Developments in Selected CESEE Countries:

Economic Downturn Continues in an Adverse International Environment[1, 2, 3]

1 Introduction

Economic dynamics in most of the CESEE countries remained very subdued during the review period. This development was largely in line with broader European developments and in fact was substantially fueled by them. Economic weaknesses in the euro area affected the region via several channels, most importantly through external demand. Developments in the euro area still had an adverse impact on sentiment, while external financing conditions tended to improve as financial markets recovered in Europe and globally.

However, domestic factors also impacted on economic conditions. The deleveraging process is still ongoing in some countries, weighing on real sector dynamics. Furthermore, most CESEE countries are still undergoing fiscal consolidation, which further dampens domestic demand. Given considerable spare capacity and unabated uncertainty about future economic developments, companies have tended to refrain from investing, which in turn had an adverse effect on labor market conditions. It should be noted, however, that developments in Russia and, to some extent in Turkey, depart from these regional trends.

Growth at a standstill throughout most of CESEE

Economic growth in the region decelerated substantially in 2012, coming down from 4.3% year on year in the final quarter of 2011 to 1.2% in the final quarter of 2012. Quarter-on-quarter dynamics were flat throughout the whole of 2012, when excluding Turkey and Russia. The positive growth dynamics Turkey had recorded in early 2012 largely faded in the second half of the year, so that Russia, by far the largest economy of the region, was the only country that recorded positive quarter-on quarter growth dynamics in the review period. But year-on-year growth rates were also declining markedly in Russia toward the end of 2012.

Four of the ten countries under review here were in recession at the end of 2012, while growth in another five did not surpass 0.2%. With that, the regional differentiation of the economic momentum we observed in early 2012 and in fact throughout most of the crisis has narrowed, and countries seem to be less able at this stage to decouple from regional trends.

Economic dynamics mainly driven by the external sector…

Net exports were the most important driving force of GDP growth in the region in the second half of 2012. In six countries, it was even the only GDP component that contributed positively to growth. External demand has thus remained a key variable in economic developments in CESEE, and clearly the recession in the euro area has been taking its toll. In fact, export growth decelerated throughout the CESEE region. In four countries, this went hand in hand with declining growth contributions of the external sector.

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[2] *Cutoff date: April 5, 2013, (April 22, 2013, for fiscal data). This report focuses primarily on data releases and developments from October 2012 up to the cutoff date, while selectively recalling earlier developments wherever needed to put recent developments into perspective.*

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

Table 1

Real GDP Growth

	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Period-on-period change in % (seasonally and working day adjusted)							
Slovakia	3.2	2.0	0.7	0.9	0.3	0.4	0.3	0.2
Slovenia	0.6	–2.3	–0.1	–0.9	–0.2	–1.1	–0.6	–1.0
Bulgaria	1.8	0.8	0.2	0.1	0.0	0.4	0.1	0.0
Czech Republic	1.9	–1.3	–0.1	0.0	–0.5	–0.6	–0.4	–0.2
Hungary	1.6	–1.7	–0.0	0.2	–1.0	–0.6	–0.4	–0.9
Poland	4.3	2.0	0.8	0.9	0.4	0.1	0.3	0.2
Romania	2.2	0.7	1.4	–0.2	–0.1	0.6	–0.2	0.2
Croatia	–0.0	–2.0	–0.4	–0.4	–0.7	–0.7	–0.6	–0.7
Turkey	8.5	2.6	1.7	0.6	0.4	1.8	0.2	0.0
Russia	4.3	3.4	1.6	2.7	0.2	–0.4	0.7	1.8
CESEE average[1]	4.6	2.3	1.3	1.5	0.2	0.2	0.4	0.8
CESEE average (excl. Russia)[1]	4.9	1.3	1.0	0.5	0.1	0.6	0.1	–0.0
Euro area	2.0	1.4	0.1	–0.3	–0.1	–0.2	–0.1	–0.6

Source: Eurostat, national statistical offices.

[1] Average weighted with GDP at PPP.

Other countries, however, reported a somewhat rising growth impetus from trade in the latter half of 2012 (e.g. Croatia, Bulgaria, and Slovenia). Thus, several factors were at play that dampened the adverse impact of softening external demand: First, weak domestic dynamics put a damper on import demand, so that import growth declined more or less uniformly throughout the region, in some cases even more strongly than export growth. At the same time, some countries (e.g. Russia and Turkey) have started to gradually reorient their regional trading patterns toward faster-growing regions outside Europe. Finally, the CESEE region still is in a comparatively favorable competitive position against the euro area, given considerable unit labor cost improvements in manufacturing in the wake of the global financial crisis in most countries.

More recently, though, a few countries have seen some decline in price competitiveness vis-à-vis the euro area. This is true especially for Turkey, Russia and Croatia, and as of late also for Hungary and Poland. It is noteworthy that substantial parts of the deterioration are related to productivity developments, with productivity growth having turned negative in Poland and Hungary and having decelerated substantially in Croatia, where industrial production slumped toward the end of 2012. In Poland and Hungary, the situation was further accentuated by some strengthening of the exchange rate in a yearly comparison.

…as domestic demand remains weak

Domestic demand played a notable role for economic dynamics only in Russia, where both private consumption and investment added noticeably to growth. A minor positive contribution of domestic demand to growth was also reported for Romania and Bulgaria. Throughout the rest of the region, domestic demand was weak and exerted a dampening influence on the economy.

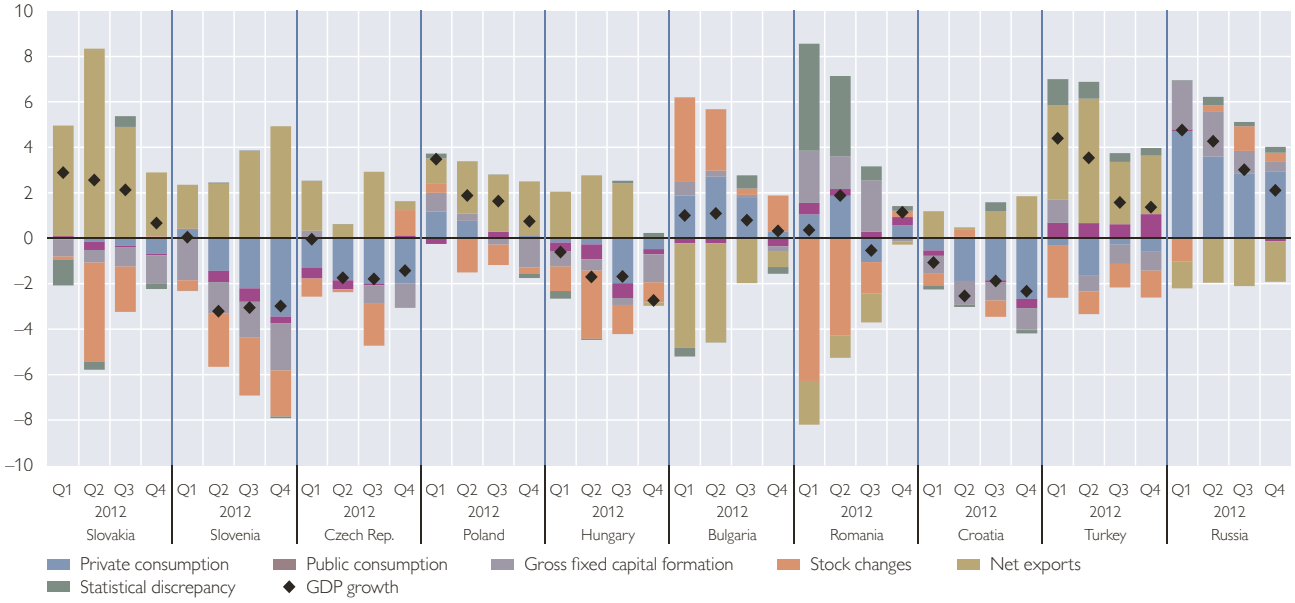
Muted credit dynamics…

Subdued real sector dynamics went hand in hand with rather anemic growth of credit to the private sector through most of the region. Some countries, particularly Hungary, but also Slovenia and Croatia, have been faced with a deleveraging of

Chart 1

GDP Growth and Its Main Components

Percentage points, GDP growth in %



Source: Eurostat, national statistical offices.

households and corporations. Likewise, consolidated bank exposures of BIS-reporting banks vis-à-vis some countries under review here have fallen (Hungary, Slovenia, more recently also Romania and Croatia). In some other countries of the region, cross-border exposures have fallen while consolidated exposures have remained stable or have grown slightly. This mirrors a broader change in bank funding structures toward a higher share of domestic funding sources. Considering that overall exposures have not diminished, this change should be seen separately from deleveraging processes; in particular, the macroeconomic effects of the shift to domestic funding sources, e.g. on overall credit supply, are different.[4]

At the same time, deleveraging is not a general phenomenon in the region. Countries like Poland, the Czech Republic and Slovakia have been spared, and, unlike the other countries covered here, Turkey and Russia still experienced a quite dynamic credit expansion, although it decelerated somewhat in the second half of 2012. However, credit growth in Turkey regained speed in early 2013.

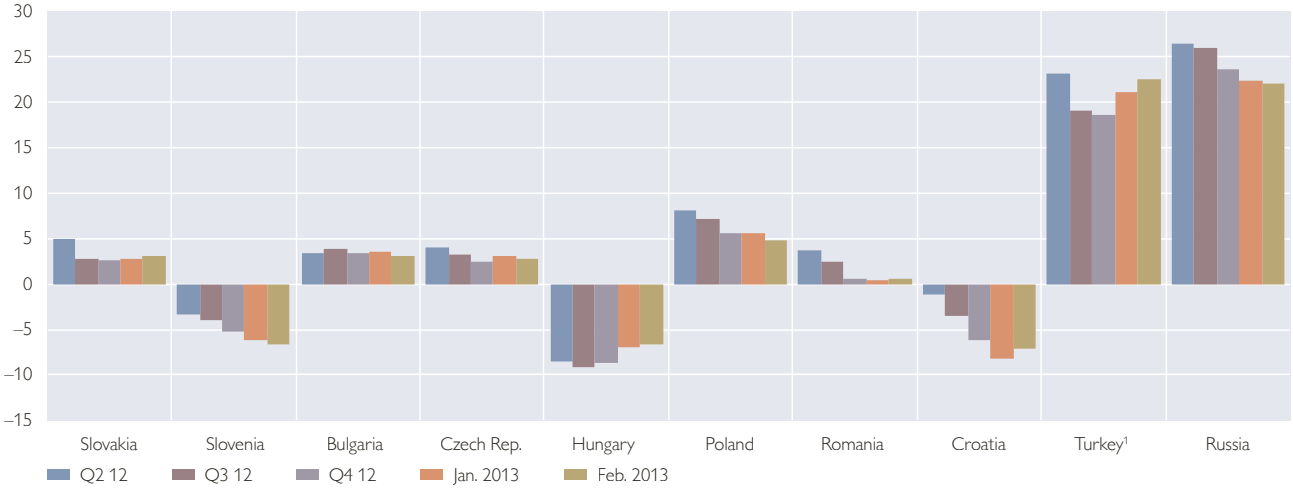
While it is notoriously difficult to disentangle the supply and demand factors of credit developments, it appears that supply as a limiting factor for credit dynamics became less important during the review period. Evidence in support of this view comes from the IIF's Emerging Markets Bank Lending Conditions Survey. The report for the fourth quarter of 2012 finds that overall lending conditions in emerging Europe improved slightly for the first time since the second quarter of 2011. This development was mainly driven by substantially improving domestic as well

[4] *Note that (quarterly) financial accounts and BIS data, which are of key importance in capturing deleveraging trends, are released with a time lag of almost four months. At the time of writing, data up to the third quarter of 2012 were available. Credit data, in turn, are available at a monthly frequency and with a shorter time lag.*

Chart 2

Growth of Credit to the Private Sector

%, year on year, adjusted for exchange rate changes



Source: National central banks.

[1] Nonadjusted.

as international funding conditions, reflecting some key central banks' accommodative stance as well as reduced concerns about the euro area crisis. However, credit standards continued to tighten somewhat, as nonperforming loan ratios increased.

…increasingly driven by low credit demand

Low demand seems to be more important for explaining credit developments in CESEE at the current juncture than credit supply bottlenecks. This claim is also supported by the IIF survey, which reports declining credit demand in the second half of 2012. This decline is related to various factors. First, labor markets remained slack, impacting on households' credit demand. Unemployment rates have increased in nearly all CESEE countries since mid-2012 (e.g. especially in Croatia, by 3 percentage points) and were in the double digits in more than half of the region in January 2013. At the same time, youth and long-term unemployment trended upward and employment declined in most of the countries. Real wage growth also decelerated throughout most of CESEE and was negative in six out of ten countries. Furthermore, fiscal consolidation is cutting into households' debt servicing capacity and also affecting consumption. Businesses are reluctant to invest in view of unfavorable demand conditions, low capacity utilization rates and an uncertain outlook for economic growth. Sentiment indicators are also far below long-term averages, with especially pessimistic expectations among households and the construction sector.

Data on sentiment hint that a subdued recovery might set in at the beginning of 2013

At the same time, there is some recent evidence that the CESEE region might already have reached the trough of economic activity in late 2012 or at the beginning of 2013. At the current juncture, especially soft data point toward an admittedly rather hesitant and still uncertain turning of the economic cycle in CESEE. The economic sentiment indicator of the European Commission (which is available for EU Member States as well as for Croatia and Turkey), for example, has been increasing since November 2012, when it reached its lowest value since late 2009. In March, the average reading stood at 95 points, more than four points

above its low. Among the subindices of the indicator, the positive trend was most pronounced in construction and among consumers (both, as mentioned, from very low levels), but industrial sentiment also brightened to some degree.

In principle, the Purchasing Managers' Index (PMI) data for Poland, the Czech Republic, Turkey and Russia also confirm this picture. The index showed an upward trend from December until February. However, it softened marginally in March, when it still indicated an expansion in Russia and Turkey (values of 50.8 and 52.3) but a contraction in Poland and the Czech Republic (values of 48.0 and 49.1).

The external environment for the CESEE countries also seems to be improving somewhat. The Economic Sentiment Indicator (ESI) for the euro area increased to 90 points in March (+4.3 points since October), while the PMI improved to 46.8 (+2.8 points since July).

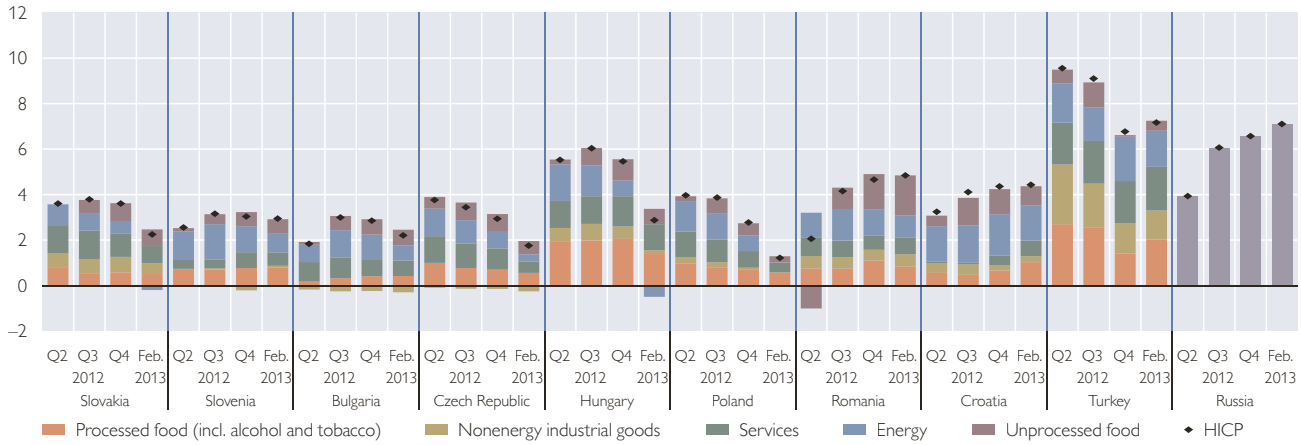
Turning to activity indicators, the picture is still somewhat blurred, and a change in trend cannot be clearly made out yet. Average growth of industrial production, for example, stopped its downward trend in December but did not gain substantial speed at the beginning of the year: the growth rate came in at only 0.2% in February. The picture is similar for construction output and retail sales: Both have recovered a bit from their lows, but are not clearly expanding yet.

Nevertheless, the most recent forecasts expect economic activity to pick up gradually starting in early 2013. Given a negative carryover effect and the weak international environment, growth for the year 2013 is set to accelerate only slightly to an average of 1.8% (after 1.7% in 2012), though. In 2014, the economic dynamics should gain some more steam, and output is projected to expand by 2.3%. With that, the recovery in the next two years will remain comparatively muted.[5]

Chart 3

HICP Inflation and Its Main Drivers

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



Source: Eurostat.

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

[5] *The figures used for calculating the regional average come from the OeNB (Bulgaria, the Czech Republic, Hungary, Poland, Romania, Croatia and Russia) and from the European Commission (Slovakia, Slovenia and Turkey). For the detailed OeNB-Bank of Finland forecast for CESEE, see Outlook for Selected CESEE Countries: Headwinds to Recovery because of Continued Weakness of the External Environment and Only Slow Pickup in Domestic Momentum.*

Moderating price pressures in most countries…

Price developments in CESEE were heterogeneous throughout the review period. While the average inflation rate for the region was roughly stable at some 5.5% to 6% (weighted average) in the second half of 2012 and in early 2013, country differences in price developments were substantial.

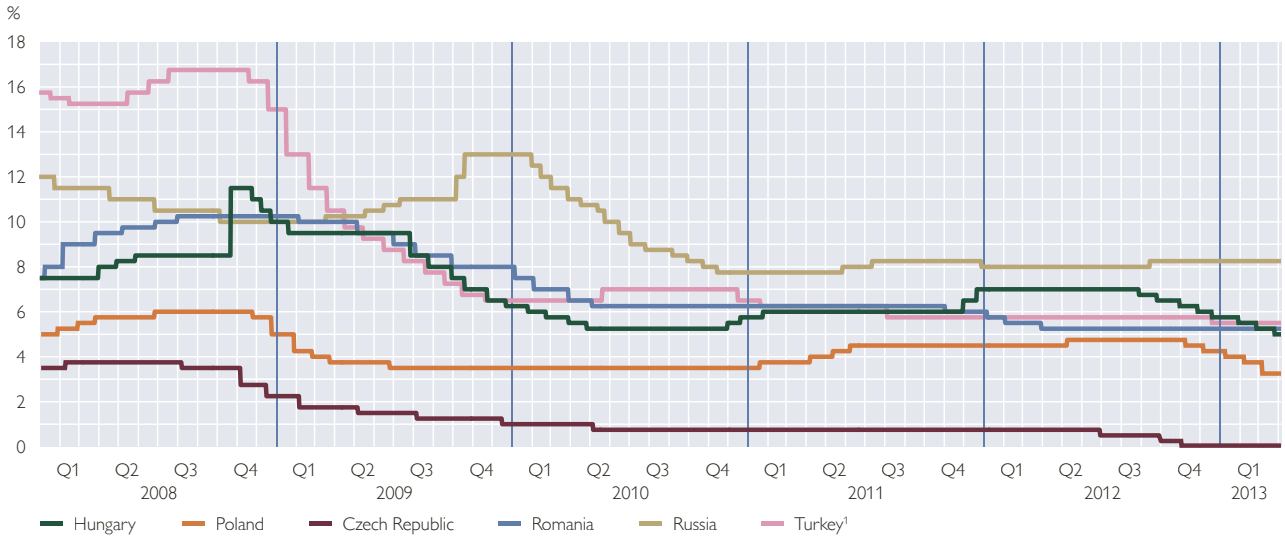
Most countries experienced disinflation during the review period, which was most pronounced in the Czech Republic, Hungary, Poland and Turkey. Inflation declined by more than 2 percentage points from the second quarter of 2012 until February 2013 in those countries. The factors behind this development include earlier tax hikes dropping out of the base in Hungary and the Czech Republic, declining price pressure from the energy component (in Hungary further accentuated by a 10% decrease in utility prices at the beginning of the year) as well as lower inflation dynamics in industrial goods in Turkey.

By contrast, price pressures in Romania and Russia increased by roughly 3 percentage points within the observation period. In both countries, pressure was strongly driven by increasing food prices. A relatively poor harvest and a low base boosted food price dynamics from the second half of 2012 onward. Additionally, hikes in administered prices in July 2012 in Romania and in July 2012 and again in early 2013 in Russia are still rippling across consumer prices.

During the review period, both the Bank of Russia (CBR) and the National Bank of Romania (BNR), have kept their main policy interest rates stable. The CBR argued that under the assumption of stable inflation expectations and in the absence of adverse food price shocks, the rate of inflation will return to the target range in the second half of 2013. The BNR, in turn, pointed out the temporary and one-off nature of the recent inflation upturn and the still considerably negative output gap, which – in conjunction with base effects kicking in during the second half of 2013 – should bring inflation back on target by year-end.

Chart 4

Policy Rate Developments in CESEE



Source: National central banks.

[1] In May 2010, the Central Bank of the Republic of Turkey replaced the borrowing rate by the one-week repo rate as a policy rate.

…provide room for monetary loosening

Demand pressure on prices was generally low also in the other countries of the region, and core inflation rates were mostly well below headline inflation rates. Among the other central banks of the region, disinflation was well reflected in interest rate decisions. Monetary policy was loosened most aggressively in Hungary and Poland. Policy rates in both countries have been cut by a cumulative 150 basis points since October 2012 to 5% and 3.25%, respectively. The Czech Republic reduced its main interest rate by 20 basis points to a record low of 0.05%, and the central bank of Turkey cut the main interest rate by 25 basis points to 5.5%.

Favorable development of external balances in the second half of 2012

Combined current and capital account positions in the CESEE region had improved substantially during the global financial crisis. After some pause in 2011, external positions again improved in most CESEE countries during the observation period, in some cases substantially so. The adjustment was most pronounced in Slovenia and Turkey, where the external balances gained close to 2% of GDP from the second quarter of 2012 to the fourth quarter of 2012 (four-quarter moving sums), and in Slovakia (2.8% of GDP). Better outcomes in the trade balance largely due to low import demand reflecting weak domestic dynamics were mainly responsible for this development. A deterioration of the external position was reported only for Russia.

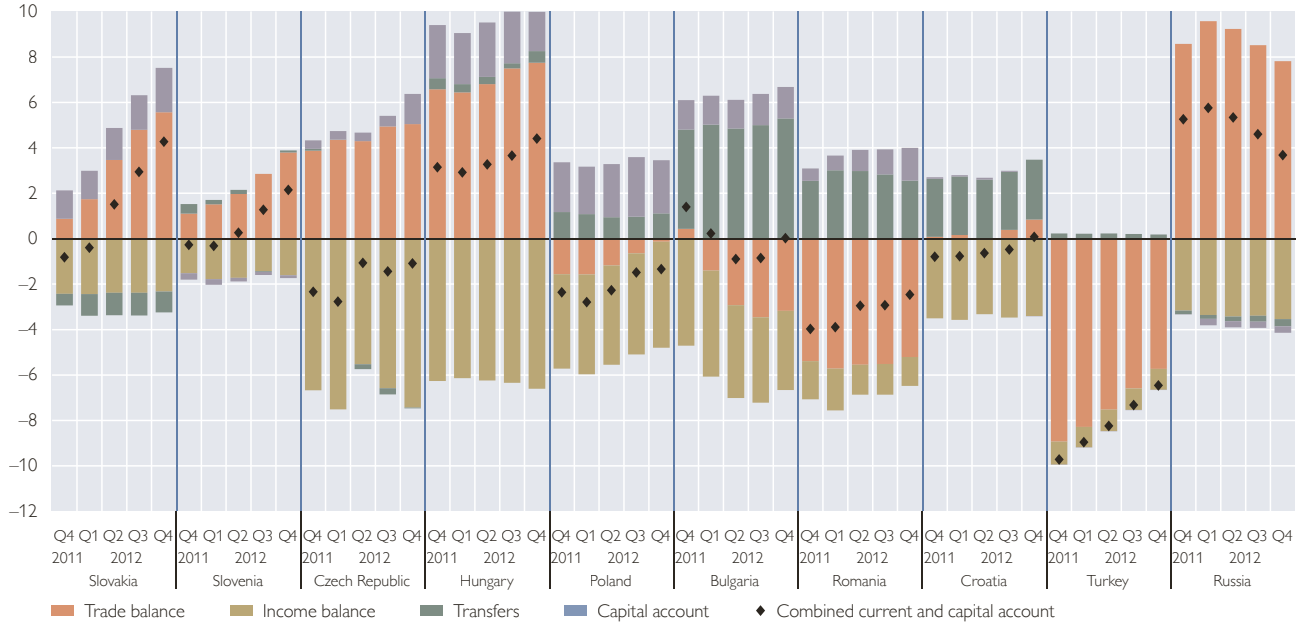
Capital flows to CESEE gain speed with substantial variation across countries

Net capital flows to the ten CESEE countries as a whole accelerated strongly from – 0.4% of GDP in the second quarter of 2012 (four-quarter moving sum) to 4.8% of GDP in the final quarter of 2012 (four-quarter moving sum). This development was driven to a substantial extent by flows to the bigger markets of the region, namely Turkey (rising inflows) and Russia (decreasing outflows). But some

Chart 5

Combined Current and Capital Account Balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

other countries of the CESEE region also reported higher net inflows of foreign capital. This is especially true of the Czech Republic and Bulgaria.

A noticeable deterioration of the financial account balance was reported only for Croatia, Hungary and Slovenia, the economically weaker countries of the region, featuring reduced inflows in Croatia and (rising) outflows in Slovenia and particularly in Hungary.

In the Czech Republic, Hungary and Slovenia, net FDI inflows made up the largest positive component of the financial account. By contrast, (net) portfolio investment represented the financial account's largest positive component in Slovakia, Poland, Croatia, Turkey, Russia, Romania and Croatia. (Net) other investment – in particular loans – were negative in all countries under observation but Turkey and Bulgaria. Net outflows from this category were related to bank deleveraging in some countries, in particular in Hungary, Slovenia, Romania and Croatia.

Financial account developments during the review period were driven by a combination of push and pull factors, including investor sentiment. (Higher) inflows were reported especially for countries with favorable CDS developments and/or a comparatively good growth outlook, while outflows could be observed from countries faced with less benign risk assessments of international investors. Investors based their judgment on the weaker growth outlook, structural problems, and an unfavorable business environment partly due to insufficient reform efforts or a lack of policy predictability and credibility.

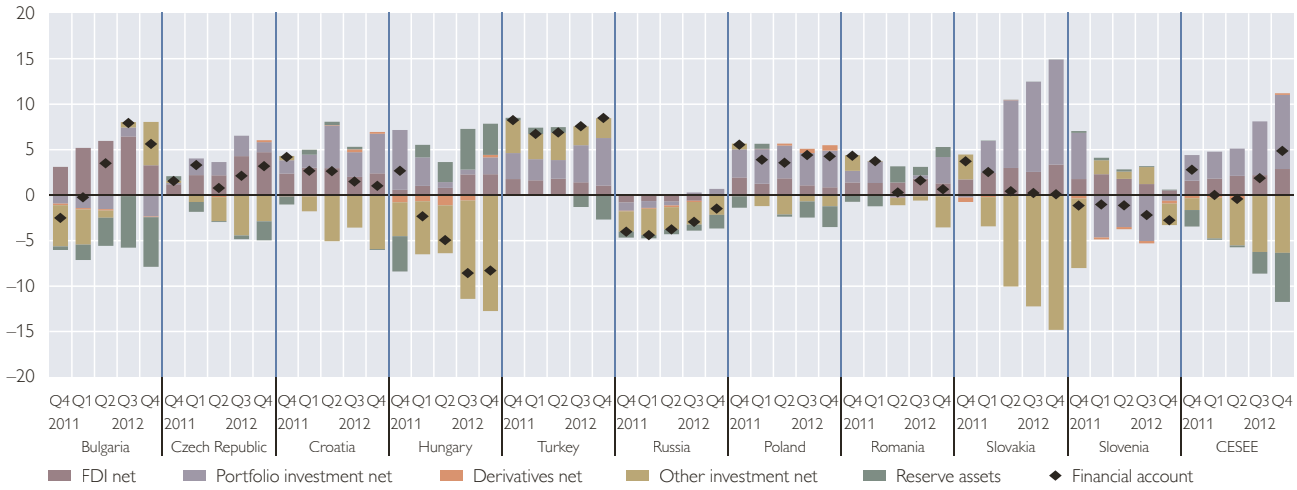
Fiscal consolidation efforts continue in 2012

Most CESEE countries continued with fiscal consolidation efforts also in 2012. The highest declines in public deficits were reported for Romania and Slovenia (–2.7% of GDP and –2.4% of GDP, respectively) followed by Poland, Croatia and Bulgaria. In some other countries, however, budget balances stagnated or deteriorated. This is especially the case for Hungary, the Czech Republic and Russia. In the former two, the deterioration was strongly related to one-off factors, however.

Chart 6

Financial Account Balance

% of GDP, four-quarter moving sum



Source: National central banks.

In Hungary, revenues from the de facto abolition of formerly compulsory private pension funds (the pension system's "second pillar") had led to a large surplus in 2011. Without those receipts, the deficit in the country would have amounted to some 5.5% of GDP, substantially higher than the 1.9% of GDP reported in 2012. In the Czech Republic, the deficit widened by 1.1% of GDP as a result of the combined impact of two one-off operations amounting to some 1.8% of GDP. Consequently, the structural budget deficits of those two countries narrowed, just like throughout most of CESEE. In Russia, boosts in public spending in the forefront of presidential elections and a public investment program in infrastructure and the nonenergy economy along with a variety of expanded social policy schemes brought down the country's budget surplus of 1.5% of GDP in 2011 to virtually zero in 2012. Russia was also the only country whose cyclically adjusted budget balance deteriorated noticeably.

With the exception of Bulgaria, all EU Member States in the CESEE region are subject to an excessive deficit procedure (EDP). Target dates scheduled for reducing excessive deficits were set at 2012 for Poland, Hungary and Romania and at 2013 for the Czech Republic, Slovenia and Slovakia. Among the first group of countries, only Hungary and Romania managed to bring down their budget deficits to below the 3% of GDP threshold in 2012. Poland posted a deficit of 3.9% of GDP. A decision on the abrogation of the EDP will formally be taken in June. At the current juncture, it only seems safe to say that Romania has met its target in a sustainable way. In the case of Hungary, the latest forecast of the European Commission projects a rise of the deficit to 3.4% of GDP in 2013 and 2014. The sustainability of the correction in 2012 will have to be assessed against this background. Deficits are expected to exceed the 3% of GDP threshold also in the Czech Republic, Slovenia, Slovakia and Croatia in the next two years.

Croatia is about to enter the EU; Latvia submits entry request to euro area

Croatia is set to become the 28th member state of the European Union on July 1, 2013. The country finished its accession negotiations on June 30, 2011, signed the Accession Treaty on December 9, 2011, and in a referendum on January 22, 2012, a majority of the Croatian population voted in favor of EU accession. The ratification process in some EU Member States, however, is still ongoing. As of April 11, 2013, ratification was still pending in Denmark and Germany.

On March 5, 2013, Latvia formally asked the European Commission and the ECB to deliver convergence reports with the aim of joining the euro area on January 1, 2014. The respective reports will be published on June 5, 2013, with the European Commission also giving a recommendation on the introduction of the euro in Latvia. Finally, the ECOFIN will take a formal decision on the matter after consulting the European Parliament and following a discussion in the European Council.

Box 1

Ukraine: Growth Stalls, Twin Deficits Widen, but Imminent Market Pressures Ease

After growth decelerated in the first half of 2012, Ukraine's economy contracted in the second half of the year, bringing full-year GDP growth down to 0.2% from 5.2% in 2011.

Widening twin deficits also contributed to a worsening macroeconomic picture. The budget deficit increased in 2012 (from 1.8% of GDP in 2011 to 3.6% in 2012) for cyclical reasons and because of a spending boost before the parliamentary elections in October 2012. Moreover, the current account deficit rose from 6.1% of GDP in 2011 to 8.2% in 2012. Slowing domestic demand has not entailed a substantial decline in import demand so far, while export growth was negatively affected by declining global demand for steel.

Foreign exchange reserves continued to shrink in the second half of 2012 before stabilizing at very low levels in early 2013 (about three months of imports). Pressures on the de facto pegged exchange rate – and in turn on foreign exchange reserves – eased after administrative measures had been introduced in late 2012 and because households' foreign currency demand declined. Furthermore, the Ukrainian government repeatedly placed Eurobonds on international markets also to conduct repayments of loans extended by the IMF under previous Stand-By Arrangements (SBAs).

In early 2013, the Ukrainian authorities started negotiations on a new SBA. Yet, two rounds of discussion ended without reaching a final agreement. Discussions on the key building blocks of a new program, namely measures to reduce Ukraine's twin deficits, and energy sector and banking reforms will continue in the near future. The EU and Ukraine in principle agreed on the terms of an association agreement (including a deep and comprehensive free trade agreement), but it still has to be signed. At a high-level summit in February, the EU called for concrete progress in particular with respect to judicial and electoral issues until May. In parallel, the Ukrainian government has been in talks with Russia on lowering import gas prices and joining the CIS customs union, which comprises Belarus, Kazakhstan and Russia.

Box 2

Western Balkans[1]: Falling into Double-Dip Recession

After growth in the region had already slowed down in 2011, almost all countries drifted into recession in 2012. Serbia was hit the hardest (–1.7%), followed by Montenegro (–0.5%), Bosnia and Herzegovina (–0.7%) and FYR Macedonia (–0.3%). Positive growth could be preserved only in Albania (+1.6%) and Kosovo (+2.7%), although at a much lower level than in 2011. The deceleration in the economic momentum was broad-based and encompassed all GDP components. In particular, private consumption declined further (in Serbia) or turned negative (in FYR Macedonia) throughout most of the region (Albania was an exception). A similar picture can be seen for gross fixed capital formation, except in FYR Macedonia, where the contribution of gross fixed capital formation declined but remained in positive territory. Bosnia and Herzegovina has not released annual GDP figures for 2012 (and quarterly GDP data are not available at all for this country), but industrial production and retail sales indicators point to a decline in GDP in the second half of 2012.

External imbalances did not change substantially in 2012 compared to 2011, with current account deficits remaining rather large in most countries. While in Kosovo and Albania, the current account deficit for 2012 decreased somewhat to 7.8% of GDP (Kosovo) and 10.5% of GDP (Albania) on the back of a reduction of the trade deficit, the current account deficitin Montenegro in 2012 remained stubbornly high (17.7% of GDP). On the contrary, an increase in the trade deficit in parallel with declining transfers brought about the widening of the current account deficit in the FYR Macedonia (to 3.9%) and in Serbia (to 10.6%). On the financial account, net FDI inflows declined markedly, especially so in Serbia, FYR Macedonia and Kosovo, while remaining broadly unchanged in the other countries, so that the overall (unweighted) coverage ratio worsened to some 50% in 2012 compared to 70% in 2011 (ranging from some 8% in Serbia to 77% in Montenegro).

Despite weak real sector dynamics and initiatives to subsidize loans in the corporate sector (Serbia), credit growth[2] in the private sector remained positive in most countries, ranging between 3% (Bosnia and Herzegovina) and 8% (Albania). Deleveraging in Montenegro continued, though at a slower pace, with credit contracting by some 5% from 11% in 2011. Credit quality improved slightly only in Serbia, contrary to the other Western Balkan countries, where the share of nonperforming loans increased further (especially so in Albania and Montenegro). In all countries covered here, it reached levels between 11% and 23% in 2012 (except in Kosovo, where IMF estimates point to a slightly increased share of bad loans of 6.5% in total outstanding loans).[3]

On the back of subdued GDP momentum and despite the adverse weather conditions in some countries, annual average inflation rates decreased in 2012 in most countries and especially so in Kosovo. In the course of the year, price dynamics in the Western Balkan region decreased in the first quarter but picked up to some extent afterwards. In annual average terms, inflation ranged between 2% and 4% in most countries under review here. Only in Serbia was inflation noticeably higher at 7.2% (and also rather volatile, with December inflation coming in at 12.2% year on year).

Against this background, the Bank of Albania cut its policy rate in several steps in 2012 to a historic low of 3.75% in January 2013. The National Bank of Serbia, in turn, increased its policy rate in several steps from 9.5% in January 2012 to 11.75% in February 2013. (In the other Western Balkan countries, monetary policy is based on pegged exchange rates or – in the case of Montenegro and Kosovo – on the unilateral use of the euro as legal tender.)

[1] *The Western Balkans comprise the EU candidate countries FYR Macedonia, Montenegro, and Serbia, as well as the potential candidate countries Albania, Bosnia and Herzegovina, and Kosovo. The designation of Kosovo is without prejudice to positions on status, and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.*

[2] *Data on credit growth are on a foreign exchange-adjusted basis.*

[3] *This deterioration took place despite initiatives for NPL resolution launched in Montenegro in the period 2011 to 2012, i.e. the "Podgorica approach," as well as the transfer of bad loans to their foreign parent banks.*

Most countries missed the general government budget targets[4] for 2012, mainly for cyclical reasons. In FYR Macedonia and Kosovo, deficits widened to 3.8% and 2.7% of GDP, respectively, while the sharpest increase was registered in Serbia, with the deficit climbing to 6.4% in 2012 partly because of election-related extra spending. Montenegro, in turn, was able to lower the general government deficit (to 4%) on the back of an expenditure-based consolidation effort coupled with increasing fiscal revenues, while Albania kept the deficit broadly stable (at 3.4% of GDP), although at the expense of lower capital spending.

After a new two-year SBA of SDR 338.2 million had been approved in September 2012 for Bosnia and Herzegovina (initial disbursement of SDR 51 million), the first review was completed in December 2012 and another SDR 51 million were disbursed. While in FYR Macedonia, the two-year Precautionary and Liquidity Line arrangement expired in January 2013 (followed by post-program monitoring), the 20-month SBA in Kosovo amounting to SDR 91 million will be in force until end-2013. So far, the authorities have drawn upon it twice for a total of SDR 78 million, and the third review was completed by the IMF's Executive Board in April 2013. Negotiations on a renewed IMF program with Serbia are underway and are mainly conditional upon fiscal consolidation efforts as well as progress on some key structural reforms. While Montenegro began accession negotiations with the EU in December 2012, such talks have not yet started with the other two candidate countries in the Western Balkans, FYR Macedonia and Serbia. Notwithstanding a recommendation by the European Commission, the European Council did not grant Albania candidate country status in December 2012.

[4] It should be noted that cross-country comparisons of NPL data are hampered by differences in classification rules.
[5] No data available for Bosnia and Herzegovina.

2 Slovakia: A Record Year for the Car Industry Boosts the Economy

Car industry drives exports, net exports drive GDP growth…

Despite losing pace in 2012, Slovakia's economy remained among the top EU performers, with annual GDP growth of 2%. However, throughout the year, growth decelerated considerably, posting only 0.7% in the last quarter. Domestic demand acted as a drag on growth, with household consumption declining more and more as a result of fiscal consolidation, worsening labor market conditions and falling real wages. Investments and inventories dropped as well, mainly due to a base effect of expanding car production lines in 2011. The automobile production boosted the Slovak economy in 2012; output expanded by 26% on average, reaching as much as 44% in July 2012. However, car manufacturing also prompted the downturn of industrial production in December. Capacity utilization in the whole economy dropped to a mere 60% at the end of 2012 as a result of slowing external demand, which, however, was still sufficient to keep GDP growth in positive territory.

…making 2012 a record year for the trade and current account balance

Imports could not keep up with the pace of exports, thus bringing the 2012 trade balance to a sizeable surplus of 5.1% of GDP. The improvement of the current account amounted to 4.4 percentage points of GDP in 2012. Net FDI inflows also strengthened to 3.4% of GDP.

Average annual HICP inflation moderated somewhat to 3.7% in 2012, with the effect of a hike in the VAT rate in the previous year ending. Inflation has been propelled mainly by regulated prices and food, reflecting world price developments in commodities and the basic lack of domestic demand pressures.

No improvement in the labor market

The situation in the labor market has been worsening further, with the employment rate broadly stable at relatively low levels (under 60%), declining hours worked and a decreasing number of self-employed persons. The unemployment rate deteriorated considerably in the last quarter of 2012, rising to 14.5%. This increase possibly anticipated a reversal of labor code reforms as well as higher social contributions of the self-employed and persons working under alternative employment forms, with both measures taking effect in 2013. Combined with productivity advances that outpaced wage dynamics, unit labor costs decreased significantly in 2012, further contributing to the economy's competitiveness.

Tough consolidation year and a debt brake ahead

For 2012, Slovakia targeted a general government deficit of 4.6% of GDP. The realized deficit came in at 4.3% of GDP. Nevertheless, public debt has increased by nearly 9 percentage points of GDP. Beside the primary deficit and contributions to the European Financial Stability Facility and the European Stability Mechanism, this rise is also due to prefinancing for 2013 of about 3 percentage points of GDP to take advantage of historically low government bond yields. For 2013, a deficit of 2.9% of GDP has been budgeted for the country to come out of the EDP. The main measures to achieve this goal comprise a reintroduction of a progressive personal income tax with a second bracket and a higher corporate income tax, several changes to social contributions, a higher bank levy tax base, a temporary profit levy for regulated industries, higher car registration fees and minor spending cuts. Also, the contributions to the second pension pillar have been decreased from 9% to 4%, and a transfer back to the pay-as-you-go pillar was made possible temporarily. In 2012, the law on fiscal responsibility became effective, creating a fiscal responsibility board and imposing a system of gradual debt brakes (on the debt-to-GDP ratio), which will first apply in 2013, following the official notification that the ratio has surpassed its first threshold of 50% (the ultimate debt limit being 60%).

Table 2

Main Economic Indicators: Slovakia

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	4.4	3.2	2.0	2.6	3.8	2.9	2.6	2.1	0.7
Private consumption	–0.7	–0.5	–0.6	–1.0	–0.5	–0.1	–0.3	–0.6	–1.2
Public consumption	1.0	–4.3	–0.6	–4.1	–4.7	0.5	–2.1	–0.4	–0.3
Gross fixed capital formation	6.5	14.2	–3.7	17.2	18.3	–3.3	–2.5	–3.7	–5.0
Exports of goods and services	16.0	12.7	8.6	10.2	7.9	5.0	10.8	11.6	7.1
Imports of goods and services	14.9	10.1	2.8	5.4	2.7	–0.2	1.6	5.7	4.2
	Contribution to GDP growth in percentage points								
Domestic demand	3.6	1.2	–2.9	–0.9	–0.8	–0.8	–5.5	–3.3	–1.9
Net exports of goods and services	0.7	2.0	5.2	3.5	4.6	4.9	8.3	4.9	2.8
Exports of goods and services	11.3	10.2	7.7	7.7	6.9	4.7	9.8	9.7	6.6
Imports of goods and services	–10.6	–8.1	–2.5	–4.2	–2.3	0.2	–1.4	–4.8	–3.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–1.4	–0.4	0.1	0.3	–1.4	–1.6	0.4	–0.2	1.8
Unit labor costs in manufacturing (nominal, per hour)	–8.8	4.3	–8.3	8.0	6.9	–5.7	–8.9	–12.6	–5.7
Labor productivity in manufacturing (real, per hour)	9.0	2.5	13.3	1.9	–0.2	11.0	14.9	15.7	11.5
Labor costs in manufacturing (nominal, per hour)	0.0	6.9	3.9	10.1	6.6	4.6	4.6	1.2	5.2
Producer price index (PPI) in industry	0.4	4.5	1.9	3.9	3.6	2.3	1.5	1.8	2.0
Consumer price index (here: HICP)	0.7	4.1	3.7	4.1	4.7	4.0	3.6	3.8	3.6
EUR per 1 SKK, + = SKK appreciation	..	..	..	..	..	..	..	..	..
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	14.4	13.6	14.0	13.2	14.0	14.1	13.7	13.7	14.5
Employment rate (%, 15–64 years)	58.8	59.5	59.7	59.9	59.5	59.6	59.8	60.1	59.4
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
SKK per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.4	0.7	6.6	5.0	0.7	3.0	1.9	1.9	6.6
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.3	–3.8	–3.1	–5.5	–3.8	–7.2	–6.7	2.7	–3.1
Domestic credit of the banking system	9.2	9.4	–7.0	4.4	9.4	9.8	2.4	–4.5	–7.0
of which: claims on the private sector	3.2	6.9	–0.1	7.5	6.9	4.3	1.4	0.5	–0.1
claims on households	4.2	3.9	3.9	4.3	3.9	3.9	3.5	3.7	3.9
claims on enterprises	–1.0	2.9	–4.0	3.2	2.9	0.4	–2.1	–3.2	–4.0
claims on the public sector (net)	6.0	2.5	–6.9	–3.1	2.5	5.4	1.0	–5.1	–6.9
Other assets (net) of the banking system	–6.1	–4.9	16.7	6.1	–4.9	0.4	6.2	3.8	16.7
	% of GDP, ESA 95								
General government revenues	32.3	33.3	33.1	. .	. .	. .	. .	. .	. .
General government expenditures	40.0	38.4	37.4	. .	. .	. .	. .	. .	. .
General government balance	–7.7	–5.1	–4.3	. .	. .	. .	. .	. .	. .
Primary balance	–6.3	–3.5	–2.5	. .	. .	. .	. .	. .	. .
Gross public debt	41.0	43.3	52.1	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	21.5	18.0	10.2	15.2	10.7	9.0	10.5	13.6	7.7
Merchandise imports	22.5	17.9	5.6	11.5	7.6	6.2	3.6	8.4	4.3
	% of GDP (based on EUR), period total								
Trade balance	1.2	1.4	5.1	0.9	2.6	4.6	5.4	4.8	5.5
Services balance	–1.1	–0.5	0.4	–0.7	0.2	0.4	0.4	0.5	0.3
Income balance (factor services balance)	–3.1	–2.4	–2.3	–2.3	–2.5	–2.3	–2.2	–2.4	–2.3
Current transfers	–0.6	–0.5	–0.9	–1.1	–1.4	–0.4	–0.9	–1.2	–1.1
Current account balance	–3.7	–2.1	2.3	–3.3	–1.1	2.3	2.7	1.7	2.5
Capital account balance	1.5	1.3	1.9	1.1	1.3	0.2	2.9	1.5	3.0
Foreign direct investment (net)	0.9	1.7	3.4	1.4	5.3	4.7	0.7	–0.2	8.4
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	74.8	76.6	75.2	78.0	76.6	77.7	76.4	73.0	75.2
Gross official reserves (excluding gold)[1]	0.8	1.0	0.9	0.9	1.0	0.9	0.9	0.9	0.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	EUR million, period total								
GDP at current prices	65,870	69,108	71,463	18,199	17,851	16,550	17,822	18,879	18,212

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: Government Determined to Tackle Crisis without International Assistance

Politics in the forefront

Political uncertainty was a dominant factor over the review period. Uncertainty surrounding the course of economic reforms diminished temporarily in late December following the constitutional court's decision to ban referendums on the laws on the bank asset management company and the state holding company, which had been passed in late October 2012. The establishment of the two institutions, which should be fully operative by September 2013 at the latest, is a key reform element to stabilize the financial sector and the economy and to ensure smooth refinancing of both the government and the banking system. In addition, a pension reform took effect at the beginning of 2013, and progress was made on labor market reform. However, the center-right government lost its parliamentary majority in late January 2013 as a consequence of corruption allegations and was finally ousted at the end of February, raising questions about the further course of fiscal consolidation and key reforms. Agreement on the formation of a new center-left government was reached in mid-March. Consolidating public finances mainly by curbing public spending (including further cuts in the public sector wage bill) while boosting the economy, among other things by promoting job creation, reducing the overindebtedness of the corporate sector, utilizing EU funds better, improving the business environment and changing insolvency legislation remain key priorities. Some changes will also be implemented to the state holding company and the bad bank law. In general, observers expect a politically rather difficult environment ahead, given the only slim parliamentary majority of the four-party coalition government.

Slight increase in the budget deficit expected for 2013 following considerable reduction in 2012

Owing mainly to a nominal wage cut in the public sector and reinforced restraint in social transfers, Slovenia succeeded in reducing the fiscal deficit in 2012 to 4.0% of GDP from 6.4% in 2011. For 2013, the European Commission expects a deficit of 5.1% of GDP, including the deficit-increasing impact of the conversion of a hybrid debt-equity instrument in the country's largest commercial bank, Nova Ljubljanska banka, into equity (0.9% of GDP). In its March 2013 EDP report, the statistical office notified a projected deficit of 4.2% of GDP for 2013, including capital injections worth 1.2% of GDP into banks. Budget execution in 2013 should be favorably influenced by a further cut in the public sector wage bill and the effects of the pension reform. However, in its Fiscal Sustainability Report of December 2012, the Commission saw Slovenia at a high sustainability risk in the medium term, mainly due to the budgetary impact of ageing costs, given that the latest pension reform will reduce pension costs only in the short term.

Economy in recession in the second half of 2012

GDP shrank by 3% year on year in the last two quarters of 2012, bringing the contraction in full-year 2012 to 2.3%. Recessionary tendencies in domestic consumption continued in the latter part of 2012. This mirrored continued savings measures implemented by the government, the ongoing contraction of credit to the household sector, very weak consumer confidence, high and increasing unemployment and declining real wages. Investment activity plummeted again in the second half of 2012, reflecting declining levels of capacity utilization, intensified deleveraging by the corporate sector and weak demand conditions. Also, destocking continued to weigh on GDP developments. On the other hand, the contribution of net exports, the single engine of growth, rose considerably in the second half of 2012. Net exports went up because the accelerating drop in imports more than offset the stagnation in exports on account of weak export demand.

Table 3

Main Economic Indicators: Slovenia

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	1.2	0.6	–2.3	0.8	–2.4	0.0	–3.2	–3.1	–3.0
Private consumption	1.3	0.9	–2.9	2.1	–0.5	0.7	–2.5	–3.8	–5.7
Public consumption	1.5	–1.2	–1.6	–1.1	–1.3	0.1	–2.4	–2.9	–1.3
Gross fixed capital formation	–13.8	–8.1	–9.3	–8.7	–3.5	–10.3	–7.6	–8.6	–10.6
Exports of goods and services	10.1	7.0	0.3	5.1	3.1	1.8	–0.3	–0.4	0.0
Imports of goods and services	7.9	5.2	–4.3	4.4	0.8	–0.8	–3.7	–5.9	–6.6
	Contribution to GDP growth in percentage points								
Domestic demand	–0.2	–0.7	–5.6	0.2	–3.8	–1.9	–5.7	–6.9	–7.8
Net exports of goods and services	1.5	1.3	3.3	0.6	1.5	1.9	2.4	3.8	4.9
Exports of goods and services	5.9	4.6	0.2	3.4	2.1	1.3	–0.2	–0.3	0.0
Imports of goods and services	–4.5	–3.4	3.1	–2.8	–0.6	0.6	2.6	4.1	4.9
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–0.6	–1.0	1.3	–2.0	0.9	1.1	1.0	2.5	0.6
Unit labor costs in manufacturing (nominal, per hour)	–1.6	0.2	5.1	0.3	4.6	0.3	11.7	2.9	6.1
Labor productivity in manufacturing (real, per hour)	5.0	1.6	–2.2	–0.4	–2.1	–2.5	–1.8	–0.1	–4.2
Labor costs in manufacturing (nominal, per hour)	3.2	1.9	2.9	–0.1	2.4	–2.3	9.7	2.8	1.7
Producer price index (PPI) in industry	2.0	4.6	0.9	4.1	3.6	1.3	0.8	0.6	0.6
Consumer price index (here: HICP)	2.1	2.1	2.8	1.5	2.6	2.5	2.5	3.2	3.0
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.4	8.4	9.0	8.0	8.9	8.7	8.3	9.3	9.7
Employment rate (%, 15–64 years)	66.2	64.4	64.1	65.1	64.4	64.0	63.8	64.3	64.2
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)	1.6	3.0	–0.7	2.9	3.0	4.3	3.3	0.4	–0.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–4.0	6.5	3.9	7.8	6.5	–6.8	–4.9	–5.5	3.9
Domestic credit of the banking system	6.7	–3.1	–2.7	–2.7	–3.1	10.8	6.8	7.5	–2.7
of which: claims on the private sector	2.8	–3.8	–7.2	–1.5	–3.8	–3.4	–5.0	–5.2	–7.2
claims on households	3.9	0.8	–0.8	1.6	0.8	0.6	–0.3	–0.6	–0.8
claims on enterprises	–1.1	–4.6	–6.4	–3.0	–4.6	–4.0	–4.7	–4.6	–6.4
claims on the public sector (net)	3.9	0.7	4.5	–1.2	0.7	14.2	11.7	12.7	4.5
Other assets (net) of the banking system	–1.2	–0.4	–2.0	–2.2	–0.4	0.4	1.4	–1.6	–2.0
	% of GDP, ESA 95								
General government revenues	44.5	44.4	45.0	. .	. .	. .	. .	. .	. .
General government expenditures	50.4	50.8	49.0	. .	. .	. .	. .	. .	. .
General government balance	–5.9	–6.4	–4.0	. .	. .	. .	. .	. .	. .
Primary balance	–4.3	–4.4	–1.9	. .	. .	. .	. .	. .	. .
Gross public debt	38.6	46.9	54.1	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	13.8	15.6	0.9	13.0	10.5	2.9	0.2	0.2	0.3
Merchandise imports	16.2	13.8	–2.3	12.0	7.1	1.6	–1.8	–3.9	–5.1
	% of GDP (based on EUR), period total								
Trade balance	–3.4	–2.9	–0.9	–2.3	–4.3	–2.0	–1.2	0.1	–0.8
Services balance	3.7	4.0	4.8	3.8	4.1	4.7	5.0	5.0	4.4
Income balance (factor services balance)	–1.4	–1.5	–1.6	–2.5	–0.9	–2.1	–1.4	–1.4	–1.7
Current transfers	0.3	0.4	0.1	0.0	0.7	–0.4	0.3	–0.8	1.2
Current account balance	–0.8	0.0	2.3	–1.0	–0.4	0.3	2.8	2.9	3.2
Capital account balance	0.0	–0.3	–0.1	–0.1	–0.9	0.1	0.3	0.0	–0.9
Foreign direct investment (net)	0.9	1.8	0.5	2.6	1.8	2.2	0.5	0.4	–1.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	114.4	111.3	115.1	117.5	111.3	116.9	115.9	114.2	115.1
Gross official reserves (excluding gold)[1]	2.0	1.8	1.7	1.8	1.8	1.6	1.7	1.7	1.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	35,607	36,172	35,466	9,382	8,968	8,529	9,079	9,139	8,719

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: Fragile Economic Growth amid Improving Fiscal Position

Growth structure changes while labor market conditions remain slack

Against the background of lackluster global economic activity, GDP growth in Bulgaria slowed to 0.5% in the second half of 2012, bringing full-year growth to 0.8%. 2012 brought about a rebalancing of the growth structure, which had been characterized by depressed domestic demand and strong positive growth contributions by net exports in recent years. Hence, on the back of improved private consumption dynamics boosted by rising wages, domestic demand turned out to be the driving force in 2012, though its upward trend moderated in the second half of the year. On a negative note, enduring adverse labor market conditions pushed the unemployment rate to 12.4% in 2012, which is an eight-year high. The growth contribution of gross fixed capital formation returned into positive territory in 2012. However, investment dynamics remained subdued due to persistently low business confidence, relatively moderate FDI inflows and limited fiscal leeway. The pace of expansion of both imports and exports decelerated in the second half of 2012, and the contribution of net exports turned negative in 2012 for the first time since 2009.

External position roughly unchanged

Despite the fact that Bulgaria's current account improved in the second half of 2012, mirroring weaker domestic demand coupled with subdued external demand, the deficit for 2012 slipped into negative territory and came to –1.3% of GDP. The bulk of the deterioration came from the goods and services balance and was only partly countered by the narrowing of the deficit in the income balance. Nevertheless, and despite declining substantially in the second half of 2012, net FDI inflows in 2012 remained roughly at the same level as in 2011 (3.3% of GDP), thus covering the current account shortfall in 2012 by a comfortable margin. The gross foreign debt ratio slightly rose to 95% of GDP at the end of 2012, with some uptick in public sector foreign debt; private sector foreign debt levels remained broadly flat.

Price competitiveness improves, inflation decelerates after slight pickup in autumn 2012

Price competitiveness has strengthened, as the growth of unit labor costs in the manufacturing sector measured in euro remained subdued and even turned slightly negative in the last three quarters of 2012 on the back of robust labor productivity growth. The real effective exchange rate appreciation came to a halt, and the exchange rate posted a mild depreciation averaging about 4% year on year in 2012. After remaining moderate in the first half of 2012 (1.9%), annual HICP inflation increased to a peak of 3.4% in September 2012 on the back of rising prices of unprocessed foods and electricity for households before decelerating to 2.2% in February 2013. The unexpectedly high bills following the electricity price hike fueled social upheavals, which led to the resignation of the government at end-February 2013 and to early elections in May 2013. Annual core inflation remained low, sinking to 1.2% on average in 2012.

Public finances improve in 2012, weak expansionary fiscal stance ahead

With revenues from indirect taxes (especially VAT receipts) augmenting, the general government deficit narrowed from 2% of GDP in 2011 to 0.8% of GDP in 2012, which is markedly lower than the deficit target (1.3% of GDP). In anticipation of the repayment of foreign debt maturing in January 2013, the Bulgarian government in July 2012 issued new five-year benchmark Eurobonds worth EUR 950 million with a 4.25% annual coupon. The 2013 budget envisages a somewhat expansionary fiscal stance, reflecting higher public consumption, rises in pensions and an increase of minimum wages as of January 2013 (used as a basis for calculating social benefits). This deficit is to be covered by a roughly equal rise of fiscal revenues based on a somewhat optimistic GDP growth forecast of 1.9% in 2013.

Table 4

Main Economic Indicators: Bulgaria

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	0.4	1.8	0.8	1.9	0.6	1.0	1.1	0.8	0.3
Private consumption	0.1	1.5	2.6	3.1	2.4	2.7	4.3	3.2	0.4
Public consumption	1.9	1.6	–1.3	–1.4	0.9	–1.3	–1.5	–0.4	–2.0
Gross fixed capital formation	–18.3	–6.5	0.8	8.3	–12.4	3.6	1.2	0.7	–1.0
Exports of goods and services	14.7	12.3	–0.4	4.1	11.2	–3.0	3.3	–0.5	–1.7
Imports of goods and services	2.4	8.8	3.7	10.2	5.3	3.4	9.8	2.6	–0.5
	Contribution to GDP growth in percentage points								
Domestic demand	–5.2	0.0	3.5	3.8	–1.5	5.8	5.5	2.2	1.3
Net exports of goods and services	5.6	1.8	–2.7	–2.8	2.5	–4.6	–4.4	–1.9	–0.7
Exports of goods and services	7.0	7.1	–0.2	2.7	5.7	–2.1	2.2	–0.3	–1.0
Imports of goods and services	–1.4	–5.2	–2.5	–5.6	–3.1	–2.5	–6.5	–1.6	0.3
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	6.1	2.7	0.1	5.9	5.8	–0.3	–1.2	1.0	1.2
Unit labor costs in manufacturing (nominal, per hour)	–5.2	0.5	0.0	2.6	5.0	1.4	–1.2	–0.2	–0.1
Labor productivity in manufacturing (real, per hour)	12.2	6.9	3.8	5.5	3.7	2.4	4.8	3.6	4.4
Labor costs in manufacturing (nominal, per hour)	6.3	7.8	3.8	8.3	8.8	3.8	3.6	3.4	4.2
Producer price index (PPI) in industry	8.4	9.3	4.4	8.1	5.9	3.8	3.0	5.0	5.8
Consumer price index (here: HICP)	3.0	3.4	2.4	3.1	2.5	1.9	1.8	3.0	2.8
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)	10.3	11.4	12.4	10.3	11.5	13.0	12.4	11.6	12.5
Employment rate (%, 15–64 years)	59.7	58.4	58.8	59.8	58.6	56.9	58.3	60.6	59.4
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)	6.4	12.2	8.5	10.3	12.2	10.7	10.1	8.7	8.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	5.0	7.9	7.5	8.5	7.9	9.2	8.2	10.1	7.5
Domestic credit of the banking system	5.1	7.3	2.4	4.5	7.3	5.4	5.5	1.7	2.4
of which: claims on the private sector	1.5	3.9	2.7	2.8	3.9	3.6	4.2	3.7	2.7
claims on households	–0.3	–0.2	–0.3	–0.1	–0.2	–0.4	–0.4	–0.5	–0.3
claims on enterprises	1.8	4.1	3.0	2.9	4.1	3.9	4.7	4.3	3.0
claims on the public sector (net)	3.7	3.4	–0.2	1.6	3.4	1.8	1.2	–2.0	–0.2
Other assets (net) of the banking system	–3.7	–3.0	–1.4	–2.7	–3.0	–3.9	–3.6	–3.1	–1.4
	% of GDP, ESA 95								
General government revenues	34.3	33.6	34.9	. .	. .	. .	. .	. .	. .
General government expenditures	37.4	35.6	35.7	. .	. .	. .	. .	. .	. .
General government balance	–3.1	–2.0	–0.8	. .	. .	. .	. .	. .	. .
Primary balance	–2.4	–1.2	0.1	. .	. .	. .	. .	. .	. .
Gross public debt	16.2	16.3	18.5	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	32.9	30.2	2.6	22.0	19.7	–2.9	6.1	3.0	3.9
Merchandise imports	15.4	22.3	8.9	24.5	13.1	10.2	17.3	6.2	2.6
	% of GDP (based on EUR), period total								
Trade balance	–7.7	–5.6	–9.1	–3.4	–8.9	–11.7	–13.0	–5.0	–7.9
Services balance	5.2	6.0	6.0	14.2	1.7	1.1	5.8	13.7	2.1
Income balance (factor services balance)	–3.1	–4.7	–3.4	–5.2	–4.4	–3.9	–2.7	–3.9	–3.2
Current transfers	4.2	4.4	5.1	3.2	3.4	7.5	6.0	3.5	4.3
Current account balance	–1.5	0.1	–1.3	8.8	–8.2	–7.0	–3.9	8.3	–4.6
Capital account balance	0.8	1.3	1.4	1.2	3.1	0.1	0.4	1.5	2.9
Foreign direct investment (net)	2.7	3.1	3.3	2.5	9.8	8.0	4.2	4.4	–2.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	102.7	94.1	94.8	94.4	94.1	95.5	96.0	96.5	94.8
Gross official reserves (excluding gold)	32.2	30.6	35.1	29.7	30.6	30.2	31.8	35.3	35.1
	Months of imports of goods and services								
Gross official reserves (excluding gold)	6.5	5.6	6.0	5.6	5.6	5.3	5.4	6.0	6.0
	EUR million, period total								
GDP at current prices	36,052	38,505	39,668	10,669	10,003	8,053	9,822	11,012	1,0781

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

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

5 Czech Republic: A Year of Records, Recession and Restraint

Net exports unable to pull the economy out of contraction…

The contraction of the Czech economy deepened further in the second half of 2012, leading to a total annual GDP decline of 1.3%. GDP growth was dragged down by a broad-based contraction of domestic demand, most notably of household consumption, which recorded a historic decline of 3.5% in 2012. This drop in demand was mainly due to ongoing fiscal consolidation, worsening labor markets and falling real wages as well as general uncertainty reflected in low though slightly improving consumer confidence. Total annual public consumption shrank, too, but its decline gradually came to a halt toward the end of 2012. Gross capital formation plunged by nearly 10% in the third quarter of 2012 and though it rebounded in the last quarter, this was solely due to restocking. Thus, the only positive GDP growth contribution came from net exports.

…even though the trade balance delivers a record surplus

The pace of both exports and imports slowed in 2012, with imports mainly driven by the import intensity of exports. Nevertheless, the difference still translated into a historical trade surplus of 3.8% of GDP for 2012. The income balance worsened, mainly because of FDI earnings dynamics. Overall, the annual current account deficit still improved to 2.4% of GDP and was more than covered by net FDI inflows of 4.7% of GDP, the highest figure in five years.

The employment rate increased slightly in the second half of 2012 to an annual average of 66.6%. However, this improvement was due mostly to the rising number of self-employed persons and persons with alternative employment forms. The total number of hours worked was cut by 1.2% to cope with the weakening economy, which was reflected in the gradually rising unemployment rate. These factors, combined with the nominal increase in compensations and a decrease in value added in manufacturing, hiked nominal unit labor costs in manufacturing by 2.9% in 2012.

CNB reaches virtual zero bound, contemplates foreign exchange interventions

Average annual HICP inflation fell to 3.5% in 2012, gradually declining throughout the year. It was mainly driven by the hike in the lower VAT rate by 4 percentage points to 10% in 2012 as well as by regulated prices (rents and energy) and higher food, housing and transport prices. As a reaction to low domestic activity and the absence of demand inflation pressures, the Czech National Bank (CNB) cut its key policy rate to a historically low "technical zero" bound of 0.05% in November 2012. Having exhausted its conventional measures, the CNB announced that it would consider intervening against the Czech koruna. At end-2012, the koruna was slightly stronger against the euro than a year earlier (25.2 EUR/CZK), having oscillated by about ±2% around this level in the second half of 2012.

One-off measures conceal another round of fiscal tightening

For 2012, the general government targeted a revised deficit of 3.2% of GDP. The actual deficit reached 4.4%. This overshoot was due to one-off accounting measures: church restitutions (1.5% of GDP; this liability will be settled over the next 30 years) and the temporary suspension in corrections in EU transfers for 2012. Without these one-offs, the deficit would have been 2.5% of GDP. For 2013, the Czech Republic committed itself to bringing its deficit down to 2.9% of GDP. Measures taken to achieve this goal comprise an increase of the lower and standard VAT rate by 1 percentage point (to 15% and 21%, respectively), the introduction of a temporary personal income tax surcharge for higher incomes, a temporarily lower pensions indexation and an elimination of mandatory health insurance caps. The negative budgetary effect of the introduction of the second pension pillar in 2013 has been revised down (from 0.5% to 0.1% of GDP) due to lower than expected participation.

Table 5

Main Economic Indicators: Czech Republic

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	2.5	1.9	–1.3	1.6	0.6	–0.1	–1.8	–1.8	–1.4
Private consumption	1.0	0.7	–3.5	1.0	0.4	–2.6	–3.7	–3.9	–3.9
Public consumption	0.5	–2.5	–1.0	–4.1	–3.2	–2.2	–2.0	–0.4	0.5
Gross fixed capital formation	1.0	–0.7	–1.7	–1.8	–2.4	1.5	–0.1	–3.4	–4.1
Exports of goods and services	15.5	9.4	3.8	7.0	3.2	7.4	2.4	3.6	2.2
Imports of goods and services	15.8	6.7	1.9	2.6	1.0	4.8	1.7	–0.6	1.7
	Contribution to GDP growth in percentage points								
Domestic demand	2.0	–0.1	–2.8	–1.3	–0.9	–2.2	–2.4	–4.7	–1.8
Net exports of goods and services	0.5	2.0	1.5	2.9	1.5	2.2	0.6	2.9	0.4
Exports of goods and services	9.1	6.3	2.8	4.6	2.2	5.6	1.8	2.5	1.6
Imports of goods and services	–8.7	–4.3	–1.3	–1.7	–0.6	–3.4	–1.1	0.4	–1.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–0.1	0.2	3.1	–0.2	0.7	4.4	3.3	2.0	2.7
Unit labor costs in manufacturing (nominal, per hour)	–9.0	–2.3	2.9	0.8	–2.9	2.0	2.4	2.3	4.9
Labor productivity in manufacturing (real, per hour)	9.2	4.2	1.7	1.5	3.1	5.2	4.6	2.6	–5.7
Labor costs in manufacturing (nominal, per hour)	–0.6	1.8	4.6	2.3	0.1	7.4	7.1	5.0	–1.1
Producer price index (PPI) in industry	0.1	3.7	2.3	3.7	4.9	3.8	2.6	2.1	0.9
Consumer price index (here: HICP)	1.2	2.1	3.5	2.0	2.8	4.0	3.8	3.4	2.9
EUR per 1 CZK, + = CZK appreciation	4.6	2.9	–2.2	2.2	–2.0	–2.8	–3.7	–2.7	0.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.4	6.8	7.1	6.6	6.5	7.2	6.8	7.0	7.2
Employment rate (%, 15–64 years)	65.0	65.7	66.6	66.1	66.1	65.6	66.5	67.1	67.0
Key interest rate per annum (%)	0.8	0.8	0.5	0.8	0.8	0.8	0.7	0.5	0.1
CZK per 1 EUR	25.3	24.6	25.1	24.4	25.3	25.1	25.3	25.1	25.2
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	1.9	2.8	4.8	1.8	2.8	4.8	5.4	4.0	4.8
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.4	–0.8	5.4	–4.8	–0.8	3.0	6.0	5.1	5.4
Domestic credit of the banking system	4.0	7.9	1.5	10.2	7.9	5.3	5.5	3.0	1.5
of which: claims on the private sector	2.1	4.1	1.9	4.5	4.1	3.8	3.3	2.4	1.9
claims on households	2.7	2.2	1.6	2.2	2.2	2.1	2.0	1.7	1.6
claims on enterprises	–0.6	1.9	0.3	2.3	1.9	1.7	1.3	0.7	0.3
claims on the public sector (net)	1.9	3.7	–0.4	5.7	3.7	1.5	2.2	0.7	–0.4
Other assets (net) of the banking system	–2.6	–4.3	–2.1	–3.5	–4.3	–3.6	–6.0	–4.1	–2.1
	% of GDP, ESA 95								
General government revenues	39.0	39.8	40.1	. .	. .	. .	. .	. .	. .
General government expenditures	43.8	43.1	44.5	. .	. .	. .	. .	. .	. .
General government balance	–4.8	–3.3	–4.4	. .	. .	. .	. .	. .	. .
Primary balance	–3.4	–1.9	–2.9	. .	. .	. .	. .	. .	. .
Gross public debt	37.8	40.8	45.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	21.3	13.8	4.6	10.0	5.2	8.4	3.2	4.1	2.9
Merchandise imports	24.1	12.2	2.6	7.9	2.1	5.9	2.4	–0.5	2.6
	% of GDP (based on EUR), period total								
Trade balance	1.4	2.4	3.8	0.7	2.3	5.7	3.5	3.5	2.6
Services balance	2.0	1.5	1.3	1.7	1.0	1.6	1.2	1.4	1.0
Income balance (factor services balance)	–7.5	–6.7	–7.5	–5.1	–4.7	–5.6	–7.0	–9.5	–7.8
Current transfers	0.2	0.1	–0.0	–0.2	–0.4	0.1	–0.4	–0.5	0.6
Current account balance	–3.9	–2.7	–2.4	–3.1	–1.7	1.9	–2.7	–5.0	–3.6
Capital account balance	0.9	0.4	1.3	0.3	1.1	0.1	0.0	0.7	4.4
Foreign direct investment (net)	2.5	1.2	4.7	–3.6	4.2	3.4	5.0	4.6	5.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	46.9	46.6	0.0	47.7	46.6	49.8	48.7	49.7	50.5
Gross official reserves (excluding gold)	20.9	19.6	22.0	19.0	19.6	20.4	20.0	20.3	22.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	3.9	3.4	3.6	3.3	3.4	3.5	3.3	3.4	3.6
	EUR million, period total								
GDP at current prices	150,365	156,180	152,813	39,878	39,984	36,193	38,281	38,519	39,820

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

6 Hungary: Struggling to Exit the Excessive Deficit Procedure

Stuck in recession

The Hungarian economy has slipped further into recession, with GDP contracting by 2.7% year on year in the fourth quarter of 2012. The worsening of economic output was attributable to a bigger decline of investments, which mirrored declining capacity utilization rates, the intensified contraction of credit to corporates and possibly also the increased tax burden on selected economic sectors. Furthermore, the contribution of net real exports turned marginally negative, as exports declined amid weakening external demand that was not sufficiently offset by the decline in imports. Against the background of deteriorating consumer confidence, stubbornly high unemployment and the continued sharp contraction of credit to households, consumption continued to decline, albeit less sharply than in the third quarter of 2012.

Authorities focused on efforts to exit the excessive deficit procedure

The abrogation of the excessive deficit procedure, under which Hungary has always stood since its EU entry in 2004, remains a top priority for the government. The government demonstrated renewed commitment in October and November 2012 to reduce the budget deficit and has pledged to take additional measures to meet the deficit targets of 2.7% of GDP in 2013 and 2.2% of GDP in 2014 (following a deficit of 1.9% of GDP in 2012). However, in its February forecast (i.e. prior to the surprisingly small deficit for 2012), the European Commission projected a deficit of 3.4% for both years, expecting expenditure slippages and revenue shortfalls compared to the official plans. On a more positive note, in its 2012 Fiscal Sustainability Report of December 2012, the Commission came to the conclusion that the risks to Hungary's fiscal sustainability were low in the medium- to long-term perspective, if fiscal consolidation plans are fully implemented.

Financing conditions have eased

The government's financing situation improved over the review period. Despite negative news about the suspension of negotiations on a new stand-by arrangement with the IMF/EU at the end of January 2013, the government successfully sold five- and ten-year U.S. dollar Eurobonds worth a combined USD 3.25 billion in mid-February. This represented slightly more than half of the planned Eurobond issuance for the year. In addition, the government has raised more funds than expected via the retail sale of euro-denominated bonds in the domestic market. Taking into account additional financial buffers and barring a substantial deterioration of market confidence, the government should be able to cover its relatively high gross financing needs in 2013 (around 20% of GDP) without major difficulty.

MNB continues monetary easing

In response to sharply declining headline inflation, weak demand conditions and sufficient spare capacities in the economy, the monetary council of the National Bank of Hungary (MNB) continued to cut the policy rate in monthly installments of 25 basis points to 5.0% by end-March 2013 (end-September 2012: 6.5%). HICP inflation decreased somewhat in the fourth quarter of 2012 and more substantially in January 2013 (to 2.8% year on year), partly as a result of a base effect (increase in the standard VAT rate in January 2012) and the 10% price reduction for household electricity, natural gas and purchased heat in January 2013. In addition, at the beginning of April, the MNB launched a "Funding for Growth Scheme" offering commercial banks temporary refinancing credit at zero interest rate for loans to SMEs with a maximum 2% risk premium. Refinancing from the MNB will be available for general forint-based lending to SMEs and for the conversion of foreign currency loans into forints, each with a maximum volume of HUF 250 billion (0.8% of GDP each). The details of the scheme will be coordinated with commercial banks.

Table 6

Main Economic Indicators: Hungary

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	1.3	1.6	–1.7	1.4	1.3	–0.6	–1.7	–1.7	–2.7
Private consumption	–3.0	0.5	–1.4	1.2	1.1	–0.4	–0.5	–3.7	–0.9
Public consumption	–0.7	–0.3	–2.3	–1.5	–0.8	–1.7	–3.1	–3.3	–1.1
Gross fixed capital formation	–9.5	–3.6	–3.8	–4.7	–2.4	–4.6	–3.0	–1.7	–5.6
Exports of goods and services	14.2	6.3	2.0	4.6	3.0	2.2	4.6	2.4	–1.1
Imports of goods and services	12.7	5.0	0.1	2.4	0.5	0.2	1.7	–0.3	–1.0
	Contribution to GDP growth in percentage points								
Domestic demand	–0.4	0.1	–3.5	–0.6	–0.9	–2.6	–4.5	–4.1	–2.6
Net exports of goods and services	1.8	1.5	1.7	2.0	2.2	2.0	2.8	2.4	–0.2
Exports of goods and services	11.0	5.5	1.8	3.9	2.6	2.2	4.2	2.2	–1.0
Imports of goods and services	–9.2	–4.0	–0.1	–1.9	–0.4	–0.1	–1.4	0.3	0.8
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–1.2	1.6	6.9	2.4	2.3	6.6	7.7	6.9	6.5
Unit labor costs in manufacturing (nominal, per hour)	–9.7	4.4	6.6	7.1	2.5	6.1	5.5	4.8	10.3
Labor productivity in manufacturing (real, per hour)	10.3	1.5	0.8	–1.5	3.2	–0.8	3.7	3.1	–2.1
Labor costs in manufacturing (nominal, per hour)	0.0	6.0	7.7	5.5	5.8	5.2	9.4	8.0	7.9
Producer price index (PPI) in industry	6.3	4.2	4.2	1.0	7.4	6.8	7.2	4.5	–1.5
Consumer price index (here: HICP)	4.7	3.9	5.7	3.4	4.1	5.6	5.5	6.0	5.5
EUR per 1 HUF, + = HUF appreciation	1.9	–1.4	–3.5	2.7	–9.1	–8.2	–9.4	–2.9	7.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	11.2	11.0	11.0	10.8	10.7	11.8	10.9	10.5	10.8
Employment rate (%, 15–64 years)	55.4	55.8	57.2	56.4	56.5	55.7	57.2	58.2	57.8
Key interest rate per annum (%)	5.5	6.0	6.8	6.0	6.3	7.0	7.0	6.9	6.2
HUF per 1 EUR	275.4	279.3	289.3	275.0	303.4	296.8	294.0	283.1	283.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.0	5.9	–3.4	5.3	5.9	1.5	0.1	–4.1	–3.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	4.2	17.8	5.1	16.8	17.8	10.0	10.1	3.9	5.1
Domestic credit of the banking system	6.4	–3.1	–11.8	–6.5	–3.1	0.4	–3.5	–8.8	–11.8
of which: claims on the private sector	3.7	–0.6	–13.7	1.6	–0.6	–1.8	–6.4	–13.6	–13.7
claims on households	4.6	–0.5	–7.3	2.1	–0.5	–2.0	–4.9	–8.2	–7.3
claims on enterprises	–0.9	0.4	–6.3	0.0	0.4	0.7	–0.9	–5.3	–6.3
claims on the public sector (net)	2.7	–2.6	1.8	–8.1	–2.6	2.3	2.9	4.8	1.8
Other assets (net) of the banking system	–7.7	–8.7	3.3	–5.0	–8.7	–9.0	–6.5	0.7	3.3
	% of GDP, ESA 95								
General government revenues	45.4	53.8	46.5	. .	. .	. .	. .	. .	. .
General government expenditures	49.7	49.5	48.4	. .	. .	. .	. .	. .	. .
General government balance	–4.3	4.3	–1.9	. .	. .	. .	. .	. .	. .
Primary balance	–0.2	8.4	2.3	. .	. .	. .	. .	. .	. .
Gross public debt	81.8	81.4	79.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	20.3	9.1	1.8	6.3	0.8	0.0	3.4	3.1	0.7
Merchandise imports	19.5	9.2	0.9	5.8	2.2	1.6	1.2	0.6	0.4
	% of GDP (based on EUR), period total								
Trade balance	3.3	3.4	4.2	2.6	2.6	4.2	5.5	4.5	2.6
Services balance	3.0	3.2	3.5	4.0	2.5	3.2	3.8	4.5	2.4
Income balance (factor services balance)	–5.7	–6.3	–6.5	–6.0	–6.0	–6.6	–7.3	–6.1	–6.1
Current transfers	0.4	0.5	0.5	0.7	1.0	–0.8	0.2	0.3	2.0
Current account balance	1.1	0.8	1.6	1.4	0.0	–0.1	2.2	3.3	0.9
Capital account balance	1.8	2.3	2.7	2.9	2.9	1.9	2.1	2.3	4.2
Foreign direct investment (net)	0.8	0.6	2.3	–1.9	5.2	2.1	–2.2	3.7	5.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	143.2	132.7	126.6	138.5	132.7	133.1	136.2	133.1	126.6
Gross official reserves (excluding gold)	34.8	37.7	34.5	38.3	37.7	35.1	36.7	35.8	34.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.2	5.3	4.8	5.5	5.3	4.9	5.0	4.9	4.8
	EUR million, period total								
GDP at current prices	96,562	99,763	97,919	25,902	25,542	21,392	23,721	25,560	27,246

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

7 Poland: Monetary Policy Council Lowers Policy Rates to Record Low Nominal Level

Domestic demand contracts during second half of 2012; export growth is weak but positive

Poland posted GDP growth of 2.0% in 2012, with foreign demand contributing 1.1 percentage points and domestic demand only 0.1 percentage points. Weak final demand led to a decrease in import absorption, which lifted GDP growth by 0.9 percentage points, implying a net export contribution of 1.9 percentage points. Growth continued to slow down in the second half of 2012, with both private consumption and gross fixed investment contracting.

GDP growth started to decelerate after foreign demand growth slowed sharply. Together with the fading out of major public investment projects, this deceleration caused fixed investment growth to fall. Thus, the volume of hours worked stagnated in early 2012 and then started to fall, while nominal wage growth in the whole economy slowed down in parallel. Coupled with somewhat elevated inflation, this slowdown implied that real hourly wages and the real wage sum in the whole economy contracted throughout 2012. Consumer confidence continued to deteriorate. Private consumption and residential investment were particularly affected.

Slower-growing exports and contracting imports led to a decline in the current account deficit in 2012. At the same time, however, net FDI inflows were smaller, too, while the capital account surplus remained unchanged. The current account deficit, however, was again nearly fully covered by non-debt creating inflows. Annual increases in manufacturing unit labor costs remained subdued until the third quarter before picking up in the fourth quarter, when (working-day adjusted) production slumped. Still, unit labor costs grew less than in the euro area in national currency terms. However, in euro terms, the annual increase was considerably higher than in the euro area in the fourth quarter of 2012 as a result of strong nominal currency appreciation year on year in that quarter.

Strong disinflation triggers easing cycle

The exchange rate against the euro stood at PLN 4.18 at end of March 2013, after the złoty had lost about half of the 4% appreciation it had undergone during the second half of 2012. In February 2013, annual inflation was 1.2% (HICP) and 1.3% (national CPI), respectively, while core inflation amounted to 1.3% (HICP) and 1.1% (CPI). Core inflation declined from April (from 3.4% and 2.7%, respectively), headline inflation from June (from 4.2% and 4.3%) amid contracting domestic demand coupled with expectations of further disinflation. The Polish Monetary Policy Council, pursuing an inflation target of 2.5% (CPI), cut the reference rate to 4.75% by monthly steps of 0.25 percentage points between early November and early February and delivered an additional cut of 0.5 percentage points to 3.25% in early March 2012.

Cyclically adjusted primary deficit expected to move into surplus in 2013

After headline and primary deficit were lowered by 2.9 percentage points of GDP, respectively, in 2011, both deficits declined further by 1.1 percentage points to –3.9% and –1.2% of GDP, respectively, in 2012. The decline in 2012 resulted from expenditure cuts only, while the revenues-to-GDP ratio did not rise, given the slowdown of growth and disinflation. As the cost of the systemic pension reform would only have to be taken into account if the Commission and the Council assess that the correction of the excessive deficit (due in 2012) was successful, i.e. only if the fiscal deficit were "slightly above 3%," it is probable that Poland will stay in the excessive deficit procedure for another year. For 2013, the Commission staff projected a marginal further decline of headline and primary deficit in its winter forecast.

Table 7

Main Economic Indicators: Poland

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	3.9	4.3	2.0	4.1	4.6	3.7	2.0	1.6	1.1
Private consumption	3.1	2.5	0.5	2.5	1.4	1.7	1.1	–0.2	–0.7
Public consumption	4.1	–1.7	0.0	–5.0	0.1	–1.0	–0.1	0.3	0.8
Gross fixed capital formation	–0.4	9.0	0.6	9.0	10.9	5.4	2.2	–1.3	–0.8
Exports of goods and services	12.1	7.7	2.4	8.9	5.2	4.0	1.9	1.2	2.7
Imports of goods and services	13.9	5.5	–1.9	5.3	1.2	1.7	–2.9	–3.9	–2.1
	Contribution to GDP growth in percentage points								
Domestic demand	4.6	3.4	0.1	2.7	3.1	2.7	–0.3	–0.8	–0.9
Net exports of goods and services	–0.7	0.9	1.9	1.4	1.5	1.1	2.3	2.4	2.0
Exports of goods and services	4.8	3.3	1.1	3.8	2.1	1.9	0.9	0.5	1.1
Imports of goods and services	–5.5	–2.4	0.9	–2.4	–0.5	–0.8	1.4	1.8	0.9
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	1.0	0.6	0.0	1.6	0.1	1.7	1.3	2.0	0.0
Unit labor costs in manufacturing (nominal, per hour)	–9.2	0.3	1.3	2.1	–2.5	–0.4	0.2	1.0	4.6
Labor productivity in manufacturing (real, per hour)	11.3	4.3	3.1	1.5	8.2	5.0	4.1	5.3	–1.7
Labor costs in manufacturing (nominal, per hour)	1.3	4.6	4.5	3.7	5.5	4.6	4.3	6.4	2.8
Producer price index (PPI) in industry	1.8	7.3	3.3	6.8	8.2	5.8	4.6	2.8	0.1
Consumer price index (here: HICP)	2.7	3.9	3.7	3.7	4.2	4.2	4.0	3.9	2.8
EUR per 1 PLN, + = PLN appreciation	8.4	–3.0	–1.6	–3.4	–10.3	–6.8	–7.0	0.3	7.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.7	9.8	10.2	9.5	9.9	10.6	10.0	10.0	10.2
Employment rate (%, 15–64 years)	59.3	59.7	59.7	60.2	59.9	58.8	59.7	60.2	60.0
Key interest rate per annum (%)	3.5	4.2	4.6	4.5	4.5	4.5	4.6	4.8	4.5
PLN per 1 EUR	4.0	4.1	4.2	4.2	4.4	4.2	4.3	4.1	4.1
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.8	12.5	4.5	10.2	12.5	9.1	11.0	7.6	4.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	3.0	6.4	3.4	2.5	6.4	1.9	8.6	4.7	3.4
Domestic credit of the banking system	10.3	14.0	1.0	14.1	14.0	13.1	10.5	4.3	1.0
of which: claims on the private sector	8.0	13.1	2.3	13.5	13.1	11.6	10.1	5.0	2.3
claims on households	8.3	7.4	0.2	9.0	7.4	6.0	4.8	0.9	0.2
claims on enterprises	–0.2	5.7	2.1	4.5	5.7	5.6	5.3	4.1	2.1
claims on the public sector (net)	2.3	0.9	–1.3	0.6	0.9	1.5	0.4	–0.7	–1.3
Other assets (net) of the banking system	–4.5	–7.9	0.2	–6.4	–7.9	–5.9	–8.1	–1.4	0.2
	% of GDP, ESA 95								
General government revenues	37.6	38.4	38.4	. .	. .	. .	. .	. .	. .
General government expenditures	45.5	43.4	42.3	. .	. .	. .	. .	. .	. .
General government balance	–7.9	–5.0	–3.9	. .	. .	. .	. .	. .	. .
Primary balance	–5.2	–2.3	–1.1	. .	. .	. .	. .	. .	. .
Gross public debt	54.8	56.2	55.6	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	22.9	11.4	5.2	10.7	6.6	5.9	1.2	5.0	8.9
Merchandise imports	25.0	11.4	1.7	9.5	4.0	6.2	–2.8	–0.4	4.3
	% of GDP (based on EUR), period total								
Trade balance	–2.5	–2.7	–1.4	–2.6	–2.7	–2.4	–1.8	–0.5	–1.0
Services balance	0.7	1.1	1.3	1.2	0.7	1.2	1.7	1.2	1.0
Income balance (factor services balance)	–3.6	–4.2	–4.5	–5.0	–3.9	–4.5	–4.3	–5.0	–4.1
Current transfers	0.8	1.2	1.1	0.8	0.6	0.5	2.0	0.8	1.0
Current account balance	–4.6	–4.5	–3.5	–5.7	–5.3	–5.2	–2.4	–3.5	–3.2
Capital account balance	1.8	2.2	2.2	1.6	3.7	1.5	2.5	2.6	2.3
Foreign direct investment (net)	0.7	2.0	0.9	3.9	2.0	–0.8	2.2	0.7	1.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	66.9	67.2	72.3	66.8	67.2	70.8	72.1	73.6	72.3
Gross official reserves (excluding gold)	18.7	19.4	20.5	18.8	19.4	19.2	20.9	20.8	20.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.1	5.0	5.3	4.9	5.0	4.9	5.3	5.3	5.3
	EUR million, period total								
GDP at current prices	354,693	369,253	381,684	90,388	97,375	87,581	91,151	94,783	108,170

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

8 Romania: Low Growth and Elevated Inflation; Budget Deficit below 3% of GDP

Severe drought hits GDP dynamics

In the second half of 2012, a severe drought had a large negative impact on growth dynamics, in particular in the third quarter, when GDP contracted. Romania recorded full-year GDP growth of 0.7% in 2012, which represents a noticeable deceleration compared to 2011. However, agriculture delivered a negative contribution of 1.4 percentage points to GDP growth, which means that GDP growth excluding the volatile agricultural output was broadly in line with the 2011 growth rate. It is also noteworthy that the GDP growth structure changed in the fourth quarter: While the contribution of net exports turned marginally positive, the contribution of gross fixed capital formation became mildly negative. After taking a hit in the third quarter, private consumption was again an important growth driver in the final quarter.

Inflation rate currently above central bank target range

Consumer price inflation (CPI) went up markedly in the second half of 2012 and in early 2013, reaching 5.7% in February. The increase is mainly the result of a rise in food prices due to the drought and of hikes in administered prices. Despite the current elevated inflation levels, the National Bank of Romania (BNR) left its key policy rate unchanged at 5.25%, as it expects inflation to return to the upper bound of the target band (2.5% ±1 percentage point) at end-2013. The BNR sees the persistently negative output gap as the main disinflation driver.

Budget deficit below 3% of GDP, precautionary international support program extended by three months

In 2012, the budget deficit fell below 3% of GDP in ESA (European System of Accounts) terms, i.e. on an accrual basis. However, the IMF pointed out that Romania missed the cash deficit target under the precautionary Stand-By Arrangement (SBA), mainly due to suspensions of reimbursements for some EU-funded projects, as the Romanian audit authorities had discovered irregularities. The 2013 budget targets a deficit of 2.4% of GDP in ESA terms. The budget plan allows public sector wages to be restored to the (nominal) level seen before the 25% cut implemented in 2010 and pensions to be raised by 4%. On the revenue side, the main measures are cuts in tax deductions, new taxes for agricultural producers, and a mandatory turnover tax of 3% on small enterprises, which previously were taxed according to their income.

In March, the IMF agreed to extend the SBA by three months to end-June 2013. The program was scheduled to expire in March. The extension is intended to give Romania enough time to implement the necessary measures to complete the combined seventh and eighth reviews under the SBA. Corrective measures on structural reforms, arrears and the 2013 budget were regarded as necessary during the last IMF/EC review. The Romanian authorities signaled that they would be interested in negotiating a new program.

Current account deficit declines; net FDI inflows continue their downtrend

In the second half of 2012, the current account deficit was 27% lower than in the same period of 2011. The full-year figure also decreased notably, mainly driven by the decline in the income deficit. As a percentage of GDP, the sizeable trade deficit stayed unchanged, because weak external demand and rising unit labor costs in the manufacturing sector impeded a reduction, while the nominal exchange rate of the leu vis-à-vis the euro depreciated only slightly during the observation period. At the same time, the surpluses in the current transfers and services balances improved only slightly. Net FDI inflows continued their downward trend in the second half of 2012. At 1.2% of GDP for the whole year, net FDI inflows covered only 31% of the current account deficit. The composition of capital inflows shifted to portfolio inflows, while other investments recorded a net outflow in 2012.

Table 8

Main Economic Indicators: Romania

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	–1.2	2.2	0.7	4.1	1.6	0.4	1.9	–0.5	1.1
Private consumption	–0.3	1.2	1.0	3.1	0.2	1.3	2.5	–1.0	1.5
Public consumption	–4.6	1.1	1.5	3.9	9.7	3.0	1.8	2.2	–0.0
Gross fixed capital formation	–2.0	7.3	5.0	10.6	7.3	11.3	5.4	7.4	–0.6
Exports of goods and services	14.2	11.0	–3.1	9.2	4.6	–2.1	–0.4	–5.1	–4.9
Imports of goods and services	12.4	10.3	–0.8	11.8	6.1	0.9	1.1	–1.7	–3.8
	Contribution to GDP growth in percentage points								
Domestic demand	–1.1	2.6	1.5	6.0	3.5	–2.2	–0.4	1.2	0.8
Net exports of goods and services	–0.0	–0.5	–0.8	–2.9	–1.2	–1.9	–1.0	–1.0	0.1
Exports of goods and services	4.0	3.7	–1.2	3.4	1.5	–1.2	–0.2	–2.0	–1.6
Imports of goods and services	–4.1	–4.1	0.4	–6.4	–2.7	–0.7	–0.8	1.0	1.8
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	–1.7	–2.5	6.9	–1.9	–0.9	5.4	5.8	8.4	7.1
Unit labor costs in manufacturing (nominal, per hour)	–7.8	1.8	6.4	2.0	8.9	8.7	7.7	6.8	2.8
Labor productivity in manufacturing (real, per hour)	15.1	5.1	0.6	5.3	–0.2	–1.4	0.6	0.3	2.8
Labor costs in manufacturing (nominal, per hour)	6.7	7.2	7.0	7.4	8.6	7.1	8.3	7.1	5.6
Producer price index (PPI) in industry	4.3	7.1	5.3	7.0	6.1	4.8	5.2	5.6	5.5
Consumer price index (here: HICP)	6.1	5.8	3.4	4.2	3.4	2.7	2.1	4.2	4.7
EUR per 1 RON, + = RON appreciation	0.7	–0.7	–4.9	–0.1	–1.1	–3.0	–6.6	–5.9	–4.2
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.6	7.7	7.3	7.5	8.0	7.9	7.2	7.0	7.2
Employment rate (%, 15–64 years)	58.8	58.5	59.5	59.1	57.9	58.0	60.0	60.8	59.3
Key interest rate per annum (%)	6.5	6.2	5.3	6.3	6.1	5.6	5.3	5.3	5.3
RON per 1 EUR	4.2	4.2	4.5	4.3	4.3	4.4	4.4	4.5	4.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	6.9	6.6	2.7	6.8	6.6	10.2	8.5	5.7	2.7
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.9	–1.6	6.7	0.7	–1.6	5.7	–1.3	1.4	6.7
Domestic credit of the banking system	13.8	11.4	0.1	12.7	11.4	13.3	15.6	8.7	0.1
of which: claims on the private sector	5.2	6.8	1.4	7.1	6.8	10.4	6.7	4.4	1.4
claims on households	1.0	1.1	0.1	0.9	1.1	3.3	1.7	0.9	0.1
claims on enterprises	4.2	5.7	1.4	6.1	5.7	7.1	5.0	3.6	1.4
claims on the public sector (net)	8.6	4.7	–1.4	5.7	4.7	2.9	8.9	4.3	–1.4
Other assets (net) of the banking system	–7.8	–3.2	–4.0	–6.6	–3.2	–8.9	–5.8	–4.4	–4.0
	% of GDP, ESA 95								
General government revenues	33.3	33.8	33.5	. .	. .	. .	. .	. .	. .
General government expenditures	40.1	39.4	36.4	. .	. .	. .	. .	. .	. .
General government balance	–6.8	–5.6	–2.9	. .	. .	. .	. .	. .	. .
Primary balance	–5.3	–3.9	–1.1	. .	. .	. .	. .	. .	. .
Gross public debt	30.5	34.7	37.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	28.5	21.1	–0.5	18.6	10.9	0.0	2.0	–3.3	–0.5
Merchandise imports	20.4	21.6	–0.5	21.9	14.7	1.9	0.6	–1.3	–2.9
	% of GDP (based on EUR), period total								
Trade balance	–4.8	–5.6	–5.6	–5.0	–5.7	–4.6	–7.4	–5.6	–4.9
Services balance	–0.4	0.3	0.4	–0.1	0.8	–0.3	0.2	0.5	1.0
Income balance (factor services balance)	–1.6	–1.7	–1.3	–0.9	–1.1	–1.6	–1.8	–1.0	–0.8
Current transfers	2.8	2.5	2.6	2.1	3.0	4.4	2.7	1.6	2.0
Current account balance	–4.0	–4.5	–3.9	–4.0	–3.0	–2.1	–6.3	–4.5	–2.6
Capital account balance	0.2	0.5	1.5	0.1	0.6	1.5	1.8	0.7	1.8
Foreign direct investment (net)	1.9	1.4	1.3	1.1	2.4	0.3	1.4	2.6	0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	74.5	75.3	75.3	76.2	75.3	76.0	75.9	75.9	75.3
Gross official reserves (excluding gold)	26.1	25.3	23.7	26.0	25.3	26.3	25.1	24.7	23.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.7	6.7	6.3	7.0	6.7	6.9	6.6	6.5	6.3
	EUR million, period total								
GDP at current prices	124,084	131,139	131,439	36,191	38,097	25,916	31,111	36,410	38,003

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

9 Croatia: Stubborn Recession Continues

Lack of domestic demand is a persistent drag on growth

In the second half of 2012, the Croatian economy continued to contract, resulting in a 2.0% decline in real GDP in 2012. Since the end of 2008, real GDP has fallen by about 11% cumulatively. Private consumption has declined since the first quarter of 2012 because of falling gross real wages in the whole economy, fiscal consolidation measures (VAT increase in March 2012) and the incipient balance sheet repair of households. Furthermore, the labor market situation became even more unfavorable, with unemployment rising by 4 percentage points to 18.5% in the course of 2012 and the employment ratio declining by almost 3 percentage points to 48.7% at the end of 2012. Gross fixed capital formation has continued to fall; it has contracted since 2009, thus denting the growth potential of the Croatian economy. The external sector continued to provide a slight positive contribution to GDP growth in 2012. While export dynamics remained subdued (also in a regional comparison), imports developed even more weakly and in fact contracted. In terms of sector output, the downturn was relatively broad-based. On a positive note, the tourist season in summer 2012 was rather good.

Balanced current account on the back of higher tourism revenue

The current account was in balance in 2012 after recording a small deficit of about 1% of GDP in the previous two years. The slight improvement was mainly driven by a somewhat rising surplus in the services account thanks to the good tourism season. The deficit in the trade balance remained broadly unchanged and price competitiveness did not improve, given rising unit labor costs in manufacturing related to a strong decline in hours worked from the second quarter of 2012 onward. On the financing side, (net) FDI inflows remained at the moderate level of 2011, while portfolio investments increased somewhat. Despite the improvement of the current account position, Croatia's external position remains vulnerable, considering that gross external debt stood at 102.3% of GDP at the end of 2012. To mitigate exchange rate fluctuations, the Croatian National Bank (HNB) has continued to intervene in the foreign exchange market, in the review period mostly by sales of foreign currency.

Following three years of moderate price dynamics, inflation picked up in the course of 2012 despite falling domestic demand. The inflationary pressures can be traced to a VAT hike in March 2012, increases in administrative prices and rising energy and food prices. At the beginning of 2013, inflation remained elevated (5.2% in January 2013), but is expected to ease somewhat in the coming months.

Croatia loses investment grade rating

On the fiscal front, public finances remained under pressure in 2012, given deteriorating economic activity and, relatedly, underperforming budget revenues. Nevertheless, the budget deficit narrowed somewhat to 4.6% of GDP, and the Croatian government is targeting a further reduction to 3.4% (according to the national methodology) of GDP in 2013. The European Commission, however, expects the deficit to rise to 5.0% and is urging further consolidation, especially the implementation of measures on the expenditure side. Gross public debt has rapidly increased since 2008 and is expected to hit 60% of GDP by 2014 according to the European Commission.

Particularly in view of the economic downturn, the relatively high external vulnerability and insufficient reforms to eliminate structural rigidities in the economy, Croatia lost its investment grade rating. S&P lowered Croatia's long- and short-term sovereign foreign currency debt rating to BB+/B from BBB-/A-3 (outlook stable) at end-2012. Moody's downgrade of Croatia to Ba1 (outlook stable) followed in February 2013.

Table 9

Main Economic Indicators: Croatia

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	–2.3	–0.0	–2.0	0.8	–0.3	–1.1	–2.5	–1.9	–2.3
Private consumption	–1.3	0.2	–2.9	0.3	0.2	–0.9	–3.1	–3.4	–4.2
Public consumption	–2.1	–0.6	–0.8	0.8	–1.1	–1.1	0.3	–0.4	–2.0
Gross fixed capital formation	–15.0	–6.4	–4.6	–7.8	–5.2	–3.9	–5.1	–4.4	–4.9
Exports of goods and services	4.8	2.0	0.4	6.7	–3.9	3.9	–4.1	0.1	3.2
Imports of goods and services	–2.8	1.3	–2.1	0.9	–3.3	0.1	–4.0	–2.8	–1.6
	Contribution to GDP growth in percentage points								
Domestic demand	–5.2	–0.3	–3.1	–2.6	–0.2	–1.8	–2.5	–3.8	–4.0
Net exports of goods and services	2.9	0.3	1.1	3.2	–0.1	1.2	0.1	1.2	1.9
Exports of goods and services	1.8	0.8	0.2	3.5	–1.4	1.2	–1.6	0.0	1.2
Imports of goods and services	1.1	–0.5	0.9	–0.3	1.4	–0.1	1.8	1.1	0.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit wage costs in manufacturing (nominal, per hour)	2.1	1.4	7.3	2.8	–0.7	8.9	6.5	5.1	8.7
Labor productivity in manufacturing (real, per hour)	–3.4	1.4	2.3	1.7	5.9	–2.6	4.3	5.1	1.6
Gross wages in manufacturing (nominal, per hour)	–1.1	2.7	9.5	4.6	5.2	6.0	11.1	10.4	10.4
Producer price index (PPI) in industry	4.3	6.4	7.0	6.3	6.4	6.1	6.8	7.9	7.3
Consumer price index (here: CPI)	1.0	2.3	3.4	2.0	2.4	1.5	3.4	4.1	4.6
EUR per 1 HRK, + = HRK appreciation	0.7	–2.0	–1.1	–2.8	–1.7	–2.0	–1.8	–0.1	–0.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	12.1	13.9	16.3	12.6	14.3	16.8	14.9	15.0	18.5
Employment rate (%, 15–64 years)	54.0	52.4	50.7	53.2	51.5	49.8	51.7	52.5	48.7
Key interest rate per annum (%)	6.0	6.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.3	7.4	7.5	7.5	7.5	7.6	7.5	7.5	7.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.0	1.6	3.2	0.6	1.6	2.6	3.3	2.1	3.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–0.2	–4.2	6.3	–4.5	–4.2	–3.9	1.5	1.7	6.3
Domestic credit of the banking system	8.1	8.8	–0.8	9.1	8.8	9.5	6.0	3.7	–0.8
of which: claims on the private sector	5.5	4.9	–4.1	3.9	4.9	5.8	2.7	–0.5	–4.1
claims on households	1.7	0.5	–0.7	1.6	0.5	1.0	0.1	–1.0	–0.7
claims on enterprises	3.7	4.4	–3.4	2.3	4.4	4.7	2.6	0.5	–3.4
claims on the public sector (net)	2.6	3.9	3.3	5.2	3.9	3.8	3.3	4.3	3.3
Other assets (net) of the banking system	–4.9	–3.0	–2.4	–3.9	–3.0	–3.1	–4.2	–3.3	–2.4
	% of GDP, ESA 95								
General government revenues	40.1	40.4	35.7	. .	. .	. .	. .	. .	. .
General government expenditures	45.3	46.1	40.3	. .	. .	. .	. .	. .	. .
General government balance	–5.2	–5.7	–4.6	. .	. .	. .	. .	. .	. .
Primary balance	–3.1	–3.5	–2.0	. .	. .	. .	. .	. .	. .
Gross public debt	42.2	46.7	53.6	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	18.1	7.8	0.1	13.2	–1.9	2.2	–7.9	0.2	6.4
Merchandise imports	–0.5	7.5	–0.7	5.6	0.1	2.0	–3.0	–1.4	–0.3
	% of GDP (based on EUR), period total								
Trade balance	–12.9	–13.9	–13.7	–13.3	–13.2	–15.1	–15.5	–12.8	–11.6
Services balance	13.0	13.9	14.6	34.6	3.6	1.7	14.0	35.5	3.9
Income balance (factor services balance)	–3.5	–3.5	–3.4	–2.9	–1.6	–5.1	–4.0	–3.4	–1.3
Current transfers	2.4	2.6	2.6	2.4	2.7	2.7	2.8	2.2	3.0
Current account balance	–1.1	–0.9	0.1	20.7	–8.5	–15.9	–2.6	21.5	–6.0
Capital account balance	0.1	0.1	–0.0	0.0	0.2	0.0	0.1	–0.1	–0.0
Foreign direct investment (net)	1.0	2.4	2.4	4.7	1.5	3.1	2.5	1.2	3.0
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	104.6	103.1	102.3	104.9	103.1	103.9	106.0	103.7	102.3
Gross official reserves (excluding gold)	24.0	25.2	25.6	25.5	25.2	25.7	26.5	25.9	25.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.2	7.2	7.2	7.3	7.2	7.2	7.4	7.3	7.2
	EUR million, period total								
GDP at current prices	44,432	44,379	43,915	11,994	11,034	9,972	10,920	11,995	11,028

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

10 Turkey: Economy Slows Markedly in Second Half of 2012

Sharp drawdown of inventories

Domestic demand contracted further in the second half of 2012 as a result of falling investment and pronounced destocking. In the last quarter of 2012, the rate of inventory depletion was the largest since the economic downturn in the first quarter of 2009. Private consumption also continued to contract, but at a slightly diminishing rate, and the unemployment rate showed an upward trend, especially in the final quarter of 2012. Nevertheless, job creation remained strong and the employment rate remained at a historically high level of almost 50%. Recent indicators suggest a recovery of economic momentum. Capacity utilization rose in seasonally adjusted terms in February and March to reach 74%, industrial production edged up slightly in January, and the PMI indicated an expansion (53.3). Credit growth also started to pick up again in December. While the annual growth rate was rather stable at the 15% target rate of the Central Bank of the Republic of Turkey (CBRT) between September and November, it has been exceeding the target since the beginning of December again.

External rebalancing fades out

The narrowing of the current account deficit continued in the second half of 2012 despite softening export growth and a slight recovery in import demand. By the end of the year, the current account deficit had shrunk to just below 6% of GDP. But in line with lower gold exports and the continued resurgence of import growth, the adjustment seems to have halted since January 2013. Following strong capital inflows, the current account has been more than fully financed since November. However, the annualized coverage of the deficit by FDI has fallen further to below 17% by the end of January, while the reliance on short-term capital inflows has increased.

CBRT remains innovative in its monetary policy

In order to reduce a potential adverse impact of volatile capital flows on macroeconomic and financial stability, the Central Bank of the Republic of Turkey (CBRT) has been refining its "reserve option mechanism" (ROM) since June 2012. This unorthodox tool, which is used to complement frequent adjustments to the interest rate corridor, allows banks to hold a certain fraction of their Turkish lira reserve requirements in foreign exchange. The amount of foreign exchange that can be held per unit of Turkish lira is stipulated by a "reserve option coefficient" (ROC), which varies between 1.4 and 2.3 depending on the fraction of reserves to which it is applied. This contributed to the USD 20 billion increase in the CBRT's foreign exchange reserves in the course of 2012 to USD 100 billion at the end of the year and alleviated appreciation pressure. Since July 2012, the lira has remained broadly stable against the dollar and the euro.

Headline inflation declines noticeably in the course of 2012

On the back of softening food prices, year-end inflation fell to 6.2%, thus coming close to the CBRT's target of 5.5%. Annual average inflation in 2012 was 9.0%. Core inflation also fell in the second half of 2012, but the gap between core and headline inflation narrowed significantly, thus limiting the policy leeway. Furthermore, fiscal policy was recently adding to price dynamics: A fiscal impulse was financed by indirect tax hikes in late 2012. Increases in special consumption taxes on fuel products, motor vehicles and alcohol added 1.1 percentage points to headline inflation.

The budget deficit of 2.3% of GDP in 2012 was above the end-year fiscal target of 1.5%. While total revenue was in line with plans, spending slippage caused the deviation from the target. The primary surplus deteriorated a bit in 2012, and the public debt-to-GDP ratio continued its declining trend (36.7% of GDP in 2012).

Table 10

Main Economic Indicators: Turkey

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	9.2	8.8	2.2	8.7	5.3	3.3	2.9	1.6	1.4
Private consumption	6.7	7.7	–0.7	7.5	3.3	–0.4	–1.3	–0.4	–0.8
Public consumption	2.0	4.7	5.7	10.3	–3.7	5.5	4.4	5.5	7.1
Gross fixed capital formation	30.5	18.0	–2.5	14.7	–0.9	0.7	–2.7	–4.2	–3.8
Exports of goods and services	3.4	7.9	17.2	11.9	5.9	15.0	24.0	15.0	15.0
Imports of goods and services	20.7	10.7	0.0	6.2	–8.2	–5.1	0.4	2.0	3.2
	Contribution to GDP growth in percentage points								
Domestic demand	13.8	9.4	–2.1	6.9	1.2	–2.6	–3.0	–1.6	–1.5
Net exports of goods and services	–4.0	–1.0	3.7	1.0	3.6	4.6	5.0	2.7	2.6
Exports of goods and services	0.8	1.7	3.7	2.5	1.3	3.1	5.1	3.2	3.3
Imports of goods and services	–4.8	–2.7	0.0	–1.5	2.3	1.5	–0.1	–0.5	–0.8
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit wage costs in manufacturing (nominal, per hour)	2.4	5.3	13.0	6.5	9.0	16.0	12.1	12.8	11.2
Labor productivity in manufacturing (real, per hour)	8.7	4.4	–0.6	4.3	1.1	–1.7	0.7	–0.5	–0.9
Gross wages in manufacturing (nominal, per hour)	11.8	10.0	12.3	11.2	10.2	14.0	12.9	12.2	10.2
Producer price index (PPI) in industry	6.2	12.3	6.1	13.8	15.3	9.9	8.0	3.6	3.3
Consumer price index (here: HICP)	8.6	6.5	9.0	6.4	9.2	10.5	9.6	9.1	6.8
EUR per 1 TRY, + = TRY appreciation	8.3	–14.5	0.9	–20.2	–19.7	–8.4	–2.7	8.5	6.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	10.9	9.0	8.4	8.4	8.3	9.6	7.5	7.9	8.5
Employment rate (%, 15–64 years)	46.3	48.4	48.9	49.9	48.4	46.3	49.9	49.9	49.5
Key interest rate per annum (%)[1]	6.8	6.1	5.7	5.9	5.8	5.8	5.8	5.8	5.7
TRY per 1 EUR	2.0	2.3	2.3	2.5	2.5	2.4	2.3	2.3	2.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	18.6	15.2	10.5	22.1	15.2	10.3	9.3	8.8	10.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–7.5	0.6	1.4	–1.1	0.6	–2.7	–3.2	0.1	1.4
Domestic credit of the banking system	30.2	19.0	16.9	26.5	19.0	18.9	17.5	14.4	16.9
of which: claims on the private sector	27.9	25.0	18.7	31.8	25.0	21.6	18.0	15.2	18.7
claims on households	8.4	8.4	5.9	10.2	8.4	7.1	5.5	5.3	5.9
claims on enterprises	19.5	16.6	12.7	21.5	16.6	14.5	12.5	9.9	12.7
claims on the public sector (net)	2.4	–6.0	–1.8	–5.3	–6.0	–2.7	–0.5	–0.8	–1.8
Other assets (net) of the banking system	–4.2	–4.4	–7.7	–3.2	–4.4	–5.9	–5.1	–5.7	–7.7
	% of GDP, ESA 95								
General government revenues	36.7	39.4	37.4	. .	. .	. .	. .	. .	. .
General government expenditures	39.4	41.3	39.7	. .	. .	. .	. .	. .	. .
General government balance	–2.6	–2.0	–2.3	. .	. .	. .	. .	. .	. .
Primary balance	1.6	2.0	1.7	. .	. .	. .	. .	. .	. .
Gross public debt	42.4	39.1	36.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	16.1	12.9	23.3	17.4	12.3	17.7	30.3	26.7	18.7
Merchandise imports	39.4	24.6	6.7	21.3	9.3	5.4	8.3	8.2	5.0
	% of GDP (based on EUR), period total								
Trade balance	–7.7	–11.5	–8.4	–11.5	–10.5	–9.2	–9.3	–7.8	–7.2
Services balance	2.1	2.6	3.0	4.8	2.3	1.2	2.9	5.0	2.7
Income balance (factor services balance)	–1.0	–1.0	–0.8	–0.9	–0.8	–1.1	–0.9	–0.8	–0.6
Current transfers	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.1	0.2
Current account balance	–6.4	–9.7	–6.0	–7.4	–8.6	–8.9	–7.2	–3.5	–4.9
Capital account balance	–0.0	–0.0	–0.0	0.0	0.0	–0.0	–0.0	–0.0	–0.0
Foreign direct investment (net)	1.0	1.8	1.1	2.1	2.1	1.2	1.8	0.7	0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	39.6	42.4	41.7	40.8	42.4	42.3	44.8	42.4	41.7
Gross official reserves (excluding gold)	11.0	10.9	12.4	11.4	10.9	10.7	11.6	12.4	12.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.9	4.0	4.7	4.4	4.0	3.9	4.2	4.6	4.7
	EUR million, period total								
GDP at current prices	551,485	554,990	612,756	143,132	137,018	138,767	150,857	166,683	156,449

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

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

11 Russia: Growth Levels Off

Domestic demand-driven GDP growth decelerates as capital formation momentum slows

Following a rather dynamic economic expansion at the beginning of 2012, GDP growth decelerated in the second, third and fourth quarters. This produced an annual growth figure of 3.4% for 2012, down from 4.3% in 2011, which was somewhat below expectations. The main driving force of the expansion in the second half of 2012 was private consumption, boosted by rapid increases in wages and pensions, while net exports continued to deliver a negative, although declining, contribution to economic activity. The slowdown in growth was largely triggered by the sharply decelerating expansion of gross fixed capital formation throughout the year, as businesses became more cautious about future prospects. With average Urals grade crude oil prices being just 1.1% higher in 2012 than in 2011, oil price changes no longer played a substantial role in stimulating the Russian economy.

According to preliminary data, in the first two months of 2013, GDP was up by only about 1% year on year. In the view of the Bank of Russia (CBR), the output gap has shrunk to near zero. This view is supported by the decrease of the unemployment rate, which in August 2012 reached a post-Soviet record low of 5.0%.

Prices surge mainly because of the poor harvest of 2012 and administrative tariff adjustments

CPI inflation increased to 6.6% at end-December 2012, which is clearly above the monetary authority's annual inflation objective of 5% to 6%. At end-February 2013, the rise in prices accelerated to 7.3%. Persisting high inflation is mainly due to first, the food price hikes stemming from a poor harvest in 2012 and second, a carryover effect of delayed increases of municipal tariffs in mid-2012 as well as further adjustments of administered prices in January 2013. High credit growth, including a retail lending boom, may also have impacted on price dynamics. Thus, while temporary and seasonal factors certainly play a role in inflation developments, core inflation was 5.7% in February 2013. Against this backdrop, the CBR increased its key interest rates by 25 basis points in September and its deposit rate by another 25 basis points in December 2012. In recent months, given weakening economic growth, government officials have suggested that the CBR should loosen its monetary stance somewhat.

High oil price keeps the federal budget in balance and the current account in surplus

In January 2013, total loans grew by 12% year on year in real terms. Correspondingly, retail loans expanded by 30%. Thus, credit growth decelerated marginally from mid-2012, partly because economic activity as a whole slowed in the second half of 2012 and partly because of the CBR's efforts (monetary tightening, moral suasion and the tightening of prudential regulations). The steady oil price and robust private consumption kept the federal budget almost in balance (deficit: 0.1% of GDP) in 2012. The sluggish state of the global economy combined with still brisk Russian domestic demand caused the country's current account surplus to shrink from 5.3% of GDP in 2011 to 3.7% a year later.

Gross external reserves remain sizeable despite continuing capital outflows

Private net capital outflows continued in 2012, even though they contracted to EUR 43.4 billion (or about 2.8% of GDP). At 30.6% of GDP at end-2012, Russia's gross external debt remains at a manageable level, and at 23.5% of GDP, the CBR's gross reserves (excluding gold) remain substantial, even if these two numbers have been slowly diverging. According to the CBR, the Cyprus crisis and remedial measures will not have an important impact on the Russian banking sector.

Table 11

Main Economic Indicators: Russia

	2010	2011	2012	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
	Year-on-year change of the period total in %								
GDP at constant prices	4.5	4.3	3.4	5.0	5.1	4.8	4.3	3.0	2.1
Private consumption	5.5	6.3	6.7	7.8	7.9	9.0	6.9	5.5	5.7
Public consumption	–1.5	0.8	–0.2	0.7	0.3	0.4	–0.1	–0.2	–0.8
Gross fixed capital formation	5.9	10.2	6.0	10.4	14.1	15.5	9.7	4.6	1.4
Exports of goods and services	7.0	0.3	1.4	–1.5	1.2	4.2	–2.0	1.8	1.4
Imports of goods and services	25.8	20.3	9.5	17.9	14.8	13.0	5.6	10.5	9.2
	Contribution to GDP growth in percentage points								
Domestic demand	7.1	7.9	5.0	9.3	7.7	5.9	5.8	4.9	3.6
Net exports of goods and services	–2.0	–4.0	–1.8	–4.4	–2.9	–1.2	–1.9	–2.1	–1.8
Exports of goods and services	2.3	0.1	0.4	–0.5	0.4	1.5	–0.7	0.5	0.4
Imports of goods and services	–4.3	–4.1	–2.2	–3.9	–3.3	–2.7	–1.3	–2.6	–2.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit labor costs in industry (nominal, per person)	2.2	9.3	8.4	8.6	9.4	9.2	8.8	7.2	8.3
Labor productivity in industry (real, per person)	11.8	4.1	4.0	4.7	3.0	5.5	3.7	3.9	2.9
Average gross earnings in industry (nominal, per person)	14.7	13.8	12.6	13.7	12.7	15.2	12.9	11.4	11.5
Producer price index (PPI) in industry	12.3	17.8	6.8	17.0	13.9	8.0	4.5	7.9	6.8
Consumer price index (here: CPI)	6.9	8.6	5.1	8.2	6.8	3.9	3.9	6.1	6.6
EUR per 1 RUB, + = RUB appreciation	9.6	–1.5	2.4	–3.9	–0.8	1.2	1.1	2.9	4.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.5	6.6	5.5	6.2	6.3	6.3	5.3	5.1	5.2
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	8.0	8.1	8.1	8.3	8.2	8.0	8.0	8.0	8.3
RUB per 1 EUR	40.3	40.9	39.9	41.2	42.1	39.5	39.8	40.0	40.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	24.6	20.9	12.1	20.4	20.9	20.1	20.1	15.0	12.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	5.8	9.9	–0.4	11.2	9.9	6.7	10.5	0.8	–0.4
Domestic credit of the banking system	22.1	19.7	15.4	17.0	19.7	21.1	22.4	19.5	15.4
of which: claims on the private sector	12.4	24.5	17.9	23.7	24.5	24.8	26.9	21.5	17.9
claims on households	3.1	6.4	8.2	5.8	6.4	7.8	8.9	8.8	8.2
claims on enterprises	9.3	18.1	9.7	17.9	18.1	17.1	18.0	12.7	9.7
claims on the public sector (net)	9.7	–4.8	–2.6	–6.7	–4.8	–3.7	–4.5	–2.0	–2.6
Other assets (net) of the banking system	–3.3	–8.7	–2.9	–7.8	–8.7	–7.8	–12.9	–5.3	–2.9
	% of GDP, ESA 95								
General government revenues	33.9	37.4	36.9	. .	. .	. .	. .	. .	. .
General government expenditures	37.4	35.9	36.5	. .	. .	. .	. .	. .	. .
General government balance	–3.4	1.5	0.4	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	39.8	24.2	9.7	22.0	29.2	21.3	10.5	8.8	0.8
Merchandise imports	37.4	23.7	12.4	13.8	19.3	17.0	11.2	15.4	7.6
	% of GDP (based on EUR), period total								
Trade balance	9.9	10.5	9.6	9.0	10.7	12.8	10.2	7.5	8.3
Services balance	–1.9	–1.9	–2.3	–2.3	–1.9	–1.8	–2.1	–3.0	–2.2
Income balance (factor services balance)	–3.2	–3.2	–3.3	–2.9	–3.0	–2.2	–4.6	–2.8	–3.5
Current transfers	–0.2	–0.2	–0.3	–0.3	–0.2	–0.2	–0.1	–0.5	–0.4
Current account balance	4.6	5.3	3.7	3.5	5.6	8.6	3.4	1.2	2.3
Capital account balance	0.0	–0.0	–0.3	–0.0	–0.0	–1.0	–0.0	–0.0	–0.0
Foreign direct investment (net)	–0.6	–0.8	0.0	0.2	–1.7	0.3	–1.5	0.4	0.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	31.8	30.6	30.6	30.7	30.6	29.5	31.1	30.5	30.6
Gross official reserves (excluding gold)	28.9	25.7	23.5	26.9	25.7	24.7	25.5	24.4	23.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	16.3	14.2	12.8	14.8	14.2	13.5	13.9	13.1	12.8
	EUR million, period total								
GDP at current prices	1,150,057	1,362,744	1,567,113	355,897	377,404	348,992	376,767	408,804	432,550

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