Developments in Selected CESEE Countries: Deteriorating External Demand and Rising Risk Aversion Increasingly Weigh on Growth in CESEE[1,2,3]

1 Introduction

Economic Recovery Loses Steam

Despite considerable intra-regional heterogeneity, the overall picture of economic conditions in Central, Eastern and Southeastern Europe (CESEE) was fairly encouraging in late 2010 and early 2011. By and large, the region seemed to have surpassed the recession and the elevated volatility that had characterized the immediate post-crisis environment. Growth was especially strong in the final quarter of 2010 (partly due to Turkey's extraordinary performance) and remained very healthy and robust also in early 2011. Rating agencies issued upgrades and/or saw improving outlooks in a number of countries.

Already in spring, however, data releases began to point toward a renewed deceleration of economic dynamics in some areas. Growth of industrial production peaked in February and almost halved after that (to some 5.5% year on year in August). Having returned to its long-run average in February, overall sentiment declined substantially afterwards. This development was driven by industrial sentiment, as consumer sentiment had never recovered to its long-term average after the financial crisis.

Deterioration in the international environment …

These data releases largely mirrored unfavorable developments in the international environment. On the one hand, the pace of growth of the global economy has been moderating since the second quarter of 2011 due to disruptions in global supply chains and the dampening effects of high commodity prices on incomes. On the other hand, risk perceptions deteriorated mainly due to renewed tensions in the context of the sovereign debt crisis in some euro area countries. Since August, financial market volatility has increased again substantially, and since September, we have been witnessing a negative feedback loop between the sovereign debt crisis and investors' perceptions about the health of European bank balance sheets.

… and increasing financial market tensions …

CESEE was not spared from negative spillovers that resulted from these developments. Since the beginning of August, equity prices have declined substantially, with losses ranging between 15% in Bulgaria and close to 35% in Hungary (only Slovakia weathered the storm without substantial stock price movements). While these losses were generally below the levels observed in Western Europe, stock price gains of a whole year were erased within just a few weeks, and in some countries (Poland, Hungary, Russia and Romania) equity prices again fell below the level recorded in September 2008.

[1] *Compiled by Josef Schreiner with input from Stephan Barisitz, Sándor Gardó, Mariya Hake, Mathias Lahnsteiner, Thomas Reininger, Jarmila Urvova, Zoltan Walko and Julia Wörz.*

[2] *Cutoff date: October 5, 2011. This report primarily focuses on data releases and developments from April 2011 up to the cutoff date, while selectively recalling earlier developments where this appears necessary to put recent developments into perspective.*

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

Table 1

Real GDP Growth

	2009	2010	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011
	Period-on-period change in % (seasonally and working day-adjusted)							
Slovakia	–4.8	4.0	0.7	0.9	0.8	0.8	0.9	0.9
Slovenia	–8.0	1.4	0.1	1.3	0.3	0.5	0.1	0.1
Bulgaria	–5.5	0.2	0.9	1.6	0.7	0.5	0.5	0.3
Czech Republic	–4.1	2.3	0.8	0.6	0.8	0.5	0.9	0.1
Hungary	–6.7	1.2	1.0	0.4	0.8	0.2	0.3	–0.0
Poland	1.6	3.8	0.7	1.1	1.3	0.9	1.1	1.1
Romania	–7.1	–1.3	–0.0	0.1	–0.2	0.4	0.5	0.2
Croatia	–6.0	–1.2	–0.5	–0.2	0.1	–0.3	–0.2	0.3
Turkey	–4.8	9.0	–0.9	0.1	1.1	3.6	1.4	1.3
Russia	–7.8	4.0	1.5	0.5	–0.0	2.3	1.0	0.2
CESEE average[1]	–5.5	4.2	0.7	0.5	0.5	1.9	1.0	0.5
Euro area	–4.2	1.8	0.3	0.9	0.4	0.3	0.8	0.2

Source: Eurostat, national statistical offices.

[1] Average weighted with GDP at PPP.

Starting from late summer 2011, rising global risk aversion also impacted adversely on financing costs for CESEE as well as on currency valuations. There were surges in eurobond spreads (most notably in Croatia, by some 260 basis points) and CDS premiums (above all in Hungary, by some 230 basis points), and currencies came under pressure. Especially the Hungarian forint, the Polish złoty and the Russian ruble depreciated strongly against the euro (by some 10%), and the Turkish lira continued the downward trend that had started in late 2010. Several central banks intervened in foreign exchange markets to ease depreciation pressures, among them the Romanian, the Polish, the Croatian and the Russian central bank. The latter two also took additional measures: In Croatia, the reserve requirement rate was increased from 13% to 14%, and in Russia, the central bank moved its exchange rate corridor vis-à-vis the U.S. dollar-euro basket from 32.15–37.15 to 32.60–37.60.

… are putting a damper on growth

The deterioration in the economic environment started to take its toll on GDP growth already in the second quarter. Economic dynamics decelerated in a number of countries, most notably in the Czech Republic, Hungary, Romania and Russia, and output expanded by only 0.5% after it had grown by 1% in the first quarter of 2011 (quarter on quarter). The comparatively solid performance of the regional aggregate mainly stems from the continuing strength of the Turkish and Polish economies, both of which have been remarkably resilient to international turbulences so far. This notwithstanding, economic expansion more or less stalled in five of the ten countries covered in this report.

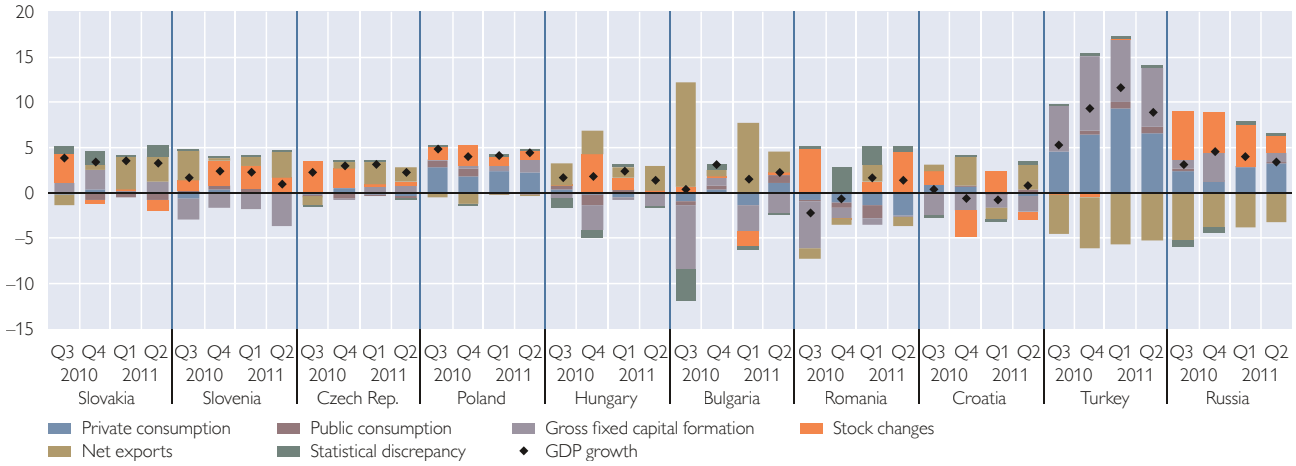
Despite a notable deceleration of export growth in the second quarter, economic dynamics were still mostly driven by the external sector as the continuing weakness of domestic demand in a number of countries dampened import growth. The revival of domestic sources of growth turned out to be much less pronounced in many CESEE countries than had been expected at the beginning of the year.

There are indications of a pickup of fixed capital formation as capacity utilization rates have risen in various countries (e.g. in the Czech Republic and Slovakia).

Chart 1

GDP Growth and Its Main Components

Percentage points, GDP growth in %



Source: Eurostat, national statistical offices.

Domestic demand, however, made a substantial contribution to growth (through strong private consumption and capital formation) only in Poland, Turkey and Russia. This went hand in hand with more favorable credit dynamics (especially in Turkey and Russia) as well as improved profitability in the enterprise sector and positive momentum in the labor market. In most of the other countries, the consolidation of public finances, the still incomplete downsizing of the construction sector and/or ongoing efforts to reduce leverage in the household sector (and in Slovenia also in the corporate sector) impeded a more vivid pickup of domestic demand.

Forecasts had to be revised downward

The weak second quarter as well as the deterioration in the international environment already adversely impacted on the forecasts for the region.[4] While, according to the IMF's World Economic Outlook, growth in the ten countries covered here will reach a solid 4.2% in 2011, partly thanks to the strong performance of Turkey (whose forecast was revised upward by 2 percentage points while the projections for the other countries were mostly revised somewhat downward), average growth in the region will decline to 3.2% in 2012. This represents a downward revision by 0.9 percentage points compared to April 2011. All countries but Croatia (for which the forecast remained unchanged) were affected by the revisions. The changes were above average for the Czech Republic, Hungary and Turkey. In the latter country, growth will decline by two-thirds to a rather meager 2.2% given decelerating capital inflows, which will dampen domestic demand while external demand will also be lower. Currently available forecasts for CESEE, however, do not fully incorporate the most recent deterioration in the international environment, which implies that the projections will most probably need to be revised downward even further.

[4] *For the detailed OeNB-BOFIT forecast for CESEE, see box 3 of this contribution.*

Inflationary Pressures Moderate after Peak in Summer

Inflation was comparatively high throughout the first half of 2011

Throughout the first half of the year, price pressures were more or less elevated across the region, with only a few exceptions (Slovenia, the Czech Republic and Croatia). Inflation was driven by rising food prices due to high world market prices for food and adverse effects from poor harvests in the region in 2010. Furthermore, high energy and commodity prices as well as hikes in indirect tax rates in some countries boosted inflation. The latter was especially visible in Poland and Slovakia, both of which increased their value-added tax rate by 1 percentage point in January 2011 (to 23% and 20%, respectively).

Several central banks had already reacted to this development by tightening monetary policy in early 2011. In the review period, the Polish central bank increased its policy rate further, by 25 basis points each in April, May and June to 4.5%, and the Russian central bank increased its rate by 25 basis points in April to 8.25%. Slovenia and Slovakia directly implemented the ECB interest rate changes of April and July.

Receding food prices and base effects have supported disinflation since summer

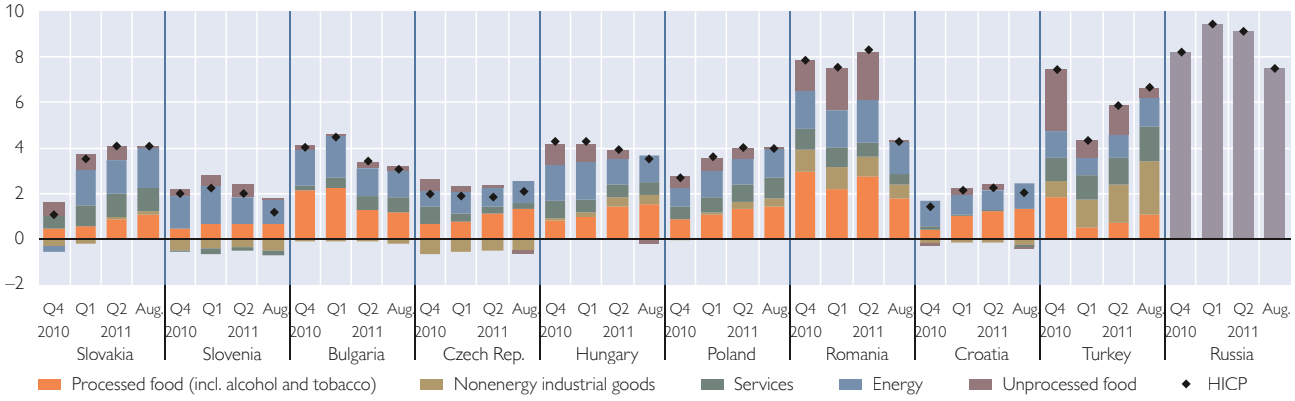
The peak of inflation, however, was already reached in summer. Most countries reported a moderation in price rises thereafter. This was, on the one hand, due to base effects, for example following the VAT increase in Romania in mid-2010. On the other hand, new harvests reaching the market took some pressure from food prices.

The one major exception from this pattern is Turkey. After a decline in inflation in early 2011, which was mainly due to base effects, price pressures have become more pronounced ever since. Unlike in most other countries, in Turkey the pickup in inflation was not mainly related to food and energy but rather to industrial goods. This was due to a positive output gap and pass-through effects from the weakening of the Turkish lira. Currency depreciation, in turn, was a byproduct of the policy mix the Turkish central bank adopted with the aim to contain portfolio capital inflows, which had been soaring since early 2010. In late 2010, the central bank launched a combined strategy of lowering policy rates, tightening reserve requirements, and widening the corridor between overnight

Chart 2

HICP Inflation and Its Main Drivers

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



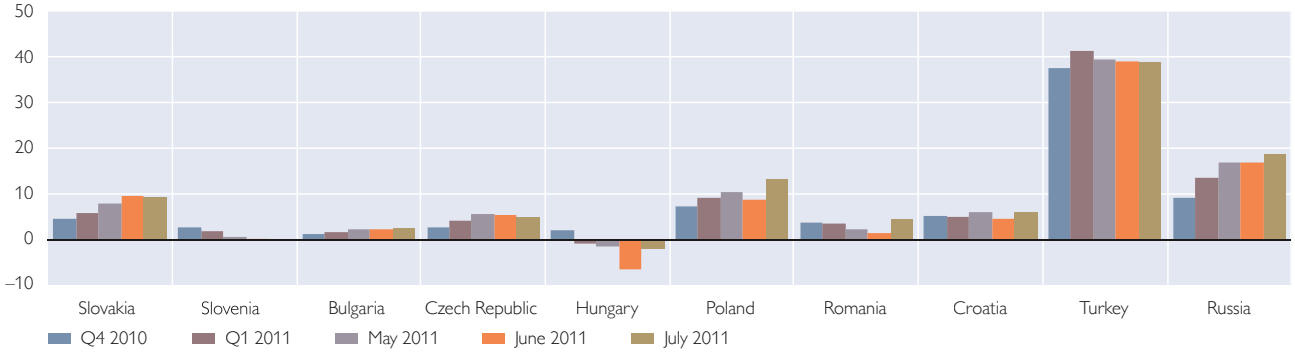
Source: Eurostat.

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

Chart 3

Growth of Credit to the Private Sector

%, year on year, not adjusted for exchange rate changes



Source: National central banks.

lending and borrowing rates. The latter measures aimed at draining liquidity from the domestic market in order to slow down credit growth and counteract the expansionary effects of low interest rates. This policy most likely fostered the weakening of the Turkish lira (and perhaps more so than the authorities originally intended) and thus helped to contain capital inflows. However, domestic loan growth remained vibrant, lingering at around 40% year on year during the summer, the highest level recorded throughout the region.

Credit growth remains lackluster …

By contrast, in most CESEE countries credit growth has remained rather lackluster. Some pickup was observed in the faster-growing economies (Slovakia, Poland, Russia), but even there the growth rates are lagging far behind those recorded in the boom years. In the remaining countries, the credit stock grew only marginally and even decreased as a percentage of GDP in five out of the ten countries (Slovenia, Bulgaria, Hungary, Romania, Russia; in the latter, however, due to a low credit stock compared to GDP).

… and NPL ratios are still elevated

Credit growth was muted despite the fact that recent lending surveys conducted in Hungary, Poland and Romania reported a slowly increasing demand for loans. According to an empirical analysis by the IMF,[5] the continuing weaknesses in credit portfolio quality as exemplified by the development of nonperforming loans (NPLs) play a role in this context.

The share of nonperforming loans in total loans has decreased substantially only in Turkey, where it has fallen to precrisis levels. Some improvement in NPL ratios was also recently observed in Russia, Slovakia, the Czech Republic and Poland. Nevertheless, NPL ratios remain definitely elevated in these countries. In the rest of the region, NPL ratios kept on rising throughout the review period. This is an indication that the cleanup of banks' balance sheets is still far from complete and needs to be speeded up in order to avoid credit supply bottlenecks further down the road.

[5] *Regional Economic Outlook Europe, October 2011.*

Improvement of External Accounts Peters Out in Some Countries

As discussed in earlier issues of this report, most CESEE countries had seen a major improvement in their external positions in 2009–10. Throughout most of the region this process continued in the first half of 2011. This development often reflected a better performance of trade balances partly due to weak domestic demand (especially in Slovenia, Bulgaria, Romania and Croatia), but also improvements in price competitiveness. An increased absorption of EU funds also played a role, e.g. in Slovenia and Slovakia.

Rising domestic demand and profit repatriations begin to weigh on current account positions

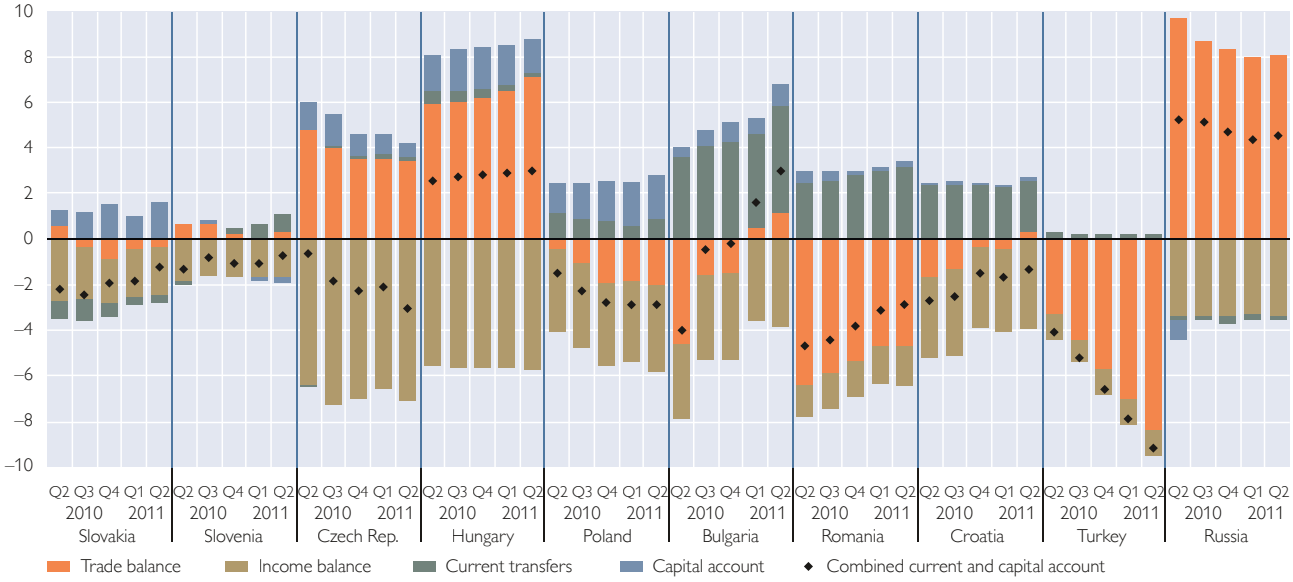
In the past quarters, however, a renewed increase in the current account deficit was observed in some countries, in particular in Poland and Turkey. Both countries enjoyed strong growth based on vivid domestic demand with corresponding effects on the trade balance. While the increase in the case of Poland was moderate, and the deficit has so far remained contained, the rise was more pronounced in Turkey, where the deficit has reached elevated levels. Looking forward, recent currency depreciations seen in both countries may help dampen the impact of deteriorating international demand on external balances.

The Czech Republic also reported a small rise in its current account deficit. Unlike in the aforementioned two countries, however, this was mainly related to a wider gap in the income balance as a growing number of foreign-owned companies recorded profits.[6] Since the Czech Republic's FDI stock was among the most profitable in CESEE (as measured by FDI-related income outflows relative to inward FDI stock) already before the crisis, it does not come as a surprise that foreign-owned companies in the Czech Republic have already been able to generate

Chart 4

Combined Current and Capital Account Balance

% of GDP, four-quarter moving sum



Source: Eurostat, national statistical offices.

[6] *A substantial part of these profits has been reinvested, thereby strengthening the financial account.*

higher profits again while such a development has not been observed in the other CESEE countries.

FDI has not yet fully recovered from the slump during the crisis

As for financial account developments, net capital flows to CESEE as a whole decelerated somewhat, from 3.5% of GDP in the second quarter of 2010 (four-quarter moving sum) to 2.7% of GDP in mid-2011 (four-quarter moving sum). This was mostly due to decreasing net inflows of portfolio investment, but net FDI inflows too were lower. On the country level, capital flows decreased substantially in Bulgaria, Hungary and Russia, while they picked up strongly in the Czech Republic, Slovakia and Turkey. As for the type of capital, other investment accounted for most of the net inflows in Croatia, Turkey, Romania and Slovakia. Portfolio investment was the most important component in Hungary, Slovenia and Poland. While in Poland this can be interpreted as a sign of the strength and attractiveness of the domestic market, Hungary and Slovenia are more dependent on portfolio financing as a substitute for other investment flows as the willingness of foreign creditors to extend credit lines has decreased. In Turkey, external financing is increasingly relying on portfolio inflows, which constitutes – in conjunction with the level of the funding needed – an element of vulnerability.

FDI represents the most important source of external financing in Bulgaria (where the current account is in surplus anyway) and the Czech Republic, and has been picking up recently in Romania and Slovenia. In general, however, FDI has not yet recovered substantially from the slump during the crisis. In some countries it is still declining (e.g. in Bulgaria, although from a high level, and in Poland and Russia), while in other countries it is only marginally above the low levels recorded during the financial crisis (Romania and Slovakia).

Fiscal Consolidation Remains a Challenge

The financial crisis severely affected fiscal accounts in CESEE. Revenues, which often had been buoyant in the precrisis years thanks to booming domestic demand, collapsed in most countries and have recovered only moderately since then, while spending pressures intensified. Against this background, fiscal consolidation became a key issue on the political agenda. In some cases, fiscal tightening started already during the recession, as efforts to preserve investor confidence prevailed over concerns about the procyclical effects of fiscal restraint during the downturn.

CESEE EU members have committed themselves to meeting the EDP deadlines …

During the observation period, fiscal consolidation in CESEE progressed. The average deficit of the region will decline from –4.6% of GDP in 2010 to –2.2% of GDP in 2011 according to recent projections, with a notable fraction of this improvement being of a structural nature. This development in the regional average, however, masks large differences across countries. Although some see rather rapid improvements (Slovakia, Poland, Russia), others are making much less headway, and some none at all (Croatia). In the EU countries of the region, consolidation is taking place under the framework of the excessive deficit procedure (EDP), which all EU Member States of the country group under review here are currently subject to. Under the EDP, benchmarks for reducing the budgetary gaps have been agreed upon, with the deadlines for the correction of excessive deficits being 2011 (Hungary and Bulgaria), 2012 (Poland and Romania) and 2013 (Czech Republic, Slovakia and Slovenia). In their national stability and convergence programs of spring 2011, the CESEE EU Member States recommitted themselves to these timelines.

… which will be difficult to achieve in some countries

In its evaluation of the programs and its country-specific recommendations within the framework of the European semester, the European Commission, however, only partly shares this view. In the case of Slovenia, the Commission found that further consolidation to correct the excessive deficit by 2013 remains a key challenge. The same is true for Poland. Measures in addition to the ones presented in the draft 2012 budget may need to be implemented to meet the 2012 deadline. Furthermore, the Commission deems it possible that the deficit in Hungary will again exceed the 3%-of-GDP threshold in 2012 unless further measures are taken. In general, the medium-term macroeconomic scenarios underpinning the budgetary projections were found to be too favorable in some cases (e.g. in the Czech Republic, Poland, Slovakia and Slovenia), which may thwart the achievement of budgetary objectives in the years to come.

While the headline fiscal balances in Turkey and Russia have developed positively, given robust economic dynamics and – in the case of Russia – high oil prices, in Croatia the budget deficit will increase in 2011 due to weak economic momentum; it is expected to contract slowly to a level of just below 3% only by 2013, the prospective year of Croatia's EU entry.

The public debt situation in CESEE remains less problematic than in a number of Western European countries. Public debt levels have remained below 50% in most countries, only Hungary (81.9% of GDP) and Poland (56.1% of GDP) recorded higher debt ratios as at the first quarter of 2011.

Box 1

Ukraine: Growth Mainly Driven by Private Consumption, IMF Program Currently Off Track

Following the recovery in 2010, the Ukrainian economy continued to grow in the first half of 2011. Yet, annual GDP growth decelerated from 5.3% in the first quarter to 3.8% in the second quarter. GDP growth was mainly driven by private consumption. Inventory restocking and gross fixed capital formation also delivered positive growth contributions, but to a much smaller extent than private consumption. At the same time, the contribution of net exports became increasingly negative in the first half of 2011.

The deteriorating current account confirmed that growth was driven mainly by domestic demand. In the four quarters up to mid-2011, the current account deficit increased to 4.2% of GDP, from 2.1% at end-2010. On a positive note, net FDI inflows fully covered the current account deficit. In September 2011, foreign exchange reserves fell by USD 3.25 billion due to valuation effects as well as central bank interventions in the foreign exchange market to keep the hryvnia stable vis-à-vis the U.S. dollar. After falling to single-digit levels in 2010, the inflation rate trended upward and reached 11.9% in June 2011. Since then, it has come down to reach 5.9% in September due to favorable food price developments. However, core inflation remained rather high at 8.1% in September (only marginally down from 8.6% in June).

In July 2010, the IMF approved its second Stand-By Arrangement (SBA) for Ukraine since the beginning of the global financial crisis. So far, two tranches amounting to a total of EUR 2.6 billion out of a total of EUR 11.6 billion have been disbursed under the second SBA. However, the program veered off track in early 2011, as the Ukrainian authorities did not implement all the measures previously agreed upon. Meanwhile, some progress has been made (including adjustments in the pension system), but the Ukrainian government has remained reluctant to raise gas prices for households, which is a key condition for the IMF to continue with the program.

Box 2

Western Balkans:[1] Tentative Recovery amid Increasing External Risks

As in 2010, when the Western Balkan countries experienced a moderate recovery mainly driven by external demand, net exports again provided a strong contribution to GDP growth in the region in the first half of 2011, as suggested by the available data. The only notable exception is FYR Macedonia, where gross capital formation and private consumption also became a main source of GDP growth. While real GDP growth in 2010 ranged between 0.7% in Bosnia and Herzegovina and 4.1% in Albania, available GDP data for the first half of 2011 show increasing GDP growth in FYR Macedonia (5.2% year on year) and Serbia (3.1%), and a slowdown in Albania (3.4%). Quarterly GDP data are not available for Montenegro and Bosnia and Herzegovina. However, retail sales growth rates suggest an acceleration (+14.1% year on year in Montenegro, +15.5% in Bosnia and Herzegovina year on year in the second quarter of 2011), while construction and industrial production growth rates in these two countries also broadly tended to pick up.

These developments went hand in hand with a recovery of growth of credit to the private sector, as bank lending resumed momentum in Bosnia and Herzegovina (+4.8% year on year) and accelerated in Albania (+10.3%), FYR Macedonia (+7.8%) and Kosovo (+14.3%), while contracting considerably only in Montenegro (–11.8%). On the downside, the share of nonperforming loans accelerated further in Albania (to 15.5% of total loans by mid-2011), Montenegro (24.3%) and Serbia (19.7%), while remaining broadly steady in Bosnia and Herzegovina and FYR Macedonia, albeit at already elevated levels (11.8% and 9.2%, respectively). So far, despite their large exposure to Greece (in particular of FYR Macedonia, Albania and Serbia), negative spillovers from the Greek debt crisis – through either trade or bank channels – have remained contained.

After a substantial improvement in external imbalances in 2009–10, the current account balance deteriorated in the majority of the Western Balkan countries, as domestic demand stabilized, but also due to falling remittances (Albania) in the first half of 2011. In the same period, net FDI inflows developed heterogeneously, increasing only in FYR Macedonia, Albania and Bosnia and Herzegovina, covering, on average, only 60% of the current account deficit.

The IMF remains an important policy anchor for several countries in the region. Serbia was granted a new SBA (with a total volume of EUR 1.1 billion) in September 2011 after the successful completion of a two-year SBA with the IMF in April 2011. FYR Macedonia, in March 2011, drew EUR 220 million under a Precautionary Credit Line (PCL) arrangement approved in January 2011; in late summer, the IMF positively completed the first review of the arrangement. The SBA with Kosovo was derailed in June due to the significant increase of public sector wages and was transformed into a non-financing IMF Staff-Monitored Program. Despite the challenging political environment in Bosnia and Herzegovina, the SBA with the IMF remains well on track and will be completed in June 2012.

Mainly due to international commodity price developments, price growth has gained momentum in all Western Balkan countries since mid-2010, and inflation even reached double-digit levels in Kosovo (10.6%) and Serbia (14.7%) in April 2011. Since then, inflation has decelerated in Albania and Serbia. The central banks of these two countries reduced their policy rates as a response to falling inflation and a more benign inflation outlook.

Despite the slightly improved growth performance, general government deficits appear to have widened somewhat in the first six months in 2011 (except for Bosnia and Herzegovina) due to lower-than-expected inflows of VAT and personal income revenues (Serbia, Montenegro) as well as increased government expenditures (Albania, Kosovo). Looking forward, fiscal policy in the Western Balkans will need to strike a balance between continuing or renewing consolidation efforts and avoiding an overly procyclical policy stance given the deterioration in the international environment and its knock-on effects on cyclical developments in this subregion.

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

Box 3

OeNB-BOFIT September 2011 Projections for Selected CESEE Countries: Growth Moderates Due to Worsening External Demand[1]

The recent macroeconomic projections for selected CESEE countries by the OeNB and the Bank of Finland's Institute for Economies in Transition (BOFIT) with the cutoff date September 29, 2011, show a downward revision of the growth prospects for selected Central, Eastern and Southeastern European economies as a result of the rapidly deteriorating external environment. The baseline is – mainly for technical reasons – based on a rather optimistic outlook for euro area GDP growth[2] and leads to moderate economic growth in the CESEE-7[3] region of 2.8% in 2011 and 2.5% in 2012. Therefore we have decided to add a more pessimistic scenario, which seems to become more realistic every day. This scenario, for which we assume a potentially worse growth performance of euro area GDP in 2012 (1 percentage point lower), would push the 2012 growth rate of the CESEE-7 region down to 1.9%. The contribution of external demand, which has to date represented the main growth driver, will decline over the projection horizon. Domestic demand will strengthen in all countries, but will remain negative in Hungary. Poland, the largest economy in the region, continues to be an exception in terms of both growth rates and reversed growth drivers. Russian economic growth in the first half of 2011 was weaker than forecast, while the expansion of imports exceeded expectations. Consequently, our GDP forecast was revised downward to 4.4% in 2011 and 2012. The import rebound is expected to remain buoyant in 2011, but to lose speed in 2012. With a moderate economic recovery in the second half of the year, Croatian GDP is forecast to expand by a modest 0.4% in 2011 and to pick up slightly to 1.3% in 2012 on the back of strengthening domestic demand.

Risks to growth are clearly tilted to the downside and comprise substantially slower-than-assumed growth in the euro area and additional contagion risks through banking and financial market channels. Furthermore, uncertainty prevails over the appropriate response to existing and possibly newly arising fiscal consolidation needs. For Russia forecast risks are likewise manifold and mainly downside, comprising lower oil prices induced by global disturbances and growth setbacks, new bouts of risk aversion, uncertainties with respect to consumer confidence, a new food inflation wave, and heightened import growth in case of stronger-than-expected ruble appreciation.

How Would CESEE-7 Growth React to a More Pronounced Dip in Euro Area Growth? A Sensitivity Analysis

The current projections are based on rather optimistic external assumptions, which do not incorporate the consequences of the most recent developments in the euro area. Therefore, this section illustrates the sensitivity of our growth forecast for the CESEE-7 countries to a potentially worse growth performance in the euro area. More specifically, euro area GDP growth in 2012 is assumed to be 1 percentage point lower than the baseline range of 0.4%–2.2% year on year.

[1] *Compiled by Julia Wörz. The OeNB and the Bank of Finland's Institute for Economies in Transition (BOFIT) compile semiannual forecasts of economic developments in selected CESEE countries (Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania as well as Russia). These forecasts are based on a broad range of available information, including country-specific time-series models for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania (for technical details, see Crespo Cuaresma, J., M. Feldkircher, T. Slačík and J. Wörz. 2009. Simple but Effective: The OeNB's Forecasting Model for Selected CESEE Countries. In: Focus on European Economic Integration Q4/09. pp. 84–95). The projections for Russia, which were prepared by BOFIT, are based on a SVAR model.*

[2] *The projections rest on technical assumptions about euro area developments for GDP, imports, interest rates and inflation rates. These assumptions are taken from the September 2011 macroeconomic projection exercise, prepared by the ECB for the Eurosystem. Average annual real GDP growth of the euro area is thus assumed to range between 1.4% and 1.8% in 2011 and between 0.4% and 2.2% in 2012.*

[3] *Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania. Latvia and Lithuania are not covered by our own projections, but are included in the CESEE-7 aggregate based on the September 2011 IMF World Economic Outlook projections.*

Table 1

GDP and Import Projections for 2011 and 2012, Baseline

	GDP			Imports		
	2010	2011	2012	2010	2011	2012
	Year-on-year growth in %					
CESEE-7	2.0	2.8	2.5	13.0	7.6	5.7
Bulgaria	0.3	2.5	2.8	4.3	8.3	6.5
Czech Republic	2.2	2.0	1.8	17.6	7.9	5.8
Hungary	1.1	1.5	1.1	12.0	7.5	4.5
Poland	3.8	3.7	2.9	11.5	6.2	6.0
Romania	–1.5	1.5	3.0	12.3	7.7	4.3
Russia	4.0	4.4	4.4	24.2	18.0	9.0
Croatia	–1.1	0.5	1.2	–1.4	–3.5	0.6

Source: OeNB-BOFIT September 2011 forecast, Eurostat, IMF.

Lower euro area growth implies lower CESEE-7 growth in the same year for various reasons. First of all, because the euro area represents the major trading partner for all countries in the region, slower euro area growth automatically reduces the CESEE-7 region's external demand for goods and services. Second, a contraction of economic activity may trigger a range of channels through which economic activity in the region may be affected. One possible consequence may be stronger funding constraints for euro area banks active in the CESEE-7. This would induce greater deleveraging in the region. A more pronounced dip in the euro area could also increase uncertainty in the CESEE-7, in turn affecting investment and consumption decisions. Negative wealth effects as a result of continued turbulences in stock markets could also arise in the region and could have a negative impact on private consumption. Such effects tend to be smaller in the CESEE-7 than in some Western European countries, though. In such an environment, additional (procyclical) fiscal consolidation measures may become necessary in some CESEE-7 countries to retain investor confidence. Not all of these effects will necessarily materialize, and their growth impact would certainly vary from country to country, but the point is that there is an array of channels that may transmit lower growth in the euro area to the CESEE-7 countries.

The scenario of 1-percentage-point lower euro area GDP expansion in 2012 is implemented in the time-series projection models for the five CESEE countries Bulgaria, the Czech Republic, Hungary, Poland and Romania. The reduction is spread evenly over the entire year and thus does not change the quarterly profile of euro area growth. In our models, the major influence of this change on CESEE-7 growth comes through the drop in external demand as compared to the baseline. Exchange rate developments are also directly affected in the model, apart from indirect effects on all growth components feeding through the system. However, our quantitative assessment of the growth impact on the CESEE-7 does not consider most of the financial transmission channels mentioned above. Hence, our sensitivity analysis has to be interpreted as a conservative estimate of the effects. In order to calculate the effect of the euro area dip on the CESEE-7 region as a whole, GDP growth in Latvia and Lithuania for 2012 was scaled down by the average growth reduction for the CESEE-5 aggregate. The results are given in table 2 below.

Table 2

Sensitivity of CESEE-7 GDP Growth Projections to a Moderation of Euro Area Growth in 2012

	2012	
	Baseline	Scenario
	Year-on-year growth in %	
CESEE-7	2.5	1.9
Bulgaria	2.8	2.0
Czech Republic	1.8	1.3
Hungary	1.1	0.5
Poland	2.9	2.2
Romania	3.0	2.8

Source: OeNB.

Growth in the region as a whole would be 0.6 percentage points lower in 2012 relative to the baseline under these weaker external growth assumptions. Individual countries would be affected differently: The outlook for Poland, by far the largest economy in the region, would fall by 0.7 percentage points to only 2.2% year on year. Likewise, growth projections for Bulgaria would be lowered by 0.8 percentage points. In Hungary, projected growth for 2012 would be more than halved to 0.5% year on year, falling by 0.6 percentage points. Projected GDP in the Czech Republic would also be taken down by 0.5 percentage points. By contrast, the impact on Romania would be smaller. The projected growth rate would only drop by 0.2 percentage points to 2.8%. The results of this sensitivity analysis, which underpin the dependence of the region on developments in the euro area, represent a lower bound of the potential impact arising from weaker euro area growth, given that not all transmission channels are explicitly captured in the underlying models.

CESEE-7: External Demand to Fade as Main Growth Driver

In the second half of 2011, external demand, which held up as the most important growth component in the first half of the year, will further recede and domestic demand will sustain the moderate economic expansion in all countries apart from Hungary. Here, frequent policy turns and interference in existing contracts are aggravating corporate and household financing conditions. With restocking having come to an end and capacity utilization high in most countries, investment will pick up and, together with private consumption, will back domestic demand in the remainder of 2011. Strong liquidity and profitability conditions of the nonfinancial corporate sector underscore this trend in Poland. The improvement of domestic demand will be especially pronounced in Bulgaria and Romania. This is partly the result of a base effect – domestic demand continued to contract in both countries in the second half of 2010 – and partly reflects improving labor market conditions. Strong public infrastructure investments in Bulgaria and high capacity utilization in Romania further add to powerful investment growth. Leading indicators in both countries were stable, albeit at low levels, in mid-2011.

Export growth, which was strong in recent quarters, will moderate considerably, given strongly decelerating growth in the major trading partner countries. The importance of individual growth drivers will thus remain mixed throughout the region in the latter half of 2011. Poland and Romania will display a positive contribution of domestic demand and a negative contribution of external demand, while net exports will remain the only positive growth component in Hungary. The Czech Republic will also show a strongly positive contribution of external demand. In Bulgaria, growth will become increasingly balanced.

For 2011 as a whole, the CESEE-7 region will expand by 2.8% and thus more moderately than projected in our March forecast. Growth in Poland, the largest economy, will not expand further compared to 2010, but the country will remain the region's growth engine, with its GDP augmenting by 3.7% year on year. Hungary and Romania are expected to show a growth rate of 1.5%, while the Czech and Bulgarian economies will grow by 2% and 2.5%, respectively. This implies an acceleration of growth dynamics for all countries apart from the Czech Republic and Poland. In the Czech

Republic, the fiscal austerity package will restrict further growth, while in Poland investment growth will moderate after strong pre-election public investments. The deteriorating external environment and rising uncertainty about developments in the euro area imply that economic growth will remain well below its precrisis level and that catching-up will resume at a slow pace.

Based on the assumptions concerning euro area growth as prepared by the ECB in the context of the September 2011 macroeconomic projection exercise, economic growth in 2012 will moderate to 2.5% in the region. As described above, a more realistic assumption concerning economic growth in the euro area in 2012 would lower CESEE-7 growth by 0.6 percentage points down to 1.9% per annum. The growth moderation will be led by the Central European countries, while the Southeastern European economies of Bulgaria and Romania will continue to show a domestic demand-driven expansion that relies heavily on private consumption. In Hungary, domestic demand will be further hampered by the strength of the Swiss franc given the high ratio of private foreign currency loans. In general, the contribution of net exports is falling in all countries except for Poland and will either yield almost no contribution to GDP growth (in the Czech Republic and Poland along with somewhat deteriorating price competitiveness) or will make a negative contribution (in Bulgaria and Romania). By contrast, the growth contribution of domestic demand is rising in all countries apart from Poland, where it remains at a comparatively high level. In Hungary, domestic demand and, in particular, private consumption will remain subdued to the extent that its overall contribution will remain slightly negative. For the region as a whole, several factors will weigh on economic activity in addition to the weakening external environment, namely tight and uncertain financing conditions, hesitant investors and uncertainties about capital inflows. Import demand will ease compared to 2011 and will range between 4.3% (in Romania) and 6% (in the Czech Republic and Poland); it will reach 6.5% in Bulgaria.

Risks to the current projections are clearly on the downside. A further and possibly substantial deterioration of external demand in the form of rising economic and financial tensions in the euro area has not been factored into the projections. Negative consequences for the CESEE-7 region via trade and supply-chain links could arise if economic growth in the euro area weakens or even stagnates. Additional possible contagion through the financial sector and the banking system imply further downside risks. Moreover, uncertainty prevails over the appropriate response to existing and possibly newly arising fiscal consolidation needs in the region. Investor sentiment toward the region has remained rather positive during the sovereign debt crisis in Southern Europe. The July/August rating upgrades for the region (long-term foreign-currency sovereign debt ratings for Bulgaria, Romania and the Czech Republic in July and August 2011) and the improvements in the outlook for Hungary, Latvia and Lithuania between May and August may reflect some upward risks. Yet, these moves in general indicate a rather backward-looking stance, as is illustrated very impressively by the most recent political developments, inter alia with respect to repayment conditions for foreign currency loans, in Hungary.

Russia: Growth Is Relatively Brisk, but Leveling Off

The speed of Russia's economic recovery declined to 3.7% year on year in the first half of 2011, i.e. to less than forecast, after a revival of 4% in 2010. Private consumption continued to grow steadily, although slightly more slowly than expected (by some 5% to 6% in the first half of 2011). Public consumption has hardly increased at all so far this year. The country's export volume has also underperformed forecasts, not growing at all in the first quarter of 2011, yet some indications point to a slight pickup in the second quarter. The revival of fixed investment has been hesitant, although it appears to have gained some life in spring and expanded 2.7% in the first half of 2011. The

post-trough wave of inventory restocking continued. Similar to 2010, the lower GDP growth performance was partly due to an unexpectedly swift rebound of imports.

Regarding the second half of 2011, growth is forecast to pick up from a slow second quarter, supported by easing inflation, so that prices will erode household purchasing power less than since the summer of 2010. Year-on-year growth may also benefit from a base effect, given that economic activity in the third quarter of 2010 was subdued due to production losses (particularly in agriculture) caused by extreme weather conditions in the summer. The full-year 2011 GDP growth forecast of 4.4% is also supported by investment, which should gain momentum, since the output gap is closing. The rebuilding of inventories may continue in 2011.

However, the economic expansion is projected to slow down soon, assuming the oil price will level off, i.e. no longer rise, during the forecast period. Full-year GDP growth will remain at 4.4% in 2012, given the current year's partly low GDP level (another base effect), the partial winding-back of corporate social taxes in 2012, and accelerated government spending increases connected with the elections.

Private consumption is forecast to remain the crucial driver of growth and to increase briskly. Pension and public sector wage increases penciled in so far are relatively moderate, but there official indications have been made publicly that larger hikes might be possible. Wages in the private sector are anticipated to rise swiftly as unemployment declines gradually from a relatively low level. Consumer loans are expected to grow further. Public consumption is anticipated to increase in 2012, since the authorities plan to augment total general government spending by around 6% in real terms in the forefront of elections. Export volumes are projected to grow rather slowly. While oil deliveries will continue to be sluggish, exports of gas and nonenergy commodities should expand more swiftly. Fixed investments are foreseen to recover in 2012, as preslump capacity utilization rates will have been attained. Restocking is expected to subside in 2012.

Russia's import surge has shown signs of leveling off in the summer of 2011. The rebound is considered to be frontloaded and is projected to ease from this year's 18% to below 10% in 2012, assuming that the economy's import propensity over the forecast period will not substantially differ from what it was in the preslump boom years. The already regained share of imports will cushion the decline in import growth.

Our forecast is based on the expectation that the world economy and trade will continue to grow briskly in the coming years and that the oil price (Brent) will level off only slightly from its average of about USD 110 in 2011. Forecast risks are manifold and mainly downside. Global disturbances and growth setbacks could bring down the price of oil and of other Russian export commodities and could also squeeze the country's export volume somewhat. New bouts of risk aversion could swiftly impact capital flows into and from Russia. Uncertainties in the advanced economies may also affect Russian consumer confidence. Any new food inflation wave would cut into consumer demand (food items account for almost 40% of the CPI). Uncertainties, whether external or domestic (inter alia, the pre-election period) could further delay the revival of investments. Import growth may prove to be faster than forecast, e.g. if ruble appreciation in real terms outstrips expectations.

Croatia: Protracted Recovery of Domestic Demand

Against the background of stagnating economic activity, economic conditions remained gloomy in Croatia in the first half of 2011. In particular, weak domestic demand continued to weigh on the Croatian economy. Although private consumption showed some tentative signs of recovery as the effects of the tax reform 2010 (including the abolition of the special "crisis tax") started to fully materialize, it still remained weak, given high unemployment, contracting real wages and the ongoing process of financial deleveraging and restructuring in the household sector. Similarly, public consumption grew only moderately in view of increasing fiscal constraints. Furthermore, investment activity (in particular construction) remained depressed. Net exports continued to contribute positively to economic growth, as imports contracted faster than exports.

With a moderate economic recovery in the second half of the year, the Croatian economy is forecast to grow by 0.4% in 2011 as a whole. The growth pattern seen in 2009 and 2010 will also prevail in 2011, implying a negative contribution of domestic demand and a positive contribution of net exports (albeit less pronounced than in previous years). Private and public consumption are expected to strengthen somewhat in the second half of the year in the wake of the upcoming parliamentary elections in December 2011. At the same time, restocking is expected to compensate slightly for weak investment activity. A fairly good tourism season is expected to underpin exports in the third quarter of 2011, but given the base effect-related slump in exports in the first quarter of 2011, export growth will turn out to be negative in full-year 2011. However, given the faster contraction of imports, the contribution of net exports to growth will remain positive.

GDP growth is expected to accelerate to 1.3% in 2012, driven mainly by a pickup in domestic demand. Consumption will remain weak, though. In particular, the need for increasing fiscal consolidation following the election year 2011 will affect public consumption. At the same time, private consumption is estimated to pick up slightly as the first signs of improving labor market conditions become apparent and the support measures of the government taken in September 2011 to support borrowers who have taken out loans in Swiss francs will help ease households' financial situation. After having contracted considerably for three consecutive years, gross fixed capital formation is forecast to recover in 2012, mainly driven by gradually increasing FDI inflows ahead of EU entry in 2013. In a less supportive global environment, exports are expected to grow only marginally in 2012. At the same time, the investment-driven recovery of domestic demand will also contribute to a pickup in import growth, so that the positive contribution of net exports to GDP growth is likely to decrease further.

2 Slovakia: Export-Driven Growth, Fiscal Consolidation and Labor Market Reforms

Output driven by external demand, domestic demand deteriorates

In the first half of 2011, GDP growth was rather solid but, contrary to the same period of 2010, driven only by external demand. Exports continued to grow at double-digit rates on an annual basis. The pace of imports, which consisted mainly of intermediate and capital goods, has been slowing down; the fastest growing items included parts and accessories of motor vehicles and semiconductor devices. Imports were thus mainly driven by export-oriented industrial production rather than consumer demand.

Private consumption was indeed subdued, which is also reflected in declining retail sales. One of the reasons for this are the government's fiscal austerity measures, which also depressed public consumption. While restocking slowed down, gross fixed capital investment continued to grow. Hence, gross fixed capital formation has been the only domestic demand component to positively contribute to GDP growth in 2011 so far. However, the pace of industrial production has been slowing down, and so has industrial confidence, implying a moderation in investment activity looking forward. The decline in unit labor costs came to a halt in the first half of 2011, reflecting lower productivity growth and higher nominal wages.

The current account deficit improved in the first half of 2011 compared to the same period of the previous year, and so did all components except for the income balance, which deteriorated slightly due to profit repatriation. Net FDI turned negative due to outflows of other capital.

Inflation accelerates

Annual average HICP inflation rose in the first half of 2011, peaking at 4.2% in May, and moderated to 4.1% in August. Inflation was mainly affected by rising global energy and food prices as well as by a 1-percentage-point VAT hike at the beginning of the year and rising transport and housing services costs.

Labor market: some improvement, structural problems and reform efforts

While employment remained below the precrisis level, unemployment reached its lowest level since 2009 in the second quarter of 2011. However, unemployment continues to vary strongly between regions, and long-term unemployment accounts for more than two-thirds of the total figure. This suggests that the labor market also suffers from structural problems. The labor code was amended, taking effect from September 2011, with the aim of improving flexibility in the labor market and fostering job creation.

Continuing consolidation efforts in public finances

After having posted a general government deficit of 7.9% of GDP in 2010, Slovakia has committed itself under the EU's excessive deficit procedure to bring the deficit down to 4.9% by 2011 and to 2.9% by 2013. This implies a reduction in the structural deficit by 4.3% of GDP between 2010 and 2013. So far, the implementation of this year's budget appears to be on track to reach the envisaged target.

The consolidation measures scheduled for 2011 have been mainly expenditure based (cuts in the public wage bill and other spending), but also revenue enhancing (1-percentage-point VAT rate hike, higher excise duties, a broadening of the income tax and social contributions base). In 2012, parliament is set to adopt changes to the pension system (concerning, e.g., pension indexation, investment rules in the fully funded pillar) and the health care system (e.g. the transformation of hospitals into joint stock companies, medication policy) and further amendments to income tax and social contributions legislation (aimed at simplifying the system) as well as a bank levy. In addition, a public debt ceiling is to be introduced.

Table 2

Main Economic Indicators: Slovakia

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	5.8	–4.8	4.0	4.7	4.2	3.8	3.5	3.5	3.3
Private consumption	6.2	0.3	–0.3	–0.1	–1.3	–0.2	0.5	–0.1	0.0
Public consumption	6.1	5.6	0.1	5.9	–1.1	0.9	–3.3	–2.5	–4.3
Gross fixed capital formation	1.0	–19.9	3.6	–3.4	1.8	4.8	10.6	1.2	6.2
Exports of goods and services	3.1	–15.9	16.4	18.3	16.1	17.3	14.3	15.8	12.4
Imports of goods and services	3.1	–18.6	14.9	10.9	16.0	19.2	13.5	11.3	9.0
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	–7.4	2.4	–0.3	4.0	4.0	1.5	–0.2	–0.8
Net exports of goods and services	0.0	2.6	1.0	4.8	0.3	–1.1	0.5	3.6	2.8
Exports of goods and services	2.7	–13.3	11.6	12.8	11.3	11.5	10.8	12.7	10.0
Imports of goods and services	2.7	–15.9	10.6	8.0	11.0	12.7	10.3	9.1	7.2
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	2.7	2.5	22.8	36.0	30.0	15.4	13.7	6.3	2.7
Average gross earnings in industry (nominal)	7.6	2.7	5.1	5.8	6.1	4.9	3.8	2.9	4.8
Unit labor costs in industry (nominal)	5.5	0.7	–15.2	–22.7	–18.5	–9.3	–9.0	–3.7	2.0
Producer price index (PPI) in industry	2.5	–6.6	0.1	–3.4	0.1	1.9	1.8	5.3	5.1
Consumer price index (here: HICP)	3.9	0.9	0.7	–0.0	0.7	1.0	1.1	3.5	4.1
EUR per 1 SKK, + = SKK appreciation	8.0	3.8	3.8	..	..	..	..	..	..
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.6	12.1	14.4	15.2	14.4	14.2	13.9	13.9	13.2
Employment rate (%, 15–64 years)	62.3	60.2	58.8	58.0	58.6	59.2	59.3	59.0	59.6
Key interest rate per annum (%)	4.0	..	..	..	..	..	..	..	..
SKK per 1 EUR	31.3	..	..	..	..	..	..	..	..
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.8	3.2	4.4	–1.2	1.8	3.5	4.4	2.8	3.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–8.0	–1.4	1.3	3.3	3.2	–1.6	1.3	0.3	2.5
Domestic credit of the banking system	12.5	23.0	9.2	9.4	9.9	12.0	9.2	4.2	3.8
of which: claims on the private sector	11.2	6.0	3.2	2.4	2.1	1.9	3.2	4.6	6.8
claims on households	7.0	3.5	4.2	3.3	3.6	3.8	4.2	4.3	4.5
claims on enterprises	4.2	2.4	–1.0	–0.9	–1.5	–1.9	–1.0	0.3	2.4
claims on the public sector (net)	1.3	17.0	6.0	7.0	7.8	10.2	6.0	–0.4	–3.0
Other assets (net) of the banking system	0.3	–18.4	–6.1	–13.9	–11.4	–7.0	–6.1	–1.7	–2.4
	% of GDP, ESA 95								
General government revenues	32.9	33.6	33.1	. .	. .	. .	. .	. .	. .
General government expenditures	35.0	41.6	41.0	. .	. .	. .	. .	. .	. .
General government balance	–2.1	–8.0	–7.9	. .	. .	. .	. .	. .	. .
Primary balance	–0.8	–6.5	–6.6	. .	. .	. .	. .	. .	. .
Gross public debt	27.8	35.4	41.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	13.4	–16.8	22.8	17.7	26.4	23.9	23.0	25.9	16.9
Merchandise imports	13.4	–20.0	25.5	11.1	28.3	32.7	29.0	25.3	17.4
	% of GDP (based on EUR), period total								
Trade balance	–1.2	1.5	0.2	2.0	2.2	–1.9	–1.2	2.9	2.1
Services balance	–0.7	–2.0	–1.1	–1.8	–1.3	–0.9	–0.6	–0.8	–0.9
Income balance (factor services balance)	–2.9	–2.0	–1.9	–2.3	–2.3	–1.2	–1.9	–2.5	–2.4
Current transfers	–1.3	–1.1	–0.6	0.4	–0.9	–1.3	–0.7	1.4	–0.8
Current account balance	–6.1	–3.6	–3.5	–1.6	–2.3	–5.3	–4.3	1.0	–1.9
Capital account balance	1.2	0.7	1.5	2.6	0.0	1.8	1.9	0.3	2.3
Foreign direct investment (net)	4.5	–0.5	0.2	2.1	0.3	–2.3	1.1	1.7	–1.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	0.0	71.9	74.7	72.9	74.6	75.0	74.7	77.6	78.1
Gross official reserves (excluding gold)[1]	19.8	0.8	0.8	0.8	0.9	0.8	0.8	0.9	0.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	2.8	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	EUR million, period total								
GDP at current prices	64,687	63,051	65,906	15,149	16,267	17,470	17,020	15,833	17,131

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

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

3 Slovenia: Weaker-than-Expected Economic Growth Complicates Fiscal Consolidation

Economic growth slowed sharply in the second quarter of 2011, exports and inventories remain supportive

In Slovenia, GDP growth slowed to 1.6% during the first half of 2011 as the rate of economic expansion tumbled to 0.9% in the second quarter, its lowest level since the first quarter of 2010. In seasonally and working day-adjusted terms, the economy hardly expanded during the first half of the year. Domestic demand contracted due to a deep fall in investment, particularly in the construction sector, which is still adjusting after the precrisis boom. Falling capital formation reflected worsening demand conditions, weakening industrial confidence, slowing capacity utilization and a deepening contraction of credit to the corporate sector. There was only little growth in final consumption during the first half of 2011, as consumer confidence remained weak, lending to households started to slow again, the decline in employment accelerated and real wage growth slowed sharply. As export growth held up well, while the weakening of domestic demand translated into a sharp slowdown in import growth in the second quarter, net exports contributed 2 percentage points to the overall GDP growth rate during the first half of the year. Changes in inventories boosted GDP growth by the same amount.

Inflationary environment remains benign

Inflation slowed to a range of 1.1% to 1.2% by July-August 2011 from a range between 2.0% and 2.4% seen between November 2010 and May 2011. Core inflation fluctuated between 0.1% and 0.6% between March and August, with still falling prices for services and nonenergy industrial goods. As for non-core components, inflationary pressures eased substantially during the observation period both for energy and unprocessed food. Weak domestic demand and a decline in unit labor costs support the low inflationary environment. Labor cost developments presumably also helped the combined current and capital account turn into a small surplus in the second quarter of 2011, although the improvement during the first half of the year resulted mainly from the higher absorption of EU funds.

Weaker economy and bank recapitalization expenditure slow fiscal consolidation in 2011

In its 2011 Stability Programme of April 2011, the government set a general government budget deficit target of 5.5% of GDP. This target is substantially higher than the one of the previous update (4.2%), taking into account the unanticipated recapitalization of the country's biggest bank and a weaker macroeconomic environment. To ensure that this deficit target will be met despite weaker growth and the unforeseen capital injections into two state-owned enterprises (amounting to 0.5% of GDP), parliament in mid-September adopted a supplementary budget for 2011. The supplementary budget envisages lower revenue and expenditure targets and expenditure cuts in particular in public investment, capital transfers and subsidies. The Stability Programme update envisages a reduction of the deficit to 3.9% of GDP in 2012 and to 2.9% in 2013, in line with the obligations under the excessive deficit procedure. However, the 2012 budget is fraught with substantial uncertainty since the government collapsed in mid-September, and early elections have been called for early December. In its assessment of the Stability Programme, the European Council in July 2011 called for concrete measures to underpin the 2012 deficit target. The outgoing government has submitted a law to parliament to keep social benefits, pensions and public sector wages unchanged in 2012 instead of the usual inflation-indexation but the chances of the bill of being adopted are small.

Table 3

Main Economic Indicators: Slovenia

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	3.6	–8.0	1.4	–0.7	2.0	1.7	2.3	2.3	0.9
Private consumption	3.7	–0.1	–0.7	–0.7	0.2	–1.1	0.8	0.1	0.1
Public consumption	6.1	2.9	1.5	0.4	0.2	1.3	1.6	1.9	0.1
Gross fixed capital formation	7.8	–23.3	–8.3	–10.1	–4.3	–9.9	–7.2	–8.3	–16.4
Exports of goods and services	2.9	–17.2	9.5	6.5	12.0	11.4	8.2	11.1	8.3
Imports of goods and services	3.7	–19.6	7.2	4.2	10.6	5.9	7.8	9.6	3.9
	Contribution to GDP growth in percentage points								
Domestic demand	4.2	–10.3	–0.1	–2.0	1.1	–1.5	1.9	1.2	–2.0
Net exports of goods and services	–0.6	2.3	1.5	1.4	1.0	3.2	0.3	1.0	2.9
Exports of goods and services	2.0	–11.5	5.6	3.7	6.8	6.6	5.0	7.1	5.4
Imports of goods and services	2.6	–13.8	4.1	2.4	5.8	3.4	4.7	6.1	2.5
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	3.1	–8.4	12.4	9.1	17.8	12.6	10.4	13.3	7.6
Average gross earnings in industry (nominal)	7.8	1.4	8.5	9.9	9.6	8.3	6.6	5.1	3.6
Unit labor costs in industry (nominal)	4.9	10.4	–3.4	0.8	–7.0	–3.8	–3.4	–7.2	–3.7
Producer price index (PPI) in industry	3.9	–1.4	2.0	–1.2	2.1	3.2	3.8	5.7	4.8
Consumer price index (here: HICP)	5.5	0.9	2.1	1.7	2.4	2.3	2.0	2.2	2.0
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.5	6.0	7.4	7.3	7.3	7.2	7.9	8.7	7.8
Employment rate (%, 15–64 years)	68.6	67.5	66.2	66.3	66.5	66.3	65.7	63.7	64.4
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
SIT per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	6.9	3.4	1.6	2.1	1.8	1.9	1.6	0.5	1.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–11.9	6.6	–4.0	11.5	0.7	–4.8	–4.0	–0.6	4.8
Domestic credit of the banking system	20.8	2.1	6.7	–3.2	3.8	8.4	6.7	2.3	0.1
of which: claims on the private sector	22.7	4.7	2.8	4.5	5.1	3.1	2.8	1.1	0.2
claims on households	5.0	2.7	3.9	3.4	4.3	4.0	3.9	3.0	2.3
claims on enterprises	17.7	2.0	–1.1	1.1	0.8	–0.9	–1.1	–1.9	–2.2
claims on the public sector (net)	–1.8	–2.6	3.9	–7.7	–1.4	5.2	3.9	1.1	–0.0
Other assets (net) of the banking system	–2.0	–5.3	–1.2	–6.2	–2.7	–1.7	–1.2	–1.1	–3.5
	% of GDP, ESA 95								
General government revenues	42.3	43.1	43.4	. .	. .	. .	. .	. .	. .
General government expenditures	44.1	49.1	49.0	. .	. .	. .	. .	. .	. .
General government balance	–1.8	–6.0	–5.6	. .	. .	. .	. .	. .	. .
Primary balance	–0.7	–4.6	–4.0	. .	. .	. .	. .	. .	. .
Gross public debt	21.9	35.2	38.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	1.2	–19.4	13.8	7.0	15.7	17.4	14.9	19.4	13.8
Merchandise imports	5.7	–25.8	14.9	6.3	19.9	15.2	17.9	22.6	13.7
	% of GDP (based on EUR), period total								
Trade balance	–7.1	–2.0	–2.7	–1.7	–2.2	–1.9	–5.1	–3.6	–2.4
Services balance	4.0	3.2	3.0	2.9	3.3	2.8	2.9	4.2	4.3
Income balance (factor services balance)	–2.8	–2.2	–1.7	–1.9	–1.4	–1.7	–1.7	–1.8	–1.7
Current transfers	–0.8	–0.4	0.3	–0.7	–0.5	0.1	2.2	0.6	0.4
Current account balance	–6.7	–1.5	–1.2	–1.3	–0.9	–0.7	–1.8	–0.6	0.7
Capital account balance	–0.1	–0.0	0.0	0.6	0.0	0.2	–0.6	–0.1	–0.1
Foreign direct investment (net)	1.0	–1.5	1.4	–0.5	0.7	0.3	4.9	1.0	2.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	105.2	114.1	114.9	115.9	118.7	118.1	114.9	120.1	118.5
Gross official reserves (excluding gold)[1]	1.7	1.9	2.0	1.8	2.1	1.9	2.0	1.8	1.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3
	EUR million, period total								
GDP at current prices	37,280	35,311	35,416	8,145	9,126	9,178	8,967	8,374	9,242

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

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

4 Bulgaria: Timid Recovery despite Stagnant Domestic Demand, Fiscal Consolidation on Track

GDP growth still fueled by external demand

Following negligible GDP growth of 0.2% in 2010, the recovery of the Bulgarian economy picked up momentum in the first half of 2011, with growth coming to 1.9%. On the back of rather strong external demand, in particular at the beginning of the year, exports remained the driving factor, but were compensated for by the parallel rebound in import growth so that the contribution of net exports remained on the level of 2010 (near 5%). This positive momentum was partly offset by a negative growth contribution of domestic demand. In particular, gross capital formation remained depressed (even though the contraction of gross fixed capital formation moderated somewhat), due to persistently low business confidence, declining FDI inflows and fiscal constraints. Similarly, despite a moderating downward trend, private consumption stagnated in the first half of 2011 mainly due to adverse labor market conditions. However, on a positive note, private consumption growth turned positive in the second quarter after having still been in the red in the first quarter.

External competitiveness strengthens, negative ULC growth in industry

Bulgaria registered a surplus in its combined current and capital account during the first half of 2011 (1.7% of GDP). The sharp turnaround (from a deficit of 5.6% of GDP in the first half of 2010) was attributable almost completely to the goods and services balance. Contrary to that, net FDI inflows moderated further and became even negative temporarily in the first quarter of 2011 due to net payments on intercompany credits (which are recorded as FDI). External competitiveness strengthened in the first half of 2011 as nominal ULC in industry fell for the first time since 2004. Moreover, partly due to adverse labor market conditions, labor productivity growth in industry doubled compared to the same period in 2010 (12.3% in the first half of 2011).

Easing inflation pressures

After several quarters of rising inflation due to food and energy price increases, annual inflation decreased to 3.1% (both HICP and CPI) in August 2011, after a peak of 4.6% (both HICP and CPI) in February 2011. The decrease in inflation was mainly the result of continued low domestic demand pressures combined with moderating international commodity prices. Annual core inflation also moderated to 28% on average in the first eight months of 2011.

Banking sector: rising NPLs but substantial capital buffers

The share of nonperforming loans (NPLs) in the Bulgarian banking sector increased considerably (11.2% in the first half of 2011) compared to the same period in 2010 (7.5%), but the capital adequacy ratio of the Bulgarian banking sector remained elevated, close to 18% (as at the first half of 2011), and the loan-to-deposit ratio fell to 114% in June 2011 (from 123% a year earlier). Negative spillovers from the Greek crisis remained limited during the observation period, despite the substantial share of Greek-owned banks (28% in terms of total assets as at end-2010) in the Bulgarian banking sector.

EDP exit well on track

Bulgaria's recent fiscal performance suggests that the 2011 deficit target of 2.5% of GDP is within reach, which would imply the end of the EU excessive deficit procedure (EDP) after the fiscal outcomes of 2011 have been validated by Eurostat. On the back of higher revenues due to increased social security contributions as well as higher indirect tax revenues, but also due to spending restraint, the general government deficit on a cash basis decreased to 0.9% of GDP in the first half of 2011, down from 2.2% of GDP in the same period of 2010. In June 2011, parliament passed amendments to the State Budget Structure Act, which include a budget deficit ceiling of 2% of GDP and a limit of 40% of GDP for public expenditures.

Table 4

Main Economic Indicators: Bulgaria

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	6.2	–5.5	0.2	–4.8	1.0	0.3	3.1	1.5	2.2
Private consumption	3.4	–7.6	–1.2	–5.6	1.4	–1.5	0.7	–2.0	1.8
Public consumption	–1.0	–6.5	–1.0	0.3	–3.0	–3.5	1.7	0.4	5.2
Gross fixed capital formation	21.9	–17.6	–16.5	–22.1	–21.9	–27.2	3.2	–12.4	–9.1
Exports of goods and services	3.0	–11.2	16.2	6.9	16.3	22.9	15.8	25.8	12.3
Imports of goods and services	4.2	–21.0	4.5	–1.5	2.9	5.3	10.7	10.0	7.5
	Contribution to GDP growth in percentage points								
Domestic demand	7.7	–15.5	–5.0	–9.7	–5.4	–7.7	1.8	–5.8	0.0
Net exports of goods and services	–1.5	10.0	5.2	4.1	5.9	11.4	0.7	7.7	2.3
Exports of goods and services	1.8	–6.5	7.7	3.2	7.6	12.2	6.9	14.1	6.9
Imports of goods and services	3.3	–16.5	2.6	–0.9	1.7	2.8	5.9	6.4	4.6
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	1.2	–8.5	8.0	6.9	7.4	8.4	9.2	15.2	9.5
Average gross earnings in industry (nominal)	24.9	10.7	10.0	9.7	9.2	10.8	10.3	8.9	8.3
Unit labor costs in industry (nominal)	23.4	21.2	1.9	2.7	1.7	2.2	1.0	–5.5	–1.1
Producer price index (PPI) in industry	11.1	–6.3	8.5	4.1	8.5	10.3	11.3	13.2	10.3
Consumer price index (here: HICP)	12.0	2.5	3.0	1.9	2.9	3.3	4.0	4.5	3.4
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)	5.7	6.9	10.3	10.2	10.1	9.6	11.3	12.1	11.3
Employment rate (%, 15–64 years)	64.0	62.6	59.7	58.8	60.2	60.6	59.0	57.3	58.2
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)	8.8	4.2	6.4	7.7	8.0	8.4	6.4	7.4	8.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–12.3	1.7	5.0	3.5	2.9	4.8	5.0	4.5	6.2
Domestic credit of the banking system	26.3	6.6	5.1	7.5	9.1	7.0	5.1	5.7	3.8
of which: claims on the private sector	28.4	4.1	1.5	2.9	2.2	1.7	1.5	2.0	2.7
claims on households	10.3	2.3	–0.3	1.8	1.5	0.3	–0.3	–0.3	–0.2
claims on enterprises	18.1	1.8	1.8	1.1	0.8	1.4	1.8	2.3	2.9
claims on the public sector (net)	–2.1	2.5	3.7	4.6	6.9	5.3	3.7	3.7	1.1
Other assets (net) of the banking system	–5.1	–4.1	–3.7	–3.3	–4.0	–3.4	–3.7	–2.8	–2.0
	% of GDP, ESA 95								
General government revenues	39.3	36.0	34.5	. .	. .	. .	. .	. .	. .
General government expenditures	37.6	40.7	37.7	. .	. .	. .	. .	. .	. .
General government balance	1.7	–4.7	–3.2	. .	. .	. .	. .	. .	. .
Primary balance	2.5	–3.9	–2.6	. .	. .	. .	. .	. .	. .
Gross public debt	13.7	14.6	16.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	7.6	–23.0	33.1	15.0	38.4	44.3	32.7	56.4	27.9
Merchandise imports	9.2	–33.3	13.3	–5.0	14.8	15.8	26.5	32.2	19.6
	% of GDP (based on EUR), period total								
Trade balance	–24.3	–11.9	–6.7	–7.7	–9.2	–1.2	–9.2	–0.1	–6.6
Services balance	3.8	3.7	5.2	0.1	4.3	14.6	0.7	1.8	5.1
Income balance (factor services balance)	–5.0	–3.4	–3.8	–5.2	–4.0	–4.0	–2.6	–4.0	–4.6
Current transfers	2.5	2.7	4.3	5.2	5.2	4.1	3.0	4.2	7.0
Current account balance	–23.0	–8.9	–1.0	–7.6	–3.7	13.6	–8.2	1.8	1.0
Capital account balance	0.8	1.4	0.8	0.8	–1.0	1.8	1.4	0.2	0.5
Foreign direct investment (net)	17.6	7.2	4.1	0.4	5.0	4.5	5.6	–1.5	1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	105.1	108.3	102.8	107.1	107.5	104.1	102.8	98.5	96.0
Gross official reserves (excluding gold)	33.7	34.2	32.2	32.0	31.2	32.7	32.2	29.6	29.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.1	7.4	6.5	7.0	6.6	6.8	6.5	5.8	5.7
	EUR million, period total								
GDP at current prices	35,431	34,933	36,034	7,321	8,627	9,879	10,207	8,131	9,615

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

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

5 Czech Republic: Growth Is Based on Exports as Ongoing Fiscal Consolidation Dampens Domestic Demand

Solid external demand-driven growth continues

GDP growth peaked in the first quarter of 2011, both in annual (3.1%) and quarterly terms (0.9%), before decelerating in the second quarter to 2.2%. Net exports contributed about three quarters to overall growth in the first half of 2011. However, in the second quarter both exports and imports slowed from double-digit growth rates in the previous five quarters, reflecting a slowdown in external demand dynamics in major trading partner countries, in particular Germany, which absorbs about one-third of Czech exports. In addition to net exports, another major growth driver was gross fixed capital investment, which began to recover after more than two years of negative growth. It contributed an average 0.7 percentage points to growth in the first half of 2011, mainly due to investment in machinery and transport equipment, reflecting capacity utilization in industry at 85% almost reaching precrisis levels. However, decelerating industrial production growth and weakening economic sentiment indicators suggest that a further moderation of growth is under way.

Both public and private consumption dynamics and their contributions to growth were increasingly negative in the first half of 2011, reflecting fiscal consolidation measures and a labor market reviving only slowly. In the first half of 2011, the unemployment rate was slightly lower than in the same period of 2010, and employment grew by an average 0.7% year on year in the first half of 2011. The decline in unit labor costs in industry continued at a slower pace than in 2010, with productivity growing moderately but still surpassing wage growth.

Current account balance worsened, steady koruna helped keep inflation low

The Czech koruna remained broadly stable until early October 2011, doing better in annual terms than its peer currencies. The current account deficit deteriorated compared to the first half of 2010, as did all its components except the trade balance. Net FDI, which comprises mostly reinvested earnings, covered more than two-thirds of the current account deficit in the first half of 2011. Annual consumer price index inflation as measured by the Czech Statistical Office hovered at levels close to 2% in the first eight months of 2011, in line with Česká národní banka's (CNB) inflation target, and so did HICP inflation. While rising global prices of energy and food as well as administered prices put upward pressure on inflation, weak domestic demand had a dampening effect.

Fiscal consolidation measures continue

The Czech Republic has committed itself under the EU excessive deficit procedure to cutting the general government deficit to 2.9% of GDP by 2013, down from 4.7% in 2010, and to balance the budget by 2016. The structural deficit is expected to decrease from 4.0% of GDP in 2010, to 3.1% in 2011 and further to 2.3% in 2013. Meeting the 2011 deficit target of 4.2% appears to be within reach.

While in 2010 fiscal consolidation was largely revenue based, the focus in 2011 is on spending cuts (reduction of the nominal public sector wage bill by 10% except in education and health care, cuts in social benefits and other expenditures). These measures have recently been readopted, as according to the Czech constitutional court, their first adoption had not followed the proper legislative process. This notwithstanding, the measures continued to be in force until the end of 2011 so that the originally envisaged fiscal consolidation measures were not delayed or undone. The introduction of a second, defined contribution-based pension pillar scheduled for 2013 is currently under debate in parliament. To cover the related public revenue loss, a 4-percentage-point hike in the preferential VAT rate is planned for 2012.

Table 5

Main Economic Indicators: Czech Republic

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	2.5	–4.1	2.3	1.2	2.9	2.3	3.0	3.1	2.2
Private consumption	3.6	–0.2	0.2	0.3	0.9	–0.3	1.0	–0.2	–0.6
Public consumption	1.1	2.6	–0.1	2.0	0.9	–0.7	–2.4	–1.0	–1.4
Gross fixed capital formation	–1.5	–7.9	–3.1	–9.4	–6.5	–0.2	–0.1	3.3	3.5
Exports of goods and services	6.0	–10.8	18.0	18.0	20.7	15.7	17.7	15.5	9.4
Imports of goods and services	4.7	–10.6	18.0	15.4	20.0	18.6	17.9	13.5	8.0
	Contribution to GDP growth in percentage points								
Domestic demand	1.2	–3.6	1.3	–1.4	1.2	3.2	2.1	0.7	0.6
Net exports of goods and services	1.3	–0.6	1.0	2.6	1.8	–2.5	–0.1	2.4	1.6
Exports of goods and services	4.8	–8.3	12.5	12.1	14.1	10.9	12.8	12.0	7.4
Imports of goods and services	3.5	–7.7	11.4	9.5	12.3	11.8	12.1	9.7	5.8
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	–2.8	–3.1	13.8	17.1	16.0	11.2	11.5	9.5	6.2
Average gross earnings in industry (nominal)	9.0	2.4	3.6	4.5	4.0	2.8	3.1	3.9	4.4
Unit labor costs in industry (nominal)	12.3	5.4	–9.1	–10.7	–10.4	–7.6	–7.5	–5.1	–1.7
Producer price index (PPI) in industry	0.4	–1.5	0.1	–3.9	0.4	2.0	1.9	3.2	3.1
Consumer price index (here: HICP)	6.3	0.6	1.2	0.4	0.9	1.6	2.0	1.9	1.8
EUR per 1 CZK, + = CZK appreciation	11.2	–5.7	4.6	6.7	4.3	2.7	4.6	6.2	5.2
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	4.4	6.7	7.4	8.2	7.2	7.1	7.0	7.3	6.8
Employment rate (%, 15–64 years)	66.6	65.4	65.0	64.1	64.9	65.4	65.5	65.0	65.7
Key interest rate per annum (%)	3.5	1.5	0.8	1.0	0.8	0.8	0.8	0.8	0.8
CZK per 1 EUR	25.0	26.5	25.3	25.9	25.6	24.9	24.8	24.4	24.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.6	0.2	1.9	–0.8	2.8	3.9	1.9	1.3	–0.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.2	1.0	0.4	0.3	3.0	4.6	0.4	–3.3	–5.7
Domestic credit of the banking system	11.0	4.6	4.0	4.8	5.9	3.1	4.0	5.4	5.7
of which: claims on the private sector	10.6	0.3	2.1	–0.3	–0.2	0.4	2.1	3.2	3.9
claims on households	6.5	3.8	2.7	3.2	2.9	3.0	2.7	2.6	2.5
claims on enterprises	4.1	–3.5	–0.6	–3.5	–3.1	–2.6	–0.6	0.6	1.4
claims on the public sector (net)	0.4	4.3	1.9	5.1	6.1	2.7	1.9	2.2	1.8
Other assets (net) of the banking system	2.4	–5.4	–2.6	–5.9	–6.1	–3.8	–2.6	–0.8	–0.8
	% of GDP, ESA 95								
General government revenues	40.2	40.1	40.5	. .	. .	. .	. .	. .	. .
General government expenditures	42.9	46.0	45.2	. .	. .	. .	. .	. .	. .
General government balance	–2.7	–5.9	–4.7	. .	. .	. .	. .	. .	. .
Primary balance	–1.6	–4.5	–3.3	. .	. .	. .	. .	. .	. .
Gross public debt	30.0	35.3	38.5	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	9.3	–16.3	24.1	19.5	27.6	24.1	24.9	27.7	16.6
Merchandise imports	10.4	–19.2	27.0	17.8	30.3	30.7	28.7	28.4	16.7
	% of GDP (based on EUR), period total								
Trade balance	0.7	2.4	1.4	3.6	2.4	–0.5	0.5	3.8	2.6
Services balance	2.0	2.0	2.0	2.1	2.7	1.7	1.8	1.5	2.1
Income balance (factor services balance)	–4.8	–6.9	–7.0	–4.4	–8.7	–10.3	–4.2	–3.4	–10.5
Current transfers	–0.2	–0.0	0.2	0.3	0.7	–0.3	0.2	0.4	0.5
Current account balance	–2.2	–2.5	–3.2	1.6	–2.9	–9.4	–1.7	2.4	–5.2
Capital account balance	0.7	1.4	0.9	0.2	1.0	1.6	0.6	0.1	–0.0
Foreign direct investment (net)	1.0	1.0	2.6	3.5	2.1	7.6	–2.5	1.5	3.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	40.9	45.1	49.2	45.2	47.3	49.3	49.2	48.2	48.7
Gross official reserves (excluding gold)	17.8	20.8	21.6	20.9	21.5	22.3	21.6	19.9	19.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.3	4.3	3.8	4.3	4.2	4.1	3.8	3.4	3.3
	EUR million, period total								
GDP at current prices	147,942	137,258	145,091	33,636	36,560	37,046	37,850	36,338	39,187

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

6 Hungary: Continued Fiscal Consolidation despite Weaker Growth

Disappointing economic growth in the first half of 2011

Hungarian GDP grew by 1.9% year on year during the first half of 2011, slowing down from the first to the second quarter. Growth continued to be driven by net exports despite weakening external demand conditions and by inventories. Domestic consumption stagnated during the first half of the year mainly on account of weak household demand. This suggests that the substantial income tax relief taking effect at the beginning of 2011 and a pickup in wage growth in the second quarter were outweighed by tighter credit conditions, the increased costs of servicing foreign currency loans, worsening consumer confidence and significant uncertainty about future income developments. The decline in gross fixed capital formation accelerated during the first half of 2011, reflecting contracting credit to the corporate sector, the deterioration in foreign demand in the second quarter, spare capacities especially in the services sector and the ongoing recession in the construction sector. High-frequency indicators suggest that economic conditions remained weak or even deteriorated into the third quarter.

Monetary policy on hold as inflation appears to be on track to reach target by early 2013

Inflation continued to fall and reached 3.1% in July, before rising to 3.5% in August 2011. By contrast, following a rise during the first few months of 2011, core inflation fluctuated between 3.0% and 3.3% in April to August. Despite the relatively benign inflationary and weak cyclical environment as well as the favorable development of the external account, monetary policy continued to be constrained by the volatility of Hungary's risk premiums, and Magyar Nemzeti Bank (MNB) has kept its policy rate stable at 6% since January 2011. Looking forward, the MNB expects inflation to fall to its 3% target by the first half of 2013 once the effects of the increase in indirect taxes (to take effect at the beginning of 2012) dissipate and the subdued domestic environment suppresses price pressures.

Government takes additional measures to reduce budget deficit

In its 2011 Convergence Programme, the government targeted a budget surplus of around 2% of GDP, to be achieved by substantial one-off items of around 8% of GDP in net terms. The Programme foresaw a budget deficit of 2.5% in 2012 (confirmed by the draft 2012 budget), followed by a gradual reduction to 1.5% by 2015. To underpin these targets, the government has taken further corrective measures (e.g. the freeze of selected expenditure items and tax increases). In response to weaker-than-expected economic growth during the first half of 2011 and to a ruling by the European Court of Justice on VAT refunds (with a combined budgetary impact of around 1.2% of GDP), the government in mid-September adopted additional measures (e.g. improved VAT collection and limiting public procurements) to keep the 2011 budget on track. Finally, to underpin the 2012 deficit target, the standard VAT rate will be raised from 25% to 27%, and health care contributions will be increased. In September, parliament also passed a controversial law that allows the redemption of foreign currency mortgage loans at preferential exchange rates, thus infringing ex post on existing contracts. Banks, which would have to bear the full costs, have indicated that they will challenge this law by appealing to national and European courts. The government attaches priority to reducing state debt and has used parts of the repatriated pension fund assets to cut it from 81% at end-2010 to 77% at mid-2011. It plans to reduce debt by a further 4 percentage points by end-2011, drawing on its foreign currency deposits at the MNB and by selling foreign shares which had been transferred to the state from the pension funds.

Table 6

Main Economic Indicators: Hungary

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	0.8	–6.7	1.2	0.1	1.0	1.7	1.9	2.5	1.5
Private consumption	0.4	–7.8	–2.1	–3.7	–4.9	0.8	–0.5	–0.9	0.2
Public consumption	1.0	–0.2	–1.7	–1.4	–2.2	2.4	–5.0	1.5	–0.1
Gross fixed capital formation	2.9	–8.0	–5.6	–4.8	–4.5	–2.6	–9.1	–1.6	–8.1
Exports of goods and services	5.7	–9.6	14.1	15.5	15.8	13.9	11.7	14.4	8.8
Imports of goods and services	5.8	–14.6	12.0	10.4	14.4	13.0	10.3	14.4	6.1
	Contribution to GDP growth in percentage points								
Domestic demand	0.8	–10.7	–1.1	–4.3	–1.0	0.3	0.3	1.3	–1.3
Net exports of goods and services	0.0	4.0	2.2	4.3	2.0	2.4	2.6	1.2	2.8
Exports of goods and services	4.6	–7.8	10.9	12.0	12.0	10.7	9.2	12.7	7.5
Imports of goods and services	4.6	–11.8	8.7	7.7	10.0	9.3	7.7	11.5	4.8
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	0.2	–6.6	11.6	14.7	15.0	10.6	6.9	6.8	–0.3
Average gross earnings in industry (nominal)	6.3	4.7	5.1	7.9	5.2	4.5	2.9	6.2	6.5
Unit labor costs in industry (nominal)	6.4	12.2	–6.1	–6.2	–8.5	–5.8	–3.5	–0.6	6.7
Producer price index (PPI) in industry	4.6	4.6	6.3	–0.9	5.9	10.5	9.8	5.2	0.0
Consumer price index (here: HICP)	6.0	4.0	4.7	5.8	5.2	3.6	4.3	4.3	3.9
EUR per 1 HUF, + = HUF appreciation	–0.2	–10.3	1.9	9.5	4.1	–3.9	–1.8	–1.4	3.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.9	10.1	11.2	11.9	11.2	10.9	10.9	11.7	10.9
Employment rate (%, 15–64 years)	56.6	55.4	55.4	54.5	55.3	56.0	55.8	54.6	55.8
Key interest rate per annum (%)	8.7	8.6	5.5	5.9	5.3	5.3	5.4	5.9	6.0
HUF per 1 EUR	251.7	280.5	275.4	268.7	274.6	282.4	275.7	272.5	266.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.8	3.4	3.0	0.1	3.4	2.5	3.0	1.5	–1.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–3.8	13.3	4.3	11.4	12.3	3.6	4.3	5.8	6.4
Domestic credit of the banking system	18.2	–4.1	6.3	–10.5	2.8	5.4	6.3	–1.9	–10.6
of which: claims on the private sector	20.4	–4.7	3.7	–16.0	2.9	1.1	3.7	–2.3	–7.4
claims on households	12.7	0.8	4.6	–3.8	5.4	3.4	4.6	0.8	–2.2
claims on enterprises	7.6	–5.3	–1.4	–12.5	–3.0	–2.8	–1.4	–3.1	–4.7
claims on the public sector (net)	–2.1	0.5	2.6	5.5	–0.1	4.3	2.6	0.4	–3.2
Other assets (net) of the banking system	–5.6	–5.8	–7.6	–0.9	–11.7	–6.4	–7.6	–2.4	3.2
	% of GDP, ESA 95								
General government revenues	45.2	46.1	44.6	. .	. .	. .	. .	. .	. .
General government expenditures	48.9	50.6	48.8	. .	. .	. .	. .	. .	. .
General government balance	–3.7	–4.5	–4.2	. .	. .	. .	. .	. .	. .
Primary balance	0.5	0.1	–0.1	. .	. .	. .	. .	. .	. .
Gross public debt	72.3	78.4	80.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	6.3	–20.4	20.3	16.8	22.0	21.7	20.4	23.9	13.0
Merchandise imports	7.0	–24.9	19.5	12.5	22.1	22.5	20.6	22.1	11.9
	% of GDP (based on EUR), period total								
Trade balance	–1.1	2.5	3.3	3.9	3.8	2.3	3.3	5.8	4.6
Services balance	1.4	2.1	3.0	3.1	3.1	3.7	2.1	2.3	4.3
Income balance (factor services balance)	–7.0	–5.3	–5.6	–5.9	–6.1	–5.5	–4.8	–6.1	–6.6
Current transfers	–0.5	0.4	0.4	0.1	0.8	0.6	0.1	–0.3	0.4
Current account balance	–7.3	–0.2	1.1	1.1	1.5	1.1	0.6	1.7	2.8
Capital account balance	1.0	1.2	1.8	2.2	2.2	2.1	0.7	2.1	1.3
Foreign direct investment (net)	2.5	–0.2	0.4	–1.3	–1.4	0.5	3.4	–1.1	–2.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	116.0	146.9	139.8	149.1	146.2	141.8	139.8	140.5	139.1
Gross official reserves (excluding gold)	22.5	32.8	34.1	35.4	36.2	34.4	34.1	35.9	36.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.4	5.5	5.2	6.0	5.9	5.4	5.2	5.3	5.3
	EUR million, period total								
GDP at current prices	106,442	93,168	98,420	22,405	24,255	24,496	27,264	23,136	26,246

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

7 Poland: Growth Has Remained Solid amid Substantial Depreciation of the Złoty Due to Increased Global Risk Aversion

Stronger fixed investment growth but lower export growth

Poland posted annual GDP growth of 4.2% in the first half of 2011, after 3.8% in 2010. Exports and private consumption made the largest contribution to GDP growth, followed by inventory restocking and (contrary to 2010) gross fixed capital formation. Private consumption growth accelerated to 3.5% but remained below GDP growth. It benefited from an increase in the employment rate, while higher inflation reduced accelerated nominal wage growth to a real rise of only 1%, putting a lid on private consumption. Fixed investment growth accelerated notably to 7%, supporting employment growth. Rising capacity utilization, the improved profitability and strong liquidity of enterprises, the availability of EU funds, public infrastructure projects and strong housing loan growth were factors that supported investment. At the same time, export growth slowed considerably, dragging down import growth, despite stronger domestic demand. As a result, the contribution of net exports to growth continued to be moderately negative. This led to some further deterioration of the goods and services balance, which contributed to the rise of the combined current and capital account deficit by 0.3 percentage points year on year to 1.9% of GDP in the first half of 2011.

Key policy rate has been put on hold after strong currency depreciation

Inflation stood at 4.0% (HICP) and 4.3% (CPI) in August 2011, having peaked at 4.3% (HICP) and 5.0% (CPI) in May 2011 after a sustained acceleration since August 2010. Apart from the VAT rate hike at the start of the year, components related to energy and processed food (including alcohol and tobacco) were the main drivers of annual inflation. The rise in processed food prices was also decisive in the rise in core inflation to 3.5% (HICP) and 2.7% (CPI) in August, while inflation pressures from demand and labor costs currently appear to be contained as the output gap is close to zero and ULC developments in the economy as a whole have been rather benign.

After the złoty had remained roughly stable against the euro for about twelve months, it depreciated from about PLN 4.0 in July to PLN 4.5 per euro in late September, prompting Narodowy Bank Polski (NBP) to sell foreign currency. With headline inflation above the inflation target (2.5% CPI) and the expectation of favorable cyclical conditions for the near future, the Polish monetary policy council (MPC) decided to raise the key policy rate in three steps by a total of 75 basis points to 4.5% from early April to early June to reduce the risk of inflation running above the target in the medium term. Despite its view that inflation will be curbed by the global and domestic economic slowdown, the MPC refrained from lowering its key policy rate, as it considered the recent strong currency depreciation an upside risk factor for inflation.

Fiscal consolidation largely on track in 2011

In view of the 2012 deadline to put an end to its excessive deficit, the government adopted various measures in 2010 and the first half of 2011 (some of which will unfold their full effect in 2012), including a freeze on the public sector wage bill scheduled to enter into force in 2012. The authorities estimate that the general government deficit will be down to close to 3% of GDP (including the net fiscal costs of the pension reform in the amount of about 2.5% of GDP). Measured by the central government budget, the deficit (as a percentage of projected annual GDP) by end-August 2011 was only half as large as in the corresponding period of 2010 due to tax revenues above plan, cautious spending and improved liquidity management.

Table 7

Main Economic Indicators: Poland

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	5.1	1.6	3.8	2.7	3.5	4.8	4.1	4.1	4.4
Private consumption	5.7	2.0	3.1	2.3	2.8	4.3	3.0	3.5	3.6
Public consumption	7.4	2.0	4.0	1.7	2.4	4.3	7.8	–0.1	–0.9
Gross fixed capital formation	9.6	–1.0	–1.0	–12.9	–1.7	2.0	1.4	5.6	8.0
Exports of goods and services	7.0	–8.5	10.0	9.5	14.9	8.6	7.4	5.8	8.6
Imports of goods and services	8.1	–12.5	11.6	7.7	17.6	9.6	11.4	6.2	6.6
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	–1.1	4.4	2.1	4.3	5.1	5.7	4.2	4.6
Net exports of goods and services	–0.6	2.7	–0.6	0.7	–0.9	–0.4	–1.2	–0.2	–0.1
Exports of goods and services	2.9	–2.7	4.0	3.8	6.0	3.5	2.8	2.4	2.9
Imports of goods and services	3.5	–5.5	4.5	3.1	6.9	3.9	4.3	2.6	3.0
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	1.5	2.4	11.5	13.7	13.5	11.1	8.3	6.0	2.7
Average gross earnings in industry (nominal)	8.8	4.9	5.0	4.4	4.6	5.0	6.0	4.3	6.7
Unit labor costs in industry (nominal)	7.4	2.5	–6.0	–8.2	–7.7	–5.6	–2.2	–1.7	3.8
Producer price index (PPI) in industry	2.4	3.9	2.3	–1.4	1.3	4.2	5.2	7.7	7.0
Consumer price index (here: HICP)	4.2	4.0	2.7	3.4	2.5	2.1	2.7	3.6	4.0
EUR per 1 PLN, + = PLN appreciation	7.6	–18.8	8.4	12.7	10.9	4.7	5.3	1.2	1.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.2	8.3	9.7	10.7	9.6	9.2	9.4	10.2	9.6
Employment rate (%, 15–64 years)	59.2	59.4	59.3	58.2	59.3	60.0	59.6	58.9	59.7
Key interest rate per annum (%)	5.7	3.8	3.5	3.5	3.5	3.5	3.5	3.7	4.2
PLN per 1 EUR	3.5	4.3	4.0	4.0	4.0	4.0	4.0	3.9	4.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	18.6	8.1	8.8	5.5	7.1	8.9	8.8	10.9	7.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–13.6	3.2	3.0	5.1	7.8	5.2	3.0	2.1	–3.7
Domestic credit of the banking system	39.2	9.2	10.3	1.1	7.4	9.9	10.3	12.3	8.1
of which: claims on the private sector	30.1	6.7	8.0	0.8	6.6	7.0	8.0	9.7	8.5
claims on households	20.8	6.8	8.3	3.5	7.7	7.5	8.3	7.9	5.9
claims on enterprises	9.3	–0.2	–0.2	–2.6	–1.1	–0.5	–0.2	1.8	2.6
claims on the public sector (net)	9.1	2.5	2.3	0.3	0.8	3.0	2.3	2.6	–0.5
Other assets (net) of the banking system	–6.9	–4.3	–4.5	–0.7	–8.1	–6.2	–4.5	–3.5	2.9
	% of GDP, ESA 95								
General government revenues	39.5	37.2	37.8	. .	. .	. .	. .	. .	. .
General government expenditures	43.2	44.5	45.7	. .	. .	. .	. .	. .	. .
General government balance	–3.7	–7.3	–7.9	. .	. .	. .	. .	. .	. .
Primary balance	–1.5	–4.7	–5.2	. .	. .	. .	. .	. .	. .
Gross public debt	47.1	50.9	55.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	14.1	–15.8	22.9	19.9	27.9	23.1	20.6	17.0	12.0
Merchandise imports	17.2	–24.3	27.7	22.1	31.8	28.6	28.2	17.7	16.0
	% of GDP (based on EUR), period total								
Trade balance	–4.9	–1.0	–2.5	–1.8	–1.9	–2.8	–3.3	–2.1	–3.4
Services balance	1.0	1.1	0.7	0.7	1.0	0.4	0.6	1.1	1.6
Income balance (factor services balance)	–2.4	–3.8	–3.6	–3.4	–3.7	–4.0	–3.4	–3.3	–4.5
Current transfers	1.5	1.5	0.8	1.5	1.5	0.4	–0.1	0.8	2.6
Current account balance	–4.8	–2.2	–4.7	–2.9	–3.1	–6.0	–6.3	–3.5	–3.7
Capital account balance	1.1	1.6	1.8	1.6	1.2	1.5	2.8	1.9	1.5
Foreign direct investment (net)	1.9	2.0	0.7	3.9	–0.1	–0.5	–0.1	2.1	–0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	47.8	62.5	66.6	64.2	64.6	67.4	66.6	67.9	68.3
Gross official reserves (excluding gold)	11.6	16.9	18.8	18.8	19.9	20.2	18.8	19.8	19.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.2	5.2	5.1	5.7	5.8	5.7	5.1	5.3	5.2
	EUR million, period total								
GDP at current prices	363,163	311,100	354,397	81,280	85,358	87,240	100,520	88,449	93,164

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

8 Romania: Moderate Recovery amid Difficult External Environment, IMF Precautionary Stand-By Arrangement on Track

External demand slows while domestic demand stabilizes

Following a severe recession, the Romanian economy expanded moderately in the first half of 2011. Yet, GDP growth decelerated from 1.7% in the first quarter to 1.4% in the second quarter as external demand decreased. In fact, growth was largely driven by net exports in the first quarter due to a strong export performance. In the second quarter, however, the contribution of net exports turned slightly negative as export growth slowed and fell below import growth. Changes in inventories continued to deliver positive growth contributions. Investment and private consumption remained weak in the first half of 2011 but tended to stabilize in quarter-on-quarter terms (seasonally adjusted) in the second quarter. Recent retail sale figures give no clear evidence of a recovery of private consumption. Following a pickup in July, retail sales contracted again in August. Construction output posted positive annual growth rates in July and August, which is a sign of the recovery of gross fixed capital formation.

Inflationary pressures ease

After peaking at 8.5% in May 2011, annual inflation (CPI) quickly came down to 4.3% in August mainly due to a base effect – caused by the VAT rate hike one year earlier. Moreover, declining food prices supported the decline in inflation. Core inflation also fell notably from 4.4% in June to 2.9% in August. As inflation fell faster than expected, Banca Naţională a României (BNR) revised its end-year (December-to-December) projection down to 4.6% in August, partly reversing May's upward revision. The BNR projects inflation to reach its target range (3% ± 1 percentage point) in the first quarter of 2012.

Current account continues to improve, net FDI inflows still weak

In the first half of 2011 the current account deficit (measured in euro) declined by almost one-third, narrowing to 3% of four-quarter rolling GDP in mid-2011 from 4% at end-2010. The improvement in the current account was driven by a further declining trade deficit and rising current transfers to the public sector, mainly due to disbursements from EU funds. At the same time, net FDI inflows remained subdued and only partially covered the current account deficit.

Financial market stress increased, precautionary support program on track

The Romanian leu continued to fluctuate in the range of RON 4.10 to 4.35 against the euro. After strengthening in the first half of 2011, the leu weakened toward the end of September to levels of about RON 4.35 against the euro amid high volatility in international financial markets. According to market participants, the BNR intervened in the foreign exchange market to support the leu in late September and early October. In the current context of increased global uncertainty, the precautionary IMF/EU support program is an important anchor for Romania. At the end of September, the IMF Executive Board completed the second review under this arrangement. IMF staff noted that Romania was on track to meet its cash deficit target of 4.4% of GDP in 2011. Moreover, achieving the 2012 fiscal target of 3% in cash terms would be achievable. However, meeting Romania's budget deficit commitment to the EU of below 3% of GDP in ESA terms would be challenging. So far, the IMF has made available three tranches totaling about EUR 1 billion (out of a total of EUR 3.5 billion). Romania does not intend to draw on these funds, treating them as precautionary. Moreover, up to EUR 1.4 billion could be activated through precautionary EU medium-term financial assistance in case of a major unforeseen deterioration in the economic and/or financial situation.

Table 8

Main Economic Indicators: Romania

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	7.4	–7.1	–1.3	–2.2	–0.4	–2.2	–0.6	1.7	1.4
Private consumption	9.0	–10.3	–1.6	–4.4	–0.4	–0.9	–1.2	–0.7	–0.8
Public consumption	7.3	1.6	–3.6	–3.9	–4.5	–1.3	–4.3	–10.6	–0.7
Gross fixed capital formation	15.6	–25.3	–13.1	–28.3	–7.7	–15.5	–4.7	–2.2	–1.4
Exports of goods and services	7.3	–5.0	14.3	10.2	17.6	11.8	18.0	24.4	6.2
Imports of goods and services	7.1	–21.4	12.4	8.6	19.3	8.7	13.0	15.9	7.6
	Contribution to GDP growth in percentage points								
Domestic demand	8.0	–14.5	–1.1	4.8	4.0	–7.2	–2.7	–2.4	1.9
Net exports of goods and services	–0.8	7.4	–0.2	–0.9	–2.2	–1.1	–0.7	1.8	–1.1
Exports of goods and services	2.4	–1.5	4.1	4.0	4.7	3.3	4.4	6.5	2.4
Imports of goods and services	3.2	–8.9	4.3	4.9	6.8	2.2	3.9	4.8	3.5
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	6.8	10.9	17.1	22.2	20.3	14.4	12.8	14.0	3.1
Average gross earnings in industry (nominal)	21.3	11.2	9.3	12.4	8.2	8.3	8.7	7.2	9.1
Unit labor costs in industry (nominal)	14.1	0.5	–7.0	–8.4	–10.3	–5.4	–3.9	–6.0	5.8
Producer price index (PPI) in industry	15.4	1.9	6.3	3.5	6.1	7.2	8.5	10.7	8.7
Consumer price index (here: HICP)	7.9	5.6	6.1	4.6	4.3	7.5	7.8	7.5	8.3
EUR per 1 RON, + = RON appreciation	–9.4	–13.1	0.7	3.7	0.3	–0.7	–0.5	–2.6	1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.1	7.2	7.6	8.4	7.2	7.2	7.6	7.8	7.5
Employment rate (%, 15–64 years)	59.1	58.6	58.8	57.0	60.1	60.2	57.9	58.0	58.8
Key interest rate per annum (%)	9.7	9.1	6.5	7.2	6.3	6.3	6.3	6.3	6.3
RON per 1 EUR	3.7	4.2	4.2	4.1	4.2	4.3	4.3	4.2	4.1
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	17.5	9.0	6.9	8.4	8.2	6.5	6.9	3.3	2.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–10.7	5.0	0.8	8.8	12.6	4.3	0.8	–7.1	–1.8
Domestic credit of the banking system	41.5	12.6	13.8	3.0	11.4	12.2	13.8	12.2	3.1
of which: claims on the private sector	33.7	1.2	5.2	–1.7	7.3	5.1	5.2	2.6	1.7
claims on households	18.7	0.6	1.0	–1.6	2.6	1.7	1.0	–0.2	–1.2
claims on enterprises	15.0	0.6	4.2	–0.1	4.7	3.4	4.2	2.8	2.9
claims on the public sector (net)	7.8	11.4	8.6	4.7	4.1	7.1	8.6	9.5	1.4
Other assets (net) of the banking system	–13.3	–8.7	–7.7	–3.4	–15.8	–10.0	–7.7	–1.8	1.3
	% of GDP, ESA 95								
General government revenues	32.6	32.1	34.3	. .	. .	. .	. .	. .	. .
General government expenditures	38.3	40.6	40.7	. .	. .	. .	. .	. .	. .
General government balance	–5.7	–8.5	–6.4	. .	. .	. .	. .	. .	. .
Primary balance	–5.0	–7.0	–4.9	. .	. .	. .	. .	. .	. .
Gross public debt	13.4	23.6	30.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	14.2	–13.8	28.3	20.0	31.9	27.4	32.7	39.6	18.5
Merchandise imports	11.6	–31.9	20.2	13.1	27.6	17.2	22.2	26.3	15.6
	% of GDP (based on EUR), period total								
Trade balance	–13.7	–5.8	–4.9	–5.4	–6.8	–3.7	–4.0	–2.2	–6.3
Services balance	0.5	–0.2	–0.5	–1.2	–0.8	–0.3	–0.0	–1.2	–0.8
Income balance (factor services balance)	–2.5	–1.6	–1.5	–1.7	–2.0	–1.3	–1.1	–2.4	–2.1
Current transfers	4.3	3.5	2.8	1.9	2.2	3.9	3.0	2.9	3.1
Current account balance	–11.4	–4.2	–4.0	–6.4	–7.4	–1.4	–2.2	–2.9	–6.1
Capital account balance	0.5	0.5	0.2	0.2	0.1	0.2	0.2	0.4	0.1
Foreign direct investment (net)	6.6	3.1	2.0	1.9	2.4	3.0	1.0	1.6	2.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	51.8	69.1	74.7	73.1	73.6	73.8	74.7	75.7	77.1
Gross official reserves (excluding gold)	19.0	24.1	26.7	27.1	26.5	27.0	26.7	26.6	27.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.2	7.8	7.7	8.7	8.1	8.1	7.7	7.4	7.5
	EUR million, period total								
GDP at current prices	139,587	117,442	121,660	23,645	27,985	32,761	37,270	25,283	30,691

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

9 Croatia: Economy Stagnates, Successful Closure of EU Accession Negotiations

Protracted weak domestic demand weighs on economic performance

The Croatian economy stagnated in the first half of 2011. Domestic demand was anaemic, contributing negatively to growth despite some positive stimuli from inventory restocking. Investment activity remained depressed, with both private and public investment being weak given persistently low business sentiment, poor FDI inflows and limited fiscal leeway. Public consumption grew only moderately, again owing to fiscal constraints, while private consumption stayed subdued as a result of weak consumer confidence, adverse labor market conditions and ongoing household debt restructuring. Net exports contributed positively to growth, as imports contracted faster than exports, a pattern also seen in 2009 during the height of the crisis.

Current account adjustment continues, but external debt continues rising

Weak domestic demand and a good start into the tourism season helped the trade and services balances improve and led to another current account adjustment in the first half of 2011. For the first time since 1994, in 2011 the current account recorded a surplus already in the second quarter. Given modest net FDI and equity portfolio inflows, gross foreign debt continued to rise and reached 102.5% of GDP in mid-2011 on increased banking sector borrowing. At the same time, Croatia's foreign exchange reserves rose to 24.8% of GDP. Reserve accumulation came to a halt thereafter, though, as downward pressures on the kuna emerged in the summer amid renewed global tensions. This is in contrast to the usual tourism-driven appreciation trend during the summer. To stabilize the currency, Hrvatska narodna banka (HNB) intervened twice to support the kuna and increased the mandatory reserve requirements from 13% to 14% in order to absorb surplus liquidity.

Bank lending to the private sector, in particular to households, remained sluggish, while the nonperforming loan ratio in the private nonbank sector climbed to 13.5% as at mid-2011. Swiss franc appreciation put pressure on borrowers whose loans are denominated in Swiss francs. Against this background, in August 2011 the government and banks signed a memorandum on easing the position of users of housing loans denominated in Swiss francs, which inter alia envisages the fixing of the exchange rate for such loans at HRK/CHF 5.80 for a period of five years.

Putting public finances on a sustainable path remains a key challenge

Given poor economic conditions, budget revenues underperformed and public finances remained under pressure in the first half of 2011. The general government budget deficit reached 5.1% of GDP, up from 4.5% in the same period of 2010. In view of upcoming parliamentary elections in December 2011, there will be no major consolidation efforts in the remainder of 2011. Based on current growth projections, which may turn out overly optimistic given the recent deterioration in global sentiment, the government envisages a general government budget deficit of 5.4% of GDP for 2011. As a result of (largely still unspecified) measures on the expenditure side, the deficit is forecast to fall gradually to 2.7% by 2013, the prospective year of Croatia's EU entry as the country successfully closed its accession negotiations in June 2011.

As financing needs remained high, the government tapped international bond markets again in June, issuing a EUR 750 million eurobond. As a result, public debt continued to rise, reaching 43% of GDP in mid-2011 (excluding state guarantees and HBOR debt worth 17% of GDP). Direct public debt levels will rise further by the assumption of state guarantees issued for shipyard debt in the magnitude of some 3.5% of GDP, in the context of a restructuring program that was cleared by the European Commission in the final stages of the accession negotiations.

Table 9

Main Economic Indicators: Croatia

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	2.2	–6.0	–1.2	–2.3	–2.3	0.3	–0.6	–0.8	0.8
Private consumption	0.9	–8.2	–0.8	–3.9	–2.4	1.9	1.1	–0.0	0.6
Public consumption	1.8	0.0	–0.9	–1.3	–2.0	–1.0	0.7	–1.0	1.8
Gross fixed capital formation	8.2	–11.8	–11.3	–13.9	–13.4	–9.5	–8.0	–6.7	–7.3
Exports of goods and services	2.2	–17.3	6.0	2.8	6.9	4.1	10.8	–11.1	1.1
Imports of goods and services	3.3	–20.4	–1.3	–4.8	–4.9	3.4	1.1	–5.3	–6.0
	Contribution to GDP growth in percentage points								
Domestic demand	2.9	–9.0	–3.8	–5.1	–6.7	–0.0	–3.8	0.6	–2.0
Net exports of goods and services	–0.7	3.0	2.6	2.7	4.2	0.7	3.1	–1.3	2.8
Exports of goods and services	0.9	–7.2	2.1	0.8	2.2	1.9	3.6	–3.3	0.4
Imports of goods and services	1.7	–10.2	–0.5	–1.9	–2.0	1.2	0.4	–2.0	–2.3
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	3.2	0.1	6.3	8.7	4.8	7.4	4.8	0.2	5.0
Average gross earnings in industry (nominal)	6.2	1.4	0.2	0.1	–0.5	–0.5	1.6	–0.4	1.1
Unit labor costs in industry (nominal)	2.9	1.5	–5.9	–8.0	–5.0	–7.3	–3.1	–0.4	–3.7
Producer price index (PPI) in industry	8.3	–0.4	4.3	3.5	4.8	3.8	5.1	6.3	6.5
Consumer price index (here: CPI)	6.1	2.4	1.0	0.9	0.7	1.1	1.5	2.2	2.3
EUR per 1 HRK, + = HRK appreciation	1.6	–1.6	0.7	1.7	1.5	1.0	–1.2	–1.6	–1.9
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.6	9.3	12.1	11.5	12.7	11.8	12.5	14.7	13.8
Employment rate (%, 15–64 years)	57.8	56.6	54.0	54.9	53.5	53.9	53.7	52.4	52.3
Key interest rate per annum (%)	5.3	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.2	7.3	7.3	7.3	7.2	7.3	7.4	7.4	7.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.3	–0.9	4.4	1.6	2.8	3.8	4.4	3.3	3.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–3.6	1.5	–0.4	5.1	3.1	6.6	–0.4	–0.5	–2.4
Domestic credit of the banking system	13.2	–0.5	8.6	–0.9	4.1	0.4	8.6	6.6	8.3
of which: claims on the private sector	10.3	–0.6	7.0	–0.5	3.2	5.3	7.0	6.2	6.8
claims on households	6.3	–1.6	2.1	–1.8	0.1	0.9	2.1	1.4	1.7
claims on enterprises	4.0	1.0	4.9	1.4	3.0	4.3	4.9	4.8	5.1
claims on the public sector (net)	2.9	0.1	1.6	–0.4	1.0	–4.9	1.6	0.4	1.5
Other assets (net) of the banking system	–5.4	–1.8	–3.7	–2.6	–4.5	–3.1	–3.7	–2.8	–2.4
	% of GDP, ESA 95								
General government revenues	39.1	38.2	37.0	. .	. .	. .	. .	. .	. .
General government expenditures	40.4	42.3	42.2	. .	. .	. .	. .	. .	. .
General government balance	–1.4	–4.1	–5.2	. .	. .	. .	. .	. .	. .
Primary balance	0.1	–2.4	–3.2	. .	. .	. .	. .	. .	. .
Gross public debt	29.0	35.1	40.1	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	6.8	–21.6	18.3	5.7	22.6	18.6	26.0	–3.5	3.6
Merchandise imports	10.7	–26.8	–0.1	–9.3	–1.7	6.3	4.1	1.0	–1.8
	% of GDP (based on EUR), period total								
Trade balance	–22.6	–16.2	–13.0	–12.0	–13.1	–13.7	–13.0	–13.0	–11.7
Services balance	14.7	12.4	12.6	1.2	12.1	30.4	3.9	1.6	14.1
Income balance (factor services balance)	–3.3	–4.0	–3.5	–4.3	–3.0	–4.1	–2.8	–4.6	–4.2
Current transfers	2.2	2.3	2.4	2.4	2.5	2.2	2.5	2.1	2.3
Current account balance	–9.1	–5.5	–1.6	–12.8	–1.4	14.8	–9.4	–13.8	0.5
Capital account balance	0.0	0.1	0.1	0.1	0.1	0.1	–0.0	0.2	–0.0
Foreign direct investment (net)	6.8	2.6	1.3	5.0	–0.7	2.5	–1.5	0.3	3.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	85.0	99.1	101.3	98.6	100.0	99.2	101.3	103.4	102.5
Gross official reserves (excluding gold)	19.1	22.7	23.2	21.6	22.6	24.3	23.2	24.9	24.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.6	7.0	7.2	6.7	7.1	7.6	7.2	7.8	7.8
	EUR million, period total								
GDP at current prices	47,770	45,666	45,910	10,646	11,524	12,557	11,183	10,666	11,612

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

10 Turkey: Vibrant Growth, External Imbalances, Unorthodox Monetary Policy Response

Domestic demand remains buoyant …

GDP grew strongly in the first half of 2011 (10.2% year on year), with vigorous consumer demand remaining the main pillar of growth. Private consumption showed some signs of moderation in the second quarter of 2011, while investment growth remained buoyant, representing the largest positive growth component in both quarters. Credit growth moderated slightly until July, but remained strong at around 45% year on year in the period from January to August. Most recent data point toward a deceleration of loan growth in the last three weeks of September. Investment growth profited from low interest rates, good credit conditions and increasing capacity utilization. Unemployment has declined steadily, falling below its precrisis level in May. Consumer price inflation – having reached an all-time low of 4% in March – has picked up strongly since May, mainly due to food and energy price hikes, and reached 6.7% in August. Core inflation had been increasing gradually already since January and reached 6.5% in August, putting the year-end inflation target of 5.5% at risk.

… and the current account deficit stays high

As a result of brisk domestic demand, import growth remained strong throughout the first half of 2011, surpassing export growth by a wide margin. This caused the current account deficit to continue to widen from an already elevated level. The rising external imbalance was further assisted by restrained external demand and prevailing structural weaknesses even though the first quarter showed improving unit labor costs and rising labor productivity. However, import growth slowed considerably in July, to 14%, while export growth gained momentum, thus reducing the monthly current account deficit to its lowest level since October 2010. The financing of the current account deficit has not posed any problems so far but remains a spot of vulnerability. FDI inflows covered only 15% of the deficit in the first seven months while portfolio investment abated in recent months but still covered 38%. The weakness of the Turkish lira may have added to this downward trend in portfolio inflows. The monetary policy framework in place since November 2010 has induced strong depreciation (and perhaps more so than the authorities originally intended). Since the beginning of the year, the Turkish lira has depreciated considerably against both the euro (by 20%) and the U.S. dollar (12%), undercutting its weakest level against the U.S. dollar since the 2009 crisis.

The central bank sticks firmly to its unorthodox policy mix

The central bank continued to conduct its unorthodox monetary policy of low interest rates and differentiated high reserve requirement ratios (between 5% and 16%, depending on maturity) aimed at safeguarding macrofinancial stability in view of a worsening external environment. In early August, the central bank preemptively lowered the policy rate further, by 50 basis points to 5.75%, and narrowed the corridor between overnight borrowing and lending rates again by raising the borrowing rate. The corridor was widened in November 2010, which led to a period of overly high volatility in short-term interest rates, discouraging carry trade and reducing short term capital inflows.

The upside of vivid domestic growth is reflected in a strong fiscal performance, in particular as concerns headline fiscal balances. The parliamentary elections in June did not lead to fiscal looseness, and tax revenues rose. The strong growth performance and, as the authorities argue, a tax amnesty has helped fiscal headline accounts. The budget deficit between January and August of less than 1% of GDP (correcting for the almost TRY 10 billion tax amnesty flows) bodes well for meeting or even undershooting the 2.7% target.

Table 10

Main Economic Indicators: Turkey

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	0.7	–4.8	9.0	12.2	10.2	5.3	9.2	11.6	8.8
Private consumption	–0.3	–2.3	6.7	8.6	6.2	6.7	9.0	12.4	9.2
Public consumption	1.7	7.8	2.0	0.9	3.5	–0.9	3.2	6.7	7.9
Gross fixed capital formation	–6.2	–19.0	29.9	15.2	28.7	30.0	42.1	33.6	28.9
Exports of goods and services	2.7	–5.0	3.4	–0.9	12.5	–1.6	4.3	8.3	0.2
Imports of goods and services	–4.1	–14.3	20.7	22.0	19.2	16.2	25.4	27.2	18.8
	Contribution to GDP growth in percentage points								
Domestic demand	–1.2	–6.6	12.5	15.6	10.9	9.4	14.7	16.9	13.8
Net exports of goods and services	1.9	2.8	–4.5	–5.7	–2.1	–4.3	–5.7	–5.6	–5.2
Exports of goods and services	0.6	–1.2	0.8	–0.2	2.9	–0.4	1.0	1.8	0.0
Imports of goods and services	–1.2	–4.1	5.3	5.5	5.0	4.0	6.7	7.4	5.3
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	–0.3	–0.3	8.2	16.4	8.6	4.0	5.3	7.6	2.2
Average gross earnings in industry (nominal)	11.1	8.4	10.8	11.0	10.6	10.8	10.8	8.4	8.6
Unit labor costs in industry (nominal)	11.6	8.9	2.0	–4.6	1.9	6.5	5.2	0.8	6.3
Producer price index (PPI) in industry	13.0	1.0	6.2	4.6	6.6	6.6	6.7	10.1	10.0
Consumer price index (here: HICP)	10.4	6.3	8.6	9.3	9.2	8.4	7.4	4.3	5.9
EUR per 1 TRY, + = TRY appreciation	–6.3	–11.8	8.3	3.6	9.3	9.6	10.8	–3.3	–13.2
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	10.0	12.9	10.9	13.3	10.1	10.3	10.0	10.6	8.7
Employment rate (%, 15–64 years)	44.9	44.2	46.3	43.8	47.3	47.5	46.5	46.1	49.2
Key interest rate per annum (%)[1]	16.0	9.2	6.8	6.5	6.8	7.0	6.9	6.3	6.3
TRY per 1 EUR	1.91	2.16	2.00	2.09	1.96	1.96	1.99	2.16	2.26
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	24.7	13.0	18.6	12.8	17.2	15.9	18.6	20.4	20.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	6.4	–1.2	–7.3	–6.1	–6.6	–6.4	–7.3	–3.1	–1.7
Domestic credit of the banking system	19.7	21.5	30.1	26.8	30.2	28.1	30.1	26.4	26.0
of which: claims on the private sector	15.3	9.9	27.7	15.6	22.4	23.6	27.7	28.9	30.1
claims on households	6.2	2.7	8.4	4.4	5.8	7.2	8.4	9.3	10.5
claims on enterprises	9.1	7.1	19.4	11.2	16.6	16.5	19.4	19.6	19.6
claims on the public sector (net)	4.3	11.6	2.4	11.2	7.8	4.5	2.4	–2.4	–4.1
Other assets (net) of the banking system	–1.4	–7.2	–4.2	–7.8	–6.4	–5.8	–4.2	–3.0	–3.6
	% of GDP, ESA 95								
General government revenues	32.3	33.8	0.0	. .	. .	. .	. .	. .	. .
General government expenditures	34.5	40.6	0.0	. .	. .	. .	. .	. .	. .
General government balance	–2.2	–6.7	–3.6	. .	. .	. .	. .	. .	. .
Primary balance	2.8	–1.8	0.7	. .	. .	. .	. .	. .	. .
Gross public debt	39.5	43.8	41.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	13.7	–17.7	16.3	0.7	29.8	16.6	19.0	19.7	3.6
Merchandise imports	11.0	–26.7	39.5	26.5	42.8	37.0	49.4	47.6	27.5
	% of GDP (based on EUR), period total								
Trade balance	–7.1	–4.0	–7.7	–5.5	–7.0	–8.5	–9.3	–11.3	–12.7
Services balance	2.3	2.7	2.0	0.5	1.6	3.8	1.7	0.6	1.8
Income balance (factor services balance)	–1.1	–1.3	–1.1	–1.5	–1.0	–0.8	–1.1	–1.6	–0.8
Current transfers	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Current account balance	–5.6	–2.3	–6.6	–6.3	–6.2	–5.4	–8.4	–12.1	–11.5
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)	2.3	1.1	1.0	0.7	0.6	1.0	1.5	1.6	1.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	40.3	42.4	39.2	43.1	44.2	39.9	39.2	36.8	0.0
Gross official reserves (excluding gold)	10.2	11.1	11.2	11.2	11.8	10.9	10.9	10.7	0.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.3	5.4	5.4	5.4	5.6	5.0	4.9	4.5	0.0
	EUR million, period total								
GDP at current prices	499,704	440,487	553,911	115,908	136,493	151,932	149,578	133,570	141,018

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

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

11 Russia: Recovery Not Overly Buoyant despite High Oil Prices

Russia continues to benefit from high oil prices, but the recovery has lost some steam

Russia's economy continued to benefit from high and rising oil prices, although its overall performance remained somewhat lackluster. The recovery even lost some steam in the first half of 2011. Year-on-year GDP growth declined from 4.1% in the first quarter to 3.4% in the second quarter. The strongest contributions to growth were delivered by the inventory buildup (which may soon be approaching its end) and by private consumption (+5.7% in the first quarter, stimulated by the expansion of credit). With import expansion outpacing export dynamics by a wide margin, net exports remained a sizable negative contributor to overall growth. After stagnating in the first quarter, fixed investment gained some momentum in the second quarter, but its increase over the first half-year was disappointing (+2.7%). Government consumption was largely stable. On a positive note, the unemployment rate has declined to precrisis levels.

Inflation remains high but receded slightly in the summer of 2011

CPI inflation, which had remained near double digits in the second quarter of 2011, declined to a still relatively high 8.2% year on year in August. Inflation was still held up by the impact of the severe summer 2010 heat wave on food prices (possibly including second-round effects) and by global food and energy price developments. The moderation of headline inflation in the summer months was largely linked to seasonal factors. The Central Bank of the Russian Federation (CBR) continued to tighten its monetary policy, though only slightly: In May, the refinancing rate was increased from 8.0% to 8.25%, and the overnight deposit rate was lifted in May and in September by 25 basis points each to 3.75%. Over the six months to end-August 2011, the ruble's nominal effective exchange rate rose by 1.8%, while its real effective exchange rate remained flat (+0.2%). However, as international risk aversion started to rise in August, the ruble has come under downward pressure, compelling the CBR to intervene in foreign exchange markets and to move its floating exchange rate band vis-à-vis the U.S. dollar-euro basket to 32.60–37.60 from 32.15–37.15 previously.

The banking sector's expanding credit activity supports domestic demand, but some fragilities in the sector prevail

While remaining fragile to some extent, the banking sector has been stepping up credit activity and thus supporting the recovery of the real economy. In the 12 months to end-July 2011, credit to the private sector grew by 9.5% (in real terms), while deposits of the private sector increased by 10.8%. Amid this recovery, however, in July the insolvency of the Bank of Moscow, the fifth-largest Russian bank in terms of total assets, triggered one of the largest bailout operations in Russian history (including cheap loans and capital injections of a total of EUR 9.5 billion). The Bank of Moscow had turned insolvent on account of risky lending activities apparently to parties related to its former management.

For the moment, Russia retains its twin surpluses

Owing to the further improved terms of trade and despite surging imports, Russia's current account surplus remained high. Although increasing in absolute terms, gross external debt slightly declined to 30.8% of rolling four-quarter GDP at end-June 2011. Russia's foreign liabilities remain matched by the country's foreign currency reserves (including gold), which came to 27.7% of GDP at mid-year. The recovery and high oil prices as well as the gradual phasing out of anti-crisis stimuli helped the fiscal accounts turn deficit free: In the period from January to August the federal budget produced a surplus of 2.3% of GDP (while the non-oil-related part of the budget remained deeply in deficit). Following budget amendments in June, the authorities expected a balanced budget in 2011.

Table 11

Main Economic Indicators: Russia

	2008	2009	2010	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11
	Year-on-year change of the period total in %								
GDP at constant prices	5.2	–7.8	4.0	3.5	5.0	3.1	4.5	4.1	3.4
Private consumption	10.4	–4.8	3.0	–0.6	4.6	5.0	2.6	5.6	6.5
Public consumption	3.4	0.2	1.4	2.3	1.9	1.4	0.0	0.1	0.5
Gross fixed capital formation	10.6	–14.4	6.1	–4.4	6.3	5.0	11.5	–0.6	5.0
Exports of goods and services	0.6	–4.7	7.1	18.7	4.1	2.2	5.0	–0.0	3.5
Imports of goods and services	14.8	–30.4	25.6	11.4	21.7	34.9	30.1	23.1	23.4
	Contribution to GDP growth in percentage points								
Domestic demand	8.0	–12.8	6.4	0.3	6.4	9.0	8.9	7.3	6.2
Net exports of goods and services	–2.8	5.2	–2.0	4.2	–2.2	–5.2	–3.8	–3.8	–3.3
Exports of goods and services	0.2	–1.5	2.3	6.0	1.4	0.7	1.6	–0.0	1.2
Imports of goods and services	3.0	–6.7	4.3	1.7	3.5	5.9	5.4	3.8	4.4
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	3.1	0.2	11.8	16.7	15.3	8.7	7.8	4.9	4.0
Average gross earnings in industry (nominal)	25.0	3.2	14.2	11.8	15.6	15.2	14.1	13.6	14.3
Unit labor costs in industry (nominal)	21.5	3.1	1.9	–4.3	0.4	5.9	5.9	8.4	9.9
Producer price index (PPI) in industry	21.8	–6.6	12.3	13.9	12.4	8.4	14.5	21.3	19.1
Consumer price index (here: CPI)	14.1	11.8	7.1	7.3	6.2	6.6	8.2	9.4	9.1
EUR per 1 RUB, + = RUB appreciation	–3.9	–17.5	9.6	7.5	13.7	13.3	4.4	3.3	–4.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.4	8.4	7.5	8.8	7.4	6.8	6.9	7.5	6.6
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	10.9	11.4	8.0	8.6	8.0	7.8	7.8	7.8	8.2
RUB per 1 EUR	36.4	44.1	40.3	41.3	38.5	39.5	41.7	40.0	40.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	14.3	17.3	24.6	22.1	24.0	25.4	24.6	22.4	18.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	16.1	10.7	5.8	5.9	10.6	11.1	5.8	6.3	3.9
Domestic credit of the banking system	14.9	19.4	22.1	21.9	19.5	20.4	22.1	18.4	15.3
of which: claims on the private sector	34.2	2.9	12.4	–0.9	5.4	8.8	12.4	15.2	16.5
claims on households	8.0	–2.8	3.1	–2.0	0.1	1.9	3.1	3.5	4.5
claims on enterprises	26.2	5.6	9.3	1.1	5.2	6.9	9.3	11.6	12.1
claims on the public sector (net)	–19.3	16.5	9.7	22.9	14.1	11.6	9.7	3.2	–1.3
Other assets (net) of the banking system	–16.7	–12.8	–3.3	–5.7	–6.1	–6.1	–3.3	–2.2	–0.2
	% of GDP, ESA 95								
General government revenues	38.8	35.1	35.0	. .	. .	. .	. .	. .	. .
General government expenditures	33.9	41.4	38.5	. .	. .	. .	. .	. .	. .
General government balance	4.9	–6.3	–3.5	. .	. .	. .	. .	. .	. .
Primary balance	0.0	0.0	0.0	. .	. .	. .	. .	. .	. .
Gross public debt	5.7	8.3	8.6	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	24.2	–32.4	39.7	51.8	53.4	31.2	28.5	25.2	22.6
Merchandise imports	22.7	–31.3	37.4	11.9	42.0	54.5	37.9	43.5	24.9
	% of GDP (based on EUR), period total								
Trade balance	10.6	9.0	10.2	14.5	11.2	7.6	8.6	12.7	11.6
Services balance	–1.5	–1.6	–1.9	–1.5	–1.7	–2.4	–2.0	–1.7	–1.9
Income balance (factor services balance)	–2.9	–3.3	–3.4	–2.5	–4.3	–3.3	–3.3	–2.4	–4.6
Current transfers	–0.2	–0.2	–0.3	–0.2	–0.0	–0.4	–0.4	–0.2	0.0
Current account balance	6.1	3.9	4.7	10.4	5.1	1.5	3.0	8.3	5.2
Capital account balance	0.0	–0.9	0.0	0.1	0.0	–0.0	–0.0	0.0	–0.0
Foreign direct investment (net)	1.2	–0.6	–0.7	–0.7	–0.6	–0.8	–0.5	–0.5	–1.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	0.0	36.9	32.8	37.2	37.7	33.1	32.8	30.7	30.8
Gross official reserves (excluding gold)	26.1	32.9	29.7	34.0	35.7	31.9	29.7	28.0	27.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	14.2	19.2	16.4	20.4	21.1	18.0	16.4	15.1	14.7
	EUR million, period total								
GDP at current prices	1,133,334	879,044	1,116,019	231,612	275,801	297,853	310,752	285,230	316,656

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