Recent Economic Developments and Outlook

Developments in Selected CESEE Countries: Growth Moderation Mainly against the Background of External Headwinds[1,2,3]

1 Introduction

External environment remains difficult despite efforts to tackle the sovereign debt crisis in the euro area

Uncertainties in the international environment increasingly weighed on economic dynamics in the Central, Eastern and Southeastern European (CESEE) region during the review period (April to October 2012). Especially developments in the euro area were taking their toll on CESEE economies via trade integration and financial linkages but also via a more general deterioration of sentiment. Growth was dampened further by domestic factors – e.g. ongoing fiscal consolidation efforts – in a number of the countries under review.

Since the summer, several important steps have been taken toward tackling the sovereign debt crisis in the euro area. To name a few examples: (1) the initiation of the Outright Monetary Transaction program by the ECB, (2) preparatory steps toward creating a banking union (in particular a single supervisory mechanism) for the euro area as well as (3) further adjustment measures in peripheral euro area countries. These developments intensified a positive trend in the area of CDS premiums and eurobond spreads in CESEE that had already been observed since June 2012, when the European Council first adopted the goal to set up a banking union. The improvement was rather broadly based and risk perception in several countries again declined almost to the levels seen right before the collapse of Lehman in September 2008 (e.g. in the Czech Republic, Poland, Turkey and Russia). Against this backdrop, the region's floating currencies recovered part of the losses incurred vis-à-vis the euro during the second half of 2011.

External demand, however, remained weak during the observation period, with anemic growth in the euro area amid no signs of a noticeable recovery in the short term as well as a moderating momentum in the world economy. Recent growth projections see the euro area in recession in 2012 and expect only a moderate pickup of economic dynamics into marginally positive territory in 2013. World growth is forecast to come in at around 3.3% in 2012 and around 3.6% in 2013 by the IMF, somewhat weaker than expected in spring. The momentum in the world economy continues to be fueled by emerging markets. Even in these countries, however, growth in 2012 and 2013 is set to turn out lower than expected in earlier projections. All of this is holding back economic growth in the CESEE region as well, given the close real and financial links between this region and the euro area.

Cross-border deleveraging leads to headwinds for economic growth in a number of CESEE countries

Increased funding pressures and higher capital requirements prescribed by the European Banking Authority (EBA) had raised concerns in the latter part of 2011 about a potentially disorderly cross-border deleveraging by European banks. It was argued that such a development would not spare the CESEE region, as the lion's

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[2] *Cutoff date: October 5, 2012 (October 22, 2012, for fiscal and BIS data). This report focuses primarily on data releases and developments from April 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.*

share of credit there is provided by Western European banks, either through subsidiaries or via direct cross-border lending. While deleveraging has indeed taken place in the interim, it has essentially remained orderly and has affected only some countries in the region more strongly (e.g. Hungary and Slovenia). In this context, the ECB's long-term refinancing operations (in December 2011 and February 2012) had a positive impact on the liquidity conditions of euro area banks, which also benefited the financing of their CESEE subsidiaries. Parent banks managed to reach EBA requirements in the middle of 2012 without major reductions on the asset side of their balance sheets. In its report on the recapitalization of European banks, the EBA concluded that the strengthening of capital positions had not led to a significant reduction in lending to the real economy. It also recalled that the deleveraging process had already started before the capital exercise and that this process needed to continue to further strengthen banks' balance sheets.

Consolidated banking statistics from the BIS (adjusted for exchange rate changes[4]) confirm this, as there has been some deleveraging for the region as a whole but not for all CESEE countries individually. European banking groups have reduced their overall exposure to CESEE by 5% or some EUR 48 billion since the third quarter of 2011. This development occurred mainly in the fourth quarter of 2011 and again in the second quarter of 2012, with some transient rebound in cross-border lending in the first three months of 2012. The countries most affected were Hungary, Slovenia and Russia, where claims declined by more than 10% between end-September 2011 and end-June 2012. The exposure of European BIS-reporting banks to some other countries of the region, however, remained broadly unchanged or even increased slightly in the case of Slovakia and the Czech Republic.

The Emerging Markets Bank Lending Conditions Survey of the Institute of International Finance (IIF) conveys a similar picture. Its index of emerging market bank lending conditions for emerging Europe has remained below 50 (the threshold indicating an overall deterioration) since the third quarter of 2011, with the overall development of the index being strongly driven by a worsening of international funding conditions. In addition, rising nonperforming loans have also started to weigh on the development of overall lending conditions more recently. At the same time, the subindex capturing the demand for loans increased to above 50 in the second quarter of 2012.

Clearly, the development of credit to the private sector mirrored these trends. Credit growth decelerated in most CESEE countries during the review period – substantially in some countries (e.g. in Slovakia, Croatia and Turkey). Only in Russia did credit dynamics remain buoyant. The other countries covered here registered declining credit growth rates in credit to households as well as corporates, but the deterioration was generally more pronounced in the latter sector. While it is notoriously difficult to disentangle supply and demand factors of credit developments, it appears that credit supply (and consequently economic growth) was negatively affected in those CESEE countries which experienced a

[4] *Exchange rate adjustments based on OeNB calculations. The adjustment is approximate (based on plausible assumptions about the currency denomination of bank claims).*

Chart 1

Growth of Credit to the Private Sector

%, year on year, adjusted for exchange rate changes

Source: National central banks.

[1] Turkey: non adjusted.

more pronounced reduction of cross-border claims of European BIS-reporting banks.[5]

The real economy generally loses steam in the region while cross-country variation in growth rates persists

GDP growth continued to lose steam in the first quarter of 2012 and remained low in the second quarter. Output in the region expanded by an average of 0.4% and 0.5%, respectively, in the first and second quarter of 2012, after it had grown by 1.3% and 0.9%, respectively, in the last two quarters of 2011 (quarter-on-quarter figures).[6] These were the weakest GDP readings since mid-2010. Growth in the region as a whole, however, clearly remained in positive territory and with that notably stronger than in the euro area.

Aggregate figures for the whole region mask substantial differences across countries, though. In fact, the Czech Republic, Hungary, Croatia and Slovenia were in recession in the first half of 2012. Other countries fared far better, however. Slovakia, for example, has been growing at a healthy rate for the past six quarters, and dynamics in Poland were stronger than the regional average in the first quarter of 2012, while being close to the regional average in the second quarter. Growth in Romania and Turkey even picked up measurably in mid-2012. In year-on-year terms, GDP growth rates ranged from –1.7% in Croatia to +4.5% in Russia in the first half of 2012.

[5] *A more detailed analysis of financial sector developments in CESEE during the observation period can be found in the OeNB's Financial Stability Report 24 (December 2012).*

[6] *All regional averages in this text are weighted by GDP at PPP.*

Table 1

Real GDP Growth

	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Period-on-period change in % (seasonally and working-day adjusted)							
Slovakia	4.2	3.3	0.9	0.9	0.7	0.8	0.7	0.7
Slovenia	1.2	0.6	–0.2	0.6	–0.2	–1.1	0.0	
Bulgaria	0.4	1.7	0.4	0.3	0.1	0.1	0.0	0.3
Czech Republic	2.7	1.7	0.5	0.3	0.0	–0.2	–0.6	–0.2
Hungary	1.3	1.6	1.4	–0.3	0.0	0.1		–0.2
Poland	3.9	4.3	1.1	1.4	0.7	0.9	0.6	0.4
Romania	–1.7	2.5	1.2	0.0	1.1	–0.1	0.1	0.5
Croatia	–1.4	0.0	0.1	0.0	–0.3	–0.5	–0.6	–0.7
Turkey	9.2	8.5	1.4	1.3	1.7	0.6	0.4	1.8
Russia	4.3	4.3	0.9	0.6	1.7	1.6	0.6	0.1
CESEE average[1]	4.5	4.6	1.0	0.7	1.3	1.0	0.4	0.5
Euro area	2.0	1.4	0.6	0.2	0.1	–0.3	0.0	–0.2

Source: Eurostat, national statistical offices.

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

Against the background of weak domestic dynamics, net exports are once again the most important growth driver

Net exports were the most important driving force of GDP growth in the first half of 2012, contributing substantially to dynamics in all countries but Bulgaria, Romania and Russia. In the Central European countries (with the exception of Poland), they even were the only GDP component that contributed positively to growth.

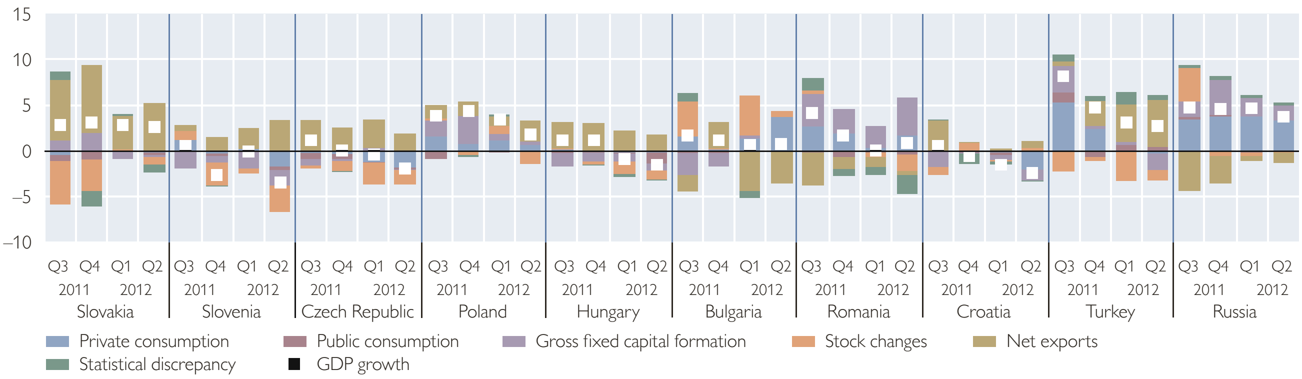
Against the backdrop of a weakening external environment and missing domestic dynamics in many countries, both export and import growth decelerated, with import dynamics receding more strongly than export dynamics. In fact, exports still expanded moderately in most countries during the observation period (in Turkey, they even boomed), while imports stagnated or even declined throughout most of the region (main exceptions: Bulgaria, and – despite strongly moderating import growth rates – Russia). It seems that the performance of exports is to some extent related to developments in the international competitiveness of the region. As a matter of fact, the improvement in cost competitiveness under way in many CESEE countries since 2009 also continued into 2012. Unit labor costs in manufacturing (measured in euro), for example, declined in a number of countries under review (e.g. in the Czech Republic, Hungary, Poland and Slovakia), while they rose by 3.7% year on year in the euro area in the second quarter of 2012. While this development was to a considerable extent driven by currencies trading lower against the euro in the second quarter of 2012 than a year earlier, notable productivity growth also played a role in several countries of the region (especially Slovakia and the Czech Republic). While exchange rate developments since mid-year have offset some of the gains during the earlier part of 2012, the price competitiveness of many CESEE countries remains well intact.

As shown in greater detail below, industrial production figures also support this picture. Output of this highly export-oriented sector continued to grow moderately throughout summer, while it was already declining in the euro area. Furthermore, it needs to be borne in mind that trade linkages with the euro area countries affected most strongly by the debt crisis are rather limited for most

Chart 2

GDP Growth and Its Main Components

Percentage points, GDP growth in %



Source: Eurostat, national statistical offices.

CESEE countries. In fact, Germany is by far the most important trading partner for the region, and economic dynamics there still remained comparatively solid in the first half of 2012.

Domestic demand, to the contrary, was rather anemic and hardly contributed to growth in the Central European countries. Some factors behind this development, which affect many CESEE countries, are ongoing fiscal consolidation efforts, subdued labor market conditions, declining real wages, considerable spare capacities, weak sentiment and – in a few countries – ongoing efforts by households (in Slovenia also by the corporate sector) to reduce leverage. Domestic demand was also surprisingly subdued in Turkey, but more than offset by brisk export growth.

However, domestic demand was not weak in all CESEE countries covered here. Notable exceptions in this respect are Bulgaria, Russia and Romania, where net exports hardly played a role in driving economic dynamics while domestic sources of growth contributed noticeably to GDP. Explanations for this development relate to strong wage growth in these three countries, and buoyant gross fixed capital formation dynamics (mainly due to infrastructure investments) in Romania. In addition, as shown above, credit growth in Russia was by far the most dynamic in the whole CESEE region.

Data on sentiment and activity so far do not indicate imminent economic turning point

Sentiment indicators mostly deteriorated in the observation period. The economic sentiment indicator of the European Commission (which is available for EU Member States only), for example, recovered somewhat from its two-year low of 89.2 points (December 2011) in the first two months of 2012. From March onward, however, it declined steadily and reached 87.7 points in September 2012, thus sitting well below its long-run average. All subindices of the indicator trended lower, with the deterioration somewhat less pronounced in the area of consumer and retail confidence.

While this general picture is also confirmed by PMI data for Poland and the Czech Republic, the Purchasing Managers' Index for Russia and Turkey has shown an upward trend since summer. The latest reading of the index from

September indicates a positive momentum in these two countries with values clearly above 50.[7]

The growth of industrial output moderated somewhat from 3.8% (regional average) in January 2012 to 2.4% in August 2012. A somewhat more notable reduction was observed in Poland and Hungary, while Slovakia posted a considerable acceleration of industrial output growth (by far the highest among CESEE countries). Likewise, no discernible momentum in activity was observed in construction and retail trade in most of the region. Construction output declined in all countries but Romania, and retail sales were essentially flat throughout the region with the exception of Romania and Russia.

In light of the recent showings of sentiment and high frequency indicators, economic growth will most likely be subdued during the remainder of 2012. Real GDP in the region covered here is projected to grow by 2.6% in 2012, two percentage points below the 2011 figure. In 2013, growth should pick up marginally to 3.1% on average.[8]

Inflation has been accelerating somewhat since summer on the back of higher food prices

Price developments in CESEE can roughly be divided into two periods: Disinflation in the first half of the year followed by some rise in price pressures since the summer. Inflation declined in most countries under observation in the first and second quarter of 2012. Substantially influenced by lower inflation contributions from processed food (incl. alcohol and tobacco), this development was most pronounced in Russia, where prices rose by 3.9% in the second quarter after an increase of 6.8% in the final quarter of 2011. Upturns in inflation rates were only seen in the Czech Republic, Hungary and Croatia and were related to VAT hikes at the beginning of the year (in the case of the former two countries and in March in the case of Croatia).

Inflation started to pick up more generally in summer, with only a few countries reporting continuing disinflation (e.g. the Czech Republic, Poland and Turkey). Rising prices of unprocessed food items in the context of hot, dry weather in many CESEE countries and also higher world market prices largely drove this development. In some countries, energy likewise started to contribute more strongly to inflation in recent months (e.g. in Slovenia, Romania and Bulgaria). Against this background, core inflation did not accelerate and remained clearly below the headline HICP throughout the region, confirming only modest, if any, demand pressure on prices.

To date, Russia is the only country where rising inflation rates have been reflected in interest rate decisions. The central bank of Russia increased its policy rate by 25 basis points to 8.25% in September against the background of higher food prices and a tariff hike. In contrast, the Czech central bank (CNB) cut its key interest rate in June and September by 25 basis points each to 0.25%, and the Hungarian central bank (MNB) did so in August and September (25 basis points each to 6.5%). While the CNB argued that the monetary policy-relevant inflation rate (CPI adjusted for first-round effects of changes to indirect taxes) will be in the lower half of the tolerance band around its inflation target over the policy horizon

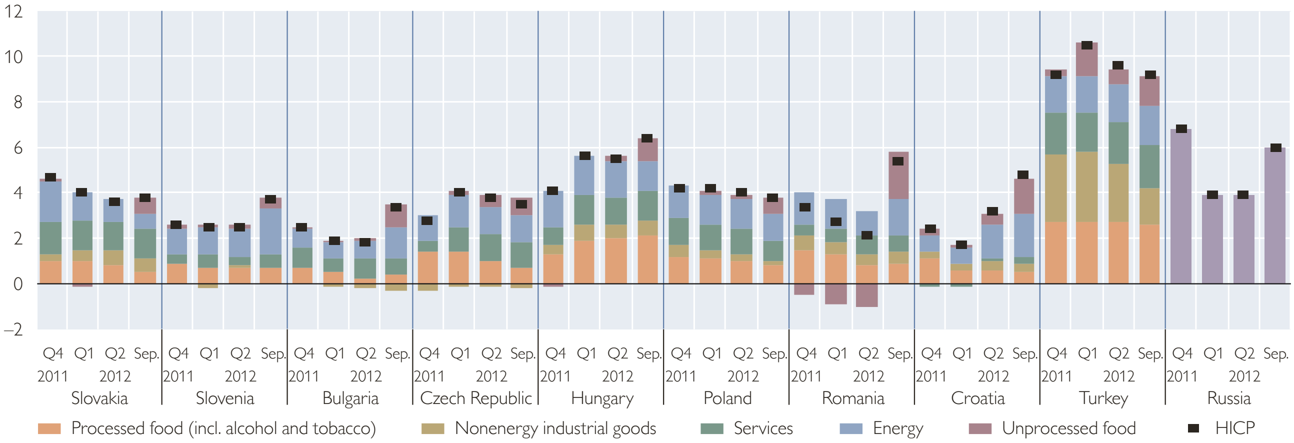
[7] *PMI indicators are only available for the four countries mentioned in this paragraph.*

[8] *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 IMF (Slovakia, Slovenia and Turkey). For the detailed OeNB-BOFIT projections for CESEE, see page 38.*

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.

(12 to 18 months), the interest rate cuts of the MNB were less expected. The central bank of Turkey continued with its unorthodox policy mix and narrowed its interest rate corridor for overnight lending in September.

Further external adjustment in the first 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, during the observation period, external positions again improved in most CESEE countries – and substantially so in some cases. The average current account balance in the region improved from 0.1% of GDP in the fourth quarter of 2011 to 0.7% of GDP in the second quarter of 2012 (four-quarter moving sums). With that, current account balances ranged from some –8% of GDP (Turkey) to about 5.5% of GDP (Russia). Improvements were most pronounced in Slovakia and Turkey, where the adjustment amounted to more than 1.5% of GDP, but also notable in the Czech Republic and Romania. This was mainly due to better outcomes in the trade balance (and in line with net export developments in the national accounts). A lower gap in the income balance played a supporting role in the Czech Republic, while Romania also recorded a higher surplus in its capital account.

The only notable exception from this pattern was Bulgaria, where a small surplus in the trade balance turned into a deficit of 2.7% of GDP (again four-quarter moving average) by the second quarter of 2012. This development was mainly fueled by rising imports (especially investment goods and energy) amid accelerating domestic demand.

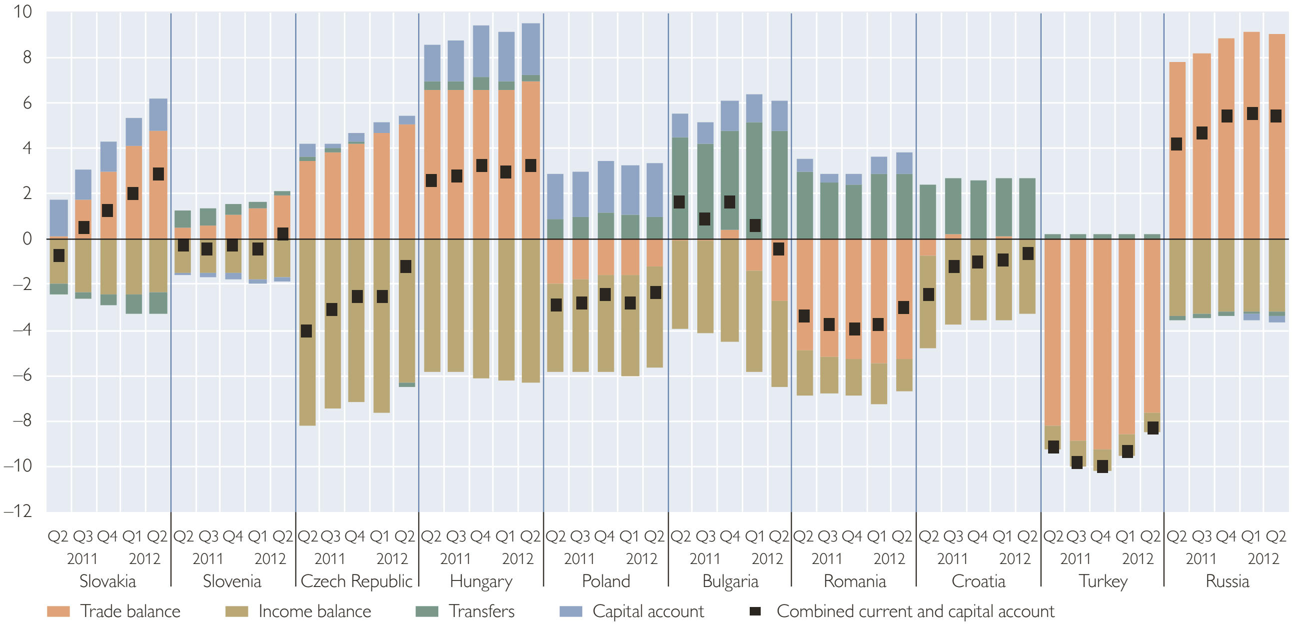
Outflows of other investments weigh on the financial account

Net capital flows to the ten CESEE countries as a whole decelerated sharply from 2.9% of GDP in the final quarter of 2011 (four-quarter moving sum) to –0.9% of GDP in the second quarter of 2012 (four-quarter moving sum). This development partly mirrored the deterioration of international sentiment that weighed on the risk perception of CESEE countries. As already explored above, deleveraging of internationally active banking groups was a factor in this context.

Chart 4

Combined Current and Capital Account Balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

Indeed, net capital flows were strongly driven by outflows from the category of other investments (including loans). This position deteriorated in all countries except for Slovenia, which saw a shift from portfolio investments to other investments in connection with bond repayments and a wider use of the ECB's long-term refinancing operations facility.

Nevertheless, the financial account was positive or balanced in most countries under review in the first half of 2012. Only Russia and Hungary reported a deficit (both countries had a current account surplus, however). In Bulgaria, the Czech Republic, Romania 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 and Croatia. (Net) other investments – in particular loans – were negative in all countries under observation but Slovenia and Turkey. In Turkey, other investments were the most important source of international financing. Russia reported capital outflows in all three categories in the period under review. Net FDI inflows covered more than 100% of the current account deficits in the Czech Republic, Bulgaria and Croatia, around 85% in Poland, roughly 50% in Romania and only around 20% in Turkey.

Fiscal consolidation efforts have continued in 2012

With the exception of Croatia, budget deficits decreased in each country under review in 2011, with deficits even turning into surpluses in Russia and Hungary. In the latter country, however, this was due to large one-off receipts from the de facto abolition of formerly compulsory private pension funds (the pension system's "second pillar"). Without these one-off revenues, the deficit would have been somewhat above 5% of GDP. The European Commission deemed this development not sustainable and thus inadequate for terminating Hungary's ongoing excessive deficit procedure (EDP) in 2011 as targeted. Subsequently, the Council of the EU set 2012 as the new target year for achieving a credible and sustainable correction, and, in late June, it concluded that Hungary had taken the necessary measures to this end. Bulgaria managed to reduce its budget deficit to 2% of GDP in 2011. Hence, the EDP against the country was abrogated on June 22, 2012. The other EU Member States in the CESEE region are still in an EDP (target dates scheduled for reducing excessive deficits: 2012 for Poland and Romania, 2013 for the Czech Republic and Slovakia).

Most CESEE EU Member States covered here have continued with consolidation in 2012. Deficits are set to decrease most markedly in Poland, Slovenia and Romania and should decline to (or stay) below the 3%-of-GDP benchmark in Bulgaria, Hungary, Poland and Romania, according to national budget plans. Budgetary targets in the CESEE EU Member States had to be adjusted in many countries already in the course of the year as economic dynamics decelerated (e.g. in Slovakia, the Czech Republic, Poland, Slovenia and Hungary). As far as the rest of the CESEE region is concerned, the deficit in Croatia is set to shrink to just below 4% of GDP, while Turkey will post a somewhat higher deficit and Russia a lower surplus in its 2012 budgets than in 2011.

Box 1

Ukraine: Declining Growth, Deteriorating External Position

After being buoyant (5.2%) in 2011, Ukraine's GDP growth (year on year) slowed down sharply to 2.0% in the first quarter of 2012, before recovering to 3.0% in the second quarter. Growth in the first six months of the year thus came to 2.5%. The slowdown is due to less dynamic household consumption and gross fixed investment. A weakening of price competitiveness, given the hryvnia's quasi-peg to the U.S. dollar, which recently appreciated against the currencies of most of Ukraine's trading partners, may have contributed to the slowing of GDP growth and also to the widening of the current account gap.

In fact, Ukraine continues to feature twin deficits, which have worsened in recent months. In the first half of 2012, the current account gap widened to 6.6% of GDP; the consolidated government budget shortfall, while still moderate, rose to 1.5% of GDP. Interventions to support the hryvnia's peg and sovereign debt repayments are responsible for a steady decline of foreign exchange reserves before a eurobond issue of USD 2 billion in July made them rise temporarily. The reserves stood at EUR 22.7 billion at end-September (about 17% of GDP). Exchange rate pressures emanated from households' depreciation expectations and from spikes of risk aversion in international financial markets, to which Ukraine is particularly sensitive given the fact that its IMF Stand-By Arrangement has been off track for over 1½ years.

CPI inflation is still strongly subdued by the repercussions of last year's bumper harvest, which inter alia triggered a food price contraction of 4.2% in May 2012 (year on year). Consumer prices were entirely flat in September 2012 (year on year).

Box 2

Western Balkans[1]: Dipping into Recession?

Real GDP growth in the Western Balkans, which had already moderated in the second half of 2011, dipped into negative territory in the first half of 2012 in Serbia (–1.7%), Albania (–0.2%[2]), FYR Macedonia (–1.1%) and Montenegro (–1.1%), partly due to adverse effects of harsh weather conditions in the first quarter of 2012 but also on the back of a worsening external environment alongside weak domestic demand. Quarterly GDP data are still not available for Bosnia and Herzegovina but industrial production and retail sales indicators point to a stagnation or moderate decline in GDP in the first six months of 2012. For Kosovo, neither quarterly GDP data nor other activity indicators are available.

External positions of Western Balkan countries did not change substantially during the review period. Despite the weakening GDP dynamics, current account deficits remained high in most countries (except for FYR Macedonia, where the shortfall is small at 2% of GDP in the second quarter of 2012 on a four-quarter moving sum basis). In all the other countries covered here, deficit ratios were still in the double-digit range (in Montenegro even somewhat above 20% of GDP). On the financing side, net FDI inflows in the first half of 2012 trended down or were broadly stable (with the latter the case in Albania, Bosnia and Herzegovina and Serbia), covering on average (unweighted average) two-thirds of the current account deficits. Only FYR Macedonia displays full coverage; in the other countries the coverage ratio ranges from one-fifth (Bosnia and Herzegovina) to three-quarters (Albania).

Disinflation continued from the second half of 2011 into the first quarter of 2012 but then inflation picked up somewhat in most countries (except for Bosnia and Herzegovina). In August 2012, inflation in the Western Balkans ranged from 1.8% (Bosnia and Herzegovina) to 7.9% (Serbia). Higher food and commodity prices were mainly driving this recent pickup in inflation. In some countries, the effect of global food price developments was augmented by domestic factors (droughts). In Albania, the central bank lowered its policy rate in two steps to 4% (with inflation most recently hovering between 2% and 3%) between March 2012 and October 2012, while, in the same period, the Serbian central bank increased its policy rate in several steps to 10.75%.

In line with weakening GDP dynamics, the pace of private sector credit growth decelerated in the first half of 2012 in almost all countries, while still remaining positive in a range from 5% to 15% in nominal and from 3% to 11% in real terms. Only in Montenegro, credit to the private sector continued to shrink both nominally and in real terms. Credit quality deteriorated, with NPL shares creeping up further in all countries. At the same time, capital adequacy ratios of banking sectors in the Western Balkans remained rather steady around 15% to 17% as of mid-2012 (no figures for Montenegro and Kosovo).

In the first half of 2012, fiscal consolidation efforts continued in a number of countries under review here, even though the economic downturn may hinder meeting headline fiscal targets in 2012. In particular, fiscal deficits narrowed in Montenegro and Albania during the first part of the year, while earlier deficits turned into small surpluses in Kosovo as well as in Bosnia and Herzegovina. However, fiscal deficits widened in FYR Macedonia (mainly due to lower-than-expected revenues) and in Serbia (given pre- and post-election increases in expenditures). In Serbia, the parliament approved renewed consolidation measures (mostly on the revenue side) in early fall in a quest to limit this year's deficit to 6.7% of GDP.

The IMF remains a major economic and financial policy anchor in the region. For Bosnia and Herzegovina, a new Stand-By Agreement (SBA) of SDR 338.2 million was approved in

[1] The Western Balkans comprise the EU candidate countries former Yugoslav Republic of Macedonia (FYR Macedonia), Montenegro and Serbia, as well as the potential candidate countries Albania, Bosnia and Herzegovina and Kosovo. Developments in Croatia are not covered here but in the subsequent country section.

[2] GDP data for Albania are only available for the first quarter of 2012, but production and sales data suggest continued weak dynamics in the second quarter of 2012.

September 2012, after a two-year program had expired in July 2012, with only one-third of the originally approved amount having been disbursed. After the SBA with Kosovo was derailed in June 2011 due to a large increase of public sector wages which had not been accorded with the IMF, the IMF approved a new 20-month SBA of SDR 90.97 million in April 2012. As for FYR Macedonia, the two-year Precautionary Credit Line arrangement will expire in January 2013. After having drawn about half of the financial means available under the program in spring 2011, FYR Macedonia has not drawn further amounts and does not envisage doing so during the remainder of the program duration. The SBA with Serbia, approved in September 2011, was frozen in February 2012 due to fiscal slippages which were not corrected by the authorities. The new government recently requested discussions on a new IMF-supported program. In response, the IMF has called on Serbia to shore up its consolidation and reform agenda (including effective implementation) and to revisit recent changes to the central bank law which have evoked concerns about a weakening of the independence of the central bank. Preparations for future EU accession of Western Balkan countries are proceeding gradually. In particular, during the review period, the European Council decided to open EU accession negotiations with Montenegro.

2 Slovakia: Car Industry Exports Keep Growth in Positive Territory

Net exports and automobile industry drive growth

Slovakia still remains among the EU's best economic performers, posting 2.9% annual GDP growth in the first half of 2012. However, growth has only been driven by external demand. Even though both exports and imports decelerated, export growth, in particular, is still relatively strong at 7.5% year on year. This has been mainly due to machinery and transport equipment exports, which accounted for 77% of total export growth in the first half of 2012, not least reflecting automobile producers' investments in new production lines and car models over the past years. In contrast, all domestic demand components have contributed negatively to output growth. Public consumption has been declining due to Slovakia's commitment, under the Excessive Deficit Procedure, to bring the public deficit below 3% of GDP by 2013. Households have been affected by fiscal consolidation, sluggish labor market conditions and general uncertainty as reflected, for instance, by a higher savings rate and low consumer confidence. Gross fixed capital formation has been dragged down by falling construction and, more generally, by both household and government restraint on capital spending.

Further improvement in the current account balance

The improvement of the current account balance seen in 2011 continued into the first half of 2012, when it reached a surplus of 2.5% of GDP. This was due to an improvement in all of its components except current transfers (lower private and EU Funds receipts), but most notably due to a 5.4%-of-GDP surplus in the trade balance. Net FDI inflows continued their upward trend, reaching 2.6% of GDP in the first half of 2012.

Inflation persistently high, competitiveness improved

HICP inflation decreased somewhat compared with 2011. However, it still remained elevated at 3.8% in August 2012. Inflation was mainly driven by increasing food and energy prices, which had been rising until May 2012 and started losing pace thereafter. On the domestic front, transportation and a new categorization of pharmaceuticals contributed to higher regulated prices.

Positive, though decelerating, economic growth since 2010 still failed to revive the sluggish labor market. Employment has been stagnating at levels just slightly below 60%, and unemployment remains elevated at 13.7% as of mid-2012. These developments, alongside growing manufacturing production, have resulted in rising labor productivity in manufacturing. Amid moderate nominal labor cost growth, this has led to a significant improvement in Slovakia's competitiveness, with unit labor costs in manufacturing declining by 7.4% in the first half of 2012 (while increasing by 3.6% in the euro area).

Fiscal consolidation imperiled by lower-than-expected tax revenues

For 2012, Slovakia has budgeted a deficit of 4.6% of GDP. However, in September, the Ministry of Finance revised down the 2012 tax revenue forecast by 0.2% of GDP. It remains to be seen whether the consolidation measures already implemented by the new government (which will take effect in the final quarter of 2012) will offset such a shortfall. The measures comprise, for instance, changes in the pension system, including the reduction of the contributions under the privately funded pillar, an introduction of a special levy on selected regulated industries and an extension of the bank levy base to include household deposits. Apart from these measures, the 2013 budget, to be submitted to parliament in the course of October with a deficit of 2.9% of GDP, relies also on recently adopted changes – in social contribution schemes as well as in corporate and personal income taxes, including the reintroduction of progressivity – which have yet to be approved by the parliament.

Table 2

Main Economic Indicators: Slovakia

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–4.9	4.2	3.3	3.4	3.5	3.0	3.4	3.0	2.8
Private consumption	0.2	–0.7	–0.4	–0.2	–0.1	–0.8	–0.3	–0.1	–0.2
Public consumption	6.1	1.1	–3.5	–1.7	–5.1	–3.3	–3.7	0.4	–2.1
Gross fixed capital formation	–19.7	12.4	5.7	1.6	6.4	5.9	8.4	–3.9	–1.1
Exports of goods and services	–15.9	16.5	10.8	16.8	13.1	6.8	7.5	6.0	8.9
Imports of goods and services	–18.1	16.3	4.5	11.4	10.9	–1.8	–1.0	2.1	3.2
	Contribution to GDP growth in percentage points								
Domestic demand	–7.2	4.2	–1.5	0.8	0.4	–4.5	–2.4	–0.7	–1.6
Net exports of goods and services	2.3	0.0	5.1	4.2	1.9	6.6	7.4	3.7	5.2
Exports of goods and services	–13.3	11.7	8.8	13.4	10.6	5.2	6.5	5.6	8.0
Imports of goods and services	15.6	–11.7	–3.7	–9.2	–8.7	1.4	0.9	–1.9	–2.8
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	7.3	–1.8	–0.7	0.0	–0.9	–0.3	–1.6	–0.8	0.3
Unit labor costs in manufacturing (nominal, per hour)	1.4	–16.8	2.6	–3.6	2.3	5.6	5.8	–4.4	–10.3
Labor productivity in manufacturing (real, per hour)	4.0	19.3	4.2	7.8	4.2	4.3	0.8	9.5	16.8
Labor costs in manufacturing (nominal, per hour)	4.7	0.0	6.9	4.0	6.6	10.1	6.6	4.6	4.7
Producer price index (PPI) in industry	–6.6	0.1	4.4	5.3	5.1	3.7	3.6	2.5	1.7
Consumer price index (here: HICP)	0.9	0.7	4.1	3.5	4.1	4.1	4.7	4.0	3.6
EUR per 1 SKK, + = SKK appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	12.1	14.4	13.6	13.9	13.2	13.2	14.0	14.1	13.7
Employment rate (%, 15–64 years)	60.2	58.8	59.5	59.0	59.6	59.9	59.5	59.6	59.8
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)	3.2	4.4	0.7	2.8	3.9	5.0	0.7	3.0	1.9
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–1.4	1.3	–3.8	0.3	2.5	–5.5	–3.8	–7.2	–6.7
Domestic credit of the banking system	23.0	9.2	9.4	4.2	3.8	4.4	9.4	11.7	4.4
of which: claims on the private sector	6.0	3.2	6.9	4.6	6.8	7.5	6.9	6.5	3.6
claims on households	3.5	4.2	3.9	4.3	4.5	4.3	3.9	3.9	3.5
claims on enterprises	2.4		2.9	0.3	2.4	3.2	2.9	2.6	0.1
claims on the public sector (net)	17.0	6.0	2.5	–0.4	–3.0	–3.1	2.5	5.2	0.7
Other assets (net) of the banking system	–18.4	–6.1	–4.9	–1.7	–2.4	6.1	–4.9	–1.5	4.2
	% of GDP, ESA 95								
General government revenues	33.5	32.3	33.2	. .	. .	. .	. .	. .	. .
General government expenditures	41.5	40.0	38.1	. .	. .	. .	. .	. .	. .
General government balance	–8.0	–7.7	–4.9	. .	. .	. .	. .	. .	. .
Primary balance	–6.6	–6.3	–3.4	. .	. .	. .	. .	. .	. .
Gross public debt	35.6	41.0	43.3	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–16.8	21.5	16.9	26.7	18.5	16.0	8.6	10.8	11.5
Merchandise imports	–20.0	22.5	13.6	27.6	21.3	7.1	2.8	6.7	9.5
	% of GDP (based on EUR), period total								
Trade balance	1.5	1.2	3.5	2.9	2.1	4.3	4.7	6.3	3.9
Services balance	–1.6	–1.1	–0.5	–0.8	–0.9	–0.7	0.2	0.4	0.4
Income balance (factor services balance)	–1.4	–1.9	–2.4	–2.5	–2.4	–2.3	–2.5	–2.3	–2.2
Current transfers	–1.1	–0.6	–0.5	1.4	–0.8	–1.1	–1.4	–0.4	–0.9
Current account balance	–2.6	–2.5	0.1	1.0	–1.9	0.2	1.0	3.9	1.2
Capital account balance	0.7	1.5	1.3	0.3	2.3	1.1	1.3	0.2	2.8
Foreign direct investment (net)	1.0	0.2	1.7	1.7	–1.6	1.4	5.3	4.7	0.7
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	72.2	74.9	76.7	77.7	78.2	78.0	76.7	76.8	74.8
Gross official reserves (excluding gold)[1]	0.8	0.8	1.0	0.9	0.9	0.9	1.0	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	62,795	65,744	69,058	15,853	17,192	18,258	17,756	16,556	17,849

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

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

3 Slovenia: Tackling the Crisis without International Assistance

Economic and financial developments in Slovenia frequently made headlines over the past few months. At the beginning of August, the three major rating agencies downgraded the country's creditworthiness by one (Fitch and S&P) and three (Moody's) notches. They also changed their assessment of the country's biggest banks and banking system to the worse. Slovenian banks are burdened by an increasing share of nonperforming loans, which erodes profitability and puts pressure on capital positions. To comply with EBA requirements, the government had to inject EUR 320 million into Nova Ljubljanska banka in mid-2012 (along with EUR 60 million by state funds). The authorities have aired that they do not plan, at the current stage, to ask for international assistance but intend to come to grips with the crisis by means of domestic policy adjustments and reforms.

Recession deepens in the second quarter of 2012, inflation is fueled by energy and food prices

The economy contracted by 1.5% year on year in the first half of 2012. Consumption diminished sharply on the back of fiscal consolidation efforts, decreasing real wages and employment, and a further reduction of both credit to households and consumer confidence. The decline in investments intensified again in the first two quarters of 2012, as economic sentiment continued to worsen, as did deleveraging in the corporate sector. Changes in inventories reduced GDP growth particularly in the second quarter. Reflecting weaker export market conditions, export growth continued to ease and turned negative in the second quarter, but as imports contracted even more, the contribution of net exports to GDP growth increased substantially compared with 2011.

Headline HICP inflation accelerated from 2.4% in March to 3.1% in August 2012. The weak economic environment was mirrored in the more benign development of core inflation (1.2%–1.6%). On the upside, ULC growth again moderated to less than 1% during the first half of 2012.

Fiscal consolidation, privatization and structural reforms as high priority

In its Stability Programme update of April 2012, the government confirmed its announcement to reduce the fiscal deficit from 6.4% of GDP in 2011 to 3.5% in 2012 and to 2.5% in 2013. However, according to the European Commission, the planned deficit path is surrounded by various risks. The Commission expects the deficit to be higher, namely 4.3% in 2012 and 3.8% in 2013. The government has finalized the budget for 2013–14 roughly along these principles, setting the deficit for 2013 at slightly below 3% of GDP. While additional savings (e.g. pension reform, cut in public sector wage expenditure and in various transfers) on the expenditure side should help achieve the target, a greater role than foreseen in the Stability Programme update is to come from tax increases or new taxes (e.g. temporary tax on real estate of greater value, increase in the motor vehicle tax, selective VAT hike).

In addition, Slovenia's parliament has recently approved legislation to set up a "bad bank" and recapitalize banks, which is seen as a prerequisite for privatizing state-owned banks and for kick-starting credit growth. Also, the creation of a new state asset management company has been approved. Moreover, the government has drafted labor market legislation (to reduce segmentation, increase flexibility and shorten the duration of unemployment insurance benefits). At the same time, an all-party commission failed to reach agreement on the implementation of a fiscal rule in the constitution to meet EU obligations and bolster market confidence. Positively, though, investor confidence manifested itself in Slovenia's successful placement of a USD 2.25 billion bond in late October.

Table 3

Main Economic Indicators: Slovenia

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–7.8	1.2	0.6	2.5	1.6	0.8	–2.4	0.2	–3.2
Private consumption	0.1	1.3	0.9	1.7	0.6	2.1	–0.5	0.6	–3.0
Public consumption	2.5	1.5	–1.2		–1.5	–1.1	–1.3	0.0	–2.0
Gross fixed capital formation	–23.2	–13.8	–8.1	–8.1	–11.8	–8.7	–3.5	–10.5	–8.9
Exports of goods and services	–16.7	10.1	7.0	11.6	8.8	5.1	3.1	2.0	–0.5
Imports of goods and services	–19.5	7.9	5.2	10.6	5.6	4.4	0.8	–1.1	–5.4
	Contribution to GDP growth in percentage points								
Domestic demand	–10.2	–0.2	–0.7	1.6	–0.6	0.2	–3.8	–2.0	–6.7
Net exports of goods and services	2.4	1.5	1.3	0.8	2.2	0.6	1.5	2.2	3.4
Exports of goods and services	–11.3	5.9	4.6	7.5	5.7	3.4	2.1	1.4	–0.3
Imports of goods and services	13.7	–4.5	–3.4	–6.7	–3.6	–2.8	–0.6	0.8	3.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	8.7	–0.6		–1.8	–1.3	–1.5	0.7	0.3	–0.2
Unit labor costs in manufacturing (nominal, per hour)	25.1	–0.6	–0.7	–5.4	–0.1	–0.4	3.5	–0.2	10.9
Labor productivity in manufacturing (real, per hour)	–15.9	3.9	2.5	8.1	3.2	0.3	–1.1	–2.1	–1.1
Labor costs in manufacturing (nominal, per hour)	5.7	3.2	1.9	2.3	3.1	–0.1	2.4	–2.3	9.7
Producer price index (PPI) in industry	–1.4	2.0	4.6	5.7	4.8	4.1	3.6	1.3	0.8
Consumer price index (here: HICP)	0.9	2.1	2.1	2.2	2.0	1.5	2.6	2.5	2.5
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.0	7.4	8.4	8.7	7.8	8.0	8.9	8.7	8.3
Employment rate (%, 15–64 years)	67.5	66.2	64.4	63.7	64.4	65.1	64.4	64.0	63.8
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)	3.4	1.6	3.0	0.5	1.4	2.9	3.0	4.3	3.3
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	6.6	–4.0	6.5	–0.6	4.8	7.8	6.5	–6.8	–4.9
Domestic credit of the banking system	2.1	6.7	–3.1	2.3	0.1	–2.7	–3.1	10.8	6.8
of which: claims on the private sector	4.7	2.8	–3.8	1.1	0.2	–1.5	–3.8	–3.4	–5.0
claims on households	2.7	3.9	0.8	3.0	2.3	1.6	0.8	0.6	–0.3
claims on enterprises	2.0	–1.1	–4.6	–1.9	–2.2	–3.0	–4.6	–4.0	–4.7
claims on the public sector (net)	–2.6	3.9	0.7	1.1	0.0	–1.2	0.7	14.2	11.7
Other assets (net) of the banking system	–5.3	–1.2	–0.4	–1.1	–3.6	–2.2	–0.4	0.4	1.4
	% of GDP, ESA 95								
General government revenues	43.1	44.5	44.3	. .	. .	. .	. .	. .	. .
General government expenditures	49.1	50.2	50.7	. .	. .	. .	. .	. .	. .
General government balance	–6.0	–5.7	–6.4	. .	. .	. .	. .	. .	. .
Primary balance	–4.6	–4.1	–4.5	. .	. .	. .	. .	. .	. .
Gross public debt	35.0	38.6	46.9	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–19.4	13.8	15.6	23.1	16.9	13.0	10.5	2.9	0.1
Merchandise imports	–25.7	16.2	13.8	22.9	14.9	12.0	7.1	2.5	–2.1
	% of GDP (based on EUR), period total								
Trade balance	–2.0	–3.4	–2.9	–2.7	–2.3	–2.3	–4.3	–2.5	
Services balance	3.3	3.7	4.0	3.7	4.3	3.8	4.1	4.7	4.9
Income balance (factor services balance)	–2.2	–1.4	–1.5		–1.5	–2.5	–0.9	–2.0	–1.3
Current transfers	–0.4	0.3	0.4	0.6	0.4	0.0	0.7	–0.4	0.3
Current account balance	–1.3	–0.8	0.0	0.7	0.8		–0.4	–0.2	2.9
Capital account balance	0.0	0.0	–0.3	–0.1	–0.1	–0.1	–0.9	0.1	0.3
Foreign direct investment (net)	–1.8	0.9	1.8	–0.1	2.6	2.6	1.8	2.6	0.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	113.3	114.4	111.3	118.9	117.1	117.5	111.3	115.2	113.8
Gross official reserves (excluding gold)[1]	1.9	2.0	1.8	1.8	1.8	1.8	1.8	1.6	1.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)[1]	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	35,556	35,607	36,172	8,453	9,370	9,382	8,968	8,545	9,156

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

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

4 Bulgaria: Fiscal Position Improves in spite of Slowing Growth

Strenghtening domestic demand counters negative growth contribution from net exports in the first half of 2012

After post-crisis real GDP growth had peaked in the third quarter of 2011, it was again somewhat lower in the first two quarters of 2012, but remained in positive territory (+1% year on year). GDP growth was held back by extremely unfavorable weather conditions in the first quarter of 2012 and by the deterioration of external demand during the observation period. Following three years of a negative trend, domestic demand entered positive territory in the first half of 2012 on the back of strengthened private consumption (+4.1% year on year) due to steady real wage growth and slightly improving consumer confidence. Another major growth driver in the first half of 2012 was gross fixed capital formation, which turned positive in response to increasing foreign capital inflows and higher government capital expenditures. In addition, inventories posted a remarkable increase. Export growth nearly came to a halt in the first half of 2012, while import growth accelerated on the back of strengthening domestic demand so that net exports reduced the overall GDP growth rate for the first time since the outbreak of the crisis.

Gradual reduction of external debt despite increasing external vulnerabilities

The current account deficit widened in the first half of 2012 (–5% of GDP compared with –0.7% in the first half of 2011). This was mostly attributable to the trade balance and somewhat mitigated by an increase of current transfers (reflecting a rise in remittances and a higher absorption of EU structural funds). On the financing side, net FDI inflows remained moderate, but fully covered the current account deficit. Gross external debt was broadly stable at about 93% of GDP during the observation period.

Inflation eased and then picked up slightly again, competitiveness position strengthens

After peaking in the first quarter of 2011, the annual inflation rate (HICP) came down to 1.8% in the second quarter of 2012, with the largest contribution stemming from energy and fuel prices (electricity and oil price hikes by mid-2012). Inflation, however, accelerated over the summer to reach 3.1% in August on the back of rising prices of unprocessed food. Core inflation, however, remained constrained at 1.4% as of August 2012. There have also been signs that external competitiveness has strengthened somewhat: In the first quarter of 2012, the growth of unit labor costs both in the whole economy and in the manufacturing sector decelerated somewhat, even though they remained in positive territory. This development was mainly driven by labor reduction, while gross real wages in the whole economy were still growing at a respectable annual rate of above 6%.

Abrogation of EDP, fiscal consolidation continues in a more gradual fashion

Bulgaria managed to correct its excessive deficit in 2011 on the back of mostly expenditure-side measures (i.e. lower-than-projected capital spending, freeze of public sector wages as well as cuts in subsidies), so that the Excessive Deficit Procedure was lifted in June 2012. Its fiscal performance up to July 2012 suggests that the 2012 deficit target of 1.9% of GDP is within reach. Revenues have grown (especially from VAT receipts and excise duties), thereby alleviating some of the pressure of rising expenditures. In view of upcoming parliamentary elections (second quarter of 2013), major consolidation efforts are not to be expected in the remainder of 2012 and in 2013. The budget proposal for next year currently discussed by the government and the social partners targets a deficit ratio of 1.3% of GDP, assuming a real GDP growth rate of 1.9% for 2013.

Table 4

Main Economic Indicators: Bulgaria

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–5.5	0.4	1.7	2.0	2.7	1.9	0.3	0.9	1.0
Private consumption	–7.6	0.1	–0.6	–3.0	–0.6	2.9	–1.6	2.1	6.2
Public consumption	–6.5	1.9	0.5	2.7	2.4	–2.4	–0.2	–1.4	–0.4
Gross fixed capital formation	–17.6	–18.3	–9.7	–2.4	–6.6	–12.4	–14.4	1.3	–0.3
Exports of goods and services	–11.2	14.7	12.8	25.6	13.0	4.6	13.4	–4.4	5.1
Imports of goods and services	–21.0	2.4	8.5	13.6	8.1	9.0	4.5	1.5	9.9
	Contribution to GDP growth in percentage points								
Domestic demand	–15.5	–5.2	–0.6	–2.8	0.5	2.8	–3.5	5.3	4.4
Net exports of goods and services	10.0	5.6	2.3	5.2	2.4	–1.8	4.2	–4.2	–3.3
Exports of goods and services	–6.5	7.0	7.3	13.9	7.3	3.1	6.8	–3.1	3.3
Imports of goods and services	16.5	–1.4	–5.1	–8.7	–5.0	–4.9	–2.6	–1.1	–6.6
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	13.3	6.1	1.0	–3.5	0.7	2.9	4.8	2.0	0.8
Unit labor costs in manufacturing (nominal, per hour)	24.0	–5.1	0.5	–6.3	2.2	2.0	5.1	1.8	–2.1
Labor productivity in manufacturing (real, per hour)	–9.8	12.0	6.9	12.4	6.4	6.1	3.6	2.0	5.8
Labor costs in manufacturing (nominal, per hour)	11.5	6.3	7.9	5.4	8.8	8.3	8.9	3.8	3.6
Producer price index (PPI) in industry	–6.3	8.5	9.5	13.2	10.3	8.4	6.1	3.9	3.0
Consumer price index (here: HICP)	2.5	3.0	3.4	4.5	3.4	3.1	2.5	1.9	1.8
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)	6.9	10.3	11.3	12.1	11.3	10.3	11.5	13.0	12.4
Employment rate (%, 15–64 years)	62.6	59.7	58.5	57.3	58.2	59.9	58.7	56.9	58.3
Key interest rate per annum (%)[1]	..	..	..	..	..	..	..	..	..
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.2	6.4	12.3	7.4	8.0	10.3	12.3	10.7	10.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.7	5.0	7.9	4.5	6.2	8.5	7.9	9.2	8.3
Domestic credit of the banking system	6.6	5.1	7.3	5.7	3.8	4.5	7.3	5.4	5.5
of which: claims on the private sector	4.1	1.5	3.9	2.0	2.7	2.8	3.9	3.6	4.2
claims on households	2.3	–0.3	–0.2	–0.3	–0.2	–0.1	–0.2	–0.4	–0.4
claims on enterprises	1.8	1.8	4.1	2.3	2.9	2.9	4.1	3.9	4.7
claims on the public sector (net)	2.5	3.7	3.4	3.7	1.1	1.6	3.4	1.8	1.2
Other assets (net) of the banking system	–4.1	–3.7	–3.0	–2.8	–2.0	–2.7	–3.0	–3.9	–3.6
	% of GDP, ESA 95								
General government revenues	37.1	34.3	33.6	..	..	..	..	..	..
General government expenditures	41.4	37.4	35.6	..	..	..	..	..	..
General government balance	–4.3	–3.1	–2.0	..	..	..	..	..	..
Primary balance	–3.6	–2.5	–1.4	..	..	..	..	..	..
Gross public debt	14.6	16.2	16.3	..	..	..	..	..	..
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–23.0	32.9	30.2	56.9	30.3	22.0	19.7	–2.8	6.3
Merchandise imports	–33.3	15.4	22.3	37.1	19.2	24.5	13.1	10.3	16.8
	% of GDP (based on EUR), period total								
Trade balance	–11.9	–7.7	–5.6	–3.5	–6.5	–3.3	–8.9	–11.7	–12.9
Services balance	3.7	5.2	6.0	1.8	5.2	14.0	1.6	1.3	6.3
Income balance (factor services balance)	–3.4	–3.1	–4.5	–4.5	–4.9	–4.6	–4.1	–4.0	–2.5
Current transfers	2.7	4.2	4.4	4.2	6.9	3.1	3.4	7.5	6.0
Current account balance	–8.9	–1.5	0.3	–2.1	0.8	9.2	–8.0	–6.9	–3.0
Capital account balance	1.4	0.8	1.3	0.2	0.5	1.2	3.1	0.3	0.5
Foreign direct investment (net)	7.2	2.7	4.1	0.1	2.1	3.4	10.1	5.9	2.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	108.3	102.7	93.1	98.6	96.0	93.9	93.1	93.8	93.8
Gross official reserves (excluding gold)	34.2	32.2	30.6	29.5	29.0	29.7	30.6	30.2	31.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.4	6.5	5.6	5.7	5.6	5.6	5.6	5.3	5.4
	EUR million, period total								
GDP at current prices	34,933	36,052	38,483	8,166	9,605	10,760	9,953	8,030	9,718

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

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

5 Czech Republic: Economic Activity Slows amid Negative Sentiment

Domestic demand drags the economy into recession

In the first half of 2012, the Czech Republic entered a recession with a GDP decline of 0.9% year on year. While the contraction was moderate in the first quarter, it deepened in the subsequent three months. In the first half-year, most domestic demand components dragged GDP down, while the only notable positive contribution came from net exports. Nevertheless, export growth decelerated substantially, in line with the external environment, with import growth slowing down even more due to contracting domestic demand. As household consumption suffered from consolidation measures, a sluggish labor market and general uncertainty, the consumer confidence indicator reached the lowest levels in thirteen years. For similar reasons, but also due to public investments being cut back and a further fall in construction output, gross fixed investment stagnated. At 1.9 percentage points, changes in inventories (used mainly for exports) contributed considerably to the GDP decline during the six-month period through June.

The current account reached a mild surplus of 0.9% of GDP in the first half of 2012. As in past years, developments in this area were driven strongly by the negative income balance. This was, however, almost compensated for by the trade balance surplus of 5.5% of GDP. FDI inflows amounted to 2.6% of GDP in the first half of 2012.

Inflation elevated due to tax hikes, regulated prices and commodities

HICP inflation doubled to about 4% in the first half of 2012 (against the same 2011 period), but came down to 3.4% in August. The greatest contribution to the rise in inflation (about 1.1 percentage points) came from the January 2012 hike of the lower VAT rate from 10% to 14%. Inflation was also driven by rising food prices, regulated prices (house rents, heating prices, health care) and by rising fuel prices. The monetary policy-relevant inflation rate (CPI adjusted for first-round effects of changes to indirect taxes) remained in the upper bound of the inflation target of 2% +/–1 percentage points set by the Czech National Bank (CNB).

CNB policy rates at historical lows

In June 2012, and again in September, the CNB lowered its policy rate by 25 basis points each to a historical low of 0.25% in light of low domestic activity and absent inflation pressures from domestic demand.

The exchange rate of the Czech koruna was driven mainly by developments of global risk aversion and slowing output. The Czech currency depreciated from March to June 2012, then regained previous losses until September, while reversing the trend again in early October. Against the euro, it stood at approximately the same level as a year earlier (24.8 EUR/CZK, September 2012 average).

Fiscal consolidation jeopardized by political instability

The public deficit target for this year, as set in the country's Convergence Programme, is 3% of GDP. More recently, the Ministry of Finance, however, revised this figure up to 3.2% due to lower-than-originally-projected tax revenues. For 2013, the deadline year to correct the excessive deficit under the EDP, the government plans a deficit of 2.9% of GDP. But the budget has yet to be approved by the parliament. The same goes for some consolidation measures envisaged in the budget, which have already once been rejected by the parliament. The government resubmitted them, tying them to a confidence vote. These measures comprise, in particular, hikes in the lower and the standard VAT rate by 1 percentage point to 15% and 21%, respectively, and the introduction of a temporary additional personal income tax surcharge for higher incomes. Consolidation measures on the expenditure side comprise, above all, a temporarily lowered pension indexation and lower expenditures on goods and services.

Table 5

Main Economic Indicators: Czech Republic

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–4.7	2.7	1.7	3.1	2.1	1.4	0.3	–0.2	–1.7
Private consumption	–0.4	0.6	–0.6	–0.5	–0.5	–0.7	–0.8	–2.4	–3.5
Public consumption	3.8	0.6	–1.7	–0.3	–1.3	–3.0	–2.1	–0.5	–0.9
Gross fixed capital formation	–11.5	0.1	–0.9	–1.7	1.4	–2.6	–0.7	1.7	–0.5
Exports of goods and services	–10.0	16.4	11.0	19.2	13.0	8.6	4.6	7.7	2.4
Imports of goods and services	–11.6	16.0	7.5	16.9	10.0	3.7	1.1	4.0	0.0
	Contribution to GDP growth in percentage points								
Domestic demand	–5.5	1.8		0.6	–0.4	–2.0	–2.1	–3.2	–3.5
Net exports of goods and services	0.8	0.9	2.7	2.4	2.4	3.3	2.5	3.1	1.9
Exports of goods and services	–6.5	9.8	7.5	12.9	8.7	5.7	3.2	6.0	1.8
Imports of goods and services	7.2	–8.9	–4.8	–10.4	–6.3	–2.4	–0.7	–2.9	0.0
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	1.9	–0.3	1.0	0.6	1.4	0.5	1.5	4.5	3.1
Unit labor costs in manufacturing (nominal, per hour)	–2.2	–8.4	–3.3	–3.0	–2.4	–2.4	–5.4		–2.5
Labor productivity in manufacturing (real, per hour)	2.1	12.3	9.7	8.5	10.4	9.8	10.3	7.8	9.7
Labor costs in manufacturing (nominal, per hour)	–0.2	3.0	6.1	5.2	7.8	7.1	4.4	6.7	6.9
Producer price index (PPI) in industry	–1.5	0.1	3.7	3.2	3.1	3.7	4.9	3.8	2.6
Consumer price index (here: HICP)	0.6	1.2	2.1	1.9	1.8	2.0	2.8	4.0	3.8
EUR per 1 CZK, + = CZK appreciation	–5.7	4.6	2.9	6.2	5.2	2.2	–2.0	–2.8	–3.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.7	7.4	6.8	7.3	6.8	6.6	6.5	7.2	6.8
Employment rate (%, 15–64 years)	65.4	65.0	65.7	65.0	65.7	66.1	66.1	65.6	66.5
Key interest rate per annum (%)	1.5	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7
CZK per 1 EUR	26.5	25.3	24.6	24.4	24.3	24.4	25.3	25.1	25.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	0.2	1.9	2.8	1.3	–0.8	1.8	2.8	4.8	5.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.0	0.4	–0.8	–3.3	–5.7	–4.8	–0.8	3.0	6.0
Domestic credit of the banking system	4.6	4.0	7.9	5.4	5.7	10.2	7.9	5.3	5.5
of which: claims on the private sector	0.3	2.1	4.1	3.2	3.9	4.5	4.1	3.8	3.3
claims on households	3.8	2.7	2.2	2.6	2.5	2.2	2.2	2.1	2.0
claims on enterprises	–3.5	–0.6	1.9	0.6	1.4	2.3	1.9	1.7	1.3
claims on the public sector (net)	4.3	1.9	3.7	2.2	1.8	5.7	3.7	1.5	2.2
Other assets (net) of the banking system	–5.4	–2.6	–4.3	–0.8	–0.8	–3.5	–4.3	–3.6	–6.0
	% of GDP, ESA 95								
General government revenues	38.9	39.0	39.8	. .	. .	. .	. .	. .	. .
General government expenditures	44.7	43.8	43.1	. .	. .	. .	. .	. .	. .
General government balance	–5.8	–4.8	–3.3	. .	. .	. .	. .	. .	. .
Primary balance	–4.5	–3.4	–1.9	. .	. .	. .	. .	. .	. .
Gross public debt	34.2	37.8	40.8	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–16.3	21.3	15.7	27.8	18.3	11.7	6.8	7.9	2.8
Merchandise imports	–19.2	24.1	14.0	28.6	17.6	9.3	3.7	5.2	0.2
	% of GDP (based on EUR), period total								
Trade balance	2.3	1.4	2.5	3.8	3.0	0.8	2.3	6.0	5.0
Services balance	2.0	2.0	1.7	1.6	2.1	1.9	1.3	1.6	1.2
Income balance (factor services balance)	–6.7	–7.6	–7.2	–3.2	–11.6	–8.5	–5.0	–5.2	–6.4
Current transfers	0.0	0.2	0.1	0.4	0.6	–0.3	–0.4	0.1	–0.4
Current account balance	–2.4	–3.9	–2.9	2.6	–5.9	–6.0	–1.7	2.6	–0.7
Capital account balance	1.4	0.9	0.4	0.1	0.0	0.3	1.1	0.1	0.0
Foreign direct investment (net)	1.0	2.5	2.0	1.5	3.6	–0.4	3.2	3.5	1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	43.7	47.2	46.9	46.0	46.7	47.6	46.9	50.2	48.4
Gross official reserves (excluding gold)	20.2	21.0	19.8	19.4	19.1	19.1	19.8	20.6	20.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.3	3.9	3.4	3.4	3.3	3.3	3.4	3.4	3.3
	EUR million, period total								
GDP at current prices	141,602	149,401	154,823	36,270	39,515	39,601	39,436	35,724	37,927

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

6 Hungary: Zigzagging about Precautionary International Financial Assistance

Over the summer months, talks with the EU/IMF about precautionary financial assistance seem to have come into motion, as a joint mission of the IMF, the EU and the ECB held exploratory talks in Hungary in July. Afterwards, however, the government signaled that an agreement was no "must" at all and took controversial policy moves. It, for instance, subjected the central bank to a new financial transaction tax (FTT) from the beginning of 2013 and insisted on the feasibility of its original 2013 fiscal target, which was deemed too optimistic by the prospective lenders. At the beginning of October, the government, however, brought its growth assumptions close to the forecasts of the IMF and the EU, revised the 2012 and 2013 deficit targets from 2.5% and 2.2%, respectively, to 2.7% of GDP and announced substantial additional consolidation measures to safeguard the new targets. It also backtracked on applying the FTT to the central bank.

IMF/EU deal would be beneficial to restore confidence more solidly

A deal with the IMF/EU would be highly welcome to restore investor confidence, policy credibility and predictability. This would likely lead to a reduction in the country's risk premium, thereby relieving fiscal pressures and improving financing conditions for households and corporates alike. Hungary slid into technical recession in the second quarter of 2012. The decline in consumption worsened sharply during the first half of 2012 compared with 2011, while investment activity contracted at roughly the same pace. Changes in inventories reduced the GDP growth rate further. The following factors acted as brakes on domestic demand: (1) declining real wages and employment, (2) increasingly contracting bank lending to both households and companies, (3) continued weak sentiment and low capacity utilization, (4) weak economic prospects and (5) the difficult predictability of the business environment. The growth rate of both exports and imports dwindled during the first two quarters compared with 2011 as both external and domestic demand slowed. Nevertheless, net exports remained the only engine of GDP growth during the first half of 2012.

MNB cuts policy rate despite fragile market confidence and inflation risks

Changes in the fiscal outlook for 2012–13, in the prospects for financial assistance by the IMF/EU and in the international financial market climate impacted Hungary's risk premium over the reporting period, leading overall to a modest improvement in major financial market indicators. In August and September, Hungary's central bank (MNB) cut interest rates by 25 basis points each, to 6.5%, as the Monetary Council's four external members voted down the three internal members. The interest rate cuts were based on the view that the inflation target – despite a substantial upward revision in the central bank's inflation forecasts for 2012 and 2013 – was still likely to be met. In this context, the respective Monetary Council members pointed to significant spare capacity and weak domestic demand as well as an expected fall in domestic risk premiums. Despite weak domestic demand and a negative output gap, inflation accelerated to 6% by August 2012 on the back of indirect tax hikes and a substantial acceleration of food price increases. Although energy price inflation slowed modestly during the reporting period, it was still substantially higher (around 9%) than the overall inflation rate. While demand-pull inflation pressure is expected to remain subdued over the next few quarters, supply-side effects (commodity price increases, increase in taxes and fees) and rising unit labor costs will likely slow down the deceleration of inflation.

Table 6

Main Economic Indicators: Hungary

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–6.8	1.3	1.6	2.6	1.4	1.4	1.4	–0.7	–1.3
Private consumption	–6.2	–2.2	0.0	–0.6	0.2	0.3	0.1	–0.3	–0.3
Public consumption	–0.6	–2.1	–0.6	1.7	–1.3	–1.5	–1.1	–0.8	–5.5
Gross fixed capital formation	–11.0	–9.7	–5.5	–1.5	–7.6	–7.6	–4.5	–6.6	–4.5
Exports of goods and services	–10.2	14.3	8.4	14.1	8.6	6.7	4.9	1.9	2.1
Imports of goods and services	–14.8	12.8	6.3	14.2	6.7	3.8	1.7	–0.3	0.2
	Contribution to GDP growth in percentage points								
Domestic demand	–10.4	–0.5	–0.6	1.7	–0.7	–1.4	–1.5	–2.8	–3.1
Net exports of goods and services	3.6	1.8	2.2	0.9	2.1	2.8	2.9	2.2	1.8
Exports of goods and services	–8.4	11.1	7.3	12.4	7.4	5.7	4.2	1.9	1.9
Imports of goods and services	12.0	–9.3	–5.1	–11.5	–5.3	–3.0	–1.4	0.3	–0.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.7	–3.5	3.6	2.7	4.5	4.6	2.8	5.0	4.2
Unit labor costs in manufacturing (nominal, per hour)	9.2	–9.6	4.4	0.1	8.0	7.0	2.5	6.1	5.5
Labor productivity in manufacturing (real, per hour)	–4.8	10.2	1.5	6.8	–2.2	–1.5	3.2	–0.9	3.7
Labor costs in manufacturing (nominal, per hour)	3.3	0.0	6.0	6.9	5.7	5.5	5.8	5.2	9.4
Producer price index (PPI) in industry	4.6	6.3	2.6	5.2	0.0	–0.4	5.6	6.4	6.7
Consumer price index (here: HICP)	4.0	4.7	3.9	4.3	3.9	3.4	4.1	5.6	5.5
EUR per 1 HUF, + = HUF appreciation	–10.3	1.9	–1.4	–1.4	3.1	2.7	–9.1	–8.2	–9.4
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	10.1	11.2	11.0	11.7	10.9	10.8	10.7	11.8	10.9
Employment rate (%, 15–64 years)	55.4	55.4	55.8	54.6	55.8	56.4	56.5	55.7	57.2
Key interest rate per annum (%)	8.6	5.5	6.0	5.9	6.0	6.0	6.3	7.0	7.0
HUF per 1 EUR	280.5	275.4	279.3	272.5	266.4	275.0	303.4	296.8	294.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.4	3.0	5.9	1.5	–1.0	5.3	5.9	1.5	0.1
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	13.4	4.2	17.8	5.4	5.8	16.8	17.8	9.9	10.1
Domestic credit of the banking system	–3.3	6.4	–3.1	–1.5	–10.1	–6.5	–3.1	0.4	–3.5
of which: claims on the private sector	–3.7	3.7	–0.6	–2.3	–7.4	1.6	–0.6	–1.8	–6.4
claims on households	0.8	4.6	–0.5	0.8	–2.2	2.1	–0.5	–2.0	–4.9
claims on enterprises	–4.6	–0.9	0.4	–3.1	–5.3	0.0	0.4	0.7	–0.9
claims on the public sector (net)	0.4	2.7	–2.6	0.8	–2.6	–8.1	–2.6	2.3	2.9
Other assets (net) of the banking system	–5.7	–7.7	–8.7	–2.4	3.2	–5.0	–8.7	–8.9	–6.5
	% of GDP, ESA 95								
General government revenues	46.9	45.4	53.9	. .	. .	. .	. .	. .	. .
General government expenditures	51.5	49.8	49.6	. .	. .	. .	. .	. .	. .
General government balance	–4.6	–4.4	4.3	. .	. .	. .	. .	. .	. .
Primary balance	0.1	–0.3	8.5	. .	. .	. .	. .	. .	. .
Gross public debt	79.8	81.8	81.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–20.4	20.3	9.1	20.9	10.2	6.3	0.8	0.4	3.4
Merchandise imports	–24.9	19.5	9.3	19.9	11.1	5.9	2.2	1.5	1.1
	% of GDP (based on EUR), period total								
Trade balance	2.6	3.3	3.3	5.1	3.4	2.6	2.5	4.5	5.5
Services balance	2.2	3.0	3.2	2.0	4.2	3.8	2.7	2.7	3.6
Income balance (factor services balance)	–5.4	–5.6	–6.1	–6.3	–6.4	–5.9	–5.9	–6.4	–7.2
Current transfers	0.4	0.4	0.5	–0.2	0.4	0.8	0.8	–0.8	0.3
Current account balance	–0.2	1.1	0.9	0.7	1.5	1.3	0.1	0.0	2.2
Capital account balance	1.2	1.7	2.3	2.1	1.5	2.9	2.9	1.5	1.9
Foreign direct investment (net)	0.1	0.7	0.1	–0.2	–1.8	–2.2	4.7	1.9	–2.6
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	149.7	142.4	131.3	143.2	141.9	137.3	131.3	131.1	133.9
Gross official reserves (excluding gold)	33.4	34.6	37.5	36.4	37.0	38.0	37.5	34.8	36.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.5	5.2	5.4	5.3	5.4	5.5	5.4	4.9	5.0
	EUR million, period total								
GDP at current prices	91,625	97,069	100,455	22,859	25,786	26,079	25,732	21,890	23,975

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

7 Poland: Monetary Policy Council Adopts Easing Bias

Fixed investment growth slows considerably, while export growth, albeit declining, outpaces import growth

Poland posted annual GDP growth of 2.8% in the first half of 2012, with larger contributions from foreign demand (about 2 percentage points) than from domestic demand (1.5 percentage points). The resulting import absorption reduced GDP growth by 0.7 percentage points, implying a net export contribution of 1.3 percentage points. Year-on-year growth decelerated considerably. Private consumption growth remained clearly below GDP growth. While employment growth slowed, the continuing increase in labor force participation supported consumption growth. Real wage growth turned negative, caused partly by fiscal consolidation measures. As a result, consumer confidence further deteriorated in the course of the year.

Fixed investment growth decelerated sharply, after reaching double-digit rates in the last quarter of 2011. This deceleration may be attributed to various factors: (1) falling, albeit still strong, profitability and liquidity positions of enterprises; (2) slower, albeit at a double-digit rate still high, growth of housing loans; (3) receding public nonresidential construction linked to the European Football Championship; and (4) an adverse outlook for foreign demand. Inventory change rendered a negative contribution to growth, as its buildup slowed markedly.

Export growth decelerated, too, but remained positive, while import growth turned even negative in the second quarter. The deficit in the goods and services balance declined. Stable manufacturing unit labor costs coupled with nominal currency depreciation (in year-on-year terms) supported exports and, in addition to slackening domestic demand growth, contained imports. However, given a higher deficit in the income balance, the current account deficit in the first half of 2012 was unchanged on a year earlier.

Disinflation expectations lead to easing bias

The złoty appreciated against the euro during the third quarter to the same extent as in the second quarter. In August, annual inflation was 3.8%, according to both the HICP and the national CPI, while core inflation amounted to 2.6% (HICP excl. energy and unprocessed food) and 2.1% (CPI excl. energy and food). Inflation has declined since June and, in the opinion of the Polish Monetary Policy Council (MPC), it will further decrease gradually over the coming months, as the statistical base effect wanes (given increases of tax rates and administered prices a year earlier) amid slowing demand in the economy. As the Polish MPC expected headline inflation to decelerate but to remain above the inflation target (2.5% CPI) until the end of 2012, it introduced an easing bias, but refrained from cutting the key interest rate (at 4.75%) in its session in early October. In early May, the Polish MPC had hiked the reference rate by 0.25 percentage points to 4.75%, on the basis of expectations that the slowdown would be only a mild one.

Authorities envisage continuing fiscal consolidation in 2013, albeit at a slower pace than in 2012

The Convergence Programme update submitted in April 2012 envisages a decline of the general government deficit from 5.1% of GDP in 2011 to 2.9% in 2012 and 2.2% in 2013, with consolidation in 2012 resulting equally from revenues and expenditures. The draft Budget Act 2013 adopted by the government for the central level is in line with these figures. In its end-May assessment, the Commission staff considered the general government deficit in 2012 and 2013 to come in at 3.0% and 2.5%, respectively. The cost of the systemic pension reform undertaken in 1999 (direct net cost estimated at 0.6% of GDP in 2012) is to be taken into account when the Commission and the Council will assess whether the correction of the excessive deficit (due in 2012) was successful, should the 2012 deficit (including the pension reform costs) come in at slightly above 3%.

Table 7

Main Economic Indicators: Poland

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	1.6	3.9	4.3	4.1	4.4	4.1	4.6	3.7	2.0
Private consumption	2.0	3.1	2.5	2.8	3.4	2.5	1.4	1.7	1.1
Public consumption	2.1	4.1	–1.7	–0.4	–1.6	–5.0	0.1		–0.1
Gross fixed capital formation	–1.2	–0.4	9.0	5.6	7.6	9.0	10.9	5.4	2.2
Exports of goods and services	–6.8	12.1	7.7	11.2	6.0	8.9	5.2	4.0	1.9
Imports of goods and services	–12.4	13.9	5.5	10.3	5.8	5.3	1.2	1.7	–2.9
	Contribution to GDP growth in percentage points								
Domestic demand	–1.1	4.6	3.4	3.7	4.4	2.7	3.1	2.7	–0.3
Net exports of goods and services	2.7	–0.7	0.9	0.3	0.1	1.4	1.5	1.1	2.3
Exports of goods and services	–2.7	4.8	3.3	4.7	2.7	3.8	2.1	1.9	0.9
Imports of goods and services	5.5	–5.5	–2.4	–4.4	–2.6	–2.4	–0.5	–0.8	1.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	2.3	1.1	0.5	–0.3	0.5	1.7	0.2	1.6	1.0
Unit labor costs in manufacturing (nominal, per hour)	0.5	–9.2	0.6	0.5	1.5	2.4	–2.0	–0.4	–0.1
Labor productivity in manufacturing (real, per hour)	4.3	11.3	4.0	2.6	4.4	1.3	7.6	4.9	4.4
Labor costs in manufacturing (nominal, per hour)	4.6	1.3	4.6	3.1	6.0	3.7	5.5	4.6	4.3
Producer price index (PPI) in industry	3.9	2.3	7.5	7.7	7.1	7.1	8.2	5.8	4.6
Consumer price index (here: HICP)	4.0	2.7	3.9	3.6	4.0	3.7	4.2	4.2	4.0
EUR per 1 PLN, + = PLN appreciation	–18.8	8.4	–3.0	1.2	1.4	–3.4	–10.3	–6.8	–7.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.3	9.7	9.8	10.2	9.6	9.5	9.9	10.7	10.0
Employment rate (%, 15–64 years)	59.4	59.3	59.7	58.9	59.7	60.2	59.9	59.2	60.0
Key interest rate per annum (%)	3.8	3.5	4.2	3.7	4.2	4.5	4.5	4.5	4.6
PLN per 1 EUR	4.3	4.0	4.1	3.9	4.0	4.2	4.4	4.2	4.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.1	8.8	12.5	11.0	7.3	10.2	12.5	9.1	11.0
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	3.2	3.0	6.4	2.1	–3.7	2.5	6.4	1.9	8.6
Domestic credit of the banking system	9.2	10.3	14.0	12.2	8.1	14.1	14.0	13.1	10.5
of which: claims on the private sector	6.7	8.0	13.1	9.7	8.5	13.5	13.1	11.6	10.1
claims on households	6.8	8.3	7.4	7.9	5.9	9.0	7.4	6.0	4.8
claims on enterprises	–0.2	–0.2	5.7	1.8	2.6	4.5	5.7	5.6	5.3
claims on the public sector (net)	2.5	2.3	0.9	2.6	–0.5	0.6	0.9	1.5	0.4
Other assets (net) of the banking system	–4.3	–4.5	–7.9	–3.3	3.0	–6.4	–7.9	–5.9	–8.1
	% of GDP, ESA 95								
General government revenues	37.2	37.6	38.5	. .	. .	. .	. .	. .	. .
General government expenditures	44.6	45.5	43.5	. .	. .	. .	. .	. .	. .
General government balance	–7.4	–7.9	–5.0	. .	. .	. .	. .	. .	. .
Primary balance	–4.8	–5.2	–2.3	. .	. .	. .	. .	. .	. .
Gross public debt	50.9	54.8	56.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–15.8	22.9	11.4	16.8	12.0	10.7	6.6	5.9	1.2
Merchandise imports	–24.4	25.0	11.4	17.5	16.0	9.5	4.0	6.2	–2.8
	% of GDP (based on EUR), period total								
Trade balance	–1.7	–2.5	–2.7	–2.1	–3.4	–2.6	–2.7	–2.4	–1.8
Services balance	1.1	0.7	1.1	1.1	1.6	1.2	0.7	1.2	1.7
Income balance (factor services balance)	–3.8	–3.6	–4.2	–3.3	–4.4	–5.0	–3.9	–4.5	–4.3
Current transfers	0.5	0.8	1.2	0.8	2.5	0.8	0.6	0.5	2.0
Current account balance	–3.9	–4.6	–4.5	–3.5	–3.6	–5.7	–5.3	–5.2	–2.4
Capital account balance	1.6	1.8	2.2	1.9	1.5	1.6	3.7	1.5	2.5
Foreign direct investment (net)	1.9	0.7	2.0	2.1	–0.1	3.9	2.0	–0.8	2.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	62.4	66.9	67.2	68.3	68.9	66.8	67.2	70.8	72.0
Gross official reserves (excluding gold)	16.9	18.7	19.4	19.8	19.5	18.8	19.4	19.2	20.9
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.1	5.1	5.0	5.3	5.2	4.9	5.0	4.9	5.3
	EUR million, period total								
GDP at current prices	311,363	354,693	369,253	88,327	93,162	90,388	97,375	87,581	91,151

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

8 Romania: Achievements in Macroeconomic Stabilization Are Increasingly Being Challenged

Recovery loses momentum

Romania's economy continued to grow in the first half of 2012. Yet, economic growth decelerated to 0.8%. Exports fell more strongly than imports in the first half of 2012. The moderate growth of domestic demand kept imports at a comparatively high level, partly compensating for the dwindling export-related import demand. In the first half of 2012, private consumption grew modestly on the back of real wage growth and improving consumer sentiment, while construction activity boosted the brisk growth of gross fixed capital formation. Also during summer private consumption apparently held up well, as retail sales were supported by a public sector wage hike taking effect in June, and continued to grow despite weakening consumer sentiment. However, following strong growth until May, construction output posted negative yearly growth rates in June and July. Moreover, a severe drought will negatively impact economic growth in the second half of 2012.

Political quarrels weigh on financial markets, precautionary support program ongoing

Political disputes hit investor sentiment during summer: The government's attempts to consolidate power drew criticism from the European Commission (EC); an impeachment procedure against president Basescu finally failed as voter turnout fell short of the 50% threshold required by Romanian law. As a consequence, pressures on the Romanian leu increased and prompted central bank interventions on the foreign exchange market according to market participants. When the central bank started to restrict leu liquidity by capping the volumes allocated at weekly repo operations, the leu stabilized. A largely positive IMF/EC/World Bank review within the framework of the precautionary support program also helped calm down the situation on the foreign exchange market. The mission concluded that policy implementation remained broadly on track. Moreover, it said that the fiscal deficit target for the year as a whole (below 3% of GDP in ESA95 terms) was achievable, but would require continued spending restraint. The Romanian authorities currently do not intend to draw on the resources available under the precautionary arrangement. In August, Romania started to repay the principal of credit received under the 2009–11 Stand-By Arrangement.

After low inflation in the first half of 2012, food prices have driven up inflation more recently

Due to the negative output gap and decelerating dynamics in administered tobacco and fuel prices, inflation (CPI) temporarily dropped below the central bank's target band of 3% +/–1 percentage point in the second quarter. However, the Banca Națională a României (BNR) has left its key policy rate unchanged since March 2012, citing upside risks related to domestic and external factors. In particular, the BNR pointed to the possible impact of political tensions and international financial market turbulences on the exchange rate as well as to the impact of unfavorable weather conditions on food prices. The latter risk started to materialize over the summer months, with inflation climbing to 3.9% in August.

Current account deficit edges down; net FDI inflows still weak

In the first half of 2012, the current account deficit declined by 23% year on year, but still stood at 3.7% of GDP in the four quarters up to mid-2012. The improvement was mainly driven by the decrease in the income deficit, as well as by the increases in the current transfers surplus and in the services surplus. The sizeable trade deficit, however, stayed broadly unchanged, as external demand and rising unit labor costs in the manufacturing sector barred a reduction. Net FDI inflows remained subdued and covered only 37% of the current account deficit inmthe four quarters up to mid-2012. Thus, net FDI coverage did not improve markedly compared with 32% at end-2011.

Table 8

Main Economic Indicators: Romania

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–6.6	–1.7	2.5	1.7	1.4	4.4	1.9	0.3	1.1
Private consumption	–10.3	–0.4	1.3	–1.3	–0.7	3.6	2.7	0.5	2.2
Public consumption	2.9	–4.1	–3.6	–6.7	–2.8	–0.7	–4.0	–1.3	–2.4
Gross fixed capital formation	–28.1	–2.1	6.2	–2.1	–1.4	11.4	10.3	12.2	15.5
Exports of goods and services	–6.2	15.1	10.5	21.8	8.2	9.2	3.8	–2.7	–0.6
Imports of goods and services	–21.4	12.7	11.5	16.9	10.6	12.8	5.7	–0.7	0.2
	Contribution to GDP growth in percentage points								
Domestic demand	–13.6	–1.6	3.2	1.6	1.7	6.6	4.2	2.1	3.8
Net exports of goods and services	7.0	0.0	–0.8	–0.5	–3.7	–3.6	–1.3	–1.1	–0.4
Exports of goods and services	–1.9	4.3	3.5	11.0	3.6	3.5	1.3	–1.6	–0.3
Imports of goods and services	8.9	–4.3	–4.3	–11.4	–7.3	–7.0	–2.5	0.6	–0.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	3.1	7.5	1.9	1.0	2.6	4.1	0.2	4.3	4.3
Unit labor costs in manufacturing (nominal, per hour)	1.5	–8.3	4.3	–5.0	7.1	5.3	11.0	12.2	9.9
Labor productivity in manufacturing (real, per hour)	13.3	15.9	2.9	10.7	1.2	2.5	–1.7	–4.4	–1.5
Labor costs in manufacturing (nominal, per hour)	14.1	6.7	7.7	5.2	8.3	7.9	9.2	7.2	8.3
Producer price index (PPI) in industry	1.9	6.3	8.9	10.7	8.7	8.7	7.6	5.7	6.1
Consumer price index (here: HICP)	5.6	6.1	5.8	7.5	8.3	4.2	3.4	2.7	2.1
EUR per 1 RON, + = RON appreciation	–13.1	0.7	–0.7	–2.6	1.1	–0.1	–1.1	–3.0	–6.6
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.2	7.6	7.7	7.8	7.5	7.5	8.0	7.9	7.2
Employment rate (%, 15–64 years)	58.6	58.8	58.5	58.0	58.8	59.1	57.9	58.0	60.0
Key interest rate per annum (%)	9.1	6.5	6.2	6.3	6.3	6.3	6.1	5.6	5.3
RON per 1 EUR	4.2	4.2	4.2	4.2	4.1	4.3	4.3	4.4	4.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	9.0	6.9	6.6	3.3	2.5	6.8	6.6	10.2	8.5
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	5.0	0.8	–1.4	–7.1	–1.8	0.7	–1.4	5.7	–1.3
Domestic credit of the banking system	12.6	13.8	11.4	12.2	3.1	12.7	11.4	13.3	15.6
of which: claims on the private sector	1.2	5.2	6.8	2.6	1.7	7.1	6.8	10.4	6.7
claims on households	0.6	1.0	1.1	–0.2	–1.2	0.9	1.1	3.3	1.7
claims on enterprises	0.6	4.2	5.7	2.8	2.9	6.1	5.7	7.1	5.0
claims on the public sector (net)	11.4	8.6	4.7	9.5	1.4	5.7	4.7	2.9	8.9
Other assets (net) of the banking system	–8.7	–7.7	–3.4	–1.8	1.3	–6.6	–3.4	–8.9	–5.8
	% of GDP, ESA 95								
General government revenues	32.1	33.3	32.3	. .	. .	. .	. .	. .	. .
General government expenditures	41.1	40.1	37.8	. .	. .	. .	. .	. .	. .
General government balance	–9.0	–6.8	–5.5	. .	. .	. .	. .	. .	. .
Primary balance	–7.5	–5.3	–4.0	. .	. .	. .	. .	. .	. .
Gross public debt	23.6	30.5	33.4	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–13.8	28.5	20.5	39.8	18.3	18.0	10.1	0.1	2.6
Merchandise imports	–31.9	20.4	21.4	30.9	21.1	21.5	14.2	1.8	0.2
	% of GDP (based on EUR), period total								
Trade balance	–5.8	–4.8	–5.5	–4.0	–8.0	–4.9	–5.2	–4.7	–7.2
Services balance	–0.2	–0.4	0.3	0.2	0.2	–0.1	0.7	–0.3	0.1
Income balance (factor services balance)	–1.6	–1.6	–1.6		–3.9	–0.9		–1.8	–2.5
Current transfers	3.5	2.8	2.4	2.3	2.7	2.0	2.7	4.6	2.7
Current account balance	–4.2	–4.0	–4.4	–2.5	–8.9	–3.9	–2.8	–2.3	–6.9
Capital account balance	0.5	0.2	0.5	1.1	0.5	0.1	0.6	1.8	1.8
Foreign direct investment (net)	3.1	1.9	1.3	0.6	1.1	1.1	2.2	0.1	1.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	68.7	74.7	72.5	75.7	76.7	74.6	72.5	73.1	73.3
Gross official reserves (excluding gold)	23.9	26.2	24.4	26.1	26.7	25.4	24.4	25.4	24.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.8	7.7	6.7	7.4	7.5	7.0	6.7	6.9	6.6
	EUR million, period total								
GDP at current prices	118,189	123,737	136,192	24,905	31,551	37,318	42,417	25,146	31,215

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

9 Croatia: From Stagnation to Recession

Fall in economic activity accelerates in the second quarter of 2012

Following stagnation in 2011, GDP contraction started in the last quarter of 2011 and intensified in the course of 2012. GDP dropped by 1.7% in the first half of 2012. The decline in economic activity was essentially caused by a slump in domestic demand. In particular, private consumption shrank by 1.9% year on year, which was, inter alia, driven by: (1) ongoing poor labor market conditions with an unemployment rate of about 15.9% in the first half of 2012, (2) private households' restructuring needs and (3) subdued credit growth. In the public sector, fiscal consolidation continued depressing public consumption. Economic conditions also stayed weak for private investments, as indicated by the persistent negative contribution to GDP growth since 2009, which amounted to –0.9% in the first half of 2012. In contrast, the contribution of net exports to GDP growth had remained positive from mid-2011, equaling 0.5% in the first half of 2012.

Despite moderate current account deficit, fragile external position with high level of gross external debt

The current account position remained broadly unchanged in the first half of 2012 compared with the same period in 2011. The trade balance worsened slightly, whereas the positive services balance and the deficit in the income balance improved somewhat. On the financing side, FDI (net) inflows remained moderate. Overall, FDI flows (net) were noticeably under the average of 5% of GDP of the precrisis period 2000 to 2007.

Gross external debt has remained slightly above 100% of GDP since 2009. About 60% of debt is owed by nonfinancial private companies, 25% by banks and 15% by the public sector. Foreign exchange reserves, which decreased by 8% between April and July 2012, came to EUR 11 billion (25% of GDP) at the end of July and covered close to three-quarters of short-term external debt. To mitigate exchange rate pressures, Hrvatska narodna banka (HNB) intervened several times in the first half of 2012. In its latest foreign exchange intervention in September, the HNB purchased foreign currency from the market (worth EUR 58 million) after having sold foreign currency (totaling EUR 1.5 billion) between November 2011 and mid-2012.

Inflation remained at an elevated level

Inflation picked up in the spring of 2012 on the back of rising prices in the agricultural and energy sectors as well as a general hike of the main VAT rate of 2 percentage points in March 2012. In August, inflation ran at an elevated 4.0% (year on year).

Government sets ambitious budget targets

In mid-2012, the government revised this year's budget, which now envisages a deficit of 3.9% of GDP (in ESA 95 terms), only slightly up from the earlier target of 3.8%. The new target seems ambitious in view of worsening GDP dynamics and an expected deficit of 4.4% for 2012 according to the October 2012 IMF projections (WEO). Fiscal consolidation was mainly concentrated on revenue-enhancing measures during the first half of 2012 (i.e. VAT increase, new property tax). According to the fiscal responsibility law, future fiscal consolidation is set to focus more on the expenditure side, as has been urged by international institutions for some time.

Table 9

Main Economic Indicators: Croatia

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–6.9	–1.4	0.0	–1.2	0.6	0.8	–0.4	–1.3	–2.2
Private consumption	–7.4	–0.9	0.2	0.0	0.6	0.1	0.2	–0.3	–3.3
Public consumption	0.4	–1.6	–0.3	–1.7	1.6	–0.3	–0.9	–1.5	–0.2
Gross fixed capital formation	–14.2	–15.0	–7.2	–6.9	–7.0	–8.6	–6.0	–2.8	–5.9
Exports of goods and services	–16.2	5.2	2.0	–3.5	4.8	6.8	–3.6	2.4	–1.8
Imports of goods and services	–21.4	–1.4	1.2	3.7	4.4	0.8	–3.6	1.1	–3.3
	Contribution to GDP growth in percentage points								
Domestic demand	–10.8	–3.8	–0.3	1.4	0.7	–2.6	–0.5	–1.1	–2.8
Net exports of goods and services	3.9	2.4	0.3	–2.5	0.0	3.2	0.1	0.3	0.7
Exports of goods and services	–6.8	1.9	0.8	–1.1	1.8	3.5	–1.3	0.7	–0.7
Imports of goods and services	10.7	0.6	–0.5	–1.5	–1.8	–0.3	1.5	–0.5	1.4
	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)	12.3	2.0	1.5	4.6	–1.1	2.9	–0.5	9.5	0.0
Labor productivity in manufacturing (real, per hour)	–3.4	–3.3	1.4	–4.9	2.8	1.5	6.0	–5.1	3.7
Gross wages in manufacturing (nominal, per hour)	8.1	–1.1	2.7	–0.6	1.6	4.5	5.4	3.9	0.0
Producer price index (PPI) in industry	–0.4	4.3	6.4	6.3	6.5	6.3	6.4	6.1	6.8
Consumer price index (here: CPI)	2.4	1.0	2.3	2.2	2.3	2.0	2.4	1.5	3.4
EUR per 1 HRK, + = HRK appreciation	–1.6	0.7	–2.0	–1.6	–1.9	–2.8	–1.7	–2.0	–1.8
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.3	12.1	13.9	14.7	13.8	12.6	14.3	16.8	14.9
Employment rate (%, 15–64 years)	56.6	54.0	52.4	52.4	52.3	53.2	51.5	49.8	51.7
Key interest rate per annum (%)	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
HRK per 1 EUR	7.3	7.3	7.4	7.4	7.4	7.5	7.5	7.6	7.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	–0.9	4.4	3.5	3.3	3.5	3.7	3.5	2.7	3.2
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	1.5	–0.4	–4.5	–0.5	–2.4	–5.2	–4.5	–4.1	1.6
Domestic credit of the banking system	–0.5	8.6	11.4	6.6	8.3	12.0	11.4	10.0	4.5
of which: claims on the private sector	–0.6	7.0	5.7	6.2	6.8	6.8	5.7	5.3	0.1
claims on households	–1.6	2.1	0.5	1.4	1.7	1.7	0.5	0.9	0.0
claims on enterprises	1.0	4.9	5.2	4.8	5.1	5.1	5.2	4.3	0.1
claims on the public sector (net)	0.1	1.6	5.7	0.4	1.5	5.2	5.7	4.8	4.5
Other assets (net) of the banking system	–1.8	–3.7	–3.4	–2.8	–2.4	–3.1	–3.4	–3.2	–2.9
	% of GDP, ESA 95								
General government revenues	36.4	35.0	34.7	. .	. .	. .	. .	. .	. .
General government expenditures	40.5	39.9	39.7	. .	. .	. .	. .	. .	. .
General government balance	–4.1	–4.9	–5.0	. .	. .	. .	. .	. .	. .
Primary balance	–2.4	–2.9	–2.8	. .	. .	. .	. .	. .	. .
Gross public debt	35.1	41.2	45.7	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–21.3	18.1	7.8	10.2	11.0	13.3	–1.9	2.3	–7.5
Merchandise imports	–26.8	–0.2	7.3	13.8	11.1	5.4	–0.1	2.1	–2.7
	% of GDP (based on EUR), period total								
Trade balance	–16.6	–13.4	–14.2	–15.0	–14.8	–13.6	–13.5	–15.6	–15.8
Services balance	13.1	13.3	14.2	1.5	14.0	34.5	4.0	2.2	14.8
Income balance (factor services balance)	–4.0	–3.5	–3.6	–4.9	–4.9	–2.8	–1.8	–5.2	–3.5
Current transfers	2.3	2.4	2.6	2.4	2.5	2.4	3.0	2.8	2.7
Current account balance	–5.1	–1.1		–15.9	–3.2	20.4	–8.2	–15.9	–1.9
Capital account balance	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	3.4	0.9	2.3	0.4	2.5	4.5	1.5	2.3	1.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	101.9	103.6	101.9	105.9	105.4	103.7	101.9	102.8	104.7
Gross official reserves (excluding gold)	23.2	23.8	24.9	25.5	25.4	25.2	24.9	25.4	26.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	7.0	7.2	7.2	7.6	7.4	7.3	7.2	7.2	7.4
	EUR million, period total								
GDP at current prices	44,784	44,867	44,888	10,243	11,306	12,181	11,159	10,020	11,078

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

10 Turkey: Economic Moderation Continues as External Imbalances Remain in Place

Contribution of domestic demand turns negative

Domestic demand contracted in the first half of 2012 due to strongly declining investments as well as stagnating private consumption. Likewise, credit growth receded further and reached roughly 23% in year-on-year terms at the end of July at an annualized rate (in contrast to the peak of almost 43% at the end of August 2011). Capacity utilization, despite having recovered moderately to 75% in April, also shows a negative trend. The slight rise in the employment rate to almost 50% in the second quarter of 2012 helped bring the unemployment rate down again after a temporary rise in the first quarter.

Expansion of exports to the Middle East reverses growth drivers

Real export growth abided at double-digit rates in the first half of 2012. Falling external demand from the euro area was more than offset by a shift toward serving markets in the Middle East. In combination with falling imports, the trade and current account deficit narrowed. In the second quarter of 2012, the current account deficit amounted to 8.3% of GDP (four-quarter moving sum). The reduction in external imbalances is, however, likely to be of a temporary nature, as export growth was strongly driven by gold exports to Iran in the summer and is thus unlikely to persist. Short-term capital inflows continue to be the main source of financing of the current account deficit; the annualized coverage of FDI remained mostly below 20% up to July. Thus, both the size and financing of the current account remained fairly unfavorable.

Inflation remains above target

In addition to the persistent current account deficit, inflation remained elevated at 8.9% in August. Food, energy and tobacco contributed most to inflation, while core inflation continued to trend downward. Expiring base effects from earlier tax adjustments in administered prices (tobacco and energy items) and from hikes in unprocessed food prices in the closing quarter of 2011 should bring inflation down somewhat in the second half of 2012. Nevertheless, the central bank's end-year inflation target of 5.5% will most likely be missed. The end-year inflation forecast of the Central Bank of the Republic of Turkey (CBRT) stood at 6.2% in early October.

The Turkish central bank continued to manage liquidity through adjustments of the interest rate corridor. In its latest MPC decision on September 18, the CBRT narrowed the corridor by lowering the overnight lending rate by 150 basis points to 10%. The unorthodox monetary policy mix helped reverse the appreciation of the Turkish lira which had taken place at the beginning of the year. As from April 2012, the lira remained relatively stable and was valued 2.3 against the euro at end-September (TYR/USD: 1.8).

Fiscal position deteriorates

The first months of 2012 still brought strong revenue growth, which alleviated some of the pressure of rising expenditure on the fiscal position. The primary surplus nevertheless deteriorated in the first half of 2012. Since May 2012, revenue growth slowed down considerably as a result of faltering domestic demand, while public expenditure growth remained strong, pushing the central budget deficit on a 12-month rolling basis to 2% of GDP at the end of August and thus below the end-year fiscal target of –1.5% of GDP. The authorities target the public debt stock (as defined by ESA 95) to decrease relative to GDP from 37% in 2012 to 35% in 2013 and 32% in 2014.

Table 10

Main Economic Indicators: Turkey

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–4.8	9.2	8.5	12.1	9.1	8.4	5.0	3.3	2.9
Private consumption	–2.3	6.7	7.8	12.1	8.3	7.8	3.4	0.2	–0.5
Public consumption	7.8	2.0	4.5	7.0	9.0	10.3	–4.3	5.5	4.4
Gross fixed capital formation	–19.0	30.5	18.5	35.7	29.0	15.0	1.3	1.5	–7.4
Exports of goods and services	–5.0	3.4	6.4	8.7	0.5	10.2	6.6	11.9	19.8
Imports of goods and services	–14.3	20.7	10.9	28.0	18.9	6.8	–5.1	–6.0	–3.6
	Contribution to GDP growth in percentage points								
Domestic demand	–7.7	13.8	9.5	17.1	13.9	7.2	1.6	–2.1	–2.8
Net exports of goods and services	2.5	–4.0	–1.4	–5.1	–4.6	0.5	2.8	4.1	5.1
Exports of goods and services	–1.1	0.8	1.4	1.8	0.1	2.1	1.4	2.4	4.1
Imports of goods and services	3.6	–4.8	–2.8	–6.9	–4.8	–1.7	1.4	1.7	1.0
	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)	11.0	1.3	6.9	1.8	7.5	8.2	10.3	17.7	11.8
Labor productivity in manufacturing (real, per hour)	–0.3	9.9	2.8	7.3	1.8	2.7	–0.1	–4.7	1.0
Gross wages in manufacturing (nominal, per hour)	10.0	11.8	10.0	9.2	9.5	11.2	10.2	12.2	12.9
Producer price index (PPI) in industry	1.0	6.2	12.3	10.1	10.0	13.8	15.3	9.9	8.0
Consumer price index (here: HICP)	6.3	8.6	6.5	4.3	5.9	6.4	9.2	10.5	9.6
EUR per 1 TRY, + = TRY appreciation	–11.8	8.3	–14.5	–3.3	–13.2	–20.2	–19.7	–8.4	–2.7
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	12.9	10.9	9.0	10.6	8.7	8.4	8.3	9.6	7.5
Employment rate (%, 15–64 years)	44.2	46.3	48.4	46.1	49.2	49.9	48.4	46.3	49.9
Key interest rate per annum (%)[1]	9.2	6.8	6.1	6.3	6.3	5.9	5.8	5.8	5.8
TRY per 1 EUR	2.2	2.0	2.3	2.2	2.3	2.5	2.5	2.4	2.3
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	13.0	18.6	15.2	20.4	20.7	22.1	15.2	10.3	9.3
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–1.2	–7.5	0.6	–3.1	–1.6	–1.1	0.6	–2.7	–3.2
Domestic credit of the banking system	21.5	30.2	19.0	26.6	26.2	26.5	19.0	18.9	17.5
of which: claims on the private sector	9.9	27.9	25.0	29.0	30.3	31.8	25.0	21.6	18.0
claims on households	2.7	8.4	8.4	9.3	10.5	10.2	8.4	7.1	5.5
claims on enterprises	7.1	19.5	16.6	19.7	19.8	21.5	16.6	14.5	12.5
claims on the public sector (net)	11.6	2.4	–6.0	–2.4	–4.1	–5.3	–6.0	–2.7	–0.5
Other assets (net) of the banking system	–7.2	–4.2	–4.4	–3.1	–3.8	–3.2	–4.4	–5.9	–5.1
	% of GDP, ESA 95								
General government revenues	33.5	36.7	46.4	. .	. .	. .	. .	. .	. .
General government expenditures	40.4	39.4	47.8	. .	. .	. .	. .	. .	. .
General government balance	–6.9	–2.6	–1.4	. .	. .	. .	. .	. .	. .
Primary balance	–1.8	1.6	2.6	. .	. .	. .	. .	. .	. .
Gross public debt	45.5	39.4	37.9	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–17.7	16.1	12.9	20.4	3.3	17.4	12.3	17.7	30.4
Merchandise imports	–26.7	39.4	24.6	47.8	27.5	21.3	9.2	5.0	8.3
	% of GDP (based on EUR), period total								
Trade balance	–4.0	–7.7	–11.5	–11.2	–12.8	–11.5	–10.4	–9.1	–9.3
Services balance	2.7	2.1	2.3	0.8	2.0	4.4	2.0	1.0	2.5
Income balance (factor services balance)	–1.3	–1.0	–1.0	–1.5	–0.8	–0.9	–0.8	–1.1	–0.9
Current transfers	0.4	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2
Current account balance	–2.3	–6.4	–10.0	–11.7	–11.5	–7.9	–8.9	–8.9	–7.5
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	1.1	1.0	1.8	1.8	1.1	2.1	2.0	1.2	1.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	42.5	39.7	42.7	37.3	37.9	41.1	42.7	42.6	45.0
Gross official reserves (excluding gold)	11.1	11.0	10.9	10.7	11.3	11.4	10.9	10.7	11.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.4	4.9	4.0	4.5	4.6	4.4	4.0	3.9	4.2
	EUR million, period total								
GDP at current prices	440,371	551,485	555,453	134,035	140,590	143,029	137,799	139,268	150,906

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 Continues – But Pressures Increase

Russian growth forged ahead, supported by strong domestic demand and high oil prices

Russian GDP growth forged ahead in the first quarter of 2012 and slowed only slightly in the second quarter, producing an economic expansion of 4.5% for the first six months of the year. The strongest contributions to growth came from household consumption (backed by strong public sector wage increases prior to the presidential election of March 2012, swift retail credit growth and rapidly receding inflation) and gross fixed investment (taking over from inventory restocking, which apparently made a pause). Thus, buoyant domestic demand once again caused export growth to be outpaced by import growth. In the first eight months of the year, the Russian economy benefited from average oil prices that were slightly higher (+1.7%) than in the corresponding period of the previous year. However, weakening export demand, rising capacity utilization and swelling inflation put pressure on economic expansion in recent months.

From a post-Soviet low, inflation moved back up in the summer

CPI inflation fell to a post-Soviet low of 3.6% in April and May 2012, before moving back up to 6.6% in September. The record low was due to a combination of factors: the moderation of food price rises carried over from the bountiful harvest of 2011, the deceleration of money supply growth due to increased capital outflows and federal budget surpluses, and the election-related six-month delay of the annual adjustment of municipal tariffs that usually takes place in January. The sharp uptick of inflation from June is traceable to (1) the implementation of the tariff hike in mid-year, (2) the depreciation of the ruble in May and June 2012 (from end-April to end-June the ruble nominally lost about 12% against the U.S. dollar and 6% against the euro), and (3) a lower base of comparison for food prices in the summer months topped by a poorer harvest in 2012. High credit growth may also have contributed to inflationary pressure by fueling consumption and investment.

Owing to upward pressures on inflation, the CBR raised its key interest rates slightly

Given prospects for inflation to rise further in the coming months and thus possibly to exceed the Bank of Russia's annual inflation objective of 5%–6%, the CBR raised its key interest rates by 0.25% to 8.25% in mid-September. The CBR had abstained from heavy intervention during the downward pressures on the Russian currency in April and May, and it even widened the ruble's fluctuation corridor slightly in mid-July to provide greater exchange rate flexibility. Both policy measures were in line with its intended piecemeal move to inflation targeting.

Russia is experiencing a credit boom and continues to boast twin surpluses

As at end-June 2012, credit to the private sector had grown 21% year on year in real terms (exchange rate-adjusted). Bank deposits had increased by 11%. The high oil price and robust economic growth kept the federal budget in surplus of 1.4% of GDP in January–August 2012. The draft federal budget for 2013 and the planned 2014–15 period, submitted to the State Duma in early October, provides for deficits of 0.8% of GDP in 2013, 0.2% in 2014 and for balanced books in 2015. Due to the further slight improvement of the terms of trade and to the depreciation of the ruble in the second quarter, Russia's current account surplus rose to 6.6% of GDP in the first half year.

However, capital outflows are unrelenting

Private capital outflows are estimated to have reached EUR 41.9 billion in January–September 2012. This high outflow – including outward FDIs – appears to be partly linked to Russia's massive earnings on energy exports. The country seems unable to offer adequate investment opportunities for all its inflows of money. At 31.9% of rolling four-quarter GDP in mid-2012, Russia's gross external debt remains at a quite manageable level, and at 28.4% of GDP in mid-2012, the CBR's gross reserves (excl. gold) continue to cover most of the country's gross foreign debt.

Table 11

Main Economic Indicators: Russia

	2009	2010	2011	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
	Year-on-year change of the period total in %								
GDP at constant prices	–7.8	4.3	4.3	4.0	3.4	5.0	4.8	4.9	4.0
Private consumption	–5.1	5.1	6.7	6.0	6.0	7.1	7.6	7.1	6.5
Public consumption	–0.6	–1.4	1.5	1.7	1.5	1.5	1.4	–0.5	0.0
Gross fixed capital formation	–14.4	5.8	8.0	–0.6	4.9	7.9	13.2	15.0	7.9
Exports of goods and services	–4.7	7.0	0.4	–0.4	2.0	–1.5	1.4	4.4	–1.4
Imports of goods and services	–30.4	25.8	20.3	28.7	23.7	17.9	14.9	10.2	2.9
	Contribution to GDP growth in percentage points								
Domestic demand	–13.1	7.0	7.9	7.9	7.1	9.1	7.3	5.2	4.8
Net exports of goods and services	5.2	–2.0	–3.9	–4.8	–3.8	–4.4	–2.9	–0.5	–1.1
Exports of goods and services	–1.5	2.3	0.1	–0.1	0.7	–0.5	0.5	1.5	–0.5
Imports of goods and services	6.7	–4.3	–4.1	–4.7	–4.5	–3.9	–3.3	–2.1	–0.7
	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)	4.8	2.2	9.3	9.0	10.2	8.6	9.4	9.2	8.8
Labor productivity in industry (real, per person)	0.3	11.8	4.1	4.9	4.1	4.7	3.0	5.5	3.7
Average gross earnings in industry (nominal, per person)	4.8	14.7	13.8	14.4	14.7	13.7	12.7	15.2	12.9
Producer price index (PPI) in industry	–6.6	12.3	19.0	21.4	19.3	18.6	16.6	10.8	7.0
Consumer price index (here: CPI)	11.8	6.9	8.6	9.6	9.6	8.2	6.8	3.9	3.9
EUR per 1 RUB, + = RUB appreciation	–17.5	9.6	–1.5	3.3	–4.4	–3.9	–0.8	1.2	1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	8.4	7.5	6.6	7.5	6.6	6.2	6.3	6.5	5.5
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	11.4	8.0	8.1	7.8	8.2	8.3	8.2	8.0	8.0
RUB per 1 EUR	44.1	40.3	40.9	40.0	40.3	41.2	42.1	39.5	39.8
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	17.3	24.6	21.1	22.4	19.0	20.5	21.1	20.2	20.3
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	10.7	5.8	9.9	6.3	3.8	11.2	9.9	6.7	10.5
Domestic credit of the banking system	19.4	22.1	20.0	18.4	15.3	17.0	20.0	21.2	22.7
of which: claims on the private sector	2.9	12.4	24.5	15.2	16.5	23.7	24.5	24.8	26.9
claims on households	–2.8	3.1	6.4	3.5	4.5	5.8	6.4	7.8	8.8
claims on enterprises	5.6	9.3	18.1	11.6	12.1	17.9	18.1	17.0	18.0
claims on the public sector (net)	16.5	9.7	–4.6	3.2	–1.3	–6.6	–4.6	–3.6	–4.2
Other assets (net) of the banking system	–12.8	–3.3	–8.7	–2.2	–0.1	–7.8	–8.7	–7.8	–12.8
	% of GDP, ESA 95								
General government revenues	35.0	34.8	38.2	. .	. .	. .	. .	. .	. .
General government expenditures	41.4	38.3	36.6	. .	. .	. .	. .	. .	. .
General government balance	–6.3	–3.5	1.6	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	8.3	8.6	9.2	. .	. .	. .	. .	. .	. .
	Year-on-year change of the period total (based on EUR) in %								
Merchandise exports	–32.4	39.8	24.2	24.1	20.9	22.0	29.2	21.4	10.8
Merchandise imports	–31.3	37.4	23.7	44.0	26.0	13.8	19.3	16.4	10.8
	% of GDP (based on EUR), period total								
Trade balance	9.0	10.2	10.7	12.1	10.9	9.1	10.9	13.2	10.7
Services balance	–1.6	–2.0	–1.9	–1.6	–1.8	–2.3	–2.0	–1.6	–1.8
Income balance (factor services balance)	–3.3	–3.3	–3.2	–2.5	–4.5	–2.9	–3.1	–2.4	–4.2
Current transfers	–0.2	–0.2	–0.2	–0.2	0.1	–0.3	–0.2	–0.2	–0.1
Current account balance	3.9	4.7	5.4	7.8	4.7	3.6	5.7	9.0	4.5
Capital account balance	–0.9	0.0	0.0	0.0	0.0	0.0	0.0	–1.1	0.0
Foreign direct investment (net)	–0.6	–0.6	–0.8	–0.2	–1.5	0.2	–1.7	0.3	–2.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	36.9	32.6	31.6	30.4	30.4	30.6	31.6	30.6	31.9
Gross official reserves (excluding gold)	32.9	29.6	26.3	27.7	27.3	27.4	28.7	27.6	28.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	19.2	16.3	14.2	15.1	14.6	14.8	15.4	14.8	15.3
	EUR million, period total								
GDP at current prices	879,525	1,121,860	1,333,135	291,975	323,641	350,066	367,453	341,122	365,667

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