Developments in Selected CESEE Countries:

Gradual Recovery in the Offing – Moderating External Imbalances, but Vulnerabilities Remain an Issue[1,2,3,4]

1 Introduction

Financial markets are beginning to stabilize and macrofinancial risks are decreasing somewhat

In the months after the collapse of Lehman Brothers, Central, Eastern and Southeastern European (CESEE) financial markets experienced substantial disruptions and posted pronounced losses. Negative sentiment, tight international liquidity and decreasing capital flows to the region triggered currency pressures, negatively impacted the financing of current account deficits and maturing external debt, and ultimately led to the adoption of international rescue packages for some countries of the region (among them Hungary and Romania). Along with rising confidence in global markets and some regained risk appetite, this stepped-up international support contributed to an easing of financial market strains, which had started at the end of the first quarter of 2009 and continued during the review period. Support packages were often accompanied by coordinated commitments by European banking groups to keep their overall exposure to the countries concerned steady. Such commitments helped dispel concerns about a possible meltdown of financial systems in the region.

Money and debt markets stabilized and asset prices began to reverse in late February and early March. These improvements were broad-based, visible in all financial market segments and across all countries (although to a different extent, depending on country-specific vulnerability profiles). Especially CDS premiums, eurobond yield spreads and equity prices recovered substantial parts of post-Lehman losses. However, most financial instruments are still trading below their values of summer 2008, i.e. shortly before the crisis hit the CESEE region (see box 1), and markets tend to remain fickle in an environment of elevated uncertainty.

After a pronounced increase during the last months of 2008 and in early 2009, the macrofinancial risks of the countries of the region have diminished somewhat. Again, this development was mainly brought about by international support for the region. In addition, improvements in fundamentals – especially in external accounts and inflation – may have played a role. However, macrofinancial risks in CESEE, while being rather heterogeneous across countries, persist, given the marked deterioration in the international economic environment and the ongoing and prospective impact of the crisis fallout in the real sector, in particular on banks balance sheets and profits.[5]

… while the economic downturn has deepened

While financial markets have broadly stabilized, the crisis fully fed through into the real economy in the review period. Although a marked economic slow-

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[2] *Cutoff date: October 9, 2009 (and November 3, 2009, for fiscal data). This report focuses primarily on data releases and developments from April 2009 up to the cutoff date; earlier developments are recalled where it appears necessary to put recent developments into perspective.*

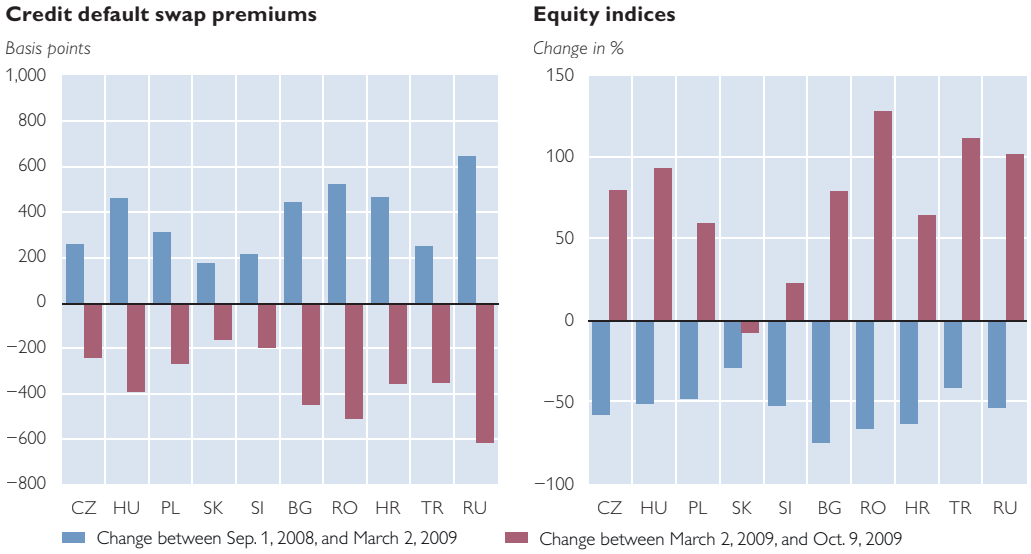
[3] *This report covers the Czech Republic, Bulgaria, Hungary, Poland, Romania, Slovakia and Slovenia as well as Croatia, Turkey and Russia.*

[4] *For statistical information on selected economic indicators for CESEE countries not covered in this section (Albania, Bosnia and Herzegovina, FYR Macedonia, Serbia, Montenegro and Ukraine), see the Statistical Annex in this issue.*

[5] *A more comprehensive analysis of macrofinancial developments in CESEE countries can be found in the OeNB's Financial Stability Report 18 (publication scheduled for December 2009).*

Chart 1

Development of Selected Financial Market Indicators



Source: Thomson Reuters.

down had already been visible in the fourth quarter of 2008, it turned into a fully-fledged recession in the first quarter of 2009. Until then, CESEE had still outperformed the euro area in terms of growth, and growth prospects had also been somewhat more favorable. The crisis of the real economy intensified as declining external demand put a damper on export growth. This in turn negatively impacted the highly export-oriented industrial sector of the region, sparking cutbacks on investment and a substantial reduction of inventories. Low investment demand also had an adverse effect on imports, which contracted even more strongly than exports in most CESEE countries. Alongside, consumer confidence weakened substantially, reducing private consumption.

Average annual growth in the countries covered in this report declined from around 0% in the last quarter of 2008 to –8.3% in the first quarter of 2009 before recovering slightly thereafter. Looking at individual countries, year-on-year growth reached negative territory in the first quarter of 2009 throughout the region, with the notable exception of Poland. Weak economic dynamics continued in the second quarter, which, however, saw slightly improving (though, apart from Poland, still negative) year-on-year growth rates in Slovakia and Croatia and a more pronounced improvement in Turkey, where the contraction in the first quarter had been deepest among the countries under review. This trend becomes more apparent when looking at quarterly changes in working day and seasonally adjusted data: Growth was again positive in Slovenia, Poland, the Czech Republic and above all in Slovakia and Turkey (no comparable data are available for Bulgaria and Croatia), while output declined quarter on quarter – albeit at a lesser pace – in the other countries.

Leading indicators developed somewhat more favorably during most of the recent months. An upward trend is especially visible in sentiment indicators, which have increased steadily since reaching their long-term lows in early 2009.

Table 1

Gross Domestic Product

In real terms, annual change in % (nsa)

	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
Slovakia	10.4	6.4	9.3	7.9	6.6	2.5	−5.6	−5.3
Slovenia	6.8	3.5	5.7	5.5	3.9	−0.8	−8.3	−9.3
Bulgaria	6.2	6.0	7.0	7.1	6.8	3.5	−3.5	−4.9
Czech Republic	6.1	2.7	2.7	4.2	3.9	0.0	−4.4	−5.8
Hungary	1.2	0.6	1.8	2.1	1.3	−2.5	−6.7	−7.5
Poland	6.8	4.9	6.3	5.8	5.5	2.4	1.1	1.1
Romania	6.2	7.1	8.2	9.3	9.2	2.9	−6.2	−8.7
Croatia	5.5	2.4	4.3	3.4	1.6	0.2	−6.7	−6.3
Turkey	4.7	0.9	7.2	2.8	1.0	−6.5	−14.3	−7.0
Russia	8.1	5.7	8.7	7.5	6.0	1.2	−9.8	−10.9
CESEE region	6.7	4.3	7.3	6.0	4.8	−0.2	−8.3	−7.7
Euro area	3.1	0.9	2.0	2.2	1.1	−1.6	−4.8	−4.9

Source: Eurostat, national statistical offices.

The inventory cycle should also help support GDP dynamics during the second half of 2009, as destocking had come to an end by mid-2009; moreover, on purely statistical grounds, positive base effects will give some boost to annual growth rates starting in the fourth quarter. Overall, this suggests that the decline in activity seen in the review period has broadly come to an end. Box 2 discusses the growth outlook of CESEE countries until the year 2011.

Recession leads to a shift in the composition of growth …

A remarkable feature of recent GDP developments is the change in the composition of GDP growth that was observed in the first half of 2009. While in 2008, GDP dynamics were mainly driven by domestic demand in most countries (with the exception of the Czech Republic), this component made a significant negative contribution to economic dynamics in the first half of 2009.

… away from domestic demand

Within domestic demand, both gross fixed capital formation and inventories decreased substantially. In the second quarter, reductions of gross fixed capital formation ranged from –1.3% year on year in Poland to –27.3% in Slovenia. Moreover, compared to the first quarter, the decline in investment further accelerated in the second quarter (the only notable exception was Hungary, where investments were supported by large-scale public construction projects). The decline in construction investment was less pronounced than the overall reduction (it even increased markedly in Poland, possibly in the run-up to the 2012 European football championships). Thus, the brunt of the decrease in gross fixed capital formation took place in industry.

Sinking global demand and the general deterioration in the international economic environment led to shrinking production in the highly export-oriented industrial sector. In July industrial output in the countries under review fell by an average 11.5%, with the decreases ranging from 4.5% in Romania to 23.5% in Slovakia. Capacity utilization in industry has been on a downward trend since early 2008 and reached levels of between 75% in the Czech Republic and 52% in Slovakia in the third quarter; these were the lowest values that had been recorded for years and in some countries they were even the lowest values since

the beginning of data collection in the early 1990s. Still, the downswing was somewhat mitigated by spillover effects from fiscal stimuli in Western Europe (especially car scrapping schemes), which also benefited exports of key industrial sectors of the region. The outlined developments went hand in hand with substantial stock depletion, which was largely in line with the inventory cycle.

Private consumption was unbalanced throughout the region, but its decline was generally somewhat less pronounced than that of the other components. In the Czech Republic, Poland and Slovakia, private consumption growth even stayed in positive territory, a development which can partly be explained by comparatively good labor market developments (e.g. in Poland) or by policy stimuli (e.g. car scrapping schemes in Slovakia). Still, private consumption dynamics dampened GDP growth noticeably in Hungary, Bulgaria, Russia, Croatia and especially in Romania. Waning consumer confidence, deteriorating labor markets, declining real wage growth (which even turned negative in Hungary and Russia) and increased precautionary saving have apparently played a role in this context.

… to net exports

In contrast, net exports, which had dampened economic activity in many countries throughout 2008, took over as the most important driving source. Shrinking exports (in a range of –8.9% in Russia and –21.3% in Slovenia in the second quarter) caused by fading international demand were overcompensated by declining imports (between –17.8% in the Czech Republic and –37.9% in Russia). Imports suffered from generally weak domestic (especially investment) demand and were also somewhat impacted by weak international demand, as in CESEE, production intended for export is often characterized by a relatively high import content.

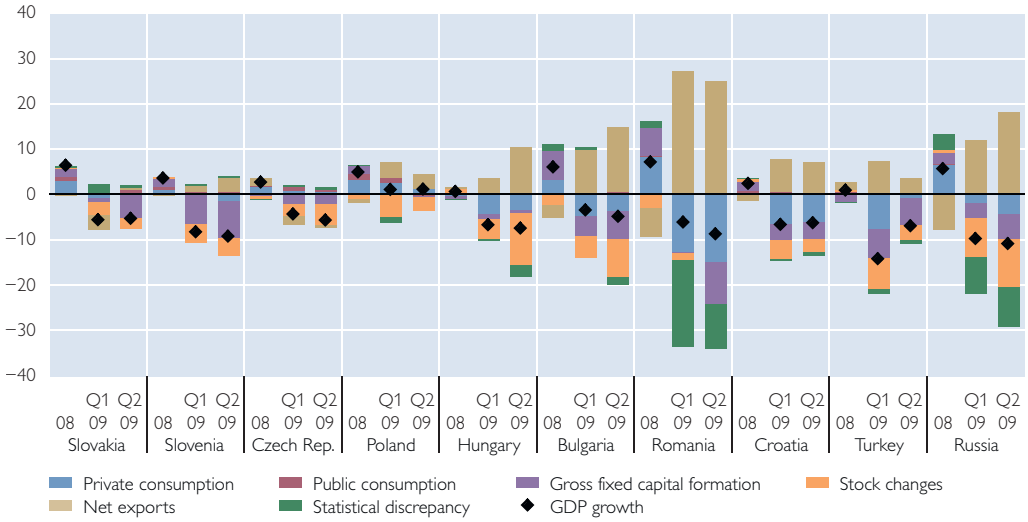
… and went hand in hand with adverse credit developments

Credit dynamics slowed down markedly as a consequence but possibly also a cause of subdued GDP dynamics. Annual growth rates (adjusted for exchange rate changes) declined in a range of between 6.8 percentage points in Croatia and as much as 20.1 percentage points in Russia between the first quarter and July. Lending to the private sector stagnated in Hungary and Russia and even turned negative in

Chart 2

GDP Developments

Percentage points, GDP growth in %

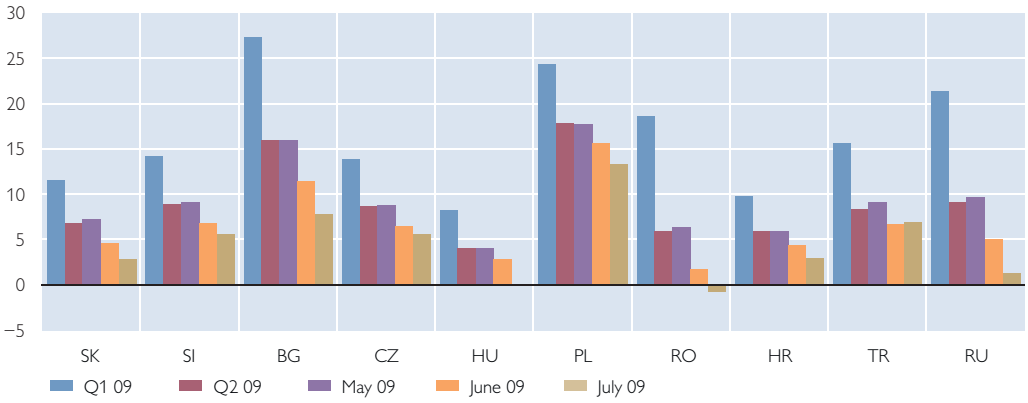


Source: Eurostat, national statistical offices.

Chart 3

Growth of Credit to the Private Sector

Year-on-year growth in %, adjusted for exchange rate changes



Source: National central banks.

Note: Turkey: non-adjusted.

Romania on account of the widespread use of foreign currency credit and weaker currencies. Monthly credit growth figures (adjusted for exchange rate changes) have been negative since the start of the year in Hungary, Romania, Croatia and Russia, while some pick-up could recently be observed in Slovenia, the Czech Republic and Turkey.

Weak credit dynamics were primarily driven by the growth of credit to corporations, which decelerated more strongly than credit to households. This again relates mainly to the fact that the industrial sector was hit harder by the crisis than other sectors and, consequently, the demand for investment credit shrunk.

On the other hand, however, there are also signals that restrictions of bank lending contributed to subdued credit developments. Bank lending surveys conducted in Poland and Hungary[6] indicate that (especially nonprice) credit conditions were tightened in the first half of 2009 against the background of deteriorating debt servicing capacities of bank clients and uncertain economic prospects. As for the third quarter, Hungarian banks reported that they intended to relax their credit standards while Polish banks envisaged additional tightening.

Both surveys showed a worsening in credit portfolios as the economic downturn started to impair borrowers' ability to repay their loans. This can also be seen in nonperforming loans (NPL) figures: The share of nonperforming loans in total loans has started to pick up in all CESEE countries covered in this report since the second half of 2008. This development was particularly strong in Romania, where the NPL ratio rose to almost 20% in the second quarter of 2009, but also in Russia.[7]

Quarter-on-quarter growth of banking sector deposits dipped into negative territory in Slovakia, Bulgaria and Croatia in the first quarter before turning positive again in the second quarter (except for Croatia, where it stayed negative). The

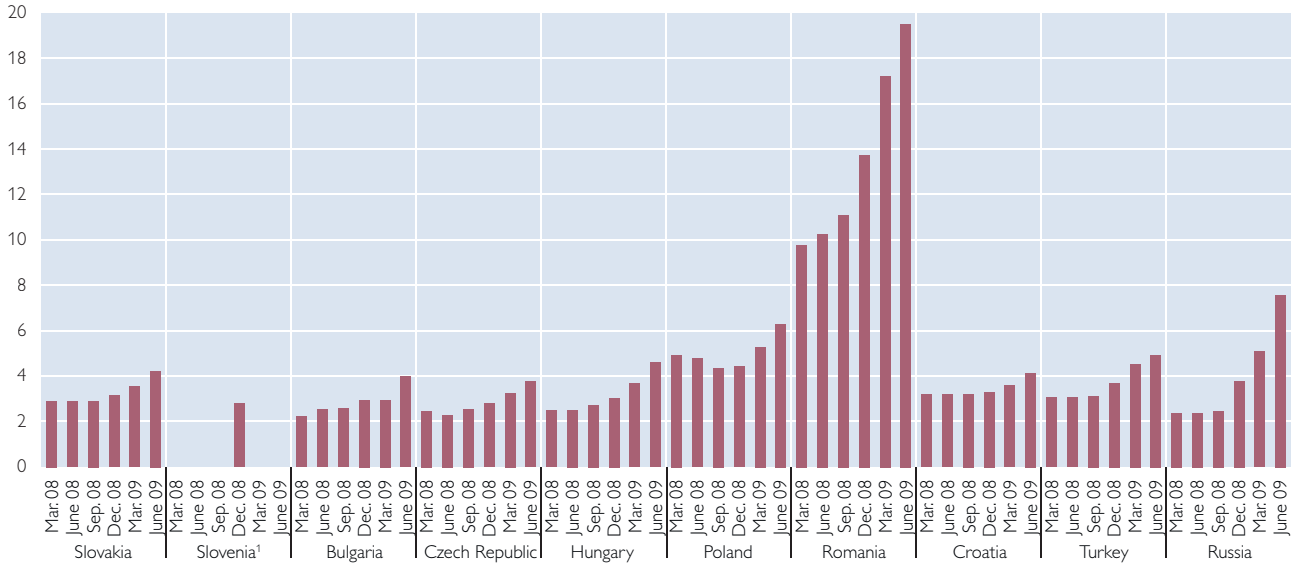
[6] *Among the countries under review, only Poland and Hungary publish bank lending surveys.*

[7] *It should be noted that due to substantial differences in classification regulations, NPL figures cannot be compared across countries.*

Chart 4

Nonperforming Loans

% of total credit



Source: National central banks.

[1] Slovenia publishes nonperforming loan details only at annual frequency.

declines were caused mainly by deposit withdrawals by enterprises, while deposits of households remained stable or even increased somewhat (e.g. in Bulgaria and Croatia). This implies that at least to some extent enterprises resorted to deposits when access to credit became increasingly difficult.

A decrease in external imbalances is a positive side effect of weak real sector dynamics

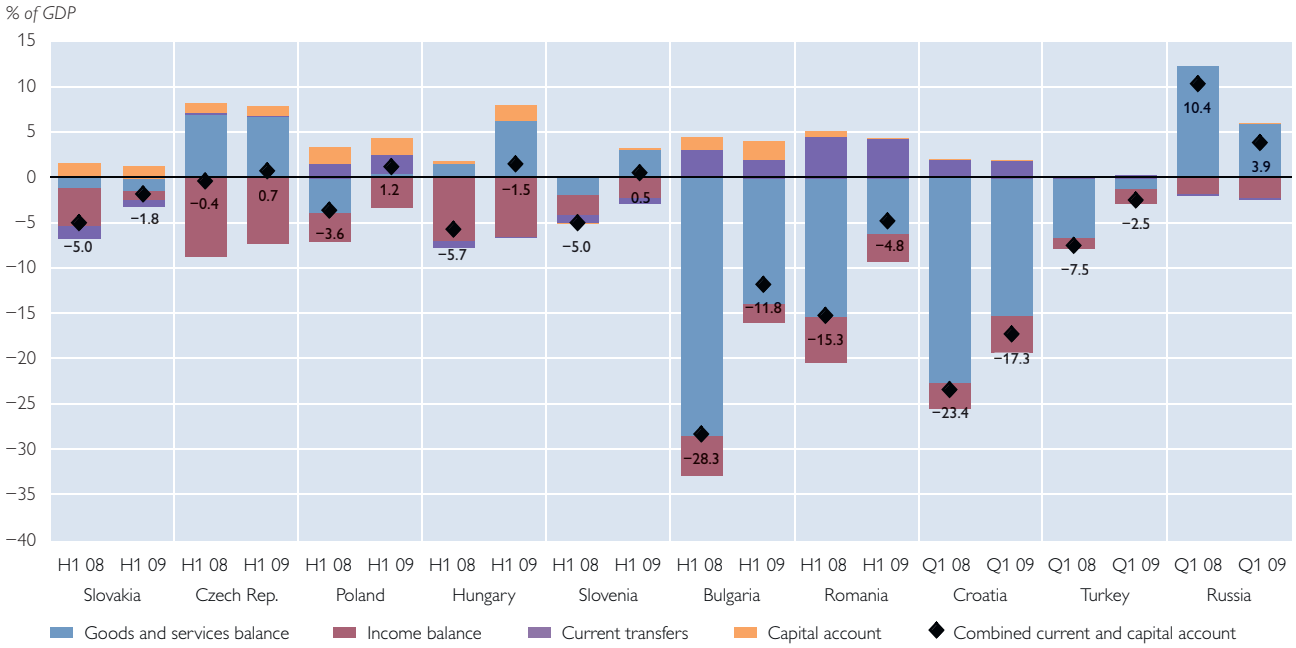
The economic downturn and the associated reduction in domestic demand led to a marked improvement in the external accounts of the countries of the region. Combined current and capital account deficits decreased throughout CESEE and in some countries even turned into a surplus (e.g. in the Czech Republic, Poland, Hungary and Slovenia) in the first half of 2009. Only Russia registered a lower surplus in its combined current and capital account as oil prices were lower in the first half of 2009 than in the same period of 2008.

Generally, the development was driven mainly by an improvement in the goods and services balance, as imports declined more strongly than exports, mirroring the development of net exports in the national accounts. This can be traced to weak domestic demand but also to exchange rate movements, which dampened import dynamics in countries with flexible exchange rate regimes. In some countries (especially the Czech Republic, Slovakia, Bulgaria and Romania), lower outflows in the income balance also positively impacted on external accounts, as outflows of investment income declined in line with corporate profit. A more notable decline in current transfers – most likely due to a reduction in workers' remittances – was observable in Bulgaria and Romania.

Compared to 2008, net foreign direct investment (FDI) flows into the region decreased in all countries in the first half of 2009. In Slovakia, Slovenia, Hungary and Russia, net FDI even turned negative. The development was fuelled by reductions in FDI inflows driven by both reductions in equity and reinvested earnings

Chart 5

Balance of Payments



Source: National central banks.

and by other capital. Portfolio investment developed unevenly, with especially Slovakia and Hungary reporting more substantial net outflows. Other investment inflows decreased throughout most of the region, and in Slovenia, Romania, Bulgaria, Turkey and Russia, even negative figures were reported, most probably due to banking sector outflows, as for example evidenced by consolidated foreign claims of BIS reporting banks in the first quarter (BIS data for the second quarter are not yet available). A substantial increase could be observed in Hungary only as IMF money was disbursed.

Concerning quarterly dynamics, i.e. the change from the first to the second quarter, it needs to be noted that net FDI inflows decreased throughout most of the region. By contrast, net portfolio investment inflows, which had been negative in the first quarter in most of CESEE, improved in all countries and also often fully offset or even overcompensated adverse FDI developments. This also mirrors the broad stabilization in financial markets. Overall, however, financial account positions developed somewhat unequally as other investment flows did not show a uniform trend: They deteriorated in Hungary and Croatia and to some extent in the Czech Republic and Poland too, while remaining broadly unchanged or improving in the other countries.

Currencies stabilized or appreciated somewhat, but could not recover the entire losses since fall 2008

The crisis had a profound impact on the currencies of CESEE countries with flexible exchange rate regimes.[8] Especially in late 2008 and early 2009, these countries' currencies came under severe pressure and traded at values not seen for

[8] *Foreign exchange market developments in early 2009 are described in greater detail in Focus on European Economic Integration Q2/09, 6–53.*

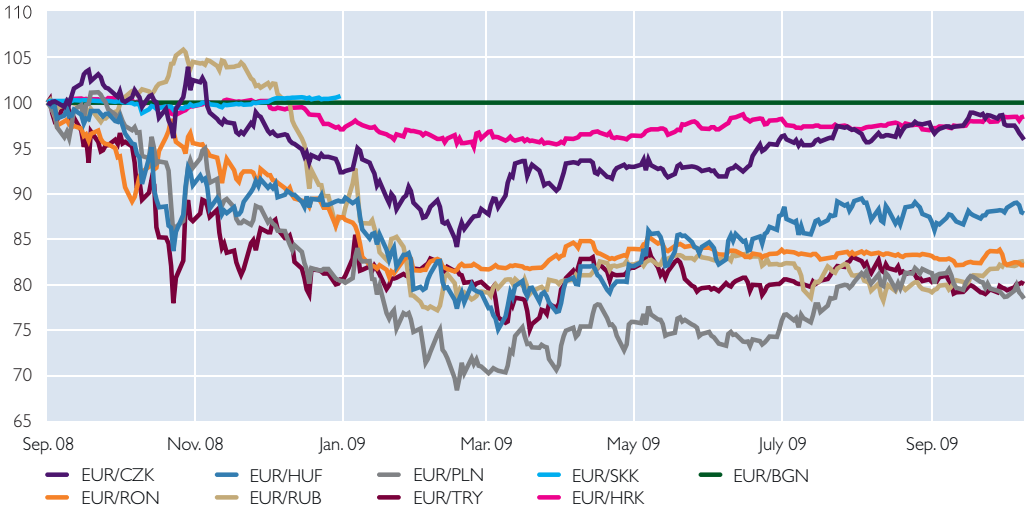
many years. Between mid-September and early March, losses against the euro amounted to between 14% in the Czech Republic and up to 30% in Poland. This weakening took place in close context with a heightened risk aversion vis-à-vis emerging markets in general after the Lehman collapse, continuous downward revisions of growth forecasts for CESEE countries and perceived adjustment needs resulting from substantial economic imbalances in a number of countries, all of which adversely affected sentiment vis-à-vis the region.

Since late February and early March, however, the situation has improved in line with gradually returning financial market confidence. In fact, since then, the

Chart 6

Exchange Rate Developments

Sep. 1, 2008 = 100 *Cutoff date: Oct. 9, 2009*



Source: Thomson Reuters.

Note: An increase in value denotes an appreciation.

Czech koruna, the Polish złoty and the Hungarian forint have firmed against the euro (by around 11% to 14%), while the Romanian leu and the Turkish lira have stabilized. The Russian ruble, whose exchange rate is managed against a basket of U.S. dollar and euro, weakened considerably despite substantial foreign exchange interventions, as its fluctuation band against the basket was gradually widened between November 2008 and January 2009.[9] Since then, the currency recovered and firmed by some 10% against its basket (caused mainly by its appreciation against the U.S. dollar). However, among the currencies with flexible exchange rates only the Czech koruna has again come close to reaching the trading levels seen before the collapse of Lehman Brothers, while some currencies still trade far below their value of September 2008 (especially the Turkish lira and the złoty, but also the ruble).

… which, however, improved the competitive position of some countries of the region

While industrial unit labor costs (ULCs) grew dynamically in the euro area in the review period against the background of falling productivity and roughly constant wages (+14.5% year on year in the second quarter), the majority of the

[9] *See Focus on European Economic Integration Q2/09.*

CESEE countries covered here reported declining ULCs (measured in euro) in the same period. Decreases in unit labor costs, in euro terms, were most pronounced in Poland, but also notable in Russia and Romania, i.e. in countries with flexible exchange rates. ULCs in Slovenia and Slovakia rose, albeit to a lesser extent than in the euro area, while ULCs in Bulgaria increased more strongly than those in the euro area.[10]

This implies that the price competitiveness of most CESEE countries vis-à-vis the euro area has improved in the review period. Also Slovakia and Slovenia, the two euro area countries covered in this report, managed to expand their competitive edge against the euro area as a whole. Bulgaria was the only country losing price competitiveness in the observation period.

Looking ahead, CESEE economies with flexible exchange rate regimes may not be in a position to fully sustain recent gains in price competitiveness, however. In fact, appreciating exchange rates in a number of these countries during the third quarter have already reversed some of the gains.

In most CESEE countries, ULC developments (measured in local currency) too were more favorable than in the euro area during the review period. While wages in industry tended to grow faster in CESEE countries than in the euro area – despite substantial wage moderation, particularly in Bulgaria and Romania, which had recorded very buoyant nominal wage dynamics until 2008 – this was more than offset by better productivity developments. This in turn suggests that the CESEE countries were faster in adjusting the amount of labor used in industry to lower output than the euro area countries (i.e. less labor hoarding in CESEE countries).

Table 2

Development of Unit Labor Costs in Industry

	Nominal wages in industry				Unit labor costs in industry (in local currency)				Exchange rate of the local currency against the euro (year-on-year change in the period average)				Unit labor costs in industry (in EUR)			
	2007	2008	Q1 09	Q2 09	2007	2008	Q1 09	Q2 09	2007	2008	Q1 09	Q2 09	2007	2008	Q1 09	Q2 09
	Annual change in %															
Slovakia	6.4	6.8	2.7	1.7	–3.1	7.0	13.5	3.0	10.2	8.0	9.7	4.2	6.8	15.6	24.5	7.3
Slovenia	6.7	7.8	–0.7	–1.0	1.3	9.6	8.5	10.8	0.0	0.0	0.0	0.0	1.3	9.6	8.5	10.8
Bulgaria	20.1	22.2	12.2	11.3	10.4	21.9	32.1	29.7	0.0	0.0	0.0	0.0	10.4	21.9	32.1	29.7
Czech Republic	8.6	8.3	2.7	2.9	1.9	8.3	9.7	3.4	2.1	11.2	–7.5	–7.0	4.1	20.5	1.4	–3.8
Hungary	8.4	6.6	3.6	3.3	–0.7	8.5	20.3	12.3	5.1	–0.2	–11.8	–13.3	4.3	8.3	6.1	–2.6
Poland	8.7	9.7	5.1	3.3	2.5	8.3	10.0	2.9	3.0	7.6	–20.6	–23.5	5.6	16.5	–12.7	–21.2
Romania	21.6	21.3	15.7	8.9	11.2	16.4	21.5	6.2	5.6	–9.4	–13.6	–13.0	17.4	5.5	5.0	–7.5
Croatia	5.5	7.2	0.4	0.4	3.1	6.0	0.0	–3.8	–0.2	1.6	–1.7	–1.4	2.9	7.7	–1.7	–5.1
Turkey	9.6	..	..	..	6.6	..	..	..	1.1	–6.3	–16.3	–7.9	7.8	..	..	..
Russia	26.0	24.0	5.4	2.2	20.4	20.6	13.6	9.5	–2.6	–3.9	–18.2	–15.7	17.3	15.9	–7.1	–7.7
Memo item:																
Euro area	2.7	3.0	0.5	–0.7	0.5	4.1	16.4	14.5	0.0	0.0	0.0	0.0	0.5	4.1	16.4	14.5

Source: Eurostat, national statistical offices, wiiw, ECB.

[10] *There are no comparable data for ULCs in industry available for Turkey. Developments in manufacturing, however, suggest broadly constant ULCs in the second quarter.*

Weak GDP dynamics have boosted unemployment …

The economic downturn has begun to affect labor markets. Especially in the first quarter, seasonally adjusted unemployment rates increased markedly and continued to rise further – though at a somewhat slower pace – in the second quarter, when they stood at levels of between 5.8% in Slovenia and 13.2% in Turkey. In July and August, this trend was unabated in Slovakia, Bulgaria, the Czech Republic and Croatia, while unemployment stabilized in Slovenia and Poland. However, compared to the unemployment rate of 9.3% in the euro area (in the second quarter), the labor market situation in most CESEE countries still looks somewhat better. This is related to the tremendous labor market improvements in the boom period until late 2007 and early 2008, but presumably also to the fact that the crisis started to impact on the CESEE countries somewhat later than on the euro area. Latest data also show that the most vulnerable groups in the labor market suffered more from the effects of the crisis than the average employee: In Slovakia, Hungary and Croatia, youth unemployment rates soared to levels of up to 25% and are, on average, more than 10 percentage points above the total unemployment rate. Employment data also deliver information on the changing trends in CESEE labor markets. Employment growth has been negative in all countries but Poland since the beginning of the year, and employment rates have been decreasing concurrently.

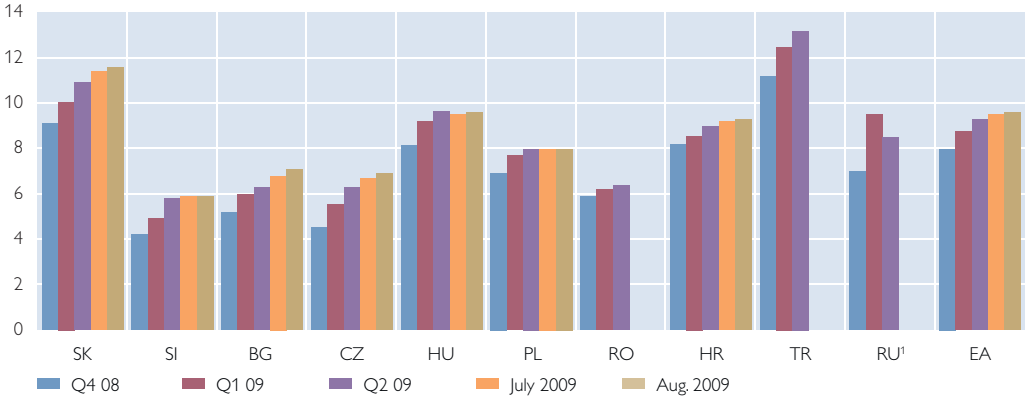
… and supported disinflation

Inflation in CESEE countries fell from average levels of 10.5% in 2008 to 7.5% year on year in August 2009. However, the reduction in price growth was somewhat uneven throughout the region: Generally, price pressures decreased more notably in countries with fixed exchange rate regimes, probably because they had not been exposed to the marked exchange rate depreciation in late 2008 and early 2009. While, for example, price growth slowed by 10.7 percentage points in Bulgaria, inflation remained broadly unchanged in Poland (partly because of previous exchange rate movements). In Hungary, it has even increased somewhat since July due to hikes in value-added tax. Slovenia and the Czech Republic are the only countries in the sample that experienced deflation in July, before price dynamics edged up again somewhat in August.

Chart 7

Unemployment Rates

Seasonally adjusted, %



Source: Eurostat.

[1] Russia: non-seasonally adjusted.

The decline in inflationary pressures was brought about primarily by weak economic dynamics impacting on all inflation components. This is especially evident when looking at core inflation rates, which decreased just as strongly as headline inflation rates in most countries. In addition, commodity and energy prices that are lower today than a year ago and partly favorable base effects in food prices contributed to dampening price pressures.

Similar monetary policy responses to the crisis across the region

CESEE central banks reacted to abating price pressures and declining medium-term inflation risks by lowering their policy rates (in a range of 25 basis points in Poland to 325 basis points in Turkey).[11] Fading depreciation pressures and stabilizing financial markets after March 2009 provided room for rate cuts.

Table 3

Consumer Price Index (HICP)

Annual change in %

	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
Slovakia	1.9	3.9	3.4	4.0	4.5	3.9	2.3	1.1
Slovenia	3.8	5.5	6.5	6.4	6.2	3.1	1.7	0.6
Bulgaria	7.6	12.0	12.4	14.0	12.5	9.0	5.1	3.1
Czech Republic	3.0	6.3	7.6	6.7	6.5	4.4	1.5	1.0
Hungary	7.9	6.0	6.9	6.8	6.3	4.2	2.7	3.6
Poland	2.6	4.2	4.5	4.3	4.4	3.6	3.6	4.3
Romania	4.9	7.9	8.0	8.6	8.2	6.9	6.8	6.1
Croatia[1]	2.9	6.1	5.9	6.6	7.4	4.5	3.8	2.9
Turkey	8.8	10.4	8.8	10.3	11.7	10.9	8.4	5.7
Russia[1]	9.1	14.1	12.8	14.8	14.9	13.8	13.9	12.6
CESEE region	7.2	10.5	9.7	10.9	11.2	10.0	9.2	8.1
Euro area	2.1	3.3	3.4	3.6	3.8	2.3	1.0	0.2

Source: Eurostat, national statistical offices, wiiw.

[1] *CPI.*

Fiscal deficits on the rise

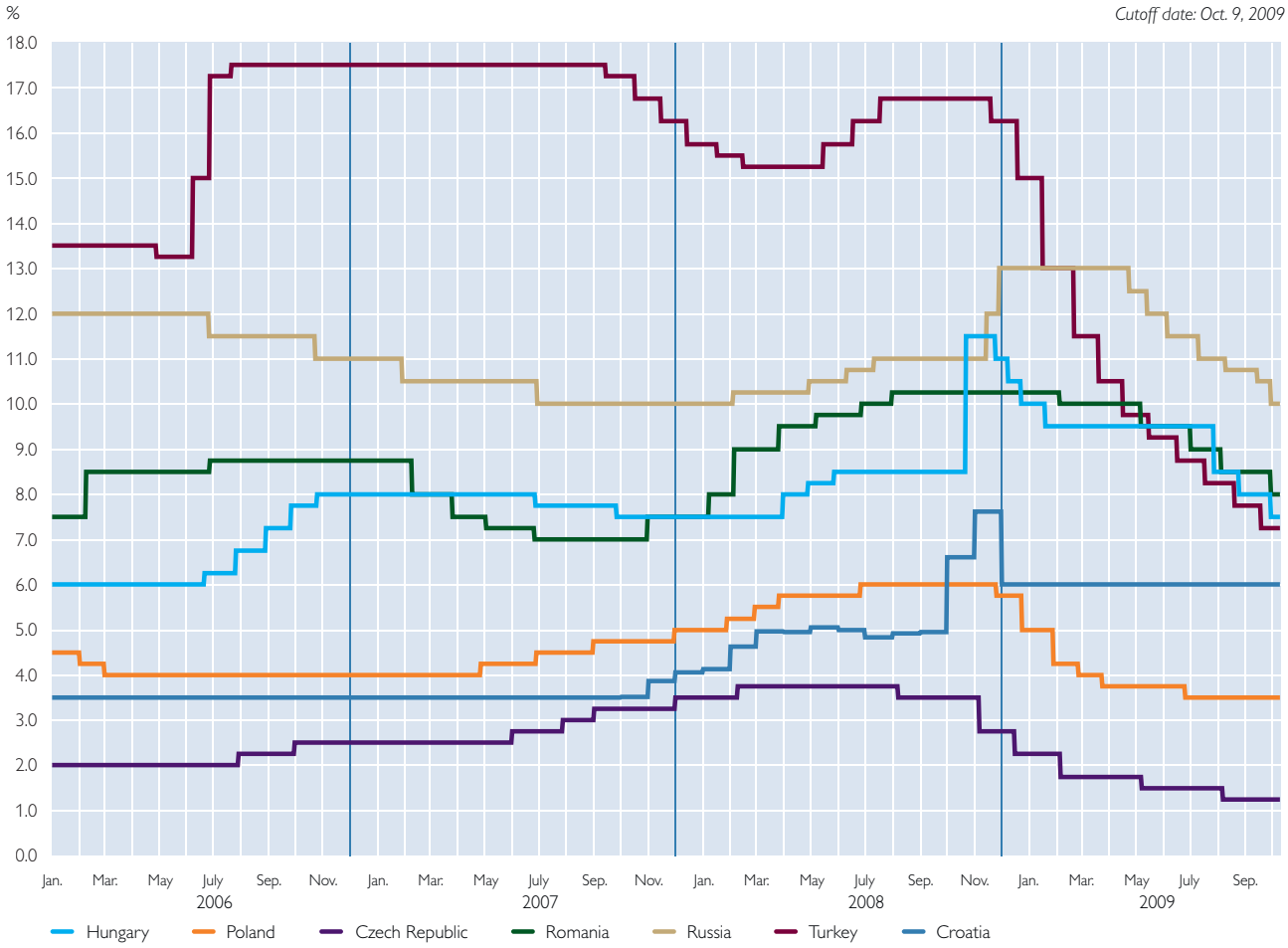
CESEE countries' fiscal policy responses to the crisis have been manifold, with Russia being the only country where a major stimulus package was launched. This variety in countermeasures was due to three partly interrelated reasons. First, government balances were already under stress in several countries, which limited room for increased deficit spending. Second, most of the countries of the region are small and open economies. A strong fiscal stimulus would thus have leaked into imports (delaying the correction of external imbalances) rather than propelled domestic demand. Third, for countries with high external financing needs, fiscal expansion could have heightened international investors' risk aversion and thus complicated access to foreign funds. Therefore these countries tended to take procyclical fiscal tightening measures in order to underpin investor confidence.

While some governments in the region reacted to the crisis with (moderate) initial fiscal impulses, most of them switched to consolidation measures (especially expenditure cuts in the public sector) in the course of 2009 in order to counter

[11] *The ECB policy rates apply for Slovakia and Slovenia. Due to its currency board arrangement, there is no policy rate for Bulgaria.*

Chart 8

Policy Rate Developments in CESEE



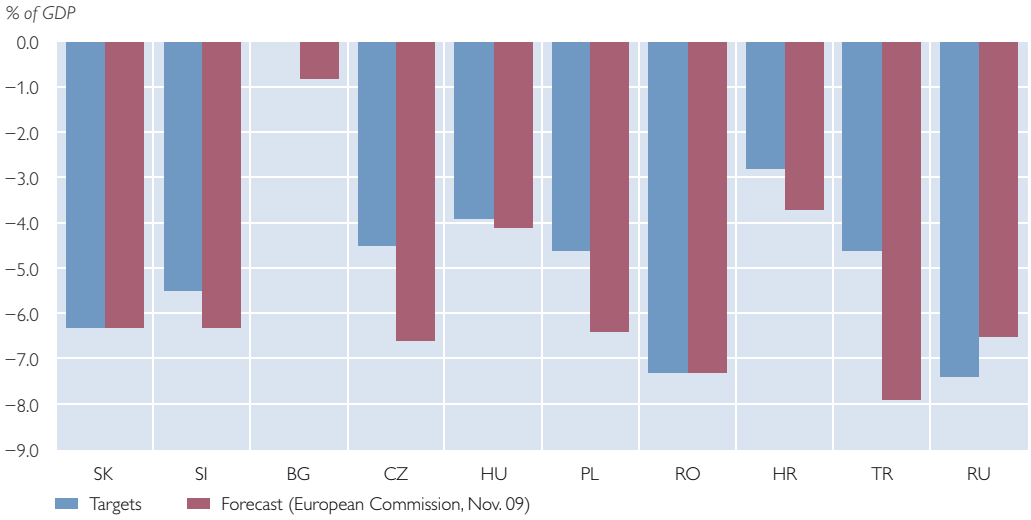
Source: National central banks.

adverse budgets dynamics. This became necessary as initial fiscal targets for 2009 were often based on growth assumptions that were soon outdated once the crisis' full effects hit the real economy. Upward revisions of budget deficit targets made in the course of the year were partly substantial and amounted to around 5% of GDP in Slovenia and Slovakia (although some consolidation measures were taken at the same time) and to more than 10% of GDP in Russia. Supplementary budgets or budget amendments have been approved in Poland, Slovenia, Croatia and Russia. According to recent forecasts, the current budgetary targets of Bulgaria, the Czech Republic, Poland, Croatia and Turkey for 2009 still appear ambitious.

Hungary has been subject to an excessive deficit procedure (EDP) since 2004, and in July 2009, EDPs were opened for Romania and Poland. Given the risk that the Czech Republic, Slovenia and Slovakia will be in an excessive deficit situation in 2009, the European Commission has prepared a report in line with article 104(3) of the Treaty establishing the European Community that could lead to the opening of an EDP by the Ecofin Council in early December 2009. According to current European Commission forecasts, public households will deteriorate

Chart 9

Comparison of 2009 Budget Targets with Forecasts



Source: National sources, European Commission.

substantially in 2009 and only Bulgaria will not surpass the 3% of GDP threshold for budget deficits. For 2010, European Commission projections assume somewhat decreasing or at least roughly unchanged deficits throughout the region, with more notable increases expected only for Slovakia and Poland.

Some progress in EU accession negotiations

The accession negotiations with the EU candidate countries Croatia and Turkey progressed in the review period. Croatia opened six new chapters and closed five in its accession negotiations with the EU in October, after talks were resumed in the wake of a rapprochement between Croatia and Slovenia over a bilateral border dispute. A final agreement concerning this dispute is now in preparation. After this breakthrough, negotiations are progressing in 16 chapters while 12 chapters have already been closed provisionally.

Turkey and the EU have opened 11 negotiation chapters and so far only one chapter has been closed provisionally. As Turkey does not yet meet all of its statutory obligations – particularly with regard to the extension of the customs union with the EU to Cyprus – the opening of the chapters on these matters has been delayed. Moreover, the EU will not close any other chapter provisionally before Turkey has not met all of its statutory obligations.

Box 1

Financial Market Developments in CESEE: Markets Are in the Process of Stabilizing as Global Risk Appetite Rebounds

Following months of stressed financial markets in CESEE triggered by the collapse of Lehman Brothers in September 2008, market tensions started to ease in February and March 2009 (see box 1 in Focus on European Economic Integration 2/08 and Q2/09). Over the review period (April 10, 2009, to September 30, 2009), stabilization tendencies continued and some financial market segments even performed rather strongly. Global risk appetite and investor confidence in emerging markets increased further, also thanks to the global policy response to the crisis and its spillover effects on emerging markets (i.a. increase of IMF resources, formally agreed at the G-20 summit in April). Multilateral support programs for CESEE countries remained on track and presumably also had positive external effects on the countries of the region that have not been accorded such packages. Money market spreads against the euro area mostly declined, while local currency bond spreads remained broadly stable, with remarkable spread contractions in Turkey and Hungary. Eurobond as well as CDS spreads continued to retreat and came back close to the levels seen prior to the collapse of Lehman. Equity prices sustained their recovery, while exchange rates of currencies with free floats or managed floats either stabilized or continued to strengthen against the euro. In turn, the stabilization tendencies in foreign exchange markets gave central banks more room to cut interest rates in response to falling inflation and rising negative output gaps.

Over the review period, three-month money market spreads against the euro area mostly trended downwards. Spreads contracted most noticeably in Russia (−850 basis points), Romania (−400 basis points), Turkey (−240 basis points) and Hungary (−160 basis points). Money market spread contractions were largely associated with sizeable interest rate cuts (see introductory part of this report). In Russia and Romania, liquidity conditions have apparently improved considerably, as witnessed by money market rates moving towards policy rates (i.e. money market rates fell more strongly than policy rates). Also in Croatia (−75 basis points) and Bulgaria (−45 basis points), money market spreads decreased noticeably. By contrast, money market spreads remained broadly unchanged in the Czech Republic while they widened in Poland (+70 basis points).[1]

Spreads of government bonds denominated in local currency remained broadly stable over the review period with the exception of those in Turkey, Hungary and Bulgaria. Turkey performed best, with spreads tightening by 400 basis points, while in Hungary, spreads were down by 200 basis points. By contrast, spreads widened by 100 basis points in Bulgaria. On average, the CESEE region performed better in this market segment than other emerging market regions, thus reversing the poorer performance in the first few months after the Lehman crisis. The J.P. Morgan Government Bond Index spread for emerging Europe declined by 80 basis points, while the corresponding spreads for Asia, Latin America and Middle East/Africa increased by about 60 basis points.

Across the CESEE region, eurobond spreads retreated substantially from their highs seen in late 2008 and early 2009. However, despite the notable downward movements in recent months, eurobond spreads have so far not fully returned to the levels preceding the collapse of Lehman. Between April and September 2009, spreads on euro-denominated eurobonds tightened by more than 200 basis points in Croatia, Hungary and Romania, by about 150 basis points in Poland and Bulgaria and by 80 basis points in Turkey. Turkey's eurobond spread had already peaked in October 2008 and began to decline somewhat earlier than those of the other countries. In Croatia, Hungary and Romania, eurobond spreads fell more strongly than the average emerging market spread (J.P. Morgan Euro EMBI Global Index, −170 basis points) during the review period, after having recorded sharp increases following the collapse of Lehman. Spreads on Russian U.S. dollar-denominated eurobonds decreased by 230 basis points, which was broadly in line with developments seen for the overall market (J.P. Morgan EMBI Global Index).

[1] *The development in Poland may be explained inter alia by changing market expectations about future policy rate cuts.*

Similar to developments observed in the eurobond market, CDS spreads of CESEE countries tightened significantly in recent months (on CDS spreads, see also the report on a recent East Jour Fixe at the OeNB in the Highlights section of this report). The downward trend continued throughout the review period, interrupted only by temporary hikes in early summer. At end-September 2009, however, spreads were still trading slightly above the levels seen prior to the collapse of Lehman Brothers. CDS spreads of Slovakia and the Czech Republic returned closest to this level. Countries that recorded the largest widening of CDS spreads after the bankruptcy of Lehman Brothers (Hungary, Bulgaria, Romania, Russia and Turkey) also saw the most pronounced contractions in absolute terms (about 150 to 200 basis points). After these countries had been trading in a wide range in the first quarter of 2009 (the differential between Turkey at the lower end and Russia at the upper end reached about 400 basis points), spreads converged to about 200 basis points at end-September 2009. In the other countries, CDS spreads declined by between 60 basis points (Slovakia, Czech Republic) and 100 basis points (Poland, Croatia) over the review period.

Easing market tensions were also evident in equity markets, with most CESEE equity indices rising considerably in recent months. Over the review period, all equity indices except for Slovakia's (−10%) supported the recovery, which started in February and March 2009.[2] It is noteworthy that during the summer, Turkey's and Hungary's equity indices already surpassed levels reached before the collapse of Lehman Brothers, while most other indices moved closely towards this threshold. Equity price gains during the review period ranged from 20% in Poland to about 60% in Hungary, Bulgaria and Turkey. The Morgan Stanley Capital International Emerging Markets Eastern Europe Index (covering the Czech Republic, Hungary, Poland and Russia) performed only slightly better than mature stock markets, increasing by 30% while the EUROSTOXX 50 rose by 28% and the Dow Jones Industrial Average by 20%. However, its performance was slightly worse than the emerging markets' average (MSCI Emerging Markets index: +35%). A comparison among emerging markets reveals that emerging Asia, as represented by the MSCI EM Asia Index (+40%), outperformed all other emerging market regions.

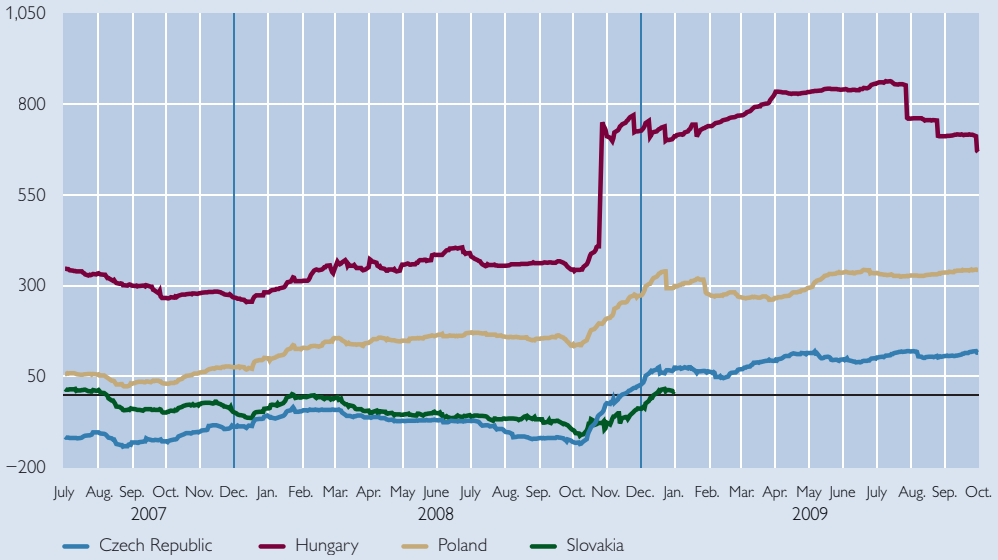
While equity indices rebounded, CESEE currencies either stabilized or continued to recover a part of their earlier losses. Over the review period, the Hungarian forint, the Czech koruna and the Polish złoty strengthened against the euro. After a notable recovery during the summer, the złoty lost some of its value more recently, while the other currencies stayed broadly stable. Still, at end-September 2009, all floating currencies, except for the Czech koruna, were traded way off the levels seen before the collapse of Lehman Brothers.

[2] *However, Slovakia's equity market developed more strongly than those of other CESEE countries in the years 2007 and 2008, so that its medium-term performance compares well with that of other stock markets in the region.*

Chart 1a

3-Month Money Market Rate Spreads against the Euro Area

Basis points *Cutoff date: Sep. 30, 2009*

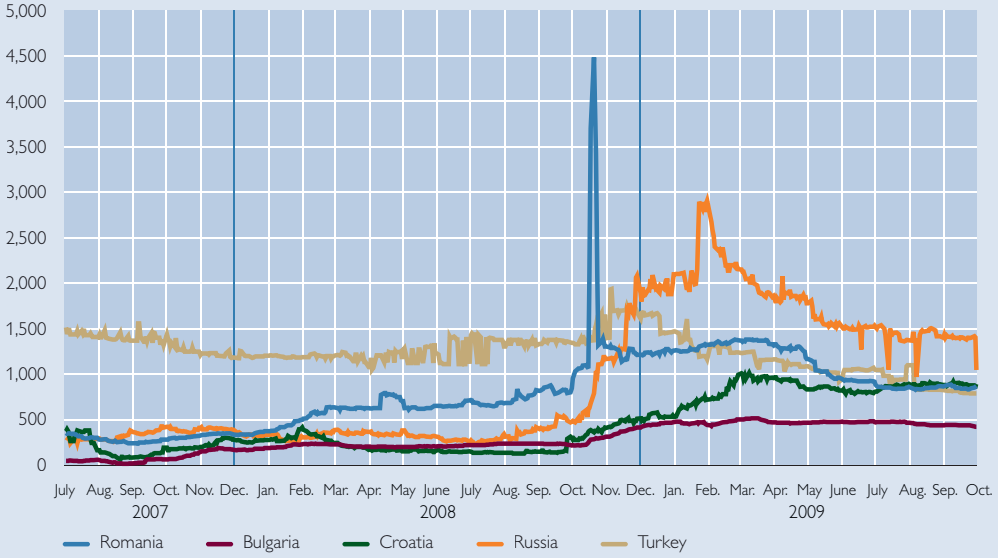


Source: Bloomberg.

Chart 1b

3-Month Money Market Rate Spreads against the Euro Area

Basis points *Cutoff date: Sep. 30, 2009*

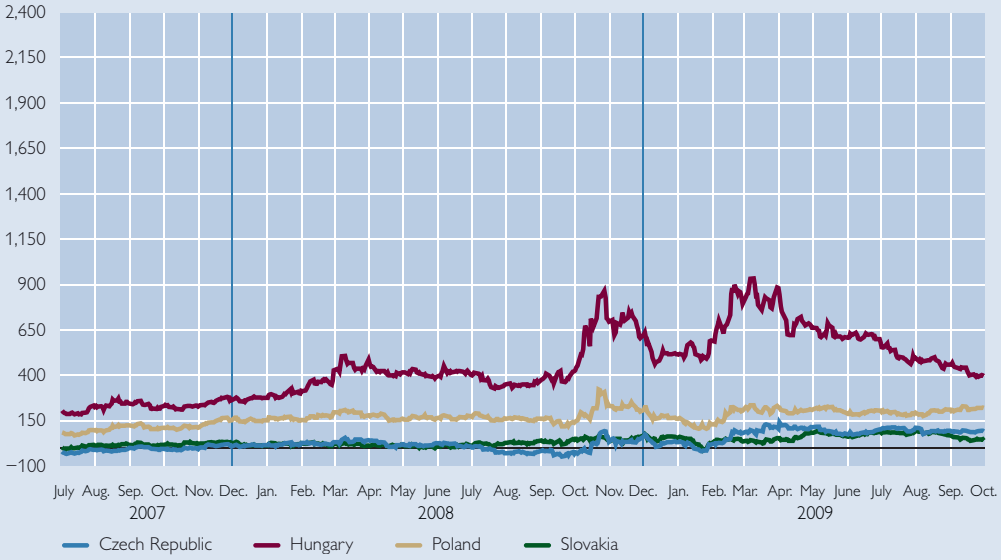


Source: Bloomberg.

Chart 2a

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI, basis points *Cutoff date: Sep. 30, 2009*

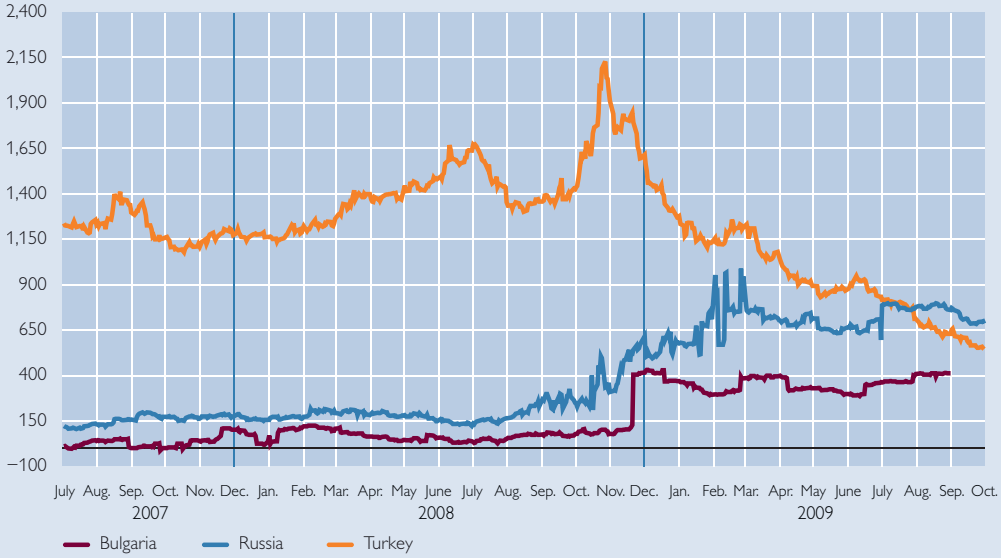


Source: Bloomberg, OeNB.

Chart 2b

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI for Russia and Turkey, Eurostat data for Bulgaria, basis points *Cutoff date: Sep. 30, 2009*



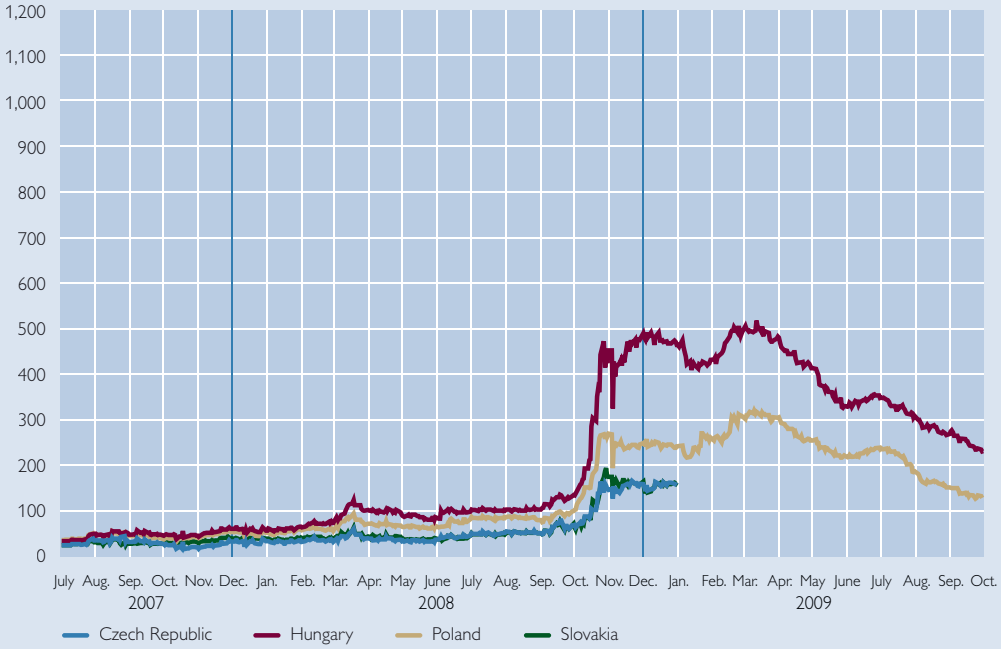
Source: Bloomberg, Eurostat, OeNB.

Note: The latest observation period for Bulgaria is Aug. 31, 2009.

Chart 3a

Euro-Denominated Eurobond Yield Spreads

JPM Euro-EMBI global index, basis points *Cutoff date: Sep. 30, 2009*

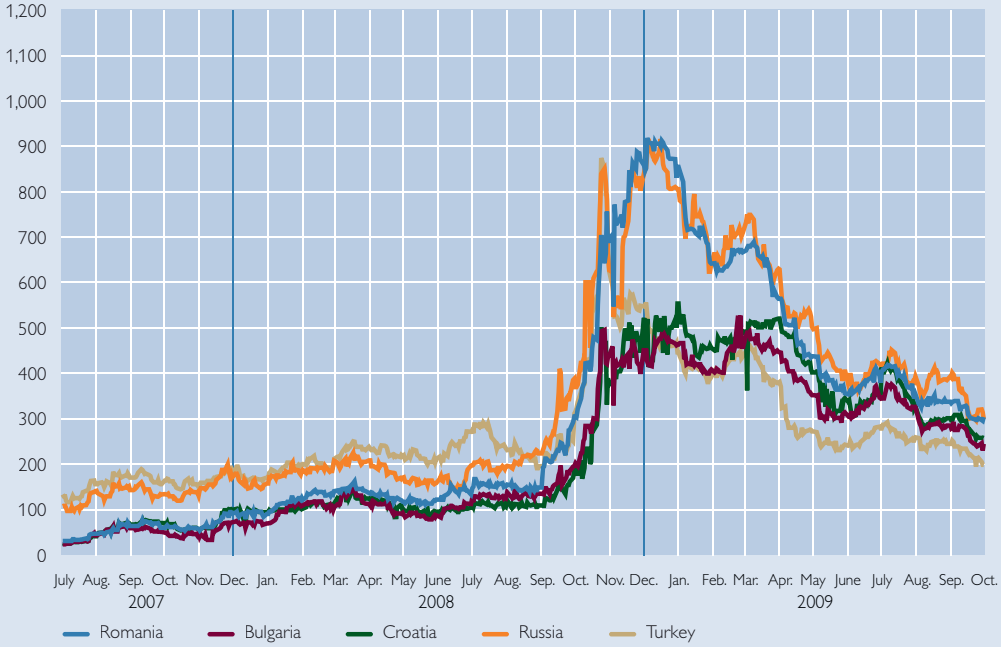


Source: Bloomberg, OeNB.

Chart 3b

Euro-Denominated Eurobond Yield Spreads

JPM Euro-EMBI global index, for Russia JPM EMBI global index, basis points *Cutoff date: Sep. 30, 2009*

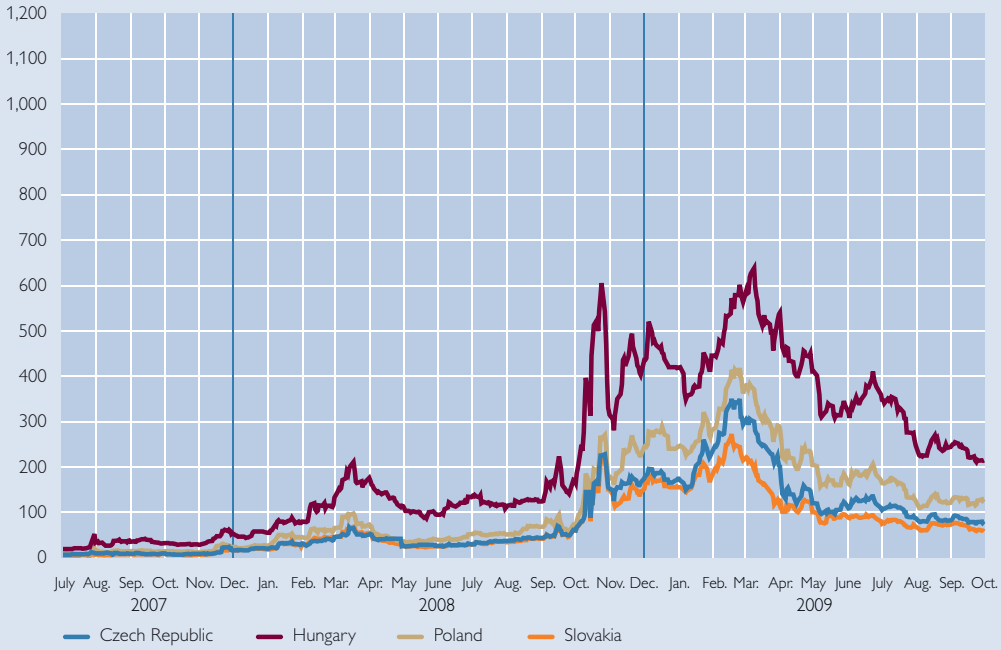


Source: Bloomberg, OeNB.

Chart 4a

Sovereign 5-Year Credit Default Swap Spreads

Basis points *Cutoff date: Sep. 30, 2009*

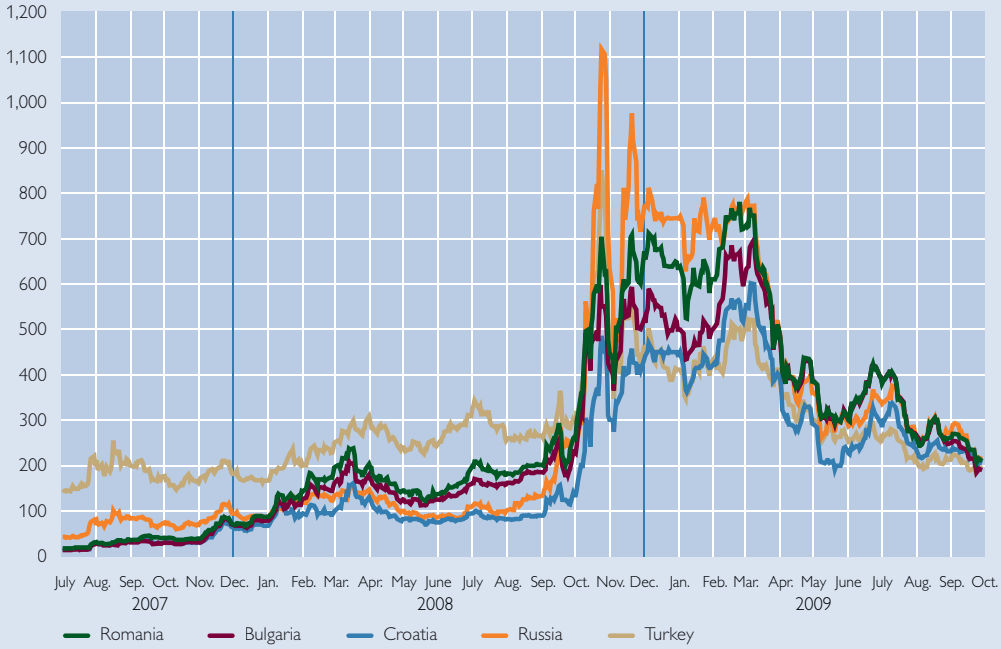


Source: Thomson Reuters, OeNB.

Chart 4b

Sovereign 5-Year Credit Default Swap Spreads

Basis points *Cutoff date: Sep. 30, 2009*



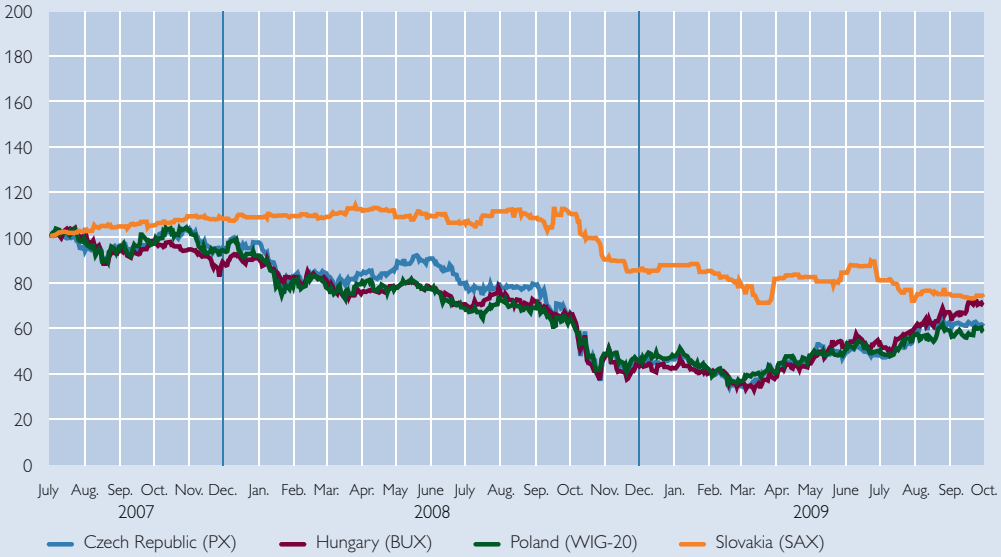
Source: Thomson Reuters, OeNB.

Note: Bulgaria and Russia USD-based.

Chart 5a

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*

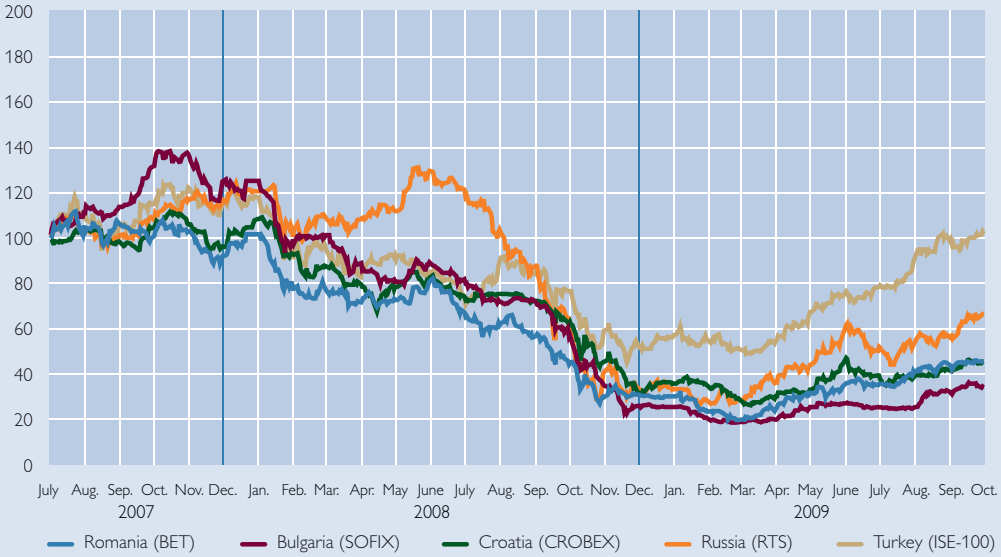


Source: Thomson Reuters, OeNB.

Chart 5b

Stock Market Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*

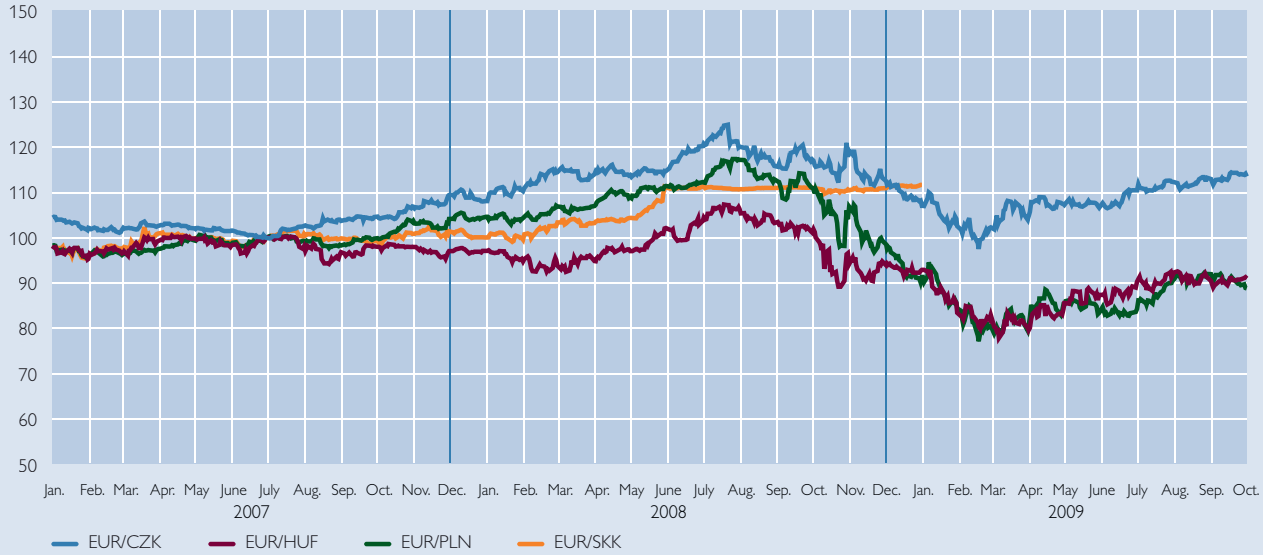


Source: Thomson Reuters, OeNB.

Chart 6a

Exchange Rate Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*



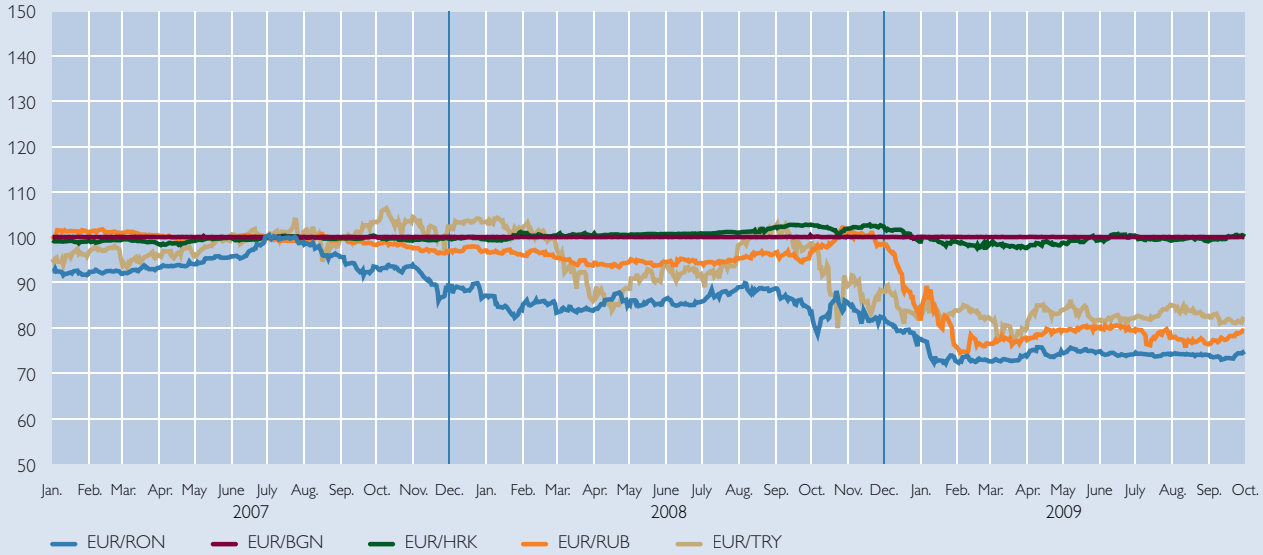
Source: Eurostat, OeNB.

Note: An increase in value means a nominal appreciation.

Chart 6b

Exchange Rate Developments

June 29, 2007 = 100 *Cutoff date: Sep. 30, 2009*



Source: Eurostat, OeNB.

Note: An increase in value means a nominal appreciation.

Box 2

OeNB-BOFIT Outlook for CESEE Countries: The Region Is Reaching the Trough, a Gradual Recovery, Mainly Driven by External Demand, to Be Seen from 2010 Onwards[1]

In 2009, GDP in the CEE-8[2] will contract by almost 4%, although Poland, the largest country in this group, will post positive growth. In 2010, growth in the CEE-8 will turn slightly positive (+0.5%) before recovering further by a moderate +2.6% in 2011. Croatia's growth profile will be broadly similar to that of the CEE-8. Following a deep contraction by 8% in 2009, the Russian economy will grow by 3% in both 2010 and 2011.

As already explained in the March OeNB-BOFIT projections,[3] the CESEE region was hit hard by the global financial crisis. Measured in average annual terms, the extent of the decline in growth will be very similar in the CEE-8 and in the euro area in 2009. Thus, the positive growth differential of the past years will not be visible this year. However, most countries' performance will actually be far below the average, and the projected growth rate of −3.8% is significantly influenced by the strong performance of Poland, the largest economy in the region. On the back of strong domestic demand, Poland's economy is expected to grow by +1%. Hence, the country is leading in terms of performance, not only within the region, but also within the EU as a whole. For 2010, a slight recovery is projected for the CEE-8 aggregate (+0.5%). In 2011, all countries will experience positive, albeit still relatively low growth rates and the economy of the CEE-8 region as a whole will expand by 2.6%.

Table 1

CEE-8 GDP Outcomes 2008 and Projections for 2009 to 2011

	Eurostat	OeNB		
	2008	2009f	2010f	2011f
	Year-on-year growth in %			
CEE-8	**3.7**	**−3.8**	**0.5**	**2.6**
Bulgaria	6.0	−5.2	−0.1	1.6
Czech Republic	3.2	−5.2	0.6	2.6
Hungary	0.6	−6.7	−1.1	3.3
Poland	4.8	1.0	1.9	3.1
Romania	7.1	−7.7	0.3	3.1

Source: OeNB September 2009 forecast, Eurostat.

In 2009, apart from Poland, all CEE-5[4] countries are set to experience negative growth, ranging from −5.2% in the Czech Republic and Bulgaria to −7.7% in Romania. In 2010, modest growth will be observed in the Czech Republic and Romania. Poland will continue to perform significantly better, reaching almost 2% of GDP growth, and Hungary will be at the other end of the range (−1.1%). 2011 will see positive growth rates at around 3% (Bulgaria: 1.6%).

[1] *The OeNB and the Bank of Finland Institute for Economies in Transition (BOFIT) compile semiannual forecasts of economic developments in selected CESEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania, Russia and Croatia), with the OeNB being in charge of the projections for the EU Member States as well as Croatia and BOFIT for the forecast regarding Russia. The cutoff date for all projections contained in this box is September 28, 2009. The forecasts are based on a broad range of available information, including newly developed country-specific time series models for Bulgaria, the Czech Republic, Hungary, Poland and Croatia. A description of the forecast model can be found in the study by Crespo Cuaresma et al. in this issue. The forecast for Romania draws on information from various sources and expert judgment. The projections for Russia were prepared by BOFIT and are based on a structural vector autoregressive (SVAR) model. The projections rest on preliminary global growth projections and technical assumptions about euro area import growth, oil prices and USD/EUR exchange rates, which are prepared by the ECB for the Eurosystem in the context of broad macroeconomic projection exercises. Imports of the euro area are expected to shrink substantially in 2009 and to recover moderately thereafter. The oil price will recover steadily up until 2011, but will stay well below its pre-crisis level. The EUR/USD exchange rate is assumed to rise moderately in 2009 and to remain unchanged over the remaining projection horizon.*

[2] *In this box, CEE-8 comprises the CESEE EU Member States that have not yet introduced the euro: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania. While we also cover the Baltic states in our CEE-8 aggregate (based on forecasts from the IMF and Consensus Economics), we do not go into detail as regards developments in these countries.*

[3] *See box 2 of "Developments in Selected Central, Eastern and Southeastern Countries" in Focus on European Economic Integration Q2/09.*

[4] *In this box, CEE-5 comprises Bulgaria, the Czech Republic, Hungary, Poland and Romania.*

1 Outlook for CEE-5: Poland Outperforms the Region as a Whole in 2009, Gradual Recovery in 2010 and 2011

The economic crisis has hit the region later but more severely than Western Europe; in most countries, the crisis interrupted rapid catching-up. However, the fundamentals continue to indicate that this process will continue in the medium to longer term. The first half of 2009 saw a major decline in economic activity in all CEE-5 but Poland. In the second quarter of 2009, this trend continued in the CEE-5 in year-on-year terms, again apart from Poland. However, in some countries, the trough (in quarter-on-quarter terms) was reached in the first quarter (Czech Republic, Poland).[5]

The significant downturn in the ***first half of 2009*** *was mainly driven by a slump in exports triggered by the lack of external demand (again, the decline was less pronounced in Poland, possibly helped by the comparatively strong currency depreciation that took place in late 2008 and early 2009), a strong decrease in gross fixed capital formation and substantial destocking related to faltering export demand and worsening economic sentiment. Private consumption delivered a substantial negative contribution to growth in all countries as labor market conditions started to deteriorate, wage growth decelerated in real terms and credit growth declined substantially. Imports contracted more sharply than exports in almost all countries. Thus, net exports developed into the most important GDP-sustaining component in all countries apart from the Czech Republic.*

Just as the crisis has hit the region with a time lag, recovery will take place with some delay too. In the ***second half of 2009****, domestic demand will not pick up compared to the first half, and the positive contribution of net exports will continue to rely on the slump in imports (which, however, will lose momentum in all countries).*[6] *Exports are going to remain weak for the rest of 2009 due to lackluster import growth in the euro area, partly due to the end of Western European car scrappage schemes. These schemes were particularly important for the Czech Republic and Hungary in the first half of 2009. The inventory cycle will help support GDP dynamics during the second half of 2009, as destocking had come to an end by mid-2009. The positive contribution of net exports in most countries (ranging between 19 percentage points in Romania and 2½ percentage points in Poland for the whole year of 2009) will partly be temporary and is particularly strong in the countries with the largest declines in domestic demand. Export-oriented Czech Republic is the only country showing a negative contribution of net exports in 2009 because of the country's high dependence on the car industry, one of the industries worldwide hit hardest by the crisis.*

The moderate growth projected for the region for ***2010*** *is expected to stem from external demand. We expect mostly positive though very small contributions from net exports to GDP, ranging between 0.1 percentage points in the Czech Republic to 1.7 percentage points in Hungary. Again, Poland is the only exception, with a projected small negative contribution (−0.5 percentage points) in 2010.*

Current account imbalances have been reduced significantly in most countries during the crisis, while the turmoil in the financial markets seen in late 2008 and early 2009 has abated. Hence, we expect investment activity to stabilize in 2010 and exports to rise as a consequence of an improved environment worldwide (imports will also pick up somewhat from their depressed 2009 levels). For the region as a whole, the external growth impetus will however be too weak to bring the CEE countries back on a robust growth track as early as in 2010, since

[5] *In all other countries, the decline lessened notably, apart from Hungary, where it stayed roughly constant. No seasonally adjusted data are available for Bulgaria. The decline in nonseasonally adjusted GDP deepened from −3.5% year on year in the first quarter of 2009 to −4.9% in the second quarter. Various factors indicate that the recession is bottoming out: The third quarter is usually the strongest performing quarter of the year, inventories have been drawn down, some investment and restocking must occur in the near future and base effects from a weak performance in 2008 will not be seen before the fourth quarter.*

[6] *The unprecedented collapse of international trade in late 2008 and early 2009 is reflected in major downward revisions in projections of import growth compared to our last forecast. However, with exports falling substantially as well, the net effect on our revisions of GDP growth is rather moderate.*

demand continues to be weak. As the crisis' effects on the real economy materialize only with a certain time lag (through rising unemployment, precautionary savings and weak confidence), private consumption will remain subdued. All countries will continue to have little room for anticyclical fiscal measures. In a few countries, there might even be a (moderately) negative impact on GDP dynamics coming from (continued) fiscal tightening.

Improving external demand conditions and the continued process of restocking will lead to a positive growth performance in all countries in ***2011****. The strong growth of both exports and imports is partly due to base effects arising from previously low levels. Compared to pre-crisis levels, growth will stay subdued and the contribution of domestic demand will remain weaker due to lagged real economy effects. Hungary, whose domestic demand has already been sluggish for a couple of years, will be an exception and show some recovery in investments.*

The forecasts for 2010 and 2011 are still subject to considerable uncertainty, mainly related to developments in Western Europe. External demand and external financing conditions for the CEE-8 may be negatively affected if the gradual recovery of the world economy and the euro area that we assume in our baseline scenario does not materialize (risk of a double dip). Another risk factor would be a renewed increase in risk aversion vis-à-vis emerging economies. Moreover, domestic demand may also be weaker than expected, in particular if the real economy impact of the financial crisis in the CEE-8 countries turns out to be stronger than anticipated.

2 BOFIT-OeNB Forecast for Russia: Deep Contraction in 2009, Global Crisis Probably Prelude to Lower Trend Growth

The world economic crisis hit Russia hard through the sharp decline in oil prices and the drying up of international financial markets, which triggered a credit crunch. In the first half of 2009, Russia's total output fell by 10.4% year on year, although the second quarter performance showed signs of stabilization. The drop in GDP was primarily due to a fall in fixed investment (estimated at 19% in the first eight months over the same period in 2008) and a substantial reduction of inventories. A drop in economic activity and the strong devaluation of the ruble in early 2009 also caused a sharp contraction of imports. Month-on-month and quarter-on-quarter data point to a bottoming out of GDP growth in the summer of 2009. Real monthly estimates of GDP reached their lowest point in early 2009 and have been rising again since May. Unemployment rates (International Labour Organization methodology) leveled off over spring and summer.

In the ***second half of 2009****, private consumption is likely to be boosted by trickle-down effects of recovering oil and staple revenues, by the stabilization of the job market and by wage recovery. Moreover, growth in government consumption should kick in, since the revised federal budget for 2009 provides for a sizable fiscal stimulus as it foresees higher expenditure (+7% of GDP) despite falling revenues. A budget deficit of over 8% of GDP is expected (2008: surplus of 4.1%). The turnaround in the second half of 2009 will be supported by modest growth in export demand. Import growth will probably remain subdued, given its sharp decrease in the first half of the year and the continuing impact of the ruble devaluation of early 2009. However, persisting elevated (double digit) inflation has been eroding competitiveness gains sparked by devaluation, and recovering consumer demand may contribute to a gradual pick-up of imports toward the end of the year. Net exports will probably deliver a positive contribution to GDP growth for the first time in years. Given the weak economic performance in the earlier part of the year, total output in 2009 will register a substantial contraction, which we project at 8.0%.*

Owing to considerable lingering uncertainty and limited credit availability, investment – hit by a severe credit crunch – is not expected to pick up until ***2010****. At that point, investment will join private and government consumption, buoyed by the stabilization of the global recovery, as the driving forces of Russian economic expansion. The continuing, though smaller fiscal stimulus in 2010 will include an expansion of social policy measures. Budget shortfalls in both*

2009 and 2010 are to be covered mostly by money from reserve and welfare funds. While exports will continue to grow modestly, the recovery of domestic demand and the likely almost return of the ruble's real effective exchange rate to the level posted in the previous year will revive imports – to the point that net exports' contribution to growth will revert to negative territory. GDP growth will be relatively moderate in 2010 and 2011 (+3% in both years).

The risks to these projections are mainly on the downside. As in the past, Russia's economic performance continues to largely depend on the oil price, and therefore on the strength of the world economy's recovery, which is expected to remain quite fragile for some time. Another risk factor relates to nonperforming loans, which have already reached a high level and whose further expansion would perpetuate the credit squeeze and act as a major drag on the economy's recovery. Inflation is also a cause of concern: If it does not subside in the remaining months of 2009, the Russian currency could get under renewed downward pressure, which might even again destabilize the financial system. Finally, the world economic crisis may dampen Russian investment growth and hence the economy's medium- to long-term growth trajectory if the banking sector (or capital market) fails to at least partly make up for the breakdown of foreign investment finance.

Table 2

Russia GDP Outcome 2008 and Projections for 2009–2011

	Rosstat	BOFIT-OeNB		
	2008	2009f	2010f	2011f
	Year-on-year growth in %			
Russia	5.6	–8.0	3.0	3.0

Source: Rosstat 2008, BOFIT forecast 2009–2011.

Table 3

Croatia: GDP Outcome 2008 and Projections for 2009–2011

	Eurostat	OeNB		
	2008	2009f	2010f	2011f
	Year-on-year growth in %			
GDP	2.4	–5.4	1.4	2.8

Source: OeNB September 2009 forecast, Eurostat.

3 Croatia: Outlook Resembles That of the CEE-8 as a Whole

Croatia's GDP contracted by 6.5% in the first half of 2009 and is expected to recover gradually in the second half; it will decline by 5.4% in 2009 as a whole. In 2010, private consumption and imports will start to pick up, leading to another negative contribution of net exports. The moderately positive growth rate of 1.4% will be driven by investment growth and private consumption. For 2011 we expect a steady continuation of this trend, domestic demand will further strengthen while net exports will continue to contribute negatively to the growth rate of 2.8%.

2 Slovakia: Caught in the Crosswinds of the Global Economy

Crisis is increasingly taking its toll on the real economy

While the introduction of the euro in 2009 has provided some shelter for Slovakia's financial markets against global headwinds, the country's real economy has been severely affected by the crisis. This is due to Slovakia's high degree of openness and its strong dependence on a few export-oriented sectors.

International developments provide both positive and negative impact on GDP

Growth slowed markedly, entering negative territory in the first and second quarter of 2009. The downturn was mainly driven by stock changes and investments, both posting substantially negative growth contributions. This development was related to fading global demand, which led to decreasing industrial output and lower capacity utilization, weak industrial sentiment and pronounced uncertainties concerning future demand conditions in international markets. The decline in credit to corporations (–2.0% year on year in July) can be seen as a symptom of sluggish investment demand, but possibly to some extent also as its cause (e.g. in the SME sector). While net exports contributed negatively to growth in the first quarter, a tentative recovery of exports turned its growth contribution into positive territory in the second quarter. This development is related to economic trends in important trading partner countries (especially Germany) and the Slovak car industry benefiting from scrapping bonuses for used cars in other countries. Private consumption growth held up relatively well, despite a drop in retail sales (–11.6% year on year in July) and rising unemployment (up 2.6 percentage points from its low at end-2008). Especially the Slovak car scrapping scheme seems to have supported consumption, as the number of car registrations soared. In tandem, growth of credit to households – though decelerating – remained on a fairly high level of 15.4% year on year in July. Looking at the quarterly growth profile, GDP grew again (by 2.2%) in the second quarter after a fall by 11.0% in the first quarter.

As a side effect of the crisis, external accounts have improved

The growth slowdown led to a reduction in the combined current and capital account deficit to 1.8% of GDP in the first half of 2009 (5% of GDP in the first half of 2008). This development was almost entirely driven by the income balance, as outflows of investment income declined strongly in line with shrinking profits. Looking at the quarterly profile of the balance of payments, a marked improvement in the goods balance was observable in the second quarter, mirroring the development of net exports in the national accounts. After posting positive values in the first quarter, the second quarter saw FDI outflows, given substantial reductions in intercompany loans.

… as has inflation

HICP inflation decelerated from 1.4% in April to 0.5% in August 2009, mainly on the back of declining prices of industrial goods and unprocessed food, the latter being supported by base effects. The decrease in core inflation was equally strong, indicating the price-dampening effect of the economic downturn.

… while public finances are set to deteriorate in 2009 and 2010

The deficit originally budgeted for 2009 was 1.7% of GDP (based on what turned out to be a largely unrealistic growth assumption of 6.5%). Against the background of actual GDP developments, a substantial overshoot is likely. In fact, the present forecast for 2009 is a 6.3% shortfall. In September, the Slovak government presented a draft budget for the coming year, which sets a deficit ceiling of 5.5% of GDP. This would imply a somewhat lower deficit than currently expected for this year. The draft budget assumes GDP growth to reach 1.9% in 2010. Initially the deficit target for 2010 had been 2.9% of GDP (according to the stability program published in April 2009).

Table 4

Main Economic Indicators: Slovakia

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	8.5	10.4	6.4	9.3	7.9	6.6	2.5	−5.6	−5.3
Private consumption	5.8	7.0	6.1	8.3	5.6	6.0	4.6	−1.2	0.7
Public consumption	10.2	−1.3	4.3	0.7	9.6	5.3	2.3	1.2	5.9
Gross fixed capital formation	9.3	8.7	6.8	7.5	11.8	7.3	1.4	−4.1	−17.6
Exports of goods and services	21.0	13.8	3.2	11.2	8.1	2.7	−7.8	−25.3	−20.5
Imports of goods and services	17.7	8.9	3.3	10.6	7.7	3.6	−6.7	−23.2	−21.9
	Contribution to GDP growth in percentage points								
Domestic demand	6.7	6.6	6.3	9.2	6.8	6.9	2.9	−4.4	−6.2
Net exports of goods and services	2.2	4.6	−0.0	1.0	0.7	−0.7	−1.0	−3.3	0.4
Exports of goods and services	18.0	13.2	3.1	11.7	8.1	2.5	−7.7	−26.8	−20.4
Imports of goods and services	15.8	8.6	3.2	10.6	7.3	3.2	−6.7	−23.5	−20.8
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	11.3	9.9	0.4	4.1	4.4	0.9	−7.2	−8.9	−1.2
Gross average wage of industry (nominal)	6.7	6.4	6.8	8.4	8.7	7.8	2.8	2.7	1.7
Unit labor costs in industry (nominal)	−4.1	−3.1	7.0	4.0	4.2	7.2	12.3	13.5	3.0
Producer price index (PPI) of industry	8.4	2.1	6.1	4.9	6.2	6.6	6.7	−5.1	−7.4
Consumer price index (here: HICP)	4.3	1.9	3.9	3.4	4.0	4.5	3.9	2.3	1.1
EUR per 1 SKK, + = SKK appreciation	3.7	10.2	8.0	4.0	7.5	10.8	10.1	..	..
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	13.4	11.2	9.6	10.5	10.1	8.9	8.7	10.4	11.3
Employment rate (15−64 years)	59.4	60.7	62.3	61.3	61.7	63.1	62.9	61.0	60.4
Key interest rate per annum (%)	4.0	4.4	4.0	4.3	4.3	4.3	3.4	..	..
SKK per 1 EUR	37.2	33.8	31.3	33.0	31.4	30.3	30.3	..	..
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	15.3	13.0	4.8	10.6	6.6	6.4	4.8	9.8	6.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−0.7	0.7	−8.0	−0.8	−10.1	−8.5	−8.0	−11.9	−5.5
Domestic credit of the banking system	13.3	13.6	12.5	14.0	15.3	15.1	12.5	27.8	28.0
of which: claims on the private sector	14.3	15.1	11.2	16.6	15.2	14.9	11.2	11.8	9.6
claims on households	6.9	6.9	7.0	7.1	7.4	7.7	7.0	6.4	5.3
claims on enterprises	7.5	8.1	4.2	9.5	7.8	7.2	4.2	5.4	4.3
claims on the public sector (net)	−1.1	−1.5	1.3	−2.6	0.1	0.2	1.3	16.0	18.4
Other assets (net) of the banking system	2.7	−1.3	0.3	−2.6	1.5	−0.2	0.3	−6.1	−16.1
	% of GDP, ESA 95								
General government revenues	33.5	32.5	32.5	..	..	..	..	..	..
General government expenditures	36.9	34.4	34.8	..	..	..	..	..	..
General government balance	−3.5	−1.9	−2.3	..	..	..	..	..	..
Primary balance	−2.0	−0.5	−1.1	..	..	..	..	..	..
Gross public debt	30.4	29.3	27.7	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	29.1	27.0	13.4	18.2	21.2	19.1	−2.2	−21.2	−25.3
Merchandise imports	27.5	21.5	13.4	17.0	21.5	20.1	−1.9	−19.6	−29.1
	% of GDP (based on EUR), period total								
Trade balance	−4.5	−1.2	−1.1	1.3	−2.0	−0.6	−2.8	−0.3	1.6
Services balance	1.4	0.7	−0.7	−0.6	−0.6	−0.7	−1.0	−2.7	−1.6
Income balance (factor services balance)	−3.7	−4.3	−3.5	−0.8	−7.4	−3.2	−2.3	−0.5	−1.3
Current transfers	−0.1	−0.6	−1.3	−1.4	−1.3	−1.1	−1.5	−0.4	−1.0
Current account balance	−7.0	−5.4	−6.6	−1.4	−11.3	−5.6	−7.5	−3.9	−2.4
Capital account balance	−0.1	0.6	1.2	0.9	2.4	0.5	1.1	1.7	0.9
Foreign direct investment (net)	6.8	3.9	3.4	−1.2	3.4	3.8	7.0	1.2	−5.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	54.8	54.8	58.0	54.8	59.7	59.1	58.0	61.1	69.0
Gross official reserves (excluding gold)[1]	21.5	22.3	19.5	21.1	20.2	19.4	19.5	0.3	0.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	3.0	3.1	2.8	2.9	2.8	2.7	2.8	0.0	0.0
	EUR million, period total								
GDP at current prices	44,629	54,900	65,026	14,213	16,042	17,550	17,221	14,648	15,640

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

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

3 Slovenia: Economic Crisis Still Impacts Several Areas

Mixed signals about growth dynamics

Slovenia's GDP contracted by 8.8% during the first half of 2009; this slowdown was primarily driven by investments triggered by worsening financing opportunities, weak demand and a sharp drop in capacity utilization since the beginning of 2009. Private consumption contracted by 1.4%, reflecting a decline in employment and slowing growth of the real net wage sum, deteriorated access to credit and weak consumer sentiment. By contrast, public consumption growth accelerated to 4.0%, mirroring increased expenditure on wages and transfers to households. Net real exports contributed 2.3 percentage points to annual GDP growth, as the decline in imports was bigger than that in exports. Destocking shaved 4 percentage points off GDP growth. In contrast to the gloomy picture painted by the year-on-year comparison, working day and seasonally adjusted data showed GDP expanding by 0.7% compared to the first quarter.

Inflation has dropped to low levels

Inflation has decreased gradually and turned into modest deflation of 0.6% year on year in July, before edging up to +0.1% in August. Disinflation was driven by energy and unprocessed food prices. Core inflation has moderated as well, mainly due to an easing of price pressure for nonenergy industrial goods, but also on account of services. Less positively, ULC growth at the whole-economy level remained high in the first half (at around 13% year on year), as the slump in productivity by far outweighed the effect of decelerating wage growth.

Weak domestic demand leads to improvement in the current account

Slovenia registered a small surplus in its combined current and capital account during the first half of 2009. The sharp turnaround (from a deficit of 5% in the first half of 2008) stemmed almost completely from the goods and services balance, partly as a result of weak domestic demand and partly due to an improvement in the terms of trade. Slovenia registered a strong portfolio capital inflow (due to two eurobond issues by the government) and the repatriation of portfolio assets by Slovene banks. At the same time, banks – as a consequence of more difficult access to funding abroad – repaid liabilities to nonresidents, which they partly compensated with government deposits and borrowing from the central bank.

Domestic lending still suffers from crisis

Domestic credit growth to households and nonbank corporations has been losing steam since the beginning of 2009. Within this aggregate, the dynamics of lending to corporations has deteriorated more than that of lending to households. In the meantime, the state-run export and development bank has begun to extend loan guarantees for corporate loans to banks, while two major banks have issued bonds backed by a state guarantee. Also, a new law has enabled the Slovene government to undertake guarantees for bank loans to natural persons in order to cover possible defaults of vulnerable groups of the population.

After big budget deficits in 2009 and 2010, gradual decrease envisaged for 2011

In mid-July the Slovene parliament approved a second supplementary budget for 2009, in which it raised the general government's deficit target from 3.7% to 5.5% of GDP. The revision had become necessary as the deeper than expected recession cut into budget revenues and envisaged savings could not be fully realized. Alongside spending cuts, the supplementary budget included some measures aimed at mitigating the effects of the crisis. The draft budget for 2010 and 2011 foresees an unchanged deficit in 2010 and a reduction to 5% in 2011. These new targets are substantially higher than the ones included in the April 2009 stability program update and represent a more back-loaded consolidation path.

Table 5

Main Economic Indicators: Slovenia

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	5.9	6.8	3.5	5.7	5.5	3.9	−0.8	−8.3	−9.3
Private consumption	2.9	5.0	2.2	3.7	3.5	0.7	1.0	0.1	−2.7
Public consumption	4.1	2.5	3.7	2.0	3.3	4.6	5.0	3.8	4.3
Gross fixed capital formation	10.4	11.9	6.2	16.9	10.3	4.5	−5.3	−22.5	−27.3
Exports of goods and services	12.5	13.8	3.3	7.6	8.0	4.2	−6.2	−20.8	−21.3
Imports of goods and services	12.2	15.7	3.5	9.7	9.2	3.0	−6.6	−22.1	−24.8
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	8.2	3.8	7.4	6.5	3.2	−1.5	−10.0	−12.7
Net exports of goods and services	0.1	−1.5	−0.2	−1.6	−1.0	0.9	0.7	1.4	3.2
Exports of goods and services	8.2	9.6	2.5	5.7	5.9	3.1	−4.6	−16.0	−16.1
Imports of goods and services	8.1	11.1	2.7	7.3	6.9	2.3	−5.2	−17.4	−19.3
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	7.8	5.3	−1.0	1.3	3.5	−0.4	−8.1	−8.3	−10.5
Gross average wage of industry (nominal)	5.5	6.7	7.8	8.3	9.7	9.4	4.2	−0.7	−1.0
Unit labor costs in industry (nominal)	−2.2	1.3	9.6	6.7	6.0	10.6	14.5	8.5	10.8
Producer price index (PPI) of industry	2.3	5.4	5.7	5.9	6.3	6.5	3.8	1.4	−0.4
Consumer price index (here: HICP)	2.5	3.8	5.5	6.5	6.4	6.2	3.1	1.7	0.6
EUR per 1 SIT, + = SIT appreciation	−0.0	..	..	..	..	..	..	..	..
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	6.1	5.0	4.5	5.1	4.2	4.2	4.3	5.4	5.7
Employment rate (%, 15−64 years)	66.6	67.8	68.6	67.1	68.3	70.1	68.8	66.7	67.6
Key interest rate per annum (%)	3.5	..	..	..	..	..	..	..	..
SIT per 1 EUR	239.6	..	..	..	..	..	..	..	..
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.3	26.0	6.9	10.7	9.9	8.4	6.9	8.0	5.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−17.1	−23.1	−11.9	−18.7	−15.2	−14.0	−11.9	−10.7	−1.0
Domestic credit of the banking system	26.3	35.1	20.8	30.6	27.3	23.5	20.8	21.5	10.7
of which: claims on the private sector	28.7	42.6	22.7	36.7	34.4	29.2	22.7	18.0	10.1
claims on households	7.5	9.0	5.0	8.2	7.4	6.3	5.0	3.6	2.6
claims on enterprises	21.3	33.6	17.7	28.5	27.0	22.8	17.7	14.3	7.5
claims on the public sector (net)	−2.4	−7.5	−1.8	−6.1	−7.0	−5.6	−1.8	3.6	0.7
Other assets (net) of the banking system	−1.0	14.0	−2.0	−1.2	−2.2	−1.1	−2.0	−2.9	−4.1
	% of GDP, ESA 95								
General government revenues	43.3	42.4	42.4	..	..	..	..	..	..
General government expenditures	44.6	42.4	44.2	..	..	..	..	..	..
General government balance	−1.3	0.0	−1.8	..	..	..	..	..	..
Primary balance	0.1	1.3	−0.7	..	..	..	..	..	..
Gross public debt	26.7	23.3	22.5	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	16.6	16.3	1.3	6.3	6.4	2.3	−9.6	−22.4	−24.1
Merchandise imports	16.3	18.1	5.7	10.9	11.7	8.7	−7.1	−26.9	−33.3
	% of GDP (based on EUR), period total								
Trade balance	−3.7	−4.8	−7.1	−5.6	−6.9	−7.8	−8.1	−1.5	0.5
Services balance	3.2	3.0	4.3	3.8	4.9	5.0	3.4	3.2	4.0
Income balance (factor services balance)	−1.4	−2.3	−2.8	−1.7	−2.7	−4.1	−2.6	−2.6	−2.0
Current transfers	−0.6	−0.7	−0.6	−1.4	−0.3	0.2	−0.8	−1.6	0.3
Current account balance	−2.5	−4.8	−6.2	−4.9	−5.0	−6.7	−8.0	−2.4	2.9
Capital account balance	−0.4	−0.2	−0.1	−0.1	0.0	−0.1	−0.3	−0.1	0.4
Foreign direct investment (net)	−0.6	−0.6	1.0	1.3	−1.5	1.3	3.1	−1.4	−3.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	77.6	100.8	105.3	105.5	108.8	108.7	105.7	102.3	104.5
Gross official reserves (excluding gold)[1]	17.2	1.9	1.7	2.0	1.7	1.7	1.7	1.4	1.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	3.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	31,013	34,471	37,126	8,726	9,636	9,647	9,117	8,270	8,996

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

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

4 Bulgaria: First Recession Since 1997, Triggered by Plummeting Domestic Demand

Output contracts by 4.2% in the first half of 2009, growth pattern changes substantially

For the first time since 1997, Bulgaria has suffered a recession, attributable to a sharp decline in private consumption, capital formation and exports. At the same time, imports slumped even more strongly. Accordingly, the growth pattern in Bulgaria has shifted remarkably: Domestic demand – the growth engine of the last years – now provides a substantial negative, net exports a clearly positive contribution to growth. The recession was clearly visible also on the production side, with industrial output shrinking by nearly 12% and new orders in the manufacturing sector declining by 32% year on year in the first half of 2009.

Several factors were responsible for the breakdown of domestic demand. Economic sentiment deteriorated dramatically in the first half of 2009. At the same time, both households and corporations faced a mix of increased liquidity pressures that emerged from reduced foreign capital inflows and sharply decelerating credit growth. Wage growth also moderated, especially in the industrial sector. Households also saved more, presumably for precautionary reasons (household deposits had gone up by about 9% year on year as at end-June 2009).

Recession leads to a welcome correction of macroeconomic imbalances

Some long-standing imbalances started to unwind as the global crisis hit the country. The current account deficit diminished to 14% of GDP in the first half of 2009 (i.e. compared to the first half of 2008 it halved; however, it is still one of the largest in the CESEE region). At the same time, the inflow of net FDI moderated further, though less severely than in the second half of 2008 (net FDI now account for more than 80% of the combined current and capital account deficit). The Bulgarian central bank's foreign exchange reserves remained roughly stable during the first nine months of 2009.

The sharp disinflation process continued in 2009. In August, HICP inflation was only 1.3% year on year (August 2008: 12%). Initially, this had been helped by slower increases in food, services and energy prices; more recently, the strongly growing negative output gap contributed to slowing price growth.

Against this background, in July 2009 Bulgaria's finance minister announced that the country intended to join ERM II in the near future (while retaining its currency board, which has been in place since 1997).

Anti-crisis management through fiscal impulses

As monetary policy is constrained by the currency board, fiscal policy took a proactive role in anti-crisis management in the first half of 2009, when general government expenditures were nearly 25% higher year on year due to significant capital expenditure supporting infrastructure and social projects and further fiscal injections in the run-up to the parliamentary elections in July 2009. Part of this additional spending (about 1% of GDP) was financed from the Fiscal Reserve Account, which however still stood at a sizeable level of about 11.5% of GDP in August 2009.

… followed by consolidation after parliamentary elections

As a consequence of unexpectedly high spending increases and revenue shortfalls in the first half of 2009, the newly elected government revised the original budget surplus target (1.5% of GDP) downwards and now pursues a balanced budget target for both 2009 and 2010. In order to achieve this goal, the government took several consolidation steps on the expenditure side, including a freeze of public sector wages and pensions until next summer, and stepped up efforts to curb tax evasion, thus raising revenues. A fully-fledged budget proposal for 2010 is currently under preparation.

Table 6

Main Economic Indicators: Bulgaria

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.3	6.2	6.0	7.0	7.1	6.8	3.5	−3.5	−4.9
Private consumption	9.5	5.3	4.8	6.5	5.4	6.4	1.5	−6.3	−5.6
Public consumption	−1.3	3.1	0.1	−4.4	2.0	0.4	1.2	−0.4	4.1
Gross fixed capital formation	14.7	21.7	20.3	15.5	28.6	22.3	15.8	−14.1	−16.3
Exports of goods and services	8.7	5.2	2.9	9.2	5.1	3.8	−6.0	−17.4	−15.8
Imports of goods and services	14.0	9.9	4.9	5.8	13.7	4.2	−3.2	−21.1	−24.3
	Contribution to GDP growth in percentage points								
Domestic demand	12.3	11.2	7.2	6.0	15.4	4.0	4.3	−13.5	−16.7
Net exports of goods and services	−6.4	−5.6	−2.8	0.1	−9.8	−1.1	−0.5	9.9	14.3
Exports of goods and services	5.6	3.4	1.9	6.1	3.5	2.6	−3.5	−11.8	−10.7
Imports of goods and services	12.0	9.1	4.6	6.0	13.3	3.7	−3.0	−21.8	−25.0
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	10.4	8.7	0.3	7.1	4.4	0.0	−9.1	−14.9	−14.1
Gross average wage of industry (nominal)	10.8	20.1	22.2	25.0	24.0	22.5	17.8	12.2	11.3
Unit labor costs in industry (nominal)	0.2	10.4	21.9	16.3	18.7	22.8	29.8	32.1	29.7
Producer price index (PPI) of industry	6.9	8.4	10.8	14.4	13.0	12.1	3.6	0.6	−3.5
Consumer price index (here: HICP)	7.4	7.6	12.0	12.4	14.0	12.5	9.0	5.1	3.1
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)	9.0	7.0	5.7	6.6	5.9	5.2	5.1	6.4	6.4
Employment rate (%, 15−64 years)	58.7	61.7	64.0	62.6	63.9	65.0	64.3	62.6	63.3
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)	26.9	31.2	8.8	29.0	24.4	19.5	8.8	6.3	3.6
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	21.4	1.5	−12.3	2.2	−3.1	−4.3	−12.3	−10.5	−7.1
Domestic credit of the banking system	11.1	38.7	26.3	35.7	35.2	31.1	26.3	23.1	16.1
of which: claims on the private sector	18.2	45.3	28.4	44.0	43.9	40.4	28.4	23.0	11.6
claims on households	8.4	14.8	10.3	14.8	15.1	14.0	10.3	8.6	4.8
claims on enterprises	9.8	30.5	18.1	29.2	28.7	26.4	18.1	14.4	6.8
claims on the public sector (net)	−7.1	−6.7	−2.1	−8.3	−8.7	−9.3	−2.1	0.1	4.5
Other assets (net) of the banking system	−5.6	−9.0	−5.1	−8.9	−7.7	−7.4	−5.1	−6.3	−5.4
	% of GDP, ESA 95								
General government revenues	39.5	41.5	39.1	..	..	..	..	..	..
General government expenditures	36.5	41.5	37.3	..	..	..	..	..	..
General government balance	3.0	0.1	1.8	..	..	..	..	..	..
Primary balance	4.4	1.1	2.7	..	..	..	..	..	..
Gross public debt	22.7	18.2	14.1	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	26.7	12.6	13.0	25.8	22.3	17.7	−10.0	−26.8	−33.3
Merchandise imports	26.6	18.2	15.7	21.8	32.9	18.2	−5.1	−29.8	−39.7
	% of GDP (based on EUR), period total								
Trade balance	−22.1	−25.1	−25.7	−25.8	−30.5	−22.3	−24.8	−16.0	−14.9
Services balance	3.7	2.6	2.4	−3.5	2.7	10.1	−1.1	−0.8	3.4
Income balance (factor services balance)	−2.7	−3.9	−3.5	−1.3	−7.0	−2.8	−2.9	−2.8	−1.3
Current transfers	2.7	1.2	1.5	2.0	4.3	0.6	−0.4	1.7	2.5
Current account balance	−18.5	−25.2	−25.3	−28.7	−30.5	−14.5	−29.2	−17.8	−10.3
Capital account balance	0.7	−2.1	0.8	2.7	0.2	0.4	0.4	2.6	1.5
Foreign direct investment (net)	23.9	28.7	16.7	11.5	24.7	18.4	11.8	10.3	9.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	81.9	100.2	107.7	100.8	106.8	110.1	107.7	106.0	106.9
Gross official reserves (excluding gold)	32.9	38.8	35.0	37.8	39.7	42.4	35.0	31.8	31.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.8	5.4	5.0	5.3	5.4	5.8	5.0	4.9	5.6
	EUR million, period total								
GDP at current prices	25,238	28,899	34,118	6,894	8,152	9,515	9,557	7,138	8,345

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

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

5 Czech Republic: Deep Recession despite Some Dampening Effects from Car Purchase Subsidies in Several EU Countries

Has the trough been reached?

The global economic crisis showed its full impact in the first half of 2009, with real GDP contracting by 4.4% in the first quarter and by 5.8% (both figures year on year) in the second quarter. However, in the second quarter real output remained stable quarter on quarter, which may suggest that the trough has been reached or is within reach. Gross fixed capital formation and particularly the reduction of stocks put a major damper on growth in the first half of 2009. Private and public consumption counteracted, delivering a very similar contribution to GDP dynamics. This was due to waning private consumption growth, alongside with stepped up public consumption in the wake of the EU Presidency and some fiscal stimulus measures (see below). Subsidies for car purchases that were in place in some big EU economies were key for Czech net exports to recover somewhat during the first half of 2009 and thus to noticeably reduce their negative contribution to growth.

All monetary and fiscal hands on deck to mitigate recession

Inflation has fallen abruptly, mainly thanks to the unwinding of the effects of past changes to indirect taxes, the slower growth of regulated prices and the anti-inflationary development of fuel and food prices. Low capacity utilization has presumably also helped. Headline inflation and the inflation rate relevant for monetary policy decisions[12] have converged and are currently fluctuating below the lower boundary of the tolerance band of the Česká národní banka's (CNB) inflation target (3% ± 1 percentage point). Against this backdrop, the CNB further cut the key interest rate in the first half of 2009 in two steps to 1.25%. On the fiscal side – in addition to the first stimulus package approved earlier in the year[13] – the parliament recently endorsed a new anti-crisis act, which includes further measures such as reduced social insurance contributions, an extended eligibility period for unemployment benefits or subsidies on car purchases. The latter measure, however, would have to be initiated by the government in order to become effective. In fact, the cabinet recently pushed a fiscal consolidation package through parliament, which will reduce the budget deficit envisaged for 2010 from 7.4% to approximately 5.2% of GDP.

Crisis: labor market feels full blow, foreign exchange market continues recovery

In the first half of 2009 the slump in economic activity increasingly fed through to the labor market in form of a rapid decline in the number of vacancies as well as a sharp rise in unemployment. The latter, however, still remains comparatively low by EU standards. Also, wage growth responded to the fall in demand and slowed down considerably. In the second quarter of 2009, unit labor costs in Czech koruna (CZK) grew only moderately in year-on-year terms (and fell slightly if measured in euro).

Despite some setbacks brought about not least by political turbulences, the appreciation trend of the CZK versus the euro (which resumed in March 2009) continued in the review period, and the Czech currency is currently fluctuating almost at levels recorded prior to the collapse of Lehman Brothers. The temporary weakness of the koruna in late 2008 and early 2009 along with sluggish domestic demand has presumably helped improve the combined current and capital account balance, which displayed a slight surplus in the first half of 2009. Net FDI inflows dropped markedly in the wake of the crisis but still remained in the positive.

[12] *Defined as headline inflation adjusted for first-round effects of changes to indirect taxes.*

[13] *See Focus on European Economic Integration Q2/09 for details.*

Table 7

Main Economic Indicators: Czech Republic

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.8	6.1	2.7	2.7	4.2	3.9	0.0	−4.4	−5.8
Private consumption	5.2	5.0	3.4	3.7	3.3	3.3	3.4	1.8	1.5
Public consumption	1.2	0.7	1.6	−0.3	2.9	3.7	0.4	4.4	2.6
Gross fixed capital formation	6.0	10.8	−1.1	1.3	−1.2	−0.5	−3.5	−7.5	−7.2
Exports of goods and services	15.8	15.0	6.6	14.3	14.9	8.3	−9.2	−19.3	−17.6
Imports of goods and services	14.3	14.3	5.0	12.8	11.0	4.6	−6.7	−18.4	−17.8
	Contribution to GDP growth in percentage points								
Domestic demand	5.6	5.4	1.1	0.6	0.5	0.7	2.4	−3.1	−5.6
Net exports of goods and services	1.2	0.7	1.6	1.8	3.9	3.6	−2.7	−1.7	−0.6
Exports of goods and services	13.6	14.1	6.7	14.5	14.7	8.2	−9.9	−21.8	−19.2
Imports of goods and services	12.5	13.3	5.0	12.7	10.8	4.6	−7.2	−20.1	−18.6
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	9.3	6.5	0.5	3.3	4.7	4.9	−10.1	−5.8	−0.1
Gross average wage of industry (nominal)	6.1	8.6	8.3	11.6	8.7	7.5	5.9	2.7	2.9
Unit labor costs in industry (nominal)	−2.9	1.9	8.3	7.9	3.8	3.0	18.3	9.7	3.4
Producer price index (PPI) of industry	1.6	4.0	4.5	5.6	5.1	5.5	1.6	−1.1	−3.6
Consumer price index (here: HICP)	2.1	3.0	6.3	7.6	6.7	6.5	4.4	1.5	1.0
EUR per 1 CZK, + = CZK appreciation	5.1	2.1	11.2	9.8	13.8	15.9	5.7	−7.5	−7.0
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	7.2	5.4	4.4	4.7	4.3	4.3	4.4	5.8	6.4
Employment rate (%, 15−64 years)	65.3	66.1	66.6	66.1	66.6	66.7	66.8	65.6	65.4
Key interest rate per annum (%)	2.2	2.9	3.5	3.7	3.8	3.6	3.0	2.0	1.6
CZK per 1 EUR	28.3	27.8	25.0	25.5	24.8	24.1	25.4	27.6	26.7
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.0	16.1	13.6	14.3	11.3	13.2	13.6	12.3	9.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−5.7	−0.1	0.2	−4.2	−5.6	0.1	0.2	4.1	2.6
Domestic credit of the banking system	14.7	15.3	11.0	15.6	9.8	9.7	11.0	8.9	9.3
of which: claims on the private sector	12.1	18.2	10.6	17.1	16.0	14.7	10.6	9.0	5.2
claims on households	6.8	9.1	6.5	8.8	8.3	8.0	6.5	6.2	5.4
claims on enterprises	5.3	9.2	4.1	8.3	7.7	6.6	4.1	2.7	−0.3
claims on the public sector (net)	2.6	−2.9	0.4	−1.4	−6.1	−5.0	0.4	−0.1	4.1
Other assets (net) of the banking system	4.0	0.9	2.4	2.9	7.1	3.4	2.4	−0.7	−2.7
	% of GDP, ESA 95								
General government revenues	41.1	41.9	40.9	..	..	..	..	..	..
General government expenditures	43.8	42.6	43.0	..	..	..	..	..	..
General government balance	−2.6	−0.7	−2.1	..	..	..	..	..	..
Primary balance	−1.5	0.5	−1.0	..	..	..	..	..	..
Gross public debt	29.4	29.0	30.0	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	20.6	18.2	10.5	17.5	20.7	15.2	−8.8	−24.8	−24.8
Merchandise imports	20.8	16.0	11.3	18.7	18.7	13.9	−3.8	−25.8	−27.6
	% of GDP (based on EUR), period total								
Trade balance	2.0	3.4	2.8	4.9	4.2	2.9	−0.7	4.7	5.5
Services balance	1.4	1.6	2.2	2.5	2.4	2.1	1.9	2.0	1.4
Income balance (factor services balance)	−5.6	−7.7	−7.8	−4.1	−12.7	−7.4	−6.7	−4.5	−9.8
Current transfers	−0.4	−0.5	−0.3	0.1	0.2	−0.8	−0.7	0.4	−0.3
Current account balance	−2.6	−3.2	−3.1	3.5	−5.9	−3.2	−6.2	2.7	−3.2
Capital account balance	0.3	0.6	0.8	0.8	1.4	0.2	1.0	1.8	0.5
Foreign direct investment (net)	2.8	5.1	4.1	2.5	5.7	4.4	3.7	1.5	−0.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	38.2	40.5	39.0	41.1	44.9	43.2	39.0	37.8	39.9
Gross official reserves (excluding gold)	20.8	18.4	17.8	18.0	17.3	17.3	17.8	18.8	19.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.4	2.9	3.0	2.9	2.8	2.8	3.0	3.3	3.4
	EUR million, period total								
GDP at current prices	113.739	127.427	148.129	34.261	37.848	38.959	37.061	31.543	34.362

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

6 Hungary: Financial Strains Ease, but Real Economy Remains Very Weak

Recession continues to deepen amid destocking

Hungarian GDP contracted by 7.2% year on year in the first half of 2009. Driven by household consumption, final consumption went down by 4.6%. A sharp decline in employment, decreasing real wages, reduced public transfers, limited access to borrowing and increased savings contributed to weak consumption by households. Investment fell by 4.8%, with the decline in investment in machinery and equipment being particularly pronounced. Net exports contributed 7.1 percentage points to GDP growth, as imports fell much more than exports. The favorable development of net real exports translated into a substantial improvement in the combined current and capital account, which had registered a minor surplus during the first half of 2009. It is noteworthy that economic activity continued contracting in the second quarter, albeit at a slower pace than in the first quarter (–2% quarter on quarter).

Temporary hike in inflation

Inflation rose to 3.7% in June, mainly due to unprocessed food and fuel prices, but also reflecting the sharp weakening of the forint in the fourth quarter of 2008 and in the first quarter of 2009. It edged up further in July and August in reaction to the increase in the main VAT rate and some consumption taxes coming into force on July 1. In its latest inflation report Magyar Nemzeti Bank (MNB) expected inflation to peak at 6% to 6.5% in the first quarter of 2010, to rapidly fall thereafter to 2.5% by the third quarter of 2010 and to stabilize at around 2% throughout 2011, given the negative output gap and weak domestic demand.

Financial market tensions subside

Tensions in the Hungarian financial markets have eased substantially in recent months. Foreign-owned banks are benefitting from sustained support by their parent banks, while three major banks without foreign parent banks have received foreign currency loans directly from the government, and one of them additionally a capital injection. The regular government bond auctions have been characterized by strong demand and declining yields, and the government's eurobond issue in mid-July was substantially oversubscribed. The disinflationary environment, along with decreasing financial stability risks, enabled MNB to cut interest rates gradually between end-July and end-September by a total of 200 basis points to 7.5%.

Despite these positive developments, Hungary's risk premiums are still relatively high, reflecting the economy's comparably high vulnerability. Lending by domestic banks to the private sector has been decreasing continuously since early 2009, as banks have been tightening their lending standards and credit demand decreased in tandem. However, according to the latest bank lending survey, banks intend to modestly ease their credit conditions and increase lending volumes during the second half of 2009. Banks' credit risks have been mitigated by the appreciation of the forint in the review period.

Fiscal consolidation and performance under the IMF/EU loan program on track

So far, Hungary has complied with the conditions of the IMF and EU loan agreements, and the agreements have been extended by six months until October 2010 in order to also cover the time after the general elections scheduled for spring 2010. The government has progressed with structural reforms and moved on with its tax reform. The unexpectedly deep recession threatened to lead to a widening of the budget deficit to around 4.6% of GDP, compared to the original 2.9% target. In response, the government has taken additional consolidation measures and, in agreement with the IMF and the EU, set the deficit target for 2009 at 3.9%; the targets agreed upon for 2010 and 2011 are 3.8% and 3%, respectively.

Table 8

Main Economic Indicators: Hungary

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	4.0	1.2	0.6	1.8	2.1	1.3	−2.5	−6.7	−7.5
Private consumption	1.7	0.6	−0.5	0.6	1.4	0.1	−4.0	−7.2	−6.4
Public consumption	3.8	−7.5	0.7	1.5	1.0	2.7	−2.0	−0.2	1.8
Gross fixed capital formation	−3.7	1.8	−2.6	−5.1	−1.9	−1.5	−2.7	−6.9	−3.3
Exports of goods and services	18.6	16.4	4.8	15.3	10.3	3.6	−8.2	−18.6	−14.0
Imports of goods and services	14.8	13.4	4.7	13.0	12.5	3.5	−8.7	−22.0	−22.6
	Contribution to GDP growth in percentage points								
Domestic demand	1.7	−1.0	0.4	−0.3	3.8	1.3	−2.8	−9.7	−15.1
Net exports of goods and services	3.0	3.1	0.3	3.0	−2.0	0.3	0.3	3.6	10.3
Exports of goods and services	16.6	16.7	5.6	18.2	12.0	4.2	−9.6	−25.1	−17.5
Imports of goods and services	13.6	13.6	5.3	15.2	14.0	4.0	−9.9	−28.6	−27.8
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	11.4	9.2	−1.4	6.0	3.3	−2.5	−10.8	−13.4	−7.9
Gross average wage of industry (nominal)	8.6	8.4	6.6	7.7	7.1	6.9	4.9	3.6	3.3
Unit labor costs in industry (nominal)	−2.5	−0.7	8.5	1.6	3.6	9.9	19.0	20.3	12.3
Producer price index (PPI) of industry	6.5	0.2	5.3	5.0	5.3	3.9	6.9	7.7	6.7
Consumer price index (here: HICP)	4.0	7.9	6.0	6.9	6.8	6.3	4.2	2.7	3.6
EUR per 1 HUF, + = HUF appreciation	−6.1	5.1	−0.2	−2.7	0.1	6.6	−4.0	−11.8	−13.3
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	7.5	7.4	7.9	8.0	7.7	7.8	8.0	9.7	9.6
Employment rate (%, 15−64 years)	57.3	57.3	56.7	56.1	56.5	57.3	56.7	55.1	55.6
Key interest rate per annum (%)	6.7	7.8	8.7	7.5	8.3	8.5	10.5	9.6	9.5
HUF per 1 EUR	264.1	251.3	251.7	259.4	248.0	236.1	263.5	294.1	285.9
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.6	11.0	8.7	15.2	9.1	8.5	8.7	8.6	11.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−4.1	−6.8	−3.8	−9.2	−7.7	−4.7	−3.8	4.9	7.7
Domestic credit of the banking system	21.9	21.3	18.2	28.9	17.9	18.1	18.2	14.0	13.8
of which: claims on the private sector	16.7	19.3	20.4	26.9	16.8	17.7	20.4	24.0	15.2
claims on households	8.6	9.1	12.7	12.1	9.2	9.8	12.7	14.1	10.1
claims on enterprises	8.1	10.2	7.6	14.7	7.6	7.9	7.6	10.0	5.1
claims on the public sector (net)	5.2	1.9	−2.2	2.0	1.1	0.4	−2.2	−10.0	−1.4
Other assets (net) of the banking system	−4.2	−3.4	−5.6	−4.5	−1.1	−4.9	−5.6	−10.2	−9.6
	% of GDP, ESA 95								
General government revenues	42.6	44.8	45.5	..	..	..	..	..	..
General government expenditures	51.9	49.8	49.3	..	..	..	..	..	..
General government balance	−9.3	−5.0	−3.8	..	..	..	..	..	..
Primary balance	−5.4	−0.9	0.4	..	..	..	..	..	..
Gross public debt	65.6	65.9	72.9	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	17.5	16.8	6.7	15.7	14.4	6.8	−8.6	−26.5	−25.2
Merchandise imports	16.5	12.5	7.1	13.2	14.2	9.5	−7.3	−29.0	−32.2
	% of GDP (based on EUR), period total								
Trade balance	−2.3	0.2	−0.1	1.5	0.4	−1.5	−0.3	3.7	6.2
Services balance	1.4	1.0	0.8	0.2	1.1	1.8	−0.0	0.6	1.9
Income balance (factor services balance)	−6.2	−7.5	−7.3	−7.0	−7.0	−7.8	−7.2	−6.4	−6.6
Current transfers	−0.3	−0.5	−0.6	−1.2	−0.2	−0.3	−0.9	−0.8	0.6
Current account balance	−7.5	−6.8	−7.2	−6.5	−5.7	−7.9	−8.5	−2.9	2.1
Capital account balance	0.7	0.7	1.0	0.2	0.4	0.5	2.8	1.5	1.9
Foreign direct investment (net)	3.1	1.6	2.4	1.4	3.3	−0.2	4.9	0.2	−3.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	90.5	96.9	114.0	103.3	108.5	110.7	114.9	123.6	131.3
Gross official reserves (excluding gold)	18.2	16.1	22.6	16.4	16.6	16.2	22.6	27.3	27.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	2.8	2.5	3.4	2.5	2.4	2.4	3.4	4.2	4.4
	EUR million, period total								
GDP at current prices	89,929	101,377	105,983	23,536	27,265	28,508	26,675	19,592	22,385

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

7 Poland: Economic Growth amid Global Recession

Net exports offset contraction in domestic demand

Poland posted annual GDP growth of 1.1% in the first half of 2009 (with accelerating quarter-on-quarter growth) as the positive growth contribution of net exports more than offset a comparatively moderate domestic demand contraction. Net exports improved sharply as imports fell more than exports. The sizeable depreciation of the Polish złoty between July 2008 and February 2009 probably had a dampening effect on imports rather than a stimulating one on exports, given the slump in external demand and companies' problems with foreign exchange call options.[14] While the weaker złoty hurt households indebted in foreign currency, the concentration of such debt on upper middle-income households helped moderate the curbing impact on demand. At the same time, the larger domestic market (and thus a smaller share of exports in total final demand than in other countries of the region) dampened the knock-on effect of the foreign demand slump on Polish domestic demand. Infrastructure investment offset the contraction of other investment. Private consumption benefited from both annual employment and real wage growth remaining positive.

Although banks' lending conditions generally tightened, outstanding credit declined in exchange rate-adjusted terms only to the corporate sector (and not until April), while it continued expanding fairly strongly to households. Recent monthly indicators imply further GDP growth. In particular, sentiment indicators have improved, even if the majority of them is still pessimistic.

Excessive deficit in 2008 requires fiscal correction by 2012

Poland's ESA-95 budget deficit for 2008 amounted to 3.9% of GDP. The October 2009 fiscal notification showed an expected deficit for 2009 of 6.3% of GDP, while in November the European Commission forecast the deficit to reach 6.4% of GDP in 2009 and 7.5% in 2010. In its EDP recommendation of July 2009, the Ecofin took the current exceptional economic situation into account and required a correction "as rapidly as possible by 2012." Specifically, the authorities should implement the fiscal stimulus measures in 2009 as planned, while ensuring an average annual fiscal correction of at least 1.25 percentage points of GDP from 2010 onwards. In July, parliament passed a supplementary budget for 2009, and in its 2010 draft budget, the Polish government estimated the general government deficit to amount to 6% of GDP in 2009 and to 7% of GDP in the following year.

Monetary Policy Council sees inflation rather below than above target in the medium term

Annual inflation stood at 4.3% (HICP) and at 3.7% (national CPI) in August 2009, after its low of 3.2% (HICP) in January. This development was the result of the earlier sizeable currency depreciation (although some re-appreciation took place since March) and increases in food and regulated (mainly energy) prices. Taking into account low demand pressure and slower labor cost growth, the Polish Monetary Policy Council (MPC) reconfirmed its assessment that "the probability of inflation running below the inflation target (i.e. 2.5% of national CPI) in the medium term is higher than the probability of its running above the target." At end-June, the MPC lowered the key policy rate from 3.75% to 3.5% and cut the required reserve rates from 3.5% to 3%.

While the government has dropped its earlier target date to adopt the euro (2012) as a result of the economic crisis, the MPC maintained its view that Poland should join ERM II and the euro area at the earliest date possible after the necessary political support for the legal changes required for euro adoption has been secured.

[14] *See Focus on European Economic Integration Q2/09.*

Table 9

Main Economic Indicators: Poland

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.2	6.8	4.9	6.3	5.8	5.5	2.4	1.1	1.1
Private consumption	5.0	4.9	5.4	5.7	5.3	4.6	6.0	3.9	2.2
Public consumption	6.1	3.7	7.6	6.0	4.2	7.4	12.7	6.0	−1.3
Gross fixed capital formation	14.9	17.2	8.2	14.8	14.7	4.5	4.2	−0.0	−1.3
Exports of goods and services	14.6	9.1	7.2	10.3	11.1	8.3	−0.2	0.5	−14.0
Imports of goods and services	17.4	13.5	8.3	12.9	11.7	7.6	2.0	−7.1	−19.2
	Contribution to GDP growth in percentage points								
Domestic demand	7.6	9.2	5.6	7.9	6.6	5.5	3.0	−1.3	−2.0
Net exports of goods and services	−1.3	−2.1	−0.8	−1.5	−0.8	−0.1	−0.9	3.5	3.2
Exports of goods and services	5.2	3.5	2.8	4.1	4.4	3.3	−0.1	0.2	−5.8
Imports of goods and services	6.5	5.5	3.6	5.6	5.2	3.4	0.8	−3.3	−9.0
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	9.5	5.9	1.5	4.8	5.0	1.3	−4.7	−3.9	0.4
Gross average wage of industry (nominal)	5.2	8.7	9.7	10.4	11.2	10.1	7.4	5.1	3.3
Unit labor costs in industry (nominal)	−3.8	2.5	8.3	5.2	6.0	9.0	12.8	10.0	2.9
Producer price index (PPI) of industry	2.3	2.3	2.6	3.0	2.5	2.1	2.5	4.9	4.2
Consumer price index (here: HICP)	1.3	2.6	4.2	4.5	4.3	4.4	3.6	3.6	4.3
EUR per 1 PLN, + = PLN appreciation	3.3	3.0	7.6	8.7	11.6	14.5	−3.1	−20.6	−23.5
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	14.1	9.7	7.2	8.2	7.2	6.7	6.8	8.4	8.0
Employment rate (%, 15−64 years)	54.5	57.0	59.2	58.0	58.9	60.0	60.0	58.9	59.3
Key interest rate per annum (%)	4.1	4.4	5.7	5.3	5.8	6.0	5.8	4.4	3.7
PLN per 1 EUR	3.9	3.8	3.5	3.6	3.4	3.3	3.8	4.5	4.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	16.0	13.4	18.6	13.6	16.3	17.3	18.6	17.5	14.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−1.8	−9.0	−13.6	−12.1	−9.7	−10.6	−13.6	−9.3	−6.3
Domestic credit of the banking system	18.2	20.0	39.2	23.0	25.0	28.9	39.2	38.7	30.9
of which: claims on the private sector	16.0	22.5	30.1	23.3	22.8	23.6	30.1	29.7	23.1
claims on households	11.1	14.6	20.8	15.0	14.9	15.4	20.8	21.1	17.7
claims on enterprises	4.9	7.9	9.3	8.2	8.0	8.2	9.3	8.6	5.4
claims on the public sector (net)	2.2	−2.5	9.1	−0.3	2.1	5.3	9.1	9.0	7.8
Other assets (net) of the banking system	−0.5	2.4	−6.9	2.7	1.1	−0.9	−6.9	−11.9	−10.2
	% of GDP, ESA 95								
General government revenues	40.2	40.3	39.6	..	..	..	..	..	..
General government expenditures	43.9	42.2	43.3	..	..	..	..	..	..
General government balance	−3.6	−1.9	−3.6	..	..	..	..	..	..
Primary balance	−1.0	0.4	−1.4	..	..	..	..	..	..
Gross public debt	47.7	45.0	47.2	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	20.3	13.4	14.2	21.7	23.1	20.5	−6.2	−22.2	−24.8
Merchandise imports	23.9	19.5	17.2	24.1	26.2	23.9	−2.4	−28.2	−33.4
	% of GDP (based on EUR), period total								
Trade balance	−2.0	−4.0	−4.9	−4.3	−5.1	−4.7	−5.4	−1.1	−0.5
Services balance	0.2	1.1	1.0	0.7	1.0	0.7	1.5	1.2	1.3
Income balance (factor services balance)	−2.8	−3.8	−2.6	−2.8	−3.3	−2.3	−2.2	−2.3	−4.2
Current transfers	1.9	2.0	1.5	1.2	2.0	2.1	0.9	2.2	2.3
Current account balance	−2.7	−4.7	−5.1	−5.3	−5.6	−4.3	−5.2	−0.0	−1.2
Capital account balance	0.6	1.1	1.1	1.6	1.9	0.4	0.5	2.7	0.9
Foreign direct investment (net)	3.2	4.2	2.2	3.8	2.2	0.9	2.1	1.9	2.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	47.3	50.8	47.4	52.2	53.2	51.4	47.7	48.7	53.4
Gross official reserves (excluding gold)	12.9	13.7	11.6	14.4	14.7	13.8	11.6	12.6	13.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.7	3.8	3.2	3.9	4.0	3.7	3.2	3.5	4.0
	EUR million, period total								
GDP at current prices	272,199	311,669	362,137	83,341	91,139	94,984	92,673	69,911	73,364

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

8 Romania: Deep Recession, Reduced External Imbalances, Painful Adjustment

Deep recession and increasing unemployment

After growth had stopped abruptly in the fourth quarter of 2008, real GDP contracted by 7.6% in the first half of 2009. However, the speed of the downturn decelerated in the second quarter, as GDP fell by 1.1% in quarter-on-quarter terms compared to 4.6% in the previous quarter. The recession has been associated with a substantial shift in the composition of growth, as domestic demand collapsed and the contribution of net exports turned positive, with imports declining more strongly than exports. The impact of the crisis on the real economy is also beginning to be reflected in rising unemployment. The unemployment rate increased to 6.6% in the second quarter 2009 from 5.9% in the second quarter 2008.

The output gap – which has turned strongly negative – has helped reduce inflation to 4.9% in August 2009 from 8.1% a year earlier. Against this background, and in view of the stabilization of the Romanian leu in recent months, Banca Națională a României has cut its key policy rate five times since February 2009 and by a total of 225 basis points to now 8%. According to its latest inflation report, the central bank expects inflation to decline to 4.3% by end-2009 and to decrease further to 2.6% by end-2010 (and thus to the lower end of its target range of 3.5% +/–1 percentage point).

External imbalances are shrinking

Against the backdrop of collapsing domestic demand, external imbalances declined markedly in the first half of 2009. However, the depreciation of the leu (which had lost almost 35% against the euro since mid-2007, but remained roughly stable during the review period) may as well have helped to improve external accounts. Supported by both exchange rate and productivity developments, unit labor costs in industry (measured in euro) have also developed favorably in recent quarters (–7.5% year on year in the second quarter of 2009, compared to +14.5% year on year in the euro area). Mainly due to a shrinking trade deficit, the current account deficit contracted by almost three quarters from January to July 2009 period-on-period. It is also noteworthy that net FDI inflows fully covered the current account gap in this period (while only having covered half of the deficit in 2008). International reserves stood at EUR 28.3 billion by end-September 2009, up 14% from end-April. Disbursements made under the IMF/EU financial support package and easing pressures on the exchange rate explain this development.

IMF/EU program so far on track, but increasing implementation risks

At the end of September 2009 the IMF completed the first review under Romania's stand-by arrangement (which is part of a multilateral financial support package totaling EUR 20 billion, including funds from the IMF, the EU, the World Bank and the EBRD). So far, implementation has been appropriate, which enabled the disbursement of the second tranche of the IMF loan (EUR 1.85 billion). Half of it went into foreign exchange reserves, the other half into financing the budget deficit. During the review period, the budget deficit target for 2009 was revised to 7.3% of GDP (from 4.6%) and the one for 2010 to 5.9% of GDP (from 3.6%), since the economic contraction turned out to be sharper than expected. As regards the further implementation of the IMF/EU support package, fiscal policy is the main concern, i.e. the achievement of the revised budget deficit target for 2009 and a budget plan for 2010 that is in line with the program. Further efforts in this area might be hampered by political developments (collapse of the ruling coalition, upcoming presidential elections). A particular bone of contention is the harmonization of wage schemes in the public sector.

Table 10

Main Economic Indicators: Romania

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	7.9	6.2	7.1	8.2	9.3	9.2	2.9	−6.2	−8.7
Private consumption	12.8	11.6	9.1	15.5	13.4	16.0	−4.5	−12.2	−14.9
Public consumption	−3.8	1.2	3.1	5.4	−0.8	4.2	3.9	3.0	1.0
Gross fixed capital formation	19.9	28.9	19.3	33.2	30.0	24.3	2.8	−0.3	−25.6
Exports of goods and services	9.8	7.8	18.9	25.8	30.7	21.1	−0.2	−20.8	−12.0
Imports of goods and services	22.7	27.8	17.1	35.1	28.8	19.5	−10.4	−33.3	−27.9
	Contribution to GDP growth in percentage points								
Domestic demand	15.3	17.8	12.0	21.6	21.9	14.0	−2.6	−14.1	−24.1
Net exports of goods and services	−10.2	−16.6	−6.3	−19.6	−13.4	−7.7	7.7	27.0	25.1
Exports of goods and services	4.3	3.5	8.5	15.4	14.7	8.8	−0.1	−14.4	−6.8
Imports of goods and services	14.4	20.1	14.9	35.0	28.0	16.4	−7.8	−41.4	−31.9
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	11.3	9.4	4.9	8.8	10.3	6.7	−5.4	−4.2	2.8
Gross average wage of industry (nominal)	15.7	21.6	21.3	18.5	24.5	23.3	18.8	15.7	8.9
Unit labor costs in industry (nominal)	4.1	11.2	16.4	9.1	12.5	15.6	27.4	21.5	6.2
Producer price index (PPI) of industry	11.6	8.1	15.9	14.4	17.2	19.7	12.1	5.7	1.4
Consumer price index (here: HICP)	6.6	4.9	7.9	8.0	8.6	8.2	6.9	6.8	6.1
EUR per 1 RON, + = RON appreciation	2.8	5.6	−9.4	−8.4	−10.2	−9.5	−9.5	−13.6	−13.0
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	7.6	6.7	6.1	6.6	5.9	5.7	6.1	7.2	6.6
Employment rate (%, 15−64 years)	58.8	58.8	59.1	57.7	59.7	60.5	58.3	57.4	59.2
Key interest rate per annum (%)	8.5	7.5	9.7	8.6	9.7	10.2	10.3	10.1	9.7
RON per 1 EUR	3.5	3.3	3.7	3.7	3.7	3.6	3.8	4.3	4.2
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	28.1	33.7	17.5	34.8	38.9	31.1	17.5	15.4	11.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	−3.2	−8.7	−10.8	−9.8	−12.7	−12.9	−10.8	−7.4	−4.6
Domestic credit of the banking system	30.4	55.9	41.5	59.7	65.6	58.9	41.5	38.7	29.5
of which: claims on the private sector	37.7	51.2	33.7	58.6	59.8	51.5	33.7	25.0	12.2
claims on households	20.7	29.1	18.7	32.3	32.6	28.1	18.7	14.2	7.8
claims on enterprises	17.0	22.1	15.0	26.3	27.2	23.4	15.0	10.8	4.4
claims on the public sector (net)	−7.3	4.7	7.8	1.1	5.8	7.4	7.8	13.7	17.3
Other assets (net) of the banking system	0.9	−13.6	−13.3	−15.1	−14.0	−14.8	−13.3	−15.9	−13.2
	% of GDP, ESA 95								
General government revenues	33.1	33.5	32.8	..	..	..	..	..	..
General government expenditures	35.3	36.0	38.4	..	..	..	..	..	..
General government balance	−2.2	−2.5	−5.5	..	..	..	..	..	..
Primary balance	−1.3	−1.8	−4.8	..	..	..	..	..	..
Gross public debt	12.4	12.6	13.6	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	15.3	14.8	13.9	16.0	23.7	19.6	−2.3	−19.2	−21.6
Merchandise imports	24.3	26.5	9.8	16.0	19.7	18.1	−10.8	−34.6	−38.3
	% of GDP (based on EUR), period total								
Trade balance	−12.0	−14.4	−13.4	−16.5	−15.6	−13.0	−10.3	−6.2	−5.9
Services balance	0.0	0.4	0.6	0.7	0.7	0.0	1.1	−0.4	0.2
Income balance (factor services balance)	−3.3	−3.4	−3.9	−5.0	−4.7	−3.6	−2.8	−2.9	−3.2
Current transfers	5.0	3.9	4.5	5.7	4.3	5.5	3.1	5.4	3.5
Current account balance	−10.3	−13.5	−12.1	−15.1	−15.4	−11.1	−8.9	−4.2	−5.5
Capital account balance	−0.0	0.7	0.4	0.6	0.5	0.1	0.6	0.0	0.1
Foreign direct investment (net)	8.9	5.7	6.7	7.7	10.1	5.6	4.5	8.6	3.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	42.1	47.3	53.7	48.2	51.2	52.6	53.7	53.2	58.4
Gross official reserves (excluding gold)	21.8	20.4	19.2	19.9	19.1	19.4	19.2	18.7	20.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.9	5.6	5.3	5.4	5.1	5.1	5.3	5.4	6.3
	EUR million, period total								
GDP at current prices	97,931	123,660	136,661	24,705	31,509	38,673	41,774	22,614	26,197

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

9 Croatia: Financial Crisis Leads to Financing Strains in Early 2009

Economic downturn in full swing

After a gradual slowdown in growth over the course of 2008, the spillovers of the global crisis fully hit Croatia in the first half of 2009. Mostly due to a slump in domestic demand, GDP contracted by 6.5% year on year during this period. Private consumption fell by some 10% on the back of waning consumer confidence, tightening credit conditions, fiscal adjustments and deteriorating labor market conditions. Similarly, investment activity plummeted by 12.5% due to a downturn in construction activity, a slowdown in FDI inflows and corporations' more limited access to (foreign) funding. The reduction in inventories was also pronounced, so that overall domestic demand accounted for a strong negative contribution of 13 percentage points to GDP in the first half of 2009. In light of subdued external demand and lower (but better-than-expected) tourism revenues, exports in goods and services declined by 17% year on year in the first half of 2009, while imports plunged by a marked 23%. Thus, the contribution of net exports to GDP growth was strongly positive in the first six months of 2009.

Rapidly narrowing external imbalances, temporary financing strains in the first quarter of 2009

Against this backdrop, Croatia's external imbalances narrowed considerably in the first half of 2009, with the current account deficit reaching 6% of GDP on a rolling four-quarter basis (first half of 2008: 9.3%). At the same time, net FDI inflows to Croatia slowed markedly too, covering only a third of the deficit. Financing needs were especially high in the first quarter of 2009, when the limited access to foreign funds, portfolio investment outflows and more moderate FDI inflows were reflected in decreasing foreign exchange reserves. Against the background of gradually softening global liquidity conditions, financing pressures eased in the second quarter of 2009, and Croatia's foreign debt increased by EUR 1.5 billion, reaching EUR 40.8 billion or 87.6% of rolling four-quarter GDP (first half of 2008: 78% of GDP). At the same time, reserve accumulation resumed and by June 2009 foreign exchange reserves again reached their end-2008 levels.

HNB safeguards financial stability

In view of declining inflation, Hrvatska narodna banka's (HNB) main focus remained on safeguarding the exchange rate and ensuring financial stability. After downward pressures in the first quarter of 2009, the kuna strengthened in the second and third quarter of 2009 on the back of improving global investor sentiment and seasonal factors (tourism). More recently, the HNB even intervened on foreign exchange markets against the kuna to prevent a more marked appreciation.

Despite being highly capitalized, the banking sector has lost its strong momentum of previous years. In fact, credit growth decelerated sharply over the first half of 2009. In contrast to other countries, the slowdown was particularly pronounced in the retail and less so in the corporate segment. At the same time, lending to government picked up considerably (+74% year on year in June 2009).

Coping with fiscal challenges

The government adopted a set of anti-recession measures, including the revision of the 2009 budget. On the back of plummeting revenues, the budget was adjusted already three times this year, including expenditure cuts and revenue boosting measures, such as the introduction of a temporary "crisis tax" and the increase of the main VAT rate from 22% to 23%. Given the severity of the economic downturn, Croatia's deficit is nevertheless expected to reach 2.8% of GDP in 2009 (original target: 0.9%). In early 2009, the government took out a EUR 1 billion loan from domestic banks, and in May it issued a eurobond of EUR 750 million in order to finance its deficit and refinance maturing public debt. Another bond issue in the final quarter of 2009 is currently being considered.

Table 11

Main Economic Indicators: Croatia

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	4.7	5.5	2.4	4.3	3.4	1.6	0.2	−6.7	−6.3
Private consumption	3.5	6.2	0.8	4.2	2.3	0.4	−3.2	−9.9	−9.4
Public consumption	2.2	3.4	1.9	0.5	3.2	1.3	2.7	3.9	1.2
Gross fixed capital formation	10.9	6.5	8.2	9.8	12.6	6.6	3.5	−12.4	−12.7
Exports of goods and services	6.5	4.3	1.7	3.6	4.4	1.6	−2.5	−14.2	−19.8
Imports of goods and services	7.4	6.5	3.6	7.1	8.3	6.5	−7.1	−20.9	−24.7
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	7.1	3.5	6.9	6.2	3.9	−2.7	−13.1	−12.4
Net exports of goods and services	−1.2	−1.7	−1.3	−2.7	−3.1	−2.5	3.3	7.1	7.0
Exports of goods and services	2.9	2.0	0.8	1.3	1.9	1.0	−1.0	−4.9	−8.4
Imports of goods and services	4.1	3.7	2.1	4.0	4.9	3.5	−4.3	−12.0	−15.4
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	2.5	2.4	1.1	3.3	3.2	−0.2	−1.6	0.9	4.5
Gross average wage of industry (nominal)	7.5	5.5	7.2	7.6	7.2	7.1	6.9	0.4	0.4
Unit labor costs in industry (nominal)	4.6	3.1	6.0	4.1	3.8	7.5	8.8	0.0	−3.8
Producer price index (PPI) of industry	2.9	3.4	8.5	7.5	8.7	11.1	6.7	1.2	−0.6
Consumer price index (here: CPI)	3.2	2.9	6.1	5.9	6.6	7.4	4.5	3.8	2.9
EUR per 1 HRK, + = HRK appreciation	1.1	−0.2	1.6	1.1	1.3	1.8	2.1	−1.7	−1.4
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	11.5	9.8	8.6	10.2	8.1	7.1	9.0	9.7	9.1
Employment rate (%, 15−64 years)	55.7	57.2	57.8	56.0	57.6	59.7	57.8	56.5	56.5
Key interest rate per annum (%)	4.5	4.5	9.0	8.9	9.0	9.0	9.0	9.0	9.0
HRK per 1 EUR	7.3	7.3	7.2	7.3	7.3	7.2	7.2	7.4	7.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	18.0	18.3	4.3	14.4	11.1	14.7	4.3	3.3	1.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	2.8	12.0	−3.6	7.8	6.9	5.0	−3.6	−8.0	−7.1
Domestic credit of the banking system	20.6	14.1	13.2	11.8	9.7	9.0	13.2	15.7	11.2
of which: claims on the private sector	22.0	14.9	10.3	12.6	10.6	11.3	10.3	9.4	5.0
claims on households	11.1	9.4	6.3	8.9	8.0	6.1	6.3	4.6	1.7
claims on enterprises	11.0	5.5	4.0	3.7	2.7	5.2	4.0	4.8	3.3
claims on the public sector (net)	−1.4	−0.8	2.9	−0.8	−0.9	−2.3	2.9	6.3	6.2
Other assets (net) of the banking system	−5.4	−7.8	−5.4	−5.2	−5.5	0.8	−5.4	−4.4	−3.0
	% of GDP, ESA 95								
General government revenues	24.4	25.3	24.5	..	..	..	..	..	..
General government expenditures	27.3	27.8	25.8	..	..	..	..	..	..
General government balance	−3.0	−2.5	1.4	..	..	..	..	..	..
Primary balance	−1.0	−0.7	0.1	..	..	..	..	..	..
Gross public debt	35.7	33.1	33.5	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	17.2	8.6	6.0	8.8	8.0	13.4	−5.2	−13.7	−23.9
Merchandise imports	14.0	10.8	10.7	14.0	15.9	15.9	−2.0	−23.9	−30.6
	% of GDP (based on EUR), period total								
Trade balance	−21.3	−22.0	−22.9	−23.7	−26.0	−21.0	−21.4	−16.5	−17.3
Services balance	14.6	14.6	14.7	1.0	15.0	35.3	4.1	1.2	11.8
Income balance (factor services balance)	−3.0	−2.6	−3.4	−2.8	−6.7	−2.0	−2.0	−4.0	−4.9
Current transfers	2.8	2.4	2.2	2.0	2.3	2.1	2.3	1.9	2.6
Current account balance	−6.9	−7.6	−9.4	−23.4	−15.4	14.3	−16.8	−17.3	−7.8
Capital account balance	−0.3	0.1	0.1	0.0	0.1	0.1	0.1	0.0	0.1
Foreign direct investment (net)	6.5	8.1	6.8	10.1	7.2	2.3	8.3	3.9	3.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	74.9	75.7	82.6	79.5	78.3	77.9	82.6	83.4	87.6
Gross official reserves (excluding gold)	22.3	21.7	19.3	22.4	22.0	21.1	19.3	18.9	19.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.3	5.2	4.6	5.3	5.2	4.9	4.6	4.7	5.3
	EUR million, period total								
GDP at current prices	39,098	42,831	47,372	10,853	11,974	13,012	11,533	10,506	11,510

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

10 Turkey: Sizeable Output Contraction Dampened by Stimulus Measures

Private demand responds strongly to temporary tax cuts

In the first two quarters of 2009, GDP continued to decline considerably in annual terms. The trough was reached in the first quarter, however; seasonally and working-day adjusted GDP rose sharply in the second quarter of 2009 (+7.1% quarter on quarter). Consumer spending responded strongly to a stimulus package in the order of 2.9% of GDP (including measures taken until April 2009), which included temporary tax cuts (to expire in October and totaling 0.7% of GDP). Investment activity remained weak. Private sector machinery and equipment investment decreased further quarter on quarter due to continued low capacity utilization rates and uncertainties over prospective aggregate demand developments. Still, capacity utilization recovered from its record low in January (63.8%) up to 72.3% in July, but is expected to remain below potential for some time to come. Public consumption made a noticeably positive contribution to GDP dynamics in the first quarter, however, this was not sustained in the second quarter. With imports collapsing more than exports in the first quarter, net exports showed a strong positive contribution in this period and continued to support GDP dynamics, although their contribution was substantially lower in the second quarter.

Historically low inflation allowed continued monetary easing

Two-thirds of the stimulus measures (1.8 percentage points) directly affect the budget. Turkey's support package is relatively large compared to the CESEE region, but small within the OECD. The Turkish banking sector, which is characterized by a diversified asset structure and a comparatively small share of loans to the private sector, required only limited support during the financial crisis. Its profitability rose strongly in 2009 on the back of increased holdings of government treasuries, the flip side of which is manifested in soaring public sector net credit, which has predominantly been financed by issuing new treasury bonds directly to the domestic banking sector. This development has further compounded the downward trend in loan growth to the private sector, reaching a low of +4% year on year in June, compared to 30% year on year during 2008. The government expects Turkey's budget deficit to peak at 6.6% of GDP in 2009 and to decline thereafter, following the implementation of a more rule-based fiscal policy which aims at stabilizing the public debt-to-GDP ratio in 2010 and 2011.

On the basis of the expectation of a weak economy and therefore low inflation rates, the Turkish central bank continued its monetary easing cycle by further reducing the lending rate down to 7.25% or by 275 basis points in five consecutive steps between March and September 2009. The central bank has announced to maintain its accommodating policy stance composed of rate cuts and the provision of liquidity to the markets, which it would change in case of an unexpectedly strong recovery. The year-end inflation target of 7.5% is well within reach for 2009, inflation stood at 5.3% year on year in August.

IMF stand-by agreement still under negotiation

Talks on a new stand-by agreement are ongoing with the IMF, but a swift completion seems unlikely at the moment. The uncertainty concerning the IMF negotiations and global financial conditions have caused rather high volatility of the exchange rate around the level of TRY/EUR 2.1 during the review period. Between January and July 2009, the current account deficit narrowed by almost 80% period on period, owing mainly to an improvement in the trade balance, as imports fell more strongly than exports. Also, FDI inflows (net) declined substantially, partly due to reduced purchases of real estate by foreigners.

Table 12

Main Economic Indicators: Turkey

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.9	4.7	0.9	7.2	2.8	1.0	−6.5	−14.3	−7.0
Private consumption	4.6	4.6	0.8	6.6	1.9	−0.5	−4.5	−10.2	−1.2
Public consumption	8.4	6.5	1.9	5.5	−3.4	2.6	3.4	5.2	0.5
Gross fixed capital formation	13.3	5.4	−7.1	6.1	−2.9	−9.7	−19.4	−27.5	−24.6
Exports of goods and services	6.6	7.3	2.3	13.0	3.6	3.0	−8.5	−11.2	−10.1
Imports of goods and services	6.9	10.7	−3.8	13.9	1.6	−3.5	−23.7	−31.3	−20.5
	Contribution to GDP growth in percentage points								
Domestic demand	7.1	5.9	−0.7	8.1	2.3	−0.7	−11.1	−20.3	−9.9
Net exports of goods and services	−0.4	−1.4	1.7	−1.1	0.4	1.7	5.4	7.0	3.8
Exports of goods and services	1.5	1.7	0.5	3.0	0.8	0.7	−2.1	−2.7	−2.4
Imports of goods and services	1.9	3.0	−1.1	4.1	0.5	−1.0	−7.4	−9.7	−6.2
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	6.2	2.7	−0.5	4.6	2.1	−0.5	−8.0	−14.6	−5.0
Gross average wage of industry (nominal)	11.5	9.6	..	11.1	10.1	11.1	..	..	..
Unit labor costs in industry (nominal)	5.1	6.6	..	6.2	7.8	11.6	..	..	..
Producer price index (PPI) of industry	9.7	6.0	13.0	6.7	15.6	16.2	13.3	7.8	−1.8
Consumer price index (here: HICP)	9.3	8.8	10.4	8.8	10.3	11.7	10.9	8.4	5.7
EUR per 1 TRY, + = TRY appreciation	−7.2	1.1	−6.3	2.2	−8.4	−2.9	−14.9	−16.3	−7.9
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	8.6	8.7	9.6	10.5	8.0	8.9	11.1	14.5	12.5
Employment rate (%, 15−64 years)	45.9	45.8	45.9	43.3	47.4	47.7	45.2	41.4	44.7
Key interest rate per annum (%)	15.6	17.2	16.0	15.4	15.6	16.7	16.4	12.6	9.6
TRY per 1 EUR	1.8	1.8	1.9	1.8	2.0	1.8	2.0	2.2	2.1
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	22.2	15.3	24.7	21.8	16.8	20.5	24.7	19.0	18.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	10.3	3.0	6.4	1.4	−0.6	−0.2	6.4	7.1	5.8
Domestic credit of the banking system	17.0	20.5	19.7	25.2	22.8	23.7	19.7	15.5	17.4
of which: claims on the private sector	20.0	18.2	15.3	21.8	23.6	23.0	15.3	8.1	5.1
claims on households	8.5	6.7	6.2	9.0	9.1	9.1	6.2	3.6	2.6
claims on enterprises	11.4	11.5	9.1	12.8	14.5	13.8	9.1	4.6	2.5
claims on the public sector (net)	−3.0	2.3	4.3	3.3	−0.8	0.7	4.3	7.3	12.3
Other assets (net) of the banking system	−5.1	−8.3	−1.4	−4.8	−5.4	−2.9	−1.4	−3.6	−5.0
	% of GDP, ESA 95								
General government revenues	22.5	19.6	19.3	..	..	..	..	..	..
General government expenditures	21.4	20.6	21.5	..	..	..	..	..	..
General government balance	1.2	−1.0	−2.2	..	..	..	..	..	..
Primary balance	7.2	4.4	2.7	..	..	..	..	..	..
Gross public debt	46.1	39.4	39.5	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	17.8	12.9	13.8	23.3	13.3	24.6	−3.6	−14.5	−23.0
Merchandise imports	19.1	10.3	11.1	22.2	17.0	19.7	−11.6	−33.3	−32.6
	% of GDP (based on EUR), period total								
Trade balance	−7.8	−7.2	−7.1	−6.8	−8.8	−7.4	−5.2	−1.0	−4.6
Services balance	2.6	2.1	2.4	0.7	1.8	4.3	2.3	0.9	2.2
Income balance (factor services balance)	−1.3	−1.1	−1.1	−1.1	−1.3	−0.8	−1.2	−1.6	−1.5
Current transfers	0.4	0.3	0.3	0.3	0.2	0.3	0.3	0.4	0.3
Current account balance	−6.1	−5.8	−5.5	−6.9	−8.2	−3.6	−3.7	−1.4	−3.5
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)	3.6	3.1	2.1	2.1	2.5	1.6	2.5	1.6	1.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	39.9	38.0	39.8	34.2	36.4	39.7	39.8	41.8	41.1
Gross official reserves (excluding gold)	11.1	10.5	10.2	9.9	9.6	10.6	10.2	10.6	10.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.8	4.6	4.3	4.3	4.1	4.4	4.3	4.6	4.6
	EUR million, period total								
GDP at current prices	418,088	472,996	499,703	119,518	121,436	143,890	114,859	96,803	106,874

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

11 Russia: Deep Contraction, Turning Point Reached?

While GDP dropped sharply in the first half of 2009, there are some signs of an incipient turnaround

Russia will experience a major economic contraction in 2009. GDP dropped by 10.4% year on year in the first half of 2009, pushed by shrinking domestic demand – particularly by plummeting gross fixed capital formation (–18.9% between January and August) – and by an even stronger drawdown of inventories. However, measured on a quarter on quarter basis, GDP may have bottomed out in the spring and summer of 2009. After economic activity had fallen by around 9% in the first quarter of 2009 (quarter on quarter), it stabilized in the second quarter. Monthly estimated GDP has been on the rise since May. While enterprise profitability took a dive in late 2008 and early 2009, profits recovered in the spring of 2009. After spiking in February (9.5%), unemployment rates have fallen again (July: 8.3%). In contrast, credit to the private sector remains subdued and the share of nonperforming loans continues to expand (end-June: 7.6%).

… supported by a partial recovery of the oil price, a weakening of capital outflows and major fiscal stimulus

Economic stabilization has been supported by the partial recovery of the oil price and by the weakening of capital outflows from the private sector in recent months. The second quarter even saw modest net capital inflows. Cyclical support has also come from fiscal policy: While the original federal budget plan (passed in October 2008, oil price assumption USD 95 per barrel) had aimed at a surplus of 3.5% of GDP, the amended budget (April 2009, oil price: USD 41) provides for a deficit of 7.4% of GDP: Revenues are expected to shrink by 5.7% of GDP, expenditures to increase by 5.8% of GDP, compared to the budget execution in 2008. Between January and August 2009, the actual federal budget shortfall came to 4.7% of pro-rata GDP. The deficit has largely been financed by the Reserve Fund, which decreased from EUR 97.2 billion at end-2008 to EUR 59.8 billion eight months later. At end-August 2009, the National Wealth Fund still stood at a near-record level of EUR 63.2 billion.

Fragile financial stabilization

Owing to oil price developments and the global recession, Russia's combined current and capital account surplus declined to 3.2% of GDP in the first half of 2009 (first half of 2008: 8.1% of GDP). While Russia's gross external debt came to EUR 339.6 billion in mid-2009, and thus had hardly changed in absolute terms since end-2008, its ratio to total GDP rose by about 3 percentage points to 33.5%, given the country's deep slump and the depreciation of the ruble. The partial recovery of the oil price in recent months contributed to a fragile stabilization of the country's foreign exchange reserves, which came to EUR 281 billion at end-September 2009. The ruble's nominal effective exchange rate stabilized at its depreciated level in February (–18% against August 2008) and has in fact slightly appreciated since; however, its real effective exchange rate is strengthening and approaching its pre-crisis level.

Accommodative monetary policy

This is because of persisting, if slightly weakening, double-digit inflation (11.6% in August 2009 year on year), which has partly been the outcome of the ruble's slide itself, partly driven by accommodative fiscal and monetary policies. Given the petering out of devaluation effects, decelerating wage growth in industry, and the sizable output gap, the Russian central bank expects inflation to further level off. Therefore, and to support the economic recovery and overcome the credit crunch, the monetary authority has cut the refinancing rate in several steps by a total of 2.5 percentage points since April. As at early October, this key rate stood at 10.0%.

Table 13

Main Economic Indicators: Russia

	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09
	Year-on-year change of the period total in %								
GDP at constant prices	7.7	8.1	5.7	8.7	7.5	6.0	1.2	−9.8	−10.9
Private consumption	11.2	13.6	11.2	12.0	13.3	12.1	7.9	−3.2	−7.0
Public consumption	2.4	3.4	2.4	2.6	2.3	2.5	2.4	1.3	2.0
Gross fixed capital formation	18.1	21.1	9.9	23.5	17.4	12.1	−2.0	−16.3	−21.7
Exports of goods and services	7.3	6.4	0.1	9.8	0.3	2.0	−8.7	−14.5	−8.9
Imports of goods and services	21.4	26.5	14.5	20.9	19.4	21.5	0.9	−34.3	−37.9
	Contribution to GDP growth in percentage points								
Domestic demand	10.5	13.1	10.0	10.8	13.6	11.5	4.5	−13.5	−20.2
Net exports of goods and services	−5.1	−9.1	−7.8	−5.6	−10.1	−9.9	−5.4	11.9	18.2
Exports of goods and services	3.7	3.2	0.1	4.9	0.1	0.9	−4.8	−7.4	−4.1
Imports of goods and services	8.8	12.3	7.9	10.6	10.3	10.8	0.6	−19.3	−22.3
	Year-on-year change of the period average in %								
Labor productivity of industry (real)	10.1	4.6	3.1	5.9	5.5	5.4	−3.7	−7.0	−6.7
Gross average wage of industry (nominal)	21.4	26.0	24.0	28.1	28.1	26.6	15.1	5.4	2.2
Unit labor costs in industry (nominal)	10.2	20.4	20.6	20.9	21.4	20.2	19.9	13.6	9.5
Producer price index (PPI) of industry	12.5	14.0	21.8	25.7	26.4	30.2	4.9	−8.3	−10.1
Consumer price index (here: CPI)	9.8	9.1	14.1	12.8	14.8	14.9	13.8	13.9	12.6
EUR per 1 RUB, + = RUB appreciation	3.4	−2.6	−3.9	−5.1	−5.6	−4.0	−0.9	−18.2	−15.7
	Period average levels								
Unemployment rate (ILO definition, %, 15−64 years)	7.2	6.2	6.4	6.8	5.6	5.9	7.1	9.1	8.6
Employment rate (%, 15−64 years)	..	..	..	..	..	..	..	..	..
Key interest rate per annum (%)	11.6	10.3	10.9	10.2	10.5	11.0	11.9	13.0	12.2
RUB per 1 EUR	34.1	35.0	36.4	36.3	36.9	36.5	36.0	44.4	43.8
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	40.6	44.2	14.6	36.9	32.4	26.5	14.6	9.3	7.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	27.9	30.0	15.7	24.0	21.3	25.5	15.7	15.7	11.1
Domestic credit of the banking system	18.5	24.9	15.8	24.2	20.2	14.5	15.8	12.5	14.5
of which: claims on the private sector	40.3	42.6	33.5	43.1	40.8	39.1	33.5	28.8	16.3
claims on households	12.2	11.6	7.6	11.5	11.3	11.5	7.6	4.7	0.5
claims on enterprises	28.0	31.0	26.0	31.7	29.5	27.6	26.0	24.1	15.8
claims on the public sector (net)	−21.7	−17.7	−17.7	−18.9	−20.6	−24.5	−17.7	−16.2	−1.8
Other assets (net) of the banking system	−5.9	−10.7	−16.9	−11.3	−9.1	−13.5	−16.9	−18.9	−18.6
	% of GDP, ESA 95								
General government revenues	39.5	40.4	38.4	..	..	..	..	..	..
General government expenditures	31.1	34.4	33.6	..	..	..	..	..	..
General government balance	8.4	6.0	4.8	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	8.6	7.2	5.7	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	22.6	6.7	24.2	34.4	30.5	39.5	−1.6	−40.1	−38.2
Merchandise imports	28.5	24.6	22.7	23.2	23.4	29.7	15.7	−26.8	−33.3
	% of GDP (based on EUR), period total								
Trade balance	14.1	10.1	10.6	13.6	11.9	11.2	6.2	7.7	8.4
Services balance	−1.4	−1.5	−1.5	−1.3	−1.5	−1.8	−1.4	−1.6	−1.5
Income balance (factor services balance)	−3.0	−2.4	−2.9	−1.8	−4.3	−3.0	−2.4	−2.1	−4.2
Current transfers	−0.2	−0.3	−0.2	−0.2	−0.0	−0.2	−0.3	−0.2	−0.0
Current account balance	9.6	5.9	6.0	10.4	6.1	6.2	2.1	3.8	2.6
Capital account balance	0.0	−0.8	0.0	−0.0	0.1	0.0	0.0	0.1	0.1
Foreign direct investment (net)	0.7	0.7	1.2	1.4	1.5	1.1	0.8	−1.6	−0.5
	% of GDP (rolling four-quarter GDP. based on EUR), end of period								
Gross external debt	30.2	33.9	30.2	30.9	32.5	34.5	30.2	30.8	32.8
Gross official reserves (excluding gold)	28.5	33.6	25.9	31.8	33.7	34.1	25.9	25.4	27.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	16.2	18.5	14.2	17.7	18.7	18.9	14.2	13.8	15.1
	EUR million, period total								
GDP at current prices	788,447	944,159	1143,675	244,751	276,185	319,041	303,698	191,007	212,969

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