7	6.0	5.5	2.7	1.9	1.6	0.7
EUR per 1 HUF, + = HUF appreciation	–1.4	–3.5	–2.6	–2.9	7.1	0.1	–0.5	–5.0	–4.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	11.0	11.0	10.3	10.5	10.8	11.8	10.3	9.9	9.2
Employment rate (%, 15–64 years)	55.8	57.2	58.5	58.2	57.8	56.6	58.3	59.2	59.7
Key interest rate per annum (%)	6.0	6.8	4.4	6.9	6.2	5.5	4.7	4.0	3.3
HUF per 1 EUR	279.3	289.3	296.9	283.1	283.4	296.6	295.6	298.0	297.6
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	5.9	–3.3	6.5	–4.1	–3.3	5.5	4.5	3.1	6.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	17.8	5.1	6.6	3.9	5.1	14.4	10.3	1.0	6.6
Domestic credit of the banking system	–3.1	–11.8	0.4	–8.8	–11.8	–5.2	–4.4	5.8	0.4
of which: claims on the private sector	–0.6	–13.7	–4.6	–13.6	–13.7	–6.0	–6.5	–2.9	–4.6
claims on households	–0.5	–7.3	–2.3	–8.2	–7.3	–2.0	–2.7	–1.6	–2.3
claims on enterprises	–0.1	–6.3	–2.3	–5.3	–6.3	–3.9	–3.7	–1.3	–2.3
claims on the public sector (net)	–2.6	1.8	4.9	4.8	1.8	0.8	2.1	8.7	4.9
Other assets (net) of the banking system	–8.7	3.4	–0.5	0.7	3.4	–3.7	–1.3	–3.7	–0.5
	% of GDP, ESA 95								
General government revenues	54.3	46.6	47.6	. .	. .	. .	. .	. .	. .
General government expenditures	50.0	48.7	49.8	. .	. .	. .	. .	. .	. .
General government balance	4.3	–2.1	–2.2	. .	. .	. .	. .	. .	. .
Primary balance	8.4	2.2	2.0	. .	. .	. .	. .	. .	. .
Gross public debt	82.1	79.8	79.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	97.1	97.8	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	33.6	31.6	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	3.1	3.6	4.4	4.0	1.8	4.6	4.0	5.3	3.8
Services balance	3.2	3.5	3.6	4.4	2.4	3.4	4.0	4.7	2.3
Income balance (factor services balance)	–6.5	–6.6	–6.1	–6.0	–6.8	–5.7	–6.6	–5.8	–6.0
Current transfers	0.6	0.4	1.1	0.1	2.2	0.2	1.0	0.6	2.3
Current account balance	0.4	0.9	3.0	2.5	–0.3	2.4	2.3	4.8	2.4
Capital account balance	2.3	2.7	3.5	2.3	4.1	2.7	3.3	2.4	5.3
Foreign direct investment (net)	1.0	2.1	0.6	3.1	4.8	1.7	–3.7	–2.3	6.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	134.8	128.5	118.7	135.3	128.5	127.1	125.9	119.3	118.7
Gross official reserves (excluding gold)	38.1	34.8	34.4	36.0	34.8	36.2	34.7	31.3	34.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.4	4.8	4.7	4.9	4.8	5.0	4.8	4.3	4.7
	EUR million, period total								
GDP at current prices	98,872	97,129	98,066	25,520	26,834	21,747	24,449	25,132	26,738

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

8 Poland: Economic Growth Becoming More Balanced

Export-led recovery translates into domestic demand growth

In 2013, annual GDP growth amounted to 1.6%, with exports contributing 2.0 percentage points (ppts) and domestic demand subtracting 0.1. Weak total final demand caused imports to roughly stagnate, implying a net export contribution of 1.7 ppts. In parallel, the current account deficit fell to only 1.3% of GDP. Annual GDP growth accelerated from 0.5% in the first quarter to 2.3% in the final quarter.

Export growth, the increase in public consumption, the substantial rise of average retirement pensions and the acceleration of wage growth coupled with disinflation helped improve sentiment, invigorate private consumption growth and trigger fixed-investment expansion in the second half of 2013. In parallel, the share of profitable companies rose substantially. Finally, employment growth set in, sufficiently strong to lower unemployment rates despite a strong increase in the labor force. Credit growth is generally subdued, only consumption loan growth clearly accelerated.

Interest rate policy on hold

External price competitiveness of manufacturing has improved in year-on-year terms, as strong productivity gains exceeded accelerated wage growth so that unit labor costs declined, and the złoty has been slightly weaker than a year earlier since mid-2013. The złoty was roughly stable against the euro from October to March at close to 4.20 per euro. In February, annual headline inflation stood at 0.7% (both HICP and national CPI). Headline was close to core inflation, as the decline in energy prices and the rise in unprocessed food prices offset each other. The Polish Monetary Policy Council, pursuing an inflation target of 2.5% (CPI), has maintained the reference rate at 2.5% since July 2013 and recently issued forward guidance to remain on hold until the end of the third quarter.

One-off surplus in 2014, and moderate structural improvement

The general government deficit in 2013 amounted to 4.3% of GDP, higher than envisaged in the convergence program of April 2013 (3.5%), as weaker economic growth and steeper disinflation caused the revenue-to-GDP ratio to decline strongly. In response to ECOFIN decisions to extend the deadline for correcting the excessive deficit to 2014 and 2015 and to require Poland to take corrective action by October 1, 2013, and April 15, 2015, respectively, the Polish authorities adopted measures to improve the fiscal balance in 2014 by 10 ppts so that the European Commission expects a surplus of 5.0% of GDP. This, however, includes 8.8% of GDP one-off revenue due to changes in the pension system that will not count under the new ESA 2010 rules (coming into force in autumn 2014). These changes consist in transferring about 50% of the private pension funds' (OFEs) assets (state bonds) and liabilities (future pay-outs) to the public pay-as-you-go social insurance fund (ZUS). This transfer (one-off revenue) will lower explicit general government gross debt to 50% of GDP by end-2014. Participants may opt to continue to put part of their future contributions into OFEs; unless they do so by June, contributions will by default flow into notional individual pension accounts in ZUS. Permanent measures on the revenue side amount to 0.6 ppts (e.g. refraining from the envisaged cut in VAT rates and fees for the use of digital frequencies). Permanent measures on the expenditure side comprise a partial public wage freeze (0.15 ppts) and pension-related cuts: abolition of early retirement scheme (0.2 ppts), further gradual increase of retirement age to 67 years (0.1 ppts) and lower interest payments given changes in the pension system (0.3 ppts). The European Commission expects the deficit for 2014 without one-off revenues at 3.8% of GDP and the structural deficit at 2.9% of GDP.

Table 8

Main Economic Indicators: Poland

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	4.5	1.9	1.6	1.6	0.8	0.5	1.2	2.0	2.3
Private consumption	2.6	1.2	0.8	0.4	0.7	–0.1	0.3	0.9	2.2
Public consumption	–1.7	0.2	2.0	1.3	1.2	–0.3	4.8	1.5	2.1
Gross fixed capital formation	8.5	–1.7	–0.4	–2.3	–5.1	–2.7	–3.3	0.8	1.5
Exports of goods and services	7.7	3.9	4.3	2.6	4.1	1.3	3.4	6.5	6.0
Imports of goods and services	5.5	–0.7	0.7	–2.6	–1.2	–1.6	–2.1	3.2	3.3
	Contribution to GDP growth in percentage points								
Domestic demand	3.6	–0.1	–0.1	–0.8	–1.4	–0.9	–1.5	0.5	1.1
Net exports of goods and services	0.9	2.1	1.7	2.5	2.2	1.4	2.6	1.6	1.2
Exports of goods and services	3.3	1.8	2.0	1.2	1.7	0.6	1.6	3.1	2.6
Imports of goods and services	–2.4	0.3	–0.3	1.3	0.5	0.8	1.0	–1.5	–1.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	1.4	0.7	. .	0.8	0.7	2.6	1.7	1.9	. .
Unit labor costs in manufacturing (nominal, per hour)	0.7	1.7	0.2	1.5	5.9	2.8	0.5	–1.0	–1.5
Labor productivity in manufacturing (real, per hour)	3.9	2.7	3.3	4.9	–2.9	1.2	1.2	3.4	7.3
Labor costs in manufacturing (nominal, per hour)	4.6	4.5	3.4	6.4	2.8	4.1	1.7	2.3	5.6
Producer price index (PPI) in industry	7.3	3.3	–1.2	2.8	0.1	–0.5	–1.9	–1.1	–1.3
Consumer price index (here: HICP)	3.9	3.7	0.8	3.9	2.8	1.3	0.5	0.9	0.6
EUR per 1 PLN, + = PLN appreciation	–3.0	–1.6	–0.3	0.3	7.5	1.8	1.3	–2.6	–1.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.8	10.2	10.5	10.0	10.2	11.4	10.6	9.9	9.9
Employment rate (%, 15–64 years)	59.3	59.7	60.0	60.2	60.0	58.7	59.8	60.7	60.8
Key interest rate per annum (%)	4.2	4.6	2.9	4.8	4.5	3.7	3.0	2.5	2.5
PLN per 1 EUR	4.1	4.2	4.2	4.1	4.1	4.2	4.2	4.2	4.2
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	12.5	4.5	6.2	7.6	4.5	6.6	7.0	6.1	6.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	6.4	3.3	–2.8	4.7	3.3	6.2	0.9	–1.5	–2.8
Domestic credit of the banking system	14.0	1.0	8.1	4.3	1.0	4.0	6.6	7.7	8.1
of which: claims on the private sector	13.1	2.3	4.2	5.0	2.3	3.5	3.6	3.9	4.2
claims on households	7.4	0.2	2.7	0.9	0.2	1.6	1.5	2.7	2.7
claims on enterprises	5.7	2.1	1.5	4.1	2.1	1.8	2.1	1.3	1.5
claims on the public sector (net)	0.9	–1.3	3.9	–0.7	–1.3	0.5	3.0	3.8	3.9
Other assets (net) of the banking system	–7.9	0.2	0.9	–1.4	0.2	–3.6	–0.5	–0.1	0.9
	% of GDP, ESA 95								
General government revenues	38.4	38.3	37.5	. .	. .	. .	. .	. .	. .
General government expenditures	43.5	42.2	41.8	. .	. .	. .	. .	. .	. .
General government balance	–5.1	–3.9	–4.3	. .	. .	. .	. .	. .	. .
Primary balance	–2.4	–1.1	–1.7	. .	. .	. .	. .	. .	. .
Gross public debt	56.2	55.6	57.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	37.3	41.0	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	33.4	35.7	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–2.7	–1.4	0.6	–0.4	–1.0	–0.2	1.3	1.1	0.1
Services balance	1.1	1.2	1.4	1.1	1.0	1.4	1.8	1.1	1.2
Income balance (factor services balance)	–4.6	–4.6	–4.2	–5.3	–4.0	–4.2	–4.9	–5.0	–3.0
Current transfers	1.2	1.0	1.0	0.8	0.9	0.4	2.3	0.5	0.8
Current account balance	–5.0	–3.7	–1.3	–3.8	–3.1	–2.5	0.5	–2.2	–1.0
Capital account balance	2.0	2.2	2.3	2.6	2.3	0.9	3.5	2.4	2.4
Foreign direct investment (net)	2.4	1.1	–0.2	0.9	1.6	1.2	–0.5	0.5	–1.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	67.5	72.7	70.8	73.7	72.7	72.5	70.7	72.2	70.8
Gross official reserves (excluding gold)	19.4	20.6	19.1	20.8	20.6	21.0	20.3	19.6	19.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.0	5.3	5.0	5.3	5.3	5.5	5.3	5.1	5.0
	EUR million, period total								
GDP at current prices	370,414	381,518	388,811	95,181	107,523	90,939	94,244	95,183	108,444

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

9 Romania: Relatively High GDP Growth, Improving External Position

Growth speeds up in the second half of 2013

Economic growth accelerated in the second half of 2013, bringing the full-year figure to 3.5%, the highest growth rate since 2008. Growth was driven by an outstandingly good agricultural output and a remarkable export performance. However, with imports picking up, the growth contribution of net exports declined since mid-2013. In contrast to the first half of the year, domestic demand contributed positively to growth due to recovering private consumption, which was supported by moderate real wage growth. Yet, declining public consumption and above all shrinking gross fixed capital investments cloud the overall favorable growth picture somewhat. Moreover, agricultural output is rather volatile and cannot be seen as a sustainable growth driver. Furthermore, the banking sector is still burdened with a high share of nonperforming loans in total loans, and private sector credit growth remained negative in nominal terms.

Combined current and capital account balance in surplus

Romania's current account balance improved notably in 2013, as the deficit came down to 1.1% of GDP. The improvement was mainly driven by a retreating trade deficit, as export growth was supported by falling unit labor costs in the manufacturing sector and import growth was weak due to subdued domestic demand. It should also be noted that the surplus in the capital account increased noticeably in the second half of the year mainly due to a better absorption of EU structural and cohesion funds. As a result, the combined current and capital account even posted a surplus of 1.2% in 2013. This surplus, together with positive net FDI and portfolio inflows, more than compensated for net outflows in the category other investments, which were related to orderly cross-border bank deleveraging and IMF repayments. In sum, financial account dynamics resulted in a markedly falling external debt stock. Against the backdrop of the improving external position, financial market stress in some emerging economies had only limited impact on Romanian financial markets.

Precautionary support program broadly on track, budget deficit declines further

Romania's precautionary support program with the IMF and the EU remained broadly on track, as the general government budget deficit target was missed only by a small margin, while most other end-December performance criteria and structural benchmarks were met. In 2013 the budget deficit, which was affected by increased co-financing expenditure to support EU fund absorption, fell to 2.3% of GDP. In line with the program, the budget plan targets a deficit of 2.2% of GDP for 2014, taking inter alia into account again higher co-financing expenditure, an increase in minimum wages as well as another targeted increase in public sector salaries. Revenue-side measures include an excise rate hike for energy products, which was, however delayed by three months. Foregone earnings due to the delay will be compensated by some expenditure freezes.

Inflation rate falls below target band

Annual consumer price inflation (CPI) fell further to 1.6% in December almost dropping to the lower bound of Banca Naţională a României's (BNR) inflation target band of 2.5% ±1 percentage point. Declining food prices due to the bumper harvest, a cut in the VAT rate for some bakery products as of September 2013 as well as a negative output gap were among the main factors behind this decline. Disinflation continued in early 2014, as inflation declined to 1.1% in February. The BNR cut its key policy rate further in November, January and February by 25 basis points each time, to 3.5%. The central bank expects inflation to remain below the target band for a while before picking up again in the second half of 2014.

Table 9

Main Economic Indicators: Romania

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	2.4	0.5	3.5	–0.6	0.8	2.1	1.4	4.2	5.4
Private consumption	1.5	1.4	1.3	1.6	0.3	–0.2	0.4	1.9	2.8
Public consumption	0.6	1.0	–1.5	1.7	–0.7	0.9	–5.8	–6.9	3.8
Gross fixed capital formation	7.7	4.2	–3.4	7.8	–2.7	–9.5	–2.2	–2.1	–2.6
Exports of goods and services	12.0	–1.8	13.1	–4.1	–2.6	7.4	8.2	20.3	16.8
Imports of goods and services	10.6	–0.3	2.3	–1.5	–2.1	–0.1	–3.6	7.9	5.1
	Contribution to GDP growth in percentage points								
Domestic demand	2.6	1.0	–0.9	0.1	0.5	–3.1	–6.8	0.8	1.0
Net exports of goods and services	–0.2	–0.5	4.4	–0.7	0.1	4.2	6.3	3.0	3.5
Exports of goods and services	4.1	–0.6	5.5	–1.6	–1.0	4.1	3.7	7.5	6.0
Imports of goods and services	–4.3	0.1	–1.1	0.9	1.0	0.0	2.6	–4.5	–2.5
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–8.1	5.2	2.1	8.1	7.7	4.5	2.1	1.7	1.0
Unit labor costs in manufacturing (nominal, per hour)	1.6	7.1	–1.6	7.4	3.6	1.2	–1.3	–3.8	–2.6
Labor productivity in manufacturing (real, per hour)	5.1	0.2	7.2	0.0	2.2	5.7	6.7	8.5	7.8
Labor costs in manufacturing (nominal, per hour)	7.2	7.3	5.4	7.4	5.9	7.0	5.3	4.4	5.0
Producer price index (PPI) in industry	7.1	5.3	2.1	5.6	5.5	5.2	2.8	0.7	–0.5
Consumer price index (here: HICP)	5.8	3.4	3.2	4.2	4.7	4.8	4.4	2.4	1.3
EUR per 1 RON, + = RON appreciation	–0.7	–4.9	0.9	–5.9	–4.2	–0.8	0.7	1.9	1.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.7	7.3	7.6	7.0	7.2	7.8	7.8	7.3	7.5
Employment rate (%, 15–64 years)	58.5	59.5	59.7	60.8	59.3	58.1	60.2	61.0	59.5
Key interest rate per annum (%)	6.2	5.3	4.8	5.3	5.3	5.3	5.3	4.7	4.1
RON per 1 EUR	4.2	4.5	4.4	4.5	4.5	4.4	4.4	4.4	4.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	6.6	2.7	8.8	5.7	2.7	4.2	5.0	4.8	8.8
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–1.6	6.7	13.6	1.4	6.7	9.2	11.2	13.6	13.6
Domestic credit of the banking system	11.4	0.1	–5.4	8.7	0.1	–2.1	–7.4	–11.7	–5.4
of which: claims on the private sector	6.8	1.5	–3.3	4.4	1.5	–0.1	–1.2	–3.4	–3.3
claims on households	1.1	0.1	–0.5	0.9	0.1	–0.4	–0.6	–1.1	–0.5
claims on enterprises	5.7	1.4	–2.7	3.6	1.4	0.3	–0.6	–2.3	–2.7
claims on the public sector (net)	4.7	–1.4	–2.2	4.3	–1.4	–2.0	–6.2	–8.3	–2.2
Other assets (net) of the banking system	–3.2	–4.1	0.6	–4.4	–4.1	–2.9	1.3	2.9	0.6
	% of GDP, ESA 95								
General government revenues	33.9	33.7	32.7	. .	. .	. .	. .	. .	. .
General government expenditures	39.4	36.7	35.0	. .	. .	. .	. .	. .	. .
General government balance	–5.5	–3.0	–2.3	. .	. .	. .	. .	. .	. .
Primary balance	–3.9	–1.2	–0.5	. .	. .	. .	. .	. .	. .
Gross public debt	34.7	38.0	38.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	51.1	52.4	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	21.4	21.0	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–5.6	–5.6	–2.4	–5.7	–4.8	–2.0	–2.7	–2.7	–2.1
Services balance	0.3	0.9	1.8	1.0	1.3	2.2	2.0	2.2	1.5
Income balance (factor services balance)	–1.7	–2.3	–3.1	–1.5	–1.5	–3.1	–2.6	–3.1	–3.9
Current transfers	2.5	2.6	2.6	1.6	2.3	3.0	3.7	1.7	2.4
Current account balance	–4.5	–4.5	–1.1	–4.6	–2.7	0.0	0.4	–1.9	–2.1
Capital account balance	0.5	1.5	2.3	0.8	1.8	1.1	1.9	3.1	2.6
Foreign direct investment (net)	1.4	1.7	1.8	2.6	1.4	1.5	2.9	0.0	2.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	75.2	75.9	67.9	76.5	75.9	75.7	73.6	71.6	67.6
Gross official reserves (excluding gold)	25.3	23.8	22.9	24.8	23.8	24.3	24.0	24.1	22.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	6.7	6.3	6.4	6.5	6.3	6.5	6.6	6.6	6.4
	EUR million, period total								
GDP at current prices	131,289	131,267	142,117	35,847	38,504	27,389	33,280	38,626	43,348

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

10 Turkey: Mounting Political Risk Adds to Economic Vulnerability

Public investment and domestic demand spur growth in 2013

The Turkish economy continued to expand robustly in the second half of 2013, leading to an annual growth rate of real GDP of 4%, almost twice as high as the figure for 2012. Growth was driven primarily by domestic demand, in particular private consumption remained strong and gross fixed capital formation rebounded notably. The latter was supported by high public expenditure on infrastructure projects, strongly boosting construction activity. Also public consumption ticked up again in the final quarter. However, economic activity showed decreasing dynamics in the third and fourth quarter in seasonal and calendar adjusted terms. Further, confidence indicators fell sharply around the turn of the year and only recovered partly in March.

External imbalances remain high

In line with strong household consumption and investment, import growth was vivid and increased in particular in the fourth quarter (9.3% year on year). At the same time, exports declined in the second half of the year. The contribution of net exports to GDP growth was thus negative in 2013 as a whole. Stagnating exports along with strong import growth over the entire year – both developments are still influenced among other factors by the normalization in the gold balance – caused the current account deficit to widen (after a temporary contraction in the third quarter) to –7.9% of GDP by year-end 2013. Financing continues to be heavily reliant on short-term capital inflows. In 2013, FDI net inflows covered roughly 15% of the deficit, portfolio investments amounted to about 36%.

Substantial currency depreciation over the second half of 2013 added to a rise in inflation up to 7.5% at the end of the year. This implies an overshooting of the 5% target, and inflation continued to rise in recent months, reaching 8.4% in March. Unemployment remained high at around 9% owing to slow rehiring of previously laid-off workers in an environment of heightened uncertainty, tighter monetary policy and persistent structural weaknesses. Strong GDP growth in 2013 helped to keep the fiscal deficit (1.6% of GDP) and public debt (36% of GDP) at low levels. The finance minister ruled out fiscal slippage related to elections in 2014. Local elections at the end of March brought a clear victory for the ruling AKP party. Presidential elections will be held on August 10.

Strong pressure on the lira from external and domestic factors

In 2013, Fed tapering and rising political risks related to the government's response to the Gezi park protests and more recently to corruption allegations put the lira repeatedly under substantial pressure. On January 24, the lira reached an all-time low of 2.34 TRY/USD (3.19 TRY/EUR). The cumulative depreciation between mid-May 2013 and January 24, 2014, amounted to 28.2% against the USD and 36.1% against the EUR. Following a decisive interest rate hike by the CBRT on January 28, the currency stabilized and regained roughly 6% against both, USD and EUR. On January 28, the CBRT decided to raise the main policy rate (one-week repo) from 4.5% to 10%. As bank funding was done at the overnight lending rate of 7.75% prior to the interest rate decision, the effective rate hike was only 225 basis points.

The CBRT has taken further macroprudential measures to curb high credit growth. In October, credit card limits were introduced and provisioning rates for consumer, export and SME loans were changed. In combination with higher interest rates, credit growth has decelerated in recent weeks, still outpacing the 15% target and remaining considerably above deposit growth.

Table 10

Main Economic Indicators: Turkey

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	8.5	2.5	4.0	1.5	1.3	2.9	4.5	4.3	4.4
Private consumption	7.9	–0.7	4.6	–0.2	–0.2	3.4	5.1	4.7	5.3
Public consumption	4.4	6.4	5.9	5.5	8.5	7.6	7.8	1.7	6.8
Gross fixed capital formation	17.6	–1.9	4.3	–3.3	–1.7	1.5	3.4	6.0	6.4
Exports of goods and services	6.5	17.8	0.1	14.1	16.1	5.1	0.1	–2.3	–1.5
Imports of goods and services	9.6	0.6	8.5	2.9	6.4	7.1	11.8	5.8	9.3
	Contribution to GDP growth in percentage points								
Domestic demand	9.1	–1.8	7.1	–1.2	–1.2	3.8	9.1	7.1	8.0
Net exports of goods and services	–1.0	3.6	–2.1	2.4	2.0	–0.7	–3.1	–2.0	–2.7
Exports of goods and services	1.4	3.8	0.0	3.0	3.6	1.2	0.0	–0.6	–0.4
Imports of goods and services	–2.4	–0.2	–2.2	–0.7	–1.5	–1.8	–3.1	–1.4	–2.3
	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)	6.2	13.5	10.4	13.3	12.2	8.1	11.9	10.7	10.9
Labor productivity in manufacturing (real, per hour)	3.2	–1.3	1.4	–1.2	–1.8	0.3	0.0	1.8	3.4
Gross wages in manufacturing (nominal, per hour)	9.7	11.9	12.0	12.0	10.1	8.5	11.8	12.7	14.6
Producer price index (PPI) in industry	12.3	6.1	5.7	3.6	3.3	3.9	4.2	7.6	6.9
Consumer price index (here: HICP)	6.5	9.0	7.5	9.1	6.8	7.4	6.8	8.2	7.5
EUR per 1 TRY, + = TRY appreciation	–14.5	0.9	–8.6	8.5	6.4	–0.1	–3.7	–13.5	–15.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.0	8.4	8.9	7.9	8.5	9.6	8.1	8.9	9.1
Employment rate (%, 15–64 years)	48.4	48.9	49.5	49.9	49.5	47.9	50.8	50.3	49.1
Key interest rate per annum (%)[1]	6.1	5.7	4.8	5.8	5.7	5.5	4.8	4.5	4.5
TRY per 1 EUR	2.3	2.3	2.5	2.3	2.3	2.4	2.4	2.6	2.8
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	15.2	10.5	21.1	8.8	10.5	13.6	15.4	19.0	21.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.6	1.4	–5.9	0.1	1.4	1.1	–1.0	–2.7	–5.9
Domestic credit of the banking system	19.0	16.9	31.9	14.4	16.9	18.5	22.0	29.5	31.9
of which: claims on the private sector	25.0	18.7	33.5	15.2	18.7	21.0	27.0	33.1	33.5
claims on households	8.4	5.9	8.3	5.3	5.9	7.0	8.1	8.8	8.3
claims on enterprises	16.6	12.7	25.1	9.9	12.7	14.0	18.9	24.3	25.1
claims on the public sector (net)	–6.0	–1.8	–1.6	–0.8	–1.8	–2.5	–5.0	–3.6	–1.6
Other assets (net) of the banking system	–4.4	–7.7	–4.8	–5.7	–7.7	–6.0	–5.5	–7.8	–4.8
	% of GDP, ESA 95								
General government revenues	36.6	37.8	39.1	. .	. .	. .	. .	. .	. .
General government expenditures	37.4	38.9	40.7	. .	. .	. .	. .	. .	. .
General government balance	–0.8	–1.1	–1.6	. .	. .	. .	. .	. .	. .
Primary balance	2.5	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	39.9	36.2	36.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	44.3	47.7	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–11.5	–8.3	–9.8	–7.8	–7.1	–8.7	–11.2	–9.5	–9.6
Services balance	2.6	2.9	2.8	4.6	2.6	1.2	2.8	4.6	2.5
Income balance (factor services balance)	–1.0	–0.9	–1.1	–0.9	–0.7	–1.0	–1.6	–0.9	–1.0
Current transfers	0.2	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.2
Current account balance	–9.7	–6.1	–7.9	–3.9	–5.0	–8.3	–9.8	–5.8	–7.8
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)	1.8	1.2	1.2	0.7	0.8	1.1	0.8	1.4	1.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	42.4	41.9	. .	42.7	41.9	44.0	44.3	44.0	. .
Gross official reserves (excluding gold)	10.9	12.4	13.0	12.4	12.4	13.2	12.7	13.0	13.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.0	4.7	4.8	4.6	4.7	5.0	4.8	4.9	4.8
	EUR million, period total								
GDP at current prices	554,990	612,718	617,011	166,958	156,550	150,448	160,233	159,251	147,079

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

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

11 Russia: Crimean Crisis Raises Uncertainty for Already Sluggish Economy

Declining investment pulls economic growth down, Crimean crisis further weakens prospects

Russian economic growth once again declined (to 1.3% in 2013) and might further level off due to the impact of uncertainty and economic sanctions, triggered by the crisis in Crimea. The factors slowing down economic activity in the second half of 2013 remained the same as in the previous six months. Against the backdrop of the slight decline of the average annual oil price in 2013, over the whole year gross capital formation decreased by about 6%, while fixed investment stagnated. This implies that large-scale destocking continued, although at a somewhat lower pace in the fourth quarter. With real export growth accelerating and real import growth decelerating in 2013, the contribution of net exports to GDP increased somewhat. Due to a relatively tight fiscal policy, government consumption remained flat.

Private consumption, supported by retail credit expansion, remains the sole growth driver

The only growth driver left is private consumption, buoyed by rising wages and pensions and by the continuing, but weakening, retail credit boom. Near record-low unemployment (5.6% in February 2014), stubbornly elevated inflation, and shrinking current account surpluses substantiate the view that the Russian economy is near full capacity. The Economy Ministry estimates GDP growth to have approached zero in the first quarter of 2014 (year on year).

Partly depreciation-driven inflation remains elevated

After coming to 6.5% at end-2013 and thus missing the Bank of Russia's (CBR) annual target of 5% to 6%, CPI inflation slightly declined to 6.2% in February 2014. This was probably on account of the government's freezing of administrative price adjustments, while the ruble's steady depreciation over 2013 sharply accelerated in January-February 2014. This accelerated depreciation (no less than 10% from end-2013 to end-February 2014) was largely caused by the U.S. monetary authorities' tapering actions, coupled with Russia's renewed growth slowdown.

Additional Crimean crisis-induced pressure on the ruble triggers strong CBR intervention

Then, in the three weeks since the outbreak of the Crimean crisis at the end of February, the ruble declined by another 2% to 3% before bouncing back in late March. The CBR contributed to this restabilization by strongly intervening in the market and by raising the key interest rate by 150 basis points to 7.0%. The forex sale (about EUR 8 billion) was substantially larger than provided for by the monetary authority's automatic intervention mechanism, which had been scaled back step by step in recent years.

Private capital outflow further accelerates in Q1 2014

In 2013 the total outflow of private capital from Russia came to EUR 47.2 billion (about 3% of GDP), which exceeded that of 2012 (EUR 42.5 billion). According to expert estimates, it further accelerated to about EUR 45 billion to EUR 50 billion in the first quarter of 2014. As at end-February 2014, the Russian credit boom continued; retail lending, which had overheated last year, lost some momentum. Largely due to the economic slowdown, the general government budget balance deteriorated to –1.3% of GDP in 2013.

Current account surplus descends to its lowest level since the 1998 crisis

Given the sluggish state of the global economy, the slightly lower oil price, and Russia's all-but-closed output gap, the current account surplus declined to 1.6% of GDP. Driven mostly by the accumulation of external liabilities by enterprises, the country's gross external debt has been rising lately, but continues to be relatively modest (33.5% of GDP at end-2013). At the same time, forex reserves (excluding gold), still ample, have been shrinking in absolute terms in recent months (mid-March 2014: ca. EUR 322 billion or about 21% of GDP).

Table 11

Main Economic Indicators: Russia

	2011	2012	2013	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13
	Year-on-year change of the period total in %								
GDP at constant prices	4.3	3.4	1.3	3.0	2.0	0.8	1.0	1.3	2.0
Private consumption	6.7	7.9	4.7	7.4	7.2	5.7	4.4	4.7	4.1
Public consumption	1.4	4.6	0.5	4.5	3.9	0.6	0.4	0.4	0.4
Gross fixed capital formation	9.1	6.4	–0.1	5.9	3.4	–0.5	–1.3	0.1	0.5
Exports of goods and services	0.3	1.4	4.2	1.2	1.3	0.0	3.7	7.4	5.6
Imports of goods and services	20.3	8.8	3.7	10.1	7.9	7.3	3.4	5.3	–0.1
	Contribution to GDP growth in percentage points								
Domestic demand	7.9	5.2	1.2	5.3	3.7	2.5	1.2	0.6	0.8
Net exports of goods and services	–4.0	–1.6	0.4	–2.1	–1.5	–1.6	0.4	0.7	1.8
Exports of goods and services	0.1	0.4	1.3	0.4	0.4	0.0	1.2	2.1	1.7
Imports of goods and services	–4.1	–2.0	–0.9	–2.5	–1.9	–1.6	–0.8	–1.4	0.0
	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)	9.0	7.6	7.9	6.3	6.6	9.2	8.3	8.5	5.5
Labor productivity in industry (real, per person)	4.4	4.8	2.4	4.8	4.5	0.7	2.5	2.5	3.5
Average gross earnings in industry (nominal, per person)	13.8	12.6	10.3	11.4	11.4	9.9	11.0	11.2	9.2
Producer price index (PPI) in industry	17.8	6.8	3.4	7.9	6.8	4.3	2.5	4.4	2.3
Consumer price index (here: CPI)	8.5	5.1	6.8	6.1	6.6	7.2	7.2	6.3	6.4
EUR per 1 RUB, + = RUB appreciation	–1.5	2.4	–5.7	2.9	4.4	–1.5	–3.7	–8.0	–9.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.6	5.5	5.5	5.1	5.2	5.8	5.4	5.3	5.5
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	5.3	5.3	5.5	5.3	5.5	5.5	5.5	5.5	5.5
RUB per 1 EUR	40.9	39.9	42.3	40.0	40.3	40.2	41.4	43.4	44.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	20.9	12.1	15.7	15.0	12.1	15.1	16.3	16.8	15.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	9.9	–0.3	2.7	0.8	–0.3	4.5	1.8	2.3	2.7
Domestic credit of the banking system	19.7	15.4	17.5	19.5	15.4	17.0	18.1	18.2	17.5
of which: claims on the private sector	24.5	17.9	16.9	21.5	17.9	19.9	18.2	19.1	16.9
claims on households	6.4	8.2	7.4	8.8	8.2	8.4	8.2	8.1	7.4
claims on enterprises	18.1	9.7	9.6	12.7	9.7	11.5	10.1	11.0	9.6
claims on the public sector (net)	–4.8	–2.6	0.6	–2.0	–2.6	–2.9	–0.1	–0.9	0.6
Other assets (net) of the banking system	–8.7	–3.0	–4.6	–5.3	–3.0	–6.4	–3.5	–3.7	–4.6
	% of GDP, ESA 95								
General government revenues	37.3	37.1	36.1	. .	. .	. .	. .	. .	. .
General government expenditures	35.7	36.7	37.3	. .	. .	. .	. .	. .	. .
General government balance	1.5	0.4	–1.3	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	9.0	10.0	10.5						
	Year-on-year change of the period total (based on EUR) in %								
Debt of nonfinancial corporations (consolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (consolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	10.4	9.1	8.6	7.6	8.2	10.0	8.4	8.0	8.3
Services balance	–1.9	–2.4	–2.8	–3.0	–2.3	–2.2	–2.7	–3.7	–2.5
Income balance (factor services balance)	–3.2	–3.5	–3.8	–2.9	–3.6	–2.4	–5.2	–4.0	–3.6
Current transfers	–0.2	–0.3	–0.4	–0.5	–0.4	–0.3	–0.3	–0.6	–0.6
Current account balance	5.2	2.8	1.6	1.1	1.9	5.0	0.2	–0.3	1.6
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)	–0.8	–1.2	–0.7	0.4	1.0	–5.2	1.9	0.7	–0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	30.5	31.0	33.5	30.8	31.0	34.3	34.1	33.5	33.5
Gross official reserves (excluding gold)	25.7	23.7	21.6	24.5	23.7	23.6	22.9	22.4	21.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	14.2	12.5	11.5	12.9	12.5	12.7	12.2	11.9	11.5
	EUR million, period total								
GDP at current prices	1,366,840	1,557,572	1,574,075	407,459	429,937	364,671	386,266	403,652	419,487

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