Recent Economic Developments

Developments in Selected CESEE Countries:

After the Drought – Tentative Economic Stabilization in the CESEE Region[1,2,3,4]

1 Introduction

Moderate improvement in economic dynamics since the third quarter of 2009 …

After suffering an economic slump in early 2009, the Central, Eastern and South-eastern European (CESEE) region entered a period of stabilization in the second half of the year as external demand recovered and the inventory cycle started to turn. Despite remaining in negative territory throughout most of the region, annual GDP growth rates have been improving markedly since the second and third quarters of 2009. The most severe downturn in economic activity since the early stages of transition therefore seems to have come to an end.

Annual average growth in the region under review improved from –7.7% in the second quarter of 2009 to –1.2% in the fourth quarter. Hence, the recovery was more pronounced than in the euro area. Although the regional aggregate was strongly influenced by the positive readings in Russia and Turkey, the two biggest economies of the region, the trend of improving economic dynamics was broadly based and encompassed all countries except Bulgaria. Poland and Turkey posted positive annual growth in the final quarter of 2009; in the latter country, however, this is partly the result of the weak base of a year earlier.

Table 1

Real Gross Domestic Product

	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Annual change in % (not seasonally adjusted)							
Slovakia	6.2	–4.7	6.8	1.6	–5.7	–5.5	–4.9	–2.6
Slovenia	3.5	–7.8	3.6	–0.8	–8.2	–9.2	–8.3	–5.5
Bulgaria	6.0	–5.0	6.8	3.5	–3.5	–4.9	–5.4	–5.9
Czech Republic	2.5	–4.2	3.4	–0.1	–3.9	–5.2	–5.0	–2.8
Hungary	0.6	–6.3	1.4	–2.5	–6.7	–7.5	–7.1	–4.0
Poland	5.0	1.7	5.5	2.6	0.9	1.2	1.2	3.3
Romania	7.3	–7.1	9.4	3.1	–6.2	–8.7	–7.1	–6.5
CESEE-7 average	4.5	–2.8	5.2	1.5	–2.5	–3.2	–3.0	–0.8
Croatia	2.4	–5.8	1.6	0.2	–6.7	–6.3	–5.7	–4.5
Turkey	0.7	–4.7	0.9	–7.0	–14.5	–7.7	–2.9	6.0
Russia	5.6	–7.8	6.6	0.0	–9.4	–10.8	–7.7	–3.8
Euro area	0.6	–4.1	0.7	–1.8	–5.2	–5.5	–3.8	–1.7

Source: Eurostat, national statistical offices.

[1] *Compiled by Josef Schreiner with input from Stephan Barisitz, Markus Eller, Jarko Fidrmuc, Sándor Gardó, Mathias Lahnsteiner, Thomas Reininger, Tomáš Slačík, Zoltan Walko and Julia Wörz.*

[2] *Cutoff date: March 31, 2010 (April 22 for fiscal data). This report primarily focuses on data releases and developments from October 2009 up to the cutoff date, while selectively recalling earlier developments wherever necessary to put recent developments into perspective.*

[3] *This report covers Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia as well as Croatia, Turkey and Russia. In terms of GDP at PPP, the region's economic output breaks down as follows: Bulgaria 2%, the Czech Republic 5%, Hungary 4%, Poland 13%, Romania 6%, Slovakia 2%, Slovenia 1%, Croatia 2%, Turkey 19% and Russia 46%.*

[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.*

The favorable momentum becomes more visible when looking at quarterly changes of seasonally adjusted GDP figures: According to these data, Slovakia, Slovenia, the Czech Republic, Poland, Turkey and Russia reported positive growth in the fourth quarter. No comparable data are available for Bulgaria and Croatia.

…driven mainly by an uptick in external demand…

The economic cycle changed course mainly because global economic and financial conditions improved, which fostered external demand. World trade expanded again as of May 2009, and quarter-on-quarter growth in the euro area (the major trading partner of the region) turned positive in the third quarter. These improvements in the international environment are clearly visible in the development of GDP components throughout the region, where positive growth impulses originated mainly from the external sector. While in the early stages of the crisis, the external sector propped up growth primarily because imports shrank more strongly than exports, the export performance clearly improved in the second half of 2009 and positive growth rates were reported for many countries in the fourth quarter, among them the Czech Republic, Hungary, Bulgaria, Romania and Russia. At the same time, import demand also increased somewhat, in part driven by stronger exports due to the comparatively high import content of exports in CESEE, but generally remained depressed, as domestic (especially investment) demand stayed weak.

…and a turn in the inventory cycle

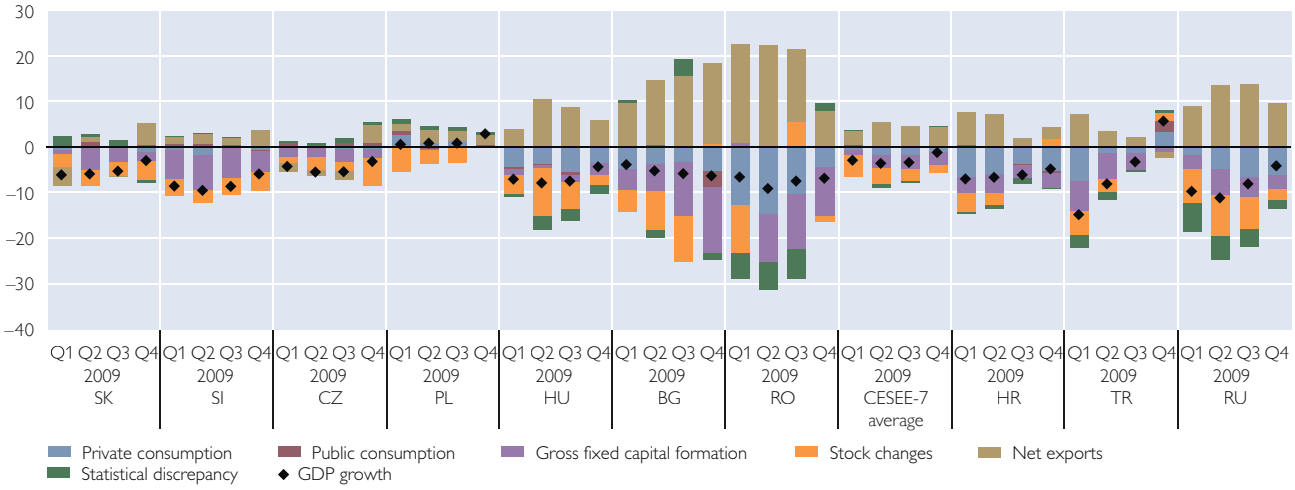
Some countries also display signs of a turn of the inventory cycle. After dampening GDP in early 2009, stock changes contributed positively to growth in Bulgaria, Croatia and Turkey. In Poland, Hungary and Russia, the negative growth contribution of the component decreased considerably. Again, this trend becomes more apparent when looking at quarterly changes in seasonally adjusted data: In the fourth quarter of 2009, stock changes supported growth in the Czech Republic, Poland, Hungary and Russia.

The other GDP components generally continued to act as a drag on growth. This is especially true for gross fixed capital formation, which weighed substan-

Chart 1

GDP Developments

Percentage points, GDP growth in %



Source: Eurostat, national statistical offices.

tially on economic dynamics in most countries due to low levels of capacity utilization, still generally weak demand and partly harder access to finance. Private consumption made a negative contribution in Hungary, Bulgaria, Romania and Russia as a result of deteriorating labor market conditions, decelerating and partly negative wage growth as well as rising debt burdens and necessary balance sheet repairs. Substantially positive growth contributions could be observed only in Turkey.

Industrial sector performs especially well

Activity indicators improved strongly. Especially industrial production has recovered from its lows in early 2009, when its annual declines were in the double digits throughout the region. The recovery gained speed in mid-2009, and by the end of the year industrial output was expanding again, in some cases strongly, on an annual basis in half of the countries under observation (Turkey, Poland, Slovakia, Romania and Russia). These industrial dynamics were fueled by the pickup in international demand and by companies' efforts to refill their empty stocks.

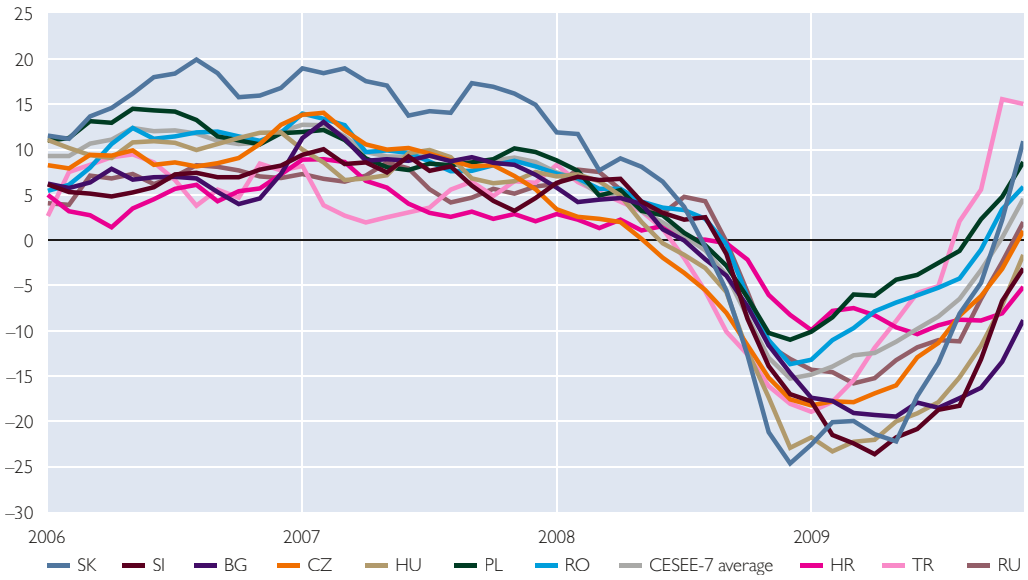
Other activity indicators, especially retail sales and construction output, developed less favorably, however. The contraction continued in both segments in the majority of countries in late 2009. Especially construction output remained depressed, in particular in Bulgaria, Romania, Slovenia and Slovakia, where double-digit decreases were measured for December 2009. Thus, the recovery of the industrial sector, which had been hit by the crisis at an early stage and especially hard, seems to be progressing faster than that of other sectors. The marked improvement of the Economic Sentiment Indicator since spring 2009 was also driven to a substantial extent by industry.

The stabilization of the economic dynamics observed in the second half of 2009 therefore relies heavily on the highly export-oriented manufacturing sector. Unless domestic demand picks up, growth in the region will not become self-supporting.

Chart 2

Industrial Production

Year-on-year changes, three-month moving averages



Source: Eurostat, wiiw.

The future development of economic dynamics abroad, especially in the euro area, the region's most important trading partner, will be crucial for the further recovery. Euro area growth itself, however, hinges strongly on temporary factors, particularly on monetary and fiscal policy stimuli, but also on the inventory cycle. The effects of these factors will fade out in the course of the year. According to recent forecasts, growth in the euro area is going to be sluggish in 2010 and 2011 and substantially lower than in emerging markets, but also lower than, for instance, in the U.S.A. The emerging markets are set to drive worldwide economic dynamics in the coming years and to bring growth of world output back close to pre-crisis levels in 2010.

Gradually improving economic outlook for CESEE; regional differences remain

According to recent forecasts for CESEE,[5] growth is expected to come in at around 2.5% on average this year, somewhat above euro area growth, but substantially below world output and growth in other emerging market regions. Dynamics in CESEE are strongly driven by Turkey and Russia, the largest countries in the sample, which are also projected to grow most strongly. Both are forecast to expand by around 4%, because their export structures are less concentrated on European markets and the brightening outlook for raw material prices will foster growth in Russia. Croatia and possibly Hungary will be the only countries in the sample to experience a further modest decline in economic activity in 2010. 2011 will see a modest increase in growth to 3.5% on average, with growth rates ranging between 2% and 4% in the individual countries.

The economic expansion is not expected to return to pre-crisis levels even in the medium run. According to IMF forecasts for the period from 2012 to 2014, the region's economy will expand by around 4% after having grown by around 6.5% in the boom years before the crisis. Nevertheless, income levels will continue to catch up to the euro area average. After temporarily dipping into negative territory in 2009, the region's growth differential vis-à-vis the euro area will increase to between 2 and 2.5 percentage points from 2011 onward.

Decline in external imbalances continues in the second half of 2009…

The economic downturn and the associated reduction in domestic demand led to a marked improvement of CESEE countries' external accounts. Combined current and capital account deficits decreased throughout CESEE and in some countries (e.g. in the Czech Republic and Hungary) even turned into a surplus in 2009. Only Russia registered a lower surplus in its combined current and capital account mainly because oil prices fell.

Generally, the improvement was driven primarily by a better goods and services balance, mirroring net exports in the national accounts. With the exception of Russia, imports generally declined more strongly than exports on the back of weak domestic demand as well as exchange rate movements, which put somewhat of a damper on import dynamics in countries with flexible exchange rate regimes. In some countries, above all the Czech Republic, Slovakia, Slovenia and Hungary, outflows of investment income also declined in line with corporate profits. Current transfers remained roughly unchanged throughout the region.

Developments in the second half of 2009 broadly continued the trends lined out above. Current account balances improved in all countries vis-à-vis the corresponding quarters of 2008, mainly driven by trade in goods and services.[6]

[5] *For a detailed OeNB forecast for selected CESEE countries, see box 2.*

[6] *The external accounts of Croatia, Bulgaria (and to a lesser extent Turkey) showed a seasonal pattern with high surpluses in the third quarter attributable to the concentration of tourism revenues during the summer months.*

Chart 3

Current and Capital Account of the Balance of Payments

% of GDP

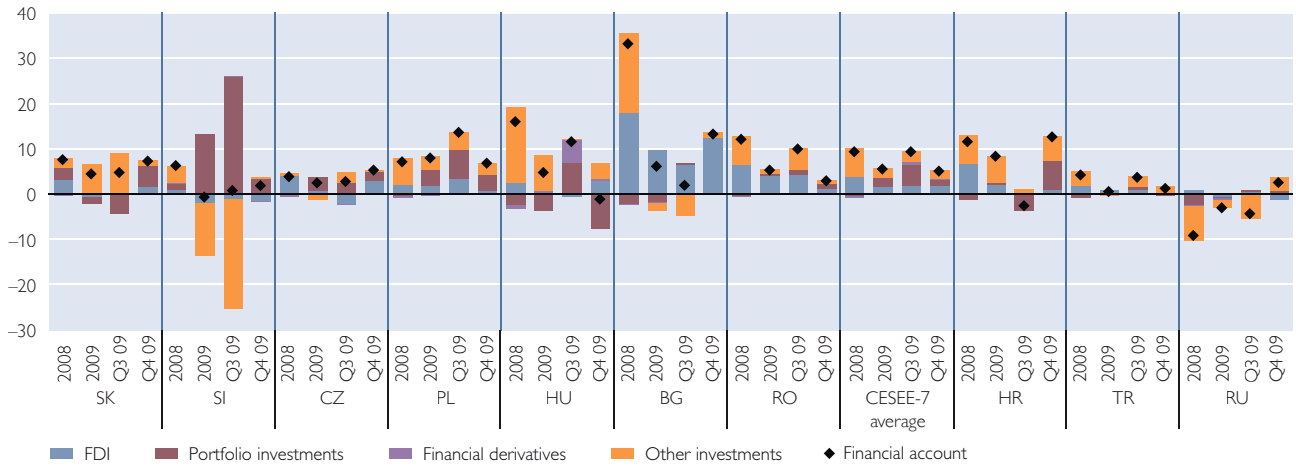
Source: National central banks.

In parallel to the reduction of current account deficits, surpluses in the financial account also decreased substantially in 2009; Slovenia even recorded a deficit. One cause for this was the decline in FDI inflows driven by both reductions in equity capital and reinvested earnings and by other capital. In Slovakia, Hungary and Slovenia, net FDI balances even turned slightly negative in 2009. Reductions in other investment turned out to have a strong impact as well, most probably

Chart 4

Financial Account of the Balance of Payments

% of GDP



Source: National central banks.

as a result of banking sector outflows, as evidenced for example by changes in the exchange rate-adjusted external positions of BIS reporting banks during the first three quarters of 2009 (BIS data for the fourth quarter are not available yet). The Czech Republic, Slovenia, Bulgaria, Turkey and Russia recorded outflows from other investment in 2009. Portfolio investment developed unevenly, with especially Slovakia and Hungary reporting more substantial net outflows than in 2008.

As to the quarterly dynamics, i.e. the change from the third to the fourth quarter, net FDI inflows as well as other investments again increased in half of the countries under observation, while the decreases in the other countries were mostly moderate. No clear trends could be observed in portfolio investments.

…while external debt ratios increase throughout the region

Gross external debt augmented strongly in 2009 owing to buoyant debt-creating flows and debt dynamics that were unfavorable especially because GDP shrank throughout most of the region. Gross external debt-to-GDP ratios increased by between 2.6 percentage points in Bulgaria and as much as 23.3 percentage points in Hungary and ranged from 37% in Russia to nearly 140% in Hungary. In many CESEE countries, a growing share of the external debt is created by the public sector, with governments tapping the external market for new borrowing and refinancing. However, the share of public external debt in overall external debt remains low for instance in Bulgaria and Russia.

Ongoing adjustment of the labor market raises unemployment …

The general economic slump also impacted the labor market. Unemployment rates increased throughout the region within a range of 1 to 3 percentage points from 2008 to 2009 (broadly in line with euro area developments) and in January 2010, stood between 6.2% (Slovenia) and 14.1% (Slovakia). This trend will continue in 2010, when – according to recent projections – unemployment will increase further (especially in the countries which did not experience a sharp deterioration in 2009). Latest data also show that the most vulnerable groups on the labor market were more strongly affected than the average. Youth unemployment rates soared to levels of up to 30% in Slovakia and on average lie more than 13 percentage points above the total unemployment rate.

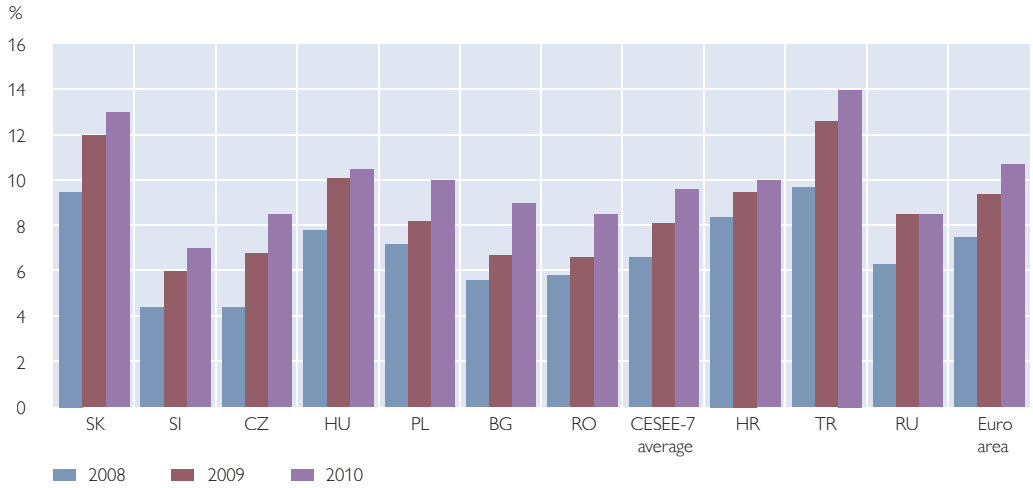
Employment data also herald the changing trends on CESEE labor markets. Employment growth has been negative in all countries but Poland since early 2009 and employment rates have been decreasing hand in hand. The deterioration so far, however, was less pronounced than was to be expected given the decline in economic activity. Just like in the euro area, there is evidence that part of the adjustment was carried out by reducing the hours worked whereas employment decreased only comparatively little (however, comparable data are only available for five of the ten countries). Companies tried to keep their labor force employed and therefore expanded flexible and/or short working schemes. This strategy may well be related to companies having experienced shortages (especially of skilled labor) in the boom years preceding the crisis. The aggregate figures, however, mask important differences between sectors: In all countries, employment declined most strongly in manufacturing, the sector most affected by the economic downturn. Job losses were almost exclusively concentrated there in the Czech Republic, Romania and Slovakia (to a somewhat lesser extent, this also applies to Poland).

… dampens wage increases …

Adverse labor market developments had a clear impact on wages. Nominal wage growth in the whole economy decelerated markedly. However, it remained in positive territory in most countries in the region in the fourth quarter, except in

Chart 5

Unemployment Rates



Source: Eurostat; forecasts: wiiw.

Slovenia and Hungary. The same is true for real wages, as declining inflation did not cut into salaries to a substantial extent. The only exception in this respect was Romania, where above-average price rises pushed real wage growth into the red.

Wage developments in industry resembled the pattern for the whole economy, with wage growth decelerating strongly in the course of 2009 but generally remaining in positive territory. Only in Croatia did nominal wages decrease in an annual comparison in the final quarter of 2009. At the same time, labor

… and, together with improving productivity, boosts competitiveness

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)			
	2008	2009	Q3 09	Q4 09	2008	2009	Q3 09	Q4 09	2008	2009	Q3 09	Q4 09	2008	2009	Q3 09	Q4 09
	Annual change in %															
Slovakia	7.6	2.7	1.6	4.7	6.5	1.5	–3.7	–16.0	8.0	3.8	9.7	4.2	15.0	5.4	5.7	–12.5
Slovenia	7.8	1.4	1.0	3.5	4.9	9.7	9.8	–2.8	0.0	0.0	0.0	0.0	4.9	9.7	9.8	–2.8
Bulgaria	21.4	11.4	9.6	11.2	20.0	21.9	20.9	13.9	0.0	0.0	0.0	0.0	20.0	21.9	20.9	13.9
Czech Republic	8.1	4.0	5.5	7.1	11.4	6.4	5.2	–3.7	11.2	–5.7	–5.8	–2.2	23.9	0.3	–0.9	–5.7
Hungary	6.3	4.6	5.7	5.1	6.4	12.0	11.0	–0.6	–0.2	–10.3	–13.0	–2.7	6.2	0.5	–3.4	–3.3
Poland	8.8	4.9	4.4	5.1	7.4	2.5	–1.0	–6.4	7.6	–18.8	–21.1	–9.7	15.6	–16.8	–21.9	–15.5
Romania	21.3	11.2	10.0	9.5	14.1	0.4	–3.5	–13.4	–9.4	–13.1	–15.4	–10.5	3.4	–12.7	–18.3	–22.6
Croatia	7.2	–0.9	–0.6	–3.6	3.8	–0.8	–1.8	–6.4	1.6	–1.6	–1.9	–1.4	5.5	–2.3	–3.7	–7.7
Turkey	10.7	8.5	7.9	9.5	11.6	4.0	3.0	–11.5	–6.3	–11.8	–15.1	–7.9	4.5	–8.3	–12.5	–18.6
Russia	25.0	3.2	0.7	5.2	21.5	5.0	1.1	–2.6	–3.9	–17.4	–18.5	–17.3	16.8	–13.3	–17.6	–19.4
Memo item: Euro area	3.0	0.4	0.4	0.5	4.1	9.6	8.3	1.6	0.0	0.0	0.0	0.0	4.1	9.6	8.3	1.6

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

productivity recovered from its trough in late 2008 to early 2009 as industrial output recovered and labor inputs adjusted to the changing economic reality. Productivity growth in the final quarter of 2009 was positive in most countries, in some cases strongly positive. Productivity advances overcompensated wage increases in Slovenia, the Czech Republic, Poland, Slovakia, Romania, Croatia, Russia and Turkey, resulting in a decline in unit labor costs (ULCs). ULCs remained more or less stable in Hungary and increased substantially in Bulgaria.

While industrial ULC growth in the euro area increased throughout the review period given falling productivity and roughly constant wages, a majority of the CESEE countries in this sample reported declining ULCs (measured in euro). ULC decreases, in euro terms, were most pronounced in Poland, Turkey and Romania, i.e. in countries with flexible exchange rates, but also in Russia. In Slovenia and Slovakia, ULCs also sank, while in Bulgaria they increased more strongly than in the euro area.

The generally more favorable development of ULCs in CESEE than in the euro area implies that the price competitiveness of most CESEE countries has improved vis-à-vis the euro area in the review period. Slovakia and Slovenia, the two euro area members covered in this report, also increased their price competitiveness within the monetary union somewhat. Only Bulgaria suffered deteriorating price competitiveness in the observation period.

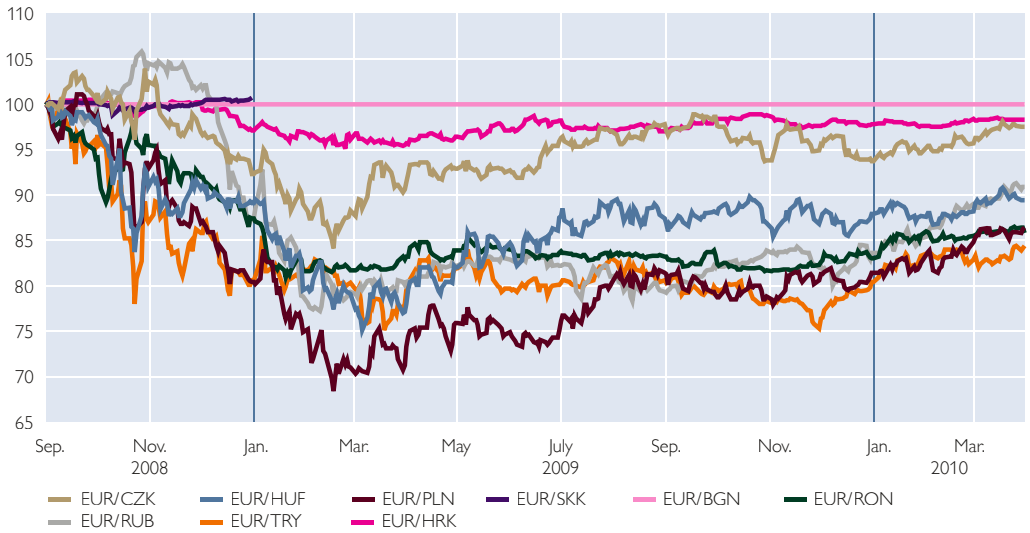
Pressures on the competitive position in the offing

Looking forward, CESEE economies with flexible exchange rate regimes may, however, not be in a position to fully sustain recent gains in price competitiveness. In fact, in a number of these countries slowly appreciating exchange rates during the second half of 2009 and in early 2010 have already reversed some of the gains, especially of the Polish złoty and the Russian ruble. These currencies appreciated by 15% and 11%, respectively, against the euro since mid-2009; the Turkish lira gained 5%. The other currencies of the region stayed broadly stable vis-à-vis the

Chart 6

Exchange Rate Developments against the Euro

Sep. 1, 2008 = 100 *Cutoff date: March 31, 2010*



Source: Thomson Reuters.

Note: A rise is an appreciation.

euro. Apart from the Czech koruna, which recently came close to pre-Lehman trading levels, no currency could fully reverse the losses experienced after the intensification of the financial crisis in fall 2008. Moreover, ULC developments in the first quarter of 2010 will be adversely affected by a base effect related to the strong depreciation in early 2009.

Credit dynamics were dampened but have recently appeared to be rebounding

In line with general economic conditions, credit dynamics in the private sector remained weak and even decelerated further in most of the countries under observation. However, the most recent monthly data show some signs of stabilization in annual growth rates (adjusted for exchange rate changes): Credit expansion remained broadly stable in the Czech Republic and Hungary in December and January. Some improvement was even observed, e.g. in Slovakia, Romania (although growth rates in this country are still negative) and above all in Turkey, where consumption and GDP also expanded strongly in late 2009.

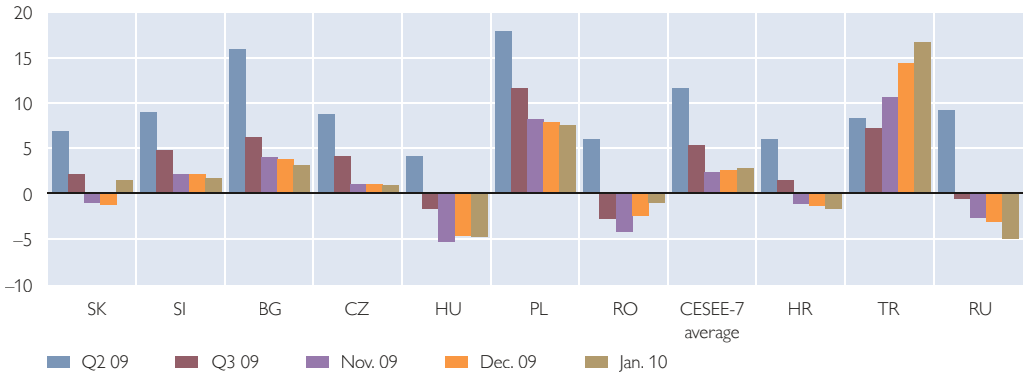
While the deceleration in credit dynamics in the early stages of the crisis was primarily driven by the growth of credit to corporations, this picture has become increasingly blurred in recent months. In January 2010, the annual growth of credit to corporations still stood at lower levels than the growth of credit to households in most countries (exceptions are Romania, Croatia and Russia). However, it decelerated less strongly, in some cases much less strongly, than credit to the household sector in more than half of the region compared to the first three quarters of 2009. This easing can be interpreted as further evidence for the above-mentioned relaxation of economic strains in the industrial sector: Production is on an upward path again, thereby fostering credit demand.

Bank lending surveys conducted in Poland and Hungary indicate that banks generally stopped tightening lending policies in late 2009 and early 2010. However, some differences among credit segments were visible: Standards for housing loans were eased in both countries, and the availability of corporate loans was increased in Poland but tightened marginally further in Hungary. In both countries, however, mostly nonprice standards for consumer credits were tightened somewhat, although less than in previous quarters. The deterioration in the quality of loan portfolios and reduced creditworthiness of clients were quoted as the major reason for tightening.

Chart 7

Growth of Credit to the Private Sector

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



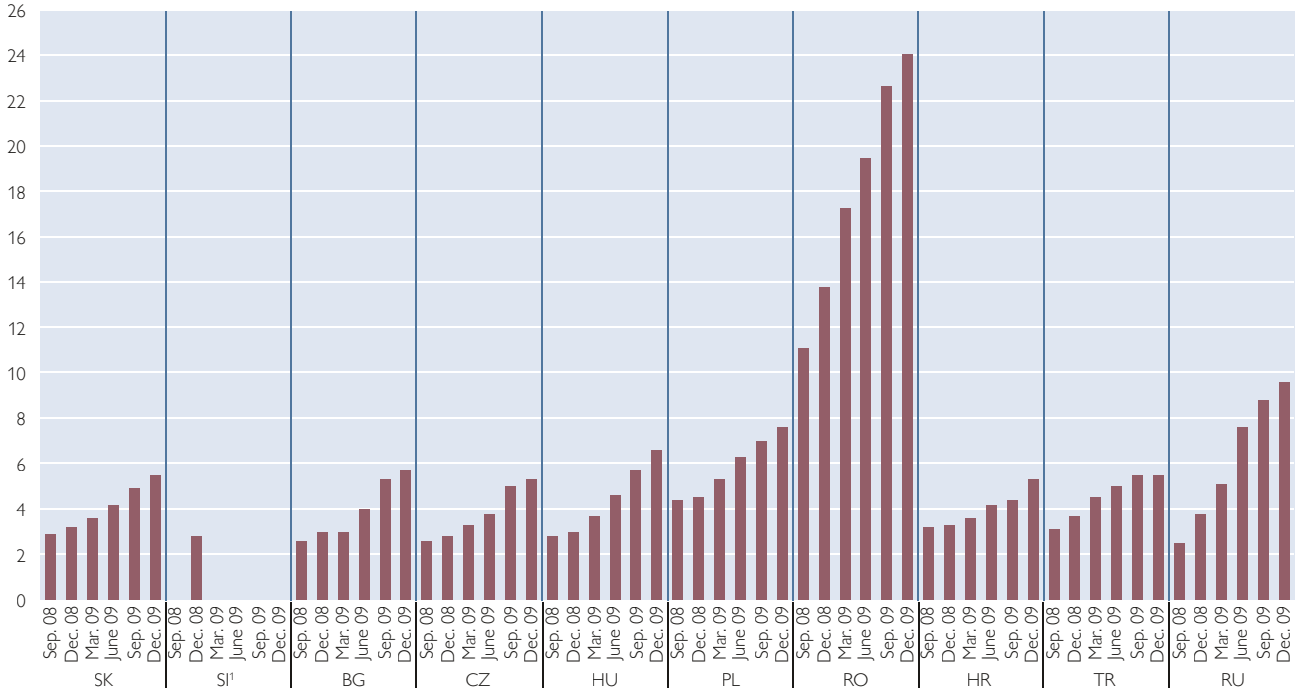
Source: National central banks.

Note: Turkey: nonadjusted rate.

Chart 8

Nonperforming Loans

% of total credit



Source: National central banks.

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

The fact that the economic downturn started to take its toll on borrowers' ability to repay their loans can be clearly seen in nonperforming loan (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 pronounced in Romania, where the NPL ratio increased to almost 25% in the last quarter of 2009, but also in Russia.[7] In some countries such as Turkey, however, the deterioration seems to have lost some speed in recent months.

Generally dampened price dynamics gain some speed at the turn of the year

Price pressure decreased in most CESEE countries, with annual inflation coming down from 10.5% on average in 2008 to 7.8% in 2009. This development was attributable mainly to the economic slump and the accompanying negative output gap, which is also clearly visible in core inflation rates: Core inflation declined just as strongly as headline inflation. However, there are clear differences in the inflation performance of the individual countries. Price pressure decreased much less in Hungary, Poland, Romania and Russia than in the rest of the region, on the one hand because of increases in administered prices and indirect taxes. On the other hand, exchange rate effects from the depreciation in early 2009 may well have played a role. Fixed rate and euro area countries generally showed a some-

[7] *It should be noted that NPL figures cannot be compared across countries because classification regulations differ substantially.*

Table 3

Consumer Price Index (HICP)

	2008	2009	Sep. 09	Oct. 09	Nov. 09	Dec. 09	Jan. 10	Feb. 10
	Annual change in %							
Slovakia	3.9	0.9	0.0	–0.1	0.0	0.0	–0.2	–0.2
Slovenia	5.6	0.9	0.0	0.2	1.8	2.1	1.8	1.6
Bulgaria	12.0	2.5	0.2	0.3	0.9	1.6	1.8	1.7
Czech Republic	6.3	0.6	–0.3	–0.6	0.2	0.5	0.4	0.4
Hungary	6.0	4.0	4.8	4.2	5.2	5.4	6.2	5.6
Poland	4.2	4.0	4.0	3.8	3.8	3.8	3.9	3.4
Romania	7.9	5.6	4.9	4.3	4.6	4.7	5.2	4.5
CESEE-7 average	5.8	3.3	3.7	2.6	3.0	3.2	3.3	3.0
Croatia[1]	6.1	2.4	1.0	1.3	1.8	1.9	1.1	0.7
Turkey	10.4	6.3	5.3	5.1	5.5	6.5	8.2	10.1
Russia[1]	14.1	11.8	10.8	9.8	9.2	8.9	8.1	7.2
Euro area	3.3	0.3	–0.3	–0.1	0.5	0.9	1.0	0.9

Source: Eurostat, national statistical offices, wiiw.

[1] *CPI.*

what more pronounced decline of inflation between 2008 and 2009, and price increases also stood at lower levels in recent months.

Despite remaining at comparatively low levels, inflation has increased somewhat in most CESEE countries in recent months. This is due primarily to the energy component of the HICP, given rising energy prices and positive base effects. In addition, unprocessed food prices played an important role in Turkey. Nevertheless, core inflation remained stable or decreased somewhat further also in recent months.

Most central banks in the region reacted to declining price pressure and medium-term inflation risks but also to decreasing risk premiums in the course of the stabilization of financial markets by lowering their policy rates by between 125 basis points in the Czech Republic and 850 basis points in Turkey in 2009.[8] Monetary easing continued in early 2010 in Hungary (–75 basis points), Romania (–150 basis points) and Russia (–50 basis points).

Fiscal deficits continue to rise

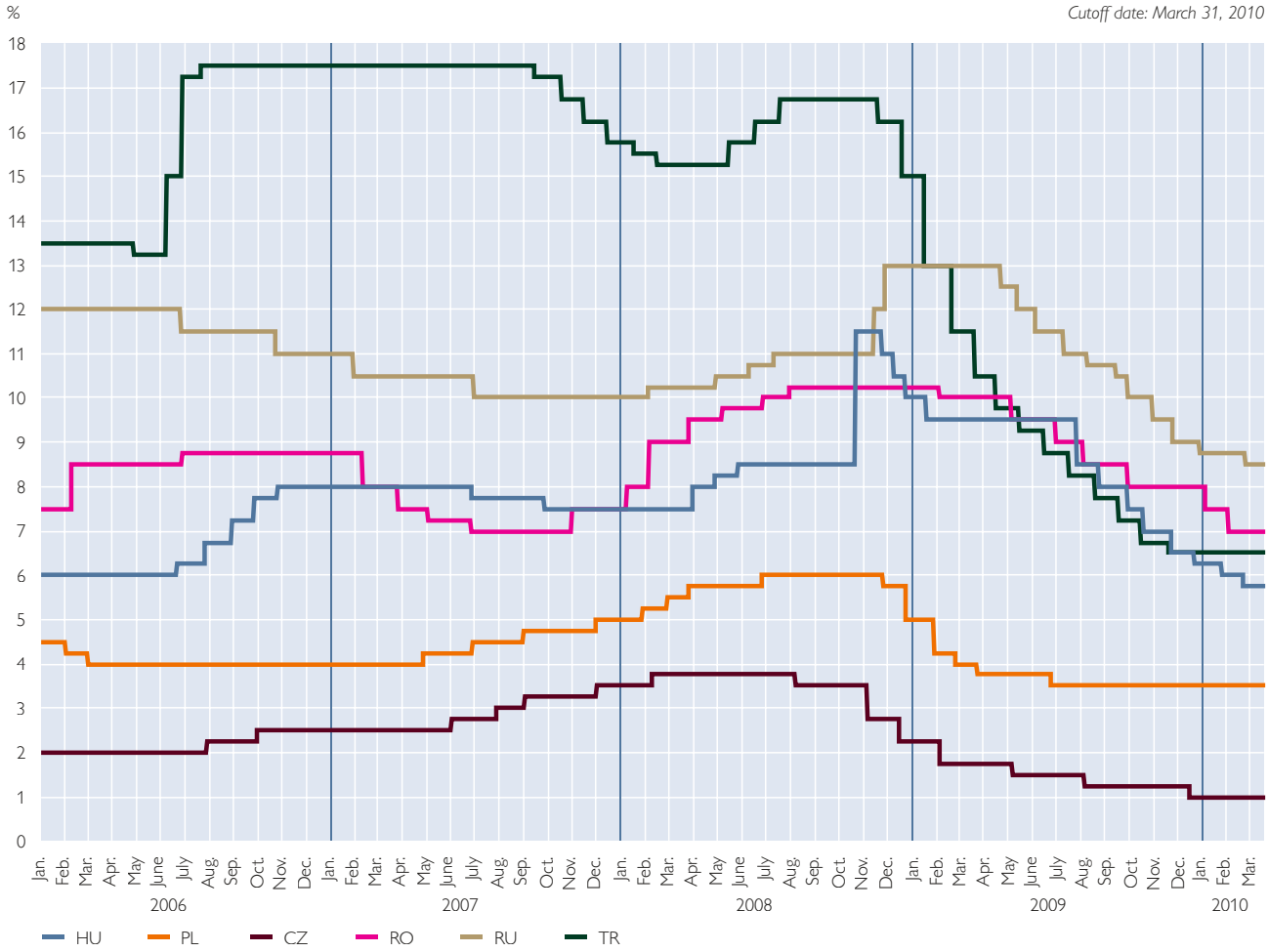
While some governments in the region reacted to the crisis with (moderate) initial fiscal impulses, as the year 2009 went on, most of them switched to consolidation measures, especially expenditure cuts in the public sector, to counteract adverse budget dynamics. This became necessary because initial fiscal targets for 2009 were often based on growth assumptions that slipped grossly out of reach as the crisis hit the real economy fully. The upward revisions of budget deficit targets in the course of the year were thus often substantial and amounted to around 5% of GDP in Slovenia and Slovakia (despite some consolidation measures) and to more than 10% of GDP in Russia.

All in all, deteriorating public finances in CESEE are mainly the outcome of diminishing budget revenues and increasing expenditures due to automatic stabilizers, both as a result of the recession. Fiscal balances worsened in a range of

[8] *The ECB policy rates apply to Slovakia and Slovenia. Bulgaria has no policy rate because it operates a currency board.*

Chart 9

Policy Rate Developments in CESEE



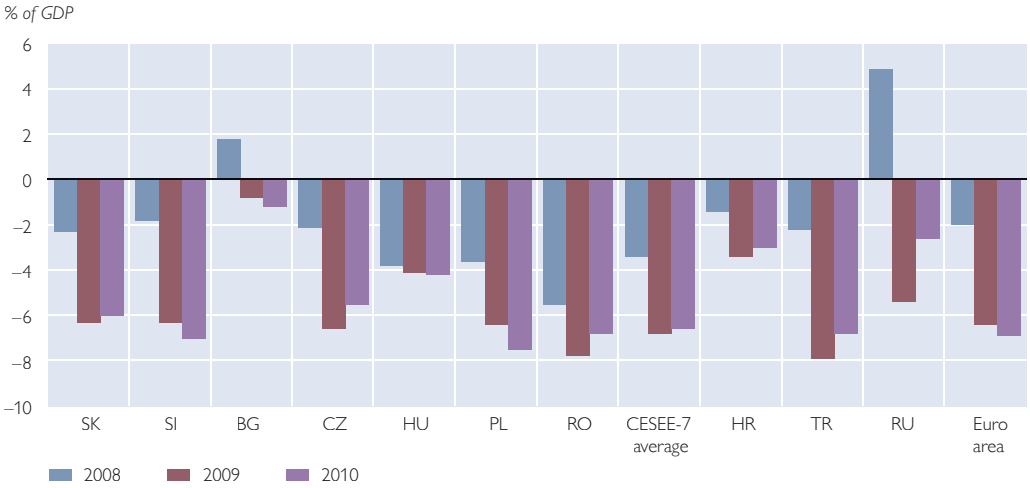
Source: National central banks.

between 0.2 percentage points in Hungary and 10.3 percentage points in Russia in 2009 when compared to 2008 and generally stood well above the 3% of GDP threshold enshrined in the Maastricht Treaty. Consequently, all EU Member States under observation in this report are now subject to an excessive deficit procedure (EDP) except Bulgaria, where an EDP will presumably be opened in the course of 2010. Hungary has been in the EDP since 2004, and EDPs were opened for Romania and for Poland in July 2009 and for the Czech Republic, Slovenia and Slovakia in December 2009. Deadlines for the correction of the excessive deficit range from 2011 for Hungary to 2013 for the Czech Republic, Slovenia and Slovakia. Gross public debt levels also increased throughout CESEE. However, only Hungary fails to meet the 60% of GDP threshold, while the other countries still meet the target with a substantial margin.

The European Commission's autumn 2009 projections for 2010 assume a marked improvement in the government deficit only in Russia. Some minor reductions are also forecast for Slovakia, the Czech Republic, Romania, Croatia and Turkey. In the other countries, public finances are set to deteriorate further

Chart 10

Development of General Government Deficits



Source: Eurostat, European Commission.

in 2010. Apart from Bulgaria and possibly Croatia, all CESEE countries will miss the benchmark of 3% of GDP also this year. Forecasts for 2010 are generally somewhat more pessimistic than fiscal plans of the individual countries as published in their updated Convergence Programmes. This is especially true for Bulgaria and Poland.

EU accession negotiations continue

The accession negotiations with the EU candidate countries Croatia and Turkey proceeded further in the review period. Croatia opened six new chapters and closed five in its accession negotiations with the EU in October after talks were unblocked in the wake of a rapprochement between Croatia and Slovenia over a bilateral border dispute. A final agreement in this dispute is now under preparation. Negotiations are now ongoing in 30 out of 35 chapters, 17 have already been closed provisionally.

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

Box 1

Financial Market Developments in CESEE: Decline in Global Risk Appetite Weighs on Sound Performance

The rebound on CESEE financial markets that started in early 2009 (see box 1 in Focus on European Economic Integration Q2/09 and Q4/09) continued over the review period (end-September 2009 to end-March 2009). However, the recovery from the market corrections triggered by the collapse of Lehman Brothers has been uneven. Moreover, the decline in the global risk appetite caused by concerns over the fiscal situation in Greece has had a negative impact on worldwide financial markets in recent months and has dampened the overall sound performance that CESEE displayed on average over the review period. Segments of some countries' financial markets have recovered to pre-Lehman levels.

Among the countries hit hardest by the financial market upheaval following the collapse of Lehman Brothers, Russia and Turkey recovered particularly fast, with Russian financial markets outperforming all others in recent months. As illustrated by credit default swap (CDS) and eurobond spreads, the relative risk perception has changed in favor of these countries, as early as in late 2008 with regard to Turkey. In addition, equity indices rebounded, most strongly so in Russia and Turkey. Hungary's performance was also above average in many financial market segments. Countries that were affected relatively little, i.e. Slovakia, the Czech Republic and Poland, also performed well during the recovery period, but have not been able to fully reverse the losses in all financial market segments yet. Over the review period, different financial market segments showed the following broad tendencies: Driven to a considerable extent by further monetary easing in CESEE countries, money market rate spreads against the euro area declined across the region except in Poland, where the policy rate was kept unchanged. Local currency government bond spreads narrowed or remained stable, except in Turkey, where several local factors caused spreads to widen. Following months of significant spread contractions on CDS and eurobond markets for CESEE sovereigns, the downward trend was interrupted, but resumed more recently. Most CESEE stock indices recorded further gains, while exchange rates either remained broadly stable or continued to strengthen against the euro.

Three-month money market spreads against the euro area declined further over the review period in all CESEE countries except Poland, where the spread stayed almost unchanged. Divergent policy rate developments in CESEE countries compared to the euro area explain part of this development. While the ECB's main refinancing rate was kept at 1%, all CESEE national central banks with the exception of the National Bank of Poland continued to lower their key policy rates.[1] In Croatia, the three-month money market spread declined by 740 basis points as kuna liquidity increased mainly due to central bank measures (i.e. foreign currency purchases in the final quarter of 2009, lowering of reserve requirements in February 2010). In Russia and Romania, where spreads against the euro area declined by more than 350 basis points, the three-month money market rate fell below the policy rates in March 2010, reflecting market expectations of additional policy rate cuts and ample liquidity conditions in the interbank market, and, in Russia, also due to foreign currency purchases by the central bank. In the Czech Republic, the spread tightening was more in line with policy rate cuts, while in Hungary and in Turkey, spreads declined less than would have been indicated by policy rate developments. At end-March 2009, three-month money market spreads against the euro area stood below pre-Lehman levels in Turkey, Romania and Croatia.

Local currency government bond spreads declined in most CESEE countries. In an environment of declining policy rates and continued disinflation, Russia's local currency bonds performed best, with spreads tightening by more than 400 basis points. By contrast, Turkey's local currency government bond spread started to increase in mid-October 2009 after having declined by more than 1,600 basis points from end-October 2008. A constitutional court

[1] *Policy rates were cut by 200 basis points in Hungary, 175 basis points in Russia, 150 basis points in Romania, 75 basis points in Turkey and 25 basis points in the Czech Republic.*

ruling in favor of a withholding tax on security transactions for foreigners,[2] uncertainty about a possible IMF support package (that ultimately was not agreed), political tensions as well as rising inflation and market expectations that monetary tightening was in the offing contributed to the spread widening. In Slovakia and the Czech Republic, spreads stayed almost unchanged. Local Turkish and Polish currency bond spreads as well as more recently Hungarian spreads already came back to levels seen before the collapse of Lehman Brothers. A comparison among emerging market regions reveals that CESEE performed best on average during the observation period. The JPM government bond index spread for emerging Europe declined by 60 basis points, while the corresponding spreads for Asia, Latin America and the Middle East/Africa stayed broadly unchanged or decreased only slightly.

Across the CESEE region, eurobond spreads continued to decline over the review period, albeit at a lower pace than in the months before. The positive performance in CESEE was accompanied by rating or rating outlook improvements in some countries. However, the downtrend of eurobond spreads was interrupted by a period of rising spreads from mid-January until end-February/early March 2010. Against the backdrop of uncertainty about global economic prospects and fiscal developments in Greece, investor confidence declined and volatility on global financial markets increased during this period. As a consequence, benchmark bond yields went down, while the appetite for risky assets subsided. Throughout the entire review period, euro-denominated eurobond spread contractions ranged from 30 to 45 basis points in Poland, Bulgaria, Croatia and Turkey to about 70 basis points in Romania and Hungary. The CESEE region's performance (JPM Euro Emerging Markets Bond Index Europe Index, –60 basis points) was broadly in line with developments in other emerging market regions. Russia's dollar-denominated eurobond spread tightened by almost 140 basis points and clearly outperformed the emerging markets' average (JPM EMBI Global Index, –80 basis points). At end-March 2010, the eurobond spreads of all countries except Russia and Turkey stood slightly above the levels seen before the collapse of Lehman Brothers.

The CDS market developed somewhat differently than the eurobond market. After seven months of significant tightening, CDS spreads on CESEE sovereign issues trended upward (or in a few cases sideward) from October 2009 until mid-February 2010 and then resumed their downward movement. In Romania, the spread widening in October 2009 was most pronounced, as the disbursements of funds from the IMF and the EU under the multilateral support program were delayed amid political uncertainties. In the meantime, the political situation has normalized, the support package has come back on track, and CDS spreads on Romania have retreated notably again. By end-March 2010, CDS spreads in most of the countries had fallen somewhat below or approximately to the same level as at end-September 2009. Only in Russia (–75 basis points) did CDS spreads decline more noticeably. After CDS on Russia had been traded with the highest spread within our country sample during the peak crisis period, Russian CDS spreads ended the review period just above those in Slovakia, the Czech Republic and Poland. At end-March 2010, the CDS spreads of all countries fell below 200 basis points. The CDS spreads of about half the countries have thus returned to pre-Lehman territory, whereas the CDS spreads of the other half were still being traded with a (small) margin above the levels before the collapse of Lehman.

The performance of CESEE stock indices diverged considerably over the review period. The recovery that had started in February 2009 continued almost uninterruptedly only in Romania (+35%) and with some setbacks in Russia, Turkey, Poland and Hungary (+10% to +20%). After Turkey's and Hungary's equity indices had surpassed pre-Lehman levels already in summer 2009, Russia, Poland and Romania also exceeded this benchmark in recent months. Over the review period, equity price indices stayed relatively unchanged in the Czech Republic and Croatia, while the Slovak and Bulgarian equity indices even lost some ground. The weak

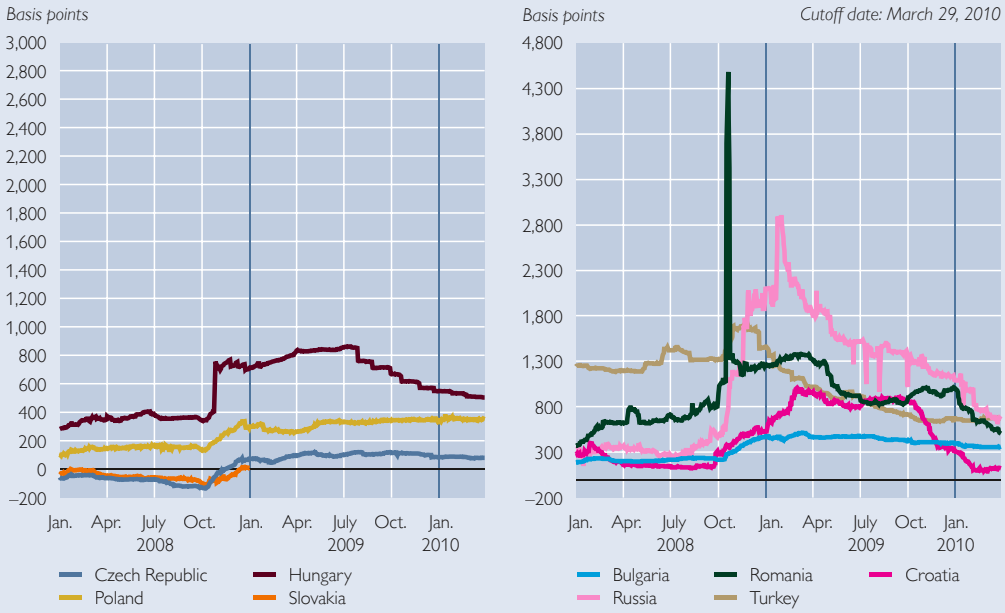
[2] *On October 16, 2009, the Constitutional Court ordered the equalization of tax rates for domestic and international investors on investments such as bonds, shares and mutual funds after the government had abolished the tax for foreigners in 2006. By end-March 2010, the issue was still unresolved.*

performance during January and February 2010 in almost all countries was in line with global trends and has to be seen in the context of increasing risk aversion related to concerns about the fiscal situation in Greece. Over the review period, emerging Europe, as represented by the MSCI EMEE Index (covering the Czech Republic, Hungary, Poland and Russia), performed somewhat better than the emerging market average (MSCI EM index) and mature stock markets (S&P 500, EURO STOXX).

CESEE currencies either stayed broadly stable or continued to strengthen against the euro over the review period. Other emerging markets' exchange rates also generally tended to strengthen against the major currencies. In CESEE, appreciation tendencies were most pronounced in Poland and Russia, where the currencies appreciated by almost 10% against the euro. The ruble's strengthening is related inter alia to EUR/USD movements (the euro depreciated by 8% against the U.S. dollar over the review period), as it is tied to a currency basket consisting of 55% U.S. dollars and 45% euro. As appreciation pressures on the ruble intensified, the central bank made repeated and sizeable foreign currency purchases to prevent the ruble from strengthening too fast, and made several moves to adjust the ruble's corridor against its basket. All CESEE currencies except for the Czech koruna were still being traded far below the levels seen before the collapse of Lehman Brothers.

Chart 1

Three-Month Money Market Rate Spreads against the Euro Area

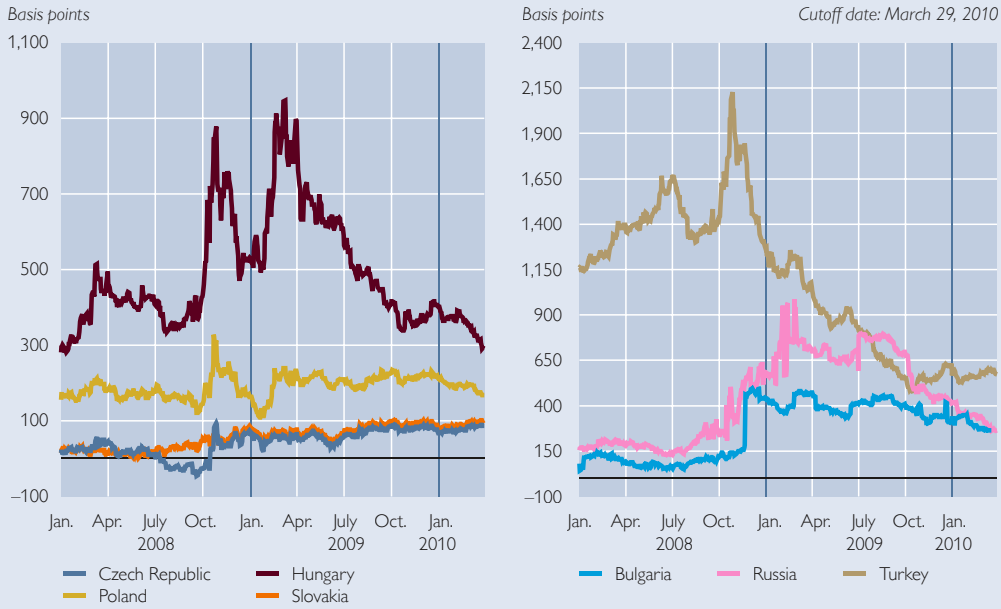


Source: Bloomberg, Thomson Reuters, OeNB.

Chart 2

Local Currency Government Bond Yield Spreads against the Euro Area

Country subindices of JPM EM-GBI, Eurostat data for Bulgaria

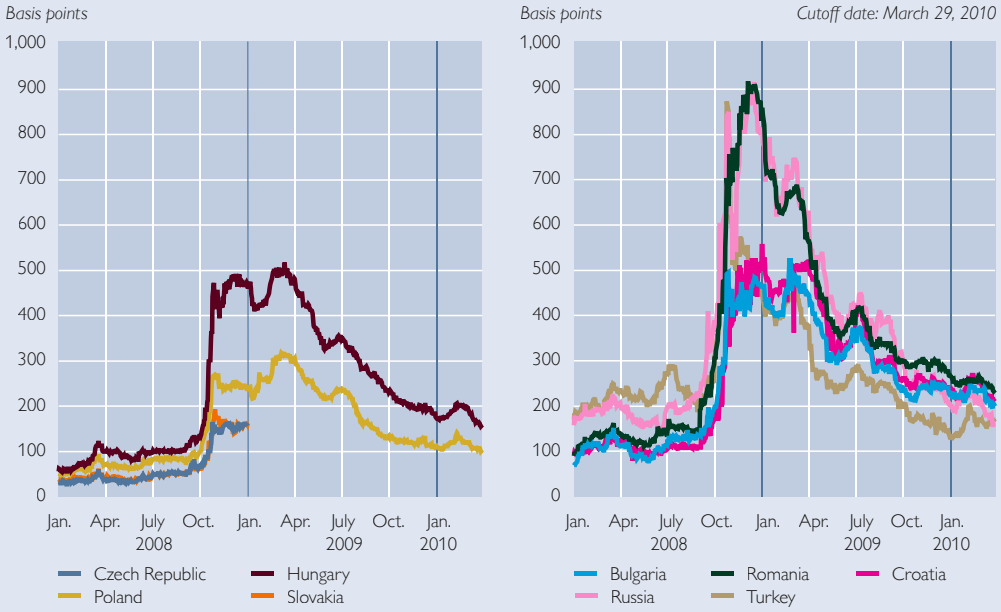


Source: Bloomberg, Thomson Reuters, Eurostat, OeNB.

Chart 3

Eurobond Yield Spreads

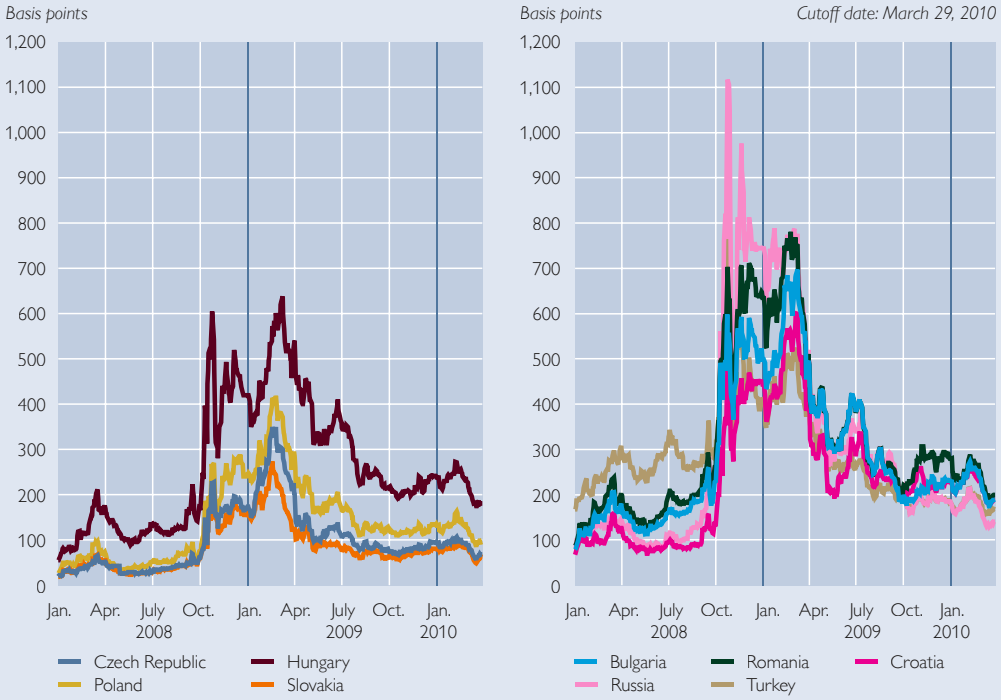
JPM Euro-EMBI global index, JPM EMBI global index for Russia



Source: Bloomberg, Thomson Reuters, OeNB.

Chart 4

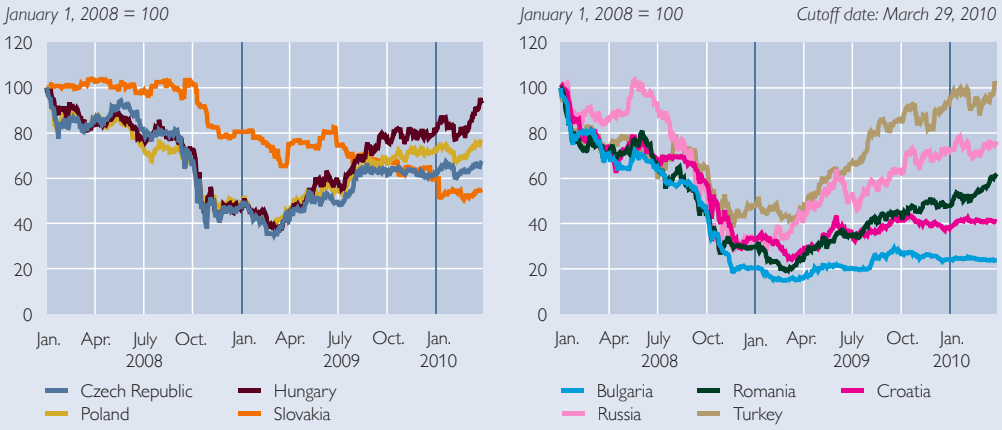
Sovereign Five-Year Credit Default Swap Spreads



Source: Thomson Reuters, OeNB.

Chart 5

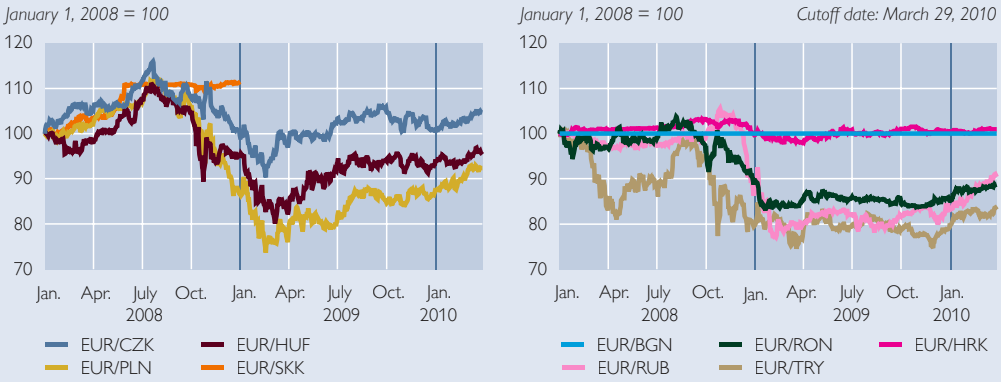
Stock Market Developments



Source: Thomson Reuters, OeNB.

Chart 6

Exchange Rate Developments



Source: Thomson Reuters, OeNB.

Note: An increase in value means a nominal appreciation.

2 Slovakia: Strong Public Expenditures Support Growth

Public consumption mitigates output decline

Output continued to decline during the third and fourth quarters of 2009, albeit at a slower pace than before. The downturn was mainly driven by investment, which posted substantially negative growth contributions. Public consumption, in contrast, turned around in the fourth quarter of 2009, possibly reflecting an increase in public expenditures ahead of parliamentary elections in June 2010. Correspondingly, domestic credit expanded again at double-digit rates, largely driven by credit to the public sector. While still negative, private consumption nevertheless improved during 2009.

Positive growth contribution of net exports

The continued slide in exports was largely balanced out by slumping imports. In the final quarter of 2009, net exports therefore not only entered positive territory for the first time in two years, but even posted strong growth. The trade balance also turned positive, while the current account deficit declined to below 2% of GDP in the third quarter of 2009, which is mainly traceable to a negative income balance in the second half of 2009. Net foreign direct investment was negative in the second quarter of 2009 and improved only slightly in the third quarter.

Labor market tensions

The labor market reacted to the output contraction only with some delay. Unemployment increased by more than 5 percentage points to 13.9% between the last quarter of 2008 and the final quarter of 2009, with most of the rise attributable to the second half of 2009. At the same time, labor market participation declined to less than 60% of the labor force. Labor market developments continued to deteriorate in the last quarter of 2009. Correspondingly, nominal wages in industry increased only moderately by 4.7%, while labor productivity soared by 22.7% and unit labor costs dropped by 16% in the fourth quarter of 2009.

Zero inflation in the last quarter of 2009

HICP inflation decelerated from 1.0% in the second quarter to 0.0% in the fourth quarter of 2009, leading to an annual average of only 0.9% for 2009. Core inflation was negative but close to zero, showing that the dampening effect on prices of the economic downturn continued. Notwithstanding low average inflation rates, different product groups showed quite divergent price dynamics. Foodstuff, clothing, and transport, for instance, were characterized by price declines, while prices for alcoholic beverages and various services increased by more than 5% on average in 2009. Producer prices fell by no less than 6.5% in 2009, with energy prices having fallen, but mainly because of price declines that were triggered by competitive pressure from neighboring CESEE countries (especially the Czech Republic and Hungary) that experienced exchange rate depreciations.

Significant budget deficit revisions

The budget deficit originally envisaged for 2009 was 1.7% of GDP (based on an ultimately largely unrealistic GDP growth assumption of 6.5%). The actual 2009 budget deficit eventually ran to 6.8%. In September 2009, the Slovak government presented a draft budget for 2010, which sets a deficit ceiling of 5.5% of GDP and assumes GDP growth to reach 1.9% in 2010. The latter figure was revised upward to 2.8% in February 2010. Initially, the 2010 deficit target had been 2.9% of GDP (according to the stability program published in April 2009).

Table 4

Main Economic Indicators: Slovakia

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	10.6	6.2	–4.7	6.8	1.6	–5.7	–5.5	–4.9	–2.6
Private consumption	6.9	6.0	–0.7	6.0	4.5	–0.9	0.4	–0.3	–1.9
Public consumption	0.1	5.3	2.8	6.1	4.0	1.3	6.9	–0.2	2.9
Gross fixed capital formation	9.1	1.8	–10.5	0.6	–7.1	–3.9	–17.7	–11.4	–7.3
Exports of goods and services	14.3	3.2	–16.5	2.9	–7.6	–25.2	–20.3	–15.0	–5.2
Imports of goods and services	9.2	3.1	–17.6	3.6	–7.8	–22.3	–22.2	–15.6	–10.3
	Contribution to GDP growth in percentage points								
Domestic demand	6.6	5.9	–6.1	7.2	0.9	–4.0	–7.1	–6.3	–6.7
Net exports of goods and services	4.7	0.2	0.5	–0.5	0.2	–4.0	1.0	–0.1	4.7
Exports of goods and services	13.6	3.1	–15.8	2.7	–7.6	–26.5	–20.2	–13.3	–4.7
Imports of goods and services	8.9	2.9	–16.3	3.2	–7.9	–22.4	–21.2	–13.2	–9.4
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	14.4	1.7	1.6	2.6	–10.6	–13.9	–6.9	5.9	22.7
Average gross earnings in industry (nominal)	6.4	7.6	2.7	9.1	4.2	3.0	1.5	1.6	4.7
Unit labor costs in industry (nominal)	–6.9	6.5	1.5	6.3	18.4	20.9	9.2	–3.7	–16.0
Producer price index (PPI) in industry	–1.4	2.5	–6.6	3.2	–0.1	–5.1	–7.5	–8.1	–5.8
Consumer price index (here: HICP)	1.9	3.9	0.9	4.5	3.9	2.3	1.1	0.4	0.0
EUR per 1 SKK, + = SKK appreciation	10.2	8.0	3.8	10.8	10.1	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	11.2	9.6	12.1	8.9	8.7	10.4	11.3	12.6	13.9
Employment rate (%, 15–64 years)	60.7	62.3	60.2	63.1	62.9	61.0	60.4	60.1	59.2
Key interest rate per annum (%)	4.4	4.0	. .	4.3	3.4	. .	. .	. .	. .
SKK per 1 EUR	33.8	31.3	. .	30.3	30.3	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.0	4.8	3.2	6.4	4.8	9.8	6.4	3.0	3.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.7	–8.0	–1.4	–8.5	–8.0	–11.9	–5.5	–1.8	–1.4
Domestic credit of the banking system	13.6	12.5	23.0	15.1	12.5	27.8	28.0	26.2	23.0
of which: claims on the private sector	15.1	11.2	6.0	14.9	11.2	11.8	9.6	7.6	6.0
claims on households	6.9	7.0	3.5	7.7	7.0	6.4	5.3	4.3	3.5
claims on enterprises	8.1	4.2	2.4	7.2	4.2	5.4	4.3	3.2	2.4
claims on the public sector (net)	–1.5	1.3	17.0	0.2	1.3	16.0	18.4	18.6	17.0
Other assets (net) of the banking system	–1.3	0.3	–18.4	–0.2	0.3	–6.1	–16.1	–21.4	–18.4
	% of GDP, ESA 95								
General government revenues	32.5	32.5	34.0	. .	. .	. .	. .	. .	. .
General government expenditures	34.4	34.8	40.8	. .	. .	. .	. .	. .	. .
General government balance	–1.9	–2.3	–6.8	. .	. .	. .	. .	. .	. .
Primary balance	–0.5	–1.1	–5.3	. .	. .	. .	. .	. .	. .
Gross public debt	29.3	27.7	35.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	27.0	13.4	–16.8	19.1	–2.2	–21.2	–25.3	–18.2	–1.6
Merchandise imports	21.5	13.4	–20.5	20.1	–1.9	–19.6	–29.1	–23.6	–8.9
	% of GDP (based on EUR), period total								
Trade balance	–1.2	–1.1	1.9	–0.6	–2.8	–0.3	1.6	3.5	2.5
Services balance	0.7	–0.7	–2.0	–0.7	–1.0	–2.7	–1.6	–1.7	–1.9
Income balance (factor services balance)	–4.3	–3.5	–2.0	–3.3	–2.3	–0.5	–1.3	–3.0	–3.0
Current transfers	–0.6	–1.3	–1.1	–1.1	–1.6	–0.4	–1.0	–0.7	–2.1
Current account balance	–5.4	–6.6	–3.2	–5.6	–7.7	–3.9	–2.4	–1.9	–4.6
Capital account balance	0.6	1.2	0.7	0.5	1.1	1.7	0.9	0.0	0.4
Foreign direct investment (net)	3.9	3.4	–0.5	3.8	7.1	1.2	–5.6	0.2	1.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	54.8	58.2	71.6	58.9	58.2	61.8	69.5	73.3	71.6
Gross official reserves (excluding gold)[1]	22.3	19.5	0.8	19.4	19.5	0.3	0.1	0.8	0.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	3.1	2.8	0.1	2.7	2.8	0.0	0.0	0.1	0.1
	EUR million, period total								
GDP at current prices	54,940	64,899	63,332	17,481	16,889	14,656	15,587	16,568	16,522

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 has 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: Weak Domestic Demand Keeps Inflation Low

Smaller contraction of GDP in the second half of 2009

The contraction of economic output moderated somewhat in the second half of 2009, with GDP falling by 5.5% in the fourth quarter. The largest negative contribution in the fourth quarter came from investments, as capacity utilization rates stagnated at historic lows, corporate borrowing from both domestic and foreign banks came to a standstill and industrial confidence continued to languish. On top of weak investments, destocking shaved 4 percentage points off the GDP growth rate in the fourth quarter. Domestic consumption roughly stagnated in the second half of the year in year-on-year terms, as the decline in the real net wage sum (on the back of declining employment, slowing nominal wage growth and higher inflation) seems to have been mitigated mainly by a cautious recovery of household credit growth. The contribution of net real exports increased in the second half of the year as imports declined more than exports.

External imbalances continue to decline

The favorable development of net real exports was also reflected in the combined current and capital account, which posted a small deficit of around 1.5% of GDP in the second half of 2009. In addition, the current account benefited from the ongoing improvement in the terms of trade and the smaller deficit on the income balance partly due to lower interest payments on external debt and lower FDI-related income outflows. Portfolio capital inflows soared in the third quarter owing to bond issues by the government and by commercial banks (backed by state guarantees). The other investment balance posted minor inflows in the fourth quarter, following sharp outflows in the preceding quarters. The country's external debt rose to around 115% of GDP at end-2009, with the increase since mid-2009 (104% of GDP) roughly equally split between the government and the private sector (primarily banks).

Inflation rises on the back of energy and other regulated prices

Following a period of roughly zero HICP inflation between May and October 2009, inflation accelerated to 2.1% in December before falling back to 1.6% by February 2010. The acceleration was caused by a sharp increase in energy prices (partly as a result of a low base) and hikes in administered prices following the transfer of responsibility for setting municipal services prices to local communities in August 2009. By contrast, core inflation continued to decelerate gradually from 1.2% in October 2009 to 0% in February 2010. Suppressed domestic demand continued to contain inflation, and ULC growth at the macroeconomic level also decelerated substantially in the course of 2009, reaching 3.7% in the fourth quarter of 2009.

Budget deficit unchanged in 2010 but is to be brought below 3% of GDP by 2013

In November 2009, the Council of the European Union decided that an excessive budget deficit existed in Slovenia and called on the authorities to bring the deficit below 3% of GDP by 2013. In accordance with this recommendation, the government in its 2009 stability program update envisaged a reduction in the general government budget deficit from 5.5% of GDP in 2009 to 1.6% in 2013. The bulk of the deficit reduction is planned for 2011 and 2013. The deficit is targeted to remain unchanged in 2010, as the fiscal stimulus measures introduced in 2008 and 2009 are to be phased out gradually by end-2010 and as planned savings allow only for a slowing of expenditure growth. From 2011 onward, fiscal consolidation will rely on the reduction of expenditures by withdrawing the fiscal stimuli, increasing the efficiency of public administration and streamlining public services and transfers, including reforms of pension and health care systems.

Table 5

Main Economic Indicators: Slovenia

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.8	3.5	–7.8	3.6	–0.8	–8.2	–9.2	–8.3	–5.5
Private consumption	6.7	2.0	–1.4	–0.4	1.3	–1.1	–3.2	–0.4	–0.9
Public consumption	0.7	6.2	3.0	5.9	7.2	4.7	4.9	4.3	–1.4
Gross fixed capital formation	11.7	7.7	–21.6	5.6	–3.2	–22.2	–25.4	–21.9	–16.5
Exports of goods and services	13.7	2.9	–15.6	3.3	–6.1	–19.7	–21.5	–16.3	–3.6
Imports of goods and services	16.3	2.9	–17.9	2.3	–6.9	–21.1	–23.7	–17.7	–8.5
	Contribution to GDP growth in percentage points								
Domestic demand	8.7	3.6	–10.1	3.0	–1.8	–9.8	–11.4	–9.7	–9.4
Net exports of goods and services	–2.0	–0.1	2.2	0.7	1.0	1.5	2.1	1.4	3.9
Exports of goods and services	9.5	2.1	–11.5	2.5	–4.5	–14.9	–16.3	–12.0	–2.5
Imports of goods and services	11.5	2.2	–13.7	1.8	–5.5	–16.4	–18.4	–13.4	–6.4
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	6.4	3.1	–7.8	3.9	–5.4	–12.3	–16.0	–8.0	6.6
Average gross earnings in industry (nominal)	6.9	7.8	1.4	9.5	4.0	0.7	0.3	1.0	3.5
Unit labor costs in industry (nominal)	0.4	4.9	9.7	5.3	10.0	14.8	19.5	9.8	–2.8
Producer price index (PPI) in industry	4.4	3.9	–1.4	5.1	3.2	1.1	–1.6	–3.1	–2.0
Consumer price index (here: HICP)	3.8	5.5	0.9	6.2	3.1	1.7	0.6	–0.2	1.4
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.0	4.5	6.0	4.2	4.3	5.4	5.7	6.3	6.6
Employment rate (%, 15–64 years)	67.8	68.6	67.5	70.1	68.8	66.7	67.6	68.3	67.5
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
SIT per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	26.0	6.9	1.7	8.4	6.9	8.0	5.7	2.8	1.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–23.1	–11.9	6.6	–14.0	–11.9	–10.7	–1.0	6.2	6.6
Domestic credit of the banking system	35.1	20.8	2.1	23.5	20.8	21.5	10.7	3.1	2.1
of which: claims on the private sector	42.6	22.7	4.7	29.2	22.7	18.0	10.1	6.6	4.7
claims on households	9.0	5.0	2.7	6.3	5.0	3.6	2.6	2.5	2.7
claims on enterprises	33.6	17.7	2.0	22.8	17.7	14.3	7.5	4.2	2.0
claims on the public sector (net)	–7.5	–1.8	–2.6	–5.6	–1.8	3.6	0.7	–3.5	–2.6
Other assets (net) of the banking system	14.0	–2.0	–7.0	–1.1	–2.0	–2.9	–4.1	–6.5	–7.0
	% of GDP, ESA 95								
General government revenues	42.4	42.6	44.4	. .	. .	. .	. .	. .	. .
General government expenditures	42.4	44.3	49.9	. .	. .	. .	. .	. .	. .
General government balance	0.0	–1.7	–5.5	. .	. .	. .	. .	. .	. .
Primary balance	1.3	–0.6	–4.1	. .	. .	. .	. .	. .	. .
Gross public debt	23.3	22.6	35.9	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	16.3	1.3	–19.2	2.3	–9.6	–22.5	–23.9	–21.4	–7.6
Merchandise imports	18.1	5.7	–25.9	8.7	–7.1	–26.6	–32.0	–28.0	–15.8
	% of GDP (based on EUR), period total								
Trade balance	–4.8	–7.1	–1.8	–7.8	–8.1	–1.8	–0.2	–2.3	–2.8
Services balance	3.0	4.3	2.9	5.0	3.4	2.8	3.4	3.3	2.2
Income balance (factor services balance)	–2.3	–2.8	–1.9	–4.1	–2.6	–2.6	–1.7	–1.7	–1.4
Current transfers	–0.7	–0.6	–0.3	0.2	–0.7	–1.7	0.1	–0.5	1.0
Current account balance	–4.8	–6.2	–1.0	–6.6	–8.0	–3.2	1.6	–1.3	–1.1
Capital account balance	–0.2	–0.1	0.0	–0.1	–0.3	–0.1	0.5	0.0	–0.5
Foreign direct investment (net)	–0.6	1.0	–1.9	1.3	3.1	–1.7	–3.5	–1.0	–1.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	100.6	105.7	115.0	108.8	105.7	102.1	104.3	113.9	115.0
Gross official reserves (excluding gold)[1]	1.9	1.7	1.9	1.7	1.7	1.4	1.3	1.9	1.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.3	0.3	0.4	0.3	0.3	0.3	0.2	0.4	0.4
	EUR million, period total								
GDP at current prices	34,568	37,135	34,894	9,656	9,195	8,287	8,928	8,921	8,758

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 has 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: Recession Deepens due to Lag Effects in Private Agents' Adjustment and Public Sector Austerity

A further slump in domestic demand deepens the recession in the second half of 2009

The output contraction accelerated on a year-on-year basis in the second half of 2009, leading to an average annual real GDP decline of 5%. The strong negative growth contribution of domestic demand deteriorated further in the second half of 2009, as private households were apparently affected by the crisis with a certain lag and as public consumption declined sharply in the fourth quarter of 2009.

The overall unemployment rate steadily increased to nearly 9% in February 2010. According to the 2009 fall wave of the OeNB Euro Survey, the share of Bulgarians responding that the crisis had affected their job perspectives had risen substantially, and households increasingly perceived that the crisis had affected their financial situation. This is also mirrored by macro figures: Real domestic private sector credit growth decelerated further, while the share of nonperforming loans in total loans was 1.5 times higher at the end of 2009 than in mid-2009.

On the positive side: exports recover, macroeconomic imbalances are corrected further, deterioration of external competitiveness slows down

In the fourth quarter of 2009, exports returned to a mildly positive growth path as the recovery of principal export partners gained ground (about 65% of Bulgarian exports are intra-EU flows). This not only strengthened the positive growth contribution of net exports, but also the combined current and capital account, whose deficit – for the first time since 2004 – fell below 10% by year-end.

Prices moderated markedly amid the downturn (in 2009, consumer price inflation was nearly six times lower than in 2008, and producer prices even decreased). However, annual HICP inflation recently picked up somewhat to reach 1.7% in February 2010 because of a renewed increase in energy prices and excise duties on alcohol and tobacco.

Bulgaria's external competitiveness has so far not improved but it is deteriorating much more slowly now than it did until the first half of 2009. The appreciation of the real effective exchange rate came to a halt in 2009, and recently there has even been a mild depreciation of about 2% year on year. While labor productivity showed a clear trend reversal toward positive growth, wage pressure seems to have remained high, as industrial wages are still growing at an annual rate of around 10%. Thus, despite a marked deceleration to 2007 levels, annual ULC growth in industry is still the highest in the region covered in this report.

Despite significant fiscal consolidation measures since July 2009, the general government deficit remains high in 2009, delaying application for ERM II entry

Starting from a balanced budget target in July 2009, the newly elected government implemented significant consolidation measures in the second half of 2009 (of more than 2% of GDP). Due to a stronger-than-expected erosion of tax bases, the Bulgarian parliament nevertheless had to amend the budget law in December 2009, providing for a general government deficit of 1.9% of GDP in 2009. In April 2010, the Bulgarian government unexpectedly revised the deficit ratio upward to as much as 3.9% (and the 2008 surplus ratio downward from 1.8% to between 1.5% and 1.6%), as new budget data revealed a host of unfunded liabilities related to procurement deals that had mainly been concluded in 2008 and early 2009. As a consequence, Bulgaria will not apply for ERM II membership in 2010, also setting back the target year for euro adoption (formerly 2013). Having given up its aim to balance the budget in 2010, the government nevertheless announced that it will strive to keep the deficit below 3% of GDP.

Table 6

Main Economic Indicators: Bulgaria

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.2	6.0	–5.0	6.8	3.5	–3.5	–4.9	–5.4	–5.9
Private consumption	5.3	4.8	–6.3	6.4	1.5	–6.3	–5.6	–5.2	–7.9
Public consumption	3.1	0.1	–5.5	0.4	1.2	–0.4	4.1	1.0	–18.8
Gross fixed capital formation	21.7	20.3	–26.9	22.3	15.8	–14.1	–16.3	–36.5	–35.4
Exports of goods and services	5.2	2.9	–9.8	3.8	–6.0	–17.4	–15.8	–6.7	0.8
Imports of goods and services	9.9	4.9	–22.3	4.2	–3.2	–21.1	–24.3	–23.4	–20.0
	Contribution to GDP growth in percentage points								
Domestic demand	11.2	7.2	–19.3	4.0	4.3	–13.5	–16.7	–23.6	–21.8
Net exports of goods and services	–5.6	–2.8	14.7	–1.1	–0.5	9.9	14.3	15.7	17.7
Exports of goods and services	3.4	1.9	–6.2	2.6	–3.5	–11.8	–10.7	–4.5	0.4
Imports of goods and services	9.1	4.6	–20.9	3.7	–3.0	–21.8	–25.0	–20.2	–17.3
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	7.8	1.2	–8.5	4.7	–5.7	–11.4	–11.1	–9.3	–2.4
Average gross earnings in industry (nominal)	19.7	21.4	11.4	21.5	16.7	12.7	12.0	9.6	11.2
Unit labor costs in industry (nominal)	10.9	20.0	21.9	16.0	23.7	27.1	26.0	20.9	13.9
Producer price index (PPI) in industry	7.6	11.1	–6.3	12.7	4.6	–3.4	–6.9	–10.2	–4.9
Consumer price index (here: HICP)	7.6	12.0	2.5	12.5	9.0	5.1	3.1	0.8	0.9
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)	7.0	5.7	6.9	5.2	5.1	6.4	6.4	6.7	8.0
Employment rate (%, 15–64 years)	61.7	64.0	62.6	65.0	64.3	62.6	63.3	63.1	61.2
Key interest rate per annum (%)[1]	. .	. .	. .	. .	. .	. .	. .	. .	. .
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	31.2	8.8	4.3	19.5	8.8	6.3	3.6	1.6	4.3
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.5	–12.3	1.7	–4.3	–12.3	–10.5	–7.1	–9.3	1.7
Domestic credit of the banking system	38.7	26.3	6.8	31.1	26.3	23.1	16.1	15.0	6.8
of which: claims on the private sector	45.3	28.4	4.1	40.4	28.4	23.0	11.6	5.6	4.1
claims on households	14.8	10.3	2.3	14.0	10.3	8.6	4.8	2.8	2.3
claims on enterprises	30.5	18.1	1.8	26.4	18.1	14.4	6.8	2.8	1.8
claims on the public sector (net)	–6.7	–2.1	2.7	–9.3	–2.1	0.1	4.5	9.4	2.7
Other assets (net) of the banking system	–9.0	–5.1	–4.1	–7.4	–5.1	–6.3	–5.4	–4.1	–4.1
	% of GDP, ESA 95								
General government revenues	41.5	39.1	36.9	. .	. .	. .	. .	. .	. .
General government expenditures	41.6	37.3	40.8	. .	. .	. .	. .	. .	. .
General government balance	0.1	1.8	–3.9	. .	. .	. .	. .	. .	. .
Primary balance	1.1	2.6	–3.1	. .	. .	. .	. .	. .	. .
Gross public debt	18.2	14.1	14.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	12.6	12.5	–22.5	15.8	–10.4	–26.6	–33.1	–26.4	0.2
Merchandise imports	18.2	14.6	–33.2	14.8	–5.8	–29.5	–39.3	–36.6	–26.1
	% of GDP (based on EUR), period total								
Trade balance	–25.1	–25.2	–12.1	–21.1	–24.5	–16.0	–15.0	–9.2	–9.4
Services balance	2.6	3.9	4.6	12.8	–0.2	0.0	3.1	12.8	1.2
Income balance (factor services balance)	–3.9	–5.2	–4.7	–4.7	–5.5	–7.0	–6.5	–3.6	–2.2
Current transfers	1.2	2.4	2.7	1.6	0.4	3.0	3.8	2.1	2.2
Current account balance	–25.2	–24.0	–9.4	–11.4	–29.7	–20.1	–14.6	2.1	–8.1
Capital account balance	–2.1	0.8	1.4	0.4	0.4	2.6	1.5	0.8	1.1
Foreign direct investment (net)	28.7	18.2	9.8	19.7	16.0	12.7	8.0	6.5	12.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	100.4	108.7	111.3	110.4	108.7	107.2	107.2	107.8	111.3
Gross official reserves (excluding gold)	38.8	35.0	35.3	42.4	35.0	31.8	31.9	33.6	35.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.4	5.1	7.5	5.9	5.1	5.0	5.7	6.6	7.5
	EUR million, period total								
GDP at current prices	28,899	34,118	33,877	9,515	9,557	7,138	8,345	9,232	9,161

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

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

5 Czech Republic: Light at the End of the (Economic) Tunnel

The country seems to have passed the economic trough

Although the economy is not out of the woods yet, it seems to have passed the trough. GDP still kept on shrinking on a year-on-year basis in the last two quarters of 2009 (by –5.0% and –2.8%, respectively), bringing the annual average growth rate to –4.2%. However, in quarter-on-quarter terms, economic activity started to expand again in the third (0.6%) and in the final quarter (0.7%) of 2009 after three consecutive quarters of negative GDP growth. All components but public consumption acted as a drag on output in 2009. Gross fixed capital formation and particularly the reduction in inventories proved to be a damper on growth. While the contribution of net exports to GDP dynamics improved substantially over the course of the year and even turned strongly positive in the last quarter, private consumption followed exactly the opposite trend, given slower wage increases and rising unemployment.

The labor market continues to deteriorate

The economic decline continued to feed through to the labor market and was reflected in major indicators, such as a decreasing employment rate, a reduced number of vacancies and occupied jobs and, naturally, rising unemployment. The jobless rate came to 7.3% at end-2009, up by some 3 percentage points on the rate in the summer of 2008. ULCs in industry declined in the fourth quarter of 2009, with productivity growth outpacing wage increases as industrial dynamics recovered somewhat from their trough in early 2009.

Currency appreciation weakens …

As from spring 2009, the Czech koruna continued to appreciate vis-à-vis the euro up to September 2009 and has weakened slightly since then. Although the appreciation counteracted the strong recovery of the trade balance somewhat (on the back of weaker import demand), the current account deficit was still substantially lower at the end of 2009 than a year earlier (–1.1% of GDP, compared with –3.1%). Some two-thirds of this shortfall was covered by reviving FDI inflows.

… and inflation starts to increase somewhat again

After inflation had even dropped below zero in October 2009, the long-run downward trend – attributable particularly to slower growth of regulated prices and the anti-inflationary effect of low domestic demand – petered out, with price index increases edging up gradually from the fourth quarter of 2009. The recent rise was mainly brought about by a pronounced upturn in fuel prices. Yet, despite the upswing, inflation is still hovering well below the lower boundary of the tolerance band around the Czech National Bank's (CNB's) new inflation target (2% ±1 percentage point) effective from 2010. Against this backdrop, the CNB cut the key interest rate once more in December 2009, bringing it to 1.00%.

Fiscal policy focus shifts from stimulus to consolidation

On the fiscal side, the policy focus has shifted from stimulus to consolidation. In light of the unexpected depth of the recession, the general government deficit came to 5.9% of GDP in 2009, missing the parliament-approved target by around 5 percentage points. The government subsequently pushed a fiscal consolidation package through parliament, which is weighted toward the revenue side, particularly indirect taxes. This package is meant to limit the budget deficit in 2010 to 5.3% of GDP. While the revenue-raising measures of the package are of indefinite duration, spending cuts are limited to 2010. The future path of consolidation will to a large extent depend on the outcome of the upcoming election.

Table 7

Main Economic Indicators: Czech Republic

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.1	2.5	–4.2	3.4	–0.1	–3.9	–5.2	–5.0	–2.8
Private consumption	5.0	3.6	–0.2	3.8	2.3	0.9	0.0	–0.6	–0.9
Public consumption	0.7	1.0	4.4	3.1	–0.3	3.4	3.4	5.5	5.1
Gross fixed capital formation	10.8	–1.5	–8.3	–1.0	–4.1	–8.1	–7.7	–10.4	–7.0
Exports of goods and services	15.0	6.0	–10.2	7.7	–9.8	–18.5	–16.1	–7.7	3.0
Imports of goods and services	14.3	4.7	–10.2	4.3	–6.5	–17.5	–15.7	–6.1	–1.2
	Contribution to GDP growth in percentage points								
Domestic demand	5.4	1.1	–4.5	0.3	3.2	–2.2	–4.3	–4.2	–7.3
Net exports of goods and services	0.7	1.4	–0.2	3.4	–3.5	–1.9	–1.2	–1.9	4.0
Exports of goods and services	14.1	6.1	–10.7	7.6	–10.6	–20.8	–17.5	–7.9	2.9
Imports of goods and services	13.3	4.7	–10.5	4.2	–7.0	–18.9	–16.3	–6.0	–1.2
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	8.2	–2.8	–2.4	0.4	–11.3	–12.1	–7.6	0.3	11.2
Average gross earnings in industry (nominal)	7.1	8.1	4.0	7.0	5.5	1.2	2.0	5.5	7.1
Unit labor costs in industry (nominal)	–1.0	11.4	6.4	6.6	19.0	15.2	10.4	5.2	–3.7
Producer price index (PPI) in industry	2.6	0.4	–1.5	0.0	0.7	1.9	–1.1	–3.7	–3.1
Consumer price index (here: HICP)	3.0	6.3	0.6	6.5	4.4	1.5	1.0	–0.1	0.0
EUR per 1 CZK, + = CZK appreciation	2.1	11.2	–5.7	15.9	5.7	–7.5	–7.0	–5.8	–2.2
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.4	4.4	6.7	4.3	4.4	5.8	6.4	7.4	7.3
Employment rate (%,15–64 years)	66.1	66.6	65.4	66.7	66.8	65.6	65.4	65.2	65.3
Key interest rate per annum (%)	2.9	3.5	1.5	3.6	3.0	2.0	1.6	1.3	1.2
CZK per 1 EUR	27.8	25.0	26.5	24.1	25.4	27.6	26.7	25.6	25.9
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	16.1	13.6	0.2	13.2	13.6	12.3	9.1	3.2	0.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–0.1	0.2	1.1	0.1	0.2	4.1	2.6	–0.7	1.1
Domestic credit of the banking system	15.3	11.0	4.6	9.7	11.0	8.9	9.3	6.6	4.6
of which: claims on the private sector	18.2	10.6	0.3	14.7	10.6	9.0	5.2	2.0	0.3
claims on households	9.1	6.5	3.8	8.0	6.5	6.2	5.4	4.6	3.8
claims on enterprises	9.2	4.1	–3.5	6.6	4.1	2.7	–0.3	–2.5	–3.5
claims on the public sector (net)	–2.9	0.4	4.3	–5.0	0.4	–0.1	4.1	4.6	4.3
Other assets (net) of the banking system	0.9	2.4	–5.4	3.4	2.4	–0.7	–2.7	–2.7	–5.4
	% of GDP, ESA 95								
General government revenues	41.8	40.2	40.3	. .	. .	. .	. .	. .	. .
General government expenditures	42.5	42.9	46.2	. .	. .	. .	. .	. .	. .
General government balance	–0.7	–2.7	–5.9	. .	. .	. .	. .	. .	. .
Primary balance	0.4	–1.6	–4.6	. .	. .	. .	. .	. .	. .
Gross public debt	29.0	30.0	35.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	18.2	10.4	–18.3	14.8	–9.1	–24.9	–24.8	–17.6	–3.8
Merchandise imports	16.0	11.1	–21.9	13.5	–4.0	–26.0	–27.9	–20.9	–12.2
	% of GDP (based on EUR), period total								
Trade balance	3.4	2.8	5.0	2.9	–0.7	4.8	5.7	4.9	4.6
Services balance	1.4	2.2	0.7	2.1	1.9	1.7	1.0	0.3	0.0
Income balance (factor services balance)	–7.2	–7.8	–6.4	–7.4	–6.7	–4.1	–10.0	–6.6	–4.7
Current transfers	–0.8	–0.3	–0.4	–0.8	–0.7	0.5	–0.1	–1.2	–0.7
Current account balance	–3.2	–3.1	–1.1	–3.2	–6.2	2.9	–3.3	–2.6	–0.8
Capital account balance	0.6	0.8	1.1	0.2	1.0	1.8	0.5	0.6	1.7
Foreign direct investment (net)	5.1	4.1	0.7	4.4	3.6	1.7	0.0	–2.0	3.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	40.5	40.3	43.7	44.4	40.3	39.1	41.3	42.0	43.7
Gross official reserves (excluding gold)	18.4	17.8	20.8	17.3	17.8	18.9	19.0	20.0	20.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	2.9	3.0	3.9	2.8	3.0	3.3	3.4	3.7	3.9
	EUR million, period total								
GDP at current prices	127,423	147,939	137,316	38,814	37,131	31,651	34,404	35,519	35,742

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

6 Hungary: Recession Eases, Vulnerabilities Decrease

Recessionary trends ease in the second half of 2009

The decline in GDP moderated during the second half of 2009, with the economy contracting by 4% year on year in the fourth quarter. Private consumption continued to be depressed by the steep decline in the net aggregate real wage, while household credit growth ground to a halt in year-on-year terms by end-2009 and social transfers tightened. Public consumption posted modest growth in the fourth quarter, but this was due to the very weak base a year earlier. The decrease in investments deepened in the second half of the year, given low levels of capacity utilization, weak demand conditions, the faster year-on-year contraction of the stock of credit to the corporate sector and the tightening of the housing subsidy scheme from mid-2009. Net exports made a strong positive contribution in the second half, with export growth turning positive and the decline in imports having moderated sharply by the fourth quarter.

External vulnerabilities have decreased

Hungary's combined current and capital account posted a surplus of around 2.7% of GDP in the second half of 2009. The bulk of the improvement compared to the second half of 2008 (–6.8%) came from the goods and services balance, but the deficit in the income balance also was smaller mainly because dividend payments were lower. Foreign parent banks maintained their exposure to their subsidiaries, while the government was able to finance its deficit and rollover needs from the capital markets and has not drawn further funds from the IMF and the EU since September 2009. The exchange rate of the forint versus the euro was relatively stable at around 265 to 275, and the country's risk premiums as measured by CDS spreads decreased over the past few months. The improvement in the country's risk assessment and external vulnerability – along with the favorable inflation outlook – allowed the Hungarian central bank (MNB) to continue cutting interest rates in small steps by a combined 200 basis points between end-September 2009 and end-February 2010.

Inflation to diminish in the second half of 2010

Following a temporary slowdown in September and October (to 4.2%), inflation accelerated to 5.6% in February 2010 on the back of higher energy and food prices, additional increases in VAT and excise taxes and weight changes in the HICP basket at the beginning of 2010. By contrast, core inflation was stable at 5.0% to 5.3% between July 2009 and February 2010. In its latest inflation report, the MNB expected inflation to peak at 6% to 6.5% in the first quarter of 2010 and to fall rapidly in the second half of 2010 (to 3.2% to 3.3%) and further to around 2% in 2011 (below the MNB's target of 3%). Apart from the base effect of indirect tax hikes, the negative output gap and weak domestic consumption are expected to be the major disinflationary factors.

Hungary achieves 2009 budget deficit target, future surrounded by uncertainty

In February 2010, the Council of the European Union stated that Hungary had so far taken effective action to bring the budget deficit below 3% of GDP by 2011. In its convergence program update of January 2010, the government pledged to reduce the budget deficit from 4.0% of GDP in 2009 to 2.8% in 2011 and further to 2.5% in 2012. The deficit is envisaged to decline by only 0.1% of GDP in 2010, as savings measures will be counterbalanced by revenue losses due to weak economic growth and Constitutional Court decisions adversely affecting tax receipts. In 2011 to 2012, the decline in the deficit will rely on larger reductions of expenditures than of revenues. However, the budgetary outlook is uncertain, in particular given the change in government following parliamentary elections in April 2010.

Table 8

Main Economic Indicators: Hungary

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	1.0	0.6	–6.3	1.4	–2.5	–6.7	–7.5	–7.1	–4.0
Private consumption	0.4	–0.5	–7.5	0.3	–4.2	–7.2	–6.7	–9.7	–6.3
Public consumption	–7.4	–0.8	–1.1	3.7	–7.1	–2.0	–0.5	–3.1	1.0
Gross fixed capital formation	1.6	0.4	–6.5	1.6	0.4	–7.0	–3.4	–6.8	–8.1
Exports of goods and services	16.2	5.6	–9.1	4.2	–6.2	–17.8	–13.9	–6.9	3.1
Imports of goods and services	13.3	5.7	–15.4	4.4	–6.1	–21.5	–22.6	–14.6	–2.0
	Contribution to GDP growth in percentage points								
Domestic demand	–1.2	0.7	–11.5	1.5	–2.4	–10.0	–15.0	–13.2	–7.8
Net exports of goods and services	3.1	0.0	7.4	–0.1	–0.3	4.1	10.6	8.8	5.9
Exports of goods and services	16.7	6.6	–11.3	4.9	–7.4	–24.5	–17.7	–8.4	3.6
Imports of goods and services	13.6	6.6	–18.7	5.0	–7.0	–28.5	–28.2	–17.2	–2.3
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	9.4	0.2	–6.5	–1.6	–9.4	–14.9	–11.0	–4.5	4.7
Average gross earnings in industry (nominal)	8.3	6.3	4.6	6.6	4.7	3.9	3.6	5.7	5.1
Unit labor costs in industry (nominal)	–1.0	6.4	12.0	8.6	16.7	22.7	16.5	11.0	–0.6
Producer price index (PPI) in industry	0.4	4.6	4.6	3.3	6.1	7.6	6.3	4.1	0.4
Consumer price index (here: HICP)	7.9	6.0	4.0	6.3	4.2	2.7	3.6	4.9	4.9
EUR per 1 HUF, + = HUF appreciation	5.1	–0.2	–10.3	6.6	–4.0	–11.8	–13.3	–13.0	–2.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.4	7.9	10.1	7.8	8.0	9.7	9.6	10.4	10.5
Employment rate (%, 15–64 years)	57.3	56.7	55.4	57.3	56.7	55.1	55.6	55.5	55.5
Key interest rate per annum (%)	7.8	8.7	8.6	8.5	10.5	9.6	9.5	8.5	6.8
HUF per 1 EUR	251.3	251.7	280.5	236.1	263.5	294.1	285.9	271.3	270.9
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	11.0	8.8	3.4	8.5	8.8	8.6	11.9	7.5	3.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–6.8	–3.8	13.3	–4.7	–3.8	4.9	7.7	15.1	13.3
Domestic credit of the banking system	21.3	18.2	–4.1	18.1	18.2	14.0	13.7	0.8	–4.1
of which: claims on the private sector	19.3	20.4	–4.7	17.7	20.4	24.0	15.2	5.3	–4.7
claims on households	9.1	12.7	0.8	9.8	12.7	14.0	10.1	6.4	0.8
claims on enterprises	10.2	7.6	–5.5	7.9	7.6	10.0	5.1	–1.1	–5.5
claims on the public sector (net)	1.9	–2.1	0.5	0.5	–2.1	–10.0	–1.5	–4.5	0.5
Other assets (net) of the banking system	–3.4	–5.6	–5.8	–4.9	–5.6	–10.2	–9.6	–8.4	–5.8
	% of GDP, ESA 95								
General government revenues	44.8	45.4	45.8	. .	. .	. .	. .	. .	. .
General government expenditures	49.8	49.2	49.8	. .	. .	. .	. .	. .	. .
General government balance	–5.0	–3.8	–4.0	. .	. .	. .	. .	. .	. .
Primary balance	–0.9	0.4	0.7	. .	. .	. .	. .	. .	. .
Gross public debt	65.9	72.9	78.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	16.8	6.7	–19.2	6.8	–8.6	–27.0	–25.7	–18.8	–3.5
Merchandise imports	12.5	7.1	–24.8	9.5	–7.3	–28.9	–31.4	–26.0	–11.5
	% of GDP (based on EUR), period total								
Trade balance	0.2	–0.1	4.3	–1.5	–0.3	3.0	5.2	4.1	4.8
Services balance	1.0	0.9	1.6	1.9	0.1	0.5	1.6	2.8	1.2
Income balance (factor services balance)	–7.3	–7.3	–6.0	–8.1	–7.7	–6.4	–6.7	–6.0	–5.2
Current transfers	–0.5	–0.6	0.3	–0.3	–0.9	–1.0	0.6	0.6	0.9
Current account balance	–6.5	–7.1	0.2	–8.0	–8.8	–3.8	0.7	1.5	1.7
Capital account balance	0.7	1.0	1.4	0.5	2.7	1.5	1.8	1.4	0.8
Foreign direct investment (net)	1.3	2.6	–0.2	0.6	5.2	1.9	–5.8	–0.5	3.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	97.8	116.4	139.6	112.4	116.4	126.1	133.3	139.9	139.6
Gross official reserves (excluding gold)	16.2	22.7	32.8	16.4	22.7	27.3	27.5	32.5	32.8
	Months of imports of goods and services								
Gross official reserves (excluding gold)	2.5	3.4	5.5	2.4	3.4	4.2	4.3	5.3	5.5
	EUR million, period total								
GDP at current prices	101,093	105,606	93,319	27,946	27,041	20,220	22,516	24,084	26,499

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

7 Poland: Ongoing Reemergence of Export-Driven Growth

Social transfer payments and public fixed investment support growth in 2009

Poland posted an annual GDP growth rate of 1.7% in 2009. GDP growth accelerated during 2009 to come to 3.3% year on year and 1.2% quarter on quarter in the fourth quarter. Among the final demand components, private consumption posted the largest (albeit declining) growth contribution in 2009. Gross fixed investment remained stagnant, as public infrastructure projects offset the sharp fall in private sector fixed investment. However, substantial destocking of inventories slashed GDP growth by 2.7 percentage points in 2009. Exports started to grow in quarter-on-quarter terms in the third quarter, but were still lower than in the fourth quarter of the previous year. In 2009, imports fell more strongly than exports, so that net exports made a positive growth contribution. Even though imports also started to grow again on a quarter-on-quarter basis in the third quarter, the contribution of net exports to both annual and quarterly growth in the fourth quarter was still positive. Private consumption benefited from large increases in social transfer payments, from real wage growth of close to 1% and from declining but positive annual employment growth up to the third quarter of 2009 because companies retained labor during the crisis. Nevertheless, the unemployment rate rose to 8.2% in the third quarter of 2009 as a result of a further rise in the activity rate. Moreover, consumer loans continued to rise at double-digit annual rates up to the fourth quarter of 2009, when the rate slowed. For 2010, monthly indicators point to a continued improvement in manufacturing, while construction output and retail sales have so far been weaker than expected.

Disinflation due to złoty's renewed appreciation, ULC decline and low demand pressure

Annual inflation decreased to 4.0% (HICP) and 2.6% (CPI) in March 2010, after peaking at 4.5% (HICP) in July and 4.0% (CPI) in April 2009, respectively. In parallel, core inflation fell to 2.0% in March. Disinflation was the result of currency reappreciation – the złoty gained 16% against the euro from February 2009 after depreciating by 30% in the six previous months – a continuous drop in nominal ULCs in manufacturing of around 7% year on year in the fourth quarter of 2009, and low demand pressure. Taking these factors into account, the Polish Monetary Policy Council (MPC) found at the end of March 2010 that "the probabilities of inflation running below or above the inflation target (i.e. 2.5% for the CPI) in the medium term are balanced." Accordingly, the MPC has kept the key policy rate at 3.5% since end-June 2009, having lowered it from 6% from October 2008 to June 2009, and has maintained required reserve rates at 3% since mid-2009.

Convergence program update backloads fiscal consolidation to 2011 and 2012

Poland's ESA 95 budget deficit in 2009 reached 7.1% of GDP,[9] after 3.6% of GDP in 2008,[10] in response to which the Ecofin had issued an EDP recommendation in July 2009 that required a correction by 2012 by ensuring an average annual fiscal correction of at least 1.25 percentage points of GDP from 2010 onward. In 2009, the deficit rose as a result of a fall in revenues (by 2 percentage points of GDP) and a rise in expenditures (by about 1 percentage point) that mainly reflected higher social transfer payments. The convergence program update of February 2010 envisages a deficit of 6.9% of GDP in 2010 (assuming a 2009 deficit of 7.1%). It further envisages that the 2.2 percentage point increase in revenues will be nearly matched by the expansion of expenditures (mainly due to public fixed investment). The program envisages tackling the bulk of fiscal consolidation in 2011 (bringing the deficit to 5.9% of GDP) and above all in 2012 (bringing the deficit to 2.9%). Government gross debt is expected to peak at 56.3% at end-2011.

[9] *Includes net fiscal costs of 3.2% of GDP for the pension reform.*

[10] *Includes net fiscal costs of 2.9% of GDP for the pension reform.*

Table 9

Main Economic Indicators: Poland

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.8	5.0	1.7	5.5	2.6	0.9	1.2	1.2	3.3
Private consumption	4.9	5.9	2.3	5.2	6.3	4.0	1.7	2.4	0.9
Public consumption	3.7	7.5	1.2	7.4	12.4	5.6	–1.6	0.4	0.6
Gross fixed capital formation	17.2	8.2	–0.3	5.0	4.2	–0.4	–1.5	–0.6	0.7
Exports of goods and services	9.1	7.0	–10.7	9.2	–2.8	–15.2	–15.4	–11.3	–0.6
Imports of goods and services	13.5	8.1	–14.2	8.9	–1.6	–16.9	–19.8	–14.7	–5.3
	Contribution to GDP growth in percentage points								
Domestic demand	9.2	5.7	–1.2	5.8	2.7	–1.6	–2.4	–1.8	0.8
Net exports of goods and services	–2.1	–0.8	2.1	–0.4	–0.4	1.5	2.9	2.2	1.9
Exports of goods and services	3.5	2.8	–4.3	3.7	–1.0	–6.3	–6.4	–4.7	–0.2
Imports of goods and services	5.5	3.6	–6.4	4.0	–0.7	–7.8	–9.4	–6.9	–2.1
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	5.9	1.5	2.5	1.3	–4.7	–6.1	–1.0	5.4	11.9
Average gross earnings in industry (nominal)	8.7	8.8	4.9	9.1	6.5	5.9	4.2	4.4	5.1
Unit labor costs in industry (nominal)	2.6	7.4	2.5	8.1	11.9	13.4	5.2	–1.0	–6.4
Producer price index (PPI) in industry	2.1	2.4	3.9	2.0	2.9	5.8	4.8	2.7	2.4
Consumer price index (here: HICP)	2.6	4.2	4.0	4.4	3.6	3.6	4.3	4.3	3.8
EUR per 1 PLN, + = PLN appreciation	3.0	7.6	–18.8	14.5	–3.1	–20.6	–23.5	–21.1	–9.7
	Period average levels								
Unemployment rate (ILO definition, %, 15-64 years)	9.7	7.2	8.3	6.7	6.8	8.4	8.0	8.2	8.6
Employment rate (%, 15–64 years)	57.0	59.2	59.4	60.0	60.0	58.9	59.3	59.9	59.4
Key interest rate per annum (%)	4.4	5.7	3.8	6.0	5.8	4.4	3.7	3.5	3.5
PLN per 1 EUR	3.8	3.5	4.3	3.3	3.8	4.5	4.5	4.2	4.2
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.4	18.6	8.1	17.3	18.6	17.5	14.4	9.6	8.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–9.0	–13.6	3.1	–10.6	–13.6	–9.3	–6.3	–1.9	3.1
Domestic credit of the banking system	20.0	39.2	9.3	28.9	39.2	38.7	30.9	18.0	9.3
of which: claims on the private sector	22.5	30.1	6.6	23.6	30.1	29.7	23.1	16.2	6.6
claims on households	14.6	20.8	6.8	15.4	20.8	21.1	17.7	13.7	6.8
claims on enterprises	7.9	9.3	–0.2	8.2	9.3	8.6	5.4	2.5	–0.2
claims on the public sector (net)	–2.5	9.1	2.7	5.3	9.1	9.0	7.8	1.8	2.7
Other assets (net) of the banking system	2.4	–6.9	–4.3	–0.9	–6.9	–11.9	–10.2	–6.5	–4.3
	% of GDP, ESA 95								
General government revenues	40.3	39.6	37.4	. .	. .	. .	. .	. .	. .
General government expenditures	42.2	43.3	44.5	. .	. .	. .	. .	. .	. .
General government balance	–1.9	–3.7	–7.1	. .	. .	. .	. .	. .	. .
Primary balance	0.4	–1.5	–4.5	. .	. .	. .	. .	. .	. .
Gross public debt	45.0	47.2	51.0	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	13.3	14.2	–17.1	20.5	–6.2	–22.2	–23.8	–20.1	0.1
Merchandise imports	19.5	17.2	–25.4	23.9	–2.4	–28.2	–32.2	–27.8	–12.1
	% of GDP (based on EUR), period total								
Trade balance	–4.0	–4.9	–1.0	–4.7	–5.4	–1.1	–0.7	–1.0	–1.3
Services balance	1.1	1.0	1.1	0.7	1.5	1.2	1.2	0.9	1.2
Income balance (factor services balance)	–3.8	–2.6	–3.2	–2.3	–2.2	–2.3	–4.3	–3.0	–3.4
Current transfers	2.0	1.5	1.5	2.1	0.9	2.2	2.3	1.6	0.4
Current account balance	–4.7	–5.0	–1.6	–4.2	–5.2	0.0	–1.5	–1.5	–3.1
Capital account balance	1.1	1.1	1.6	0.4	0.5	2.7	1.4	0.6	2.0
Foreign direct investment (net)	4.2	2.2	2.0	0.9	2.1	1.9	1.8	3.5	0.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	51.0	47.7	62.4	51.6	47.7	48.7	52.9	59.9	62.4
Gross official reserves (excluding gold)	13.7	11.6	17.0	13.7	11.6	12.6	13.7	16.2	17.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.8	3.2	5.2	3.7	3.2	3.5	4.0	4.9	5.2
	EUR million, period total								
GDP at current prices	311,669	362,440	310,705	95,087	92,827	69,822	73,284	78,969	88,630

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

8 Romania: Waiting for Recovery, Multilateral Support Program Back on Track

Economy still in recession, unemployment on the rise

After having stabilized in quarter-on-quarter terms in the third quarter of 2009, GDP fell again in the final quarter (–1.5% in quarter-on-quarter terms), bringing the drop in full-year GDP to 7.1%. In the second half of 2009, net exports continued to deliver a strongly positive growth contribution, while domestic demand was still on the decline. In the fourth quarter of 2009, the fall in gross fixed capital formation even accelerated in year-on-year terms, whereas the decline in private consumption decelerated. Annual export growth turned positive in the fourth quarter, but the positive growth contribution of net exports diminished markedly, as imports fell less than in the first three quarters of 2009. In addition to the negative GDP dynamics, the unemployment rate increased further to 7.8% in the fourth quarter of 2009 compared to 6.1% a year earlier.

Reduction of the current account deficit goes on

The current account deficit continued to contract sharply in the second half of 2009, bringing the current account deficit for the whole year down to 4.4% of GDP from 11.6% in 2008. The external adjustment was largely driven by collapsing domestic demand reflected in a sharp decline in imports. The Romanian leu, which did not recover its losses in 2009 following depreciation by 35% against the euro in 2008, helped reduce imports and had a positive impact on ULC developments in industry. Also supported by productivity gains, industry ULCs declined by 22% in euro terms in the fourth quarter. In spite of a notable drop in the fourth quarter of 2009, net FDI inflows almost fully covered the current account gap over the year 2009.

End-2009 inflation above target, but inflation outlook allowed for further rate cuts

From November 2009 until January 2010, inflation edged up slightly, partly because excise taxes for tobacco were raised, before decreasing again in February. Hence, the downward trend of inflation, which was supported by a negative output gap, was interrupted. At end-2009, CPI inflation stood at 4.7% and thus above the central bank's target band of 3.5% ±1 percentage point. The National Bank of Romania (NBR) expects the negative output gap to persist and inflation to fall to 3.5% at end-2010. Given the inflation outlook, the NBR cut its key policy rate in January, February and March, by 50 basis points each time, to 6.5%.

Adoption of budget in January puts multilateral support program back on track

Against the background of political developments (in particular the collapse of the coalition), the IMF, the EU and the World Bank decided to postpone the completion of the review under the multilateral support program originally scheduled for November 2009. A new government under the former Prime Minister Boc was established in December 2009 following the reelection of President Băsescu. In January 2010, parliament adopted a budget for 2010, which envisages a deficit of 6.4% of GDP and which comprises fiscal consolidation measures of 2.5% of GDP, mostly on the expenditure side (including a reduction of public wages and a pension freeze). The adoption of the budget was an important step toward a positive assessment of Romania's performance under the support program. The successful completion of the review enabled disbursements of EUR 2.45 billion by the IMF (in February 2010) and EUR 1 billion by the EU (in March 2010). The NBR's foreign exchange reserves increased to EUR 32 billion in March 2010, up by almost 30% from a temporary low recorded in April 2009.

Table 10

Main Economic Indicators: Romania

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	6.3	7.3	–7.1	9.4	3.1	–6.2	–8.7	–7.1	–6.5
Private consumption	11.8	9.5	–10.6	16.5	–3.9	–12.1	–14.6	–11.1	–5.3
Public consumption	–0.3	7.2	0.7	36.9	–3.0	3.0	1.0	–0.4	–0.1
Gross fixed capital formation	30.3	16.1	–25.3	20.7	0.9	2.7	–29.7	–27.6	–31.4
Exports of goods and services	7.8	7.7	–5.2	11.8	–8.3	–9.6	–10.4	–3.7	3.9
Imports of goods and services	27.9	7.0	–21.3	10.1	–16.7	–24.8	–26.2	–20.7	–11.4
	Contribution to GDP growth in percentage points								
Domestic demand	18.3	13.3	–19.4	21.9	–3.4	–22.2	–24.6	–16.6	–16.3
Net exports of goods and services	–16.7	–2.6	16.1	–3.7	9.3	21.6	22.0	16.0	8.2
Exports of goods and services	3.5	3.5	–2.4	4.9	–3.2	–5.9	–5.3	–1.6	1.3
Imports of goods and services	20.2	6.1	–18.4	8.5	–12.5	–27.5	–27.3	–17.6	–6.9
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	15.3	6.8	11.0	8.8	–1.3	–2.7	7.7	14.2	24.9
Average gross earnings in industry (nominal)	21.4	21.3	11.2	23.3	18.9	16.3	9.7	10.0	9.5
Unit labor costs in industry (nominal)	5.3	14.1	0.4	13.7	21.6	20.3	2.0	–3.5	–13.4
Producer price index (PPI) in industry	7.5	15.4	1.9	19.2	11.4	5.7	1.4	–1.4	2.0
Consumer price index (here: HICP)	4.9	7.9	5.6	8.2	6.9	6.8	6.1	5.0	4.5
EUR per 1 RON, + = RON appreciation	5.6	–9.4	–13.1	–9.5	–9.5	–13.6	–13.0	–15.4	–10.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.7	6.1	7.2	5.7	6.1	7.2	6.6	7.2	7.8
Employment rate (%, 15–64 years)	58.8	59.1	58.6	60.5	58.3	57.4	59.2	60.4	57.4
Key interest rate per annum (%)	7.5	9.7	9.1	10.2	10.3	10.1	9.7	8.7	8.0
RON per 1 EUR	3.3	3.7	4.2	3.6	3.8	4.3	4.2	4.2	4.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	33.7	17.5	9.0	31.1	17.5	15.4	11.7	10.7	9.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–8.4	–10.7	5.0	–12.9	–10.7	–7.4	–4.6	3.7	5.0
Domestic credit of the banking system	55.9	41.5	12.6	58.9	41.5	38.7	29.5	16.8	12.6
of which: claims on the private sector	51.2	33.7	1.2	51.5	33.7	25.0	12.2	2.9	1.2
claims on households	29.1	18.7	0.6	28.1	18.7	14.2	7.8	2.1	0.6
claims on enterprises	22.1	15.0	0.6	23.4	15.0	10.8	4.4	0.8	0.6
claims on the public sector (net)	4.7	7.8	11.4	7.4	7.8	13.7	17.3	13.9	11.4
Other assets (net) of the banking system	–13.8	–13.3	–8.7	–14.8	–13.3	–15.9	–13.3	–9.8	–8.7
	% of GDP, ESA 95								
General government revenues	33.5	32.1	32.1	. .	. .	. .	. .	. .	. .
General government expenditures	36.0	37.5	40.4	. .	. .	. .	. .	. .	. .
General government balance	–2.5	–5.4	–8.3	. .	. .	. .	. .	. .	. .
Primary balance	–1.8	–4.7	–6.8	. .	. .	. .	. .	. .	. .
Gross public debt	12.6	13.3	23.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	14.8	14.1	–13.9	19.9	–1.6	–19.1	–21.1	–14.4	0.3
Merchandise imports	26.5	11.5	–32.3	20.4	–8.9	–34.0	–37.6	–34.5	–21.9
	% of GDP (based on EUR), period total								
Trade balance	–14.3	–13.7	–5.8	–13.3	–10.6	–6.8	–6.5	–5.4	–5.0
Services balance	0.4	0.5	–0.2	0.0	0.7	–0.3	–0.1	–0.2	–0.3
Income balance (factor services balance)	–3.3	–2.6	–1.8	–2.1	–0.6	–2.3	–2.5	–1.4	–1.4
Current transfers	3.9	4.3	3.5	5.2	3.2	5.4	3.4	3.8	2.3
Current account balance	–13.4	–11.6	–4.4	–10.1	–7.3	–4.0	–5.7	–3.3	–4.5
Capital account balance	0.7	0.4	0.5	0.1	0.6	0.0	0.2	0.7	0.8
Foreign direct investment (net)	5.7	6.7	4.1	5.9	5.6	8.0	4.4	4.3	1.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	47.0	51.8	67.9	51.5	51.8	51.2	56.1	63.7	67.9
Gross official reserves (excluding gold)	20.3	18.8	24.4	19.0	18.8	18.4	20.1	23.1	24.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.6	5.2	7.9	5.0	5.2	5.3	6.2	7.4	7.9
	EUR million, period total								
GDP at current prices	124,624	139,578	115,855	39,838	42,404	22,636	26,708	30,828	35,683

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

9 Croatia: Macrofinancial Stabilization with Some Remaining Vulnerabilities

Recession eases, but labor market conditions deteriorate

Having bottomed out in the first half of the year, the Croatian economy saw a mild pickup in economic dynamics in the latter part of 2009, bringing GDP growth to –5.8% in 2009. Yet, the growth pattern has hardly changed. In light of low consumer and business confidence, tight financing conditions, fiscal adjustments and worsening labor market conditions, private consumption and investment activity continued to decline, but with restocking posting increases, the negative contribution of domestic demand to growth became less pronounced. At the same time, the closing gap between import and export growth caused the positive contribution of net exports to growth to decrease.

The crisis reached the labor market with some time lag in the second half of 2009, when employment decreased by some 4% and the unemployment rate climbed to 16.7% (national methodology) by end-2009. This trend accelerated further in early-2010, as reflected by the rise in unemployment to a four-year high of 18.3% in February 2010.

Partially reduced external vulnerabilities

Croatia's external imbalances narrowed somewhat in 2009. The current account deficit fell to 5.3% of GDP (2008: 9.2%) on a strongly improving trade balance, but this went in tandem with significantly lower net FDI inflows of some 2% of GDP in 2009. At the same time, Croatia's gross foreign debt increased further and reached some 98% of GDP in 2009 (2008: 85%). Reasons for this increase – apart from the fall in GDP – were a revival of the corporate sector's foreign borrowing in the latter part of 2009 and two government eurobond issues in 2009. At the same time, reserve accumulation resumed, and by end-2009, foreign exchange reserves had surpassed pre-Lehman levels.

Improved global sentiment underpins financial market stabilization

Driven by the improvement in global investor sentiment, the rise in foreign currency inflows on eurobond issues, the revival of foreign borrowing by corporations, and seasonal factors (tourism), the kuna strengthened from the second quarter of 2009. In the last quarter of 2009, the Croatian National Bank (CNB) even intervened on the foreign exchange market on three occasions to prevent a more marked appreciation. Given the stabilization and recovery of global financial markets, the CNB did not resort to monetary policy action in the second half of 2009, but in the absence of inflationary pressures in early February 2010, it reduced mandatory reserve requirements from 14% to 13%.

Deteriorating public finances coupled with sizeable financing needs

Despite a series of budget revisions (including expenditure cuts and revenue-boosting measures), the severity of the economic downturn caused the consolidated general government budget deficit (ESA 95 methodology) to climb to 3.4% of GDP in 2009 (2008: –1.4%). To finance the deficit and refinance maturing public debt, the government tapped international markets with a USD 1.5 billion (some EUR 1 billion) eurobond again in November 2009, and it plans to make two other bond issues on domestic markets (totaling some EUR 830 million) in spring 2010. Public debt levels grew strongly in 2009, but remained still below 40% of GDP.

According to Croatia's 2009 Pre-Accession Economic Programme, the 2010 budget is based on economic growth and inflation projections of 0.5% and 2.7%, respectively, and envisages a general government deficit of 3.3% of GDP, which is expected to fall gradually to 2.3% of GDP by 2012, mainly driven by fiscal consolidation on the expenditure side. To spur domestic demand and economic recovery, the government also decided to partly abolish the crisis tax (introduced in August 2009) as of July 1, 2010.

Table 11

Main Economic Indicators: Croatia

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	5.5	2.4	–5.8	1.6	0.2	–6.7	–6.3	–5.7	–4.5
Private consumption	6.1	0.8	–8.4	0.4	–3.2	–9.9	–9.4	–6.8	–7.4
Public consumption	3.4	2.0	0.2	1.3	2.8	3.9	1.2	–0.6	–3.4
Gross fixed capital formation	6.5	8.2	–11.8	6.6	3.5	–12.4	–12.7	–10.5	–11.3
Exports of goods and services	4.3	1.7	–16.2	1.6	–2.5	–14.2	–19.8	–17.6	–11.2
Imports of goods and services	6.5	3.6	–20.7	6.5	–7.1	–20.9	–24.7	–23.5	–12.4
	Contribution to GDP growth in percentage points								
Domestic demand	7.1	3.5	–9.8	3.9	–2.7	–13.1	–12.4	–7.0	–6.6
Net exports of goods and services	–1.7	–1.3	4.7	–2.5	3.3	7.1	7.0	2.2	2.5
Exports of goods and services	2.0	0.8	–7.3	1.0	–1.0	–4.9	–8.4	–10.9	–4.4
Imports of goods and services	3.7	2.1	–12.0	3.5	–4.3	–12.0	–15.4	–13.1	–6.9
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	4.5	3.2	0.1	2.5	1.6	–3.5	–0.4	1.1	2.9
Average gross earnings in industry (nominal)	5.5	7.2	–0.9	7.1	6.9	0.4	0.4	–0.6	–3.6
Unit labor costs in industry (nominal)	0.9	3.8	–0.8	4.7	5.4	4.5	0.8	–1.8	–6.4
Producer price index (PPI) in industry	3.4	8.5	–0.4	11.1	6.7	1.2	–0.6	–2.3	0.1
Consumer price index (here: CPI)	2.9	6.1	2.4	7.4	4.5	3.8	2.9	1.2	1.7
EUR per 1 HRK, + = HRK appreciation	–0.2	1.6	–1.6	1.8	2.1	–1.7	–1.4	–1.9	–1.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.8	8.6	9.3	7.1	9.0	9.7	9.1	8.9	9.6
Employment rate (%, 15–64 years)	57.2	57.8	56.6	59.7	57.8	56.5	56.5	57.1	56.4
Key interest rate per annum (%)	3.6	5.3	6.0	4.9	6.8	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.3	7.2	7.3	7.2	7.2	7.4	7.4	7.3	7.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	18.3	4.3	–0.9	14.7	4.3	3.3	1.1	–1.2	–0.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	12.0	–3.6	1.5	5.0	–3.6	–8.0	–7.1	–6.8	1.5
Domestic credit of the banking system	14.1	13.2	–0.5	9.0	13.2	15.7	11.2	8.7	–0.5
of which: claims on the private sector	14.9	10.3	–0.6	11.3	10.3	9.4	5.0	1.9	–0.6
claims on households	9.4	6.3	–1.6	6.1	6.3	4.6	1.7	0.4	–1.6
claims on enterprises	5.5	4.0	1.0	5.2	4.0	4.8	3.3	1.5	1.0
claims on the public sector (net)	–0.8	2.9	0.1	–2.3	2.9	6.3	6.2	6.7	0.1
Other assets (net) of the banking system	–7.8	–5.4	–1.8	0.8	–5.4	–4.4	–3.0	–3.1	–1.8
	% of GDP, ESA 95								
General government revenues	40.3	39.4	38.8	. .	. .	. .	. .	. .	. .
General government expenditures	42.8	40.8	42.2	. .	. .	. .	. .	. .	. .
General government balance	–2.5	–1.4	–3.4	. .	. .	. .	. .	. .	. .
Primary balance	–0.7	0.1	–2.3	. .	. .	. .	. .	. .	. .
Gross public debt	33.1	33.5	38.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	8.6	6.8	–21.6	15.7	–4.5	–13.4	–23.7	–30.9	–16.5
Merchandise imports	10.8	10.7	–26.8	15.8	–2.0	–23.6	–30.1	–31.1	–21.2
	% of GDP (based on EUR), period total								
Trade balance	–22.0	–22.8	–16.3	–20.6	–21.2	–16.5	–17.5	–15.0	–16.3
Services balance	14.6	14.7	12.5	35.3	4.1	1.3	12.2	30.6	3.5
Income balance (factor services balance)	–2.6	–3.3	–3.7	–2.0	–1.7	–4.3	–4.8	–2.9	–2.7
Current transfers	2.4	2.2	2.3	2.1	2.4	2.0	2.6	2.0	2.6
Current account balance	–7.6	–9.2	–5.2	14.7	–16.4	–17.6	–7.5	14.7	–12.9
Capital account balance	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.3
Foreign direct investment (net)	8.1	6.8	2.1	2.3	8.2	4.0	4.1	–0.3	1.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	78.7	85.1	98.3	77.9	85.1	85.7	89.8	93.7	98.3
Gross official reserves (excluding gold)	21.7	19.3	22.9	21.1	19.3	18.9	19.5	20.4	22.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.2	4.6	7.0	4.9	4.6	4.7	5.2	5.9	7.0
	EUR million, period total								
GDP at current prices	42,831	47,372	45,380	13,012	11,533	10,506	11,510	12,204	11,160

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

10 Turkey: Robust Recovery of the Private Sector

Sound recovery based on consumption and public investment

The decline in real GDP decelerated in the third quarter of 2009 while the fourth quarter data came as a surprise, with an increase of 6% year on year, bringing the annual decline to 4.7% in 2009. The final quarter brought about a reversal of growth drivers, with consumption and public investments posting a sizeable positive contribution, not least due to the comprehensive economic support package implemented since the end of 2008 at an estimated cost of 3.4% of GDP for 2009. Private investment remained weak, as a result of historically low FDI inflows (FDI fell by 60% year on year in 2009) and low capacity utilization. Industrial production picked up steadily, showing an annual increase in October for the first time since the beginning of the crisis and reaching its pre-crisis level in November.

External imbalances declined in 2009, but net exports have turned negative again more recently

The current account deficit more than halved in 2009 even though imports surged far more than exports did in the final quarter. The reasons were to be found in the high import content of exports, the pronounced dependence on energy imports, and strong consumer demand. The contribution of net exports thus turned negative again in the fourth quarter of 2009, despite recent improvements in competitiveness. Labor productivity increased sharply in the fourth quarter of 2009, unit labor costs fell and the lira depreciated to 2.2 TRY/EUR.

Inflation reached a 40-year low of 5.1% year on year in October 2009

Year-end inflation came in at 6.3%, below the target of 7.5% for 2009. Inflation rose again in the final quarter of 2009 due to the unexpected surge in unprocessed food prices and other temporary factors (base effects and recent tax hikes). In the first quarter of 2010, inflation continued to rise to 9.3%, challenging the loose monetary stance of the Central Bank of the Republic of Turkey with its inflation target of 6.5% for 2010 and resulting in negative real interest rates from February 2010. The central bank ended its easing cycle in November 2009 with a rate cut of 25 basis points to 6.5%. Since then, it has kept the policy rate on hold. The cumulative interest rate cuts between November 2008 and November 2009 totaled 1,025 basis points. An important factor underlying the pronounced recovery is the healthy Turkish banking sector, which is characterized by high profitability, a capital adequacy ratio of 20.1% in February 2010, and a recent fall in nonperforming loans by 0.4% (December 2009 to February 2010). The growth of credit to the nonbank private sector increased again in the last quarter of 2009 and came to 14.4% year on year, following the moderate 7.2% expansion in the third quarter of 2009.

IMF negotiations end without a deal

Talks with the IMF over a new standby agreement were ended in mid-March without a deal. Given the stable recovery, the current strength in tax revenue and recent credit rating upgrades by Fitch, Moody's and S&P, the Turkish authorities saw no need for a new Stand-By Arrangement. The 2010 to 2012 medium-term program of the government should ensure fiscal discipline even without an IMF anchor, although recent political uncertainty could lead to early elections, introducing some risk of increased preelection spending. The general government budget rose to 5.5% of GDP in 2009, and public debt increased as well. The government's deficit targets for 2010 and 2011 are 4.7% and 3.5% of GDP, respectively.

Table 12

Main Economic Indicators: Turkey

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	4.7	0.7	–4.7	0.9	–7.0	–14.5	–7.7	–2.9	6.0
Private consumption	5.5	–0.3	–2.3	–0.4	–6.7	–10.1	–1.8	–1.9	4.7
Public consumption	6.5	1.7	7.8	2.6	2.8	5.1	0.5	5.2	17.9
Gross fixed capital formation	3.1	–6.2	–19.2	–8.7	–18.7	–27.6	–24.4	–18.5	–4.7
Exports of goods and services	7.3	2.7	–5.4	3.8	–8.2	–11.3	–11.0	–5.4	6.4
Imports of goods and services	10.7	–4.1	–14.4	–3.8	–24.9	–30.9	–20.6	–11.7	10.5
	Contribution to GDP growth in percentage points								
Domestic demand	5.8	–1.2	–6.5	–1.3	–11.5	–18.8	–9.7	–4.4	6.7
Net exports of goods and services	–1.3	1.9	2.8	2.0	5.8	6.9	3.6	1.9	–1.1
Exports of goods and services	1.7	0.6	–1.3	0.9	–2.0	–2.7	–2.6	–1.3	1.5
Imports of goods and services	3.0	–1.2	–4.1	–1.1	–7.8	–9.6	–6.2	–3.2	2.7
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	0.5	–0.4	4.4	0.0	–9.2	–9.6	0.2	4.8	23.7
Average gross earnings in industry (nominal)	10.4	10.7	8.5	10.8	9.1	7.1	9.2	7.9	9.5
Unit labor costs in industry (nominal)	9.6	11.6	4.0	10.9	20.2	18.5	9.1	3.0	–11.5
Producer price index (PPI) in industry	6.0	13.0	1.0	16.2	13.3	7.8	–1.8	–2.2	1.0
Consumer price index (here: HICP)	8.8	10.4	6.3	11.7	10.9	8.4	5.7	5.3	5.7
EUR per 1 TRY, + = TRY appreciation	1.1	–6.3	–11.8	–2.9	–14.9	–16.3	–7.9	–15.1	–7.9
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.7	9.6	12.9	8.9	11.1	14.5	12.5	12.4	12.0
Employment rate (%, 15–64 years)	45.8	45.9	44.2	47.7	45.2	41.4	44.7	45.9	44.9
Key interest rate per annum (%)	17.2	16.0	9.2	16.7	16.4	12.6	9.6	8.0	6.7
TRY per 1 EUR	1.8	1.9	2.2	1.8	2.0	2.2	2.1	2.1	2.2
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	15.3	24.7	13.0	20.5	24.7	19.0	18.2	16.5	13.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	3.0	6.4	–1.2	–0.2	6.4	7.1	5.8	5.1	–1.2
Domestic credit of the banking system	20.5	19.7	21.5	23.7	19.7	15.5	17.4	18.3	21.5
of which: claims on the private sector	18.2	15.3	9.9	23.0	15.3	8.1	5.1	5.4	9.9
claims on households	6.7	6.2	2.7	9.1	6.2	3.6	2.6	1.3	2.7
claims on enterprises	11.5	9.1	7.1	13.8	9.1	4.6	2.5	4.1	7.1
claims on the public sector (net)	2.3	4.3	11.6	0.7	4.3	7.3	12.3	12.9	11.6
Other assets (net) of the banking system	–8.3	–1.4	–7.2	–2.9	–1.4	–3.6	–5.0	–6.9	–7.2
	% of GDP, ESA 95								
General government revenues	19.6	21.6	22.5	. .	. .	. .	. .	. .	. .
General government expenditures	20.6	23.9	28.0	. .	. .	. .	. .	. .	. .
General government balance	–1.0	–2.2	–5.5	. .	. .	. .	. .	. .	. .
Primary balance	4.4	3.1	0.1	. .	. .	. .	. .	. .	. .
Gross public debt	39.4	39.5	45.5	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	12.9	13.8	–17.7	24.5	–3.7	–14.7	–23.1	–26.6	–4.5
Merchandise imports	10.3	11.2	–26.7	19.7	–11.7	–33.5	–32.5	–30.2	–7.4
	% of GDP (based on EUR), period total								
Trade balance	–7.2	–7.1	–3.9	–7.4	–5.2	–1.0	–4.6	–5.4	–4.3
Services balance	2.1	2.4	2.6	4.3	2.3	0.8	2.2	5.0	1.9
Income balance (factor services balance)	–1.1	–1.1	–1.3	–0.8	–1.2	–1.7	–1.5	–1.0	–0.9
Current transfers	0.3	0.3	0.4	0.3	0.3	0.4	0.3	0.3	0.5
Current account balance	–5.8	–5.5	–2.2	–3.6	–3.8	–1.5	–3.6	–1.1	–2.8
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	3.1	2.1	1.0	1.6	2.6	1.7	1.0	1.0	0.4
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	38.4	40.0	42.7	39.8	40.0	42.0	41.2	42.3	42.7
Gross official reserves (excluding gold)	10.5	10.2	11.1	10.6	10.2	10.6	10.1	11.0	11.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.6	4.3	5.5	4.4	4.3	4.6	4.6	5.3	5.5
	EUR million, period total								
GDP at current prices	472,996	499,704	441,173	144,066	114,962	97,006	107,345	122,528	114,294

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

11 Russia: Fledgling Economic Recovery, Record-Low Inflation

Incipient recovery strengthens in the final quarter of 2009

In 2009, Russia experienced its sharpest economic contraction in one and a half decades: GDP dropped by 7.8% against 2008. The driving forces of the contraction were plummeting gross fixed capital formation (–15.9%) and inventory adjustment. However, measured on a month-to-month basis, a modest recovery had already been perceptible since February 2009. This tendency strengthened in the final quarter of the year, supported by the rebound of the oil price and the reversal of capital outflows. In January 2010, the output index for key economic activities (agriculture, mining, manufacturing, energy, construction, transportation and trade) rose 3.8% (year on year). The recovery is largely borne by net exports, as imports are contracting sharply, and to a lesser degree by government consumption. In contrast, bank credit remains relatively subdued, and the share of nonperforming loans has not yet stopped rising. Unemployment remains at a high level (February 2010: 8.6%).

Financial stabilization and steady nominal reapprecation of the ruble

Because the average oil price was lower in 2009 than in 2008 and because of the global recession, Russia's combined current and capital account surplus declined to 2.9% of GDP in 2009 from 6.2% in 2008. While Russia's gross external debt slightly declined in absolute terms in 2009, the debt-to-GDP ratio rose by 7 percentage points to 37%, owing to the country's deep slump and the depreciation of the ruble's average annual exchange rate. The recovery of the oil price contributed to the slight expansion of Russia's foreign currency reserves (including gold), which reached EUR 306 billion at end-2009 (EUR 332 billion at end-March 2010) and thus bounced back to 35% of GDP. Given inflation differentials and steady nominal reappreciation since February 2009 (the trough of the financial crisis), the ruble's real effective exchange rate (REER) appreciated by over 12% in the twelve months to end-March 2010, which brings it back to roughly where it was before the devaluation of early 2009.

Downward inflation trend permits further monetary easing to support growth

Price inflation has continued its downward trend in recent months. CPI inflation (year on year) declined to 6.5% at end-March 2010, the lowest level in 12 years, because of the waning of devaluation effects followed by some impact of the reappreciation of the ruble, weaker wage growth in industry, feeble internal demand and the persisting sizeable output gap. Lower inflation has opened a window of opportunity for the Central Bank of Russia (CBR) to support economic recovery, fight the credit crunch, and curb speculative upward pressure on the ruble by lowering the refinancing rate in 12 steps by a total of 475 basis points since April 2009 to 8.25% at end-March 2010.

A relatively strong fiscal stimulus in 2009

The authorities served a relatively strong fiscal stimulus in 2009, which the Finance Ministry assesses at around 3% of GDP. The federal budget deficit reached 5.4% of GDP (the 2008 surplus had come to 4.1%). According to government estimates, the fiscal stimulus dampened GDP contraction by about 2 percentage points in 2009. The deficit was largely financed by the Reserve Fund,[11] which shrank by more than half over 2009 and came to EUR 39.2 billion at end-March 2010. In contrast, the National Wealth Fund[12] still held at around record level (end-March: EUR 66.5 billion). The federal budget of 2010 (based on rather conservative oil price assumptions) foresees a deficit of 6.8% of GDP.

[11] *The Reserve Fund, which functions as a budgetary stabilization fund and accumulates budget revenues from oil and gas, is capped at 10% of GDP.*

[12] *The National Wealth Fund is earmarked to support the state pension system.*

Table 13

Main Economic Indicators: Russia

	2007	2008	2009	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
	Year-on-year change of the period total in %								
GDP at constant prices	8.1	5.6	–7.8	6.6	0.0	–9.4	–10.8	–7.7	–3.8
Private consumption	13.6	10.6	–7.7	11.1	6.1	–2.6	–7.4	–10.7	–9.3
Public consumption	3.4	2.9	2.0	3.0	2.9	1.7	2.0	1.7	2.6
Gross fixed capital formation	21.1	10.7	–15.9	12.8	–1.1	–16.2	–22.1	–17.6	–9.5
Exports of goods and services	6.3	0.2	–4.2	2.1	–8.7	–14.9	–9.2	–2.5	8.2
Imports of goods and services	26.5	14.9	–29.8	21.8	0.9	–34.3	–38.7	–33.4	–14.4
	Contribution to GDP growth in percentage points								
Domestic demand	13.4	9.9	–15.1	11.9	3.6	–11.9	–19.3	–17.7	–11.2
Net exports of goods and services	–6.7	–5.8	11.4	–7.6	–3.8	8.8	13.5	13.8	9.3
Exports of goods and services	2.3	0.1	–1.4	0.7	–3.4	–5.5	–3.1	–0.8	3.0
Imports of goods and services	9.0	5.9	–12.8	8.3	0.4	–14.3	–16.6	–14.5	–6.3
	Year-on-year change of the period average in %								
Labor productivity in industry (real)	4.6	3.1	–1.5	5.4	–3.7	–7.0	–6.7	–0.4	7.8
Average gross earnings in industry (nominal)	26.0	25.0	3.2	27.0	18.2	5.0	2.2	0.7	5.2
Unit labor costs in industry (nominal)	20.4	21.5	5.0	20.5	23.1	13.1	9.5	1.1	–2.6
Producer price index (PPI) in industry	14.0	21.8	–6.6	30.2	4.9	–8.3	–10.1	–13.1	5.0
Consumer price index (here: CPI)	9.1	14.1	11.8	14.9	13.8	13.9	12.6	11.5	9.3
EUR per 1 RUB, + = RUB appreciation	–2.6	–3.9	–17.4	–4.0	–0.9	–18.2	–15.7	–18.5	–17.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.2	6.4	8.4	5.9	7.1	9.1	8.6	7.8	8.1
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	10.3	10.9	11.4	11.0	11.9	13.0	12.2	10.9	9.4
RUB per 1 EUR	35.0	36.4	44.1	36.5	36.0	44.4	43.8	44.8	43.6
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	44.2	14.6	16.4	26.5	14.6	9.3	7.1	9.1	16.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	29.9	15.6	10.3	25.6	15.6	15.7	11.1	5.9	10.3
Domestic credit of the banking system	24.9	15.8	16.1	14.5	15.8	12.5	14.5	19.3	16.1
of which: claims on the private sector	42.6	33.5	2.1	39.1	33.5	28.8	16.3	9.5	2.1
claims on households	11.6	7.6	–2.8	11.5	7.6	4.7	0.5	–2.8	–2.8
claims on enterprises	31.0	26.0	177.1	27.6	26.0	24.1	15.8	12.3	177.1
claims on the public sector (net)	–17.7	–17.7	14.0	–24.5	–17.7	–16.2	–1.8	9.8	14.0
Other assets (net) of the banking system	–10.6	–16.8	–10.0	–13.6	–16.8	–18.9	–18.6	–16.1	–10.0
	% of GDP, ESA 95								
General government revenues	40.2	38.8	35.5	. .	. .	. .	. .	. .	. .
General government expenditures	34.2	33.9	40.9	. .	. .	. .	. .	. .	. .
General government balance	6.0	4.9	–5.4	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	7.2	5.7	8.1	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	6.7	24.2	–32.4	39.5	–1.6	–40.2	–38.4	–36.6	–13.1
Merchandise imports	24.6	22.7	–31.3	29.7	15.7	–26.5	–33.3	–37.7	–26.6
	% of GDP (based on EUR), period total								
Trade balance	10.0	10.6	9.0	11.3	6.3	7.6	8.4	10.0	9.5
Services balance	–1.4	–1.5	–1.6	–1.8	–1.3	–1.6	–1.4	–1.9	–1.5
Income balance (factor services balance)	–2.4	–2.9	–3.2	–3.2	–2.4	–2.0	–4.4	–3.1	–3.4
Current transfers	–0.3	–0.2	–0.2	–0.2	–0.3	–0.1	–0.1	–0.3	–0.2
Current account balance	6.0	6.1	3.9	6.2	2.2	3.9	2.5	4.7	4.4
Capital account balance	–0.7	0.0	–0.9	0.0	0.0	0.1	0.1	–3.6	0.0
Foreign direct investment (net)	0.7	1.1	–0.6	1.2	0.7	–1.7	–0.5	0.7	–1.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	34.1	30.3	37.0	34.4	30.3	31.0	32.6	34.9	37.0
Gross official reserves (excluding gold)	33.4	26.1	32.7	34.0	26.1	25.6	27.6	28.9	32.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	18.6	14.2	19.2	18.9	14.2	13.9	15.2	16.3	19.2
	EUR million, period total								
GDP at current prices	948,306	1,137,448	885,423	317,667	296,632	189,075	211,970	234,583	249,795

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

Box 2

OeNB-BOFIT Outlook for CESEE Countries: Domestic Demand Remains Weak in Most of the Region, Gradual Recovery Mainly Driven by Net Exports[1]

2009 brought a severe recession to the CESEE-8[2] region, with GDP contracting by 3.5% on average (compared with –4% in the euro area). Without Poland's positive growth rate of 1.7%, CESEE-8 growth would have been considerably worse, as Romania shrank by 7.1%, Hungary by 6.3%, Bulgaria by 5% and the Czech Republic by 4.2%, and GDP in the Baltic states dropped by between 14% (Estonia) and 18% (Latvia).

According to the OeNB projections, 2010 will bring a moderate expansion of output for the CESEE-8 on average (1.3%), with highly diverse developments at the country level. Poland will once again outperform the region. In the Czech Republic and Romania, growth will amount to around 1%, while it is set to stagnate in Bulgaria and Hungary. In contrast to this year's highly heterogeneous developments, 2011 will bring a more balanced recovery for the CESEE-8 of 3.0%. The region's growth performance will nonetheless remain below pre-crisis levels in the near and medium term.

Table 1

CESEE-8 GDP Outcomes 2009 and Projections for 2010 and 2011

	Eurostat	OeNB	
	2009	2010	2011
	Year-on-year growth in %		
CESEE-8	–3.5	1.3	3.0
Bulgaria	–5.0	0.3	2.9
Czech Republic	–4.2	1.3	2.6
Hungary	–6.3	–0.2	2.5
Poland	1.7	3.0	3.4
Romania	–7.1	0.8	3.1

Source: OeNB March 2010 forecast, Eurostat.

Domestic growth drivers will not play a meaningful role in 2010 except in Poland. The moderate GDP expansion of 1.3% in the CESEE-8 region as a whole will be based on positive net exports (mainly due to protracted weak import demand) and restocking.

Investment is expected to remain low given substantial capacity underutilization, weak domestic demand prospects and fiscal constraints in many countries. Growth in investment is further hampered by tight financing conditions. In particular, investment in Bulgaria is expected to shrink further, and we expect no change in the Czech Republic and Hungary and only weak growth in Romania. While still remaining at low levels in a historical perspective, Poland will show relatively stronger investment growth partly due to large-scale public and EU cofunded projects. Private consumption will continue to fall in all countries, with the exception of Poland. The deterioration in labor markets, falling real wages in some countries and an elevated debt burden of households in several CESEE countries will all remain dampening factors for private consumption. Furthermore, as fiscal consolidation continues and thus deters a rebound in private consumption, domestic demand will continue to be weak.

Given the bleak outlook for domestic demand, we expect only moderate import growth for 2010. Based on this sluggish development in imports, net exports will remain the only growth driver in 2010 (just as in 2009). Poland is the only country in the region which – in light of

[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 of the forecast for Russia. The cutoff date for all projections in this box was March 22, 2010 (Croatia: March 26, 2010). The forecasts are based on a broad range of information, including country-specific time series models for Bulgaria, the Czech Republic, Hungary, Poland and Croatia. The forecast for Romania draws on information from various sources and expert judgment (given that the time series are as yet too short for conducting model calculations). The Baltic states are not covered in detail in our projections, but they are nevertheless included in the CESEE-8 aggregate, based on the most recent IMF projections for these three countries. The projections for Russia were prepared by the BoF/BOFIT and are based on an 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 recover gradually throughout the projection period. The oil price is assumed to increase slightly above the 2009 level. The USD/EUR exchange rate is assumed to remain stable somewhat below the 2009 level.*

[2] *Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania.*

its more favorable import growth prospects – continues to exhibit a negative contribution of net exports.

The contribution of domestic demand to GDP growth is expected to turn positive in 2011. Moreover, improving external demand will bolster exports, which in turn will have a stimulating impact on investment. We also expect private consumption to rise, yet from low levels. Both factors will contribute to higher import dynamics, with imports growing even more strongly than exports. Hence, the growth contribution of net exports should decline to around zero in the region. The individual countries, however, will not be equally affected by this development: While external demand will continue to deliver a slightly positive growth impulse in the Czech Republic and Hungary, it will dampen dynamics somewhat in the rest of the region. Private consumption will therefore return as the main driver of a still relatively moderate overall growth performance in 2011.

These forecasts are subject to considerable risks, related strongly to the developments in Western Europe. External demand and external financing conditions could be affected negatively if the gradual recovery of the world economy and the euro area assumed in our baseline fails to materialize (risk of a double dip). On the other hand, a stronger recovery than the expected moderate rebound in Western Europe would imply an upward risk to our projections. Uncertainty also prevails with respect to changes in investor confidence (i.e. the development of global risk aversion, in particular vis-à-vis emerging economies). We assume that no further deterioration will take place in 2010 and that confidence will improve somewhat toward 2011. Investor risk perceptions could also remain below their pre-crisis levels, with negative implications for the long-term catching-up process. Moreover, we expect that negative impacts from fiscal consolidation measures on domestic demand will mainly materialize in 2010. In particular our projections for 2011 are hence subject to downward risks arising from weaker-than-expected private consumption as a result of a prolonged real economy impact of the crisis. Overall, risks are more balanced than they were at the time of the last projection exercise in September 2009.

BOFIT-OeNB Forecast for Russia: Bouncing Back from Deep Contraction

In 2010, the assumed calming of the international economic situation and developments in raw material prices will brighten the outlook for income and demand on the part of consumers and companies. Annual growth figures will also get a boost from last year's extremely low basis level. Russian households are on average not heavily in debt, which bodes well for a quick and robust recovery of consumption over the next two years. With the gradual normalization of financial markets and the recovery of banking activity, companies are expected to modestly raise the level of capital formation. Stock adjustments should largely have run their course, so that the inventory effect on aggregate output is likely to turn positive in the course of 2010.

Russia's export growth (in real terms) is bound to turn positive again this year, but after that, capacity constraints of energy extraction and insufficient new investment are likely to considerably slow down growth rates. Following their incisive slump, imports are set to turn strongly upward in 2010, largely driven by consumer demand. Import demand has gained strength from a modest appreciation of the ruble, whose real exchange rate has firmed to roughly where it was before the devaluation in late 2008/early 2009. Imports are thus projected to grow considerably faster than exports, which will put the growth contribution of foreign trade back in negative territory in 2011 and will contribute to trimming overall GDP expansion.

The expected improvement of world trade will lead to higher consumption of raw materials and energy and thus to increasing demand for and rising prices of oil and other Russian staples. However, weaker-than-expected price developments in raw materials would be immediately reflected in Russia's consumption demand and economic growth. Another risk factor relates to the fragility of international financial markets: A renewed

financial distur bance and new sizeable capital outflows could swiftly affect Russian corporations' financing possibilities and markedly delay startups of investment projects. In a similar manner, larger-than-expected state borrowing could upset the balance and push companies out of range for bank loans.

Table 2

Russia GDP Outcome 2009 and Projections for 2010 and 2011

	Rosstat	BOFIT-OeNB	
	2009	2010	2011
	Year-on-year growth in %		
Russia	–7.9	5.5	5.0

Source: BOFIT-OeNB March 2010 forecast, Rosstat.

OeNB Projections for Croatia: Economic Stagnation in 2010, Growth Impetus in 2011 Arising from Prospective EU Entry

In 2010, Croatia's economy is about to stagnate, which implies a still rather bleak economic outlook. In light of still low consumer and business confidence, continued tight credit conditions, limited fiscal leeway and deteriorating labor market conditions, private consumption and investment activity are expected to remain relatively depressed. Yet, the ongoing tendency to restock might cause domestic demand to contract less strongly than in 2009. Imports are expected to continue decreasing more strongly than exports based on sluggish domestic demand. Hence, we expect net exports to again contribute positively to economic growth in 2010.

For 2011, we expect the economy to grow by 1.8% and to return to the growth pattern observed before the crisis, with a positive contribution of domestic demand and a negative contribution of net exports. Similar to previous experience with accession countries, we expect investment activity to pick up on the back of prospective EU entry (in addition to a positive impetus from renewed lending activity). Under the assumption of a successful closure of negotiations in 2010, EU accession in 2012 could be within reach, which, due to some frontloading of imports, could result in an increasingly negative contribution of net exports.

Table 3

Croatia GDP Outcome 2009 and Projections for 2010 and 2011

	Eurostat	OeNB	
	2009	2010	2011
	Year-on-year growth in %		
Croatia	–5.8	–0.1	1.8

Source: OeNB March 2010 forecast, Eurostat.