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As East You Go, the More They Grow: Transition Economies in a New Setting

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special issue on the transition economies

Vladimir Gligorov, Josef Pöschl, Sándor Richter et al.

As East You Go, the More They Grow: Transition Economies in a New Setting

*Vladimir Gligorov,
Josef Pöschl,
Sándor Richter et al.*

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Table 1

Overview developments 2002-2003 and outlook 2004-2005

	GDP				Consumer prices				Unemployment, based on LFS ¹⁾				Current account			
	real change in % against previous year				change in % against previous year				rate in %, annual average				in % of GDP			
	2002	2003	2004 forecast	2005 forecast	2002	2003	2004 forecast	2005 forecast	2002	2003	2004 forecast	2005 forecast	2002	2003	2004 forecast	2005 forecast
Czech Republic	1.5	3.1	3.3	3.6	1.8	0.1	3.2	2	7.3	7.8	9	9	-5.6	-6.2	-6.6	-6.5
Hungary	3.5	2.9	4	4.3	5.3	4.7	6.5	4.8	5.8	5.9	5.9	5.9	-7.1	-8.9	-8.0	-7.1
Poland	1.4	3.8	5	4.5	1.9	0.8	3	3	19.9	19.6	20	19	-2.7	-2.0	-1.6	-2.1
Slovak Republic	4.4	4.2	4.5	5	3.3	8.5	8	5	18.5	17.4	17	16	-8.0	-0.9	-0.9	-1.4
Slovenia	3.4	2.3	3.4	3.5	7.5	5.6	4	3.5	6.4	6.7	6.5	6.2	1.4	0.1	-0.4	-0.6
NMS-5	2.1	3.5	4.4	4.3	.	.	.	.	15.3	15.1	15.6	15.0	-4.1	-3.9	-3.8	-3.8
Estonia	7.2	5.1	5.5	5.7	3.6	1.3	2.9	3.1	10.3	10.0	9.8	9.5	-11.3	-12.6	-10.5	-9.0
Latvia	6.4	7.5	7.5	7.0	1.9	2.9	4.5	3.8	12.0	10.6	10.3	10	-7.0	-8.6	-9.3	-8.8
Lithuania	6.8	9.0	10	8.5	0.3	-1.2	0.3	1.5	13.8	12.4	11.5	10	-5.2	-6.6	-7.3	-7.5
NMS-8	2.5	3.8	4.7	4.5	.	.	.	.	15.0	14.7	15.0	14.4	-4.4	-4.3	-4.2	-4.3
EU-15 ²⁾	1.1	0.8	2	2.4	2.1	2.0	1.8	1.7	7.7	8.0	8.1	7.9	0.6	0.6	0.6	0.5
Croatia	5.2	4.3	3.2	3.5	1.7	1.8	2	1.5	14.8	14.3	14	13.5	-8.5	-7.2	-5.7	-5.1
Bulgaria	4.9	4.3	4.5	4	5.8	2.3	7	4	17.8	13.7	13	12.5	-5.6	-8.5	-7.7	-7.6
Romania	5.0	4.9	5	4.5	22.5	15.3	11	8	8.4	7.0	8	7	-3.4	-5.8	-6.4	-6.0
Albania ³⁾	4.7	6.0	6	6	1.7	3.3	3.5	3.5	15.8	15.2	14.5	14	-8.7	-6.7	-6.8	-6.9
Bosnia and Herzegovina ⁴⁾⁵⁾	5.5	3.5	5	5	0.4	0.6	0.6	0.5	40.9	42.0	42	41	-30.9	-29.6	-28.6	-28.3
Macedonia ⁴⁾	0.9	3.1	3	4	1.4	2.4	3	2	31.9	36.7	36	35	-9.6	-6.0	-5.8	-5.6
Serbia and Montenegro ⁶⁾	3.8	2.0	3	4	16.5	9.4	10	10	13.8	14.0	15	15	-11.0	-10.7	-14.3	-13.7
Belarus ⁵⁾	5.0	6.8	8	7	43.0	28.0	20	16	3.0	3.1	2.5	2.5	-2.3	-2.9	-3.0	-2.5
Russia	4.7	7.3	6.3	5.5	16.0	13.6	10	9	8.0	8.3	8.7	9	8.4	8.3	6.8	5.1
Ukraine	5.2	9.4	9.5	7	0.8	5.2	7	8	10.1	9.1	9	8.5	7.5	5.8	5.8	4.3
China	8.0	9.1	8.5	8	-0.8	1.2	3.5	3	4.0	4.5	4.5	4.5	2.9	3.3	2.1	1.6

Notes: NMS-5: the New EU Member States Czech Republic, Poland, Slovak Republic, Slovenia and Hungary. NMS-8: NMS-5 plus the three Baltic States Estonia, Latvia and Lithuania.

1) LFS (Labour Force Survey), refers to ILO definition. - 2) Current account refers to extra EU-15 flows, adjusted. - 3) Unemployment rate by registration, end of period. - 4) Consumer price inflation measured by retail prices. - 5) Unemployment rate by registration, average. - 6) Excluding Kosovo and Metohia.

Source: wiiw (June 2004); European Commission (EC), Economic Forecasts, Spring 2004.

Executive summary

This wiiw report reviews the economic situation in the new EU member states, in the countries of Southeast Europe, in Belarus, Russia and Ukraine as well as in China. For each country, it provides a forecast relating to GDP growth, inflation, unemployment and current accounts in 2004 and 2005. The report is supplemented by an analysis of the challenges posed by European integration.

The signs of a robust economic upswing in most countries of Central and Eastern Europe are overwhelming. Industrial output, construction, foreign trade and quarterly GDP figures confirm this development. The economic recovery in the 'old EU' (EU-15) has bolstered improvements in the business climate of Central and Eastern Europe. Moreover, in most of the countries in the region, economic growth has outstripped that in the EU-15; it is thus more in line with the comparatively positive growth figures recorded by the global economy as a whole. Central and Eastern Europe, together with Russia, Ukraine and China (the latter country has been included for the first time in our report), create every impression of having integrated fully into the global economy and added to its dynamics. That notwithstanding, if we disregard China, the other countries' contribution to global value-added is minimal.

The major new feature is that (in addition to Cyprus and Malta) eight countries in Central and Eastern Europe joined the European Union on 1 May 2004: the so-called New Member States (NMS-8) – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. A challenge to the enlarged Union's (EU-25) decision-making ability looms large. In the next two years the EU-25 will have to agree on a common financial perspective for the period 2007-2013. Enlargement has substantially widened income disparities within the EU; advancing towards cohesion has thus become a much more arduous undertaking.

Enlargement of the euro zone poses another challenge. Of the NMS-8, only Estonia and Lithuania currently meet all the Maastricht convergence criteria. A brief study of foreign trade data reveals that in the Baltic States, foreign trade deficits are very high: for goods even more so than for services. The NMS in Central Europe have a much better track record in this respect – or at least, they have re-established their good record by recently introducing a series of currency depreciations.

In many respects, the South-East European countries awaiting EU membership are heterogeneous. Three of them, Bulgaria, Croatia and Romania, have acquired candidate status; their economies are characterized by relatively high growth. Economic recovery is also visible in West Balkan countries, in spite of political and structural problems.

High growth in many of the low-income transition countries should not divert attention away from the shortcomings that still persist to a varying degree. Financial relations between the different types of economic agents are still unsound; the business infrastructure is not fully developed in terms of legislation, public administration and the judiciary system; high unemployment and the lack of social security are a seedbed for poverty, widespread petty crime and political instability. Finally, despite high GDP growth, structural distortions still characterize both Russia and Ukraine, whose economies continue to rely heavily on exports of crude oil as well as raw materials and semi-finished goods.

Keywords: Central and East European transition countries, Baltic states, Southeast Europe, Balkans, former Soviet Union, China, EU enlargement, industry, productivity, foreign trade, exchange rates, inflation, fiscal deficits, trade, ERM II, Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Estonia, China, Croatia, Czech Republic, Hungary, Macedonia, Latvia, Lithuania, Poland, Romania, Russia, Slovakia, Slovenia, Serbia and Montenegro, Ukraine

JEL classification: O52, O57, P24, P27, P33, P52

Table 2

Central and Eastern Europe's new EU member states (NMS-8): an overview of economic fundamentals, 2003

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovak Republic	Slovenia	NMS-8 ¹⁾	EU-15	EU-25 ²⁾
GDP in EUR at exchange rates, EUR billion	79.52	8.04	73.27	9.80	16.14	185.25	28.82	24.50	425.36	9294.93	9735.75
GDP in EUR at PPP, EUR billion	157.20	14.70	138.52	23.18	36.63	396.29	63.10	34.95	864.55	9294.93	10179.15
GDP in EUR at PPP, EU-25=100	1.5	0.1	1.4	0.2	0.4	3.9	0.6	0.3	8.5	91.3	100.0
GDP in EUR at PPP, per capita	15400	10860	13680	9970	10600	10370	11730	17500	11835	24302	22292
GDP in EUR at PPP per capita, EU-25=100	69	49	61	45	48	47	53	79	53	109	100
GDP at constant prices, 1990=100	108.6	109.2	119.3	79.6	88.1	134.6 ³⁾	116.8	130.2	129.7	128.1	128.2
GDP at constant prices, 2000=100	107.4	120.0	110.5	123.5	123.7	106.3	112.9	108.6	109.0	103.7	103.9
Industrial production real, 1990=100	99.6	84.5	171.4	57.9	53.5	139.8 ³⁾	111.6	95.8	140.2	117.8	118.8
Industrial production real, 2000=100	118.1	129.4	113.3	123.0	138.9	107.8	119.9	106.8	113.3	99.5	100.1
Employed persons - LFS, thousands, average	4733.2	594.3	3921.9	1006.9	1438.0	13616.8	2164.6	897.0	28372.6	170962.0	199772.0
Public sector expenditures, EU-def., in % of GDP	57.9	38.6	50.4	43.3	35.6	45.1	52.7	45.8	48.4	48.4	48.3
Public sector revenues, EU-def., in % of GDP	45.0	41.2	44.5	41.5	33.9	41.0	49.1	44.0	42.8	45.8	45.6
Price level, EU-15=100 (PPP/exchange rate)	51	55	53	42	44	47	46	70	49	100	96
Compensation per employee, ⁴⁾ monthly, in EUR	702	580	869	367	463	738	525	1428	724	2818	2543
Compensation per employee, monthly, EU-25=100	27.6	22.8	34.2	14.4	18.2	29.0	20.6	56.2	28.5	110.8	100.0
Exports of goods in % of GDP	54.2	50.4	52.1	28.6	41.9	29.1	67.2	46.6	42.2 ⁵⁾	27.2 ⁵⁾	27.9 ⁵⁾
Imports of goods in % of GDP	56.9	67.7	56.1	46.6	50.7	31.8	69.1	48.9	45.9 ⁵⁾	25.9 ⁵⁾	26.8 ⁵⁾
Exports of services in % of GDP	8.7	24.5	9.6	13.8	9.9	5.3	10.1	10.1	8.0 ⁵⁾	8.0 ⁵⁾	8.0 ⁵⁾
Imports of services in % of GDP	8.1	15.2	9.8	8.5	6.6	5.1	9.4	7.9	7.2 ⁵⁾	7.7 ⁵⁾	7.7 ⁵⁾
Inflow of incomes in % of GDP	2.9	2.7	1.6	3.3	1.2	1.0	2.8	2.1	1.8 ⁵⁾	6.8 ⁵⁾	6.6 ⁵⁾
Outflow of incomes in % of GDP	7.5	8.7	7.0	3.8	3.9	2.5	3.2	2.4	4.5 ⁵⁾	7.2 ⁵⁾	7.1 ⁵⁾
Current account in % of GDP	-6.2	-12.6	-8.9	-8.6	-6.6	-2.0	-0.9	0.1	-4.3 ⁵⁾	0.6	.
FDI stock per capita in EUR	3685	3795	3747	1149	1152	1257	1673	2002	2031	.	.

PPP: Purchasing power parity.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. EU-15: EU up to 30 April 2004. EU-25: EU as of 1 May 2004.

Notes: 1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) Gross wages plus indirect labour costs, whole economy, national account concept. - 5) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part A: The new EU member states

Josef Pöschl

The economy in the new member states: in the mood for growth¹

What is new in the new member states?

Following on the recent seamless introduction of the euro, the EU has once again provided ample proof of its administrative capabilities in managing the accession of ten new member states. This is all the more remarkable if we recall that the EU authorities in Brussels, Europe's quasi-government, are 'strange animals' in the sense that in GDP percentage terms they dispose of fewer budgetary resources than any other central government in the world (some EUR 100 billion or about 1% of the EU-15 GDP). Thanks to their good management of the enlargement process, the historical date, 1 May 2004, gave rise to no disruptions. In fact, 1 May 2004 merely marked the beginning of a long post-accession process of integration for the new member states (NMS).

The recent EU parliamentary elections made it painfully obvious that the EU authorities (akin to politicians in individual member states) lack the capacity to engender trust in their institutions. The turnout at the polls in the NMS was even lower than in the old member states – markedly so in Slovakia where less than 20% of the electorate actually voted. The number of EU-sceptics among the voters was also high in a number of countries; cf. the Czech Republic and Poland. The extremely low turnout in the NMS was not only a disappointment, but also a warning for the future. Moreover, the results of the EU parliamentary elections had serious implications for several NMS governments, in particular in the Czech Republic where the government stepped down.

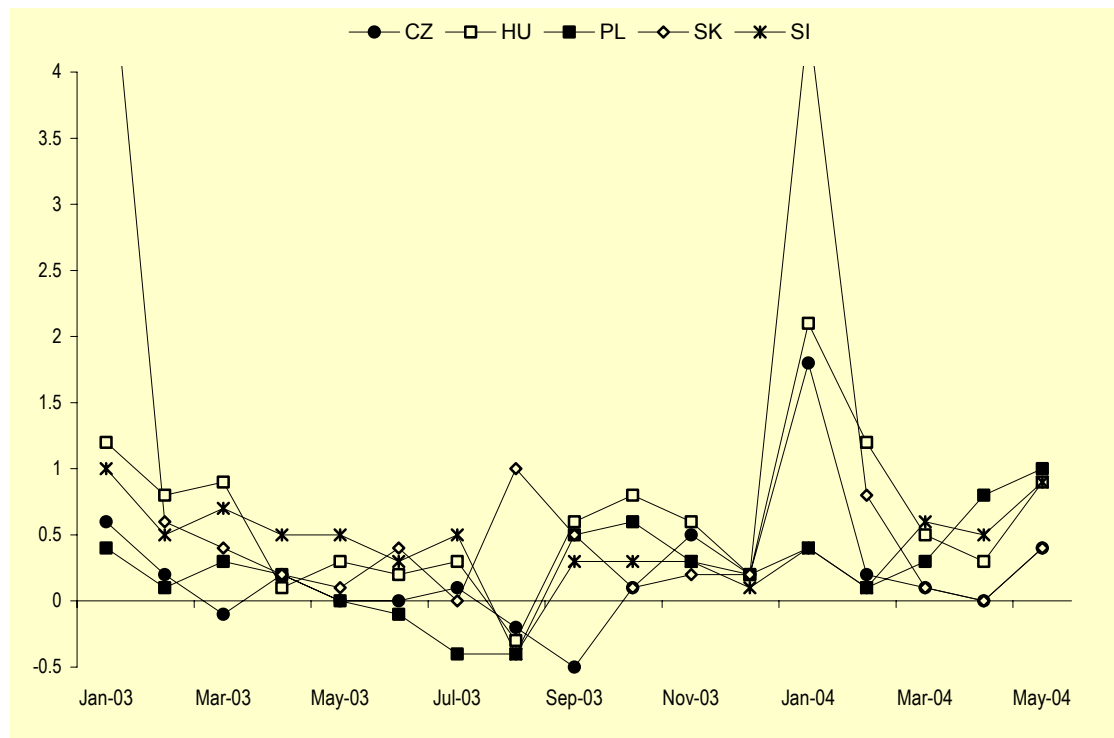
May 2004: no accession-induced price shock

A common fear in some of the NMS had been that EU accession would lead to an immediate leap in consumer prices. For example, in some countries in April it became a popular pastime to hoard stocks of sugar. Statistics show that in May 2004 all the NMS in Central and Eastern Europe recorded a higher month-on-month increase in the consumer price index than in previous months. That increase, however, was at most about 1%, far less than the increases that several countries had recorded in January 2004 when regulated prices rose and tax rates changed prior to EU accession. As Figure 1 shows, up to mid-2003 inflation tended to recede to very low or even negative rates. Since then, the trend has changed mainly on account of increases in world market prices for fuels as well as some raw materials and semi-finished goods: a development that also has an impact on the countries' producer price indices. Furthermore, some countries were obliged to modify indirect taxation to comply with EU rules and regulations; they did so on 1 May 2004 and the inflationary impact of the new measures proved minor.

¹ This overview concentrates on tendencies that have recently emerged in the new EU member states: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia (NMS-8). Its aim is to interpret the outlook as summarized in the Table 1, using the latest information on those countries for guidance. The wiiw Monthly Database served as a most important source of information. The database is a unique analytical tool that validated users can access via the Internet. Comparative tables contain 2003 data relating to economic fundamentals (such as Table 2 for the new EU member states). For analysts interested in developments in the more remote past, the wiiw Statistical Yearbook and earlier wiiw Research Reports, available both as hard copy and in electronic form, constitute ideal tools.

Figure 1: NMS: Change in consumer prices, 2003-2004

in %, month-on-month



Source: wiw Monthly Database incorporating national statistics.

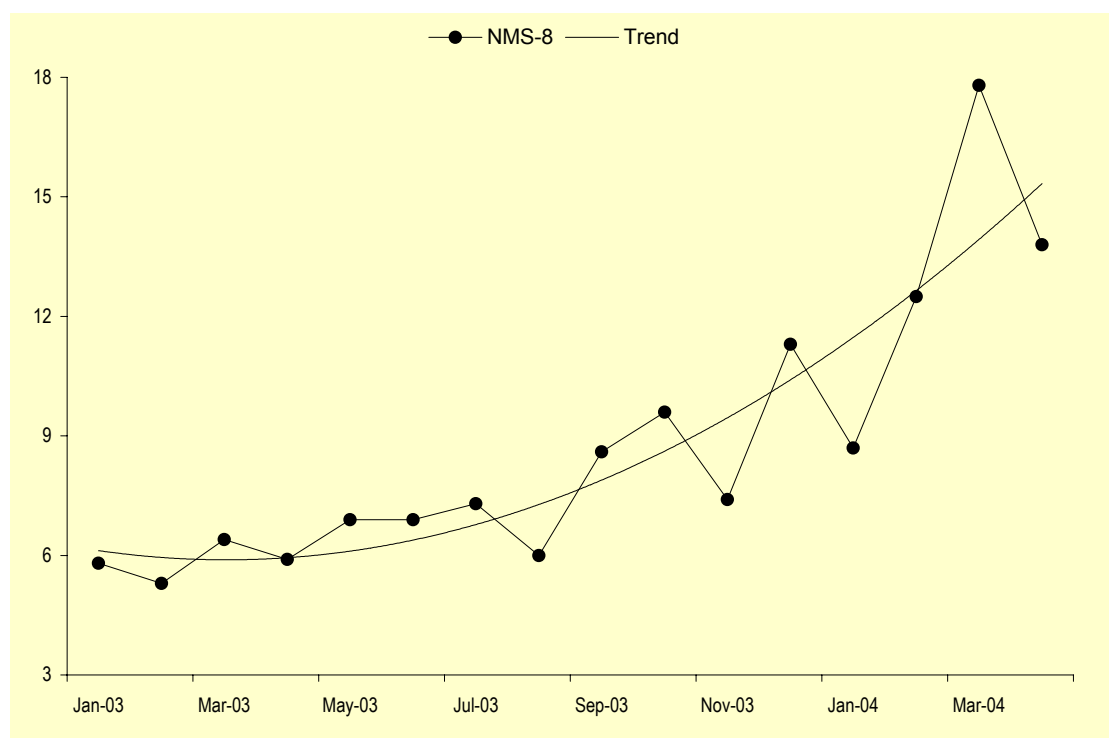
All in all, accession-induced changes in the consumer price index as a whole were few and far between. Price increases in some fields were largely offset by price decreases in others. EU enlargement can be seen to have intensified trade between the old and new member countries, as well as between the NMS themselves – at least in some business branches, such as food, where price differences between EU countries are considerable.

Clear signs of enhanced economic dynamics

Several indicators point to an improvement in the business climate throughout the NMS as a whole: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia (NMS-8). First and foremost, industrial output growth had already started to strengthen in the final quarter of 2003; the data for the first months of 2004 confirm that trend (see Figure 2). The growth in industrial output was especially remarkable in Poland, which is by far the largest economy in the region (see Table 2). Industrial output increased by 12% in the last quarter of 2003 and by 19% in the first quarter of 2004. Only two years earlier, in the first half of 2002, Poland's industrial output had been mired in stagnation. The same holds true for Hungary; in the period October 2003-March 2004 industrial output grew some 10%. A marked improvement is also to be seen in Slovenia where in the first three quarters of 2003 output had shown a tendency to stagnate.

Figure 2: NMS: Gross industrial production, 2003-2004

weighted average, year-on-year, growth in %



Source: wiiw Monthly Database incorporating national statistics.

In the Baltic States and Slovakia industrial output adopted a different growth pattern. There was no upward trend; the growth rates had been relatively high throughout 2003 and remained so in the first months of 2004: around 10% in Estonia, somewhat less in Latvia and Slovakia, and somewhat more, albeit with major fluctuations, in Lithuania.

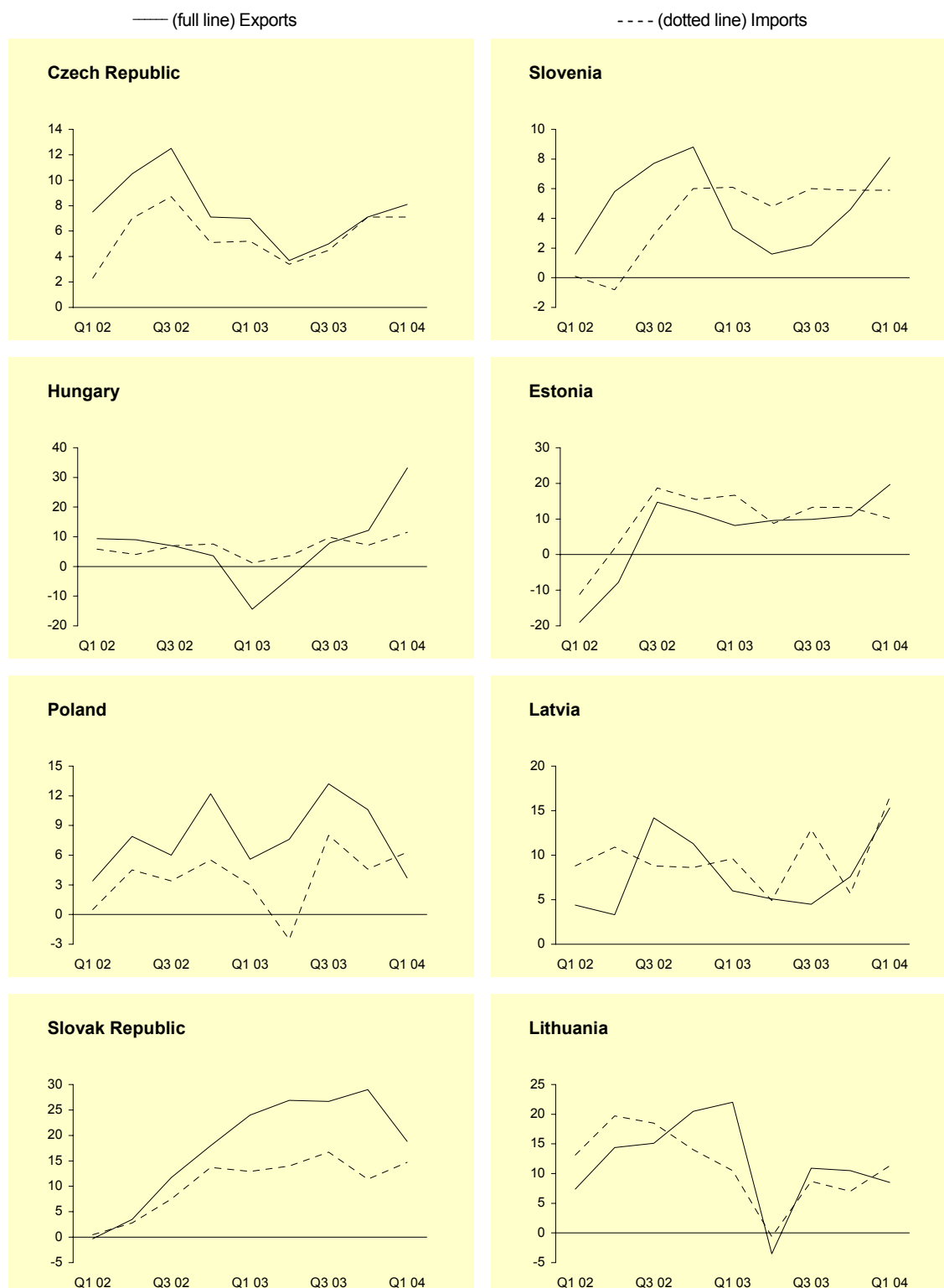
Developments in the construction sector offer a further indication of an improved business climate (see Tables attached to the individual country reports). In the Czech Republic and Hungary, in the first quarter of 2004 the output rose some 16-20% compared to the same quarter in 2003. In Poland, the decline in output dropped from 20% (first quarter 2003) to a mere 5% in the first quarter of 2004.

Exports (see Figure 3), calculated in euros, provide further confirmation of improvements in the business climate. Compared to previous quarters, export growth rates increased in the fourth quarter of 2003 and remained strong (sometimes even climbing higher) in the first quarter of 2004. In all new member states except Slovakia, export growth was at its lowest ebb in either the first or second quarter of 2003. That, however, proved to be a crucial turning point, whereafter a positive trend set in. In Slovakia exports boomed, increasing by as much as 29%. In both Estonia and Latvia rates were high: over 10%.

Imports closely shadowed the ups and downs of export growth. In the Czech Republic, Poland, Slovakia and Lithuania, export growth outstripped import growth for most of the time. Hungary, Estonia and Latvia were less successful in this respect. In Slovenia, the picture was mixed, further to which the gap between export and import growth rates is small.

Figure 3: NMS: Foreign trade (customs statistics), 2002-2004

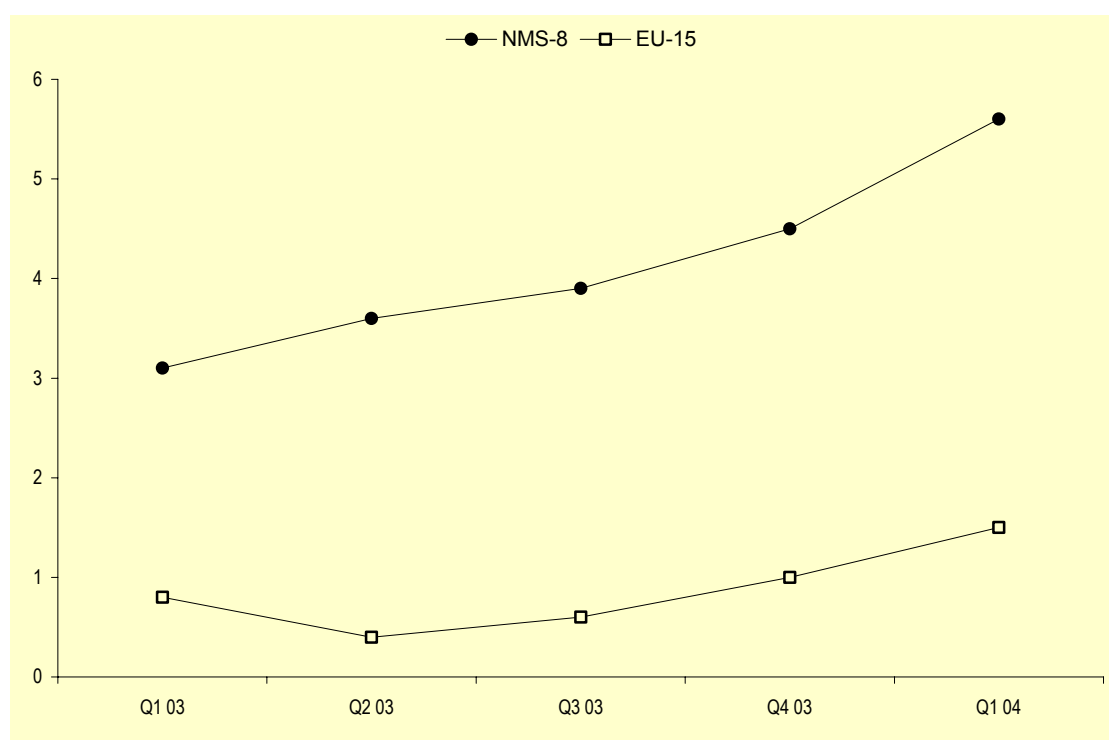
Exports, imports (EUR), year-on-year, growth rate in %



Source: wiw Monthly Database incorporating national statistics

Figure 4: NMS and EU-15: Quarterly GDP, 2003-2004

weighted average, year-on-year, growth rates in %



Source: National statistics; Eurostat.

Table 3

NMS and EU-15: Quarterly GDP, 2003-2004

year-on-year, growth rates in %

	Q1 03	Q2 03	Q3 03	Q4 03	Q1 04
Czech Republic	2.8	2.9	3.4	3.3	3.1
Hungary	2.7	2.5	2.9	3.6	4.2
Poland	2.3	3.9	4.0	4.7	6.9
Slovak Republic	4.1	3.8	4.2	4.7	5.5
Slovenia	2.2	2.1	2.3	2.5	3.7
Estonia	5.8	3.5	5.2	6.2	6.8
Latvia	8.8	6.2	7.3	7.5	8.8
Lithuania	9.6	6.8	8.8	10.6	7.7
NMS-8*	3.1	3.6	3.9	4.5	5.6
EU-15*	0.8	0.4	0.6	1.0	1.5

Note: * Weighted average.

Source: National statistics; Eurostat.

Despite having to be treated with some caution as subsequent revisions are frequent, quarterly GDP data (see Figure 4 and Table 3) also reflect a positive trend as from the turning point in mid-2003. This does not apply to Poland, even though growth gained momentum in the second half of 2003. Throughout 2002, 2003 and the first quarter of 2004, the GDP growth rates for each quarter and in all NMS were consistently higher than the corresponding EU-15 growth rates. The sole exception, however, that relates exclusively to the first half of 2002 was Poland, whose growth rates over that period were similar to those in the EU-15.

After the more or less global slump in 2001, the countries of Central and Eastern Europe were not alone in waiting some length of time for growth to recover. Today, the signs of recovery in most cases are stronger than had been expected by the core of experts, among whose ranks wiiw analysts are also to be found, at least in respect of a number of countries. The trend towards higher growth is to be seen in all NMS in Central Europe. It would seem to indicate that those countries have become full members of the international philharmonic orchestra – or at least members of the EU chamber orchestra. The parallelism with the global economic recovery as reflected in a mild upswing in the eurozone is obvious, yet the extent of recovery in most NMS is far stronger.

Of course, no guarantee can be given that the positive trend will continue or even strengthen. Severe external shocks, wherever and whenever they occur, can always have an adverse impact on economic development. Should nothing like that occur, the average growth rate in the NMS-5 (Czech Republic, Hungary, Poland, Slovakia and Slovenia) will quite likely be close to 4.5% in 2004: about 1 percentage point higher than in 2003 (3.5%). Whereas it is true that the prospects of growth have improved in all those countries, Poland's recovery is the decisive factor determining the higher growth rate expected for the region as a whole: the Polish economy weighs in at close to 45% in relation to the overall growth rate of the NMS-8 (see Table 2). As can be seen from Table 1, we expect a growth rate for 2005 that is not all that different from that of 2004.

Likely causes of the upswing

Obviously, the NMS-8 benefited from a spill-over of the improving international business climate, with the more important trading partners located in the immediate EU-15 proximity serving as mediators. Figure 3 shows clearly that GDP growth in both the NMS-8 and the EU-15 rose in parallel. The upswing in the EU-15, however, was less pronounced; this suggests that taken alone, the growth impulse from the EU-15 was not strong enough to explain fully the relatively significant acceleration of growth in the NMS-8.

The upswing was more pronounced in economies where external impulses coincided with other supportive developments, such as real depreciation against the euro and/or a decline in unit labour costs in euro terms. Those coincidences had a positive impact on foreign trade figures. These aspects are discussed in some detail below. Apart from the Baltic States with their currency board arrangements, monetary policy had an impact on exchange rate developments; in most cases the impact on the business climate was favourable.

A structural factor may also have played a growth-supporting role. Over the past few years, the NMS were able to attract a sizeable amount of FDI and to catch up in technologically more sophisticated branches and improve the quality of their products. Even in the period when the EU-15 economy

came close to stagnation, the countries in Central and Eastern Europe were able to expand their exports and enlarge their shares in EU markets.

In all NMS in Central Europe in the first quarter of 2004, the year-on-year growth of gross fixed investment was stronger than it had been one year earlier; the same can be expected for 2004 as a whole. In Poland and Slovakia, we could observe a switch from decline in the first quarter of 2003 to growth in the corresponding quarter in 2004. Gross fixed investment is always the sum of private and government investment. As regards gross fixed investment in the private sector, foreign-owned enterprises have played a major or even dominant role in the NMS. Their increased propensity to invest could be another contributory factor that helped the international business climate to spill over to the NMS. Private and public sector preparations for EU membership as well as projects financed or supported by the EU would also appear to have had a positive impact on gross fixed investment.

On the other hand, private consumption growth decelerated in the Czech Republic and Hungary (first quarter 2004 compared to first quarter 2003), but accelerated in Poland, Slovakia and Slovenia. These trends are likely to remain unchanged for the year as a whole. For the Baltic States, no quarterly growth rates were available; in all three states, we expect accelerated investment growth for 2004 in tandem with decelerated consumption growth. In several countries, particularly in Poland, the greater availability of consumer loans boosted private consumption. In the NMS, governments still have a significant influence on private consumption, as evidenced by the fixation of ceilings for regulated prices (public utilities, public transport and housing), changes in indirect taxation, cuts in social welfare programmes or increases in civil servants' pay scales. Compared to the EU-15, the NMS-8 have undergone an appreciable number of comparatively frequent and rigorous interventions or reforms in recent years that impinged painfully on large segments of the population.

Given the governments' influence on both gross fixed investment and private consumption, which is partly also an indirect one, it is difficult to say whether the individual country governments had a positive influence on the recent business upswing. However, none of the countries with government deficits exceeding 3% of GDP – the Czech Republic², Hungary, Poland and Slovakia – is currently forcing through any kind of drastic budget consolidation. This reticence possibly hints at the adoption of a relatively neutral stance in terms of the business climate. However, all these countries face the 'excessive deficit procedure' initiated by the EU Commission.

New signs of improving competitiveness

The future economic strength of the new member states will depend on the further consolidation and strengthening of the enterprise and industry base. For continuing economic success, each country needs a stock of corporations that remain competitive under liberalized market conditions. In this context, the exchange rate developments (see Figure 5) will be an important factor. If a domestic currency appreciates significantly against the currency of a main trading partner, it can create problems for some companies which would otherwise be quite successful. A trend along those lines emerged in Poland a few years ago (peaking in 2001), as a result of which the dynamics of the real sector eroded almost completely. In the meantime, reversal has set in; the zloty has depreciated and GDP growth promptly recovered.

² In the Czech case it makes sense to draw this conclusion from a comparison of the deficits in 2002 and estimates for 2004; the deficit figure for 2003, 12.9% of GDP, is bloated by methodological changes.

In the Czech Republic, appreciation tendencies also surfaced up to mid-2002; they may well have had an adverse impact on growth. The Czech National Bank, however, adopted a firm stance and combated appreciation by lowering interest rates and so paved the way for gentle depreciation. In both the Czech Republic and Poland, the manner in which the issue interest rates was handled proved instrumental to influencing exchange rate levels.

Hungary is the third new member state where depreciation against the euro can be seen to have underpinned the trend towards higher growth. In mid-2003, the Hungarian forint began depreciating and remained relatively weak up to February 2004, whereafter partial recovery ensued.

In the same context, developments in Slovakia were again different. The trend towards appreciation was never strong; hence, it could continue uninterrupted. The trade balance even improved, thanks mainly to the increase in activities on the part of foreign investment enterprises in the automotive industry. From 2001 onwards, that industry provided the backdrop for continuous GDP growth at a rate initially close to, and subsequently more than, 4%.

Slovenia has become extremely adept at keeping the real exchange rate stable and the current account in equilibrium by means of continuous depreciation in the context of a floating regime. This policy, however, has come to an end in mid-2004 and was replaced by a stable exchange rate in the ERM II.

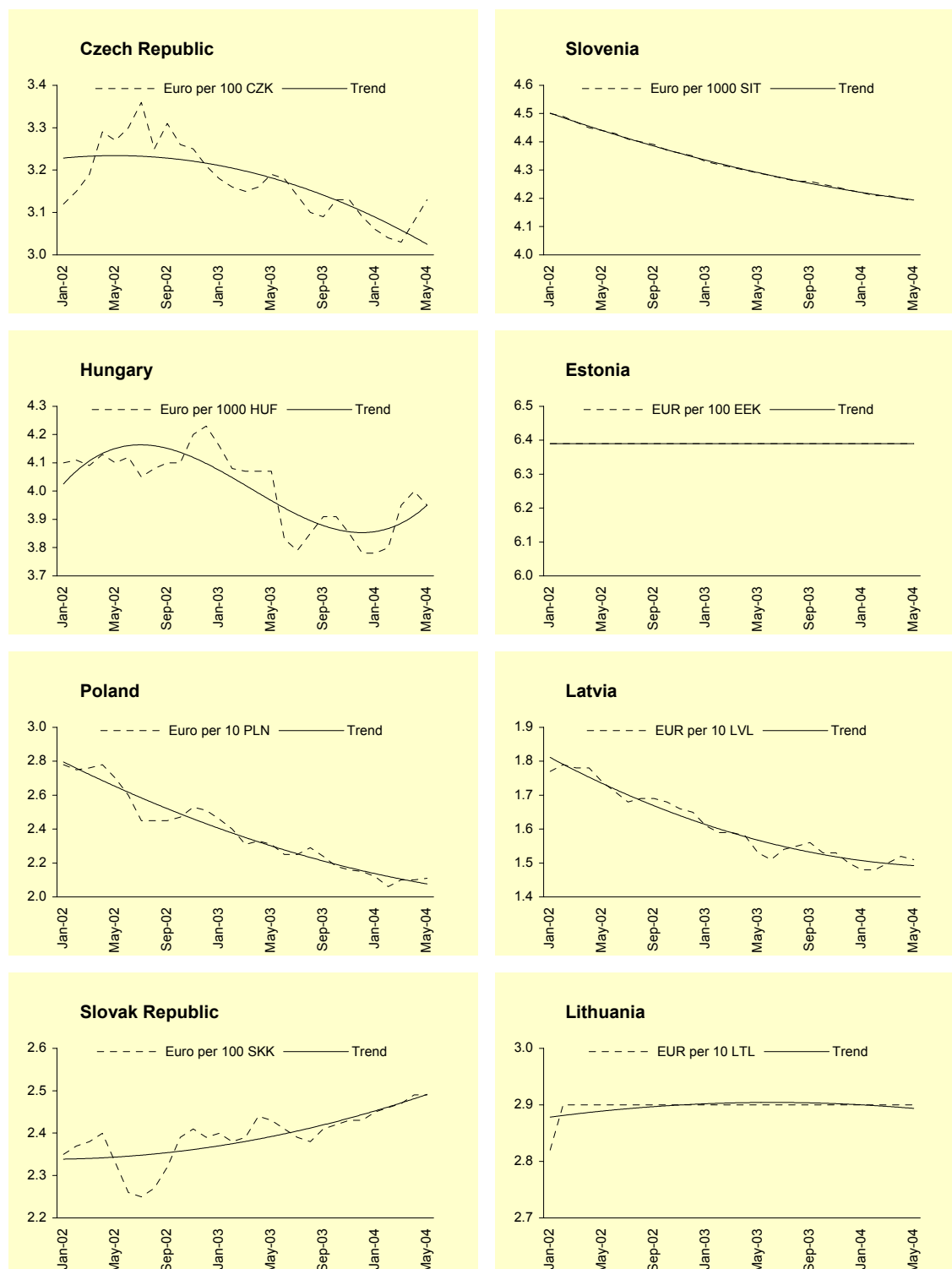
Estonia and Lithuania kept their currency pegged at a fixed rate to the euro. In Lithuania this implied a degree of real appreciation against the euro, but not in Estonia where producer prices have hardly increased since 2002. Both countries joined the ERM II on June 28. Among the three Baltic States, only Latvian companies exporting to the EU profited from depreciation, as the country's currency is pegged to a basket of currencies, whose value vis-à-vis the euro dropped when the euro recently strengthened against the US dollar.

The price competitiveness of a country's tradable sector suffers in times of real appreciation (see Figure 6). According to the definition used here, real appreciation results from nominal appreciation and domestic producer price inflation, whereas producer price inflation in the EU-15 has a contrary impact.

Slovakia is the only country to have experienced marked real appreciation: Compared to January 2002, the country's producer prices, recalculated in euros, were up by almost 20% in March 2004. Between the first quarter of 2003 and the same quarter in 2004 real appreciation amounted to about 5%. That notwithstanding, foreign trade developed quite favourably; exports rose by 19% and imports somewhat less than 15% over that period. This development can be attributed to the success enjoyed by a growing number of export-oriented foreign-owned companies, which have expanded their local operations. In marked contrast to Slovakia, Polish producer prices (in euro terms) in March 2004 were about 20% lower than at the beginning of 2002. Given the strong real depreciation, Poland's improving export performance is not surprising. In the first quarter of 2004, real depreciation amounted to about 9% year-on-year; as is to be expected under such

Figure 5: NMS: Nominal exchange rate*, 2002-2004

EUR relative to NCU, monthly average

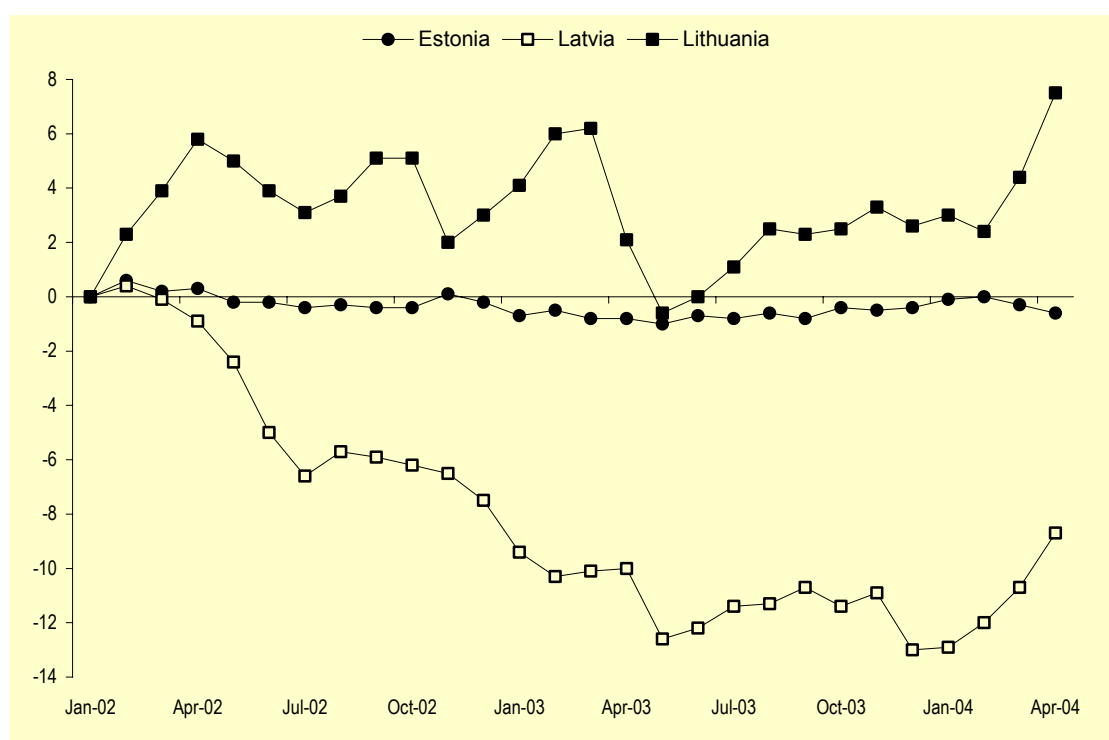
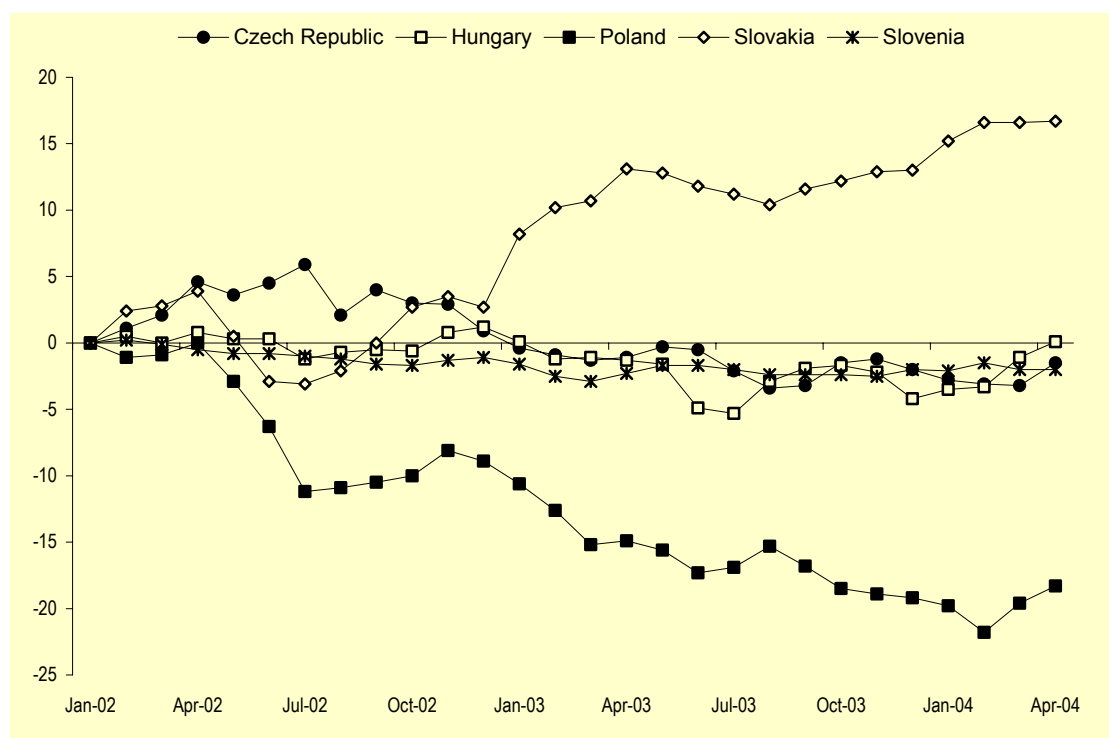


* Increasing line indicates national currency appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Figure 6: NMS: Real appreciation*, 2002-2004

EUR per NCU, PPI-deflated, in % against January 2002



* Increasing line indicates real appreciation

Source: wiiw Monthly Database incorporating national statistics.

circumstances, in terms of growth exports (13%) outstripped imports (8.5%) in the first quarter of 2004 (year-on-year). Latvia also experienced real depreciation, but to a less pronounced degree compared to Poland. In the other NMS-8, the real exchange rate in March 2004 was not all that different from the level at the beginning of 2002. In other words, here the net outcome of exchange rate and inflation developments did not pose a major threat to the exporters' ability to sell their products in the eurozone. The exception was Slovakia, yet the corporate sector as a whole was strong enough to withstand competitive pressure easily. Despite real appreciation in previous years, Slovakia still displays the lowest average price level among the new member states in Central Europe (see Table 2).

Figure 7 shows the growth in euro-adjusted unit labour costs in industry. If they decline, although the prices in the eurozone remain unchanged, export activities might be stimulated as they become more profitable. As Figure 7 shows, Slovakia is the only NMS-5 country to have experienced a rise in unit labour costs over the period March 2003-March 2004. In Slovenia, unit labour costs declined from September 2003 onwards. In Hungary, after a longer period of strong growth, the decline started in June 2003. In the Czech Republic, the decline began in January 2003. Most pronounced was the decline in unit labour costs in Poland, where it started as far back as April 2002.

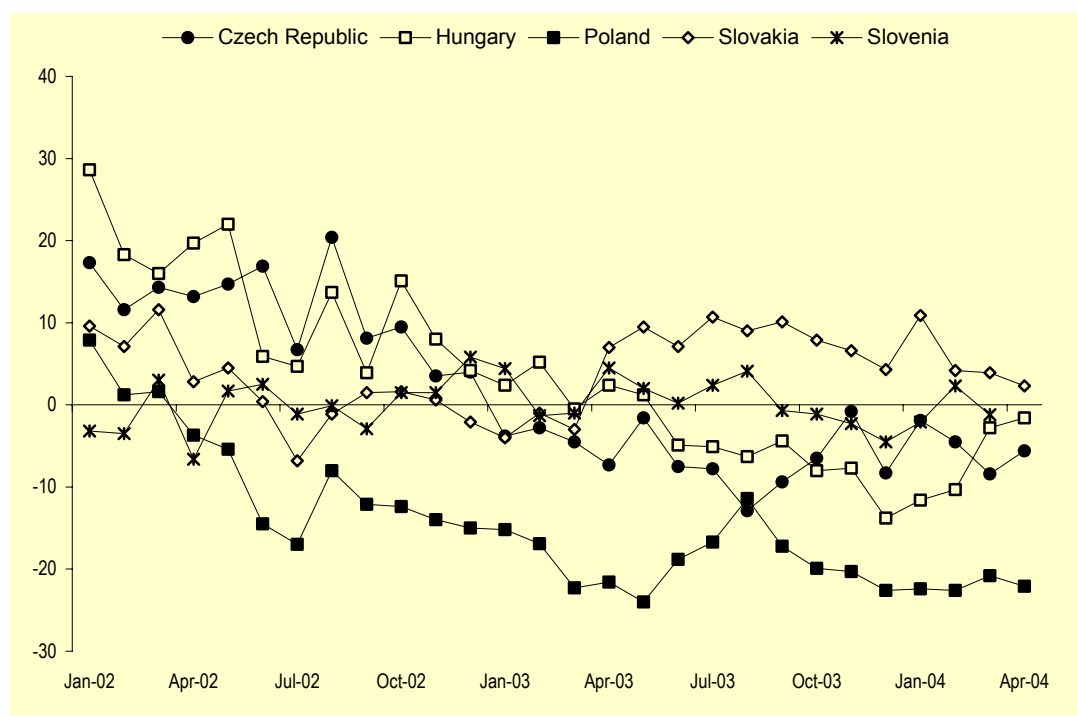
The reasons for the prevailing trend towards a decline in euro-adjusted unit labour costs were a nominal depreciation of the national currency against the euro (this holds particularly true for Poland) and/or increases in labour productivity greater than the increases in nominal wages. Figure 8 shows how industrial labour productivity has developed over the past two years. Growth in industrial labour productivity accelerated in the second half of 2003 and more particularly in the first months of 2004, at least in the Central and East European NMS; for the Baltic States, no data are available. In March 2004 the year-on-year labour productivity growth rate stood at 24% in Poland. In the same month, the rate peaked at 18% in the Czech Republic, peaking in Hungary at the same level one month earlier.

Factors such as real appreciation/depreciation or changes in unit labour costs do not, however, explain the more fundamental determinants of the international competitiveness of a country's corporate sector. The state of the companies' technical equipment is important – whether it is close to the cutting edge of technological progress or not. The market position of the companies is also important – whether they mainly produce intermediates, no-name finished goods or finished goods with internationally known brands or trademarks. These are but a few of the more fundamental determinants of competitiveness. All of them have one thing in common: it is difficult to measure their presence or absence in a specific country. In actual fact, wiiw has analysed in greater depth some fundamental aspects of competitiveness, including a comparative analysis of the development of prices per output unit in specific market segments over time and between countries.³

³ *wiiw Structural Report 2003 on Central and Eastern Europe*, October 2003.

Figure 7: NMS: Unit labour costs, 2002-2004

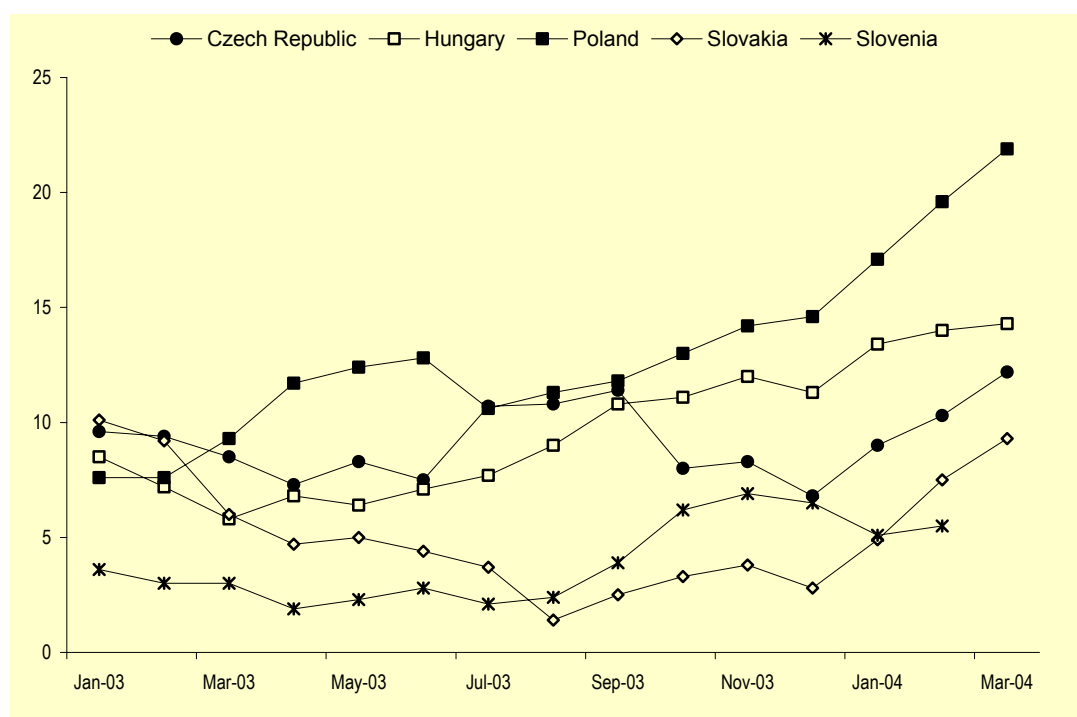
EUR-adjusted, year-on-year, growth in %



Source: wiiw Monthly Database incorporating national statistics.

Figure 8: NMS: Labour productivity in industry, 2003-2004

3-month moving average, year-on-year, in %



Source: wiiw Monthly Database incorporating national statistics.

Moderate relaxation of the unemployment problem

High labour productivity growth tends to aggravate unemployment problems, while improving individual company competitiveness through a decline in unit labour costs. Only if the rise in labour productivity is accompanied by equally pronounced output growth, does this effect not come into play. wiiw country tables, which are part of the country reports presented in this volume, include unemployment rates measured using the LFS methodology (period average data) as well as unemployment rates based on the registering of jobless persons (period-end data). The LFS data are more reliable in the context of international comparison. A comparison of first quarter data in 2004 and 2003 shows that in five NMS the rate of unemployment has declined. The countries in question were: Estonia (decline confirmed by both methods); Lithuania (only registration method results available); Poland (only registration data available); Slovenia (decline confirmed by both methods); and Hungary (at least according to LFS data). The unemployment rate increased in three other NMS: the Czech Republic (rise confirmed by both methods); Latvia (rise confirmed by both methods); and Slovakia (only LFS results available). In view of the marked increases in labour productivity that were to be observed especially in the first quarter of 2004, these results are better than one might expect. However, in several countries, and especially in Poland, where millions of people are blighted by unemployment, the problem is severe without any real prospects of it being resolved in sight. We also have to be aware of the fact that in Poland, and partly in the Baltic countries as well, agriculture still provides a refuge for people who would otherwise be jobless.

The increasing disparity between low- and high-growth countries

GDP growth (see Table 1) in the Baltic countries has ranged between 5% and 9% over the past few years, whereas nowhere in Central and Eastern Europe did it reach 5%. Data for the first quarter of 2004 suggest a general upsurge in GDP growth rates. Lithuania is the sole exception. Poland is likely to become a high-growth country once more, just as it was in the mid-1990s. However, despite the general upwards shift in growth rates, the contrast between low-growth and high-growth countries shows no signs of diminishing. On the contrary, in the Czech Republic, slight growth acceleration emerged as far back as mid-2003 without any further sign of a positive trend since; Slovenia's growth acceleration is also minor compared to other countries.

As for the relatively low growth of the Czech and Slovene economy, at least two different views on the subject prevail. One school of thought posits that those two countries were slow to reform. Up to the end of 1992, the Czech Republic and Slovakia had been one country. Since then, Slovakia has reformed both its pension and health schemes, the Czech Republic has not. Slovakia has pushed through massive and extremely unpopular cuts in social transfers, the Czech Republic has not. Slovakia has recently introduced a flat tax system and has also been more radical in its monetary and exchange rate policies. As for Slovenia, it has also taken a somewhat gradualist approach. Its privatization scheme was employee-friendly, but not investor-friendly, particularly where potential foreign investors were concerned.

The second school of thought maintains that less developed countries achieve high growth rates more easily. Indeed, in terms of GDP per capita, Slovenia is the most developed NMS within Central and Eastern Europe, followed by the Czech Republic. Hungary, which cannot aspire to 'tiger-growth' either, takes third place. The second viewpoint may make more sense than the first. In all corners of the globe, countries with large labour reserves, lacking both equipment and physical capital and beset by overall technological backwardness, have a better chance of achieving high growth rates

with appropriate policies. The growth-stimulating impact of a pension reform, for example, especially in the short term, is much less plausible. Moreover, economic theory substantiates the 'benefits of backwardness'.

High current account deficits despite relatively low trade deficits in goods and non-factor services

In Central Europe, two countries display relatively high current account deficits: the Czech Republic (6.2% of GDP in 2003) and Hungary (8.9%). The deficits in the Baltic countries are of similar dimensions, ranging from 12.6% of GDP (Estonia) to 6.6% (Lithuania). Of the Baltic countries, only Latvia has a large trade deficit in goods and non-factor services. In the other countries, exports of goods and non-factor services cover 90% or more of imports. In 2003, in per cent of GDP, the deficit in goods and non-factor services was: 7.9% in Estonia; 4.3% in Hungary; 5.5% in Lithuania and 2.2% in the Czech Republic. For the most part, the difference between these deficits and the current account deficits – 4.3 percentage points in the Czech Republic, 4.7 in Estonia, 4.6 in Hungary, but only 1.1 percentage points in Lithuania – reflects the profits earned by foreign investors. In the Czech Republic, Estonia and Hungary, the stock of foreign direct investment at the end of 2003 had reached a level ranging from EUR 3600 to EUR 3800 per capita (see Table 2), two to three times greater than in the other countries. The foreign investors reinvested part of those profits in the country, the remainder they repatriated or invested in third countries. The high deficit in the balance of incomes could cause problems in the long run – at least in the absence of adequately growing surpluses in the balance of goods and services. The profits earned by foreign direct investors create a gap between the countries' gross domestic product and gross national product. One example of a yawning gap between these two quantities is Ireland: a country which has experienced a rapid development on account of massive foreign direct investment.

Prospects for 2004 and 2005

As can be seen from the Table 1, wiiw analysts expect the positive growth trend visible in the recent past to continue in 2004, but flatten in 2005, at least for the NMS region as a whole. The rate of inflation will increase somewhat in several countries in 2004 following adjustments in prices and taxes in the context of accession to the EU. Inflation is expected to decline in 2005. The extent of that trend will depend on several factors: the development of world market prices both for crude oil and for raw and processed materials as well – and last, but not least the euro-US dollar parity. Should these factors bring about a relatively severe cost-push, they would clearly have a negative effect on growth. The central banks would start laying emphasis on fighting inflation. We count on there being low inflation again in 2005. The unemployment rate of the NMS-8 region as a whole could experience a marginal decline. With regard to the current account deficits, measured in per cent of GDP, we again expect a minor decline, at least for the NMS-8 region as a whole.

After enlargement: new EU members face new challenges

What has changed with the enlargement?

For the countries of Central and Eastern Europe, the accession process started as far back as 1989/1990, culminating in its realization on 1 May 2004. In an institutional or formal sense, 1 May 2004 truly marked a watershed. In terms of genuine economic integration, however, the change was less spectacular. Long before actual accession, close economic ties had built up between the 'old' and 'new' members of the EU. The Europe agreements provided for the gradual introduction of free trade in industrial products, while trade in agro-food products underwent partial liberalization. A genuine integration process was to be observed in trade in commodities and services trade, as well as in capital flows. To a modest extent and in a highly regulated manner, it also occurred in respect of migration. In the course of the protracted accession negotiations, an ever increasing number of *acquis* regulations entered into force in the accession countries, increasing the similarity of the legal setting with that in the incumbent EU member states long before formal accession on 1 May 2004.

What has actually changed in terms of integration since 1 May 2004?

- The new member states (NMS) have become part of the EU decision-making process with rights equal to those of the old members in all respects (judging by the low turnout for the EU parliamentary elections in June, this factor does not appear to have been appreciated all that much).
- Trade has become fully barrier-free, including services and agro-food products. Customs procedures no longer apply at the borders between old and new EU member states (or between the new member states themselves); the NMS apply the common EU external customs tariffs on imports from non-EU countries, which on average has meant a tariff reduction.
- Three old member states (Ireland, Sweden and the United Kingdom) opened up their labour markets to migrants from the ten new member states; all old member states waived all restrictions on migrants from Cyprus and Malta.
- The NMS have become an integral part of the EU-wide redistribution system. On the one hand, they are obliged to contribute to the EU budget via their own resources; on the other, they are eligible for transfers from the EU budget, mostly within the framework of Structural Policy and the Common Agricultural Policy (CAP).
- On accession, the NMS adopted the regulatory instruments of the CAP. This constituted a substantial break with pre-accession agricultural policies for all countries except Slovenia.
- Immediately after accession, the NMS are obliged to observe the stipulations of the Stability and Growth Pact; they have committed themselves to adopting appropriate measures to reduce their general government deficits to 3% of GDP.

What elements essential to the achievement of genuine integration are still missing?

– Transfers

Whereas NMS will have to pay in full their 'own resources' contributions to the EU budget from the very first day of accession, transfers from the EU budget are 'phased in'. As for transfers from the Structural Funds and the Cohesion Fund, the NMS will only enjoy treatment equal to that currently

extended to old members from 2007 onwards. Under the CAP direct payments to farmers in the NMS will begin at 25% of the final level set in the accession treaties, increasing each year before reaching 100% in 2013; the proviso being that no reforms at some stage in the future would redefine the whole philosophy and practical implementation of the CAP. NMS governments are permitted to top up the EU subsidies – up to a maximum of an additional 30 percentage points in the initial years of membership, i.e. up to the point at which EU funding together with the top-up reach 100% of the country-specific level of direct payment previously negotiated. Though in the main from own budgetary resources, the top-up may come in part from other EU transfers. In real terms (given the purchasing power of one euro in the NMS), the CAP and supplemented subsidies together will bring farmers in the NMS to a roughly balanced position whence they can compete with farmers in the old member states.

– *Provisional regulations*

The accession treaties introduced provisional regulations in several areas of the *acquis*. The NMS were granted short- or long-term exceptions to various sets of EU-wide norms and standards: primarily with respect to protection of the environment, but also in relation to transport, infrastructure, animal welfare and the food-processing industry. To a large extent, efforts to comply with the strict norms and standards by the deadlines set (in the field of environmental protection, they occasionally extend beyond 2010) will determine the level of public investment in the NMS over the coming years.

Provisional regulations may also apply to the free movement of labour. All but three old EU member states seized the opportunity to restrict the inflow of migrants and commuters from all but two NMS in the first two years of enlargement. After reviewing migration-related pressures and surveying the domestic labour market, those countries are entitled to apply the same restrictions for a further three years, whereafter following a second review they can be maintained for a further two years (seven years overall).

With regard to gaps in arable land and real estate prices in old and new members, seven to twelve years restrictions on purchase of agricultural land and five years restrictions on real estate transactions will be applied in most of the new members.

Provisional regulations also apply to the provision of transport services between two locations in one domestic market by firms from another EU member country (*cabotage*). An agreement has been reached between the old member states and the Czech Republic, Hungary, Poland and Slovakia mutually restricting such services for four to five years.

– *Monetary Union*

Finally, the new members will not participate immediately in the eurozone. On a provisional basis, they will join the group of 'outsiders' comprising three old EU members: Denmark and the United Kingdom (both countries with derogation) and Sweden (which has set no date for introducing the euro). However, the new members were not granted an opportunity to opt out; they will all have to join the European Monetary Union at a later date. Slovenia, Estonia and Lithuania joined the ERM II on 28 June 2004 and may adopt the euro in 2007. The other NMS will follow in the period 2008-2010.

The new member states and the Maastricht convergence criteria

The new member states (NMS) have committed themselves to introducing the euro as their legal tender at some point in the future. One prerequisite for joining the eurozone is the successful participation in the Union's 'new' Exchange Rate Mechanism (ERM II) for a period of at least two years. Pursuant to EU law, successful participation includes meeting the Maastricht convergence criteria pertaining to: price stability, low interest rate, low budget deficit, low government debt and a stable exchange rate relative to the euro (see Box 1).

Table 4 presents data from EU sources (as of February 2004) showing the degree to which the NMS have come to meeting the criteria set for price stability and the long-term interest rate.

The rationale behind these two criteria is to establish the basics for a common monetary policy. The convergence of nominal interest rates is of great significance in that context; to fit to a low interest rate, the inflation rate has to go down as well. In a number of countries, the inflation rate is significantly higher than the EU average. This stems primarily from increases in prices of non-tradables; it does not necessarily harm producers of tradables. The latter may not experience much of a cost-push, even in the event of an inflation rate exceeding the Maastricht limit, especially if they are able to increase labour productivity or increase efficiency in the use of imported materials and energy. In such cases, their output prices (in euro terms and given a simultaneously stable exchange rate in national currency terms) may remain unaffected by the inflation observable in the economy as a whole. Thus, inflation above the Maastricht limit may not hurt the competitiveness of the real sector; rather it is a hindrance on the path to a common monetary policy.

Table 4

NMS performance relative to the Maastricht criteria for price stability and the long-term interest rate

(status February 2004)

Country, group of countries	Inflation*	Long-term interest rate**
Average inflation in the three EU members with the lowest inflation rate (Germany, Finland, Austria)	1.1	4.13
The Maastricht convergence criteria	2.6 (average of the 3 EU members with lowest inflation rate + 1.5 percentage points)	6.13 (average of the long-term interest rates of the 3 EU members with lowest inflation rate + 2 percentage points)
NMS meeting both criteria		
Lithuania	- 0.9	5.2
Czech Republic	0.4	4.2
Poland	0.9	6.0
Estonia	1.1	4.9
Malta	2.1	4.9

(Table 4 contd.)

Table 4 (contd.)

NMS meeting the interest rate criterion, but not the inflation criterion

Latvia	3.3	5.0
Cyprus	3.4	4.7
Slovenia	5.2	6.1
Slovakia	8.6	5.0

NMS meeting neither criterion

Hungary	5.0	7.2
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Note: This table contains indications of the NMS' ability to meet the Maastricht convergence criteria based on February 2004 data. An official evaluation of the fulfilment of the convergence criteria will be published in the convergence reports to be submitted to the Council later in 2004.

* 12 month average inflation rates, February 2004

** 12 month average long-term interest rates: arithmetic mean of monthly rates over the period March 2003-February 2004. In the case of Estonia, this has not been fully harmonized.

Source: Eurostat (Statistics in focus. ECONOMY AND FINANCE THEME 2-21/2004), pp. 1-3.

Box 1

The price stability criterion requires that a member state displays a sustainable price performance and, over the twelve months prior to examination, records an average rate of inflation that does not exceed by more than 1.5 percentage points that of (at most) the three best performing EU member states in terms of price stability.

The long-term interest rate criterion requires that, over the twelve months prior to examination, a member state has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of (at most) the three best performing EU member states in terms of price stability.

The government budgetary position criterion requires that a member state has a ratio of planned or actual government deficit to GDP that does not exceed 3%, unless:

- *the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or*
- *the excess of the reference value is only exceptional and temporary and the ratio remains close to the reference value.*

The government debt criterion requires that a member state's ratio of government debt to GDP does not exceed 60%, unless the ratio is diminishing sufficiently and approaching the reference value at a satisfactory pace.

The exchange rate convergence criterion requires at least two years' participation in the ERM II and observance over the same period of the normal fluctuation margins close to central parity provided for by the mechanism.

Table 5

**NMS performance relative to the Maastricht criteria
for the budgetary position and government debt**

Country, group of countries	General government net lending, in % of GDP, 2003	General government consolidated gross debt in % of GDP, 2003
The Maastricht convergence criteria	- 3.0	60
NMS meeting both criteria		
Estonia	+ 2.6	5.8
Lithuania	- 1.7	21.9
Latvia	-1.8	15.6
Slovenia	-1.8	27.1
NMS meeting the public debt criterion, but not the budget deficit criterion		
Slovakia	-3.6	42.8
Poland	-4.1	45.4
Hungary	-5.9	59.0
Czech Republic	-12.9	37.6
NMS meeting neither criterion		
Cyprus	-6.3	72.2
Malta	-9.7	72.0

Note: This table contains indications of the NMS' ability to meet the Maastricht convergence criteria based on February 2004 data. An official evaluation of the fulfilment of the convergence criteria will be published in the convergence reports to be submitted to the Council later in 2004.

Source: Estimate of the European Commission in Spring 2004 Economic Forecasts, European Commission, p. 134.

Recent discussion with respect to the fiscal convergence criteria has been heated. A number of the old EU member states failed to meet the budget criterion when hit by last years' business slump. Quite possibly, in the not too far distant future, modifications to these criteria will be negotiated. A greater degree of flexibility is a frequent demand that is also made with a view to future developments in the NMS. When presenting a first assessment of the convergence programmes of the NMS, the EU Commissioner for Economic and Monetary Affairs, Joaquín Almunia, made known that an excessive deficit procedure for six of the NMS will be advanced, but at the same time he announced a more flexible and country-specific approach to fiscal criteria and in particular more focus on debt and sustainability in the budgetary surveillance process. Whatever the initial amount of public debt is: if a government keeps its deficit at 3% of GDP while at the same time the GDP grows permanently by 5% nominally, over time the debt-GDP ratio will converge to 60%, the ceiling set in the Maastricht treaty. Should a country's GDP advance on a path of more than 5% annual growth nominally, the country can approach or maintain the debt-GDP ratio of 60% even in the case of a deficit-GDP ratio of over 3%, i.e. in spite of violating the deficit criterion. As the NMS usually register higher GDP growth rates than the old EU members, this argument should be of interest to them.

Table 6

Meeting the price stability, interest rate, budgetary and public debt criteria: an overview

	Criteria			
	Price stability	Long-term interest rates	Budget deficit	Public debt
Countries meeting all four criteria				
Lithuania	✓	✓	✓	✓
Estonia	✓	✓	✓	✓
Countries meeting three criteria				
Czech R.	✓	✓	no	✓
Latvia	no	✓	✓	✓
Poland	✓	✓	no	✓
Slovenia	no	✓	✓	✓
Countries meeting two criteria				
Malta	✓	✓	no	no
Slovakia	no	✓	no	✓
Countries meeting one criterion				
Hungary	no	no	no	✓
Cyprus	no	✓	no	no

Source: Tables 4 and 5.

GDP growth in the NMS compared to high-income EU countries

Throughout the period 2000-2003, economic growth in the NMS-8 consistently outstripped the GDP growth rate in the group of wealthier EU countries (the 'EU-12' in Table 7). The only exceptions were the Czech Republic and Slovakia in 2000 and Poland in 2001.

Table 7

New member states (NMS-8): growth differential vis-à-vis the 12 EU countries with a GDP per capita higher than the EU-25 average

Annual GDP growth rates of NMS-8 minus the corresponding year's EU-12 growth rate (percentage points)

	2000	2001	2002	2003	Arithmetic means
Latvia	3.4	6.4	5.5	6.9	5.6
Estonia	4.3	4.8	6.3	4.5	5.0
Lithuania	0.4	4.8	5.9	8.4	4.9
Hungary	1.7	2.2	2.6	2.3	2.2
Slovakia	-1.5	2.2	3.5	3.6	2.0
Slovenia	0.4	1.1	2.5	1.7	1.4
Czech Republic	-0.2	1.0	0.6	2.5	1.0
Poland	0.5	-0.6	0.5	3.2	0.9
EU-12 growth rate	3.5	1.6	0.9	0.6	
NMS-8 growth rate	4.0	2.6	2.5	3.8	

Source: wiiw Database and Eurostat.

The Baltic States recorded the highest GDP growth rates, complying with the rule that countries with a lower GDP per capita (see Table 2) have a better chance of achieving high growth. The Czech Republic and Slovenia, with high GDPs per capita and relatively low growth, also conformed to the rule. The latter did not hold at all true for Poland. Despite a GDP per capita quite similar to that of the Baltic States, Poland recorded one of the lowest growth rates of all NMS-8 in the period under consideration. A business slump prevented Poland from exploiting its potential to the full, unlike the mid-1990s when the Polish economy had demonstrated its capacity for rapid growth.

Foreign trade in goods and services: improving import coverage in most NMS

Table 8 shows the degree to which exports of goods and non-factor services covered imports in the period 2000-2003.

Table 8

New member states (NMS-8): import coverage, 2000-2003

Sorted by the intensity of coverage increase

Goods plus non-factor services: Exports in per cent of imports

	Coverage rates (%)				Change (%-points)
	2000	2001	2002	2003	Rate 2003 - rate 2000
Poland	81.0	88.2	89.7	93.2	12.2
Slovenia	94.0	98.8	102.7	100.0	5.9
Lithuania	87.5	90.3	90.5	90.4	2.9
Slovakia	96.8	90.2	91.2	98.4	1.6
Czech Republic	95.4	96.3	96.8	96.6	1.2
Hungary	95.0	98.0	96.5	93.5	-1.5
Estonia	95.8	96.0	89.5	90.5	-5.3
Latvia	84.1	79.9	81.1	76.9	-7.1

Source: wiiw Database.

Slovenia's coverage rate reached 100% and more in both 2002 and 2003. In this sense, it can be said to have assumed the lead among the NMS-8. Its import coverage increased significantly over the period 2000-2003, yet in this latter respect Poland, with an increase in coverage of 12 percentage points (from 81% in 2000 to 93% in 2003), took first place. Some of this improvement, however, may have come about as a result of a better monitoring of the country's trade flows. The Baltic States achieved relatively low coverage; this, however, is to be expected of countries whose growth is much faster than that of their main trading partner(s). Import coverage in Latvia was especially low and worsened over time. This is all the more remarkable if we recall the real depreciation during that period (see previous section). Coverage also declined in Estonia. Table 8 does not show one thing: in both Estonia and Latvia, trade in goods and services taken together displayed a much better coverage rate than trade in goods alone. In 2003, exports of goods covered 75% of Estonia's imports and a mere 61% of Latvia's imports. In 2003, unlike the Baltic States, all the NMS in Central Europe attained import coverage rates of more than 90% – not only for goods and services together, but also for goods alone.

Towards stable nominal exchange rates

Most probably around 2010 all NMS will have introduced the euro. In several of them the corporate sector has already had the opportunity to gain experience with long-run stability or slight long-term appreciation of the currency. As Table 9 shows, the Czech Republic was the only country that experienced a more significant long-term appreciation: 12%, if we compare the annual exchange rate averages of 2003 and 2000. Lithuania experienced also some slight appreciation over that period, but has within that period introduced a fixed peg to the euro. In the case of Hungary and Slovakia appreciation was of almost negligible size. In the context of a currency board arrangement, Estonia's exchange rate remained completely unchanged. Poland and Slovenia recorded depreciation (9% and 12% respectively). Latvia's currency, with its fixed peg to a currency basket, depreciated as well in the course of the euro's appreciation against the US dollar. The country will switch to a fixed peg against the euro at the beginning of 2005.

Contrary to the Baltic states, in the NMS in Central Europe the national authorities have preserved their freedom to use the exchange rate as a policy tool, knowing that devaluation lowers the ratio between domestic prices (in euro terms) and eurozone prices.

Table 9

Euro-national currency exchange rates in NMS, 2000 to 2003

Sorted by the rate of change 2003 over 2000

	Currency (abbr.)	Units	Euro equivalent			Change*	
			2000	2001	2002	2003	2003/2000
Czech Republic	CZK	100	2.81	2.93	3.25	3.14	1.12
Lithuania	LTL	10	2.70	2.79	2.89	2.90	1.07
Slovakia	SKK	100	2.35	2.31	2.34	2.41	1.03
Hungary	HUF	1000	3.85	3.90	4.12	3.94	1.03
Estonia	EEK	100	6.39	6.39	6.39	6.39	1.00
Poland	PLN	10	2.49	2.73	2.59	2.27	0.91
Slovenia	SIT	1000	4.88	4.60	4.42	4.28	0.88
Latvia	LVL	1	1.79	1.78	1.72	1.55	0.87

Note: * Values over 1 indicate that the country's currency has appreciated against the euro.

Source: wiiw Database.

A distinct trend towards nominal appreciation was set in motion in several NMS, as can be seen by comparing the data for 2003 and 2000 in Table 9. The Czech National Bank responded swiftly by gradually lowering interest rates, down to a very low level. The drop in interest rates was accompanied by a drop in inflation, even extending down to slight deflation at times. The National Bank in Hungary reduced interest rates in a much less determined manner. Later in 2003, it responded to depreciation pressure by reverting to a policy of high interest rates. Poland, on the other hand, lowered the money market rate from 19% at the end of 2000 down to 5.8% at the end of March 2004. Slovenia's discount rate dropped from 10% in 2000 to 4.5% at the end of March 2004. Slovakia's rate merely moved from 8.8% to 6.0%. The interest rate criterion as implemented by the Maastricht treaty may have offered extra encouragement to depart from high interest rate policies. The outcome was positive. The shift towards nominal appreciation has since disappeared – at least

in the Czech Republic and Poland. It is still present in Slovakia; it has also partly re-surfaced in recent months in Hungary.

It is of crucial importance to the NMS to have an exchange rate establish itself which is adequate to the corporate sector's ability to withstand foreign competitive pressure over time. For countries with a currency board regime, it is difficult to find a solution if the chosen peg proves inadequate to the real sector's competitive strength. Possibly, the Baltic States have not been fully spared this problem – especially in the case of Latvia. In that country, very high GDP growth goes hand in hand with exceptionally low import coverage, which has even declined over time (from 84% in 2000 to 77% in 2003) despite last years' strong real depreciation.

First serious test for decision-makers in the enlarged EU: financial framework for 2007 to 2013

The greatest challenge facing the enlarged EU in the near future will be the task of preserving its decision-making ability. As important as they are, the conflicts surrounding the adoption (and subsequent ratification) of the EU Constitution are merely a prelude to the forthcoming budget bargaining for the next financial period 2007-2013. It will be the first real test whether the decision-making process currently in place is adequate to the task of securing a compromise on the most important financial issues among 25 members with sharply diverging interests. It is perhaps no exaggeration to say that if the enlarged EU resolves this problem, one could conclude that it will be able to cope with any other problem that arises.

The Commission published the first draft of the future EU budget in February 2004.⁴ After a first round of comments by member states, a revised draft will be published this summer.

One issue key to the Commission's budgetary proposals is the extent of redistribution. Current budgetary discipline sets a ceiling for 'own resources' contributions at 1.24% of the aggregate Gross National Income (GNI) of the member countries. This ceiling has never been reached: in practice, contributions to the common budget in the EU-15 amounted to around 1% of the aggregate EU GNI (some EUR 100 billion). The Commission's proposal for 2007-2013 counts on a moderate increase in 'own resources' contributions: 1.14% of the GNI on average over the period concerned (a maximum of 1.23% in 2008 and a minimum of 1.08% in 2010). The Commission's proposal for higher redistribution was fiercely criticized by six major 'net payers': Austria, France, Germany, Netherlands, Sweden and the United Kingdom. These member states are of the opinion that intra-EU redistribution should remain at the level that prevailed in the years immediately prior to enlargement; it should not exceed 1% of the member countries' GNI.

At first sight, the 0.14 percentage points difference between the two proposals would appear small, all the more so in the light of the incomparably more difficult tasks to be solved in the field of cohesion in the EU-25, not to speak of other ambitious EU targets such as meeting the Lisbon strategy targets. The major net payers' opposition to the Commission's proposal is obviously not related to a change in the expenditure structure of the EU budget or a neglect of the cohesion issues. Their objections must be seen in the context of the difficulties that France and Germany, as

⁴ 'Building our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013', Communication from the Commission to the Council and the European Parliament, Commission of the European Communities, COM (2004)101, Brussels, 10 February 2004.

well as other member countries, have been facing (and will continue to face in the near future) in meeting the budget deficit criterion set by the Stability and Growth Pact. In a period of unpopular austerity measures at home, any increase in contributions to the EU budget, even if marginal, and/or deterioration of the net position vis-à-vis the common EU budget would seem politically unacceptable.

Apart from the future extent of the EU-wide redistribution, cohesion among members countries remains a serious challenge, aimed as it is at decreasing the disparities in the level of development between highly developed and disadvantaged regions on the one hand, and high- and low-income member states on the other. Attaining any progress in this field will be significantly more difficult and expensive in the EU-25. While the EU-15 could be seen as a rich men's club with a few relatively poor members (Greece, Portugal, Spain, and previously Ireland), the proportions have changed significantly in the enlarged EU. 12 'rich' members with per capita GDP *above* the EU-25 average share the contributions to, and transfers from, the common budget with 13 member countries (Greece, Portugal and Spain as former Cohesion Countries, and all ten NMS) with per capita GDP *below* the EU-25 average. With the possible accession of Bulgaria and Romania in 2007, the ratio will shift to 12 : 15.

Average GDP per capita in the EU-25 is more than 12% lower⁵ than it was in the EU-15 and income disparities have doubled overall.⁶ Some 92% of the population in the NMS live in regions where the GDP per capita is less than 75% of the EU-25 average, and over two thirds in regions where it is below 50%. After Bulgaria and Romania's accession in 2007, the number of people living in regions with GDP per capita below 75% of the EU-25 average will more than double: from 73 million in the EU-15 to over 153 million in the EU-27. Moreover, the regional differences within the NMS are huge: a few highly developed regions on the one hand and much more regions far below the EU or national average on the other. 13 of the 41 regions in the ten NMS⁷ registered 30-40% of the EU-25 average GDP per capita in 2001. In the same comparative analysis, 5 of the 6 Bulgarian regions and 7 of the 8 Romanian regions registered an average GDP per capita equivalent to only 20-30% of the EU-25.⁸

How will the Commission and the EU member states cope with growing diversity and the inordinate task of diminishing discrepancies in development levels within the enlarged EU? As EU-wide redistribution will either remain at its pre-enlargement level or increase only marginally if the Commission manages to secure the net payers' approval of the 1.14% rate, the brunt will necessarily have to be borne by restructuring expenditures within the EU budget. The Commission's recent proposal puts forward a new scheme.

⁵ 'A new partnership for cohesion. Third Report on economic and social cohesion', European Commission, February 2004, p. vii. *wiw* estimates, taking into account the latest data revisions, indicate a slightly lower disparity – about 9% – see Table A/1.

⁶ 'Building our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013', Communication from the Commission to the Council and the European Parliament, Commission of the European Communities, COM (2004)101, Brussels, 10 February 2004, p. 16.

⁷ Estonia, Latvia, Lithuania, Cyprus, Malta and Slovenia were each considered one region.

⁸ Andreas Krueger, 'Regional Gross Domestic Product in the Candidate Countries in 2001', Eurostat, *Statistics in Focus* (General statistics), Theme 1-2, 2004.

Table 10

Overview of the 'new' financial perspectives 2007-2013

EUR million in 2004 prices, commitment appropriations

	2006*	2007	2008	2009	2010	2011	2012	2013
1. Sustainable growth	47582	59675	62795	65800	68235	70660	73715	76785
1a Competitiveness	8791	12105	14390	16680	18965	21250	23540	25825
1b Cohesion	38791	47570	48405	49120	49270	49410	50175	50960
2. Preservation & management of natural resources	56015	57180	57900	58115	57980	57850	57825	57805
2a Agriculture	43735	43500	43673	43354	43034	42714	42506	42293
2b Natural resources	12280	13680	14227	14761	14946	15136	15319	15512
3. Citizenship, freedom, security and justice	1381	1630	2015	2330	2645	2970	3295	3620
4. The EU as a global partner	11232	11400	12175	12945	13720	14495	15115	15740
5. Administration	3436	3675	3815	3950	4090	4225	4365	4500
Compensations	1041	0	0	0	0	0		0
Total appropriations for commitments	120688	133560	138700	143140	146670	150200	154315	158450

Note: * Last year of the financial perspectives 2000-2006, for comparison.

Source: 'Building our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013', Communication from the Commission to the Council and the European Parliament, COM (2004)101, Brussels, 10 February 2004, p. 43.

Table 11

Overview of the 'new' financial perspectives 2007 to 2013

Allocation by expenditure targets, in %

	2006*	2007	2008	2009	2010	2011	2012	2013
1. Sustainable growth	39.4	44.7	45.3	46.0	46.5	47.0	47.8	48.5
1a Competitiveness	7.3	9.1	10.4	11.7	12.9	14.1	15.3	16.3
1b Cohesion	32.1	35.6	34.9	34.3	33.6	32.9	32.5	32.2
2. Preservation & management of natural resources	46.4	42.8	41.7	40.6	39.5	38.5	37.5	36.5
2a Agriculture	36.2	32.6	31.5	30.3	29.3	28.4	27.5	26.7
2b Natural resources	10.2	10.2	10.3	10.3	10.2	10.1	9.9	9.8
3. Citizenship, freedom, security and justice	1.1	1.2	1.5	1.6	1.8	2.0	2.1	2.3
4. The EU as a global partner	9.3	8.5	8.8	9.0	9.4	9.7	9.8	9.9
5. Administration	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Compensations	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total appropriations for commitments	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: * Last year of the financial perspectives 2000-2006, for comparison.

Source: Own calculations from Table 10.

As can be seen in Tables 10 and 11, it is planned to allocate expenditures in the period 2007- 2013 across five chapters. Chapter 3 (Citizenship, freedom, security and justice), Chapter 4 (The EU as a global partner) and Chapter 5 (Administration) make up only a fragment of total expenditures, their share slightly increasing from 12.5% to 15%. Over 80% of the expenditures devolve on Chapter 1 (Sustainable growth) and Chapter 2 (Preservation and management of natural resources). Within

Chapter 2, environmental protection accounts for about 10% of total expenditures, while the funds allocated to agriculture drop from 36.2% in 2006 to 26.7% in 2013 owing to the reforms approved in 2003 capping expenditures on market support and direct aid between 2007 and 2013. This substantial change provides the sole opportunity for bolstering other items of expenditure. This opportunity is seized to the full in Chapter 1, sub-chapters Competitiveness and Cohesion. However, anyone who thinks increased diversity in the enlarged EU would mean increased spending on cohesion can think again. Only in the sub-chapter Competitiveness is it planned to increase funding: its share will increase from 7.3% of total expenditures in 2006 (the final year of the present financial planning period 2000-2006) to 16.3% in 2013 (the final year of the next planning period). It is planned to keep the share of the sub-chapter Cohesion practically unchanged at 32.1% (the level it will stand at in 2006 prior to the accession of Bulgaria and Romania) up until 2013, despite the fact that two very poor new countries will have joined the Union and completed their 'phasing in' in terms of structural policies in the first three years of the seven-year planning period.

The NMS will certainly benefit from the increased spending on competitiveness. The objectives of that chapter (improvement of enterprise competitiveness, increased spending on R&D, trans-European transport networks, improvement in the quality of education and training and finally a social policy agenda) are by no means less attractive to the new members than to the old ones. In this instance, however, the intention is to spread expenditures more or less equally among all 25 members, unlike expenditures on cohesion.

In the Cohesion chapter, transfers will increase from EUR 47.6 billion in 2007 to EUR 51 billion by the end of the planning period (at 2004 prices); they will be allocated among three groups of beneficiaries:

- 28.1% for highly developed member states above the average per capita GDP of the EU-25 (their underdeveloped regions or regions with structural problems and/or high unemployment), including in part a phasing-out programme;
- 23.6% for the three former Cohesion Countries, including in part a phasing-out programme; and
- 48.3% for 12 NMS, including a phasing-in programme for Romania and Bulgaria in the first three years of their membership.

As 51.7% of the total expenditures on cohesion will devolve on the old members, the NMS may find the proposed proportions unsatisfactory. However, the transfers that the Commission plans to make available for enhancing cohesion will bring about highly significant improvements compared to the situation in the period 2004-2006: a period of relatively modest transfers in the framework of structural policies on account of the 'phasing-in' process. Whereas in the period 2004-2006 the ten NMS will receive on average EUR 8 billion a year from the Structural and Cohesion Funds,⁹ from 2007 onwards annual transfers for the cohesion of this group of countries may amount to EUR 21 billion on average (both values at 2004 prices¹⁰).

⁹ Calculation based on data in 'Decision of the European Parliament and the Council on the Adjustment of the Financial Perspective for Enlargement', European Commission, COM (2003)70 final, Brussels, 11 February 2003, p. 7.

¹⁰ Calculation based on figures in 'Building our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013', Communication from the Commission to the Council and the European Parliament, Commission of the European Communities, COM (2004)101, Brussels, 10 February 2004, Annex II.

Table 12

Estimated distribution of EU expenditures for cohesion, 2007-2013

At prices of 2004

Country or group of countries	Share in total expenditures for cohesion, in %	Transfers received for cohesion, annual average, in billion euro, if redistribution is	
		1.14% of EU GNI	1.00% of EU GNI
12 'old' EU members with per capita GDP above the EU-25 average	28.1	13.9	12.2
'old' Cohesion Countries: Greece, Portugal and Spain	23.6	11.6	10.2
<i>EU-15</i>	<i>51.7</i>	<i>25.5</i>	<i>22.4</i>
Czech R.	7.7	3.8	3.2
Cyprus	0.1	0.5	0.4
Estonia	0.8	0.4	0.3
Hungary	7.3	3.6	3.1
Latvia	1.6	0.8	0.7
Lithuania	0.9	0.4	0.3
Malta	0.2	0.1	0.1
Poland	18.9	9.3	8.1
Slovakia	2.8	1.4	1.2
Slovenia	1.4	0.7	0.6
<i>'new' members 10</i>	<i>41.7</i>	<i>20.6</i>	<i>18.0</i>
Bulgaria	1.8	0.9	0.8
Romania	4.8	2.4	2.1
<i>'new' members 12</i>	<i>48.3</i>	<i>23.8</i>	<i>20.9</i>
EU-27	100.0	49.3	43.3

Source: Calculation based on figures in 'Building our Common Future. Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013', Communication from the Commission to the Council and the European Parliament. Commission of the European Communities, COM (2004)101, Brussels, 10 February 2004, Annex II.; *Figyelő* 9/2004, pp. 24-25 referring to information from the European Commission.

Even if only 1%, and not 1.14%, of the EU-25 GNI is redistributed in 2007-2013 and individual expenditure items are reduced proportionally, assistance available to the NMS as they set about catching up with the highly developed core of the EU will be much more significant than in their first three years of membership. However, this will not stop the NMS governments from fighting for every eurocent in the forthcoming bargaining process. They will direct their arguments towards achieving two aims: (i) replicating the volume of transfers received by the Cohesion Countries in the former EU-15; and (ii) securing an outcome to the bargaining process that can be presented to their constituents back home as a success. Should transfers to the NMS be substantially lower than those previously made available to the 'old' Cohesion Countries in the smaller (and on average richer) EU-15, the NMS will be bent on demonstrating that 'they do not sell out their national interests cheaply'.

It is the good growth performance, however, that will determine the speed of catching-up of the NMS with the highly developed core of the EU. Transfers may constitute an important contribution to achieving higher growth rates. Nevertheless, as the example of the *Neue Länder* in Germany illustrates, without the appropriate economic policy even a multitude of transfers that are earmarked for the NMS cannot secure catching-up.

Country reports

Josef Pöschl

Czech Republic: increasing competitiveness, higher GDP growth

Industrial production increased by 9% in the first quarter of 2004. By Czech standards, this was exceptionally high. With a rise of 8%, exports contributed positively to this result. Output in the construction sector grew by over 16% in the first quarter, surging to over 62% in April 2004. Faced with a higher VAT rate from May 2004 on, most construction companies may well have pre-dated their invoices. All this contributed to the backdrop for accelerated GDP growth: 3.1% year-on-year according to preliminary estimates for the first quarter of 2004. The major driving force was a marked increase in gross fixed investment: up 9.5%, attributable mainly to construction activities. Household consumption grew by 3.9%; this is rather low given the high wage increases. In the first quarter of 2004, gross monthly wages grew by 8.8% in nominal terms (6.2% in real terms). Moreover, consumer credits expanded further. At the end of April 2004, the stock of loans granted to households amounted to some EUR 7.9 billion or 10% of the GDP in 2003. Foreign trade contributed negatively to GDP, at least at constant prices. At current prices, the trade balance improved (see below).

On the sales side, the corporate sector profited from an upswing in the global economy; this translated into a somewhat better business climate in the eurozone, the main recipient of Czech exports. On the input side, things also developed positively for the corporate sector. Unit labour costs, in euro terms, sank almost continuously from mid-2003 onwards, without showing the slightest sign of the trend reversing in 2004. In other words, labour productivity growth almost always outstripped wage growth in euro terms. The latter was supported by the depreciation of the Czech koruna against the euro in the order of 4% (first quarter 2004 over first quarter 2003 average). Appreciation against the US dollar of more than 10% kept the rise of energy costs within limits.

Compensation of employees is still relatively low: some EUR 700 per month if calculated via exchange rates or 28% of the EU-25 average in 2003. On the other hand, the price level is only half of the EU-25 average, thanks in particular to low prices for non-tradable goods and services. Low wages are comforting for employers from the standpoint of production costs at least, whereas low prices also make life easier for employees. All in all, the impression is that a significant number of Czech producers of tradable goods are highly competitive. Trade intensity is high, and exports of goods tend to grow faster than imports. This has even been the case over the past few years, despite being confronted with an adverse business climate in most of the eurozone. The Czech trade deficit has shrunk over time only to disappear completely in recent months. Developments in services have been less favourable. Over the past few years they have always recorded surpluses: these, however, have steadily declined and recently came close to zero.

A high deficit characterizes the Czech Republic's current account, notwithstanding balance of trade in goods and services. The main contributory factor here is the profits stemming from prior foreign investment. They figure negatively in the income account, regardless whether the recipients

Table CZ

Czech Republic: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	10282.8	10272.5	10224.2	10200.8	10206.5	.	.	.	.
Gross domestic product, CZK bn, nom. ³⁾	1902.3	1984.8	2315.3	2414.7	2532.4	594.4	637.9	2700	2850
annual change in % (real) ³⁾	0.5	3.3	2.6	1.5	3.1	2.8	3.1	3.3	3.6
GDP/capita (EUR at exchange rate)	5016	5426	6644	7683	7792	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	12700	12490	14100	14920	15400	.	.	.	.
Gross industrial production									
annual change in % (real)	-3.1	5.4	6.5	4.8	5.8	6.2	9	7	7
Construction industry									
annual change in % (real)	-6.5	5.3	9.6	2.5	8.9	-0.8	16.2	.	.
Consumption of households, CZK bn, nom. ³⁾	1006.6	1059.6	1179.4	1220.6	1272.4	296.0	311.5	.	.
annual change in % (real) ³⁾	1.9	2.3	2.8	2.7	4.9	5.1	3.9	4	5
Gross fixed capital form., CZK bn, nom. ³⁾	528.3	561.5	638.6	643.3	676.9	150.3	161.9	.	.
annual change in % (real) ³⁾	-1.0	5.4	5.4	3.4	7.4	6.2	9.5	9	7
LFS - employed persons, th, avg. ⁴⁾	4764.1	4731.6	4750.2	4764.9	4733.2	4739.9	4671.0	.	.
annual change in %	-2.1	-0.7	0.4	0.3	-0.7	0.5	-1.5	.	.
LFS - employed pers. in industry, th, avg. ⁴⁾	1468.7	1429.4	1470.6	1463.1	1424.7	1426.4	1397.3	.	.
annual change in %	-3.4	-2.7	2.9	-0.1	-2.6	2.7	-2.0	.	.
LFS - unemployed persons, average	454.1	454.5	421.0	374.1	399.1	388.3	443.0	.	.
LFS - unemployment rate in %, average ⁴⁾	8.7	8.8	8.1	7.3	7.8	7.6	8.7	9	9
Reg. unemployment rate in %, end of period	9.4	8.8	8.9	9.8	10.3	10.0	10.7	11	11
Average gross monthly wages, CZK ⁵⁾	12797	13614	14793	15857	16917	15366	16722	.	.
annual change in % (real, gross)	6.2	2.4	3.8	5.3	6.7	7.6	6.4	.	.
Consumer prices, % p.a.	2.1	3.9	4.7	1.8	0.1	-0.4	2.3	3.2	2
Producer prices in industry, % p.a.	1.0	4.9	2.9	-0.5	-0.3	-0.6	1.8	3.5	2
General governm. budget, EU-def., % GDP ⁶⁾									
Revenues	46.5	42.8	44.1	45.6	45.0	.	.	.	.
Expenditures	50.1	47.3	50.6	52.0	57.9	.	.	.	.
Deficit (-) / surplus (+)	-3.7	-4.5	-6.4	-6.4	-12.9	.	.	-6	-5
Public debt, EU-def., in % of GDP ⁶⁾	14	18	25	29	38	.	.	41	42
Discount rate, % p.a., end of period	5.0	5.0	3.8	1.8	1.0	1.5	1.0	.	.
Current account, EUR mn	-1372	-2945	-3652	-4426	-4937	-254	-476	-5600	-6000
Current account in % of GDP	-2.7	-5.3	-5.4	-5.6	-6.2	.	.	-6.6	-6.5
Gross reserves of NB incl. gold, EUR mn	12771	14159	16400	22614	21341	22708	22076	.	.
Gross external debt, EUR mn	22765	23285	25368	25738	27599	24715	.	.	.
FDI inflow, EUR mn	5933	5404	6296	9012	2289	861	802	.	.
FDI outflow, EUR mn	84	47	185	219	206	1	37	.	.
Exports of goods, BOP, EUR mn	24640	31483	37251	40711	43079	10545	11380	47000	51000
annual growth rate in %	6.8	27.8	18.3	9.3	5.8	7.0	7.9	9	8.5
Imports of goods, BOP, EUR mn	26424	34876	40675	43026	45258	10678	11419	48500	51500
annual growth rate in %	4.1	32.0	16.6	5.8	5.2	5.3	6.9	7	6
Exports of services, BOP, EUR mn	6612	7436	7913	7501	6882	1516	1616	7300	7800
annual growth rate in %	-3.1	12.5	6.4	-5.2	-8.3	-18.7	6.6	6	7
Imports of services, BOP, EUR mn	5486	5904	6211	6792	6466	1415	1606	7300	8300
annual growth rate in %	7.4	7.6	5.2	9.4	-4.8	-10.3	13.5	13	14
Average exchange rate CZK/USD	34.60	38.59	38.04	32.74	28.23	29.47	26.28	.	.
Average exchange rate CZK/EUR (ECU)	36.88	35.61	34.08	30.81	31.84	31.63	32.85	32	31
Purchasing power parity CZK/USD, wiiw	14.08	14.14	14.32	14.77	14.85	.	.	.	.
Purchasing power parity CZK/EUR, wiiw	14.57	15.47	16.06	15.86	16.11	.	.	.	.

Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) Methodological break 2000/2001 - from 2001 according to ESA 95. - 4) From 2002 weighted according to census 2001. - 5) Enterprises with more than 20 employees, including part of the Ministry of Defence and the Ministry of the Interior. - 6) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

repatriate them, invest them elsewhere or reinvest them in the Czech Republic. The stock of FDI in the Czech Republic amounts to EUR 37.6 billion (end-2003) or around 50% of the GDP. The profits generated by past foreign investment amount to about 6% of GDP and imply a gap of similar size between GDP and Gross National Income. In the first quarter of 2004, FDI amounted to about EUR 1 billion. The inflow of FDI for 2004 as a whole is likely to increase compared to 2003. Foreign capital is involved in large parts of the corporate sector, the major concentration being in the production of transport equipment and the associated industries.

The massive involvement of foreign investors has had an adverse impact on employment. Compared to domestically owned enterprises, foreign-owned enterprises economize on labour input. Labour productivity is correspondingly high and permits the payment of relatively high wages. Foreign-owned manufacturers have a relatively low share in overall employment, but a high share in exports. The number of registered jobless remains around 10% of the labour force; it fell slightly below this mark at the end of May. The unemployment rate calculated on the basis of Labour Force Survey data is somewhat lower.

As mentioned already, Czech prices are on average low compared to the EU-25 overall price level. None the less, no forces nudging prices upwards are to be seen. Inflation would hardly feature at all, were it not for government intervention. Average inflation for 2004 can be expected to climb up to around 3%; for the most part this will be the outcome of higher indirect taxes, an upward shift in the upper limits of regulated prices and higher energy costs. Because of the latter, producer prices, which are much less exposed to regulations, are on the rise (1.8%, year-on-year, first quarter 2004). The import price index for the first quarter of 2004 was unchanged compared to the same period in 2003, but the increase in certain sub-groups, especially materials, may have had an impact on producer prices. Export prices rose by 2.6%. In euro terms, Czech exports may have slightly declined in price as a result of the 4% devaluation of the Czech koruna (first quarter 2004 over first quarter 2003).

The policy adopted by the Czech National Bank (CNB) last year creates the impression of having been inspired by Alan Greenspan rather than by the European Central Bank. The CNB pioneered a policy of low interest rates; this has put an end to the appreciation pressure vis-à-vis the euro that emerged after 1999. Credits, for both households and enterprises, became cheaper: a fact that helped to overcome the stagnation tendencies arising in the late 1990s. Textbook knowledge would suggest that a policy of low interest rates fuels inflation. In the case of the Czech Republic this has not been borne out. On the contrary, the economy has come close to deflation. This experience deserves much closer attention on the part of economists than it has attracted so far.

The CNB-controlled interest rates may have bottomed out. Expectations of a rise are gaining ground in the context of the inflation hike expected for 2004. If this turns out to be true, some appreciation pressure could re-emerge. The nomination of Zdeněk Tuma as CNB governor, as well as other members of the present board of directors, was the personal choice of the former president, Václav Havel. Most likely, the current president, Václav Klaus, will nominate persons of his choice for the next term. This could point to some change in CNB policy from 2005 onwards.

The deficit in the consolidated budget of the public sector was huge in 2003: 12.9% of GDP. The government debt leapt to around 40% of GDP. The reason, however, was not an immense gap between current revenues and expenditures. In addition to the normal expenditures for the year

2003, the finance ministry switched to the EU budget monitoring methodology and included the deficit of the consolidation agencies as well as the amount of credit guarantees that Czech governments had signed in the past, e.g. in the search for foreign strategic partnerships with Czech banks. Most of these items will not burden the budget for 2004 and the years thereafter. It is therefore quite realistic for the finance ministry to count on a budget deficit of around 6% of GDP in 2004 and an even lower ratio thereafter. Given increased GDP growth and higher inflation, the budget deficit in 2004 could well turn out even lower. Alternatively, the government might decide to stay with the higher deficit, thus granting themselves some budgetary breathing space for co-financing EU projects.

In 2005, interest rates will probably be higher than to date. In this context we can expect the Czech currency to appreciate somewhat against the euro. The government – a new one after the resignation of premier Špidla – will come under pressure to reduce its deficit. At the same time, however, it will have to make some budgetary funds available for the co-financing of EU projects, failing which the inflow of EU transfers will be meagre. Taken together, economic policy will barely contribute to the improvement of the business climate. Nevertheless, the latter is likely to remain friendly thanks to increasing private consumption, expanded construction activities, more corporate investment in machinery and widening export opportunities: all reasonable prospects as the competitiveness of the corporate sector is likely to remain unscathed.

Sándor Richter

Hungary: back to sustainable growth?

Despite restrictive monetary conditions, a revaluation of the national currency, cuts in government spending and a decline in household consumption, Hungary's economic performance has been improving spectacularly since late 2003. It seems that the modest recovery in the main Hungarian export markets has more than offset any obstacles to more rapid economic expansion and so helped place the country back on track again to export- and investment-driven growth.

The last quarter of 2003 already hinted at an acceleration of economic growth, but the 2004 first quarter GDP growth rate of 4.2% was much higher than expected. Even if this is partly a statistical effect due to the weak performance in the respective period of the previous year, the recovery is none the less spectacular: the best quarterly growth rate performance in the last three years. The shift in the components of growth bears even greater promise; gross fixed investment increased by close to 20% in the first quarter, within that figure investment in manufacturing rose by 31.2%. Exports increased by 19%, imports by only 16% (both in real terms) in the first three months. The trade deficit amounted to 7.6% of exports, whereas in the respective period of the previous year it had stood at 10.2% (customs statistics at current prices). Gross value-added of commodity output increased by 7.2%, while that of services by only 3.2%.

Industry data reflect the same tendency. Gross output increased by 10.8% in the first quarter of 2004 and exports sales expanded by 21%, while domestic sales declined. As in 1997-2001, the engine of growth has been foreign-owned companies in such branches as computer manufacturing, telecommunications, consumer electronics, electronic components and the automobile industry.

Table HU

Hungary: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., end of period	10222	10200	10175	10142	10117	10131	10108	10085	10065
Gross domestic product, HUF bn, nom.	11393.5	13150.8	14849.8	16740.4	18574.0	4271.2	4670.2	20500	22300
annual change in % (real)	4.2	5.2	3.8	3.5	2.9	2.7	4.2	4	4.3
GDP/capita (EUR at exchange rate)	4402	4953	5679	6782	7233	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	10200	11030	12020	12840	13680	.	.	.	.
Gross industrial production									
annual change in % (real)	10.4	18.1	3.6	2.7	6.4	4.1	10.8	13	15
Construction industry									
annual change in % (real)	9.0	7.9	7.7	17.5	0.7	-17.3	19.5	.	.
Consumption of households, HUF bn, nom.	5826.6	6689.2	7680.4	8767.2	9989.4	2367.4	2626.3	.	.
annual change in % (real)	5.4	4.4	5.7	10.3	7.6	8.5	3.8	2	2.5
Gross fixed capital form., HUF bn, nom.	2724.5	3179.8	3493.0	3916.9	4086.1	582.4	723.3	.	.
annual change in % (real)	5.9	7.7	5.0	8.0	3.0	-1.6	18.9	10	13
LFS - employed persons, th, avg. ²⁾	3811.5	3849.1	3859.5	3870.6	3921.9	3859.6	3891.5	.	.
annual change in % ²⁾	3.1	1.0	0.3	0.1	1.3	0.5	0.8	.	.
Reg. employees in industry, th pers., avg. ³⁾	834.0	844.8	833.9	817.9	801.7	807.2	789.2	.	.
annual change in %	0.8	1.3	-1.3	-1.9	-2.0	-2.7	-2.2	.	.
LFS - unemployed persons, th, average	284.7	262.5	232.9	238.8	244.5	264.7	252.2	.	.
LFS - unemployment rate in %, average	7.0	6.4	5.7	5.8	5.9	6.4	6.1	5.9	5.9
Reg. unemployment rate in %, end of period ⁴⁾	9.4	8.6	8.0	8.0	8.4	8.9	9.2	8	8
Average gross monthly wages, HUF ⁴⁾	77187	87645	103553	122482	137187	128636	140728	.	.
annual change in % (real, net)	2.5	1.5	6.4	13.6	9.2	13.9	1.1	.	.
Consumer prices, % p.a.	10.0	9.8	9.2	5.3	4.7	4.6	6.8	6.5	4.8
Producer prices in industry, % p.a.	5.1	11.6	5.2	-1.8	2.4	0.7	4.3	.	.
General governm.budget, EU-def., % GDP ⁵⁾									
Revenues	.	.	45.5	45.0	44.5	.	.	.	.
Expenditures	.	.	49.9	54.3	50.4	.	.	.	.
Deficit (-) / surplus (+)	.	-3.0	-4.4	-9.3	-5.9	.	.	-4.9	-4.3
Public debt, EU-def., in % of GDP ⁵⁾	61.2	55.4	53.5	57.1	59.1	.	.	58.7	58
Refinancing rate, % p.a., end of period	14.5	11.0	9.8	8.5	12.5	6.5	12.3	.	.
Current account, EUR mn	-3531	-4380	-3613	-4900	-6488	-1488	-1756	-6500	-6300
Current account in % of GDP	-7.8	-8.7	-6.2	-7.1	-8.9	-8.5	-9.8	-8.0	-7.1
Reserves total, excl. gold, EUR mn	10845	12038	12164	9887	10108	12499	10067	.	.
Gross external debt, EUR mn	29230.9	32571.5	37387.0	38424.9	44093.4	40384	.	.	.
FDI inflow, EUR mn	3106	2998	4391	3026	2182	403	562	.	.
FDI outflow, EUR mn	235	664	399	292	1408	472	252	.	.
Exports of goods, BOP, EUR mn	24059	31278	34697	36821	38161	8947	10213	43500	48700
annual growth rate in %	14.3	30.0	10.9	6.1	3.6	-0.5	14.1	14	12
Imports of goods, BOP, EUR mn	26102	34457	37193	39024	41132	9547	10719	46100	51000
annual growth rate in %	14.8	32.0	7.9	4.9	5.4	1.0	12.3	12	11
Exports of services, BOP, EUR mn	4910	6114	7435	7269	7036	1541	1530	.	.
annual growth rate in %	2.1	24.5	21.6	-2.2	-3.2	-0.6	-0.7	.	.
Imports of services, BOP, EUR mn	4094	4907	5809	6677	7207	1674	1912	.	.
annual growth rate in %	9.6	19.9	18.4	14.9	7.9	5.7	14.2	.	.
Average exchange rate HUF/USD	237.31	282.27	286.54	258.00	224.44	226.95	208.09	.	.
Average exchange rate HUF/EUR (ECU)	252.80	260.04	256.68	242.97	253.51	243.63	260.31	253	251
Purchasing power parity HUF/USD, wiiw	99.85	108.60	111.76	118.63	124.25	.	.	.	.
Purchasing power parity HUF/EUR, wiiw	109.11	116.74	121.28	128.33	134.09	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census 2001 and excluding conscripts. - 3) Enterprises with more than 5 employees. - 4) From 2001 wiiw estimate. - 5) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

According to surveys conducted by the Budapest-based research institute KOPINT, capacity utilization in the manufacturing sector amounted to close on 82% in the first quarter (compared to the 78% a year earlier).

The growth rate of household consumption dropped to less than half the rate a year earlier (3.8%) reflecting the marginal growth in real wages (1% compared to 14% in the first quarter of the previous year).

In May, Hungary published its 2004 Convergence Report with a new target date for the introduction of the euro: January 2010. The earlier target date 2008 announced in June 2003 had proved unsustainable in the wake of the exchange rate volatility and the loss of credibility in terms of economic and monetary policy since the second half of 2003. In early 2004 Hungary missed all but one of the four Maastricht criteria; even the one criterion it fulfilled, less than 60% public debt relative to GDP, was just marginally below the limit. Hungary has the weakest record among the new EU members. The intention to revise the 2008 target date was declared as early as January, but the government's new strategy concerning the introduction of the euro was only put forward in the Convergence Report. The new target date implies that Hungary intends to meet the four Maastricht criteria by the end of 2007, prior to spending two years thereafter (2008-2009) in the ERM II. The most important difference between the old and new strategy is the difference in timing the reduction of the budget deficit to 3% of the GDP. In order to preserve the growth momentum of the economy, the budget deficit relative to the GDP will be decreased by only 0.5 percentage points annually – and not by 1 percentage point as originally planned. This means postponing the reduction of the deficit to the mandatory level of 3% by two years, from 2005 to 2007. The new schedule makes for a more growth-friendly mode of cuts in government spending and also provides for a tax reform that leaves more income in the business sector. The projected lowering of indirect taxes is also intended to help reduce inflation to the requisite level in the critical two years prior to introducing the euro.

The new medium-term economic strategy envisages accelerating GDP growth (from 3.3-3.5% this year to 4.5-5.5% by 2008) and household consumption lagging by 1 to 1.5 percentage points behind the GDP growth rate in each of the four years. This is a pronounced shift compared to the economic policy of 2001-2003 when, on average, the annual growth rate of household consumption was about 5 percentage points higher than that of the GDP. Unlike the hasty proclamation last summer of 2008 as the target date for introducing the euro, this time round the government has consulted with the social partners and the research community before taking a decision. Negotiations with social partners are also scheduled for this autumn focusing on a medium-term price/wage agreement that would appear to be an essential prerequisite for the successful implementation of the new strategy.

Consumer price inflation amounted to 6.9% in April (year-on-year): equivalent to 4.7% inflation after adjusting for the one-time effect of the rise in excise taxes related to entry into the EU. With inflation being less than expected, the central bank had to revise its (year-end) inflation forecast for 2004 downwards to 6% (from 6.9%). Following a period of high volatility and an exchange rate fluctuating between 260 and 270 HUF/EUR in the first seven weeks of this year, the forint appreciated; it stabilized at around HUF/EUR 252 by the end of May, well within the informal exchange rate target band HUF/EUR 250 to 260 that had been targeted by the central bank prior to the exchange rate turbulence in 2003. Given the stronger forint and the improved macroeconomic data, the Monetary Council of the central bank reduced, in three discrete steps, the key rate from 12.5% to 11.5%. The

danger of the forint undergoing a substantial devaluation on account of unsustainable external disequilibrium diminished, leading to lower risk premia on forint-denominated government securities.

Economic performance in 2004 will still be determined in part by the effects of the disappearance of consumption-driven growth and in part by those of the re-emergence of export- and investment-driven growth. GDP may thus increase within the broad range of 3.7 to 4.3%. The current account deficit¹¹ will be more or less as high as in the previous year; non-debt creating financing will compensate for a greater share of the deficit than in 2003, but it will not suffice to cover it fully. The current account deficit thus remains a matter of concern. The general government deficit in January to April followed more or less the path projected, whereas with economic growth being stronger than originally assumed fulfilment of the annual target (4.6% relative to the GDP) becomes feasible – probably without any additional cuts in public expenditure.

Leon Podkaminer

Poland: a boom, but no jobs

GDP growth accelerated throughout 2003, with the growth rate rising from 2.3% in the first quarter to 4.7% in the fourth. Rapid growth continued in the first quarter of 2004 and beyond – with industrial production recording double-digit growth in April. Although the fundamental factors behind the observed performance have not changed much, it is unlikely that the extreme GDP growth in the first quarter of 2004 can be sustained in the remaining quarters of the year. It transpires that in the first quarter of 2004 inventories experienced a massive hike; this accounted for about 2.5 percentage points out of the overall 6.9% GDP growth rate recorded in that quarter. Without that rise in inventories, growth in the first quarter of 2004 would have been about 4.4%. Growth of the latter magnitude seems more likely in the quarters to come, bringing the annual GDP growth rate down to about 5%.

The exchange rate continues to be relatively stable and rather weak compared to earlier years. Combined with continuing impressive gains in labour productivity and unit labour costs, this has improved export performance. Private consumption has also been on the rise – not only on account of the purchasing power of wages having experienced a mild recovery, but also on account of relatively low interest rates having been conducive to a greater volume of consumer loans. For the first time in several years, gross fixed investment rose by 3.5%. With profits improving markedly, the corporate sector has been gradually reducing its major debts to banks that had accumulated over the period 2000-2002. Although the proportion of 'problem' loans extended to the corporate sector overall is still rather high (about 20%), it is now becoming less of a problem. In due course the accumulation of own funds in the corporate sector, combined with improvements in the sector's credit rating, should permit a more pronounced expansion of fixed investment activities. Rises in levels of capacity utilization (currently about 80% in export-oriented firms and 75% among other

¹¹ Due to methodological changes to comply with international standards, namely the inclusion of foreign-owned companies' profits re-invested in Hungary (as outflow on the current account and simultaneously as inflow on the capital account), the reported current account deficits are substantially higher than before the methodological change. These changes are of no economic significance.

Table PL

Poland: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., end of period ²⁾	38654	38644	38633	38219	38191	38237	38181	.	.
Gross domestic product, PLN mn, nom. ³⁾	615115	684982	750786	771113	814698	187098	203723	881100	948400
annual change in % (real)	4.1	4.0	1.0	1.4	3.8	2.3	6.9	5	4.5
GDP/capita (EUR at exchange rate)	3765	4419	5296	5231	4849	.	.	.	.
GDP/capita (EUR at PPP - WIIW)	8410	8960	9550	9900	10370	.	.	.	.
Gross industrial production (sales)									
annual change in % (real)	3.6	6.7	0.6	1.1	6 ⁴⁾	4.4 ⁵⁾	19.0 ⁵⁾	10	7
Construction output total									
annual change in % (real)	6.2	1.0	-6.4	-0.3	.	-20.9 ⁵⁾	-5.0 ⁵⁾	.	.
Consumption of households, PLN mn, nom.	390474	440520	479154	503960	529872	132169	139474	.	.
annual change in % (real)	5.2	2.7	2.0	3.3	3.1	1.3	4.0	3.5	3.5
Gross fixed capital form., PLN mn, nom.	156690	170430	157209	147338	148962	24621	25583	.	.
annual change in % (real)	6.8	2.7	-8.8	-5.8	-0.9	-3.8	3.5	5	6
LFS - employed persons, th, avg.	14757.0	14526.0	14207.0	13782.0	13616.8	13589.0	13465.0	.	.
annual change in %	-3.9	-1.6	-2.2	-3.0	-1.2	-0.8	-0.9	.	.
Reg. employees in industry, th pers., avg.	3138.4	2955.0	2820.6	2670.5	.	2413.0 ⁵⁾	2397.0 ⁵⁾	.	.
annual change in %	-7.1	-5.8	-4.5	-5.3	.	-3.2 ⁵⁾	-0.7 ⁵⁾	.	.
LFS - unemployed persons, average ²⁾	2391.0	2785.0	3170.0	3431.0	3328.5	3513	3509	.	.
LFS - unemployment rate in %, average ²⁾	13.9	16.1	18.2	19.9	19.6	20.5	20.7	20	19
Reg. unemployment rate in %, end of period ²⁾	13.1	15.1	17.5	20.0	20.0	20.6	20.5	19	18
Average gross monthly wages, PLN ⁶⁾	1697.1	1893.7	2045.1	2097.8	2201.5	2228.7 ⁵⁾	2332.2 ⁵⁾	.	.
annual change in % (real, gross)	4.7	1.0	2.5	0.7	4.1	2.9 ⁵⁾	4.6 ⁵⁾	.	.
Consumer prices, % p.a.	7.3	10.1	5.5	1.9	0.8	0.5	1.6	3	3
Producer prices in industry, % p.a.	5.7	7.8	1.6	1.0	2.6	3.0	4.3	4.5	4
General governm.budget, EU-def., % GDP ⁷⁾									
Revenues	40.8	40.2	41.3	41.3	41.0	.	.	.	.
Expenditures	42.6	42.03	44.8	44.9	45.1	.	.	.	.
Deficit (-) / surplus (+)	-1.9	-1.8	-3.5	-3.6	-4.1	.	.	-6	-4.5
Public debt, EU-def., % of GDP ⁷⁾	40.3	36.6	36.7	41.2	45.4	.	.	49.1	50.3
Discount rate of NB % p.a., end of period	19.0	21.5	14.0	7.5	5.8	6.5	5.8	.	.
Current account, EUR mn	-11719	-10796	-5994	-5404	-3660	-1647	-348	-3000	-4000
Current account in % of GDP	-8.1	-6.3	-2.9	-2.7	-2.0	-3.7	-0.8	-1.6	-2.1
Gross reserves of NB excl. gold, EUR mn	26224	28555	29031	27367	25847	27579	28856	.	.
Gross external debt, EUR mn	65043	74672	81380	80920	82317	82416	.	.	.
FDI inflow, EUR mn	6824	10334	6372	4371	3756	1328	860	.	.
FDI outflow, EUR mn	29	18	-97	228	343	128	21	.	.
Exports of goods, BOP, EUR mn	28215	39022	46537	49338	53836	12097	13642	58700	62800
annual growth rate in %	-2.5	38.3	19.3	6.0	9.1	8.3	12.8	9	7
Imports of goods, BOP, EUR mn	42361	52349	55094	57039	58913	13624	14777	63000	68700
annual growth rate in %	4.9	23.6	5.2	3.5	3.3	3	8.5	7	9
Exports of services, BOP, EUR mn	7850	11311	10913	10543	9844	1962	2323	10700	11100
annual growth rate in %	-18.8	44.1	-3.5	-3.4	-6.6	-6.8	18.4	9	3
Imports of services, BOP, EUR mn	6553	9771	10007	9690	9408	2214	1866	9400	9500
annual growth rate in %	10.9	49.1	2.4	-3.2	-2.9	2.4	-15.7	0	1
Average exchange rate PLN/USD	3.97	4.35	4.09	4.08	3.89	3.90	3.82	.	.
Average exchange rate PLN/EUR (ECU)	4.23	4.01	3.67	3.86	4.40	4.18	4.78	4.8	5
Purchasing power parity PLN/USD, WIIW	1.73	1.84	1.88	1.88	1.86	.	.	.	.
Purchasing power parity PLN/EUR, WIIW	1.89	1.98	2.04	2.04	2.06	.	.	.	.

Notes: 1) Preliminary. - 2) 2002 according to census May 2002. - 3) From 2001 new methodology. Revised data in 2003, not comparable to previous years. - 4) wiiw estimate. - 5) Enterprises with more than 9 employees. - 6) Including mandatory premium for social security. - 7) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

firms) should be conducive to investments on a larger scale – all the more so as firms are currently very optimistic in terms of their demand expectations. In the second quarter of 2004 only about 27% of firms polled¹² cited insufficient demand and the poor economic situation of their customers (e.g. arrears in payments) as major obstacles to their own expansion. This is a marked improvement over the first quarter of 2004 (33%) and the second quarter of 2003 (55%). Much higher investments are also to be expected in the public sector (particularly at the communal level) since the EU will be providing sizeable co-financing for many projects. Generously supported by the EU (and domestic) subsidies, agricultural investment is expected to expand very strongly.

The high growth recorded in industrial production, exports and overall GDP in the first months of 2004 may have been boosted by the realities of formal EU accession as it drew nearer. In the run-up to 1 May, many firms engaged in 'pre-emptive' exports – to avoid paying the double VAT that after entry was to be levied on exports to the EU (because of the delay in enacting proper EU regulations). Consumer demand for numerous items was also abnormally strong as rumours spread about post-accession price increases, thus giving rise to an outbreak of extensive buying.

With EU accession behind it, the pace of growth in Poland is likely to slow down somewhat over the current year. Industrial production and exports are likely to grow more moderately – a further factor being the increased likelihood of emerging production bottlenecks. Certainly, in some branches the export boom only began at the time of accession. This applies to many farm products such as poultry, bovine and milk products, the export of which to the EU had been officially restricted prior to 1 May. On the other hand, the ongoing recovery (particularly in terms of investment) will also boost imports.

Overall, though currently beneficial to exporters, EU accession is also nurturing fears among a large number of firms that to all intents and purposes have yet to learn how to function under the new conditions. 31% of the firms polled cited uncertainty about the new terms and conditions, ongoing legal and regulatory changes (and the need to adjust accordingly) as well as increased competition from EU firms, as obstacles to expansion (as against 18% in the first quarter of 2004 and 15% in the fourth quarter of 2003). Clearly, accession has caught many firms literally unprepared. Many of them, particularly small and medium-sized domestic enterprises, may not survive long enough to get accustomed to the new environment.

Despite high growth, the unemployment rate remains stuck at a very high level, with overall employment falling (albeit slowly) and employment in the enterprise sector close to stagnant. A negative employment situation, a public health system in complete disarray and renewed attempts to cut still further social spending and transfers to the most disadvantaged segments of society have induced a political crisis. The party in power (social-democratic by name, but otherwise pretty much liberal in practice) is mired in corruption and scandals; it has disintegrated as a result. The government nominated by the President does not have a secure the solid parliamentary backing. Early elections and prospects of the radicals (whether of the populist or nationalist persuasion) winning loom large. In the event that the radical parties emerge victorious, it is hard to predict the economic policy hoops they will jump through. For all their alarming rhetoric, the overall course of economic policy may not in practice change all that radically.

¹² See the website of the National Bank of Poland (www.nbp.pl/publikacje/koniunktura).

The present political instability may still have some negative repercussions. Making the best out of accession calls for a vigilant, strong and competent administration that is capable of taking decisive actions at home and adopting a firm stance towards the EU bureaucracy. Apart from that, the domestic economic situation does not seem to be adversely affected by the political confusion. The deficit in public finances is even smaller than projected (partly on account of growth having been stronger than expected). To the extent that it contributes to the weakness of the Polish currency, persistent political instability may be even viewed in a positive light. Of course, this point should not be stretched too far. At its present level, the exchange rate may be just about right for the real economy. However, if it were to drop further in value to any marked degree, that could well be an unwelcome development as it might fuel inflationary pressures that are already building up owing to the higher VAT/excise tax rates now required by the EU, as well as on account of the rising world market prices for many raw materials, including energy.

In any event inflationary pressures are quite likely to evoke a predictable response from the National Bank: higher interest rates. It is debatable whether higher interest rates will prove efficient in curbing current inflation. It does seem quite obvious, however, that much higher interest rates can disrupt overall growth at far too early a stage. A slowdown in growth in 2005 would then probably follow.

Zdenek Lukas

Slovakia: an eager reformist, yet distinctly unpopular government

In order to make up for time lost prior to 1998, Slovakia is now ramming through a series of the most radical reforms in the EU – albeit in concert with social hardship. Whereas foreign investors heap the government with praise, most Slovaks cannot conceal their disillusionment. In the second round of the presidential election on 17 April, Ivan Gasparovič, the former nationalist speaker of parliament, beat his former political friend Vladimír Mečiar; while the candidate of the governing coalition lost. Despite his primarily ceremonial position, the Slovak president has the right to veto bills, acts and amendments thereto, whereafter parliament has to decide whether to pursue or drop the issue. Based on the experience of the term of the former president, Rudolf Schuster, also a strict opponent of the current government, presidential vetoes can be seen as a means of delaying reforms rather than stopping them completely. In any event, the government has already forced through the bulk of its comprehensive economic reform programme. The programme is primarily targeted towards sustaining economic growth and reducing the budget deficit. Sustainability is to be achieved mostly by attracting foreign investors. As an appropriate tool to that end, the government has adopted a 19% tax rate for corporate profits, personal income and all other types of income: an extremely low tax rate compared to other EU countries. It came into effect on 1 January 2004. The expected decline in related revenues should be offset by a standard value-added tax rate of 19% on all goods (including staples) and services; this replaces the previous two-tier VAT scheme. Those in favour of this wide-ranging tax reform are banking on more effective tax collection, more FDI, stronger economic growth and a stabilization of budgetary revenues. However, those opposing it underscore the unfairness inherent in any flat-tax system, with the rich reaping most of the benefits of lower taxation, while the low- and medium-income groups have to bear the brunt, primarily in the form of more indirect taxes.

Table SK

Slovak Republic: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	5395.3	5400.7	5379.8	5378.6	5378.8	.	.	.	.
Gross domestic product, SKK bn, nom.	844.1	934.1	1009.8	1096.4	1195.8	272.2	308.2	1330	1460
annual change in % (real)	1.5	2.0	3.8	4.4	4.2	4.1	5.5	4.5	5
GDP/capita (EUR at exchange rate)	3546	4061	4334	4774	5358	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9160	9910	10480	11330	11730	.	.	.	.
Gross industrial production									
annual change in % (real)	-2.7	8.6	6.9	6.5	5.3	10.7	6.6	6	7
Construction industry									
annual change in % (real)	-25.8	-0.4	0.8	4.1	6.0	3.0	2.9	.	.
Consumption of households, SKK bn, nom.	473.0	519.6	577.5	623.1	667.5	159.6	176.3	.	.
annual change in % (real)	2.7	-0.9	4.9	5.3	-0.6	2.6	3.0	2	5
Gross fixed capital form., SKK bn, nom.	249.8	242.3	291.0	300.6	308.4	65.7	68.2	.	.
annual change in % (real)	-19.6	-7.2	13.9	-0.9	-1.2	-2.0	0.9	4	7
LFS - employed persons, th, avg.	2132.1	2101.7	2123.7	2127.0	2164.6	2130.8	2128.8	.	.
annual change in %	-3.0	-1.4	1.0	0.2	1.8	1.2	-0.1	.	.
LFS - employed pers. in industry, th, avg.	630.3	615.3	628.8	640.9	634.1	637.2	626.8	.	.
annual change in %	-4.9	-2.4	2.2	1.9	-1.1	-0.6	-1.6	.	.
LFS - unemployed persons, average	416.8	485.2	508.0	486.9	459.2	482.7	511.5	.	.
LFS - unemployment rate in %, average	16.2	18.6	19.2	18.5	17.4	18.4	19.3	17	16
Reg. unemployment rate in %, end of period	19.2	17.9	18.6	17.5	14.0	16.5	16.0	14	13
Average gross monthly wages, SKK	10728	11430	12365	13511	14365	13082	14541	.	.
annual change in % (real, gross)	-2.8	-4.5	0.8	5.8	-2.0	-1.0	2.7	.	.
Consumer prices, % p.a.	10.6	12.0	7.1	3.3	8.5	7.6	8.3	8	5
Producer prices in industry, % p.a.	4.3	10.8	6.5	2.1	8.3	8.5	3.0	5	4
General governm.budget, EU-def., % GDP ²⁾									
Revenues	49.8	47.6	45.5	45.2	49.1	.	.	42	43.1
Expenditures	56.9	59.9	51.5	50.9	52.7	.	.	46.1	47
Deficit (-) / surplus (+)	-7.1	-12.3	-6.0	-5.7	-3.6	.	.	-4.1	-3.9
Public debt in % of GDP ²⁾	43.8	49.9	48.7	43.3	42.8	.	.	45.1	46.1
Discount rate, % p.a., end of period	8.8	8.8	8.8	6.5	6.0	6.5	5.5	.	.
Current account, EUR mn	-920	-761	-1950	-2043	-248	-91	108	-300	-500
Current account in % of GDP	-4.8	-3.5	-8.4	-8.0	-0.9	.	.	-0.9	-1.4
Gross reserves of NB incl. gold, EUR mn ³⁾	3410	4391	4748	8824	9717	9099	10019	.	.
Gross external debt, EUR mn ⁴⁾	10470	11637	12516	12655	14654	12877	14673 ^{Feb}	.	.
FDI inflow, EUR mn	366	2089	1768	4378	506	314	276 ^{Feb}	.	.
FDI outflow, EUR mn	-348	23	39	5	20	12	1 ^{Feb}	.	.
Exports of goods, BOP, EUR mn	9603	12879	14115	15270	19355	4219.1	5011.3	22800	26200
annual growth rate in %	0.7	34.1	9.6	8.2	26.7	24.0	18.8	18	15
Imports of goods, BOP, EUR mn	10628	13860	16488	17517	19923	4358.9	4996.5	22900	26300
annual growth rate in %	-8.6	30.4	19.0	6.2	13.7	12.9	14.6	15	15
Exports of services, BOP, EUR mn	1937	2436	2779	2958	2912	691.9	458 ^{Feb}	.	.
annual growth rate in %	-10.7	25.8	14.1	6.4	-1.5	3.5	.	.	.
Imports of services, BOP, EUR mn	1732	1961	2244	2474	2703	676.9	437 ^{Feb}	.	.
annual growth rate in %	-14.5	13.2	14.5	10.3	9.2	24.1	.	.	.
Average exchange rate SKK/USD	41.42	46.20	48.35	45.34	36.77	38.96	32.43	.	.
Average exchange rate SKK/EUR (ECU)	44.12	42.59	43.31	42.70	41.49	41.80	40.58	40	39.5
Purchasing power parity SKK/USD, wiiw	15.63	16.23	16.51	16.63	17.22	.	.	.	.
Purchasing power parity SKK/EUR, wiiw	17.08	17.45	17.91	17.99	18.95	.	.	.	.

Notes: 1) Preliminary. - 2) According to ESA 95, excessive deficit procedure. - 3) From January 2002 new valuation of gold. - 4) Up to 2002 wiiw calculated from USD, in 2003 original data in EUR.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

As for the stabilization and the ultimate reduction of the budget deficit, the administration has initiated a radical reform of the welfare state: the criteria governing qualification for the receipt of full social benefits and maximum allowances have been tightened. The funding and management of the health system, encompassing public hospitals and private pharmacies, has been reorganized. As for the pension system, the Slovak parliament approved a new bill in 2003 that provided for a gradual increase in the statutory retirement age (up to 62) and the establishment of privately managed personal pension schemes, into which workers will pay half of their compulsory social security contributions. As of January 2005, the new pension scheme will be mandatory for new entrants to the labour market, whereas current workers will be given the choice.

Earlier this year the administration reduced basic social benefits to long-term jobless with the declared aim of lowering budgetary expenditures. It lowered the ceiling for transfer payments to families: for example, by introducing family allowances degressive with the number of children. As was to be expected, this reform led to a huge uproar among the Roma living in slum quarters, some 300,000 persons located predominantly in the eastern part of the country. Most of them are trapped in a vicious circle of low education and extremely low job opportunities. Major efforts will be called for to change this situation, including EU funding, for example, in the context of rural development initiatives; such a move, however, requires co-financing from national sources. In fact, pronounced social disparities are coming to the fore in general and may well scupper the current government's fragile political mandate.

The Slovak export-oriented economy has forged ahead over the past three years, despite only slight economic expansion in the EU-15 and rising unit labour costs (in euro terms) in Slovakia. As a matter of fact, the improved competitiveness of the country's industry, based as it is on a healthy shift towards higher value-added products, has opened the door to international markets. Foreign sales are still increasing at double-digit rates; they are in fact the main driving force behind the country's economic expansion. The bulk of this economic growth relates to car exports (VW Bratislava is producing an increasing number of cars in the upper price bracket); they soared by 45% and accounted for 29% of total exports in 2003. The result is a slightly positive foreign trade balance overall and a negligible current account deficit as well. Slovak GDP rose by 5.5% in the first quarter of 2004. Exports (goods and services) rose by 16% (GDP concept). Following a pronounced increase in 2001 and 2002, total domestic demand (dominated by private consumption) dropped in 2003, mostly on account of lower real household incomes. Despite hikes in both regulated prices and taxes, real incomes rose moderately in the first quarter of 2004, yielding private consumption growth of 3%. Gross fixed capital formation stagnated.

Based on increased production in the automotive sector, gross industrial production in the first four months of 2004 expanded by 6.2%. Labour productivity rose by more than 7% and real wages by 1.5%. Nevertheless, unit labour costs in euro terms are rising as appreciation of the Slovak koruna (in both nominal and real terms) has eroded a part of productivity gains. The major contributor to the country's industrial expansion was the transport equipment industry (VW Bratislava); the sector expanded by 31% and already accounts for 22% of total manufacturing. In contrast, output in the mining and energy sector declined. In the wake of the building boom, output in the construction sector rose by 2.4%.

Following an upward trend over a period of more than three years, employment stagnated in the first quarter of 2004. As a result, the registered unemployment rate has remained high, amounting to

15.3% at the end of April 2004. The labour act has been revised several times. The new bill should enhance labour market flexibility and ultimately bring the unemployment rate down. Furthermore, the rise in foreign greenfield investments will create more new jobs over time. The French carmakers PSA Peugeot-Citroën plan to invest EUR 0.7 billion by 2006 in a new plant in Trnava (western Slovakia) employing nearly 4000 workers and producing 300,000 cars a year. In March 2004 KIA, the Hyundai associate, decided to locate its first European plant in Žilina (north-western Slovakia). The investment target is some EUR 0.7 billion for a production facility employing close on 3000 workers and manufacturing at least 200,000 cars a year after 2006. If both projects materialize, their potential production capacity combined with that of VW Bratislava would be more than 900,000 cars a year. Slovakia would thus become the world's largest carmaker in per capita terms. After reaching a record level of EUR 4 billion in 2002, FDI inflows dropped to some EUR 0.5 billion in 2003. A recovery, however, is expected both this year and in future years on account of the above large-scale projects and other greenfield investment plans attracted by the low corporate tax rate. Unfortunately, investors are mainly focusing their attention on the richer western regions which dispose of a well-developed infrastructure, disregarding the poorer regions where unemployment is high. As a result, the massive regional disparities are heightened still more. In order to combat this asymmetrical development, the government intends to speed up construction of a motorway link between Bratislava and Košice, the country's second largest city located to the east. The entire motorway programme is scheduled for completion by 2012; total costs are estimated at EUR 6 billion, part of which will be covered by the EU structural or cohesion funds.

As a result of the ongoing price deregulation and higher indirect taxation, consumer prices rose by 8.3% in the first four months of the year. The inflationary impact of external factors has been relatively neutral as the stronger Slovak koruna (which reached a new high of less than SKK 40/EUR at the beginning of June) has come into play, partly offsetting the rise in dollar-based prices for imported fuels and reducing the prices of certain imported consumer goods. As yet, the central government's budget deficit has dropped appreciably and accounted for less than 1% of GDP in the first five months of 2004. Budgetary expenditures even declined in nominal terms, while revenues mainly from VAT and corporate income tax rose more sharply than expected. Apparently, some of the improvements stem from radical cutbacks in the welfare system in terms of expenditures and from the flat-tax scheme in terms of revenues. Whether both trends can be sustained remains to be seen.

In 2004 in particular, export performance and, to a gradual degree, domestic demand will be the main engines of economic growth; GDP will increase by about 4.5%. In 2005, GDP growth may accelerate to 5%, supported by exports and greater (pre-election) domestic demand. Price and tax adjustments will keep the inflation rate high: 8% this year and 5% in 2005. After an historic low in 2003, the current account deficit will rise slightly in the coming years as export growth decelerates and foreign-owned companies gradually repatriate more profits. Furthermore, the envisaged real appreciation of the Slovak koruna will support imports. After joining the EU, the Slovak economy's greatest challenge will be coping with accession to the European Monetary Union. Slovakia intends to: (a) stay in the ERM II for as brief a period as possible (i.e. two years only); and (b) meet the Maastricht criteria by 2007. Thus, the introduction of the euro will fall due in 2009. The main obstacles to achieving this ambitious target will be the need to reduce in time the general government budget deficit to 3% of GDP.

Slovenia: policy focused on ERM II entry

Available data point to more pronounced growth in 2004 than a year earlier. Driven by domestic demand, GDP grew by 3.7% in the first quarter of the year; gross fixed capital formation accelerated to 8% and private consumption to 3.7% (both indicators exceeding the levels of the previous year). Industrial production grew at a higher rate than in 2003 and growth in the construction sector remained strong (motorway construction, housing programme and building functional border facilities to Schengen standards). Retail trade turnover increased by 5% in real terms in the first quarter of the year.

The accelerated industrial production growth is correlated to a pick-up in export activities. Above-average growth was recorded for the output of both capital and intermediate goods, while the production of consumer goods remained stagnant. Manufacturing grew in line with overall output; productivity continued to rise.

Based on a broad national consensus, the Slovene authorities' prime goal is joining the eurozone at the earliest possible opportunity. Slovenia has entered the ERM II on 28 June at a rate of 239.64 SIT/EUR and intends to adopt the euro in early 2007. In order to curb inflation, the Bank of Slovenia continues to pursue its policy of gradually reducing the tolar's rate of depreciation against the euro (the ERM II allows 15% fluctuation) and lowering nominal interest rates. For its part, the government is continuing its policy of limited increases in administered prices and indirect taxes as well as frequent adjustments of excise duties on oil. Moreover, inflationary pressures will be offset by raising taxes solely in keeping with the general level of prices. In addition, the government is seeking to secure support for its price policy by cooperating with the independent regulators who set prices related to telecommunications, postal services, public broadcasting and electricity supplies. Slovenia has already met the Maastricht criteria pertaining to the fiscal deficit, public debt and long-term interest rates. Although inflation has dropped remarkably, it is still slightly higher than required by the Maastricht criterion. During the first five months of 2004, consumer prices rose 3.7% as against the same period the year previous; prices increased by 3.8% between May 2003 and May 2004.

At the end of April, in an attempt to secure further disinflation, the social partners in Slovenia signed a private sector wage policy agreement for 2004-2005 (a step provided for in the programme for entry into ERM II). The arrangement sets a cap for wage increases: one percentage point below productivity growth. The regulation of wages in the private sector shadows the wage adjustment agreement for the public sector concluded in 2003; the latter foresees real wage increases of 0.5% and 1% for 2004 and 2005, respectively. The government recently adopted a comprehensive tax reform package which envisages, *inter alia*, amendments to payroll and income taxes. It is thus envisaged that about 40% of the workforce in Slovenia will be exempt from payroll tax: a measure that should help employers to reduce labour costs, particularly in labour-intensive industries.

Data obtained from the labour force survey indicate employment growth for the first time since 2001; the number of employed was 4.2% higher in the first quarter of 2004 than in the corresponding period a year earlier. At the same time, LFS unemployment fell slightly to 6.8%.

Table SI

Slovenia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	1985.6	1990.3	1992.0	1995.7	1996.8	1994.8	.	.	.
Gross domestic product, SIT bn, nom.	3874.7	4252.3	4761.8	5314.5	5726.5	1319	1438	6160	6600
annual change in % (real)	5.6	3.9	2.7	3.4	2.3	2.2	3.7	3.4	3.5
GDP/capita (EUR at exchange rate)	10078	10421	11006	11771	12271	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	14330	15150	15920	16720	17500	.	.	.	.
Gross industrial production									
annual change in % (real)	-0.5	6.2	2.9	2.4	1.4	0.8	4.2	3.5	3
Construction output, in effect. working time									
annual change in % (real)	10.2	-1.2	-2.1	-3.4	-1.7	-7.4	.	.	.
Consumption of households, SIT bn, nom.	2185.1	2373.6	2621.8	2826.9	3066.6	.	.	.	.
annual change in % (real)	5.9	0.3	2.3	0.3	2.9	1.7	3.7	3	3.5
Gross fixed capital form., SIT bn, nom.	1019.5	1066.8	1164.4	1234.8	1350.0	.	.	.	.
annual change in % (real)	21.0	0.6	4.1	2.6	5.4	4.0	8.0	6	6
LFS - employed persons, th, avg.	886	901	916	910	897	885	922	.	.
annual change in %	-1.7	1.7	1.7	-0.7	-1.4	-3.7	4.2	.	.
Reg. employees in industry, th pers., avg.	242.8	241.6	243.5	246.1	242.2	243.2	.	.	.
annual change in %	-1.4	-0.5	0.8	1.1	-1.6	-0.9	.	.	.
LFS - unemployed persons, average	73.0	68.0	63.0	62.0	64.0	67	68	.	.
LFS - unemployment rate in %, average	7.6	7.0	6.4	6.4	6.7	7.0	6.8	6.5	6.2
Reg. unemployment rate in %, end of period	13.0	12.0	11.8	11.3	11.0	11.3	11.1	10.5	10
Average gross monthly wages, SIT	173245	191669	214561	235436	253200	244095	258118	.	.
annual change in % (real, net)	3.0	1.4	3.1	2.1	1.8	1.8	1.8	.	.
Consumer prices, % p.a.	6.1	8.9	8.4	7.5	5.6	6.3	3.7	4	3.5
Producer prices in industry, % p.a.	2.1	7.6	8.9	5.1	2.5	3.0	3.2	3.5	3
General governm.budget, EU-def., % GDP ²⁾									
Revenues	.	.	.	.	44.0	.	.	.	.
Expenditures	.	.	.	.	45.8	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-3.0	-2.7	-1.9	-1.8	.	.	-1.9	-1.8
Public debt in % of GDP ²⁾	25.1	26.7	26.9	27.8	28.6	.	.	29.1	29.5
Discount rate % p.a., end of period ³⁾	8.0	10.0	7.8	7.3	5.0	6.5	4.5	.	.
Current account, EUR mn	-664.2	-583.0	38.0	329.7	16.7	-25.2	44.0	-100	-150
Current account in % of GDP	-3.3	-2.8	0.2	1.4	0.1	-0.4	0.7	-0.4	-0.6
Gross reserves of NB excl. gold, EUR mn	3159.2	3435.8	4907.5	6701.5	6798.1	6707.8	6791.4	.	.
Gross external debt, EUR mn	8012	9490	10403	11482	12995	11950	13491	.	.
FDI inflow, EUR mn	99.2	149.1	412.4	1706.9	160.4	1.0	46.4	.	.
FDI outflow, EUR mn	44.7	71.7	161.2	98.7	269.4	65.2	68.8	.	.
Exports of goods, BOP, EUR mn	8103.2	9574.2	10454.3	11081.2	11426.5	2763.4	2984.9	12300	12900
annual growth rate in %	0.2	18.2	9.2	6.0	3.1	3.4	8.0	8	5
Imports of goods, BOP, EUR mn	9267.3	10801.2	11138.7	11346.6	11970.8	2914.7	3087.1	12900	13800
annual growth rate in %	5.4	16.6	3.1	1.9	5.5	5.5	5.9	8	7
Exports of services, BOP, EUR mn	1763.5	2051.5	2177.6	2449.2	2464.6	509.1	545.8	.	.
annual growth rate in %	-2.3	16.3	6.1	12.5	0.6	3.0	7.2	.	.
Imports of services, BOP, EUR mn	1434.0	1562.3	1642.1	1822.4	1923.6	369.3	409.0	.	.
annual growth rate in %	5.7	8.9	5.1	11.0	5.6	3.8	10.8	.	.
Average exchange rate SIT/USD	181.77	222.68	242.75	240.24	207.11	215.64	189.84	.	.
Average exchange rate SIT/EUR (ECU)	193.63	205.03	217.19	226.22	233.70	231.30	237.39	238	242
Purchasing power parity SIT/USD, wiiw	124.62	130.79	138.68	148.50	150.24	.	.	.	.
Purchasing power parity SIT/EUR, wiiw	136.17	141.02	150.19	159.28	163.87	.	.	.	.

Notes: 1) Preliminary. - 2) According to ESA 95, excessive deficit procedure. - 3) From 2001 main refinancing rate.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

Overall exports developed more dynamically than in the years before, up by 7.7% in the first four months of 2004, whereas imports grew by close on 10% over the same period. The trade deficit thus widened some 30% as against the corresponding period the year before. The growth in exports to the EU that was set in motion in the last quarter of the previous year continued on into the first months of 2004. Exports to Russia were especially high (up by 34%) owing to their previously low volume in 2003, while those to the successor states of former Yugoslavia expanded to a lesser degree (up by 13%). As had been customary in the past, the main exports supplied to Russia were medical and pharmaceutical products; those to Croatia were in the energy sector after Slovenia had resumed its electricity supplies to this country. It would appear that in general, exporting firms wanted to benefit from the favourable conditions offered by the bilateral free-trade agreements with those countries which had to be terminated upon Slovenia's entry into the EU. Analyses carried out by Slovene experts came to the conclusion that termination of the free trade agreements, particularly those with the Yugoslav successor states, would exert a negative impact, for example, on agricultural and food exports. On the other hand, the harmonization of tariff structures with the EU and the lifting of barriers to trade in sensitive goods with the EU might well offset these disadvantages. Resulting from the increased trade deficit, the current account was slightly negative in the first quarter of the year. As in 2003, Slovenia was a net exporter of FDI in the first four months of the year, with Slovene investments abroad mainly directed towards the Yugoslav successor states. Just recently the French car producer Renault, sole owner of the Revoz automotive plant and Slovenia's largest export company, decided to manufacture a new car in Slovenia.

Led primarily by domestic demand, in particular investments in infrastructure and a rise in private consumption, GDP should grow by 3.4% and 3.5% in 2004 and 2005, respectively. It is expected that the pick-up in economic activity will be accompanied by a decline in unemployment and a slight increase in employment opportunities. The country's export performance might deteriorate somewhat as a consequence of the Bank of Slovenia's policy of slowing down the national currency's rate of depreciation (in the past the tolar depreciated continuously, thus helping exporters to retain their competitiveness in foreign markets). As a result the current account might also dip slightly. The government plans to maintain its relatively tight fiscal stance in both 2004 and 2005 so as to keep the deficit well below the Maastricht criterion. Indeed, maintaining a low rate of inflation after entry into ERM II will be one of the most challenging tasks facing the Slovene authorities.

*Tauno Tyllinen**

Estonia: the current account deficit remains high

Estonia was affected by the slowdown in the global economy in 2003. The GDP growth rate dropped from 7.2% in 2002 to 5.1% in 2003: mainly the outcome of impaired export opportunities. In the first quarter of 2004, however, the country's GDP rose by 6.8%.

Domestic demand rose by 7.3% in 2003. Both private and public consumption increased some 5-6%. The increase in private consumption expenditure was supported by attendant strong growth in lending (38.4%) and palpable increases in real wages (8.5%); this was further reflected in the rise in imports of goods (13%) and retail sales (10%). The growth rate of gross fixed capital formation declined somewhat, yet remained high (11.5%).

* The author is special editor at the *Economic Trends* Magazine, Statistics Finland, Helsinki.

Table EE

Estonia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	1375.7	1369.5	1364.1	1358.6	1353.8	.	.	.	.
Gross domestic product, EEK mn, nom.	81639.7	92717.1	104337.7	116869.0	125832.1	29002.2	.	137000	149000
annual change in % (real)	-0.1	7.8	6.4	7.2	5.1	5.8	6.8	5.5	5.7
GDP/capita (EUR at exchange rate)	3793	4327	4888	5498	5940	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	8040	9010	9610	10450	10860	.	.	.	.
Gross industrial production ²⁾									
annual change in % (real)	-3.4	14.6	8.9	8.2	9.8	12.8	7.7	8	8
Construction industry ²⁾									
annual change in % (real)	-13.4	18.7	5.5	21.8	5.0	1.4	28.1	.	.
Consumption of households, EEK mn, nom.	45832.9	51036.5	57351.9	65135.3	69201.7	16060.5	.	.	.
annual change in % (real)	-2.7	8.5	5.9	9.9	5.4	5.8	.	5.3	5.2
Gross fixed capital form., EEK mn, nom.	20238.6	23769.4	28134.3	33554.7	35749.7	8131.4	.	.	.
annual change in % (real)	-15.6	14.3	13.0	17.2	5.4	22.3	.	6	5.5
LFS - employed persons, th, avg. ³⁾	579.3	572.5	577.7	585.5	594.3	576.8	589.3	595	596
annual change in % ³⁾	-4.5	-1.2	0.9	1.4	1.5	0.3	2.2	.	.
LFS - employed pers. in industry, th, avg. ³⁾	147.2	151.1	151.3	144.4	150.0	152.5	152.1	.	.
annual change in % ³⁾	-5.9	2.6	0.1	-4.6	3.9	2.3	-0.3	.	.
LFS - unemployed persons, average ³⁾	80.5	89.9	83.1	67.2	66.2	68.7	66.3	.	.
LFS - unemployment rate in %, average ³⁾	12.2	13.6	12.6	10.3	10.0	10.6	10.1	9.8	9.5
Reg. unemployment rate in %, end of period	5.2	5.9	6.1	5.4	4.9	5.8	5.2	4.5	4.3
Average gross monthly wages, EEK ⁴⁾	4440	4907	5510	6144	6723	6333	6748	.	.
annual change in % (real, gross)	6.9	6.3	6.1	7.6	8.0	8.1	6.1	.	.
Consumer prices, % p.a.	3.3	4.0	5.8	3.6	1.3	2.4	0.4	2.9	3.1
Producer prices in industry, % p.a.	-1.2	4.9	4.4	0.4	0.2	0.8	0.8	1	1.5
General governm. budget, EU-def., % GDP ⁴⁾									
Revenues	.	50.3	46.1	39.6	41.2	.	.	.	.
Expenditures	.	50.6	45.8	37.9	38.6	.	.	.	.
Deficit (-) / surplus (+)	-2.8	-0.3	0.3	1.8	2.6	.	.	0	-1
Public debt in % of GDP ⁴⁾	6.5	5.0	4.7	5.7	5.8	.	.	5.5	6
Money market rate, % p.a., end of period ⁵⁾	4.4	5.8	3.7	3.4	2.6	3.1	2.6	.	.
Current account, EUR mn	-231	-326	-376	-847	-1015	-281.6	-258.2	-920	-860
Current account in % of GDP	-4.4	-5.5	-5.6	-11.3	-12.6	-15.2	.	-10.5	-9.0
Total reserves minus gold, EUR mn	850	990	927	964	1089	996	1063	.	.
Gross external debt, EUR mn	2864	3233	3707	4490	5553	4893	.	6000	6500
FDI inflow, EUR mn	284	425	603	307	756	284	152	500	550
FDI outflow, EUR mn	79	67	226	140	137	18	43	150	170
Exports of goods, BOP, EUR mn	2364.4	3600.9	3749.4	3712.9	4052.7	913.5	1076.1	4480	4930
annual growth rate in %	.	52.3	4.1	-1.0	9.2	8.7	17.8	10.5	10
Imports of goods, BOP, EUR mn	3137.7	4441.1	4630.1	4877.9	5441.3	1260.3	1373.3	5900	6400
annual growth rate in %	.	41.5	4.3	5.4	11.6	15.6	9.0	8.5	8.5
Exports of services, BOP, EUR mn	1403.0	1628.7	1845.1	1807.5	1974.0	385.3	430.4	.	.
annual growth rate in %	.	16.1	13.3	-2.0	9.2	-12.5	11.7	.	.
Imports of services, BOP, EUR mn	869.9	1017.3	1195.4	1288.9	1219.1	247.7	271.7	.	.
annual growth rate in %	.	16.9	17.5	7.8	-5.4	-29.2	9.7	.	.
Average exchange rate EEK/USD	14.69	16.98	17.48	16.61	13.86	14.65	12.53	.	.
Average exchange rate EEK/EUR (ECU)	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Purchasing power parity EEK/USD, wiiw	6.76	6.97	7.35	7.67	7.85	.	.	.	.
Purchasing power parity EEK/EUR, wiiw	7.38	7.51	7.96	8.23	8.56	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with 20 employees and more. - 3) Persons aged 15-74. - 4) According to ESA 95, excessive deficit procedure. - 5) TALIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

Broken down according to the main branches of the economy, value-added increased most in mining and quarrying (10%) and manufacturing (over 8%), followed by financial intermediation (close to 8%) and construction (7%). Value-added decreased in both forestry (10%) and fishing (7%). Manufacturing accounted for 19%, transport, storage and communications for 16% and wholesale and retail trade for 14% of total value-added. New manufacturing capacity is mostly export-oriented, while outsourcing and subcontracting account for a large share in manufacturing output.

In 2003, Estonia recorded its lowest inflation rate since the onset of transition, thanks to favourable import prices and a drop in food prices. After slowing down in the first quarter of 2004 to 0.4% year-on-year, inflation increased again in May as higher excise taxes were levied on fuel, sugar and certain other products following Estonia's accession to the EU.

The foreign trade deficit (EUR 1.7 billion) increased to 23% of GDP in 2003. Imports of goods grew last year by 13%; exports by less than 10% (customs statistics). Estonia's current account deficit remained high in 2003, amounting to 12.6% of GDP; this was mainly the outcome of a pronounced increase in the volume of imports. Last year FDI net inflow funded 61% of the current account deficit. At the end of December 2003, FDI stock amounted to EUR 5.1 billion and the country's central government external debt was only 3.2% of GDP.

The GDP growth forecast for 2004 ranges between 5.1% and 6.0%. Recovery of export demand in the EU and the CIS countries will facilitate growth. With export revenues rising and domestic demand declining, it is expected that the current account deficit will drop from 12.6% of GDP in 2003 to below 10% in 2005. Given the price and tax adjustments necessitated by the country's accession to the EU, consumer prices in 2004 are expected to rise on average by nearly 3%. A balanced budget is expected for this year; it is most likely to turn into a minor deficit in 2005 on account of the ongoing tax reforms. Given budgetary discipline to date, the low rate of inflation and a public debt of 5.8% of GDP, the announcement that Estonia entered the ERM II on June 28 came as no surprise. The central rate of the kroon to the euro was set at 15.6466.

Tauno Tyllinen

Latvia: economic growth high current account deficit

Latvia's rapid GDP growth continued throughout 2003 at a rate of 7.5% year-on-year. On the demand side, household consumption and investment activities were the engines of growth. As a result of robust economic growth, unemployment fell from 12% in 2002 to 10.6% in 2003.

Consumer prices rose by 2.9% in 2003; producer prices by 3.2%. Both indices had registered lower inflation rates in 2002 (1.9% and 1%, respectively). The higher inflation was most probably due to the appreciation of the lat, the country's national currency, against the euro. It followed in the wake of the euro's appreciation against the US dollar, the lat being pegged to IMF special drawing rights (SDR). In the first quarter of 2004 CPI inflation reached 4.3% (a six-year high), primarily on account of price and tax adjustments related to EU accession. The central bank's reaction was to introduce an even more restrictive monetary policy; it raised the refinancing rate by 0.5% to 3.5%.

Table LV

Latvia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	2390.5	2373.0	2355.0	2338.6	2325.3	.	.	.	.
Gross domestic product, LVL mn, nom.	4224.2	4685.7	5168.3	5691.1	6322.5	1412.6	1603.0	7100	7900
annual change in % (real)	3.3	6.9	8.0	6.4	7.5	8.8	8.8	7.5	7.0
GDP/capita (EUR at exchange rate)	2833	3526	3900	4177	4216	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6990	7690	8370	9180	9970	.	.	.	.
Gross industrial production ²⁾									
annual change in % (real)	-5.4	4.7	9.2	5.8	6.5	8.7	9.2	8.5	8.3
Construction industry ²⁾									
annual change in % (real)	7.8	8.0	6.0	10.8	13.7	17.5	13.0	.	.
Consumption of households, LVL mn, nom.	2445.5	2693.5	3045.3	3259.3	3643.2	877.8	.	.	.
annual change in % (real)	3.7	7.4	7.8	6.9	8.0	9.0	.	6.5	6
Gross fixed capital form., LVL mn, nom.	980.0	1151.5	1297.4	1370.6	1527.8	273.6	.	.	.
annual change in % (real)	-6.8	10.2	11.4	13.0	7.4	19.7	.	12	12
LFS - employed persons, th, avg. ³⁾	968.0	941.0	962.0	989.0	1006.9	993.6	1002.4	.	.
annual change in % ³⁾	-1.8	-2.8	2.2	2.8	1.8	4.5	0.9	.	.
LFS - employed pers. in industry, th, avg. ³⁾	193.0	193.0	176.0	192.0	.	.	.	.	.
annual change in % ³⁾	-7.2	0.0	-8.8	9.1	.	.	.	.	.
LFS - unemployed persons, average ³⁾	161.0	159.0	145.0	134.5	119.2	119.3	130.8	.	.
LFS - unemployment rate in %, average ³⁾	14.2	14.5	13.1	12.0	10.6	10.7	11.5	10.3	10
Reg. unemployment rate in %, end of period	9.1	7.8	7.7	8.5	8.6	8.9	9.2	9	8.5
Average gross monthly wages, LVL ⁴⁾	141	150	159	173	192	177	196	.	.
annual change in % (real, gross)	2.9	3.0	3.5	6.0	.	-5.5	6.3	.	.
Consumer prices, % p.a.	2.4	2.6	2.5	1.9	2.9	1.9	4.3	4.5	3.8
Producer prices in industry, % p.a.	-4.0	0.6	1.7	1.0	3.2	2.1	5.4	3	3.3
General government budget, EU-def., % GDP ⁴⁾									
Revenues	44.9	42.5	40.8	41.9	41.5	.	.	.	.
Expenditures	50.2	45.2	42.4	44.6	43.3	.	.	.	.
Deficit (-) / surplus (+)	-5.3	-2.7	-1.6	-2.7	-1.8	.	.	-2	-2
Public debt in % of GDP ⁴⁾	13.7	13.9	16.2	15.5	15.6	.	.	16	16.1
Discount rate, % p.a., end of period	4.0	3.5	3.5	3.0	3.0	3.0	3.5	.	.
Current account, EUR mn	-609	-538	-819	-680	-842	-114	-202	-1000	-1040
Current account in % of GDP	-9.0	-6.4	-8.9	-7.0	-8.6	-5.0	.	-9.3	-8.8
Total reserves minus gold, EUR mn	832	915	1307	1209	1150	1034	1142	.	.
Gross external debt, EUR mn	3791	5056	6335	6782	7337	6267	.	.	.
FDI inflow, EUR mn	325	445	182	407	319	106	76	450	470
FDI outflow, EUR mn	-16	-10	-14	-8	-28	-6	-19	.	.
Exports of goods, BOP, EUR mn	1777.6	2229.4	2473.0	2726.1	2804.4	644.4	714.6	3060	3400
annual growth rate in %	-1.0	25.4	10.9	10.2	2.9	3.9	10.9	9	11
Imports of goods, BOP, EUR mn	2736.9	3379.5	3981.8	4251.1	4568.7	1003.1	1155.2	4980	5450
annual growth rate in %	-2.2	23.5	17.8	6.8	7.5	8.6	15.2	9	9.5
Exports of services, BOP, EUR mn	961.0	1313.2	1327.0	1327.4	1352.1	324.5	306.9	.	.
annual growth rate in %	-2.8	36.6	1.1	0.0	1.9	-1.6	-5.4	.	.
Imports of services, BOP, EUR mn	645.8	834.9	773.8	748.3	834.1	172.2	181.5	.	.
annual growth rate in %	-10.1	29.3	-7.3	-3.3	11.5	7.6	5.4	.	.
Average exchange rate LVL/USD	0.58	0.61	0.63	0.62	0.57	0.58	0.54	.	.
Average exchange rate LVL/EUR (ECU)	0.62	0.56	0.56	0.58	0.64	0.63	0.67	0.66	0.67
Purchasing power parity LVL/USD, wiiw	0.23	0.24	0.24	0.25	0.25	.	.	.	.
Purchasing power parity LVL/EUR, wiiw	0.25	0.26	0.26	0.27	0.27	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with 50 employees and more. - 3) From 2002 persons aged 15-74, up to 2002 persons aged 15 and over. - 4) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

Loans extended by Latvian banks to private persons increased by 77% in 2003. The central bank's intervention was designed not only to prevent the economy from overheating with all its inflationary fall-out, but also to curb the current account deficit that had risen as high as 8.6% of GDP. Unlike 2002, the deficit was not offset by adequate enough an inflow of FDI, but more by an increase in foreign debt. At the end of the year 2003, total FDI stock amounted to some EUR 2.7 billion.

Over recent years, Latvian export revenues (commodities and services) have always covered some 75-85% of import expenditures. Last year, wood and wood products featured as the largest commodity group within all exports; their share increased perceptibly and ultimately amounted to 35% of the total volume of exports. The share of machinery, mechanical appliances and electrical equipment also increased significantly. In imports, the latter group accounted for the largest share: 21% of all imports. In 2003 the United Kingdom (16%) usurped Germany as Latvia's most important export market, whereas on the import side Germany continued to account for the largest share (16%).

In 2004 GDP is expected to expand by about 7.5%. Both domestic demand and foreign trade will remain engines of growth. In 2004 and 2005 alike the current account deficit will stay as high as about 9% of GDP. The budget deficit will be close to 2% of GDP in 2004. The authorities intend to join the ERM II in 2005 and hope to introduce the euro on 1 January 2008.

Tauno Tyllinen

Lithuania: GDP growth to reach record level

In 2003, the Lithuanian economy once again displayed a very high rate of growth: 9% as against 6.8% in 2002. On the supply side, economic growth was predominantly attributable to strong performance in the industry and construction sectors. On the demand side, a marked rise in domestic demand was the decisive factor. Owing to a rise in employment, a sharp increase in real wages and strong growth in household lending, private consumption recorded impressive growth: over 11%. Gross fixed capital formation grew by 11.4%; public consumption by 6%. The contribution of foreign trade to GDP was also positive.

After near stagnation in 2002, consumer prices declined by 1.2% in 2003. Producer prices have also declined over recent years, but less so in 2003 than in 2002 (0.5% compared to 2.8%). Deflationary tendencies continued in the first quarter of 2004; however, they should diminish or completely vanish in the second half of the current year owing to the tax and price adjustments in the context of EU accession.

The current account deficit expanded from 5.2% of GDP in 2002 to 6.6% of GDP in 2003, the reason being a considerable deterioration in the income balance following an increase in dividend payments. At the end of 2003, FDI stock overall totalled some EUR 4 billion or somewhat over EUR 1000 per capita. The key investor countries were Denmark, Sweden and Germany. For the most part, privatization projects provided the backdrop for FDI. In 2003, delays in a large number of additional privatization projects attracted only a meagre inflow of FDI: EUR 160 million compared to EUR 772 million in 2002.

Table LT

Lithuania: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	3524.2	3499.5	3481.3	3469.1	3454.0	.	.	.	.
Gross domestic product, LTL mn, nom.	43359.4	45525.9	48378.7	51633.3	55736.7	12386.0	13357.0 ¹⁾	61500	68000
annual change in % (real)	-1.7	3.9	6.4	6.8	9.0	9.6	7.7 ¹⁾	10	8.5
GDP/capita (EUR at exchange rate)	2881	3517	3876	4301	4599	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	7440	8110	8850	9580	10600	.	.	.	.
Gross industrial production									
annual change in % (real)	-9.9	2.2	16.0	3.1	16.1	20.9	9.6	11	9
Construction industry ²⁾									
annual change in % (real)	-8.5	-17.8	7.5	21.8	23.7	22.6	18.6	.	.
Consumption of households, LTL mn, nom.	28315.5	29530.6	31352.6	33091.8	35869.2	7723.3	.	.	.
annual change in % (real)	3.2	6.4	4.0	6.2	11.1	5.2	.	7	6
Gross fixed capital form., LTL bn, nom.	9614.2	8565.3	9784.6	10549.2	11569.4	2048.3	.	.	.
annual change in % (real)	-6.1	-9.0	13.5	8.7	11.4	6.2	.	15	13
LFS - employed persons, th, avg. ³⁾	1598.4	1397.8	1351.8	1405.9	1438.0	1387.9	.	.	.
annual change in % ³⁾	0.1	-12.6	-3.3	4.0	2.3	2.4	.	.	.
LFS - employed pers. in industry, th, avg. ³⁾	330.3	290.8	281.1	293.3	297.5	299.2	.	.	.
annual change in % ³⁾	-2.7	-12.0	-3.3	4.3	1.4	5.8	.	.	.
LFS - unemployed persons, average ³⁾	263.3	273.7	284.0	224.4	203.9	218.8	.	.	.
LFS - unemployment rate in %, average ³⁾	14.1	16.4	17.4	13.8	12.4	13.6	.	11.5	10
Reg. unemployment rate in %, end of period	10.0	12.6	12.9	10.9	7.7	9.3	7.9	7.5	7
Average gross monthly wages, LTL ⁴⁾	987	971	982	1014	1056	1125	1146	.	.
annual change in % (real, gross)	4.8	-5.1	-0.3	3.8	7.8	5.1	3.1	.	.
Consumer prices, % p.a.	0.8	1.0	1.3	0.3	-1.2	-1.7	-1.2	0.3	1.5
Producer prices in industry, % p.a.	1.7	16.0	-3.0	-2.8	-0.5	4.1	-2.0	0	1
General govern.budget, EU-def., % GDP ³⁾									
Revenues	38.0	36.4	33.6	33.8	33.9	.	.	.	.
Expenditures	43.7	39.0	35.7	35.2	35.6	.	.	.	.
Deficit (-) / surplus (+)	-5.7	-2.6	-2.1	-1.4	-1.7	.	.	-2.5	-2.8
Public debt in % of GDP ³⁾	23.4	24.3	23.4	22.8	21.9	.	.	22.5	23
Money market rate, % p.a., end of period ⁴⁾	15.9	7.5	4.5	3.3	2.4	2.5	2.1	.	.
Current account, EUR mn	-1118	-730	-639	-772	-1063	-136	-269	-1300	-1480
Current account in % of GDP	-11.0	-5.9	-4.7	-5.2	-6.6	-3.8	-7.0	-7.3	-7.5
Total reserves minus gold, EUR mn	1187	1410	1835	2253	2697	2635	2759	.	.
Gross external debt, EUR mn	4499	5221	5974	5945	6905	6356	.	.	.
FDI inflow, EUR mn	457	412	499	772	160	151	113	700	750
FDI outflow, EUR mn	8	4	8	18	34	9	-3	.	.
Exports of goods, BOP, EUR mn	2951.2	4395.0	5460.8	6363.0	6760.2	1701.8	1681.5	7570	8710
annual growth rate in %	-16.3	48.9	24.3	16.5	6.2	24.9	-1.2	12	15
Imports of goods, BOP, EUR mn	4275.4	5603.3	6696.9	7770.2	8181.0	1830.8	2037.6	9080	10170
annual growth rate in %	-12.4	31.1	19.5	16.0	5.3	10.8	11.3	11	12
Exports of services, BOP, EUR mn	1025.7	1149.2	1293.0	1560.5	1600.2	352.7	362.9	.	.
annual growth rate in %	3.9	12.0	12.5	20.7	2.5	6.0	2.9	.	.
Imports of services, BOP, EUR mn	739.0	735.0	783.0	986.0	1067.7	228.9	237.6	.	.
annual growth rate in %	-4.4	-0.5	6.5	25.9	8.3	13.6	3.8	.	.
Average exchange rate LTL/USD	4.00	4.00	4.00	3.67	3.06	3.22	2.76	.	.
Average exchange rate LTL/EUR (ECU)	4.27	3.70	3.58	3.46	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/USD, wiiw	1.51	1.49	1.45	1.45	1.40	.	.	.	.
Purchasing power parity LTL/EUR, wiiw	1.65	1.60	1.57	1.55	1.52	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) According to ESA 95, excessive deficit procedure. - 4) VILIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

Lithuania's exports (customs statistics) outstripped imports in 2003 (9% versus 6%); the trade deficit dropped correspondingly to EUR 2.3 billion. Within exports, the share of the EU-15 countries declined sharply from 50% to 43%, whereas the share of the accession countries rose to 19%. The most important export markets were Switzerland (12%), Russia (10%) and Germany (10%). Mineral fuels played an increasingly important role in this context, their share in total exports rising to 20%. The next most significant export items were transport equipment (15%), together with textiles and textile products (14%). In terms of imports, the EU-15 share dropped slightly to 44%, while the share of the accession countries reached 12%. Russia accounted for 23% of Lithuania's imports. Within imports, machinery and mineral fuels were the largest commodity groups.

Lithuania's public debt fell following the drop in government-backed loans and the national currency's appreciation against the US dollar.

In 2004, domestic demand (primarily investment activity) is expected to emerge once more as the engine of growth. Thanks to EU co-financed projects, construction will play a major role in terms of investment. Economic growth of around 10% is considered likely in 2004. It is hoped that the budget deficit in 2004 will remain just below 3% of GDP, thus not impinging on the requirements set in the Stability and Growth Pact. A similarly high budget deficit can be expected for 2005, as the government plans to lower the personal income tax rate from 33% to 26%. Lithuania, fulfilling the Maastricht convergence criteria, entered the ERM II on June 28 at a 3.4528 central rate of the litas to the euro.

Table 13

Southeast Europe: an overview of economic fundamentals, 2003

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Serbia and Montenegro	NMS-8 ¹⁾	EU-15	EU-25 ²⁾
GDP in EUR at exchange rates, EUR bn	5.42	6.22	17.59	25.11	4.14	50.35	17.22	425.36	9294.93	9735.75
GDP in EUR at PPP, EUR bn	11.76	23.29	53.41	43.94	12.99	146.25	35.32	864.55	9294.93	10179.15
GDP in EUR at PPP, EU-25=100	0.1	0.2	0.5	0.4	0.1	1.4	0.3	8.5	91.3	100.0
GDP in EUR at PPP, per capita	3740	6030	6830	9890	6340	6730	4260	11835	24302	22292
GDP in EUR at PPP per capita, EU-25=100	17	27	31	44	28	30	19	53	109	100
GDP at constant prices, 1990=100	134.8	390.1 ³⁾	92.3	98.1	90.6	98.0	53.8	129.7	128.1	128.2
GDP at constant prices, 2000=100	119.4	114.1	114.0	114.5	99.3	116.4	111.7	109.0	103.7	103.9
Industrial production real, 1990=100	41.3	.	62.1	74.7	50.9	72.6	43.5	140.2	117.8	118.8
Industrial production real, 2000=100	112.0	113.4	117.2	116.3	96.3	118.5	99.0	113.3	99.5	100.1
Employed persons - LFS, thousands, average	920.0 ⁴⁾⁵⁾	634.0 ⁶⁾	2834.8	1537.0	545.1	9222.5	3220.8 ⁵⁾	28372.6	170962.0	199772.0
Public sector expenditures, nat. def., in % of GDP	28.4 ⁵⁾	46.3	40.9	50.2	22.3 ⁷⁾	32.3	.	48.4	48.4	48.3
Public sector revenues, nat. def., in % of GDP	22.2 ⁵⁾	46.7	40.9	40.9	21.3 ⁷⁾	30.0	49.4	42.8	45.8	45.6
Price level, EU-15=100 (PPP/exch. rate)	46	27	33	57	32	34	49	49	100	96
Average gross monthly wages, EUR	158 ⁸⁾⁵⁾	395	145	743	326	179	176 ⁹⁾	724 ¹⁰⁾	2818 ¹⁰⁾	2543 ¹⁰⁾
Exports of goods in % of GDP	7.3	21.2	37.9	22.2	29.1	31.0	13.6 ¹¹⁾	42.2 ¹²⁾	27.2 ¹²⁾	27.9 ¹²⁾
Imports of goods in % of GDP	29.2	76.9	50.4	50.1	47.4	38.9	40.2 ¹¹⁾	45.9 ¹²⁾	25.9 ¹²⁾	26.8 ¹²⁾
Exports of services in % of GDP	11.8	6.9	15.9	30.4	7.0	5.3	5.5 ¹¹⁾	8.0 ¹²⁾	8.0 ¹²⁾	8.0 ¹²⁾
Imports of services in % of GDP	13.1	4.2	12.9	10.5	7.0	5.2	3.9 ¹¹⁾	7.2 ¹²⁾	7.7 ¹²⁾	7.7 ¹²⁾
Inflow of incomes in % of GDP	3.2	5.0	1.6	1.7	.	0.6	0.4 ¹¹⁾	1.8 ¹²⁾	6.8 ¹²⁾	6.6 ¹²⁾
Outflow of incomes in % of GDP	0.4	1.5	4.1	5.8	.	1.8	1.2 ¹¹⁾	4.5 ¹²⁾	7.2 ¹²⁾	7.1 ¹²⁾
Current account in % of GDP	-6.7	-29.6	-8.5	-7.2	-6.0	-5.8	-10.7 ¹¹⁾	-4.3 ¹²⁾	0.6	.
FDI stock per capita in EUR	336	294	551	2044	520	465	327	2031	.	.

PPP: Purchasing power parity - wiiw estimates for Albania, Bosnia and Herzegovina, Serbia and Montenegro.

Notes: 1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1995=100. - 4) Employment total. - 5) Year 2002. - 6) Employees, end of period. - 7) Central government budget. - 8) Monthly wages in public sector. - 9) Average net monthly wages, Serbia only and including various allowances. - 10) Gross wages plus indirect labour costs, whole economy, national account concept. - 11) Serbia only. - 12) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part B: EU candidate countries and countries aspiring to EU membership

Vladimir Gligorov

Southeast Europe (SEE) overview: diverse developments

Introduction

Southeast Europe (SEE) is a diverse region. Seven countries in transition are conventionally included in it: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro.¹³ Some of these countries are constitutionally rather complex. Bosnia and Herzegovina consists of one republic (Republika Srpska) and one federation (Federation of Bosnia and Herzegovina) and is also a kind of international protectorate. Serbia and Montenegro is a state union of two states – of Serbia and Montenegro – while Serbia nominally has a province, Kosovo, that is under international protection. In this overview, developments in the region will be looked at, though some countries or provinces are not equally covered mainly because of the problems with their statistics.

The states or political entities in the region tend to be small or medium-sized, with the exception of Romania, a large state with over 22 million inhabitants. The region is diverse not only politically, but also in terms of development. On one end is Croatia, a country with a GDP per capita similar to the level in the New Member States (NMS), while on the other end one finds Albania and also Kosovo, which are in many ways typical development economies¹⁴ and are poorer than the other countries in the region. In terms of GDP per capita, the other SEE countries are not all that different, though the difference increases somewhat if this indicator is expressed in purchasing power parity (PPP) (see Table 13).

When it comes to the progress in transition, comparisons are even more difficult. In general, the region is lagging behind the NMS. The private sector is not that developed in the SEE countries, and the public sector is not reformed enough. Also, the informal economy is, as a rule, more widespread than in the NMS. The more pronounced problems with the rule of law could also be mentioned. Finally, institutional and policy integration with the EU and with the rest of the world is diverse across the region and is in general lagging behind the NMS.¹⁵

Thus, intra-regional diversity is significant, transition is progressing unevenly and integration, both within the region and with the EU and the wider world, is still an unfinished task (see also next chapter). In this overview, the current economic developments and short-term prospects will be looked at in the light of these fundamental factors together with regional and country-specific economic policy issues.

¹³ The criteria of inclusion are not precisely defined. Three can be mentioned: geography, transition and EU accession. The countries included are in Southeast Europe and in transition and are seen now as future members of the EU.

¹⁴ For instance by the Lewis criterion that more than one third of their population lives on agriculture.

¹⁵ The progress of the region and of the individual countries in the process of EU integration is discussed in the next chapter. For a more detailed account see V. Gligorov, 'European Partnership with the Balkans', *The Vienna Institute Monthly Report*, No. 4, April 2004, pp. 8-14.

Recent background

The years 1999 and 2000 were turning points in the region. With the Kosovo war over in 1999, major conflicts in SEE seemed to be over. A year later, in 2000, the regimes were changed in Croatia and then in Serbia. From then on, growth returned to the region as a whole, with the exception of Macedonia in 2001-2002. The reasons for the improved performance and for the diversity across the region cannot be attributed to the same causes, however. Though political developments in the region were not without importance for Bulgaria, Romania or Albania, still their economic results were mostly influenced by internal developments. Bulgaria experienced a major crisis in 1997 as did Albania. Romania came out of its own recession in 1999. Their positive developments were the consequence of the policy changes that were introduced in response to these different crises and recessions.

The major impact of the 1999-2000 political development was on the countries coming out of the former Yugoslavia. With the end of the war in Kosovo, a major security risk was removed. A year later, the democratization of Croatia and Serbia started. With the main security risk eliminated and the region becoming more internally and externally open, economic developments started improving. Trade in goods and services increased, foreign aid and investments grew and transition was speeded up.

It is perhaps worthwhile drawing a lesson from these developments for political underpinnings of transition. On the experience of the European transition economies and especially those in SEE, it can be argued that in transition:

- (i) democracy is a necessary condition for growth, and
- (ii) trade liberalization is conducive to growth too.

Looking at SEE only, it is clear that democratization is not a sufficient condition for growth, but it is a necessary one.¹⁶

On the experience of the SEE countries, it can also be argued that openness is beneficial for growth. Though problems with the external balances in SEE will be noticed below, it seems clear that regional and inter-regional disintegration does not help growth. This is partly due to the fact that the economies in SEE are as a rule small or of medium size and partly because of the nature of the transition process itself. Transition is a process of institutional change and of economic modernization, and internally generated institutional innovation as well as technological development may be a much more difficult and slower process. In addition, small economies tend to suffer if they are closed because of the higher costs of barriers to trade and investment. Finally, in the case of SEE, the development of tourism and of transiting services, which is important for the region, is hampered if the region is internally and externally closed.

Thus, the unilateral removal of almost all tariff barriers for exports to the EU from the Western Balkans in 2000-2001 and the signing of free trade agreements between all the SEE countries have

¹⁶ Even in the case where the international community is running a country, such as Bosnia and Herzegovina and Kosovo, that is not a substitute for democratic governance. Indeed, it turns out that, in this region, democracy is a necessary condition for the rule of law too, because, again, even the benevolent dictatorship of the international community is not proving beneficial for the entrenchment of the rule of law.

increased the access to markets to all the countries in the region and will have increasingly positive effects on trade and growth as the regime of free trade within and without the region settles in.

Current state and growth prospects

The above statements can be checked against the current state in SEE. Clearly, more democratized and more liberalized countries are doing better than those that are still having problems with both. The three candidate countries for EU integration – Croatia, Bulgaria and Romania – are recording higher growth rates, higher inflows of foreign investments, lower levels of unemployment and more stable short and medium-term growth prospects.

By contrast, in the rest of the SEE countries, growth is lower (with the exception of Albania), foreign investments are lower and unemployment is higher¹⁷. Also, the medium-term prospects are for more volatility in growth and in employment. This is certainly, at least in part, due to deficiencies in the process of democratization and in trade integration that are caused by unsettled security or constitutional issues. Albania is an outlier to both groups of countries because it has been posting high rates of growth though its democratization is far from perfect while its openness to trade is quite significant.

The growth performance will continue to be impacted by the above-mentioned political and policy factors, but the short and medium-term prospects will depend on the economic policies adopted and on their sustainability. When it comes to economic policies, the region exhibits significant diversity too. It is an interesting fact that most of the region has achieved significant price stability already in the mid- or late 1990s. Partial exceptions are Serbia and Romania. Indeed, the region has had, with the noted exceptions, more stable prices than the NMS in the past five to ten years. In addition, after 2000, the process of disinflation has been strong throughout the region and especially in countries like Serbia, Montenegro and Romania.

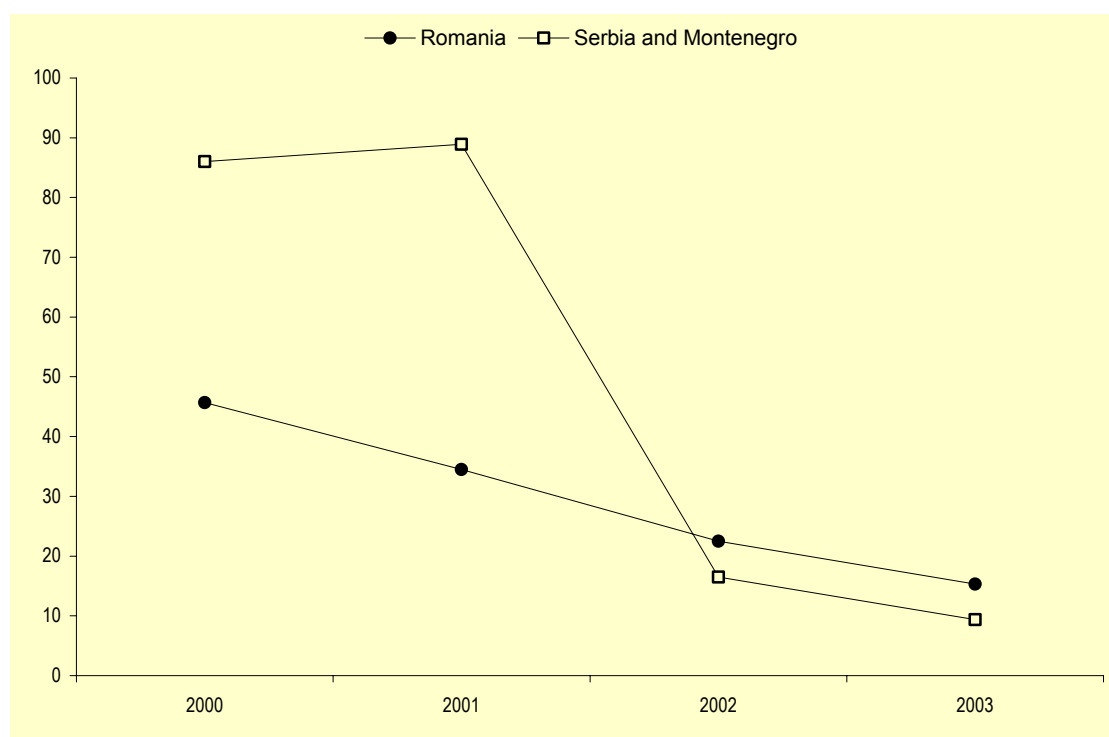
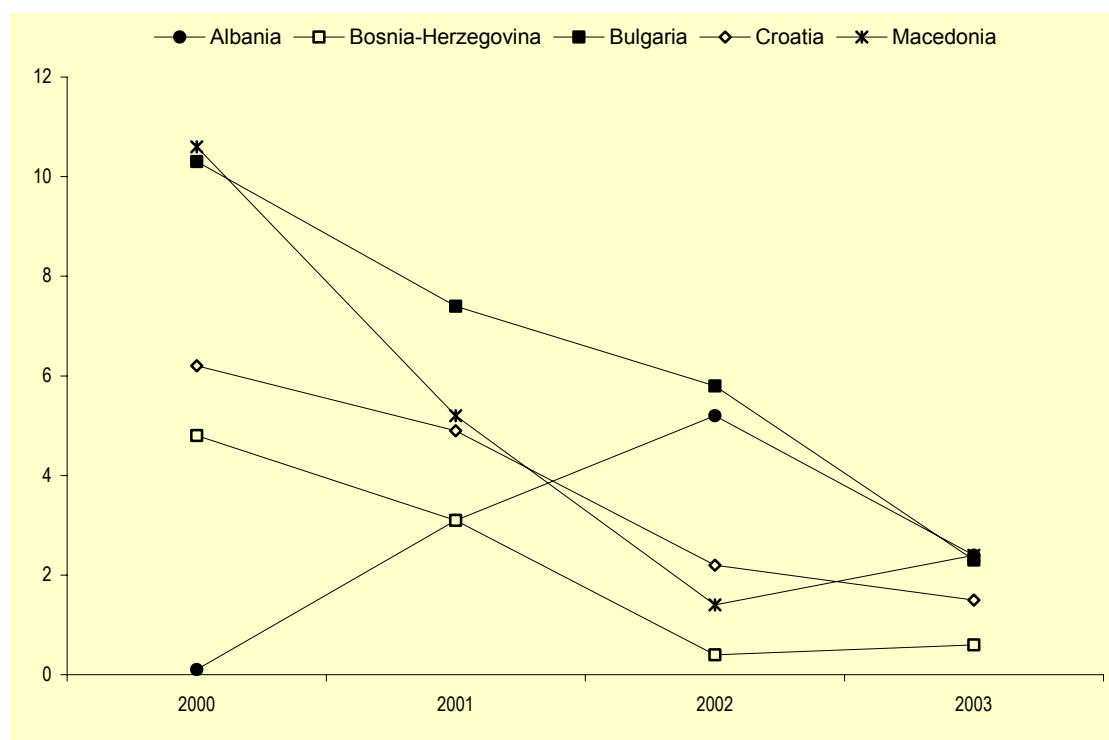
This is the consequence of the policy of fixed exchange rates, or of managed floats that look increasingly like fixed exchange regimes, that has been adhered to in most countries in the region. Thus, one finds:

- (i) two countries that have unilaterally joined the euro zone: Montenegro and Kosovo;
- (ii) two that have introduced currency boards based on the euro: Bulgaria and Bosnia and Herzegovina;
- (iii) one with a fixed peg: Macedonia, and one with a fixed peg with a quite narrow band: Croatia;
- (iv) two with managed floats: Romania and Albania;
- (v) and one with a managed float which is moving towards an undeclared crawling peg: Serbia.

¹⁷ Bosnia and Herzegovina is a special case because of the significant and prolonged reconstruction effort and the contribution of the non-resident consumption. A similar statement applies to Kosovo too. Only lately the positive economic developments in Bosnia and Herzegovina can be attributed to stabilized democratization and improved internal and external market integration.

Figure 9: SEE: Consumer price inflation, 2000-2003

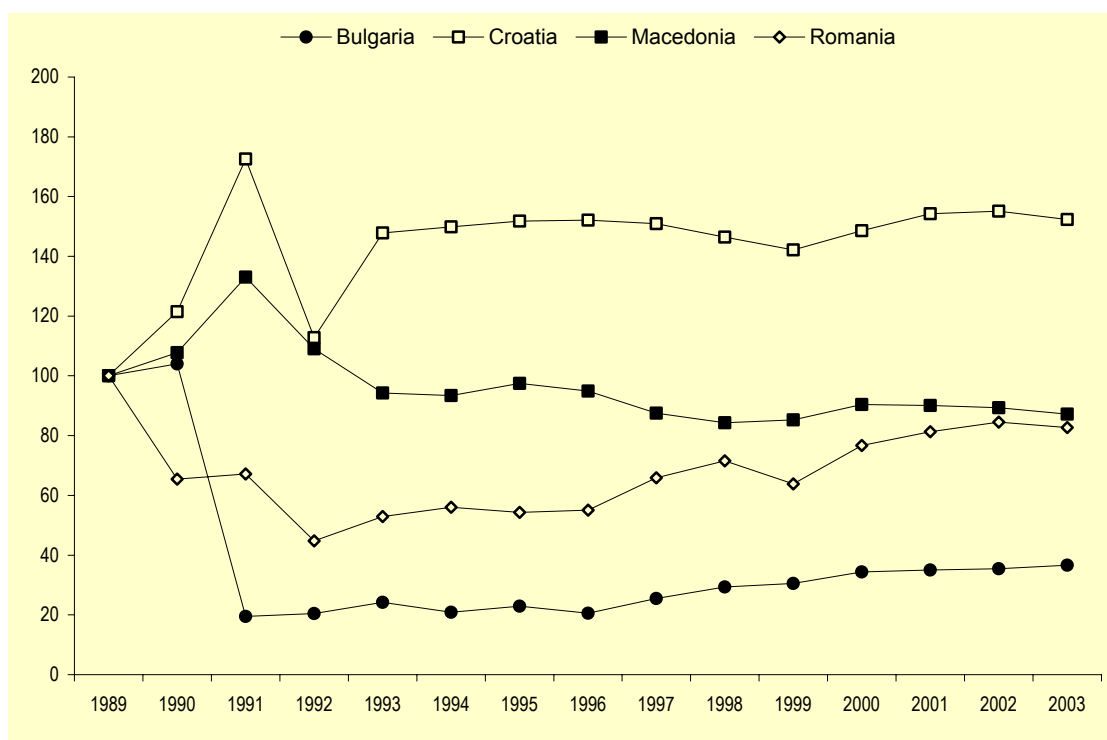
change in % against preceding year



Source: wiiw Database and national statistics.

Figure 10: SEE: Real exchange rates*

EUR per NCU, PPI-deflated, 1989 = 100



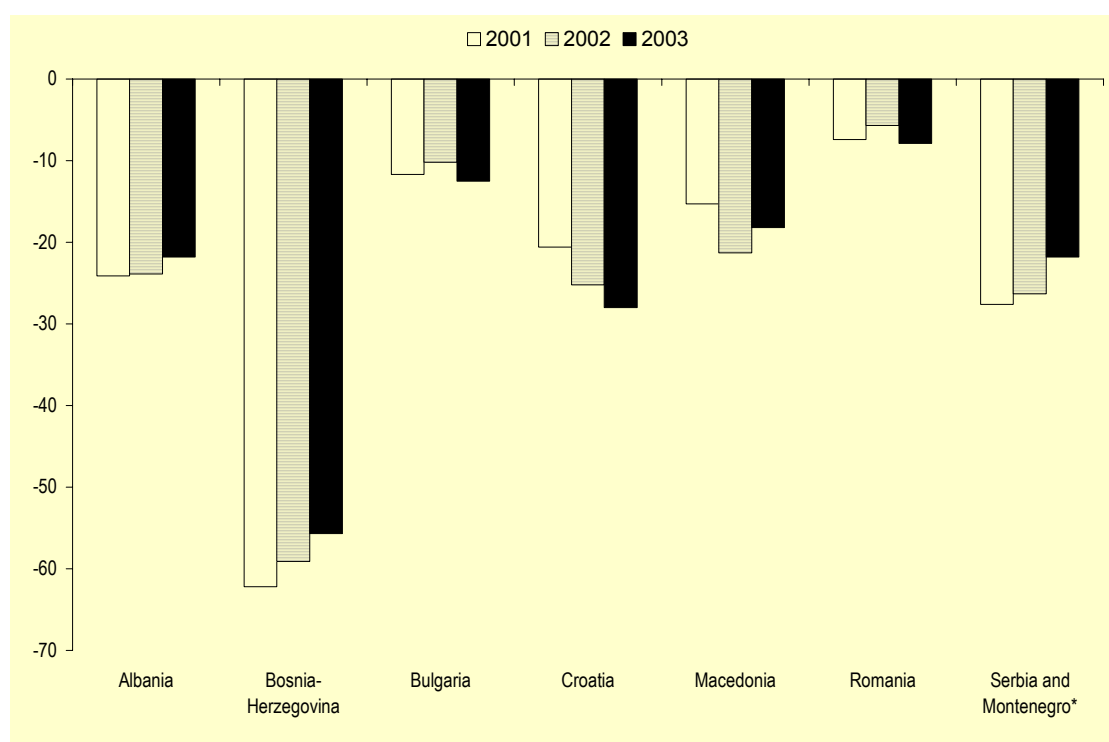
Source: wiw Database and national statistics.

Price stability by itself has not proved to lead immediately to growth. What has proved to be more important has been the progress in transition. SEE countries have been lagging in the development of proper corporate and public governance. Because of that, they have gone not only through transitional recessions, but also through an additional crisis of one sort or another. Only after transition has matured, growth has become a rule more-or-less in the whole region.

The spur in growth in the last two years or so has been supported by an expansion of consumption, which in turn has been fuelled by credit expansion speeding up throughout the region. This is mainly a consequence of the transformation of the banking sector. Banks are mostly foreign-owned and tend to have sounder balance sheets. Higher growth of credits to firms and households signal that the banks judge their clients to have incomes or wealth that can justify their growing debts. Though the SEE countries are still financially underdeveloped, the banking sector has increasingly supported private consumption and to a lesser extent business investments too.

In addition to private consumption, in a number of countries, public consumption still plays a very significant role. In Croatia, Serbia, Montenegro, and Bosnia and Herzegovina, public spending is quite high and goes mostly to consumption. In Croatia, both public spending and credit expansion have contributed to high growth of consumption that has, together with significant public investments, supported the high growth rates in the past few years. In Macedonia, Bulgaria and Romania, public spending is not so high, while in Albania it is quite low.

Figure 11: SEE: Trade balance of goods and services (BOP) in % of GDP, 2001-2003



* 2003 Serbia only.

Source: wiiw Database and national statistics.

The recent acceleration of growth has not been the consequence of consumption only, but has been supported by investments too.¹⁸ Again, there is significant diversity in both the growth of domestic and of foreign investments. An interesting point to be made here is that investments have been correlated with the normalization of international financial relations. Countries that have managed to restructure their foreign debts and to enter private financial markets have seen larger increases in investments. Most foreign investments have gone to Croatia, Romania and Bulgaria, which are countries that borrow money in private financial markets too. Countries that depend on aid, grants and concessionary credits, most other SEE countries, have seen low and volatile foreign investments.

The SEE economies stand out in comparison with the NMS in running higher foreign trade and, to a lesser extent, current account deficits (see table 13). Bulgaria had an almost balanced foreign trade before the introduction of the currency board in 1997. Since then, external imbalances have widened. In the current recovery, external positions have not improved in most cases. Though exports have been growing, imports have increased even faster. Similar developments can be expected in the short to medium term.

The higher trade flows have also had an effect on intra-regional trade. SEE is not yet very integrated. Some disintegrations are not economic but more political and the stabilization and normalization in the region is contributing to the growth of trade. Also, as could be expected, better performing

¹⁸ Here investments do not include foreign reconstruction aid and donations.

countries in the region are lifting up growth in the rest of the region with growth in trade. That should also be beneficial for the pockets of recession that are still to be found in SEE.

Table 14

SEE trade: change in import shares in percentage points, 2003/2001

	of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M
from:								
Albania			0.0	0.0	0.0	0.1	0.0	0.0
Bosnia and Herzegovina		0.0		0.0	0.2	0.0	-0.1	-0.1
Bulgaria		-0.5	0.0		0.2	1.9	-0.2	-1.9
Croatia		0.5	3.4	0.2		0.9	0.1	-0.6
Macedonia		-0.1	-0.3	-0.1	-0.2		0.0	-4.1
Romania		0.2	0.0	-0.2	0.7	-0.2		-1.5
Serbia and Montenegro		0.8	1.6	0.0	0.1	0.1	-0.3	
European Union		-4.3	-1.3	6.6	0.1	4.6	-0.2	0.6
SEE-7		1.0	4.6	0.0	1.0	2.8	-0.5	-8.1
Total change. USD billion		0.5	1.2	2.8	5.2	0.0	8.0	2.9

Note: All exports: f.o.b. – White and black boxes indicate an increase and decrease respectively in shares above 1 percentage point.

Source: IMF Direction of Trade Statistics, Croatian Bureau of Statistics, National Bank of Macedonia, National Bank of Serbia, Agency for Statistics of Bosnia & Herzegovina, Ukrainian Statistical Office, Czech Statistical Office.

Table 15

SEE trade: change in export shares in percentage points, 2003/2001

	of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M
to:								
Albania			0.1	0.1	0.1	0.4	0.1	0.6
Bosnia and Herzegovina		0.0		0.0	1.8	-0.2	0.0	2.9
Bulgaria		0.0	0.0		0.2	0.3	0.0	0.2
Croatia		-0.1	5.4	0.4		0.8	0.5	1.0
Macedonia		0.5	-0.1	-0.1	0.0		-0.1	-0.4
Romania		0.0	-1.0	0.3	0.2	0.0		-2.4
Serbia and Montenegro		0.9	-3.6	-1.2	-0.2	-6.9	-0.5	
European Union		-3.3	9.7	-2.0	-2.1	11.9	1.9	7.4
SEE-7		1.2	0.8	-0.4	2.1	-5.7	0.0	2.0
Total change. USD billion		0.1	0.2	2.1	1.8	0.0	5.7	0.6

Note: All exports: f.o.b. – White and black boxes indicate an increase and decrease respectively in shares above 1 percentage point.

Source: IMF Direction of Trade Statistics, Croatian Bureau of Statistics, National Bank of Macedonia, National Bank of Serbia, Agency for Statistics of Bosnia & Herzegovina, Ukrainian Statistical Office, Czech Statistical Office.

As can be seen from the two tables on regional trade (Table 14 and Table 15), the shares of exports to SEE have grown for all countries except Macedonia and Bulgaria, while the shares of imports from the region have increased for all countries except Serbia and Montenegro and Romania. For instance, the share of the imports of the latter from the region is smaller by 8.1 percentage points. Though these changes are not very large, they point to the fact that intra-regional trade gains in importance. This can be expected to continue to be the case especially once the intra-regional infrastructure has been improved. Indeed, it could be expected that the growth of intra-regional trade in services will be faster than that of goods.

Industrial production picks up

The SEE industries have suffered more than those in the NMS as the process of de-industrialization has been particularly sharp. The process of restructuring is still not over, but positive developments of re-industrialization can be observed in the majority of countries. High rates of growth are recorded by the candidate countries.

National statistics suggest high growth rates of industry for Serbia and Bosnia and Herzegovina and also for Albania in the first half of 2004. Industrial production in Montenegro is picking up much more slowly. In Croatia, industrial production is slowing down as a consequence of the tightening monetary policy there. In Macedonia, industry has all but collapsed at the end of last year and the beginning of this year (see table 13 and country reports).

Construction, transport and tourism

Throughout the region construction is growing quite convincingly. In earlier years this was because of the high inflow of reconstruction aid. Currently and in the future, it will be influenced more by increased private investments in housing, by business investments and by public investments in infrastructure.

Similarly, transport is growing because of the regional normalization and liberalization. The Balkans are a transit region and also a significant tourist destination. Indeed, in countries such as Croatia, Montenegro, Bulgaria and even Albania, tourism is becoming rapidly one of the most important economic activities.

Sustainability of the external position

It has been argued here that in SEE, democratization, trade liberalization, progress in transition and increased financial soundness are the main factors that support growth of private consumption and investment and thus underlie the recent recovery in the region. It has also been suggested that SEE economies tend to run high trade and current account deficits. The issue then arises whether this growth is sustainable in the short and especially medium term – specifically, whether the development of the external debt signals that the current high growth rates are not really sustainable.¹⁹

¹⁹ Sustainability is defined in the usual way: current trends do not indicate a need for a significant adjustment in economic policy.

The SEE countries again differ from each other. Bulgaria, Croatia and Serbia are countries with significant foreign debts. Croatia's foreign debt to GDP and exports in goods and services ratios are increasing year after year.²⁰ Serbia's foreign debt is difficult to evaluate because some significant parts of it are still not being serviced. Bulgaria's debt is high, but stable, i.e., its debt to GDP and debt to exports ratios are not rising but growing current account deficits may eventually create problems for the sustainability of the foreign debt in the future. Both Croatia and Bulgaria are benefiting from the recovery of their tourist industries, however.

The other SEE countries are in a better position. Macedonia is a moderately indebted country as is, less unambiguously, Bosnia and Herzegovina. Similarly, the foreign debts of Albania and Romania are not really worrisome. Still, in all these countries, high external imbalances will tend to increase their foreign debt exposure. It is difficult to assess how much of a constraint these imbalances and the growing debts are because the answers are not independent of the progress in the process of transition. As argued above, for the possibilities of credit expansion, the more advanced the process, and the better allocated and protected private property rights, the higher are the levels of indebtedness that can be considered tolerable. This is confirmed by the fact that some of these countries have had problems with their foreign debts in the past, even though they were less indebted at the time than they are now.

Of course, there are limits to indebtedness everywhere – even in the case of successful transitions. The case of Croatia illustrates the point. With high rates of growth, the advances in transition and with the growth of exports of services (i.e., tourism), the financial markets have shown marked tolerance for a rapid growth of debt to GDP ratios in the past few years. However, the limits seem to have been reached and the issue of the stabilization of foreign debt has become an important one. Similar levels of indebtedness may not be tolerable for the less advanced SEE countries. Therefore, the external position in the majority of the countries in the region will have to be tightly watched because of the persistent high trade deficits they are running.

Fiscal sustainability

The diverse picture shown by the SEE countries extends to the size of their governments and the soundness of their fiscal positions. In SEE some of the biggest governments in the transition can be found. Thus, Croatia's public expenditures are above or around 50% of GDP, those of Serbia are close to that level as are those in Bosnia and Herzegovina and Montenegro. Most other countries have smaller governments, and Albania has quite a small government (see table 13).

There are a number of reasons that explain this state of affairs. Two are perhaps worth singling out. In almost all cases, fiscal policy is being relied on more than on the other economic policies. Only in two countries, fiscal policies have been disciplined by tight monetary policy: in Bulgaria and Macedonia. In both cases, fiscal prudence was followed in order to support the stability of the exchange rate. For a variety of reasons the results have not been the same and a major reconsideration of the Macedonian policy mix implemented since 1994 is probably under way.

²⁰ More on that in V. Gligorov, 'Debt Sustainability and Growth in Croatia', *wiiw Research Reports*, No. 306, May 2004.

In most other cases, irrespective of whether states spend a lot or not, fiscal deficits are high. In that, SEE is not exceptional as in many other economies, including the EU member states, fiscal deficits are high. Those have become an issue with the international financial institutions (IFI) and the need for fiscal adjustment has been pressed hard on Croatia, Serbia and Montenegro. In the case of the protectorates, the adjustment is ongoing because the amount of aid and donations has been going down. Similarly, fiscal prudence is being suggested to Kosovo, which will also face sharply diminishing transfers from donor countries and institutions.

High public expenditures and fiscal deficits are indicators of slow reform of public governance. In the short to medium run, public sector reform will be a major challenge in many SEE countries and those will only partly, but significantly, be concerned with the restructuring of public spending and with the lowering of the fiscal deficit. The immediate effect of these austerity measures will be seen in a lower growth rate. An exception may be Macedonia because it may have to adopt fiscal measures to reverse the recession and to support development programmes.

Labour markets

With recovery under way, unemployment rates have been going down in a number of countries. There are, however, pockets of recession where employment is hard to come by and unemployment is a long-term experience, especially for the younger people. Unemployment is particularly high in Macedonia, Kosovo, Serbia and Bosnia and Herzegovina. In other SEE countries unemployment rates are high or significant, but not unusual for transition economies (See Table 1). That leads to the suggestion that, apart from other reasons for unemployment, there are three types of labour market failures in SEE:

- (i) transitional unemployment,
- (ii) dual markets, and
- (iii) market breakdowns.

The first is the one that has been studied the most and characterizes a type of a frictional unemployment because it mainly involves the time that it takes to move from the collapsing state to the growing private sector. The second may develop during transitional recession and is characterized by a large share of black market employment. For a number of reasons, the transition from informal to formal economy may get stuck so that a segmented market for labour may develop. This is clearly the case in the SEE economies. Finally, and most characteristically for SEE, there is a breakdown in the labour market due to institutional collapses of one type or another. This is the case with the pockets of recession in SEE. This situation is similar to the one analysed by A. Sen with respect to famines and mass poverty. The issue is not one of work being scarce, but of labour markets not functioning efficiently. That is certainly what explains the high levels of unemployment that can be found in post-conflict and post-crisis areas in SEE and that may also persist in cases where state institutions are weak, i.e., where weak states are to be found in SEE. The latter is true for Macedonia, while the former is more characteristic of the other pockets of recession here identified.

This typology of labour market failures may help when it comes to devising employment policies. In the SEE regions with high unemployment, active employment policies will not really be adequate. Strengthening public institutions and increased efficiency of the labour markets would be a better set of policies. These obviously take time and thus it can be expected that labour markets will continue to be a problem and thus will continue to exert a dampening effect on prospects for growth in these countries.

A final note on employment may be useful here. Noting again that SEE is a region with high and persistent trade deficits and slowly recovering exports, it is then no surprise that employment is not recovering all that fast, though there are, as maintained above, other reasons too why this is the case. Still, it is to be expected that persistently high trade deficits can go with low employment generation and high unemployment. Thus, as long as the competitiveness of SEE is not improved, labour markets will have a hard time clearing. In any case, unemployment will continue to be the main problem in most SEE countries in the short to medium term.

Conclusion

Recovery is broad-based in Southeast Europe and will continue. The recent expansion of consumption will be followed by growing investments, in some cases public as well as private. The process of re-industrialization that may have started in most countries will continue because of the more efficient private enterprise sectors. Macroeconomic imbalances will remain to be a problem, with the foreign debt constraining growth in some cases and fiscal adjustment proving to be a problem in other cases. Unemployment will be the main problem in the short to medium run.

SEE progress towards EU accession

Introduction

At the Thessaloniki summit of the European Union (EU) with the countries from the Western Balkans (WB) in late June 2003, it was declared that the integration of the EU would not be complete without the accession of Southeast Europe (SEE). This region in the EU jargon consists of seven countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro, and the territory of Kosovo, which is under international protection. The Thessaloniki declaration can be taken as a commitment by the EU to work together with the countries in this region on their accession to the EU.

The countries of the Western Balkans (a subset of five countries, i.e., SEE minus Bulgaria and Romania), participate in the Stabilization and Association process (SAP). In April 2004 a new European Partnership (EP) instrument was created for them to institutionalize this commitment. The EP sets out short- and medium-term measures that partner countries should fulfil to advance in their integration with the EU. The end state of the whole process, as stated in the EPs, is full membership in the EU.²¹ Indeed, the EPs incorporate elements of the pre-accession process though with weaker commitment, less financial support and with the overall responsibility still located with the commissioner for external affairs of the EU.

The SEE countries are at very different stages in the process of EU integration. In this regatta there are:

- the candidate countries Bulgaria and Romania;
- the new candidate country Croatia;
- an applicant country with a Stabilization and Association Agreement (SAA): Macedonia;
- a country negotiating its SAA: Albania;
- a country to start negotiations for an SAA after fulfilling certain criteria: Bosnia and Herzegovina;
- a country that is not yet ready to start negotiating an SAA agreement: Serbia and Montenegro; and
- a territory that is under a tracking mechanism within the Stabilization and Association process (SAP): Kosovo.

Candidate countries

Two Southeast European countries, Bulgaria and Romania, have conducted negotiations with the EU for membership for four years and the EU has set the date of their accession for 1 January 2007. This requires the completion of negotiations by the end of 2004 in order to leave another two years for the finalization of the accession treaty and the ratification process. In June 2004 substantial progress has been made in the negotiation process, but in the case of Romania it is still much in delay, which may lead to the postponement of the date of its accession.

* With contributions by Rumen Dobrinsky and Gábor Hunya.

²¹ More detailed discussion is in V. Gligorov, 'European Partnership with the Balkans', *The Vienna Institute Monthly Report*, No. 4, April 2004, pp. 8-14.

In the conclusion statement of the Irish presidency in mid-June, the European Council reconfirmed that Bulgaria and Romania are an integral part of the ongoing round of enlargement, which saw ten new member states join the Union on 1 May 2004, and which will conclude in 2007. According to the decisions approved in Brussels, the drawing-up of the Accession Treaty will start in July 2004, so that the treaty may be signed in 2005 at the earliest. The European Council looks forward to the Commission 2004 regular report, which will assess the two countries' ability to assume all the obligations of membership by accession time. The Union is calling on Romania and Bulgaria to improve their administrative and juridical capacities, as well as to continue economic and structural reform, and to fully and timely implement the negotiated commitments.

In June 2004 Bulgaria managed to complete the negotiation process successfully. However, there has been considerable public criticism that the negotiations have been conducted on the Bulgarian side in a rather non-transparent manner. There have been claims both by the opposition and by independent analysts that the Government did not have strong bargaining positions and that the speedy closure of some chapters has been at the expense of concessions against Bulgaria's national interests.

Romania has made slower progress and closed only 22 chapters by the end of 2003. In early June, Romania and the EU finalized another two chapters: on Agricultural Legislation as well as Financial and Budgetary Provisions. Thus six chapters remain until the end of the year, of which they hope to close the chapters on the Free Movement of Services and Energy Policy by the end of June. The outstanding chapters until the end of the year remain: Competition, Regional Policy, Environment, and Justice and Home Affairs. Competition policy is a difficult issue as some state-owned enterprises in certain sectors still enjoy privileged treatment and their payment arrears to the budget are tolerated. Progress in this respect is hesitant and Romania still has to be judged by the Commission to have a 'functioning market economy'. The chapter on the legal system is not less simple as courts have been under attack for corruption and susceptible to intervention by the state. Both new laws must be passed and implementation needs improvement. The regional policy and environment chapters present smaller problems because the institutional framework is mostly in place. Negotiations have concentrated on the amount of EU support and some transitional arrangements that Romania wants to have.

According to the results of negotiations concerning the chapter on agriculture, Bulgaria and Romania will be subject to the same treatment applied to the ten countries that just acceded to the EU. Farmers will be entitled to receive direct payments amounting to 25 per cent of the EU subsidies already in 2007 and these will gradually increase to reach the EU level in 2016.

The total Common Agricultural Policy (CAP) funds earmarked for Bulgaria for the period 2007-2009 amount to EUR 1436 million, of which EUR 388 million are set aside for market measures, EUR 431 million for direct payments to farmers, and EUR 617 million for the development of rural areas. The financial framework also envisages a progressive phasing-in of structural actions expenditure. The total funds allotted for structural actions in Bulgaria in 2007-2009 amount to EUR 2300 million, roughly based on the current EU rules. Bulgaria's contributions to the EU budget in 2007-2009 are estimated between EUR 835 million and EUR 1036 million. Bulgaria is set to get access to funds amounting to EUR 4.4 billion in the period 2007-2009. Under the agreement concluded on 14 June 2004, Bulgaria will receive EUR 240 million in addition to the amount already committed to the country from the EU's 2007-2009 budget. The sum will be spent mostly on

securing Bulgaria's borders and propping up its national budget. Meanwhile, Bulgaria will have to pay EUR 303 million to the EU in annual membership.

In the negotiations on agricultural policies, Romania obtained funds in excess of EUR 4 billion for 2007-2009. (The current national budget contains only EUR 500 million for agricultural subsidies.) The funds allotted subsequent to negotiations will be channelled into two major directions: rural development (EUR 2.3 billion EUR) and direct payments and market measures (EUR 1.6 billion). After accession, another EUR 0.8 billion will be used for projects financed from structural funds. The draft EU financial framework for 2007-2013, proposed by the European Commission, contains some rather generous provisions for Bulgaria and Romania. Romania will receive approximately EUR 11 billion in commitments, including EUR 6 billion in payments, in the 2007-2009 period. Romania's contribution to the EU budget will be approximately EUR 800 million in 2007.

If these transfers materialize, on average they would translate into annual commitments amounting to some 5-6% of (projected) GDP in this period for both of the countries. Even the payments part is about 3% of GDP. This may well be one of the most favourable financial offers to a prospective EU member state. It should accelerate the catching up of these countries from the low level of per capita GDP.²²

However, the absorption of EU funds will remain an acute problem in both countries, mainly due to a dysfunctional and inefficient public administration. The total volume of pre-accession assistance available to Romania until 2006 has been around EUR 700 million per year. This represents a very important financial resource, equal to around 1.4% of GDP, 4.4% of consolidated budget revenues, or 36% of public investment expenditures. Disbursement is less than that, but has been accelerated recently. According to the Romanian sources, the amount of payments made by the European Commission from 2001 to May 2004 amounted to some EUR 136 million for the ISPA funds supporting the upgrade in environment and transport infrastructures. They expect that by the end of 2004 it will reach EUR 330 million. The SAPARD programme is also getting functional in 200 villages which have been successful with their applications. As of mid June 2004 out of the funds allotted through the SAPARD Programme for the year 2000, only 18% (EUR 37 million) have been spent. These sums must be absorbed by end-October, else they will have to be returned to the European Commission. According to recent estimates in Bulgaria, the implementation rate (the share of contracted funds in the allocated EU funds) under the SAPARD programme (which is considered as one of the most successful in terms of absorption) in early 2004 was 64% but one has to bear in mind that not all contracted projects are completed successfully.

The actual date of the two countries' accession to the EU is still surrounded by some uncertainties. Bulgaria is ahead in the negotiations but may have to 'wait for' Romania. So far Bulgaria has been packed with Romania and it is highly unlikely that any of the two countries would accede to the EU on its own. So even if Bulgaria is ready for accession by 2007, the accession date may be postponed if Romania fails to be ready. The Commission, while warning Romania for some of the shortcomings, treats the two countries together and is making every effort to close the negotiations with Romania as soon as possible. There is a minority opinion in Romania that accession in 2009 would put the country in a better position, but the majority in the present government and among the

²² 2003 per capita GDP at PPP is about 30% of the EU-25 average while the poorest 2004 new member, Latvia, has 45%.

specialists see 2007 accession as the best opportunity to catch up in the institutional building and in getting full access to transfers from the new EU budget.

In June 2004 the EU Summit gave a go-ahead to negotiations with Croatia. Negotiations will start in early 2005. No date of accession has been put forward or suggested yet. However, the *avis* for Croatia is very positive. It says that Croatia is a functioning market economy and that it should be able to withstand competitive pressures in the medium term. It also judges Croatia to be a functioning democracy that respects human rights. The detailed assessments cite quite a number of problems, that will obviously be the matter that the negotiations will be about, but no major obstacles are envisaged. Probably the key area of concern is the efficiency of public governance and the problems with the rule of law.

The negotiations should go rather smoothly. Though it is difficult to say how long they will last, the Croats at least expect them to be quite short. It is hardly possible that they will be so fast that Croatia could join the EU in 2007, but by that time the dates for the end of the negotiations and for accession could indeed be set. The setting of these dates could coincide with the actual accession of Bulgaria and Romania, assuming everything goes as planned in the case of the latter two countries.

At the start of the negotiations, the size of the pre-accession assistance will certainly be determined and that will be quite helpful to Croatia. It is important that the international financial markets look favourably on these developments and possibly upgrade Croatia's investment rating. That should be helpful for the financing of its rather large foreign debt while the pre-accession budget support will be helpful for its strained public finances. Both should be supportive of further increase in the inflows of foreign investments.

Looking at the three candidate countries' prospects together, the most likely scenario seems to be that Bulgaria and Romania will join the EU in 2007 while Croatia will have a fixed date of accession determined at that time.

Accession to the monetary union is a different matter. Bulgaria has a currency board and intends to adopt the euro by 2009 without changing the exchange rate regime or the current parity with the euro. Similarly, Croatia intends to adopt the euro as soon as possible, at the latest two years after accession to the EU. Romania, on the other hand, will in all probability need more time to join the monetary union.

Other SAp countries

The remaining countries in SEE are much further away from the accession to the EU. Macedonia submitted its application for membership in the spring of 2004. It will most probably get the questionnaire in the preparation of the *avis* this September. If it is efficient in its response, it may expect the completion of its *avis* in the first half of 2005. It is hard to predict now what the *avis* will say. However, given that Macedonia has a SAA agreement with the EU and that it has been offered an EP, it is hard to imagine that the *avis* will be negative. It may set out the conditions for the acceptance of Macedonia's candidacy, but in the end the status will have to be granted and the negotiations will have to start. It is, however, not sensible to speculate on the speed of the whole process of accession. In the meantime, Macedonia has to implement the SAA and the EP. The assessment of the implementation progress will have a significant influence on the content of the *avis*.

Albania is negotiating its SAA and the progress is slow. Bosnia and Herzegovina has to fulfil 16 systemic conditions to start negotiating its SAA. Once the process starts, however, it can be expected to be speeded up because the institutional capacity of this country can be upgraded rather quickly once the major constitutional and other legislative issues are solved.

Serbia and Montenegro are a different matter altogether as is of course Kosovo. The process of integration of Serbia and Montenegro cannot progress before these two countries agree to create a customs union. So far they have not been able to agree on common tariff rates and on other elements of trade policy. There are economic reasons for the lack of agreement stemming primarily from the difference in the economic structure of the two states. In addition, however, the majority in Montenegro and a growing number of people in Serbia prefer to join the EU independently. Until there is a clear decision on the separation or on the strengthening of the state union of Serbia and Montenegro the process of EU integration, which in this case means the start of the negotiations for the SAA, will be stalled.

When it comes to Kosovo, the prior issue is the so-called final status of this province that is currently under international protection. The EU has a SAP tracking mechanism for Kosovo, but obviously cannot get into any kind of contractual relations with a non-sovereign political entity. Next year, 2005, a more intensive diplomatic effort will have to be made to start the search for the appropriate solution for Kosovo's sovereignty. After that, the already existing intensive involvement of the EU could be redefined to be part of the SAP and eventually lead to a SAA.

Financial support

The countries included in the SAP are eligible for financial support from the EU. Initially, around EUR 5 billion were set aside for the 2002-2006 period. Of that, less than EUR 2 billion were spent by 2004. To the remaining resources an additional EUR 70 million per year were allocated to the SEE at the Thessaloniki summit in June 2004. Most of it is in support of reconstruction. Increasingly, the EU is changing the purpose of its financial assistance from reconstruction to pre-accession. Also, some pre-accession programmes are being opened for the SAP countries and some of the instruments that proved useful in the previous enlargement are being applied to the countries of the Western Balkans. With Croatia becoming eligible for pre-accession programmes and funds and with the new financial arrangement yet to be agreed upon, it is still to be seen what will be the level of assistance allocated to the SAP countries in the next EU budget covering the period 2007-2013. There is no doubt that EU financial assistance is important to this region.

Possible timing of accessions

The above description of the process of Southeast European enlargement of the EU does not take into account directly the extensive involvement of the EU in this region in the areas of security, building of institutions, economic and financial assistance and in the political developments that includes direct involvement in public governance and in state building in the case of the two protectorates or quasi-protectorates of Kosovo and Bosnia and Herzegovina. Moreover, growing economic integration with the EU has to be taken into account. The development and growth of the region depends very much on trade with and investments from the EU. Also, intra-regional liberalization and normalization is premised on the process of EU integration. Finally, the process of the Southeast EU enlargement can hardly stop before all the countries and territories are included. Once Bulgaria, Romania and Croatia accede to the EU, the remaining region can hardly be left out.

That becomes even more obvious if the decision to start negotiations with Turkey is taken. Thus, the question of when and how rather than of whether is the only realistic one. The following table contains a forecast for the accession to the EU and for the adoption of the euro.

Table 16

SEE accession forecast			
	SAA	EU	euro
Bulgaria		2007	2009
Romania		2007	2012
Croatia	2004	2008-2009	2010-2012
Macedonia	2004	2013	2015
Albania	2007	after 2013	after 2015
Bosnia and Herzegovina	2007	after 2013	after 2015
Serbia	2007	after 2013	after 2015
Montenegro	2007	after 2013	since 2002
Kosovo	2007	after 2013	since 2002

The reasoning behind the above table is as follows. It is assumed that the EU will play by the book. It is also assumed that Bulgaria will be ready to accede to the EU on time, that is in 2007. It seems reasonable to expect that Romania will finish the negotiations by the end of 2004 and will thus be practically ready for accession in 2007 too. Barring unexpected developments, these two countries should join as planned in 2007. Croatia could be close to the end of its negotiations with the EU and could accede either in 2008 or 2009. Macedonia could start to negotiate in 2006 or 2007 and be ready to join early in the next decade, at the latest in 2013. All the other SAp countries should have their SAAs signed by 2007 and could negotiate their accession at some point after 2013. Obviously, the longer the time span the greater is the risk of making a wrong forecast.

Thus, the year 2007 seems crucial: two countries should accede, one should get its date of accession, one should have already started negotiations, and all the others should be armed with their SAAs and should start preparing for negotiations in the near future.

The adoption of the euro depends on the expectations of the particular countries. In the case of Montenegro and Kosovo, it is likely that they will not be introducing their own currencies before joining the EU. In the case of Bulgaria and Croatia, early adoption would be consistent with the expectations built into their monetary and overall economic policies. Similarly, Macedonia and the other post-Yugoslavia states will be expecting to adopt the euro as soon as possible, which is two years after joining the EU, if the system of euro adoption is not changed. The same goes for Albania too. It is only Romania that is expected to make longer use of the ERM II mechanism.

Country reports

Anton Mihailov

Bulgaria: trying to rein in a growing external imbalance

The growth of aggregate output in Bulgaria picked up speed in the first quarter of 2004 boosted by an improving external environment and booming final domestic demand. In year-on-year terms, quarterly GDP rose by 5.3% and has been on an accelerating path since the fourth quarter of 2002. On the demand side, total final consumption grew at par with GDP (by 5.2% year-on-year) while fixed investment surged by an impressive 21.4%.

All indications are that the present economic upturn is broadly based. The export-led recovery in the manufacturing industry strengthened further, with virtually all industries benefiting from growing external demand. Gross industrial output grew by more than 16% year-on-year in the first quarter, the fifth consecutive quarter of double-digit rates of growth. The boom in the tourism industry also continues with tourism revenues in the first quarter by some 30% higher (in EUR terms) than a year before. There is also a rush in construction activity (especially in hotels and residential construction), driven by an expectation that the real estate prices will continue to rise in relative terms. In the first quarter of 2004, retail sales were up by 12.5% year-on-year, an evidence of the strong consumer demand for both food and non-food products. The strengthening of growth has had a positive effect on the labour market, contributing to rising employment and falling unemployment in the first months of the year. Inflation has been relatively low at the beginning of 2004, but this is likely to be reversed in the second half of the year due to the effect of the rising oil prices.

At the same time, there are growing fears that the current pattern of growth – accompanied by a widening external imbalance – is unsustainable, and this has become a major source of concern for Bulgarian policy makers. While the lasting surge in final domestic demand has provided support to domestic economic activity during the past couple of years, it has also been associated with an ever-growing current account deficit which reached 8.5% of GDP in 2003 and continued to expand in the first quarter of 2004 (boosted further by the rising oil prices).

One of the key factors behind the enduring strength in domestic demand has been a lasting credit boom which continues, at an accelerating pace, for the fourth consecutive year. In the first quarter of 2004, credit to the non-government sector was growing at a year-on-year rate of around 50% (the rate of growth of corporate credit was around 40% while household credit was growing at a rate of some 80%). On the one hand, the surge in credit is a sign of growing consumer and investor confidence and an indication of improving financial intermediation (which had come to a virtual halt in the aftermath of the 1996-97 financial crisis). Notably, despite the monetary expansion, monetization in Bulgaria (measured by both M1 and broad money) is still below its pre-crisis level. On the other hand, the rapid credit growth, by amplifying consumer and investment demand, has undoubtedly boosted imports, thus contributing to the widening of the current account deficit.

While the problem with the external balance is indeed partly associated with the accelerating monetary expansion, under the currency board arrangement the authorities have limited policy options to address it. Practically they have no instruments for direct monetary intervention that could

Table BG

Bulgaria: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., end of period	8190.9	8149.5	7891.1	7845.8	7801.3	.	.	.	.
Gross domestic product, BGN mn, nom.	23790.4	26752.8	29709.2	32335.1	34410.2	7290.9	8055.5	38000	41000
annual change in % (real)	2.3	5.4	4.1	4.9	4.3	3.5	5.3	4.5	4
GDP/capita (EUR at exchange rate)	1481	1674	1920	2101	2249	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5120	5560	6080	6360	6830	.	.	.	.
Gross industrial production									
annual change in % (real)	-8.0	8.3	1.5	6.5	8.3	19.3	16.7	12	8
Construction output total									
annual change in % (real)	8.8	8.0	15.0	1.9	-17.2	.	.	.	.
Actual final consump. of househ., BGN mn, nom.	453.3	634.6	917.2	1151.4	1451.2	6042.4	6529.4	.	.
annual change in % (real)	-1.1	0.2	6.8	3.1	7.1	6.8	4.9	.	.
Gross fixed capital form., BGN mn, nom.	3600.5	4206.0	5415.2	5908.5	6733.1	1213.1	1505.9	.	.
annual change in % (real)	20.8	15.4	23.3	8.5	13.8	11.6	21.4	.	.
LFS - employed persons, th, avg.	2875.3	2794.7	2698.8	2739.6	2834.8	2704.3	2783.8	.	.
annual change in %	-5.3	-2.8	-3.4	1.5	3.5	2.1	2.9	.	.
Reg. employees in industry, th pers., avg.	722.5	662.0	658.4	666.8	664.2	671.4	673.9	.	.
annual change in %	-10.0	-8.4	-0.5	1.3	-0.4	3.5	0.4	.	.
LFS - unemployed persons, average	534.0	566.8	663.9	592.4	448.7	499.6	428.8	480	460
LFS - unemployment rate in %, average	15.7	16.9	19.7	17.8	13.7	15.6	13.3	13	12.5
Reg. unemployment rate in %, end of period	16.0	17.9	17.3	16.3	13.5	15.7	13.7	13	12.5
Average gross monthly wages, BGN	201.0	224.5	240.0	257.6	284.0	265.7	283.0	.	.
annual change in % (real, gross)	6.9	1.3	-0.5	1.5	7.8	3.1	0.1	.	.
Consumer prices, % p.a.	2.6	10.3	7.4	5.8	2.3	0.6	6.4	7	4
Producer prices in industry, % p.a.	2.8	17.5	3.8	1.2	4.9	7.9	1.8	.	.
General governm. budget, nat. def., % GDP									
Revenues	40.7	41.4	39.8	38.7	40.9	44.2	45.1	.	.
Expenditures	41.6	42.4	40.7	39.4	40.9	42.7	42.3	.	.
Deficit (-) / surplus (+), % GDP	-0.9	-1.0	-0.9	-0.7	0.0	1.5	2.8	.	.
Public debt in % of GDP	79.3	73.6	66.2	53.2	46.2	.	44.8	45	40
Base rate of NB % p.a., end of period	4.5	4.7	4.7	3.4	2.9	2.6	2.6	.	.
Current account, EUR mn	-586.9	-761.4	-1101.7	-925.5	-1498.5	-391.3	-481.4	-1500	-1600
Current account in % of GDP	-4.8	-5.6	-7.3	-5.6	-8.5	-10.5	-11.7	-7.7	-7.6
Gross reserves of NB excl. gold, EUR mn ²⁾	2878.7	3390.6	3734.0	4247.1	4981.0	4070.8	5038.1	.	.
Gross external debt, EUR mn ³⁾	10863.9	12038.5	12046.0	10768.6	10330.1	10574.7	10950.4	.	.
FDI inflow, EUR mn	775.0	1103.3	903.4	980.0	1253.9	260.0	294.1	1400	1200
FDI outflow, EUR mn	16.3	3.5	10.8	28.9	19.2	2.4	13.7	.	.
Exports of goods, BOP, EUR mn	3733.7	5253.1	5714.2	6062.9	6662.6	1633.1	1718.0	7000	7700
annual growth rate in %	-0.4	40.7	8.8	6.1	9.9	20.3	5.2	5	10
Imports of goods, BOP, EUR mn	4741.4	6533.0	7492.6	7754.7	8858.8	1924.7	2227.0	9500	10500
annual growth rate in %	16.3	37.8	14.7	3.5	14.2	17.3	15.7	7	10.5
Exports of services, BOP, EUR mn	1686.2	2366.2	2384.8	2478.9	2790.6	409.5	495.6	3000	3400
annual growth rate in %	5.2	40.3	0.8	3.9	12.6	2.3	21.0	7.5	13
Imports of services, BOP, EUR mn	1380.6	1818.6	1930.3	1992.9	2266.7	467.1	532.9	2500	2800
annual growth rate in %	10.5	31.7	6.1	3.2	13.7	13.0	14.1	10	12
Average exchange rate BGN/USD	1.838	2.124	2.185	2.077	1.733	1.822	1.564	1.7	.
Average exchange rate BGN/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.518	0.547	0.570	0.603	0.591	.	.	.	.
Purchasing power parity BGN/EUR, wiiw	0.566	0.590	0.618	0.646	0.644	.	.	.	.

Notes: 1) Preliminary. - 2) Converted from the national currency to EUR at the official exchange rate. - 3) Up to 2001 converted from USD to NCU, and from NCU to EUR at the official exchange rates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

cool down the rising money demand. Besides, with public finances close to balance, the government itself until now has not contributed much to the monetary expansion. Thus while the current situation may be calling for a policy reaction, the latter can only be constrained to some specific and non-conventional policy measures.

In April, the government announced, as part of a policy package drafted in the preparation of a new agreement with the IMF (expected to be rubber-stamped in July), a series of measures aiming to curb the growth of money demand. One of these quasi-monetary measures is the withdrawal of government funds (which are part of its fiscal reserve) deposited in commercial banks in order to reduce the level of liquidity in the banking system. Thus in the first half of May alone, the government withdrew funds amounting to BGN 300 million and it is estimated that in 2004 as a whole these withdrawals may reach up to BGN 750 million, which is about 8.5% of the total deposit base of the Bulgarian banking system. In addition, the central bank decided to broaden the definition of the deposit base on which it requires mandatory reserves from the commercial banks. Although formally the mandatory reserve ratio has not been raised, this measure in effect amounts to an increase in mandatory reserves and will hence curb money supply. There are early indications that the quasi-monetary measures undertaken in May did trigger a general rise in domestic interest rates. However, it remains to be seen what will be their longer-term effect, after the initial shock is channelled through the market.

Another measure agreed upon with the IMF was the decision to target a lower budget deficit in 2004 (0.4% of GDP, instead of the 0.7% incorporated in the official budget for the year). The IMF also strongly opposed plans to use funds from the fiscal reserve (which accumulates public funds that are not earmarked for immediate spending and that guarantee foreign debt payments) to finance additional public spending, including the recapitalization of some state-owned firms and the financing of public infrastructure projects. If these projects (which formally were not part of the official budget figures but were recorded 'below the line') had gone ahead, they would have pushed the actual 2004 deficit to 2.2%. Anyway, after the IMF intervention these projects have been put on hold. So the actual additional fiscal tightening effort undertaken by the government may be close to 2% of GDP. The government will also consider the possibility to use part of the fiscal reserve (which, thanks to the accumulation of privatization revenue, at the moment is around BGN 4.5 billion, while the minimum agreed upon with the IMF is BGN 2.5 billion) to reduce the foreign public debt, in particular to the IMF. One of the possible implications of these cost cutting measures is that Bulgaria will probably also put on hold the Eurobond issues planned for this year.

In these circumstances, two main factors are likely to affect economic performance in the short run. The notable effective tightening of macroeconomic policy will undoubtedly curb final domestic demand and hence may have a negative impact on economic activity. In addition, rising energy prices can also be expected to have a negative effect not only on the current account but – through rising costs – on the real economy as well. In view of this the government has revised downwards its forecast for GDP growth for 2004 as a whole (from 5.3% to 5.0%). Given the size of the expected fiscal tightening, the actual outcome for the year may be even lower.

Romania booms

After experiencing 5% annual GDP growth over the past three years, the Romanian economy continues to flourish in 2004 as well. First quarter 2004 GDP growth was 6.1%, fuelled by private consumption that rose by 8.1%. This upswing is reflected in booming sales in the retail sector, new car sales and private home construction. In March real wages in industry were almost 12% higher than a year before; this was not unjustified as labour productivity was 17% higher. Meanwhile, manufacturing production increased at a higher rate than a year before: a trend attributable to the progress achieved in privatization, restructuring and new investments.

The 7.3% increase in fixed capital formation in the first quarter of 2004 is remarkable, as is the decline in stocks. The business confidence survey for the next three months confirms an optimistic investment climate. The government, however, wants to stimulate investments even more by planning corporate tax cuts for 2005. The Ministry of Public Finance is considering reducing the profit tax to 19% as of 2005 to support the competitiveness of Romania as a business location. In 2004 the fiscal deficit may rise to 2.7% of GDP owing to increased spending on expenditures on new motorways and other construction projects. This overheating, however, may entail costs as domestic interest rates are more than 10% in real terms. Over the past twelve months the National Bank has repeatedly increased the reference interest rate in an attempt to curtail the demand for credit; it has also instructed commercial banks to keep a closer eye on their clients' creditworthiness. As a result, household borrowing has stagnated over the past few months at a level lower than the November 2003 peak, thus allowing the National Bank to reduce the intervention interest rate by 0.5 percentage points to 20.75% per year in early June.

The foreign trade deficit (goods and services) increased to EUR 600 million, a rise of 50% compared to the first quarter last year. The current account deficit, however, was significantly smaller, EUR 269 million, owing to a new high in terms of private transfers. Remittances from persons working abroad generate more inflows than FDI. We expect the current account deficit per GDP for the year as a whole to surpass 6%, and its financing could entail a certain degree of risk. It is unlikely, however, that a crisis or the recent agreement with the IMF will trigger restrictive policies in the short run. The international rating of the country is improving; external debts are relatively low and the government sees imports as being essential to greater modernization. In view of the accelerated growth in the first quarter and given that the increasing current account deficit has not triggered off a series of restrictive measures, the wiiw has revised its GDP growth forecast upwards to 5%. But following the current election year, we expect that incomes policy will become more restrictive.

Expanding foreign trade activity proceeded in tandem with a slow, but positive shift in the commodity structure. In the first four months of 2004, FOB exports totalled EUR 5.82 billion, up 17% compared to the same period in 2003. Two thirds of the exports went to the EU-15. Exports of machines (and metals) increased more rapidly than those of traditional commodities such as clothing and footwear. Structural shifts are the result of recent FDI in the car and machinery components sectors and an outcome of the export-oriented restructuring of the large Galati steel mill following its privatization. CIF imports in the first four months reached EUR 7.46 billion, up 19.2% year-on-year. The commodity structure reflects a growing demand for investment goods and means of transport.

Table RO

Romania: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	22458.0	22435.2	22408.4	21794.8	21733.6	.	.	.	.
Gross domestic product, ROL bn, nom.	545730	803773	1167687	1512617	1890778	327703	405355	2233000	2540000
annual change in % (real)	-1.2	2.1	5.7	5.0	4.9	4.4	6.1	5	4.5
GDP/capita (EUR at exchange rate)	1491	1795	2002	2221	2316	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4980	5230	5700	6360	6730	.	.	.	.
Gross industrial production									
annual change in % (real)	-2.4	7.1	8.4	6.0	3.1	3.5	5.8	6	4
Construction output total									
annual change in % (real)	-0.2	2.8	9.0	10.0	6.2	5.3	6.9	.	.
Actual final consump. of househ., ROL bn, nom.	453308	634590	917186	1151356	1451166	265187	336356	.	.
annual change in % (real)	-1.1	0.2	6.8	3.1	7.1	3.8	8.4	.	.
Gross fixed capital formation, ROL bn, nom.	96630	151947	241154	322383	425917	53616	67815	.	.
annual change in % (real)	-4.8	5.5	10.2	8.2	9.2	6.8	7.3	8	7
LFS - employed persons, th, avg. ²⁾	10775.6	10763.8	10696.9	9234.3	9222.5	8806.6	.	.	.
annual change in %	-0.6	-0.1	-0.6	-13.7	-0.1	-0.1	.	.	.
Reg. employees in industry, th pers., avg.	1991.0	1873.0	1901.0	1891.0	1855.0	.	.	.	.
annual change in %	-12.4	-5.9	1.5	-0.5	-1.9	-1.9	-2.4	.	.
LFS - unemployed persons, average ²⁾	789.9	821.2	750.0	845.3	692.0	778.8	.	.	.
LFS - unemployment rate in %, average ²⁾	6.8	7.1	6.6	8.4	7.0	8.1	.	8	7
Reg. unemployment rate in %, end of period	11.8	10.5	8.8	8.4	7.2	8.6	7.7	7	7
Average gross monthly wages, ROL	1957731	2876645	4282622	5452097	6741152	6304419	7852024	.	.
annual change in % (real, net)	-3.8	4.6	4.9	2.2	8.8	9.6	9.0	.	.
Consumer prices, % p.a.	45.8	45.7	34.5	22.5	15.3	16.7	13.6	11	8
Producer prices in industry, % p.a.	44.5	53.4	41.0	24.7	19.5	22.0	17.9	15	10
General governm. budget, EU-def., % GDP ³⁾									
Revenues	.	.	36.4	34.9	.	.	.	.	.
Expenditures	.	.	39.9	36.9	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-4.4	-3.5	-2.0	-2.0	.	.	-3	-3
Public debt, EU-def., % of GDP ³⁾	24.0	23.9	23.2	23.3	21.8	.	.	23.5	23.5
Discount rate, % p.a., end of period ⁴⁾	35.0	35.0	35.0	20.4	20.4	18.4	21.3	.	.
Current account, EUR mn ⁵⁾	-1352	-1494	-2488	-1623	-2920	-149	-269	-3500	-3500
Current account in % of GDP	-4.0	-3.7	-5.5	-3.4	-5.8	-1.6	-2.7	-6.4	-6.0
Gross reserves of NB excl. gold, EUR mn	1520.0	2654.8	4445.3	5876.8	6373.6	5802.2	6725.1	.	.
Gross external debt, EUR mn ⁶⁾	8734.3	11043.5	13507.1	14648.3	15382.8	14391.4	15809.0	.	.
FDI inflow, EUR mn ⁵⁾	980	1147	1294	1212	1381	389	414	.	.
FDI outflow, EUR mn ⁵⁾	15	-14	-18	18	36	13	7	.	.
Exports of goods, BOP, EUR mn ⁵⁾	7986	11273	12722	14675	15614	3778	4329	18000	20000
annual growth rate in %	8.3	41.2	12.9	15.4	6.4	14.3	14.6	15	10
Imports of goods, BOP, EUR mn ⁵⁾	9168	13140	16045	17427	19569	4191	4933	23000	26000
annual growth rate in %	-5.6	43.3	22.1	8.6	12.3	9.1	17.7	17	13
Exports of services, BOP, EUR mn ⁵⁾	1286	1910	2273	2468	2656	587	613	.	.
annual growth rate in %	18.1	48.5	19.0	8.6	7.6	17.6	4.4	.	.
Imports of services, BOP, EUR mn ⁵⁾	1658	2170	2402	2463	2630	570	609	.	.
annual growth rate in %	2.0	30.9	10.7	2.5	6.8	9.2	6.8	.	.
Average exchange rate ROL/USD	15332.9	21692.7	29060.9	33055.5	33200.1	33155.4	32430.0	.	.
Average exchange rate ROL/EUR (ECU)	16295.6	19955.8	26026.9	31255.3	37555.9	35619.9	40573.7	41000	43500
Purchasing power parity ROL/USD, wiiw	4464.1	6349.2	8437.8	10175.4	11853.6	.	.	.	.
Purchasing power parity ROL/EUR, wiiw	4877.9	6845.7	9138.1	10914.1	12928.7	.	.	.	.

Notes: 1) Preliminary. - 2) From 2002 break in methodology and according to census March 2002. - 3) According to ESA 95, excessive deficit procedure. - 4) Reference rate of NB from February 2002. - 5) Up to 1999 wiiw calculated from USD. - 6) Medium- and long-term.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.

Consumer price inflation does not appear to have been affected much by the boom in demand. CPI is tending downwards to a one-digit level by the end of the year. High international energy prices, however, may trickle through later in the year, thus stopping the downward inflationary trend. Demand-pulled effects can also not be excluded in the latter part of the year. We expect a stricter inflation target for 2005 to support the planned denomination of the ROL.

Privatization has achieved some progress over the past ten months. The final terms and conditions of the largest deals, such as the sale of the Brasov tractor plant and the national oil company PETROM, are still under negotiation with the companies that won the tenders prior to the new owners taking over. When the Austrian OMV has paid more than EUR 600 million for PETROM and once revenue from the privatization of the BCR bank starts to flow in, FDI will increase to EUR 2 billion in 2004.

The remaining 72 loss-making state-owned enterprises are located mainly in coal mining, energy production and district heating. The government decided to cancel the debts and penalties that 31 companies owed to the state budget so as to make them more attractive to investors. Previously relief actions of this kind were restricted to companies that were being sold for privatization purposes, whereas today they are also applied to state-owned companies in current operation with no imminent prospects of being privatized. Such measures run counter to the principle of free competition and hardly heighten the country's image as a 'functioning market economy'. None the less, it seems that the Commission will accord Romania this status, honouring the progress towards privatization and paving the country's path towards EU accession in 2007. Having closed two chapters in June 2004, Romania still has to finalize six chapters by the end of the year or early 2005.

Both national and presidential elections are due in November 2004. Although it may appreciate the rapid economic growth achieved under the present social-democratic minority government (PSD), supported by the Hungarian Democratic Alliance (UDMR), the electorate is also frustrated by widespread corruption. The results of the local elections in June 2004 revealed a PSD on the decline and the socio-liberal opposition grouping (PNL-PD alliance) on the rise. The overall loser was the nationalistic Greater Romania Party (PRM), which secured only about 5% of the votes. It seems that thanks to the opposition, the outcome of the upcoming parliamentary elections will be much closer than previously expected. The PSD, however, will likely emerge as the strongest party and provide the next President. If it needs to join forces in the next government with a current opposition party, an unstable 'great coalition' would emerge which may be incapable of agreeing on EU-conforming reforms.

Hermine Vidovic

Croatia: a new EU candidate

Economic indicators for the first months of 2004 point to a slowdown in growth. Industrial production growth has gradually lost momentum over recent months. In the first five months of the year, it rose 4.1% (down from 5.6% in the first quarter). Within industry, manufacturing showed above-average growth, the highest growth rates being registered in basic metals, publishing and printing, wood and wood products, electrical machinery and equipment and other transport equipment. Continued

Table HR

Croatia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	4554	4437	4437	4443	4443	.	.	.	.
Gross domestic product, HRK mn, nom.	141579	152519	165640	176429	189883	43492	.	199900	210000
annual change in % (real)	-0.9	2.9	4.4	5.2	4.3	4.9	.	3.2	3.5
GDP/capita (EUR at exchange rate)	4102	4502	4998	5361	5651	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	7510	8050	8600	9270	9890	.	.	.	.
Gross industrial production ³⁾									
annual change in % (real)	-1.4	1.7	6.0	5.4	4.1	4.6	5.6	4	4
Construction industry, hours worked ³⁾									
annual change in % (real)	-7.7	-9.1	3.6	12.8	22.8	19.2	.	.	.
Consumption of households, HRK mn, nom.	81546	89637	98054	106027	111918	26928	.	.	.
annual change in % (real)	-2.9	4.2	4.5	6.6	4.1	4.9	.	2.5	3
Gross fixed capital form., HRK mn, nom.	33025	33281	36984	43674	52637	11691	.	.	.
annual change in % (real)	-3.9	-3.8	7.1	10.1	16.8	16.2	.	6	6
LFS - employed persons, th, avg.	1492	1553	1469	1528	1537	1538 ⁴⁾	.	.	.
annual change in %	-3.4	4.1	-5.4	4.0	0.6	1.1 ⁴⁾	.	.	.
Reg. employees in industry, th pers., avg.	299.5	291.9	287.2	281.0	282.6	280.5	274.2	.	.
annual change in %	-3.0	-2.5	-1.6	-2.2	0.6	-0.9	-2.3	.	.
LFS - unemployed persons, average	234.0	298.0	277.0	266.0	256.0	253 ⁴⁾	.	.	.
LFS - unemployment rate in %, average	13.6	16.1	15.9	14.8	14.3	14.1 ⁴⁾	.	14	13.5
Reg. unemployment rate in %, end of period	20.4	22.3	23.1	21.3	19.1	21.0	19.1	18.5	18
Average gross monthly wages, HRK	4551	4869	5061	5366	5623	5459	5832	.	.
annual change in % (real, net)	10.1	3.4	1.6	3.1	3.8	6.3	4.3	.	.
Retail prices, % p.a. ⁵⁾	4.2	6.2	4.9	1.7	1.8	1.7	1.8	2	1.5
Producer prices in industry, % p.a.	2.6	9.7	3.6	-0.4	1.9	3.4	0.2	1	1
General governm.budget, IMF-def., % GDP									
Revenues	48.4	46.2	44.7	45.2	44.9	.	.	.	.
Expenditures	56.6	52.7	51.5	50.0	49.5	.	.	.	.
Deficit (-) / surplus (+), % GDP	-8.2	-6.5	-6.8	-4.8	-6.3	.	.	-4.5	-4
Public debt in % of GDP	.	51.1	51.6	51.6	52.7	.	.	55	56
Discount rate % p.a., end of period	7.9	5.9	5.9	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn ⁶⁾	-1312	-498	-810	-2035	-1806	-999	.	-1500	-1400
Current account in % of GDP	-7.0	-2.5	-3.7	-8.5	-7.2	.	.	-5.7	-5.1
Gross reserves of NB excl. gold, EUR mn	3012.6	3783.2	5333.6	5651.3	6554.1	5782.2	6178.5	.	.
Gross external debt, EUR mn	9937.2	11865.2	12830.6	14813.7	18893.1	15830.4	19619.7	.	.
FDI inflow, EUR mn ⁶⁾	1377	1180	1743	1193	1518	316	.	.	.
FDI outflow, EUR mn ⁶⁾	44	4	173	566	55	21	.	.	.
Exports of goods, BOP, EUR mn ⁶⁾	4124	4951	5313	5312	5569	1386	.	5800	6000
annual growth rate in %	1.0	20.1	7.3	0.0	4.8	15.5	.	4	3
Imports of goods, BOP, EUR mn ⁶⁾	7219	8424	9892	11309	12587	2739	.	13000	13500
annual growth rate in %	-6.4	16.7	17.4	14.3	11.3	12.4	.	3	4
Exports of services, BOP, EUR mn ⁶⁾	3494	4440	5443	5911	7639	783	.	.	.
annual growth rate in %	-1.1	27.1	22.6	8.6	29.2	11.8	.	.	.
Imports of services, BOP, EUR mn ⁶⁾	1968	1982	2175	2561	2640	531	.	.	.
annual growth rate in %	16.9	0.7	9.7	17.7	3.1	-5.6	.	.	.
Average exchange rate HRK/USD	7.11	8.28	8.34	7.86	6.70	7.07	6.09	.	.
Average exchange rate HRK/EUR (ECU)	7.58	7.63	7.47	7.41	7.56	7.58	7.61	7.6	7.6
Purchasing power parity HRK/USD, wiiw	3.80	3.90	3.96	3.96	4.03	.	.	.	.
Purchasing power parity HRK/EUR, wiiw	4.14	4.27	4.34	4.28	4.32	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 20 employees. - 4) First half-year of 2003. - 5) From 2002 consumer prices, % p.a. - 6) wiiw calculated from USD.

Source: wiiw Database incorporating national statistics; IMF; wiiw forecasts.

downsizing of the workforce in industry led to a further increase in productivity. Construction activities remained strong. Retail trade turnover increased by 2% in real terms. As of January this year, Croatia adopted a new methodology for measuring inflation, replacing the retail price index by the consumer price index. Consumer prices rose by 2.4% in May year-on-year.

The increase in total employment (based on registration data) that had started in 2003 continued at an accelerated rate of growth throughout the first quarter of 2004. Registered unemployment fell to 18.6% in April. Data derived from the labour force survey indicate an unemployment rate of 14% in the second half of 2003 (latest available data). Despite an improvement on both counts, unemployment remains high compared to most of the new EU member states. Average real net wages have continued to grow, increasing by 4.2% in the first quarter of the year as against 3.8% in the year 2003.

The IMF and Croatia came to a preliminary agreement on a new standby agreement worth USD 99 million. The key issues during the recent negotiations were soaring foreign debt and the ever-widening budget deficit. In order to combat further increases in foreign indebtedness, the Fund and Croatian authorities agreed, *inter alia*, on: (a) gradually reducing the general government deficit from 6.3% in 2003 to 4.5% in 2004 and to less than 4% in 2005, thereby necessitating a revision of the 2004 budget with effect from mid-July so as to achieve those targets; (b) funding the budget deficit, including extra-budgetary deficits, primarily from domestic sources in both 2004 and 2005; and (c) limiting the scope of public enterprises to incur major debts. Moreover, the new standby arrangement envisages stabilizing the foreign debt to GDP ratio at 77% (measured in euros). Although the change had been announced earlier this year, it was decided to postpone the reduction of the VAT rate from 22% to 20%. The new standby agreement is precautionary in nature; funds have been allocated, but will not be drawn upon. The arrangement is expected to enter into effect from August onwards.

Foreign debt continued to increase in 2004; by the end of March it had risen to EUR 20.4 billion: EUR 1.6 billion higher than at the end of last year. The major portion (36%) is owed by the state, whose share, however, is declining. The banks account for about one third of the total foreign debt. This year Croatia faces a debt service burden of some USD 3.8 billion, about two thirds of which falls due in the second half of the year.

Foreign trade developed dynamically in the first four months of 2004. According to customs statistics, overall exports expressed in current euros expanded by about 13%, while imports grew by only 4%. Consequently, the trade deficit was somewhat lower than over the same period the previous year. The good export performance was mainly due to shipbuilding and electrical machinery and equipment manufacture. Exports to the Yugoslav successor states (excluding Slovenia), some CIS countries and the Baltic states grew appreciably, while those to the EU increased at below-average rates. As for imports, it is interesting to note that although still the single largest import item, car imports dropped for the first time after years of marked growth. Information on the 2004 current account developments is not yet available. Overnight stays by foreign tourists were up by 8% during the first four months of the year. This would suggest that earnings from tourism equivalent to at least the level of the prior year can be expected.

In April 2004 the European Commission recommended that accession negotiations be opened with Croatia. The Commission has come to the conclusion that Croatia is a functioning democracy with

stable institutions guaranteeing the rule of law. However, it has also stressed the need for continued collaboration with the International Criminal Tribunal for the Former Yugoslavia and requested additional efforts pertaining to the return of refugees, improvements in minority rights, judicial reform, regional cooperation and the fight against corruption. As for the economic criteria, it was stated that Croatia can be regarded as a functioning market economy. Croatia was formally granted candidate status at the EU summit in June; accession negotiations will start at the beginning of 2005. As for a possible EU entry date, the British Minister for Europe, Denis MacShane, went on record with a statement to the effect that Croatia would join the EU 'certainly before the end of the decade, and hopefully, much sooner'.

GDP growth will lose momentum in 2004; wiiw expects a rise of some 3.2% supported by continued (public) investment activities. Additional impetus may well come from household consumption on account of higher wages and increased transfer payments. The official GDP target set by the Ministry of Finance for the current year is 3.5-4%; this seems a somewhat optimistic figure. Achieving the deficit target agreed upon with the IMF will become rather difficult as the planned increases in excise duties and cuts in the health sector will not be sufficient to offset the announced repayments of pension arrears. Assuming that the export trends observed during the first months of the year continue while tourism develops along the same lines as the previous year, the current account might close with a slightly lower deficit than in 2003. The European Council's decision to initiate accession negotiations might have a significant impact on the dynamics of the country's economy.

Vladimir Gligorov

Macedonia: stability with low growth

The first half of 2004 has been characterized by a slow recovery of industrial production that had dropped dramatically at the end of last and the beginning of this year. An optimistic forecast could see a stagnation for the year as a whole. GDP may still grow by up to 3% with good results in agriculture and growth in services. But the risks on the side of recession may increase if the recovery stalls once again.

Prices have been falling this year, which is consistent with the lack of growth. These negative tendencies have been the consequence of the tight fiscal and monetary policies that were followed in 2003. Under the pressure of the IMF, a sharp fiscal adjustment was engineered in 2003. Macedonia had followed a prudent fiscal policy from the initial stabilization in 1994 until the near civil war that erupted in 2001. After political stabilization and the election of the new government, public expenditures were slashed to stabilize the budget. In 2003, the fiscal deficit was just above 1% and the intention is to have an almost balanced budget this year.

In addition to that, monetary policy was rather restrictive. Again, in order to support political stabilization, money supply was tight in order to keep the foreign exchange market stable. Macedonia has a fixed exchange rate with the denar pegged to the euro. With the GDP and the fiscal balance moving in a very volatile manner, the peg was seen as the main anchor of stability. It

Table MK

Macedonia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	2017.1	2026.4	2034.9	2042.0	2050.0	.	.	.	.
Gross domestic product, MKD mn, nom.	209010	236389	233841	243970	253493	.	.	268900	285200
annual change in % (real)	4.3	4.5	-4.5	0.9	3.1	.	.	3	4
GDP/capita (EUR at exchange rate)	1709	1921	1887	1959	2018	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5700	6010	5850	6030	6340	.	.	.	.
Gross industrial production									
annual change in % (real) ²⁾	-2.6	3.0	-2.9	-5.3	4.7	3.4	-26.2	0	3
Construction output, value added									
annual change in % (real)	10.4	-1.1	-14.4	0.6	4.1	.	.	.	.
Consumption of households, MKD mn, nom.	145693	175965	163788	188179	.	.	.	.	.
annual change in % (real)	3.6	11.1	-11.6	.	.	.	.	.	.
Gross fixed capital form., MKD mn, nom.	34710	38332	34716	40448	.	.	.	.	.
annual change in % (real)	-1.4	-3.2	-8.6	.	.	.	.	.	.
LFS - employed persons, th. avg.	545.2	549.8	599.3	561.3	545.1	.	.	.	.
annual change in %	1.0	0.8	9.0	-6.3	-2.9	.	.	.	.
Reg. employees in industry, th pers., avg. ³⁾	119.8	114.4	122.5	110.9	107.2	108.5	103.3	.	.
annual change in % ³⁾	5.5	-4.5	-4.8	-9.5	-3.3	-8.5	-4.8	.	.
LFS - unemployed persons, average	261.5	261.7	263.2	263.5	315.9	.	.	.	.
LFS - unemployment rate in %, average	32.4	32.2	30.5	31.9	36.7	.	.	36	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average net monthly wages, MKD	9664	10193	10552	11279	11824	11571	12041	.	.
annual change in % (real, net)	3.6	-0.3	-1.9	5.0	3.6	6.4	2.1	.	.
Retail prices, % p.a.	-1.1	10.6	5.2	1.4	2.4	2	1.7	3	2
Producer prices in industry, % p.a.	-0.1	10.7	2.0	-0.9	-0.3	1.5	-1.5	2	2
Central governm. budget, nat.def., % GDP									
Revenues	24.2	26.7	27.0	28.7	21.3	.	.	.	.
Expenditures	23.8	24.4	29.5	29.3	22.3	.	.	.	.
Deficit (-) / surplus (+), % GDP	0.3	2.3	-2.5	-0.6	-1.0	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	8.9	7.9	10.7	10.7	6.5	8.0	6.5	.	.
Current account, EUR mn ^{4) 6)}	-30.4	-78.5	-272.1	-384.3	-246.6	-101.8	-111.1	-250	-250
Current account in % of GDP	-0.9	-2.0	-7.1	-9.6	-6.0	.	.	-5.8	-5.6
Gross reserves of NB, excl. gold, EUR mn ⁶⁾	428.0	461.5	845.5	692.8	786.9	.	.	.	.
Gross external debt, EUR mn ^{5) 6)}	1431.9	1545.2	1638.3	1486.3	1417.0	1436.3	1425.3	.	.
FDI inflow, EUR mn ⁶⁾	30.7	189.4	493.2	82.6	83.8	4.4	33.7	.	.
FDI outflow, EUR mn ⁶⁾	0.3	-0.7	1.0	0.1	0.3	0.4	0.1	.	.
Exports of goods, BOP, EUR mn ⁶⁾	1117	1433	1291	1181	1205	272.3	286.4	1300	1400
annual growth rate in %	-3.0	28.3	-9.9	-8.5	2.0	-2.0	5.2	8	8
Imports of goods, BOP, EUR mn ⁶⁾	1582	2182	1879	2035	1959	475.5	465.0	2100	2200
annual growth rate in %	-1.8	37.9	-13.9	8.3	-3.7	-2.4	-2.2	7	5
Exports of services, BOP, EUR mn ⁶⁾	256	344	273	269	289	.	.	.	.
annual growth rate in %	92.4	34.2	-20.5	-1.6	7.5	.	.	.	.
Imports of services, BOP, EUR mn ⁶⁾	217	291	295	295	291	.	.	.	.
annual growth rate in %	16.3	34.1	1.3	0.2	-1.3	.	.	.	.
Average exchange rate MKD/USD	56.90	65.89	68.04	64.74	54.30	57.18	49.05	.	.
Average exchange rate MKD/EUR (ECU)	60.62	60.73	60.91	60.98	61.26	61.31	61.29	62	64
Purchasing power parity MKD/USD, wiiw	16.70	17.70	17.91	18.32	18.18	.	.	.	.
Purchasing power parity MKD/EUR, wiiw	18.19	19.42	19.65	19.80	19.51	.	.	.	.

Notes: 1) Preliminary. - 2) Excluding small enterprises. - 3) From 2001 according to NACE. - 4) Including grants. - 5) Medium- and long-term. - 6) Converted from USD to EUR.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

could perhaps be argued that the central bank was too cautious in relaxing its stance once political stability returned and in view of the tightening of the fiscal policy. Thus, recovery was interrupted and deflationary tendencies emerged.

In May, the government was reshuffled, because the former prime minister was elected the president of the republic, and a new governor of the central bank was appointed (the six-year term of the previous governor had expired). Both the government and the central bank will have to take a hard look at the current economic developments and rethink the economic policy that they want to pursue. That will have to be in the context of the new agreement with the IMF that should be negotiated in the course of this year.

Slow recovery has not been conducive to foreign investments. Since 2001, those have been rather low. Public investments are very modest too. Finally, external developments have not been very favourable in the previous period. This year, however, exports are growing as are imports. Macedonia's trade is dependent on the region more than is the case with other Balkan countries. As growth is picking up in the region, external demand should be favourable to Macedonian exports.

The banking sector is sound and increasingly liquid. In the previous period, due to the tight monetary policy and high risks, it did not contribute all that much to the growth of production. The growth of credits is still not as convincing as in some of the other countries in the region, however. With the increased political stability and a more accommodative economic policy, that should change.

With deflation, wages have been growing in real terms. Employment, however, is not increasing and the unemployment rate is quite high. It jumped to close to 37% (LFS measure) due to the cuts in public expenditures last year. Indeed, unemployment is the main economic and social problem. For most of the transition, the successive governments have given precedence to stability and the redistribution of resources over employment and growth. It looks as if the patience of the public is wearing thin and that there is a short-term window of opportunity to change the course and target growth and employment.

On 1 April, the Stabilization and Association Agreement of the EU with Macedonia came into effect. At about the same time, Macedonia submitted its application for full membership in the EU. The EU council has instructed the European Commission to prepare the questionnaire that will enable the EU to decide whether it is ready to open negotiations for full membership of Macedonia. EU accession is one issue on which there is very wide consensus in the country. An increased level of engagement on the part of the EU will, if it comes to that, prove to be essential for the stability and development of this country and of the region as a whole.

Vladimir Gligorov

Serbia and Montenegro: growth despite instability

In the first half of 2004, Serbia and Montenegro (S&M) will post positive growth, though political turbulences have not ceased. In Serbia, it is expected that industrial production will grow 5-6% in the first half of the year and will continue to grow in the second half as well. Agricultural production

Table CS

Serbia and Montenegro: Selected Economic Indicators *)

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year	8372.7	8342.5	8326.4	8304.7	8300.0	.	.	.	.
Gross domestic product, CSD mn, nom.	191099	381661	771800	1006900	1124000	.	.	1273500	1456900
annual change in % (real) ²⁾	-18.0	5.0	5.5	3.8	2.0	.	.	3	4
GDP/capita (EUR at exchange rate)	1945	2990	1558	1996	2075	.	.	.	.
Gross industrial production ³⁾									
annual change in % (real)	-23.1	11.1	0.0	1.7	-2.7	-3.1	10.8	4	5
Construction output, value of work done									
annual change in % (real)	-9.9	14.4	-29.8	.	.	.	.	.	.
Actual final consump. of househ., CSD mn, nom.	147781	302081	.	.	.	.	.	.	.
Gross fixed investment, CSD mn, nom.	24868	59316	80003	.	.	.	.	.	.
annual change in % (real)	-26.3	13.3	-4.1	.	.	.	.	.	.
LFS - employed persons, th, Oct.	3325.0	3324.0	3320.0	3220.8	.	.	.	.	.
annual change in %	-14.6	0.0	-0.1	-3.0	.	.	.	.	.
Reg. employees in industry, th pers., avg.	804.5	764.7	744.0	685.8	640.0	620 ⁴⁾	567	.	.
annual change in %	-9.3	-5.0	-2.7	-7.8	-6.7	.	-8.6	.	.
LFS - unemployed persons, average	528.0	480.5	490.2	517.3	.	.	.	.	.
LFS - unemployment rate in %, average	13.7	12.6	12.9	13.8	14.0	.	.	15	15
Reg. unemployment rate in %, end of period ^{4/5)}	25.5	26.7	27.9	31.2	34.8	34.4	34.9	32	32
Average net monthly wages, CSD ⁶⁾	1309	2588	5545	9208	11500	9917	12566	.	.
annual change in % (real, net)	-15.0	6.5	13.3	29.9	13.6	.	16.7	.	.
Consumer prices, % p.a.	44.9	86.0	88.9	16.5	9.4	11.5	8.3	10	10
Producer prices in industry, % p.a.	43.4	106.5	85.1	8.7	4.6	4.8	5.7	5	5
General governm. budget, nat. def., % GDP									
Revenues	41.5	36.4	41.5	50.4	49.4	.	.	.	.
Expenditures	.	.	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	.	.	.	.	.	.	.	.
Public debt in % of GDP									
Discount rate, % p.a., end of period	26.3	26.3	16.4	9.5	9.0	9	8.5		
Current account, EUR mn ^{4/7)}	-672	-382	-729	-1828	-1710	-495	-608	-2400	-2500
Current account in % of GDP ⁴⁾	-7.1	-4.0	-5.6	-11.0	-10.7	.	.	-14.3	-13.7
Gross reserves of NB, excl. gold, EUR mn ⁷⁾	157.9	429.9	1138.6	2076.8	2728.2	.	.	.	.
Gross external debt, EUR mn ^{7/8)}	12422	12292	13306	11352	9641	.	.	.	.
FDI net, EUR mn ^{4/7)}	105	55	186	502	1109	7.4	120.9	.	.
Exports of goods, BOP, EUR mn ^{4/7)}	1572	2097	2252	2547	2180	577.2	595.6	2500	2750
annual growth rate in %	-41.9	33.4	7.4	13.1	.	.	3.2	15	10
Imports of goods, BOP, EUR mn ^{4/7)}	3092	4048	5439	6674	6446	1537.7	1893.0	7200	8000
annual growth rate in %	-28.6	30.9	34.4	22.7	.	.	23.1	12	11
Exports of services, BOP, EUR mn ^{4/7)}	442	681	832	854	886	212.5	272.6	.	.
annual growth rate in %	-45.8	54.1	22.2	2.6	.	.	28.3	.	.
Imports of services, BOP, EUR mn ^{4/7)}	228	320	363	567	632	131.8	170.4	.	.
annual growth rate in %	-39.4	40.4	13.4	56.2	.	.	29.3	.	.
Average exchange rate CSD/USD	11.01	16.69	66.84	64.19	57.44	58.88	56.31	.	.
Average exchange rate CSD/EUR (ECU)	11.74	15.30	59.44	60.79	65.26	63.36	69.40	76	80

Notes: *) CSD: New international currency-code for Dinar. Excluding Kosovo and Metohia.

1) Preliminary. - 2) Based on GMP. - 3) Excluding private enterprises. - 4) From 2003 Serbia only. - 5) In % of unemployed plus employment. - 6) From 2002 Serbia only and including various allowances. - 7) Converted from USD. - 8) In 2003 including a part of Montenegrin foreign debt.

Source: wiw Database incorporating national statistics; wiw forecasts.

should rebound from last year's drop which was due to the severe drought. The tertiary sector is also growing, though precise figures are lacking. All in all, GDP should grow by about 3% in 2004 or perhaps more if agriculture does even better than expected.

Growth is mainly supported by consumption. Public consumption is to increase this year. This was a stumbling block in the negotiations with the International Monetary Fund (IMF) because of the initially projected general budget deficit of around 4% of GDP. Eventually, an agreement was reached that the deficit would not exceed 2.5%, the gap to be closed mainly with higher public revenues. In the first half of 2004, wages in the public sector have continued to grow quite fast signalling that a lax fiscal policy has indeed been implemented. This is in part due to the presidential elections held in June 2004. It is to be expected that public expenditures will continue to be generous because there are local and provincial election in the autumn and early parliamentary elections are quite likely before the end of the year as well.

According to anecdotal evidence investments are picking up. However, disinvestments will have to accelerate as well later this year and next year because the restructuring of public firms will have to be speeded up. The combined effect may very well be dampening for growth. What is certain is the continued growth of the trade deficit. Though the data are coming with a significant lag, the imports' coverage by exports has probably reached a historical low in the first quarter of 2004: it is only about 30% – this despite the fact that exports are rising, but imports are rising even faster. The current account deficit, though not as large as the trade deficit, is also expected to grow, on the basis of observed trends and in view of the other developments in consumption and investment. The government and the central bank together with the IMF expect that the trade and current account deficits will start to narrow down in the medium term and continue on that path subsequently. Otherwise, the sustainability of the exchange rate and of the overall macroeconomic stability will be endangered.

The current economic developments are mostly the consequence of the policies pursued by the previous government. The new government, coming in at the end of March 2004, has had little chance to make its mark on the economy. It has been faced with a very large agenda and not much political stability. Its two main tasks were to adopt this year's budget and to restart the reform process. While it has succeeded in patching up a budget, which is being corrected along the way, it has largely taken a pause when it comes to the reform process.

The stalled privatization process is probably the main victim of the change of government. The new one wanted to review previous privatizations and to introduce innovations in the law on privatization. With that, it succeeded in initiating a lot of public debate about a number of privatizations, but it has been unable to do much about those. It, however, did succeed in slowing down the process considerably. It intended to restart the selling of banks and perhaps of the fixed and mobile telephone companies, but then the presidential elections interfered. The government's candidate did quite poorly in the first round and that led to more political instability. It seems likely at this point that early parliamentary elections will have to be held in the autumn of this year.

In addition to taking a pause in the process of transition, the new government put its relations with the international community on hold. The main stumbling block has been the cooperation with the Hague Tribunal. The new government would rather prefer not to cooperate with it at all. That, however, has costs. The EU feasibility study that should open the door to the negotiations of the

Stabilization and Association Agreement has been postponed. Also, the entrance into NATO's Partnership for Peace has been delayed. Indeed, unlike the previous government, the new one has shown little initiative in international relations. This is partly due to its inability to make progress in the two fundamental problems that Serbia faces: its relations with Montenegro and Kosovo.

Montenegro is a small state that is in a state union with Serbia. In economic and political matters, the two states are basically independent. They share the foreign and defence ministries, though they largely follow their own independent foreign and security policies. They also have different monetary, fiscal and trade regimes. As a consequence, it does not make much sense to report their economic developments jointly.

Montenegro uses the euro and relatively high inflation has been a problem for its competitiveness in the past few years. Inflation was fuelled by the high level of public expenditures with the attendant high fiscal deficit. Beginning with the last year, fiscal policy has been more responsible with higher revenues and stable expenditures. This has slowed down inflation while industrial production and tourism have started to recover. Growth of the former is still quite sluggish as is the overall GDP growth. This year's GDP is expected to grow by 2-3% while some acceleration is expected next year.

Political stability in Montenegro is a problem though unlike that in Serbia. The current Serbian government does not have a problem with legitimacy but with low parliamentary and public support. The government of Montenegro, however, enjoys sufficient parliamentary and even public support, but is troubled by issues of legitimacy. The recent assassination of the editor-in-chief of the main opposition daily has raised additional issues of the government's legitimacy. Specific to Montenegro is the fact that the parliamentary opposition lacks legitimacy too, because the main opposition parties were staunch supporters of Milošević. Thus, the main alternative is the non-parliamentary opposition of an NGO called the Group for Change. The Group is yet to prove powerful enough to initiate early elections, so the existing type of stability will persist at least until well into 2005.

In 2005, the deliberations on the final status of Kosovo will start. This international protectorate is expected to demand full independence from Serbia. It is hard to see how that demand will be denied and it is also hard to predict the political consequences that it will initiate. In any case, a reconsideration of the relationship between Serbia, Montenegro and Kosovo seems unavoidable in the next two years.

Mario Holzner

Bosnia and Herzegovina: the EU, 1 state, 1 republic & 1 federation

Once again the political setting of Bosnia and Herzegovina (B&H), obtruded in 1995 by the international community in Dayton, Ohio, is proving to be a stumbling block towards political normalization of the country. However, no realistic alternative to a weak central state and the division of the country into two Entities (Republika Srpska, RS and the Federation of B&H, FBiH) controlled by the High Representative of the International Community in B&H, who is at the same time the EU's Special Representative in B&H, is in sight. Paradoxically it is also the EU who criticizes in its 2004

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 ¹⁾	2004 forecast	2005 forecast
Population, th pers., mid-year	3651	3700	3725	3781	3798	3828	3862	.	.
Gross domestic product, BAM mn, nom.	6116	7559	8990	10050	10960	11650	12170	12800	13500
GDP annual change in % (real)	37.0	15.6	10.0	5.5	4.5	5.5	3.5	5	5
GDP/capita (EUR at exchange rate)	857	1045	1234	1359	1475	1556	1611	.	.
GDP/capita (EUR at PPP - wiiw)	.	.	4830	5210	5500	5860	6030	.	.
Gross industrial production annual change in % (real) ²⁾	.	23.3	12.1	9.3	-2.0	11.5	3.8	6.5	6
Reg. employees, th pers., end of period	.	651.3	630.9	640.6	625.6	637.7	634.0	.	.
annual change in %	.	.	-3.1	1.5	-2.3	1.9	-0.6	.	.
Reg. unemployed, th pers, average	.	398.5	409.3	421.2	422.2	441.9	459.6	.	.
Reg. unemployment rate in %, average	.	38.0	39.3	39.7	40.3	40.9	42.0	42	41
Average gross monthly wages, BAM	.	454	503	541	652	660	733	.	.
Federation BiH	.	507	551	626	652	710	773	.	.
Republika Srpska	.	256	314	387	444	528	612	.	.
Retail prices, % p.a.	.	.	3.7	4.8	3.1	0.4	0.6	0.6	0.5
General government budget, BAM mn									
Revenues	.	.	57.7	53.7	49.7	48.0	46.7	.	.
Expenditures	.	.	65.5	60.7	53.1	50.3	46.3	.	.
Deficit (-) / surplus (+)	.	.	-7.8	-7.0	-3.4	-2.3	0.4	.	.
Current account, EUR mn	.	-703	-1031	-956	-1363	-1839	-1844	-1870	-1950
Current account in % of GDP	.	-18.2	-22.4	-18.6	-24.3	-30.9	-29.6	-28.6	-28.3
Gross foreign reserves, EUR mn	74	145	443	522	1379	1260	1422	.	.
General government foreign debt, EUR mn	.	.	1915	2074	2261	2194	2054	.	.
Exports of goods, BOP, EUR mn	.	597	781	1274	1268	1169	1321	1430	1520
annual growth rate in %	.	.	30.7	63.2	-0.5	-7.9	13.1	8.2	6.3
Imports of goods, BOP, EUR mn	.	3400	3875	4120	4576	4692	4786	4960	5160
annual growth rate in %	.	.	14.0	6.3	11.1	2.5	2.0	3.6	4.0
Exports of services, BOP, EUR mn	.	378	370	391	421	403	430	.	.
annual growth rate in %	.	.	-2.0	5.5	7.8	-4.3	6.8	.	.
Imports of services, BOP, EUR mn	.	186	212	214	227	254	262	.	.
annual growth rate in %	.	.	14.2	0.7	5.9	12.1	3.1	.	.
Average exchange rate BAM/USD	1.73	1.76	1.83	2.12	2.19	2.08	1.73	.	.
Average exchange rate BAM/EUR (ECU)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Purchasing power parity BAM/USD, wiiw	.	.	0.46	0.47	0.48	0.48	0.48	.	.
Purchasing power parity BAM/EUR, wiiw	.	.	0.50	0.51	0.52	0.52	0.52	.	.

Notes: BAM: ISO-Code for the convertible mark in Bosnia and Herzegovina.

1) Preliminary. - 2) Based on weighted averages for the Federation of Bosnia and Herzegovina and Republika Srpska.

Source: IMF, CBBH, ASBH, wiiw forecasts.

Stabilization and Association Process (SAP) report the fact that the government at the state level remains underdeveloped while tensions between state and Entities still affect government business and reform. By the end of 2003 the European Commission (EC) published a Feasibility Study which reviewed B&H's readiness to open negotiations on a Stabilization and Association Agreement (SAA) with the EU. The study identified 16 key reform areas which should be addressed effectively in order to start negotiations. However, the 2004 EC SAP report found only moderate progress achieved so far. Political confrontation in the wake of the local elections in October 2004 might further impede the reform process.

Despite the political obstacles, the economic situation has been improving very much in comparison to 2003 when economic growth was only mediocre. In January to May 2004 industrial production grew by 15% in FBiH and by 10% in RS year-on-year. For the same period FBiH exhibits an export growth rate of 18%, while imports grew only by 8% (in euro terms). This will help reduce the enormous B&H current account deficit of about 30% of GDP, which is the highest among the SEE countries.²³ However, registered unemployment rates remain fairly stable above 40%.²⁴ An improving external position alone will not help reduce unemployment substantially. In the first four months of 2004 turnover in retail trade in FBiH increased by as much as 33% compared to the same period in 2003. However, FBiH's price development in the first five months of 2004 is near deflationary levels. This might indicate that much of the increase in domestic demand was satisfied by imports. Government consumption will not be the impetus for a reduction of unemployment as government spending has been constantly reduced over recent years. Though FDI inflows are increasing, their level is still low. B&H producers will face a further reduction of tariff protection in the years to come. The country will have to increase its competitiveness and productivity and thus might experience a rather jobless growth in the short term.

Mario Holzner

Albania: conditional growth

Albania, the least developed country in Southeast Europe, recorded the highest economic growth rate (6%) among the Balkan countries in 2003. At the same time it recorded low inflation and a decreasing unemployment rate. The strong growth performance was mainly driven by the construction and the services sectors, an export boost and the fact that power supply has improved. Conditions seem to be favourable for a further upward tendency in the years to come.

General legislative elections are planned for 2005 and the ruling Socialist Party might find it necessary to increase government consumption before the polls. This may enhance the boom in the construction sector. Moreover, there is an increasing trend of tourists coming from Kosovo to stay for holidays on the Albanian coast. This will lead to an additional foreign exchange inflow. In the wake of economic recovery of the EU, which is by far the most important trading partner of Albania, exports

²³ The IMF believes the current account deficit in GDP to be much lower due to missing inclusion of estimates of the Non-Observed Economy (NOE) in GDP and various other deficiencies of B&H statistics. Including the NOE in GDP would decrease the current account deficit figure to some 20% of GDP in 2003, which is still much higher than in the other SEE countries.

²⁴ Again, household surveys show a much lower figure for the unemployment rate, also due to the shadow economy. This figure is about half of the registered unemployment rate.

Table AL

Albania: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 ¹⁾	2004	2005
	forecast								
Population, th pers., 1st of January ²⁾	3324	3354	3373	3401	3063	3112	3145	.	.
Gross domestic product, ALL mn, nom.	333071	425356	488611	551282	610426	677684	744585	815300	892700
annual change in % (real)	-10.3	12.7	8.9	7.7	7.6	4.7	6.0	6	6
GDP/capita (EUR at exchange rate)	593	752	986	1223	1551	1645	1721	.	.
GDP/capita (EUR at PPP- wiiw)	2010	2270	2520	2800	3390	3560	3740	.	.
Gross industrial production, ALL mn	45964	48491	55702	64500	80576	71157	75948	.	.
annual change in % (real)	-25.8	26.1	30.0	0.9	6.5	2.1	3.0	3.5	4
Construction industry, ALL mn	14322	17440	23942	33628	62874	58281	67757	.	.
annual change in % (real)	-10.5	18.0	17.8	27.2	14.0	8.7	11.3	.	.
Reg. employment total, th pers., average	1107	1085	1065	1068	921	920	.	.	.
annual change in %	-0.8	-2.0	-1.8	0.3	-13.8	-0.1	.	.	.
Reg. unemployed, th pers., end of period	194	235	240	215	181	172	.	.	.
Reg. unemployment rate in %, end of period	14.9	17.8	18.2	16.8	16.4	15.8	15.2	14.5	14
Monthly gross wages in public sector, ALL	9558	11509	12708	14963	17218	20923	.	.	.
annual change in % (real)	-16.9	-0.2	9.9	17.7	11.6	8.1	.	.	.
Consumer prices, % p.a.	32.1	20.9	0.4	0.1	3.1	5.2	2.4	3.5	3.5
Consolidated budget, nat.def., % GDP									
Revenues	17.0	22.0	22.0	21.9	22.2	22.2	.	.	.
Expenditures	30.2	33.3	33.9	30.9	30.5	28.4	.	.	.
Deficit (-) / surplus (+)	-13.2	-11.3	-11.9	-9.1	-8.3	-6.2	.	.	.
Interest rate, % p.a., end of year ³⁾	35.3	20.4	14.8	7.8	8.0	11.2	7.3	.	.
Current account, EUR mn	-224	-58	-125	-177	-243	-445	-360	-410	-440
Current account in % of GDP	-11.3	-2.3	-3.7	-4.3	-5.1	-8.7	-6.7	-6.8	-6.9
Gross reserves, EUR mn	500	574	488	695	852	902	906	.	.
Gross external debt, EUR mn	773	899	1040	1269	1339	1252	1168	.	.
Exports of goods, fob, BOP, EUR mn	147	183	258	276	341	349	395	420	440
annual growth rate in %	-18.5	24.3	40.8	7.1	23.4	2.6	13.2	6.2	4.8
Imports of goods, cif, BOP, EUR mn	604	738	1051	1165	1487	1572	1577	1660	1760
annual growth rate in %	-16.8	22.1	42.5	10.8	27.7	5.7	0.3	5.3	6.0
Trade balance of goods, BOP, EUR mn	-457	-554	-793	-889	-1147	-1222	-1182	.	.
Trade balance in % of GDP	-23.2	-22.0	-23.8	-21.4	-24.1	-23.9	-21.9	.	.
Average exchange rate ALL/USD	148.9	150.6	137.7	143.7	143.5	140.2	121.9	.	.
Average exchange rate ALL/EUR (ECU)	168.9	168.7	147.0	132.6	128.5	132.4	137.5	135	140
Purchasing power parity ALL/USD, wiiw	45.1	50.5	52.6	53.9	54.2	56.6	57.8	.	.
Purchasing power parity ALL/EUR, wiiw	50.0	56.0	57.4	57.9	58.8	61.2	63.3	.	.

Notes: ALL: ISO-Code for the Albanian lek.

1) Preliminary. - 2) Until 2000: population estimates; 2001: census data; thereafter: projection. - 3) 3-month treasury bill rate.

Source: IMF, INSTAT, Bank of Albania, EBRD; wiiw forecasts.

may be expected to grow further. This could also contribute to a further reduction of the trade deficit in goods, which is currently far above 20% of GDP. The poor electric power supply – a major bottleneck in the past – has improved. Given the international aid in this sector and favourable weather conditions for Albania's hydroelectric power plants, the situation might improve even further. Substantial FDI inflows have finally started to come in. Austrian RZB bank took over 100% of the main Albanian bank, the Savings Bank of Albania. The USD 126 million deal was the largest privatization project in Albanian history. Experience from other transition countries has shown that FDI in the banking sector is often followed by foreign investment in other parts of the economy. Thus, in principle, Albania's short- and long-term economic outlook is quite favourable.

The main risk to economic success is political instability. Albania's society faces a significant potential for conflicts in domestic policies. Tensions occur between the main political parties and within the ruling Socialist Party itself. Political infighting has also dampened Albania's progress in the country's EU Stabilization and Association Process (SAP) by delaying the reform programme. The EU commission, in its 2004 SAP report, points to lacking proper implementation of reforms particularly in the issues central to the rule of law, including the fight against organized crime and corruption and the functioning of the judicial system.

Part C: Russia, Belarus and Ukraine; China

Country reports

Peter Havlik

Russian Federation: high – and broader-based – growth continues

The Russian economy continues to grow at a brisk pace. GDP increased by more than 7% in 2003 – significantly more than most forecasters (including wiiw) had previously expected – and rapid economic expansion continued at a similar rate throughout the first few months of 2004. High world market prices for the main Russian export commodities (especially energy carriers, but metals as well) still provide the key growth stimulus; however, given the continued strength of export and budget revenues, growth is becoming broader-based and thus apparently more sustainable as well. In both 2003 and early 2004 investments increased markedly (by about 12% each year): in particular, in export-oriented and export-related sectors of the economy (such as energy, metals and transport). Robust investment demand stimulated rapid growth in the construction sector, as well as expansion of both domestic production and imports of machinery and equipment. Private consumption and real household incomes also continue to boom. With the government budget displaying a sizeable surplus (more than 4% of GDP in the first quarter of 2004) and foreign exchange reserves standing at a record level (USD 85 billion as at end of May 2004), the Russian economy is now in the best shape it has ever been since the transition began. After the financial crisis in 1998, Russian GDP increased by almost 40% (yet it is still almost 20% below the level of 1990). Doubling GDP by 2010, the official target proclaimed by President Putin in his inaugural speech following the elections, would call for annual growth of more than 9%: an unrealistic proposition. Nevertheless, the prospects of relatively high economic growth (5-6% per year) over the medium term are fairly good.

Consumer price inflation is gradually declining, albeit slowly, to some 10% per year in 2004, as the appreciating rouble eases somewhat the inflationary pressures stemming from increases in regulated prices and tariffs and the surging money supply (more than 40% year-on-year in mid-2004) fuelled by major inflows of foreign exchange revenues. At the same time producer price inflation has recently accelerated (to nearly 20% on an annual basis in mid-2004) as a result of an upsurge in energy and transport tariffs. Given the envisaged adjustments to administered prices (e.g. for electricity and gas), it is quite probable that lasting higher producer prices will eventually translate into higher consumer price inflation as well. In any event, the official inflation target (of less than 10% in 2004 and 8.5% in 2005) will be missed once again – though probably not too far off. From the macroeconomic point of view, a more important variable has been the exchange rate. The rouble has appreciated by some 10% against the US dollar in nominal terms (May 2004 against the pre-year period); in real terms by around 20%. With respect to the euro, the rouble has remained more or less stable; real appreciation has thus been considerable (10-20% between May 2003 and May 2004, depending on the deflator used). Diverging USD and EUR exchange rate developments not only mean that a unit of Russian exports (which are quoted predominantly in USD) buys less imports (a large part of which is billed in EUR), but also that appreciation of the rouble makes domestic products less competitive compared to imports. Whereas the volume of Russian exports is

Table RU

Russia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., end of period	145925	145185	144317	143467	143500	.	.	143000	142700
Gross domestic product, RUB bn, nom.	4823.2	7305.6	8943.6	10834.2	13285.2	2892.1	3598.9	15500	17700
annual change in % (real)	6.4	10.0	5.1	4.7	7.3	7.5	7.4	6.3	5.5
GDP/capita (EUR at exchange rate)	1256	1928	2365	2540	2676	.	.	3100	3450
GDP/capita (EUR at PPP - wiiw)	5460	6130	6630	7160	7890	.	.	8340	8860
Gross industrial production									
annual change in % (real)	11.0	11.9	4.9	3.7	7.0	6.0	7.6	6	5
Construction output total									
annual change in % (real)	6.0	17.0	9.9	2.7	14.4	13.7	13.8	.	.
Consumption of households, RUB bn, nom.	2526.2	3295.2	4318.1	5418.1	6561.1	1445.9	.	.	.
annual change in % (real)	-2.9	7.3	9.5	8.9	7.9	7.9	11	9	9
Gross fixed capital form., RUB bn, nom.	693.9	1232.0	1689.3	1943.4	2417.7	376.7	412.5	.	.
annual change in % (real)	6.4	18.1	10.2	3.0	12.9	12.5	13.1	12	12
LFS - employed persons, th, avg.	62475	64255	64400	66071	65700	64104	65300	.	.
annual change in %	6.9	2.8	0.2	2.6	-0.6	-1.4	1.9	.	.
Reg. employment in industry, th pers., avg.	14297	14543	14692	14768	.	.	.	.	.
annual change in %	1.0	1.7	1.0	0.5	.	.	.	.	.
LFS - unemployed persons, average	9323.0	7515.0	6416.0	5712.0	5948.0	6575	6387	.	.
LFS - unemployment rate in %, average	13.0	10.5	9.1	8.0	8.3	9.3	8.9	8.7	9
Reg. unemployment rate in %, end of period	1.7	1.4	1.6	2.1	2.3	2.3	2.3	.	.
Average gross monthly wages, RUB	1522.6	2223.4	3240.4	4360.0	5509.0	4794.3	6167.0	.	.
annual change in % (real, gross)	-22.0	20.9	19.9	16.2	10.3	9.7	15.0	.	.
Consumer prices, % p.a.	85.7	20.8	21.6	16.0	13.6	14.6	10.8	10	9
Producer prices in industry, % p.a.	58.9	46.6	19.1	11.8	15.6	19.4	19.0	18	15
General governm.budget, nat.def., % GDP									
Revenues	25.2	28.7	29.9	32.4	31.1	30.3	29.0	.	.
Expenditures	26.1	26.8	26.9	31.4	29.8	26.6	24.7	.	.
Deficit (-) / surplus (+), % GDP	-0.9	1.9	3.0	1.0	1.4	3.7	4.3	.	.
Public debt, nat.def., in % of GDP ²⁾	94.2	57.1	44.1	36.9	28.7	.	.	.	.
Refinancing rate of NB % p.a., end of per.	55	25	25	21	16	18	14	.	.
Current account, EUR mn ³⁾	23100	50619	37885	30789	31772	10824	10393	30000	25000
Current account in % of GDP	12.6	18.0	11.1	8.4	8.3	12.7	9.6	6.8	5.1
Gross reserves of NB, excl. gold, EUR mn	8387	26139	37026	42290	58531	48388	65187	.	.
Gross external debt, EUR mn	176298	172903	169530	147067	145337	145193	152984	.	.
FDI inflow, EUR mn ³⁾	3105	2933	3069	3660	1012	1296	3238	.	.
FDI outflow, EUR mn ³⁾	2071	3433	2828	3736	3657	567	3499	.	.
Exports of goods, BOP, EUR mn ³⁾	70898	113510	113744	113468	120282	28958	29796	125000	125000
annual growth rate in %	8.5	60.1	0.2	-0.2	6.0	16.0	2.9	4	0
Imports of goods, BOP, EUR mn ³⁾	37102	48483	60022	64470	66753	14749	15338	73000	80000
annual growth rate in %	-27.1	30.7	23.8	7.4	3.5	4.7	4.0	9	10
Exports of services, BOP, EUR mn ³⁾	8509	10337	12773	14393	14185	2845	3116	14000	14000
annual growth rate in %	-21.6	21.5	23.6	12.7	-1.4	-6.7	9.5	-1	0
Imports of services, BOP, EUR mn ³⁾	12529	17540	22967	24848	24001	4773	5126	25000	26000
annual growth rate in %	-13.2	40.0	30.9	8.2	-3.4	-11.4	7.4	4	4
Average exchange rate RUB/USD	24.62	28.13	29.17	31.35	30.57	31.66	28.63	29	30
Average exchange rate RUB/EUR (ECU)	26.24	26.03	26.13	29.65	34.55	33.98	35.83	35	36
Purchasing power parity RUB/USD, wiiw	5.54	7.47	8.50	9.73	10.94	.	.	12	13
Purchasing power parity RUB/EUR, wiiw	6.04	8.20	9.32	10.51	11.74	.	.	13	14

Notes: 1) Preliminary. - 2) Estimated. - 3) wiiw calculated from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

essentially unaffected by exchange rate movements, appreciation of the rouble has caused great pain, especially for the consumer goods industry where domestic production has to compete with cheaper and better-quality imports. Output in the textiles, footwear and leather industries dropped in the first quarter.

In the first quarter of 2004, exports were up by 20% in USD terms compared to a year earlier, largely thanks to higher energy revenues (crude oil, oil products and natural gas making up nearly 60% of the total). Imports increased by more than 20%, with imports of machinery and transport equipment (especially passenger cars) rising faster than average (in EUR terms both exports and imports were flat; Russia still publishes its foreign trade figures solely in USD terms). The foreign trade surplus (USD 18 billion) was higher than in the previous year, yet the current account surplus (USD 11 billion) showed a decline owing to a higher deficit in services trade and negative investment incomes. Despite high world market prices for energy and metals (and rising Russian production and exports), export revenue growth will most likely bottom out while imports, fuelled by robust domestic demand and an appreciating rouble, will continue to grow rapidly. Although the trade and current account surpluses are expected to remain appreciable, the contribution of net exports to GDP growth has been gradually diminishing. Apart from exports, the main pillar of growth over the past few years has been private consumption, yet investments have also been recently gaining in importance. In 2005, slightly lower growth in private consumption is likely whereas investment growth will remain robust. However, despite net FDI inflows picking up in the first quarter of 2004, we do not expect any marked upturn in FDI inflows (Russia registered a net outflow of FDI in 2003) as the investment climate – especially for foreign investors – will remain rough. The recent campaign directed against the ‘oligarchs’ may even discourage the return of flight capital. That notwithstanding, most Russian companies, especially those engaged in export activities, face a relatively comfortable situation (except for Yukos, which may face bankruptcy owing to an enormous tax fine imposed on the company recently); they can easily finance investments from their own revenues (or credits).

Despite positive economic indicators prevailing in recent times, sustainable long-term development is still uncertain given the lack of progress in administrative reforms, insufficient transparency of legal regulations and, last but not least, structural distortions in an economy which is excessively dependent on fluctuating world market commodity prices. wiw expects Russian GDP growth to exceed 6% in 2004 (and probably 5% in 2005), yet there is broad consensus that the current rate of economic growth cannot be sustained unless the pace and, especially, the implementation of structural, institutional, legal and banking sector reforms increase substantially. Annual consumer price inflation may drop below 10% in 2005, yet there is every risk that producer price increases (especially hikes in regulated energy and transport tariffs) will soon translate into higher CPI as well. In addition to fuelling inflation, buoyant export revenues also reduce the pressure on governments to accelerate reforms and focus on attracting foreign direct investments. Both are urgently needed for the diversification and modernization of the Russian economy.

The recent investment recovery can be explained by several factors, both internal (domestic) and external. First, favourable prices have paved the way to high revenues and profits in the Russian energy and metals sectors (and to equally high revenues in the state budget) which together account for about two thirds of total investment. Secondly, low interest rates and depressed yields in international bond markets have made Russian assets a more attractive investment proposition. Over the past few months these positive developments have come to halt (or were even reversed in May 2004 when the Russian stock market suffered a swingeing blow), partly as a reaction to the

Yukos affair. In terms of medium- and especially long-term investment and growth prospects, it will be crucial not only to restore investor confidence, but also to shift investment flows from extractive to manufacturing industries. As far as foreign investors are concerned, they should not expect a particularly warm welcome in Russia, especially in 'strategic' sectors such as energy, metals, banking and telecommunications – from either the domestic owners or government officials.

The newly elected parliament (Duma) is dominated by pro-Putin forces. President Putin was confirmed in office in March 2004 by an overwhelming majority. Not only does he face almost no opposition, but he also continues to enjoy huge popular support. Political stability is thus guaranteed, unlike the speed (and above all the efficiency) of the reform process – even though virtually any draft reform law can now pass through parliament. Neither the recent shenanigans surrounding the privatization deals dating back to the early 1990s nor the recently announced plan to set up a 'Common Economic Space' (together with Belarus, Kazakhstan and Ukraine) are likely to have a significant impact on Russia's economy. More importantly, at the end of April 2004 Russia finally accepted the extension of the Partnership and Cooperation Agreement with the EU covering the new member states from Central and Eastern Europe. In May 2004, a deal was struck in Moscow with the EU that resolved a number of obstacles hindering Russia's accession to the WTO. Russia agreed to lower its average import tariffs by about 2 percentage points (from the current level of 11%), while maintaining higher import protection for aircraft, passenger cars, textiles, shoes, furniture and foodstuffs. In view of its enlargement, the EU agreed to increase the import quotas for Russian steel by 35%. A compromise solution was also found for domestic energy prices which the EU regards as being artificially low and constituting unfair indirect subsidies to Russian manufacturers. On that particular issue Russia promised to raise domestic gas prices by 2010 to USD 49-57 (from the current price of USD 27) per thousand cubic metres, while maintaining the Gazprom monopoly. The ratification of the Kyoto Protocol has apparently been put on hold. Furthermore, certain restrictions pertaining to opening branches of foreign banks and providing foreign companies access to Russian insurance and telecommunication services will also remain in place. Once an agreement has been reached with other major trading partners (especially with the United States, China and Japan), Russia's accession to the WTO and its further integration in the world economy will become quite a realistic proposition – possibly taking effect as early as 2006.

Vasily Astrov

Belarus: an unreformed economy recording high growth

At present, high economic growth is to be observed practically everywhere in the post-Soviet space. A peculiar example is Belarus, which after 6.8% in 2003 recorded 10.2% GDP growth in the first four months of 2004, whereas industrial output expanded by 6.8% and 14.4%, respectively. The high economic dynamics in Russia is certainly an important factor, since this country serves as destination for half of Belarusian exports, particularly metals, transport vehicles, chemicals, and textiles. However, domestic demand is picking up as well, largely on account of rising investments. Fixed capital formation grew by 18% in 2003, and in the first four months of 2004, total capital investment (including inventories) increased by 21.2% in real terms.

Table BY

Belarus: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 ¹⁾	2004 1st qu	2004 forecast	2005
Population, th pers., end of period	10093	10045	10019	9990	9951	9899	9849	.	.	.
Gross domestic product, BYR bn, nom. ²⁾	367	702	3026	9134	17173	26138	35930	.	46600	57800
annual change in % (real)	11.4	8.4	3.4	5.8	4.7	5.0	6.8	9.3	8	7
GDP/capita (EUR at exchange rate)	1282	1431	1023	1237	1357	1549	1555	.	.	.
GDP/capita (EUR at PPP - wiiw)	5750	6380	6700	7210	7760	8390	9200	.	.	.
Gross industrial production										
annual change in % (real)	18.8	12.4	10.3	7.8	5.9	4.5	6.8	13.0	.	.
Gross agricultural production										
annual change in % (real)	-4.9	-0.7	-8.3	9.3	1.8	0.7	6.8	.	.	.
Consumption of households, BYR bn, nom. ²⁾	186	388	1597	4566	9082	14142	18226	.	.	.
annual change in % (real)	13.4	20.6	4.5	6.3	23.6	8.9	0.7	.	.	.
Gross fixed investment, BYR bn, nom. ²⁾	68	159	624	1809	3049	4485	6684	.	.	.
annual change in % (real)	20.0	25.0	-8.0	2.0	-3.0	6.0	18.0	.	.	.
Reg. employment total, th pers., average	4370	4417	4442	4441	4417	4381	4305	.	.	.
annual change in %	0.1	1.1	0.6	0.0	-0.5	-0.8	-1.7	.	.	.
Reg. employment in industry, th pers., avg.	1204	1221	1231	1227	1212	1170	.	.	.	.
annual change in %	0.2	1.4	0.8	-0.3	-1.2	-3.5	.	.	.	.
Reg. unemployed, th pers, end of period	126.2	105.9	95.4	95.8	102.9	130.5	136.1	131.4	.	.
Reg. unemployment rate in %, end of period	2.8	2.3	2.1	2.1	2.3	3.0	3.1	3.0	2.5	2.5
Average gross monthly wages, BYR th. ²⁾	2.3	4.6	19.6	58.9	123.0	189.3	253.5	295	.	.
annual change in % (real, gross)	14.4	18.2	7.1	11.9	29.7	7.6	4.6	10	.	.
Consumer prices, % p.a.	64	73	294	169	61	43	28	22.2	20	16
Producer prices in industry, % p.a.	88	72	356	186	72	40	38	27.4	.	.
General government budget, nat.def., % GDP										
Revenues	30.8	34.1	34.9	34.8	33.5	33.0	34.0	.	.	.
Expenditures	32.9	35.5	37.8	35.4	35.1	33.2	35.6	.	.	.
Deficit (-) / surplus (+)	-2.2	-1.4	-2.9	-0.6	-1.6	-0.2	-1.7	.	.	.
Public debt in % of GDP	.	.	14.7	12.8	9.1	7.1	7.2	.	.	.
Refinancing rate of NB % p.a., end of per.	40	48	120	80	48	38	28	.	.	.
Current account, EUR mn	-758	-908	-182	-366	-486	-356	-447	.	.	.
Current account in % of GDP	-5.9	-6.3	-1.8	-3.0	-3.6	-2.3	-2.9	.	-3.0	-2.5
Gross reserves of NB, incl. gold, EUR mn	356	291	303	383	408	454	392	.	.	.
Gross external debt, EUR mn	1944	2031	2215	2281	2777	2925	2705	.	.	.
FDI inflow, EUR mn	310.0	181.4	416.2	128.6	107.0	261.5	150.8	.	.	.
FDI outflow, EUR mn	1.9	2.1	0.7	0.2	0.3	-218.2	1.3	.	.	.
Exports of goods, BOP, EUR mn	6101	5511	5293	7187	8188	8429	8924	.	.	.
annual growth rate in %	33.6	-9.7	-4.0	35.8	13.9	2.9	5.9	.	.	.
Imports of goods, BOP, EUR mn	7341	6851	5827	8144	9089	9397	10015	.	.	.
annual growth rate in %	34.2	-6.7	-14.9	39.8	11.6	3.4	6.6	.	.	.
Exports of services, BOP, EUR mn	810	826	706	1083	1230	1419	1327	.	.	.
annual growth rate in %	13.1	1.9	-14.5	53.3	13.6	15.4	-6.5	.	.	.
Imports of services, BOP, EUR mn	322	396	411	609	939	961	834	.	.	.
annual growth rate in %	21.4	23.0	3.9	48.0	54.3	2.3	-13.2	.	.	.
Average exchange rate BYR/USD ²⁾	25.0	43.6	276.7	800.0	1420.0	1804.0	2075.0	2150	.	.
Average exchange rate BYR/EUR (ECU) ²⁾	28.4	48.8	295.1	739.2	1271.9	1704.6	2346.6	.	.	.
Purchasing power parity BYR/USD, wiiw ²⁾	5.8	10.2	41.9	117.0	205.2	293.1	372.1	.	.	.
Purchasing power parity BYR/EUR, wiiw ²⁾	6.3	11.0	45.1	126.9	222.5	314.7	396.4	.	.	.

Notes: BYR: ISO-Code for the Belarussian rouble.

1) Preliminary. - 2) In denominated roubles.

Source: wiiw incorporating national statistics; IMF; CISSTAT.

The growth in Belarus is taking place against the background of falling employment (and a decline of total population at a rate of some 50 thousand per year), nearly absent FDI (the inward FDI stock stands at only some EUR 1.5 billion), and, last but not least, virtually lacking structural reforms. Belarus is a country where the fundamental features of the Soviet-type command economy have been essentially preserved up to now. The bulk of GDP is still generated in the state sector, which is dominated by huge industrial holdings inherited from Soviet times and managed often personally by President Lukashenko. While multiple exchange rates were unified back in 2000 (on the insistence of Russia and international financial organizations), extensive price controls are still very common, not least as a tool to counteract the inflationary impact of excessive monetary emissions. Despite a considerable slowdown in the past few years, inflation remains high: it stood at 28% in 2003 and is expected to reach around 20% this year. Notwithstanding all that, when measured by the PPP-adjusted per capita GDP (EUR 9200 in 2003), Belarus remains richer than both Russia (EUR 7800) and Ukraine (EUR 5100). The wealth of the country relative to its neighbours reminds of its position in the former USSR, where it was largely operating as an 'assembly line', using cheap and abundant energy, raw materials and other inputs coming from other republics, and shipping its often sophisticated manufacturing products in return.

Despite the country's deep international isolation and its largely unreformed economy, the short- and medium-term prospects are fairly good, given the optimistic prospects for Russia. By now, Belarus has a customs union and a common labour market with Russia – both within the framework of a common Union State established back in 1999. However, at the moment, further integration steps appear to be stalled. The plans to introduce the Russian rouble as the sole legal tender in Belarus, initially scheduled for January 2005, have been postponed. Also, negotiations over the price of natural gas shipments from Russia and the level of transit fees are still going on, after a failure to set up a Russian-Belarusian joint venture based on the Belarusian gas monopoly *Beltransgaz*. However, in any case, the price of Russian gas imported to Belarus (and to Ukraine alike) will stay far below the 'world market price'.

Vasily Astrov

Ukraine: signs of 'overheating'

The very high economic growth recorded by Ukraine in 2003 (9.4% according to the latest revised figures) has persisted, even accelerating to 11.3% in the first five months of 2004 (on a year-on-year basis). Over the same period, industrial output rose by 16.9%, driven by marked growth in manufacturing (19.9%), especially in machine-building (36.5%). With an increase of 29.7% in value-added, the construction sector can be seen to be booming as well.

The major factors behind this impressive performance are: (a) the consistently strong external demand for metals (particularly in the Asian markets); (b) rapid economic growth in Russia and the other CIS countries (resulting *inter alia* in a rising demand for Ukrainian machinery and transport equipment); and (c) a further upswing in domestic demand for capital goods. Fixed capital formation continues to expand at an astonishing rate: 31.3% in 2003 and as much as 52.1% in the first quarter of 2004. The particular need for major investment activity in Ukraine becomes readily apparent when

Table UA

Ukraine: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., end of period ²⁾	49710.8	49291.2	48457.1	48003.5	47622.4	47879.4	47516.7	47300	47000
Gross domestic product, UAH mn, nom.	130442	170070	204190	225810	264165	51535	62094	309500	357700
annual change in % (real)	-0.2	5.9	9.2	5.2	9.4	8.4	10.8	9.5	7
GDP/capita (EUR at exchange rate)	595	683	872	931	917	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3400	3690	4190	4570	5150	.	.	.	.
Gross industrial production									
annual change in % (real)	4.0	12.4	14.2	7.0	15.8	10.7	18.8	15	10
Construction output total									
annual change in % (real)	-8.0	9.1	16.7	-0.7	23.1	18.2	29.9	.	.
Consumption of households, UAH mn, nom.	71310	92406	112260	119899	203696	.	.	.	.
annual change in % (real)	-1.9	2.5	9.6	5.6	.	.	.	.	.
Gross fixed investment, UAH mn, nom.	17552	23629	32573	37178	51011	6124	10236	.	.
annual change in % (real)	0.4	14.4	20.8	8.9	31.3	23.1	52.1	30	15
LFS - employed persons, th, avg.	20048.2	20419.8	20238.1	20400.7	20554.7	20356.2	.	.	.
annual change in %	-12.8	1.9	-0.9	0.8	0.8	1.2	.	.	.
Reg. employees in industry, th pers., avg. ³⁾	3932.0	3445.0	3811.0	3578.1	.	.	.	.	.
annual change in %	-5.1	-12.4	-6.2	-6.1	.	.	.	.	.
LFS - unemployed persons, average	2698.8	2707.6	2516.9	2301.0	2059.5	2121.4	.	.	.
LFS - unemployment rate in %, average	11.9	11.7	11.1	10.1	9.1	9.4	.	9	8.5
Reg. unemployment rate in %, end of period	4.3	4.2	3.7	3.8	3.6	4.0	3.9	3.5	3.5
Average gross monthly wages, UAH ³⁾	177.5	230.1	311.1	376.4	462.3	402.4	518.3	.	.
annual change in % (real, gross)	-5.4	1.1	20.7	20.0	16.7	17.6	19.9	.	.
Consumer prices, % p.a.	22.7	28.2	12.0	0.8	5.2	2.2	7.4	7	8
Producer prices in industry, % p.a.	31.1	20.9	8.6	3.1	7.8	7.8	14.1	14	7
General governm.budget, nat.def., % GDP									
Revenues	25.2	28.9	26.9	27.4	28.5	29.8	28.2	21.1 ⁴⁾	.
Expenditures	26.7	28.3	27.2	26.7	28.6	26.2	26.2	23.3 ⁴⁾	.
Deficit (-) / surplus (+), % GDP	-1.5	0.6	-0.3	0.7	-0.2	3.6	1.9	-2.3 ⁴⁾	.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Refinancing rate of NB % p.a., end of period	45.0	27.0	12.5	7.0	7.0	7.0	7.0	.	.
Current account, EUR mn ⁵⁾	1559	1602	1565	3360	2559	1004	1335	2800	2400
Current account in % of GDP	5.2	4.7	3.7	7.5	5.8	11.1	14.3	5.8	4.3
Gross reserves of NB excl. gold, EUR mn ⁵⁽⁶⁾	1042	1453	3353	4088	5386	4145	6328	.	.
Gross external debt, EUR mn ⁵⁾	12381	11123	13730	9830	12190	.	.	.	.
FDI inflow, EUR mn ⁵⁾	466	644	884	734	1261	221	248	.	.
FDI outflow, EUR mn ⁵⁾	7	1	26	-5	12	1	0	.	.
Exports of goods, BOP, EUR mn ⁵⁾	12400	17008	19074	19770	21013	4739	5876	24500	26000
annual growth rate in %	2.3	37.2	12.1	3.6	6.3	3.3	24.0	17	6
Imports of goods, BOP, EUR mn ⁵⁾	12170	16165	18853	19018	21251	4451	5263	24500	26400
annual growth rate in %	-15.6	32.8	16.6	0.9	11.7	3.2	18.2	15	8
Exports of services, BOP, EUR mn ⁵⁾	3637	4111	4459	4958	4615	1120	1099	4500	4500
annual growth rate in %	4.8	13.0	8.5	11.2	-6.9	-4.8	-1.9	-2	0
Imports of services, BOP, EUR mn ⁵⁾	2155	3433	3995	3743	3237	759	665	3000	3000
annual growth rate in %	-4.3	59.3	16.4	-6.3	-13.5	-12.1	-12.4	-7	0
Average exchange rate UAH/USD	4.130	5.440	5.372	5.327	5.333	5.334	5.330	5.3	5.3
Average exchange rate UAH/EUR (ECU)	4.393	5.029	4.814	5.030	6.024	5.718	6.662	6.4	6.4
Purchasing power parity UAH/USD, wiiw	0.705	0.850	0.913	0.949	0.999	.	.	.	.
Purchasing power parity UAH/EUR, wiiw	0.768	0.932	1.001	1.026	1.072	.	.	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census 5 Dec 2001. - 3) Excluding small enterprises. - 4) Central budget, incl. amendments passed by Parliament in mid-June 2004. - 5) Converted from USD to NCU, and from NCU to EUR at the official exchange rates. - 6) Useable.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

viewed against the background of its sharp contraction throughout most of the 1990s. None the less, the investment ratio of 19.3% in 2003 is not particularly high by international standards. If it remains at that level, it will not sustain economic growth at its current pace.

The forceful economic performance has not yet translated fully into a corresponding rise in fiscal revenue. In the first four months of 2004, consolidated budget revenues rose by a 'mere' 6.2% in real terms. In particular, the revenue losses owing to the introduction of a flat 13% personal income tax, effective since January 2004, have been so far only partly offset by a broader tax base and stronger tax compliance (although further improvements in tax compliance are expected). Collection from this tax fell by 7.8% and that from profit tax (the rate of which was lowered from 30% to 25%) by 9.3% in real terms. Nevertheless, given that the GDP growth for the year as a whole is likely to be nearly twice as high as the projections underlying the 2004 budget (4.8%), the central budget expenditures have been revised upwards.

An unpleasant aspect of the current economic boom is a pick-up in inflation. This could well be interpreted as a sign of 'overheating', although the high year-on-year consumer price inflation (7.2% in January-April) reflects first and foremost the rise in food prices, following the abysmal grain harvest in 2003. This year, a good grain harvest is expected (some 35 million tons as against 20 million tons last year) so that inflationary pressure is unlikely to emanate from this side. However, the rise in industrial producer prices (15.2% in January-April, year-on-year) is somewhat alarming; it will spill over increasingly into consumer inflation by the end of the year and in 2005. In May, producer prices rose by another 2.1% (against April); this time the rise was fuelled by the soaring prices for coke and oil products (+7.7%) – a reflection of the global rise in the price of crude oil.

Customs statistics show a positive trade balance of EUR 1.25 billion in the first four months of 2004 – more than triple the amount in the first four months of 2003 – despite the stronger euro. In 2003 as a whole, the country's balance of payments recorded – for the first time since 1999 – a trade deficit (albeit marginal) in goods: EUR 238 million or 0.5% of GDP. However, the high inflow of current transfers and the revenue from pipeline transit fees accounted for a current account surplus of 5.8% of GDP; a comparable figure may be expected this year. In the first quarter of 2004 alone, the foreign exchange reserves expanded by nearly EUR 1 billion, driven primarily by favourable developments in the current account and the placement of 600 million dollars worth of sovereign Eurobonds in February. In view of the country's strong external position and the mounting inflationary pressure, an intense debate has arisen about whether the *hryvnia* should be allowed to appreciate in nominal terms. However, the National Bank seems intent upon adhering to its policy of maintaining a constant nominal exchange rate to the dollar, not least on account of pressure from the influential exporters' lobby.

In the international arena, the country's record has been mixed. On the one hand, in February Ukraine was struck from the 'black list' drawn up by the Financial Action Task Force of those countries that failed to combat money laundering, following the entry into force of pertinent legislation in June 2003. Furthermore, a twelve-month precautionary stand-by arrangement has since been reached with the IMF on a possible USD 605 million loan, even though it is highly unlikely that the country will need a loan of that order in the foreseeable future. On the other hand, Ukraine has essentially given up its initial demands for 'compensation' from the EU (which would offset the anticipated negative effects of EU enlargement) by extending the current Partnership and Cooperation Agreement with the EU-15 to the new members. Meanwhile, the EU-15 quota for

imports of Ukrainian steel remains unchanged and will be applied to the imports to the EU-25. For all the flow of optimistic rhetoric, little progress has been made to date on implementing the recently signed Common Economic Space (CES) with Russia, Belarus and Kazakhstan, even though the parliaments of all four countries have since ratified the document. Most importantly, Russia reportedly does not plan to stop levying VAT on its fuel exports – one of the main incentives for Ukraine's participation in the CES – before 2006

In early 2004, Ukraine's relations with Poland suffered a temporary setback, after a Ukrainian company, *Donbas Industrial Union Corporation*, failed to win the tender for the privatization of the Polish steel corporation, *Huta Czysta*. The Ukrainian government claimed, probably not without good reason, that the Polish authorities had taken the decision largely on political grounds. As a result, the outcome of the tender has been declared null and void. However, political considerations also seem to have a bearing on Ukraine's own privatization policy; it is often aimed at preventing Russian industro-financial groups from taking over Ukrainian assets by adjusting the terms of the tenders accordingly. Featuring on the list of enterprises to be privatized this year are: *Kryvorizhstal* (the largest Ukrainian metallurgical plant and the country's largest exporter); *Odessa State Port Plant* (the second largest producer of nitrogen fertilizers); *Pavlogradvuhillya* (a large coal-mining company); and *Ukrudprom* (an ore-extracting holding company which is to be split up into several competing units). In addition, the moratorium on the free sale of agricultural land has been prolonged until 2015 (initially, the moratorium was supposed to expire in 2005).

In March, the Ukrainian parliament (*Verkhovna Rada*) approved a proportional representation system for parliamentary elections (in lieu of the current semi-proportional, semi-majoritarian principle), while simultaneously lowering the threshold for parties entering parliament from 4% to 3%. The passage of the law was seen as being of crucial significance for the approval of far-reaching constitutional reforms, which were pushed through by the pro-Kuchma forces and envisaged, most strikingly, a reduction in presidential power in favour of parliamentary rule. However, the reform failed to obtain the requisite two-thirds majority. Thus, the importance of the presidential elections to be held on 31 October 2004 has risen correspondingly. While the opposition forces remain split, the pro-presidential coalition has agreed on a single candidate, Prime Minister Viktor Yanukovich. Although Mr. Yanukovich currently enjoys somewhat lower ratings than his main contender, the right-wing opposition leader Viktor Yushchenko, the outcome of the election is far from clear. None the less, whoever becomes Ukraine's next president will most probably have to chart a political course that runs warily between the interests of both Russia and the EU – very much akin to the policy pursued by the current president, Leonid Kuchma.

Waltraut Urban

China: limits to growth

Economic development in the first quarter of 2004 was characterized by surging fixed asset investments, stable consumption growth and rapidly expanding industrial exports. With some sectors overheating while unemployment remains high, the Chinese government faces a serious dilemma and will have to choose between cooling the economy down on the one hand or supporting employment on the other. Moreover, given the relative size and openness of the Chinese economy,

Table CN

China: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, mn pers., end of period	1259.1	1265.8 ²⁾	1277.3	1286.0	1292.0				
Gross domestic product, CNY bn, nom.	8191.1	8940.4	9593.3	10239.8	11669.4	2356.2	2710.6	13245	14702
annual change in % (real)	7.1	8.0	7.3	8.0	9.1	9.9	9.7	8.5	8
GDP/capita (USD at exchange rate)	785.7	853.0	907.1	960.5	1091.1	.	.	.	.
GDP/capita (USD at PPP - wiiw)	3717.5	4082.6	4444.3	4818.3	5344.4	.	.	.	.
Industrial value added									
annual change in % (real)	8.8	9.9	8.9	9.9	12.5	17.2 ³⁾	17.7 ³⁾	.	.
Construction output, CNY bn ⁴⁾	1115.2	1249.7	1536.1	1852.7	.	.	.	.	.
annual change in % (nominal)	10.8	12.1	22.9	20.6	.	.	.	.	.
Retail trade turnover, CNY bn	3113.4	3415.3	3759.5	4191.1	4572.5	1110.9	1283.1	.	.
annual change in % (real)	10.1	11.1	10.9	10.6	9.2	9.4	9.3	.	.
Total investment in fixed assets, CNY bn	2985.5	3291.8	3689.8	4283.9	5427.6	615.8	879.9	.	.
annual change in % (nominal)	5.1	10.3	12.1	16.1	26.7	27.8	43.0	.	.
Employment total, mn pers., end of period	713.9	720.9	730.3	737.4	744.3	.	.	.	.
annual change in %	0.9	1.0	1.3	1.0	0.9	.	.	.	.
Staff and workers, mn pers., end of period ⁵⁾	117.7	112.6	107.9	105.6	104.6 ⁶⁾	104.1	103.5	.	.
annual change in %	-4.6	-4.3	-4.2	-2.2	-0.9	-2.3	-0.5	.	.
Unemployment rate (urban) in %, end of per. ⁷⁾	3.1	3.1	3.6	4.0	4.5	4.1	4.3	4.5	4.5
Average gross annual wages, CNY ⁸⁾	8346	9371	10870	12466	12622 ⁹⁾	12701	14318	.	.
annual change in % (real) ¹⁰⁾	13.1	11.1	15.2	15.5	.	.	.	.	.
Retail prices, % p.a.	-3.0	-1.5	-0.8	-1.8	-0.1	-0.2	1.4	.	.
Consumer prices, % p.a.	-1.4	0.4	0.7	-0.8	1.2	0.5	2.8	3.5	3
General government budget, nat.def., % GDP									
Revenues	14.0	15.0	17.1	18.5	.	.	.	.	.
Expenditures	16.1	17.8	19.6	21.5	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.1	-2.8	-2.6	-3.1	-2.7	.	.	.	.
Refinancing rate of NB % p.a., end of per. ¹¹⁾	3.2	3.2	3.2	2.7	2.7	2.7	2.7	.	.
Current account, USD bn	15.7	20.5	17.4	35.4	45.9	.	.	.	.
Current account in % of GDP	1.6	1.9	1.5	2.9	3.3	.	.	2.1	1.6
Gross reserves of NB excl. gold, USD bn	154.7	165.6	212.2	286.4	403.3	316.0	439.8	.	.
Gross external debt, USD bn	151.8	145.7	170.1	171.7	194.0	.	.	.	.
FDI inflow, USD bn	40.3	40.7	46.9	52.8	53.3	13.5	14.1	.	.
FDI outflow, USD bn	1.8	0.9	6.9	2.9	.	.	.	.	.
Exports of goods total, USD bn ¹²⁾	194.9	249.2	266.2	325.6	438.4	86.3	115.7	.	.
annual change in %	6.1	27.8	6.8	22.3	34.6	33.5	34.1	.	.
Imports of goods total, USD bn ¹²⁾	165.8	225.1	243.6	295.3	412.8	87.3	124.1	.	.
annual change in %	18.2	35.8	8.2	21.2	39.9	52.4	42.3	.	.
Trade balance of goods, USD bn ¹²⁾	29.1	24.1	22.5	30.3	25.5	-1.0	-8.4	.	.
Average exchange rate CNY/USD	8.28	8.28	8.28	8.28	8.28	8.28	8.28	8.28	8.28
Average exchange rate CNY/EUR	8.89	7.65	7.35	7.75	9.37	8.84	10.34	.	.
Purchasing power parity CNY/USD, wiiw ¹³⁾	1.75	1.73	1.69	1.69	1.69	.	.	.	.
Purchasing power parity CNY/EUR, wiiw	1.91	1.86	1.83	1.83	1.84	.	.	.	.

Notes: CNY: ISO-Code for the Chinese yuan.

1) Preliminary. - 2) Census results from 1st Nov. 2000. - 3) Enterprises with annual sales revenue above 5 million yuan only. - 4) Construction enterprises with independent accounting systems. - 5) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives and foreign invested enterprises. - 6) End of September 2003. - 7) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 8) Average gross annual wages of staff and workers, defined as: total wages of staff and workers per average number of staff and workers; since 1998: "staff on duty" only. - 9) Jan-Sep 2003. - 10) Staff and workers cost of living index is used as deflator for calculating real wage. - 11) Overnight rate. - 12) According to customs statistics. - 13) Purchasing power parity, ICP-method; see Ren Ruoan, The Vienna Institute Monthly Report 1996/2.

Source: China Statistical Yearbook; International Financial Statistics; China Monthly Statistics; China Daily; Asian Development Bank (ADB, ARIC Indicators); World Investment Report 2003 (UNCTAD);.

its future path will have a significant impact on the development of the neighbouring region and that of the world at large, too. China is the second-largest economy in Asia (after Japan), the sixth-largest economy in the world and ranks fourth in world trade.

GDP growth in China reached 9.7% in the first quarter of 2004, after 10.7% in the previous quarter and 9.1% for the whole year 2003; this is one of the highest growth rates of any country in the world and higher than most experts expected. Growth was mainly driven by investment in fixed assets, surging 43% year-on-year in the first quarter of 2004. Investment boomed in the extreme in a number of sectors; the steel industry rose by 107%, with very high growth being recorded in real estate, non-metal mineral products and vehicles as well. This is raising fears of overheating and a build-up of over-capacity. In order to contain growth in those sectors and guard against a boom/bust cycle, the Chinese authorities started last year to control property loans, particular in high-end housing. In the first few months of this year the credit restrictions were also imposed on other sectors displaying disproportionately rapid growth. Soaring profits, however, are undermining this policy. In the first three months of 2004, overall industrial profits were reported to be 44% higher than in the same period last year; major steel companies recorded a rise in profits of 126% and non-ferrous metal producers a rise of 280%!

Both monetary and fiscal policies have become more restrictive. After raising the bank reserve requirement ratio by one percentage point to 7% back in September 2003, the ratio was increased further by 0.5 percentage points as of 1 April 2004. However, the People's Bank of China (PBC), the country's central bank, is still hesitant about raising the target interest rate in order to avoid increasing costs for the less prosperous debtors in the country. As for fiscal policy, the government has announced that the pro-active fiscal policy implemented after the Asian crisis in 1997/1998 will be phased out step by step and the issuance of treasury bonds will be reduced from yuan 140 billion (USD 17 billion) in 2003 to yuan 110 billion (USD 13 billion) this year. The general budget deficit is projected to stay at the same level as last year in absolute terms; however, it will decline further as a percentage of GDP, probably reaching 2.5% in 2004. (As for the size of the Chinese budget deficit, one has to bear in mind that it is not measured in line with international standards and thus may be substantially underestimated.)

Private consumption in the first three months of 2004 was supported by rapidly rising incomes – especially in rural areas (9.2%) where 60% of all Chinese still live and benefit from significant price hikes for numerous agricultural products (wheat prices rose by 19.9%, corn by 21.5%, soybeans by 31.4% and cotton by 47.7%). However, retail trade turnover as a proxy for private demand expanded in real terms at the same pace as last year (9.2%). Measured in terms of the consumer price index, the overall price level rose 2.8% year-on-year in the first quarter. This is still moderate by international standards, but points to significant acceleration if compared to the very low rates of inflation and/or deflation over the past few years in China. Some doubts are also being voiced whether the index correctly captures actual inflation. Producer prices for industrial products rose 3.7% and selected information on the rise of ex-factory prices for important industrial inputs, such as 17-33% for steel, 35.7% for aluminium, 14.5% for copper and 6.7% for crude oil in January, suggest that inflation will accelerate further throughout the year.

Exports continued to grow rapidly in the first three months of the year, up 34.1% over the same period last year. They took advantage of the upswing in the world economy that was particularly pronounced in Asia and the USA, which together absorbed 70% of China's merchandise exports.

However, imports rose even more sharply at a rate of 42.3% on account of two factors: a surge in demand for capital goods, raw materials and intermediate inputs; and rapidly rising prices in many sectors (viz. crude oil, ferrous and non-ferrous metals). This development resulted in a (moderate) trade deficit of USD 8.4 billion (exports still cover imports by 93%): China's first trade deficit for many years. Foreign direct investment remained high; actual inflows reached USD 14.1 billion in the first quarter of 2004, slightly higher than in the same period last year. Moreover, contracted foreign direct investment was up 49.2%, pointing to a further increase in FDI in the future.

In the light of the recent trade deficit, the US government relaxed its pressure on China to revalue its currency; it probably relented in the light of a number of Chinese 'shopping tours' to US enterprises and certain statements issued by the Chinese monetary authorities that indicated a more flexible approach towards exchange rate policy in the foreseeable future. (Ever since the Asian crisis in 1997/1998, the yuan has been pegged to the US dollar at a rate ranging between 8.276 and 8.278. In the run-up to the US presidential elections, the low fixed value of the Chinese currency is cited as being responsible for the huge trade deficit with China – and thus for the job losses in US industry.)

On the supply side, the industrial sector remained by far the fastest growing segment of the economy, with industrial value-added expanding at a rate of 17.7% (compared to 17.2% in the same period last year).²⁵ However, driven by fixed investments, industrial production growth is highly concentrated in a few sectors, primarily steel and other metals, cement and vehicles. Production growth, however, is also above average in certain export-driven sectors such as electronics. Growth was less impressive, for instance, in the production of silk and silk textiles, garments, some white goods (e.g. freezers) and certain types of consumer electronics (e.g. colour-TV and hi-fi sets). Value-added of agriculture expanded by 4.5% and VAD of the services sector by 7.7%, up 1 and 0.1 percentage points respectively from the growth rates in the first quarter of last year.

Despite the rapid expansion of the economy, unemployment remains high. The unemployment rate is probably close to 15% on account of the ongoing restructuring of state-owned enterprises, rural migration and pressure attributable to young people entering the labour market. (According to Chinese labour statistics, the number of young people – i.e. those under the age of 35 – entering the labour market peaked during the period 2001-2005.) Quite remarkably, China has no reliable data on unemployment. The current official unemployment rate of 4.3% refers solely to registered urban unemployment; this is known to be but a fraction of the actual overall unemployment rate. However, a new system for compiling unemployment data, based on surveys in line with international practice, will be gradually introduced. A survey has been launched in 66 cities as a first step.

The difficult task facing the Chinese authorities as they strive to contain economic growth and secure employment, whereby conflicting interests between central and local governments also play a certain role, is best illustrated by the example of the automotive industry: According to a study by the Development Research Centre, a think tank linked to China's State Council, for every job created in China's automotive industry, seven more appeared elsewhere in the economy; the industry accounted for 1.5 percentage points of GDP growth last year. Moreover, exploding car sales (2002: 80%; 2003: 36%) attracted huge amounts of investment capital (domestic and foreign) to the industry; car-making capacity is projected to outstrip demand in 2005. When this occurs, the

²⁵ Comprising industrial enterprises with annual sales revenue above yuan 5 million (USD 604,000) only, VAD of the total secondary sector (including construction) expanded at a rate of 11.6%.

crowded market will set off a shakedown process, winnowing out the less competitive – probably smaller domestically owned enterprises located in the poorer provinces of China. Back in February this year, vehicle manufacture rose by 18% and outstripped sales. At the end of April, China's 13 largest car makers were sitting on unsold stocks some 28% larger than last year.

On the political front, some major amendments to the constitution were adopted at the annual meeting of the People's National Congress in March this year, pertaining to the protection of private property rights, social security and human rights, and incorporating the principle of the so-called 'Three Represents' in the preamble. The latter is an ideological construct, going back to former President Jiang Zemin, designed to broaden the basis of the Communist Party of China beyond workers and peasants so as to include private entrepreneurs as well.

Prospects: On the assumption that the world economy will peak this year and that the measures to cool China's overheated economy in various sectors will take effect without any serious impact on overall growth, wiiw expects the Chinese GDP to expand at a rate of 8.5% in 2004 and at 8% in 2005.

In a longer-term perspective, however, the Chinese government envisages average GDP growth of around 7%, putting the emphasis on 'qualitative' rather than 'quantitative' growth. This should be more in balance with existing natural resources and help to reduce both social and regional disparities.

Appendix

**Selected Indicators of
Competitiveness**

Table A/1

GDP per capita at current PPPs (EUR), from 2004 at constant PPPs

	1990	1995	1999	2000	2001	2002	2003	2004	2005	2006	2010	2015
									projection assuming 4% p.a. GDP growth and zero population growth p.a.			
Czech Republic		11135	12698	13530	14101	14922	15402	15941	16499	17158	20073	24422
Hungary	7797	7844	10200	11032	12019	12841	13675	14221	14833	15426	18047	21956
Poland	4934	6129	8405	8955	9547	9901	10373	10891	11382	11837	13847	16848
Slovak Republic		7114	9161	9914	10479	11328	11731	12259	12872	13387	15661	19054
Slovenia	9793	10937	14331	15151	15916	16719	17501	18096	18729	19478	22787	27724
Estonia	.	5793	8038	9011	9609	10451	10857	11454	12107	12591	14730	17922
Latvia	7815	4636	6987	7692	8367	9183	9967	10615	11305	11757	13754	16734
Lithuania	8059	5454	7441	8106	8851	9575	10604	11664	12656	13162	15398	18733
Cyprus	10527	13296	15902	17278	18294	18390	18839	19593	20377	21192	24791	30162
Malta	.	11134	14052	15062	15124	15479	15605	16229	16879	17554	20535	24985
Bulgaria	5104	4987	5117	5555	6079	6359	6826	7134	7419	7716	9026	10982
Romania	4739	4867	4982	5233	5702	6359	6729	7066	7383	7679	8983	10929
Croatia	5853	5182	7511	8045	8600	9269	9891	10207	10564	10987	12853	15638
Macedonia	3856	3747	5696	6007	5848	6034	6338	6528	6789	7061	8260	10050
Russia	7744	5739	5462	6125	6628	7163	7885	8381	8842	9196	10758	13089
Ukraine	5748	3304	3403	3685	4191	4567	5153	5617	5994	6233	7292	8872
									projection assuming 2% p.a. GDP growth and zero population growth p.a.			
Germany	18188	19064	21990	23117	23456	23957	24056	24537	25027	25528	27632	30508
Greece	10035	11519	13928	14952	15683	17042	17780	18135	18498	18868	20423	22549
Spain	11592	13974	17824	18899	19669	20711	21236	21661	22094	22536	24393	26932
Austria	16783	20245	24255	25921	26144	26688	26966	27505	28055	28616	30975	34199
Portugal	9578	11675	14979	15953	16481	17048	16727	17062	17403	17751	19215	21214
Turkey	3987	4808	5743	6260	5571	5951	6256	6381	6508	6638	7186	7933
USA	20276	24284	30189	32032	32427	33638	34348	35035	35736	36450	39455	43562
Japan	16570	19846	22612	23982	24380	24831	25437	25945	26464	26994	29219	32260
EU(15) average	15187	17683	21337	22664	23338	24060	24302	24788	25284	25790	27916	30821
EU(25) average	.	15933	19365	20593	21275	21991	22292	22773	23265	23768	25889	28808
European Union (25) average = 100												
	1990	1995	1999	2000	2001	2002	2003	2004	2005	2006	2010	2015
Czech Republic		70	66	66	66	68	69	70	71	72	78	85
Hungary	.	49	53	54	56	58	61	62	64	65	70	76
Poland	.	38	43	43	45	45	47	48	49	50	53	58
Slovak Republic		45	47	48	49	52	53	54	55	56	60	66
Slovenia	.	69	74	74	75	76	79	79	81	82	88	96
Estonia	.	36	42	44	45	48	49	50	52	53	57	62
Latvia	.	29	36	37	39	42	45	47	49	49	53	58
Lithuania	.	34	38	39	42	44	48	51	54	55	59	65
Cyprus	.	83	82	84	86	84	85	86	88	89	96	105
Malta	.	70	73	73	71	70	70	71	73	74	79	87
Bulgaria	.	31	26	27	29	29	31	31	32	32	35	38
Romania	.	31	26	25	27	29	30	31	32	32	35	38
Croatia	.	33	39	39	40	42	44	45	45	46	50	54
Macedonia	.	24	29	29	27	27	28	29	29	30	32	35
Russia	.	36	28	30	31	33	35	37	38	39	42	45
Ukraine	.	21	18	18	20	21	23	25	26	26	28	31
Germany	.	120	114	112	110	109	108	108	108	107	107	106
Greece	.	72	72	73	74	77	80	80	80	79	79	78
Spain	.	88	92	92	92	94	95	95	95	95	94	93
Austria	.	127	125	126	123	121	121	121	121	120	120	119
Portugal	.	73	77	77	77	78	75	75	75	75	74	74
Turkey	.	30	30	30	26	27	28	28	28	28	28	28
USA	.	152	156	156	152	153	154	154	154	153	152	151
Japan	.	125	117	116	115	113	114	114	114	114	113	112
EU(15) average	.	111	110	110	110	109	109	109	109	109	108	107
EU(25) average	.	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1996-2003

EUR-based, annual averages

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Czech Republic								
Producer price index, 1989=100	253.0	265.4	278.4	281.2	295.0	303.6	302.0	301.1
Consumer price index, 1989=100	301.0	326.6	361.6	369.2	383.6	401.6	408.8	409.3
GDP deflator, 1989=100	275.8	297.8	329.5	339.1	359.4	377.4	388.0	394.6
Exchange rate (ER), CZK/EUR	34.01	35.80	36.16	36.88	35.61	34.08	30.81	31.84
ER nominal, 1989=100	204.9	215.7	217.9	222.2	214.5	205.3	185.6	191.9
Real ER (CPI-based), 1989=100	88.1	86.9	80.3	81.2	76.9	71.8	65.1	68.6
Real ER (PPI-based), 1989=100	93.5	94.5	90.4	90.8	87.1	82.6	75.0	79.0
PPP, CZK/EUR	12.64	13.31	14.47	14.57	15.47	16.06	15.86	16.11
ERDI (EUR based)	2.69	2.69	2.50	2.53	2.30	2.12	1.94	1.98
Average monthly gross wages, CZK	9825	10802	11801	12797	13614	14793	15857	16917
Average monthly gross wages, EUR (ER)	289	302	326	347	382	434	515	531
Average monthly gross wages, EUR (PPP)	777	812	815	878	880	921	1000	1050
GDP nominal, bn CZK	1567.0	1679.9	1839.1	1902.3	2150.1	2315.3	2414.7	2532.4
Employed persons - LFS, th., average	4972.0	4936.5	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2
GDP per employed person, CZK	315158	340306	377970	399297	454404	487402	506762	535032
GDP per empl. person, CZK at 1999 pr.	387489	387428	388931	399297	428683	437917	442910	459802
Unit labour costs, 1989=100	263.3	289.5	315.1	332.8	329.8	350.8	371.8	382.0
Unit labour costs, ER adj., 1989=100	128.5	134.2	144.6	149.8	153.7	170.8	200.3	199.1
Unit labour costs, PPP adj., Austria=100	25.40	27.64	30.09	30.73	31.53	34.65	40.22	38.97
Hungary								
Producer price index, 1989=100	349.2	420.4	467.9	491.8	548.8	577.3	567.0	580.6
Consumer price index, 1989=100	493.5	583.8	667.3	734.0	805.9	880.1	926.7	970.2
GDP deflator, 1989=100	422.8	500.7	563.9	611.4	670.9	728.4	793.8	855.8
Exchange rate (ER), HUF/EUR	191.15	210.93	240.98	252.80	260.04	256.68	242.97	253.51
ER, nominal 1989=100	293.8	324.2	370.3	388.5	399.6	394.5	373.4	389.6
Real ER (CPI-based), 1989=100	77.0	73.1	74.0	71.4	68.2	63.0	57.8	58.8
Real ER (PPI-based), 1989=100	97.1	89.7	91.4	90.8	87.2	83.4	80.4	83.2
PPP, HUF/EUR	80.52	92.93	102.93	109.11	116.74	121.28	128.33	134.09
ERDI (EUR based)	2.37	2.27	2.34	2.32	2.23	2.12	1.89	1.89
Average monthly gross wages, HUF	46837	57270	67764	77187	87645	103553	122482	137187
Average monthly gross wages, EUR (ER)	245	272	281	305	337	403	504	541
Average monthly gross wages, EUR (PPP)	582	616	658	707	751	854	954	1023
GDP nominal, bn HUF	6893.9	8540.7	10087.4	11393.5	13150.8	14849.8	16740.4	18574.0
Employed persons - LFS, th., average	3648.1	3646.3	3697.7	3811.5	3849.1	3859.5	3870.6	3921.9
GDP per employed person, HUF	1889723	2342292	2728020	2989243	3416591	3847597	4325014	4735960
GDP per empl. person, HUF at 1999 pr.	2732562	2859956	2957830	2989243	3113419	3229667	3331319	3383380
Unit labour costs, 1989=100	326.7	381.7	436.7	492.2	536.6	611.2	700.8	772.9
Unit labour costs, ER adj., 1989=100	111.2	117.8	117.9	126.7	134.3	154.9	187.7	198.4
Unit labour costs, PPP adj., Austria=100	22.87	25.23	25.53	27.05	28.66	32.71	39.22	40.40
Poland								
Producer price index, 1989=100	3189.0	3578.0	3839.6	4058.4	4375.0	4445.0	4489.4	4606.2
Consumer price index, 1989=100	4577.9	5260.0	5880.7	6309.9	6947.2	7329.3	7468.5	7528.3
GDP deflator, 1989=100	3176.3	3622.2	4050.3	4323.6	4629.5	4822.4	4883.3	4906.5
Exchange rate (ER), PLN/EUR	3.377	3.706	3.923	4.227	4.011	3.669	3.856	4.398
ER, nominal, 1989=100	2118.3	2324.1	2460.5	2651.1	2515.7	2300.9	2418.3	2758.3
Real ER (CPI-based), 1989=100	59.9	58.1	55.8	56.7	49.8	44.1	46.4	53.6
Real ER (PPI-based), 1989=100	76.6	75.5	74.0	75.1	68.9	63.2	65.7	74.2
PPP, PLN/EUR	1.4960	1.6601	1.8209	1.8933	1.9792	2.0352	2.0371	2.0558
ERDI (EUR based)	2.26	2.23	2.15	2.23	2.03	1.80	1.89	2.14
Average monthly gross wages, PLN ^{*)}	874	1066	1233	1697	1894	2045	2098	2201
Average monthly gross wages, EUR (ER)	259	288	314	401	472	557	544	501
Average monthly gross wages, EUR (PPP)	584	642	677	896	957	1005	1030	1071
GDP nominal, bn PLN	387.8	472.4	553.6	615.1	685.0	750.8	771.1	814.7
Employment total - reg., th., average	15020.6	15438.7	15800.4	15373.5	15017.5	14923.6	14589.9	14468.6
GDP per employed person, PLN	25820	30595	35035	40011	45612	50309	52853	56308
GDP per empl. person, PLN at 1999 pr.	35146	36520	37398	40011	42599	45105	46795	49619
Unit labour costs, 1989=100	3619.4	4246.1	4795.7	6171.4	6468.1	6596.9	6522.7	6455.4
Unit labour costs, ER adj., 1989=100	170.9	182.7	194.9	232.8	257.1	286.7	269.7	234.0
Unit labour costs, PPP adj., Austria=100	32.60	36.32	39.15	46.11	50.92	56.16	52.30	44.22

*) Poland: Methodological change in 1999 (broader wage coverage).

(Table A/2 ctd.)

(Table A/2 ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003
								prelim.
Slovak Republic								
Producer price index, 1989=100	273.5	285.8	295.3	307.9	341.2	363.4	371.1	401.9
Consumer price index, 1989=100	317.8	337.2	359.8	397.9	445.6	477.2	493.0	534.9
GDP deflator, 1989=100	239.3	255.4	268.7	286.1	310.4	323.5	336.4	352.2
Exchange rate (ER), SKK/EUR	38.40	38.01	39.60	44.12	42.59	43.31	42.70	41.49
ER, nominal, 1989=100	231.4	229.0	238.6	265.8	256.6	260.9	257.3	250.0
Real ER (CPI-based), 1989=100	94.2	89.4	88.4	90.1	79.2	76.8	74.9	68.4
Real ER (PPI-based), 1989=100	97.6	93.2	93.3	99.2	90.0	87.7	84.6	77.1
PPP, SKK/EUR	15.26	15.86	16.41	17.08	17.45	17.91	17.99	18.95
ERDI (EUR based)	2.52	2.40	2.41	2.58	2.44	2.42	2.37	2.19
Average monthly gross wages, SKK	8154	9226	10003	10728	11430	12365	13511	14365
Average monthly gross wages, EUR (ER)	212	243	253	243	268	286	316	346
Average monthly gross wages, EUR (PPP)	534	582	610	628	655	690	751	758
GDP nominal, bn SKK	638.4	712.7	781.4	844.1	934.1	1009.8	1096.4	1195.8
Employed persons, - LFS, th., average	2224.9	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6
GDP per employed person, SKK	286956	323079	355425	395905	444440	475509	515460	552440
GDP per empl. person, SKK at 1999 pr.	343027	361950	378496	395905	409615	420561	438387	448747
Unit labour costs, 1989=100	234.9	251.9	261.2	267.8	275.8	290.6	304.6	316.4
Unit labour costs, ER adj., 1989=100	101.5	110.0	109.5	100.8	107.5	111.4	118.4	126.6
Unit labour costs, PPP adj., Austria=100	24.72	27.90	28.06	25.46	27.15	27.82	29.29	30.50
Slovenia								
Producer price index, 1989=100	5982.4	6347.2	6727.8	6869.0	7391.3	8048.9	8459.4	8670.8
Consumer price index, 1989=100	8635.7	9360.9	10100.5	10716.2	11670.2	12650.2	13598.9	14360.6
GDP deflator, 1989=100	8141.7	8856.2	9524.2	10085.7	10653.0	11616.4	12537.9	13205.9
Exchange rate (ER), SIT/EUR	169.51	180.40	186.27	193.63	205.03	217.19	226.22	233.70
ER, nominal, 1989=100	5253.6	5591.0	5772.9	6001.0	6354.5	6731.1	7011.3	7243.1
Real ER (CPI-based), 1989=100	78.7	78.6	76.2	75.5	74.9	74.8	74.0	73.8
Real ER (PPI-based), 1989=100	101.3	102.5	99.1	100.4	102.9	102.1	101.1	103.6
PPP, SIT/EUR	117.22	124.21	131.47	136.17	141.02	150.19	159.28	163.87
ERDI (EUR based)	1.45	1.45	1.42	1.42	1.45	1.45	1.42	1.43
Average monthly gross wages, SIT	129125	144251	158069	173245	191669	214561	235436	253200
Average monthly gross wages, EUR (ER)	762	800	849	895	935	988	1041	1083
Average monthly gross wages, EUR (PPP)	1102	1161	1202	1272	1359	1429	1478	1545
GDP nominal, bn SIT	2728.2	3110.1	3464.9	3874.7	4252.3	4761.8	5314.5	5726.5
Employment total - reg., th., average	741.7	743.4	745.2	758.5	768.2	779.0	783.5	777.2
GDP per employed person, SIT	3678186	4183408	4649803	5108573	5535629	6112406	6783026	7367668
GDP per empl. person, SIT at 1999 pr.	4556455	4764211	4923931	5108573	5240840	5306981	5456408	5626915
Unit labour costs, 1989=100	4976.3	5316.8	5637.1	5955.0	6422.0	7099.4	7576.8	7901.6
Unit labour costs, ER adj., 1989=100	94.7	95.1	97.6	99.2	101.1	105.5	108.1	109.1
Unit labour costs, PPP adj., Austria=100	53.22	55.67	57.77	57.89	58.94	60.83	61.70	60.69
Estonia								
Producer price index, 1992=100	344.3	374.6	390.4	385.7	404.6	422.4	424.1	424.9
Consumer price index, 1992=100	445.2	495.1	535.7	553.3	575.5	608.9	630.8	639.0
GDP deflator, 1992=100	433.8	479.2	522.3	544.7	573.8	606.9	633.9	649.1
Exchange rate (ER), EEK/EUR	15.074	15.670	15.783	15.647	15.647	15.647	15.647	15.647
ER, nominal, 1992=100	94.8	98.5	99.2	98.4	98.4	98.4	98.4	98.4
Real ER (CPI-based), 1992=100	23.8	22.6	21.4	20.7	20.3	19.6	19.3	19.5
Real ER (PPI-based), 1992=100	29.8	28.7	27.6	27.5	27.4	26.7	26.6	27.0
PPP, EEK/EUR	6.179	6.699	7.230	7.384	7.513	7.960	8.230	8.561
ERDI (EUR based)	2.44	2.34	2.18	2.12	2.08	1.97	1.90	1.83
Average monthly gross wages, EEK	2985	3573	4125	4440	4907	5510	6144	6723
Average monthly gross wages, EUR (ER)	198	228	261	284	314	352	393	430
Average monthly gross wages, EUR (PPP)	483	533	571	601	653	692	747	785
GDP nominal, bn EEK	56.0	68.3	78.3	81.6	92.7	104.3	116.9	125.8
Employed persons - LFS, th., average	619.3	617.2	606.5	579.3	572.5	577.7	585.5	594.3
GDP per employed person, EEK	90371	110706	129169	140928	161951	180609	199605	211732
GDP per empl. person, EEK at 1999 pr.	113458	125825	134713	140928	153732	162089	171516	177669
Unit labour costs, 1992=100	451.1	486.9	525.0	540.1	547.2	582.8	614.1	648.8
Unit labour costs, ER adj., 1992=100	476.0	494.2	529.1	549.1	556.4	592.5	624.4	659.6
Unit labour costs, PPP adj., Austria=100	30.13	32.59	35.26	36.08	36.55	38.50	40.16	41.34

(Table A/2 ctd.)

(Table A/2 ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003
								prelim.
Latvia								
Producer price index, 1992=100	322.9	336.1	342.5	328.8	330.8	336.4	339.8	350.7
Consumer price index, 1992=100	417.9	453.0	474.3	485.7	498.3	510.8	520.5	535.6
GDP deflator, 1992=100	313.4	335.2	350.7	367.5	381.3	389.4	402.8	416.5
Exchange rate (ER), LVL/EUR	0.6900	0.6574	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449
ER, nominal, 1992=100	79.5	75.7	76.2	71.9	64.5	64.8	67.1	74.3
Real ER (CPI-based), 1992=100	21.3	19.0	18.5	17.3	15.4	15.4	16.0	17.6
Real ER (PPI-based), 1992=100	26.7	24.6	24.1	23.6	21.9	22.1	22.6	24.7
PPP, LVL/EUR	0.2275	0.2382	0.2457	0.2529	0.2567	0.2623	0.2650	0.2728
ERDI (EUR based)	3.03	2.76	2.69	2.47	2.18	2.15	2.20	2.36
Average monthly gross wages, LVL	99	120	133	141	150	159	173	192
Average monthly gross wages, EUR (ER)	143	183	202	226	267	283	297	298
Average monthly gross wages, EUR (PPP)	434	504	543	557	583	606	653	706
GDP nominal, bn LVL	3.076	3.563	3.903	4.224	4.686	5.168	5.691	6.323
Employed persons - LFS, th., average	949.0	990.0	986.0	968.0	941.0	962.0	989.0	1006.9
GDP per employed person, LVL	3241	3599	3958	4364	4979	5372	5754	6279
GDP per empl. person, LVL at 1999 pr.	3800	3945	4148	4364	4798	5070	5249	5540
Unit labour costs, 1992=100	344.7	403.7	426.4	428.7	413.5	416.1	437.3	461.0
Unit labour costs, ER adj., 1992=100	433.6	533.1	559.6	596.6	640.9	641.9	651.5	620.5
Unit labour costs, PPP adj., Austria=100	22.26	28.51	30.25	31.80	34.15	33.83	33.99	31.54
Lithuania								
Producer price index, 1992=100	1064.8	1128.7	1079.0	1097.4	1273.0	1234.8	1200.2	1194.2
Consumer price index, 1992=100	1528.8	1664.9	1749.8	1763.8	1781.4	1804.6	1810.0	1788.3
GDP deflator, 1992=100	1124.3	1281.3	1346.0	1337.8	1351.7	1350.3	1349.9	1337.4
Exchange rate (ER), LTL/EUR	5.0118	4.5272	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528
ER, nominal, 1992=100	218.0	196.9	195.4	185.8	160.9	155.9	150.5	150.2
Real ER (CPI-based), 1992=100	16.0	13.5	12.9	12.3	10.7	10.5	10.3	10.6
Real ER (PPI-based), 1992=100	22.2	19.1	19.7	18.3	14.2	14.5	14.4	14.6
PPP, LTL/EUR	1.4728	1.6382	1.6973	1.6534	1.6048	1.5700	1.5545	1.5218
ERDI (EUR based)	3.40	2.76	2.65	2.58	2.30	2.28	2.23	2.27
Average monthly gross wages, LTL	618	778	930	987	971	982	1014	1056
Average monthly gross wages, EUR (ER)	123	172	207	231	262	274	293	306
Average monthly gross wages, EUR (PPP)	420	475	548	597	605	626	652	694
GDP nominal, bn LTL	32.3	39.4	44.4	43.4	45.5	48.4	51.6	55.7
Employed persons - LFS, th., average	1620.4	1570.7	1597.6	1598.4	1397.8	1351.8	1405.9	1438.0
GDP per employed person, LTL	19927	25070	27778	27127	32570	35788	36726	38760
GDP per empl. person, LTL at 1999 pr.	23711	26176	27608	27127	32235	35458	36397	38774
Unit labour costs, 1992=100	1248.0	1422.9	1612.0	1742.3	1441.5	1326.1	1333.4	1303.3
Unit labour costs, ER adj., 1992=100	572.4	722.5	824.9	937.8	895.9	850.4	885.8	867.7
Unit labour costs, PPP adj., Austria=100	20.11	26.45	30.51	34.20	32.67	30.66	31.62	30.18
Bulgaria								
Producer price index, 1989=100	5645.0	60462.0	71789.8	73804.8	86741.7	90010.9	91073.6	95535.6
Consumer price index, 1989=100	12637.6	146392.9	173732.5	178203.6	196584.0	211052.2	223319.1	228455.7
GDP deflator, 1989=100	6399.9	67110.2	83015.2	86086.7	91854.7	98008.9	101688.7	103753.6
Exchange rate (ER), BGN/EUR	0.220	1.896	1.972	1.956	1.956	1.956	1.956	1.956
ER, nominal, 1989=100	23704.0	203894.4	212116.3	210349.5	210349.5	210349.5	210349.5	210349.5
Real ER (CPI-based), 1989=100	242.7	183.3	162.8	159.2	147.1	140.0	135.1	134.7
Real ER (PPI-based), 1989=100	484.5	392.2	341.2	327.5	290.4	285.4	281.8	273.0
PPP, BGN/EUR	0.0450	0.4589	0.5586	0.5662	0.5895	0.6176	0.6462	0.6443
ERDI (EUR based)	4.90	4.13	3.53	3.45	3.32	3.17	3.03	3.04
Average monthly gross wages, BGN	13	128	183	201	225	240	258	284
Average monthly gross wages, EUR (ER)	60	67	93	103	115	123	132	145
Average monthly gross wages, EUR (PPP)	294	279	328	355	381	389	399	441
GDP nominal, bn BGN	1.8	17.4	22.4	23.8	26.8	29.7	32.3	34.4
Employment total - reg., th., average	3285.9	3157.4	3152.6	3087.8	2980.1	2968.1	2978.6	3020.7
GDP per employed person, BGN	536	5521	7112	7705	8977	10010	10856	11392
GDP per empl. person, BGN at 1999 pr.	7210	7082	7375	7705	8413	8792	9190	9452
Unit labour costs, 1989=100	5228.7	51394.5	70706.6	74239.8	75933.5	77680.7	79763.6	85504.9
Unit labour costs, ER adj., 1989=100	22.1	25.2	33.3	35.3	36.1	36.9	37.9	40.6
Unit labour costs, PPP adj., Austria=100	11.03	13.14	17.56	18.33	18.74	18.96	19.28	20.14

(Table A/2 ctd.)

(Table A/2 ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Romania								
Producer price index, 1989=100	14928.8	37725.0	50235.3	72589.7	111371.6	157085.7	195817.1	234000.9
Consumer price index, 1989=100	13643.6	34758.8	55300.0	80629.4	117450.2	157932.6	193526.3	223135.8
GDP deflator, 1989=100	15453.6	38220.3	58917.0	87061.6	125581.5	172603.1	212943.5	253743.5
Exchange rate (ER), ROL/EUR	3862.90	8090.92	9989.25	16295.57	19955.75	26026.89	31255.25	37555.87
ER, nominal, 1989=100	23482.7	49184.9	60724.9	99061.2	121311.6	158218.2	190001.5	228303.2
Real ER (CPI-based), 1989=100	222.7	186.2	146.4	165.7	142.0	140.8	140.8	149.7
Real ER (PPI-based), 1989=100	181.5	151.6	139.6	156.8	130.4	123.0	118.4	120.9
PPP, ROL/EUR	918.8	2212.7	3378.2	4877.9	6845.7	9138.1	10914.1	12928.7
ERDI (EUR based)	4.20	3.66	2.96	3.34	2.92	2.85	2.86	2.90
Average monthly gross wages, ROL	426610	846450	1357132	1957731	2876645	4282622	5452097	6741152
Average monthly gross wages, EUR (ER)	110	105	136	120	144	165	174	179
Average monthly gross wages, EUR (PPP)	464	383	402	401	420	469	500	521
GDP nominal, bn ROL	108920	252926	371194	545730	803773	1167687	1512617	1890778
Employed persons - LFS, th., average ¹⁾	10935.5	11050.0	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5
GDP per employed person, th. ROL	9960.2	22889.2	34227.5	50645.0	74673.7	109161.3	163804.2	205018.0
GDP per empl. person, th. ROL at 1999 pr.	56113.1	52139.0	50578.0	50645.0	51768.9	55061.3	66971.0	70343.4
Unit labour costs, 1989=100	15896.6	33945.0	56104.5	80826.4	116186.1	162629.8	170221.1	200376.8
Unit labour costs, ER adj., 1989=100	67.7	69.0	92.4	81.6	95.8	102.8	89.6	87.8
Unit labour costs, PPP adj., Austria=100	22.44	23.84	32.25	28.09	32.96	34.98	30.18	28.81
Croatia								
Producer price index, 1989=100	370129.0	378641.8	374098.2	383824.8	421055.7	436213.7	434468.8	442713.3
Consumer price index, 1989=100	408671.4	423383.3	447516.2	466311.8	495223.5	519489.4	530918.1	538866.3
GDP deflator, 1989=100	320477.1	344066.9	373062.5	387324.9	405475.9	421771.6	427028.3	440633.8
Exchange rate (ER), HRK/EUR	6.80	6.96	7.14	7.58	7.63	7.47	7.41	7.56
ER, nominal, 1989=100	210895.8	215699.6	221182.2	234912.7	236628.2	231483.2	229555.6	234410.3
Real ER (CPI-based), 1989=100	66.8	67.0	65.9	68.0	65.7	62.6	62.0	63.6
Real ER (PPI-based), 1989=100	65.7	66.3	68.3	70.3	67.3	64.8	64.5	65.6
PPP, HRK/EUR	4.119	3.795	4.038	4.139	4.273	4.341	4.284	4.321
ERDI (EUR based)	1.65	1.83	1.77	1.83	1.79	1.72	1.73	1.75
Average monthly gross wages, HRK	3243	3668	4131	4551	4869	5061	5366	5623
Average monthly gross wages, EUR (ER)	477	527	579	600	638	678	724	743
Average monthly gross wages, EUR (PPP)	787	967	1023	1100	1139	1166	1253	1301
GDP nominal, bn HRK	108.0	123.8	137.6	141.6	152.5	165.6	176.4	189.9
Employment total - reg., th., average	1329.5	1310.9	1384.8	1364.5	1341.0	1348.3	1359.0	1359.8
GDP per employed person, HRK	81219	94447	99364	103759	113739	122850	129821	139644
GDP per empl. person, HRK at 1999 pr.	98160	106322	103163	103759	108647	112817	117751	122750
Unit labour costs, 1989=100	252664.5	263840.3	306241.5	335438.2	342731.6	343080.8	348513.1	350333.1
Unit labour costs, ER adj., 1989=100	119.8	122.3	138.5	142.8	144.8	148.2	151.8	149.5
Unit labour costs, PPP adj., Austria=100	46.98	49.98	57.16	58.13	58.95	59.66	60.50	58.03
Macedonia								
Producer price index, 1989=100	170357.8	177512.8	184616.7	184429.3	204156.7	208245.3	206371.4	205758.1
Consumer price index, 1989=100	295385.2	303065.2	302769.8	300643.1	318070.8	335557.6	341583.4	345689.3
GDP deflator, 1990=100	43692.4	45183.5	45800.5	47072.7	50948.2	52787.9	54581.7	55020.0
Exchange rate (ER), MKD/EUR	50.08	56.20	61.07	60.62	60.73	60.91	60.98	61.26
ER, nominal, 1989=100	155515.9	174525.6	189641.9	188247.5	188584.8	189169.5	189371.4	190258.3
Real ER (CPI-based), 1989=100	68.1	75.8	83.5	84.5	81.5	79.2	79.5	80.5
Real ER (PPI-based), 1989=100	105.3	114.4	118.6	117.3	110.6	110.9	112.0	114.6
PPP, MKD/EUR	23.14	18.02	17.93	18.19	19.42	19.65	19.80	19.51
ERDI (EUR based)	2.16	3.12	3.41	3.33	3.13	3.10	3.08	3.14
Average monthly net wages, MKD	8817	9063	9394	9664	10193	10552	11279	11824
Average monthly net wages, EUR (ER)	176	161	154	159	168	173	185	193
Average monthly net wages, EUR (PPP)	381	503	524	531	525	537	570	606
GDP nominal, bn MKD	176.4	186.0	195.0	209.0	236.4	233.8	244.0	253.5
Employed persons - LFS, th., average	537.6	512.3	539.8	545.2	549.8	599.3	561.3	545.1
GDP per employed person, MKD	328212	363103	361231	383348	429919	390185	434620	465033
GDP per empl. person, MKD at 1999 pr.	353604	378285	371265	383348	397216	347941	374828	397862
Unit labour costs, 1996=100	100.0	96.1	101.5	101.1	102.9	121.6	120.7	119.2
Unit labour costs, ER adj., 1996=100	100.0	85.6	83.2	83.5	84.9	100.0	99.1	97.4
Unit labour costs, PPP adj., Austria=100	21.17	18.89	18.55	18.36	18.65	21.73	21.33	20.43

*) Romania: Methodological break in 2001/2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Russia								
Producer price index, 1989=100	1356086	1559505	1670224	2653986	3890743	4631930	5176181	5983666
Consumer price index, 1989=100	574672	659723	841807	1563235	1888388	2296280	2663684	3025945
GDP deflator, 1989=100	603994	694938	823780	1420084	1955433	2277730	2635381	3011715
Exchange rate (ER), RUB/EUR	6.63	6.54	11.06	26.24	26.03	26.13	29.65	34.55
ER, nominal, 1989=100	954960	941800	1592973	3778114	3747905	3762448	4268826	4974471
Real ER (CPI-based), 1989=100	215.0	187.9	252.3	326.1	272.8	230.2	229.9	240.5
Real ER (PPI-based), 1989=100	81.3	70.2	110.2	163.6	115.3	99.2	100.6	103.1
PPP, RUB/EUR	2.395	3.048	3.546	6.035	8.195	9.322	10.512	11.743
ERDI (EUR based)	2.77	2.15	3.12	4.35	3.18	2.80	2.82	2.94
Average monthly gross wages, RUB	790.2	950.2	1051.5	1522.6	2223.4	3240.4	4360.0	5509.0
Average monthly gross wages, EUR (ER)	119	145	95	58	85	124	147	159
Average monthly gross wages, EUR (PPP)	330	312	297	252	271	348	415	469
GDP nominal, bn RUB	2007.8	2342.5	2629.6	4823.2	7305.6	8943.6	10834.2	13285.2
Employment total - reg., th., average	65950	64693	63812	63963	64327	64710	65650	65700
GDP per employed person, RUB	30445	36210	41209	75406	113570	138210	165030	202210
GDP per empl. person, RUB at 1999 pr.	71580	73993	71038	75406	82478	86169	88927	95346
Unit labour costs, 1989=100	462122	537566	619616	845252	1128465	1574175	2052394	2418672
Unit labour costs, ER adj., 1989=100	48.4	57.1	38.9	22.4	30.1	41.8	48.1	48.6
Unit labour costs, PPP adj., Austria=100	23.48	28.86	19.87	11.27	15.17	20.84	23.71	23.36
Ukraine								
Producer price index, 1989=100	30290361	32622718	36928917	48413810	58532296	63566073	65536621	70648477
Consumer price index, 1989=100	12229109	14172537	15674826	19233012	24656721	27615528	27836452	29283948
GDP deflator, 1989=100	12819488	15140086	16950568	21587839	26575880	29218423	30715221	32843915
Exchange rate (ER), UAH/EUR	2.322	2.113	2.768	4.393	5.029	4.814	5.030	6.024
ER, nominal, 1989=100	33408633	30401439	39821583	63212950	72357554	69260000	72375540	86682014
Real ER (CPI-based), 1989=100	353.5	282.3	338.7	443.4	403.4	352.4	373.0	433.1
Real ER (PPI-based), 1989=100	127.3	108.4	124.5	150.0	148.0	133.1	134.7	152.1
PPP, UAH/EUR	0.5201	0.5560	0.6109	0.7680	0.9324	1.0011	1.0257	1.0721
ERDI (EUR based)	4.46	3.80	4.53	5.72	5.39	4.81	4.90	5.62
Average monthly gross wages, UAH	126.0	143.0	153.0	177.5	230.1	311.1	376.4	462.3
Average monthly gross wages, EUR (ER)	54	68	55	40	46	65	75	77
Average monthly gross wages, EUR (PPP)	242	257	250	231	247	311	367	431
GDP nominal, bn UAH	81.5	93.4	102.6	130.4	170.1	204.2	225.8	264.2
Employment total - reg., th., average	23231.8	22597.6	22348.7	21823.7	21268.5	21015.5	21378.6	21550
GDP per employed person, UAH	3509	4132	4591	5977	7996	9716	10562	12258
GDP per empl. person, UAH at 1999 pr.	5909	5891	5846	5977	6495	7179	7424	8057
Unit labour costs, 1989=100	12811424	14583936	15723252	17844302	21286399	26035521	30461300	34471071
Unit labour costs, ER adj., 1989=100	38.3	48.0	39.5	28.2	29.4	37.6	42.1	39.8
Unit labour costs, PPP adj., Austria=100	16.49	21.49	17.87	12.60	13.13	16.59	18.39	16.93
Austria								
Producer price index, 1989=100	104.8	105.2	104.7	103.7	107.9	109.6	109.2	111.0
Consumer price index, 1989=100	123.3	125.0	126.1	126.8	129.8	133.3	135.7	137.5
GDP deflator, 1989=100	122.0	123.1	123.7	124.5	126.3	128.9	130.7	133.2
Exchange rate (ER), ATS-EUR/EUR	0.9636	1.0017	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.0511	1.0386	1.0407	1.0165	0.9951	1.0120	1.0158	1.0293
ERDI (EUR based)	0.92	0.96	0.97	0.98	1.00	0.99	0.98	0.97
Average monthly gross wages, EUR-ATS	2157	2180	2245	2296	2355	2389	2438	2499
Average monthly gross wages, EUR (ER)	2239	2177	2225	2296	2355	2389	2438	2499
Average monthly gross wages, EUR (PPP)	2052	2099	2157	2259	2367	2360	2400	2427
GDP nominal, bn EUR-ATS	178.0	182.5	190.6	197.1	206.7	212.5	218.3	224.3
Employment total - reg., th., average	3415.4	3424.5	3446.6	3478.8	3506.5	3522.5	3532.9	3565.5
GDP per employed person, EUR-ATS	52131	53289	55309	56647	58939	60330	61800	62900
GDP per empl. person, EUR-ATS at 1999 pr.	53199	53895	55667	56647	58099	58270	58868	58792
Unit labour costs, 1989=100	118.5	118.2	117.9	118.5	118.5	119.8	121.0	124.2
Unit labour costs, ER adj., 1989=100	130.2	124.9	123.7	125.4	125.4	126.8	128.1	131.5
Unit labour costs, PPP adjusted	0.51	0.49	0.49	0.49	0.49	0.50	0.51	0.52

ER = Exchange Rate, PPP = Purchasing Power Parity, ERDI = Exchange Rate Deviation Index (ER / PPP).

ATS-EUR: ATS divided by fixed parity before 1999 (1€ = 13.7603 ATS).

For new EU member states PPPs are taken from Eurostat. For the rest of the countries PPPs have been estimated by wiiw using the OECD benchmark PPPs for 1996 and 1999 and extrapolated with GDP price deflators.

Sources: National statistics; WIFO; Eurostat; Benchmark results of the 1996 Eurostat-OECD comparison by analytical categories, OECD, 1999; Purchasing power parities and real expenditures, 1999 benchmark year, OECD 2002; wiiw estimates.

Table A3

Indicators of macro-competitiveness, 1996-2003

	annual changes in %							
	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
								average
Czech Republic								
GDP deflator	8.8	8.0	10.6	2.9	6.0	5.0	2.8	1.7
Exchange rate (ER), CZK/EUR	-0.9	5.3	1.0	2.0	-3.4	-4.3	-9.6	3.3
Real ER (CPI-based)	-6.7	-1.3	-7.6	1.1	-5.3	-6.6	-9.3	5.3
Real ER (PPI-based)	-4.9	1.2	-4.4	0.5	-4.1	-5.1	-9.2	5.3
Average gross wages, CZK	18.3	9.9	9.2	8.4	6.4	8.7	7.2	6.7
Average gross wages, real (PPI based)	13.0	4.8	4.1	7.4	1.4	5.6	7.7	7.0
Average gross wages, real (CPI based)	8.7	1.3	-1.3	6.2	2.4	3.8	5.3	6.6
Average gross wages, EUR (ER)	19.3	4.4	8.2	6.3	10.2	13.5	18.6	3.2
Employment total	0.2	-0.7	-1.4	-2.1	-0.7	0.4	0.3	-0.7
GDP per empl. person, CZK at 1999 pr.	4.1	0.0	0.4	2.7	7.4	2.2	1.1	3.8
Unit labour costs, CZK at 1999 prices	13.6	10.0	8.8	5.6	-0.9	6.4	6.0	2.8
Unit labour costs, ER (EUR) adjusted	14.6	4.4	7.7	3.6	2.6	11.1	17.2	-0.6
Hungary								
GDP deflator	21.2	18.4	12.6	8.4	9.7	8.6	9.0	7.8
Exchange rate (ER), HUF/EUR	17.5	10.3	14.2	4.9	2.9	-1.3	-5.3	4.3
Real ER (CPI-based)	-2.6	-5.1	1.3	-3.5	-4.5	-7.6	-8.2	1.6
Real ER (PPI-based)	-3.0	-7.6	1.9	-0.7	-4.0	-4.3	-3.7	3.5
Average gross wages, HUF	20.4	22.3	18.3	13.9	13.5	18.2	18.3	12.0
Average gross wages, real (PPI based)	-1.1	1.6	6.3	8.4	1.7	12.3	20.4	9.4
Average gross wages, real (CPI based)	-2.6	3.4	3.5	3.6	3.4	8.2	12.3	7.0
Average gross wages, EUR (ER)	2.5	10.8	3.6	8.6	10.4	19.7	25.0	7.3
Employment total	-0.8	0.0	1.4	3.1	1.0	0.3	0.3	1.3
GDP per empl. person, HUF at 1999 pr.	3.1	4.7	3.4	1.1	4.2	3.7	3.1	1.6
Unit labour costs, HUF at 1999 prices	16.8	16.8	14.4	12.7	9.0	13.9	14.7	10.3
Unit labour costs, ER (EUR) adjusted	-0.6	5.9	0.1	7.4	6.0	15.4	21.1	5.7
Poland								
GDP deflator	18.8	14.0	11.8	6.7	7.1	4.2	1.3	0.5
Exchange rate (ER), PLN/EUR	7.7	9.7	5.9	7.7	-5.1	-8.5	5.1	14.1
Real ER (CPI-based)	-8.0	-2.9	-4.1	1.6	-12.2	-11.4	5.3	15.4
Real ER (PPI-based)	-3.7	-1.4	-2.0	1.4	-8.3	-8.2	4.0	12.9
Average gross wages, PLN *)	26.5	21.9	15.7	10.6	11.6	8.0	2.6	4.9
Average gross wages, real (PPI based)	12.6	8.6	7.8	30.3	3.5	6.3	1.6	2.3
Average gross wages, real (CPI based)	5.5	6.1	3.5	28.3	1.3	2.4	0.7	4.1
Average gross wages, EUR (ER)	17.4	11.1	9.2	27.8	17.6	18.1	-2.4	-8.0
Employment total	1.9	2.8	2.3	-2.7	-2.3	-0.6	-2.2	-0.8
GDP per empl. person, PLN at 1999 pr.	4.0	3.9	2.4	7.0	6.5	5.9	3.7	6.0
Unit labour costs, PLN at 1999 prices	21.7	17.3	12.9	28.7	4.8	2.0	-1.1	-1.0
Unit labour costs, ER (EUR) adjusted	12.9	6.9	6.7	19.4	10.5	11.5	-5.9	-13.2
Slovak Republic								
GDP deflator	4.3	6.7	5.2	6.5	8.5	4.2	4.0	4.7
Exchange rate (ER), SKK/EUR	-0.1	-1.0	4.2	11.4	-3.5	1.7	-1.4	-2.8
Real ER (CPI-based)	-3.3	-5.1	-1.1	2.0	-12.2	-3.0	-2.6	-8.7
Real ER (PPI-based)	-3.6	-4.5	0.1	6.3	-9.2	-2.6	-3.5	-8.8
Average gross wages, SKK	13.3	13.1	8.4	7.2	6.5	8.2	9.3	6.3
Average gross wages, real (PPI based)	8.8	8.3	5.0	2.8	-3.8	1.6	7.0	-1.8
Average gross wages, real (CPI based)	7.1	6.6	1.6	-3.0	-4.9	1.0	5.8	-2.0
Average gross wages, EUR (ER)	13.5	14.3	4.1	-3.7	10.4	6.4	10.8	9.4
Employment total	3.6	-0.9	-0.3	-3.0	-1.4	1.0	0.2	1.8
GDP per empl. person, SKK at 1999 pr.	2.5	5.5	4.6	4.6	3.5	2.7	4.2	2.4
Unit labour costs, SKK at 1999 prices	10.6	7.2	3.7	2.5	3.0	5.4	4.8	3.9
Unit labour costs, ER (EUR) adjusted	10.8	8.3	-0.5	-8.0	6.7	3.6	6.3	6.9
Slovenia								
GDP deflator	11.0	8.8	7.5	5.9	5.6	9.0	7.9	5.3
Exchange rate (ER), SIT/EUR	10.7	6.4	3.3	4.0	5.9	5.9	4.2	3.3
Real ER (CPI-based)	3.2	-0.2	-3.1	-0.8	-0.9	-0.1	-1.1	-0.2
Real ER (PPI-based)	4.2	1.1	-3.3	1.3	2.5	-0.8	-1.0	2.4
Average gross wages, SIT	15.3	11.7	9.6	9.6	10.6	11.9	9.7	7.5
Average gross wages, real (PPI based)	8.0	5.3	3.4	7.3	2.8	2.8	4.4	4.9
Average gross wages, real (CPI based)	4.9	3.1	1.6	3.3	1.6	3.3	2.1	1.8
Average gross wages, EUR (ER)	4.1	5.0	6.1	5.4	4.5	5.7	5.3	4.1
Employment total	-0.5	0.2	0.2	1.8	1.3	1.4	0.6	-0.8
GDP per empl. person, SIT at 1999 pr.	4.1	4.6	3.4	3.7	2.6	1.3	2.8	3.1
Unit labour costs, SIT at 1999 prices	10.8	6.8	6.0	5.6	7.8	10.5	6.7	4.3
Unit labour costs, ER (EUR) adjusted	0.0	0.4	2.7	1.6	1.8	4.4	2.5	0.9

*) Poland: Methodological change in 1999 (broader wage coverage). Growth in 1999 comparable according to new methodology.

(Table A/3 ctd.)

Table A3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.	1996-03 average
Estonia									
GDP deflator	24.3	10.5	9.0	4.3	5.3	5.8	4.4	2.4	5.5
Exchange rate (ER), EEK/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.5
Real ER (CPI-based)	-15.4	-4.9	-5.7	-2.9	-2.0	-3.4	-1.4	0.7	-2.4
Real ER (PPI-based)	-11.0	-3.7	-4.0	-0.2	-0.7	-2.3	-0.5	1.4	-1.2
Average gross wages, EEK	25.7	19.7	15.4	7.6	10.5	12.3	11.5	9.4	11.3
Average gross wages, real (PPI based)	9.5	10.0	10.8	8.9	5.4	7.6	11.1	9.2	7.9
Average gross wages, real (CPI based)	2.1	7.6	6.7	4.2	6.3	6.1	7.6	8.0	5.8
Average gross wages, EUR (ER)	23.6	15.1	14.6	8.6	10.5	12.3	11.5	9.4	10.6
Employment total	-2.2	-0.3	-1.7	-4.5	-1.2	0.9	1.4	1.5	-0.5
GDP per empl. person, EEK at 1999 pr.	6.9	10.9	7.1	4.6	9.1	5.4	5.8	3.6	5.9
Unit labour costs, EEK at 1999 prices	17.6	7.9	7.8	2.9	1.3	6.5	5.4	5.6	4.8
Unit labour costs, ER (EUR) adjusted	15.6	3.8	7.1	3.8	1.3	6.5	5.4	5.6	4.2
Latvia									
GDP deflator	14.9	7.0	4.6	4.8	3.8	2.1	3.4	3.4	3.7
Exchange rate (ER), LVL/EUR	1.2	-4.7	0.6	-5.7	-10.2	0.5	3.5	10.7	-0.8
Real ER (CPI-based)	-11.9	-10.6	-2.7	-6.8	-10.8	0.2	3.7	9.7	-2.2
Real ER (PPI-based)	-10.5	-7.7	-2.0	-2.3	-7.0	0.8	2.4	9.0	-0.9
Average gross wages, LVL	10.3	21.6	11.1	5.8	6.1	6.3	8.8	11.3	9.0
Average gross wages, real (PPI based)	-3.0	16.8	9.0	10.2	5.4	4.6	7.7	7.8	7.5
Average gross wages, real (CPI based)	-6.2	12.2	6.1	3.3	3.4	3.7	6.8	8.1	5.3
Average gross wages, EUR (ER)	9.0	27.6	10.4	12.2	18.1	5.8	5.1	0.5	9.9
Employment total	-2.5	4.3	-0.4	-1.8	-2.8	2.2	2.8	1.8	0.7
GDP per empl. person, LVL at 1999 pr.	17.9	3.8	5.1	5.2	10.0	5.7	3.5	5.5	4.9
Unit labour costs, LVL at 1999 prices	-6.4	17.1	5.6	0.5	-3.5	0.6	5.1	5.4	3.6
Unit labour costs, ER (EUR) adjusted	-7.5	22.9	5.0	6.6	7.4	0.2	1.5	-4.8	4.4
Lithuania									
GDP deflator	20.6	14.0	5.1	-0.6	1.0	-0.1	0.0	-0.9	2.5
Exchange rate (ER), LTL/EUR	-3.1	-9.7	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	-4.5
Real ER (CPI-based)	-20.4	-15.6	-4.4	-4.5	-12.6	-2.2	-1.7	3.0	-4.5
Real ER (PPI-based)	-16.4	-14.1	3.1	-7.0	-22.2	1.9	-0.8	1.9	-4.7
Average gross wages, LTL	28.6	25.9	19.5	6.2	-1.7	1.2	3.2	4.1	7.7
Average gross wages, real (PPI based)	10.3	18.7	25.0	4.4	-15.2	4.3	6.2	4.6	5.6
Average gross wages, real (CPI based)	3.2	15.6	13.7	5.4	-2.7	-0.1	2.9	5.4	4.9
Average gross wages, EUR (ER)	32.7	39.3	20.4	11.7	13.5	4.4	6.9	4.4	13.3
Employment total	-0.7	-3.1	1.7	0.1	-12.6	-3.3	4.0	2.3	-1.5
GDP per empl. person, LTL at 1999 pr.	8.8	10.4	5.5	-1.7	18.8	10.0	2.6	6.5	6.4
Unit labour costs, LTL at 1999 prices	18.2	14.0	13.3	8.1	-17.3	-8.0	0.6	-2.3	0.8
Unit labour costs, ER (EUR) adjusted	21.9	26.2	14.2	13.7	-4.5	-5.1	4.2	-2.0	5.9
Bulgaria									
GDP deflator	120.9	948.6	23.7	3.7	6.7	6.7	3.8	2.0	55.4
Exchange rate (ER), BGN/EUR	153.8	760.2	4.0	-0.8	0.0	0.0	0.0	0.0	46.3
Real ER (CPI-based)	17.3	-24.5	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-7.8
Real ER (PPI-based)	10.9	-19.0	-13.0	-4.0	-11.3	-1.7	-1.3	-3.1	-7.2
Average gross wages, BGN	74.4	865.6	43.3	9.7	11.7	6.9	7.3	10.2	56.4
Average gross wages, real (PPI based)	-24.2	-9.9	20.7	6.7	-5.0	3.0	6.1	5.1	3.3
Average gross wages, real (CPI based)	-21.3	-16.6	20.7	6.9	1.2	-0.4	1.4	7.8	2.7
Average gross wages, EUR (ER)	-31.3	12.3	37.7	10.6	11.7	6.9	7.3	10.2	11.2
Employment total	0.1	-3.9	-0.2	-2.1	-3.5	-0.4	0.4	1.4	-1.0
GDP per empl. person, BGN at 1999 pr.	-9.5	-1.8	4.1	4.5	9.2	4.5	4.5	2.8	3.5
Unit labour costs, BGN at 1999 prices	92.8	882.9	37.6	5.0	2.3	2.3	2.7	7.2	53.0
Unit labour costs, ER (EUR) adjusted	-24.1	14.3	32.2	5.9	2.3	2.3	2.7	7.2	7.5
Romania									
GDP deflator	45.3	147.3	54.2	47.8	44.2	37.4	23.4	19.2	46.2
Exchange rate (ER), ROL/EUR	46.9	109.5	23.5	63.1	22.5	30.4	20.1	20.2	36.6
Real ER (CPI-based)	8.4	-16.4	-21.4	13.2	-14.3	-0.9	0.1	6.3	-5.0
Real ER (PPI-based)	-1.5	-16.5	-7.9	12.3	-16.8	-5.7	-3.8	2.2	-4.9
Average gross wages, ROL	51.7	98.4	60.3	44.3	46.9	48.9	27.3	23.6	45.3
Average gross wages, real (PPI based)	1.2	-21.5	20.4	-0.2	-4.2	5.6	2.1	3.5	0.1
Average gross wages, real (CPI based)	9.3	-22.1	0.8	-1.1	0.9	10.7	3.9	7.2	-0.8
Average gross wages, EUR (ER)	3.2	-5.3	29.9	-11.6	20.0	14.1	6.0	2.9	6.2
Employment total *)	-1.9	1.0	-1.9	-0.6	-0.1	-0.6	.	-0.1	.
GDP per empl. person, ROL at 1999 pr.	6.0	-7.1	-3.0	0.1	2.2	6.4	21.6	5.0	2.8
Unit labour costs, ROL at 1999 prices	43.1	113.5	65.3	44.1	43.7	40.0	4.7	17.7	40.9
Unit labour costs, ER (EUR) adjusted	-2.6	1.9	33.9	-11.7	17.4	7.3	-12.8	-2.0	3.3

*) Romania: In 2002 no comparable growth rate available due to methodological break.

(Table A/3 ctd.)

Table A3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.	1996-03 average
Croatia									
GDP deflator	3.6	7.4	8.4	3.8	4.7	4.0	1.2	3.2	4.1
Exchange rate (ER), HRK/EUR	0.7	2.3	2.5	6.2	0.7	-2.2	-0.8	2.1	1.3
Real ER (CPI-based)	-0.4	0.4	-1.7	3.1	-3.3	-4.7	-0.9	2.6	-0.6
Real ER (PPI-based)	-0.2	0.8	3.1	3.0	-4.3	-3.7	-0.5	1.8	0.0
Average gross wages, HRK	12.3	13.1	12.6	10.2	7.0	3.9	6.0	4.8	7.3
Average gross wages, real (PPI based)	10.8	10.6	14.0	7.4	-2.5	0.3	6.5	2.8	4.9
Average gross wages, real (CPI based)	8.5	9.2	6.5	5.7	0.7	-0.9	3.7	3.2	3.6
Average gross wages, EUR (ER)	11.6	10.6	9.8	3.7	6.2	6.3	6.9	2.6	5.9
Employment total	-6.2	-1.4	5.6	-1.5	-1.7	0.5	0.8	0.1	0.3
GDP per empl. person, HRK at 1999 pr.	12.9	8.3	-3.0	0.6	4.7	3.8	4.4	4.2	3.0
Unit labour costs, HRK at 1999 prices	-0.5	4.4	16.1	9.5	2.2	0.1	1.6	0.5	4.2
Unit labour costs, ER (EUR) adjusted	-1.2	2.1	13.2	3.1	1.4	2.3	2.4	-1.6	2.8
Macedonia									
GDP deflator	2.9	3.4	1.4	2.8	8.2	3.6	3.4	0.8	2.9
Exchange rate (ER), MKD/EUR	1.9	12.2	8.7	-0.7	0.2	0.3	0.1	0.5	2.6
Real ER (CPI-based)	2.0	11.2	10.2	1.2	-3.5	-2.8	0.4	1.3	2.1
Real ER (PPI-based)	2.7	8.6	3.7	-1.1	-5.7	0.3	0.9	2.4	1.1
Average net wages, MKD	2.8	2.8	3.7	2.9	5.5	3.5	6.9	4.8	3.7
Average net wages, real (PPI based)	3.1	-1.4	-0.3	3.0	-4.7	1.5	7.9	5.1	1.3
Average net wages, real (CPI based)	0.5	0.2	3.8	3.6	-0.3	-1.9	5.0	3.6	1.7
Average net wages, EUR (ER)	0.9	-8.4	-4.6	3.6	5.3	3.2	6.8	4.3	1.1
Employment total	.	-4.7	5.4	1.0	0.8	9.0	-6.3	-2.9	0.2
GDP per empl. person, MKD at 1999 pr.	.	7.0	-1.9	3.3	3.6	-12.4	7.7	6.1	1.7
Unit labour costs, MKD at 1999 prices	.	-3.9	5.6	-0.4	1.8	18.2	-0.8	-1.2	2.5
Unit labour costs, ER (EUR) adjusted	.	-14.4	-2.8	0.4	1.6	17.8	-0.9	-1.7	-0.4
Russia									
GDP deflator	45.8	15.1	18.5	72.4	37.7	16.5	15.7	14.3	23.1
Exchange rate (ER), RUB/EUR	12.6	-1.4	69.1	137.2	-0.8	0.4	13.5	16.5	22.9
Real ER (CPI-based)	-22.0	-12.6	34.3	29.3	-16.3	-15.6	-0.1	4.6	1.8
Real ER (PPI-based)	-25.0	-13.6	56.8	48.5	-29.5	-14.0	1.4	2.4	3.5
Average gross wages, RUB	48.4	20.2	10.7	44.8	46.0	45.7	34.6	26.4	28.7
Average gross wages, real (PPI based)	-1.6	4.6	3.3	-8.9	-0.4	22.4	20.4	9.3	5.9
Average gross wages, real (CPI based)	0.4	4.7	-13.3	-22.0	20.9	19.9	16.0	11.2	3.6
Average gross wages, EUR (ER)	31.8	21.9	-34.6	-38.9	47.2	45.2	18.6	8.4	4.4
Employment total	-0.7	-1.9	-1.4	0.2	0.6	0.6	1.5	0.1	0.0
GDP per empl. person, RUB at 1999 pr.	-2.9	3.4	-4.0	6.1	9.4	4.5	3.2	7.2	3.6
Unit labour costs, RUB at 1999 prices	52.8	16.3	15.3	36.4	33.5	39.5	30.4	17.8	24.1
Unit labour costs, ER (EUR) adjusted	35.8	18.0	-31.9	-42.5	34.6	39.0	14.9	1.1	0.7
Ukraine									
GDP deflator	66.2	18.1	12.0	27.4	23.1	9.9	5.1	6.9	13.8
Exchange rate (ER), UAH/EUR	20.4	-9.0	31.0	58.7	14.5	-4.3	4.5	19.8	12.4
Real ER (CPI-based)	-31.6	-20.1	20.0	30.9	-9.0	-12.7	5.8	16.1	3.6
Real ER (PPI-based)	-20.4	-14.8	14.9	20.5	-1.3	-10.1	1.3	12.9	2.7
Average gross wages, UAH	72.6	13.5	7.0	16.0	29.6	35.2	21.0	22.8	18.9
Average gross wages, real (PPI based)	13.5	5.4	-5.5	-11.5	7.2	24.5	17.4	13.9	5.9
Average gross wages, real (CPI based)	-4.2	-2.1	-3.3	-5.4	1.1	20.7	20.0	16.7	5.5
Average gross wages, EUR (ER)	43.3	24.7	-18.3	-26.9	13.3	41.2	15.8	2.5	5.5
Employment total	-2.1	-2.7	-1.1	-2.3	-2.5	-1.2	1.7	0.8	-0.9
GDP per empl. person, UAH at 1999 pr.	-8.1	-0.3	-0.8	2.2	8.7	10.5	3.4	8.5	4.0
Unit labour costs, UAH at 1999 prices	87.8	13.8	7.8	13.5	19.3	22.3	17.0	13.2	14.6
Unit labour costs, ER (EUR) adjusted	55.9	25.1	-17.7	-28.5	4.2	27.8	12.0	-5.5	1.8
Austria									
GDP deflator	1.3	0.9	0.5	0.6	1.4	2.1	1.4	1.9	1.1
Exchange rate (ER), ATS-EUR/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.5
Real ER (CPI-based)	2.2	4.4	1.1	-0.3	-0.4	-0.5	0.3	0.7	0.7
Real ER (PPI-based)	2.2	4.4	0.5	-0.4	0.1	0.4	0.3	0.0	0.7
Average gross wages, ATS-EUR	0.8	1.1	3.0	2.3	2.6	1.4	2.1	2.5	1.9
Average gross wages, real (PPI based)	0.8	0.7	3.4	3.3	-1.4	-0.2	2.4	0.8	1.1
Average gross wages, real (CPI based)	-1.1	-0.2	2.0	1.7	0.2	-1.2	0.2	1.2	0.5
Average gross wages, EUR (ER)	-0.9	-2.8	2.2	3.2	2.6	1.4	2.1	2.5	1.4
Employment total	-0.7	0.3	0.6	0.9	0.8	0.5	0.3	0.9	0.5
GDP per empl. person, ATS-EUR at 1999 pr.	2.7	1.3	3.3	1.8	2.6	0.3	1.0	-0.1	1.3
Unit labour costs, ATS-EUR at 1999 prices	-1.9	-0.2	-0.3	0.5	0.0	1.1	1.0	2.6	0.6
Unit labour costs, ER (EUR) adjusted	-3.6	-4.0	-1.0	1.4	0.0	1.1	1.0	2.6	0.1

ER = Exchange Rate, PPI = Producer price index, CPI = Consumer price index.

Sources: National statistics and wiw estimates.

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