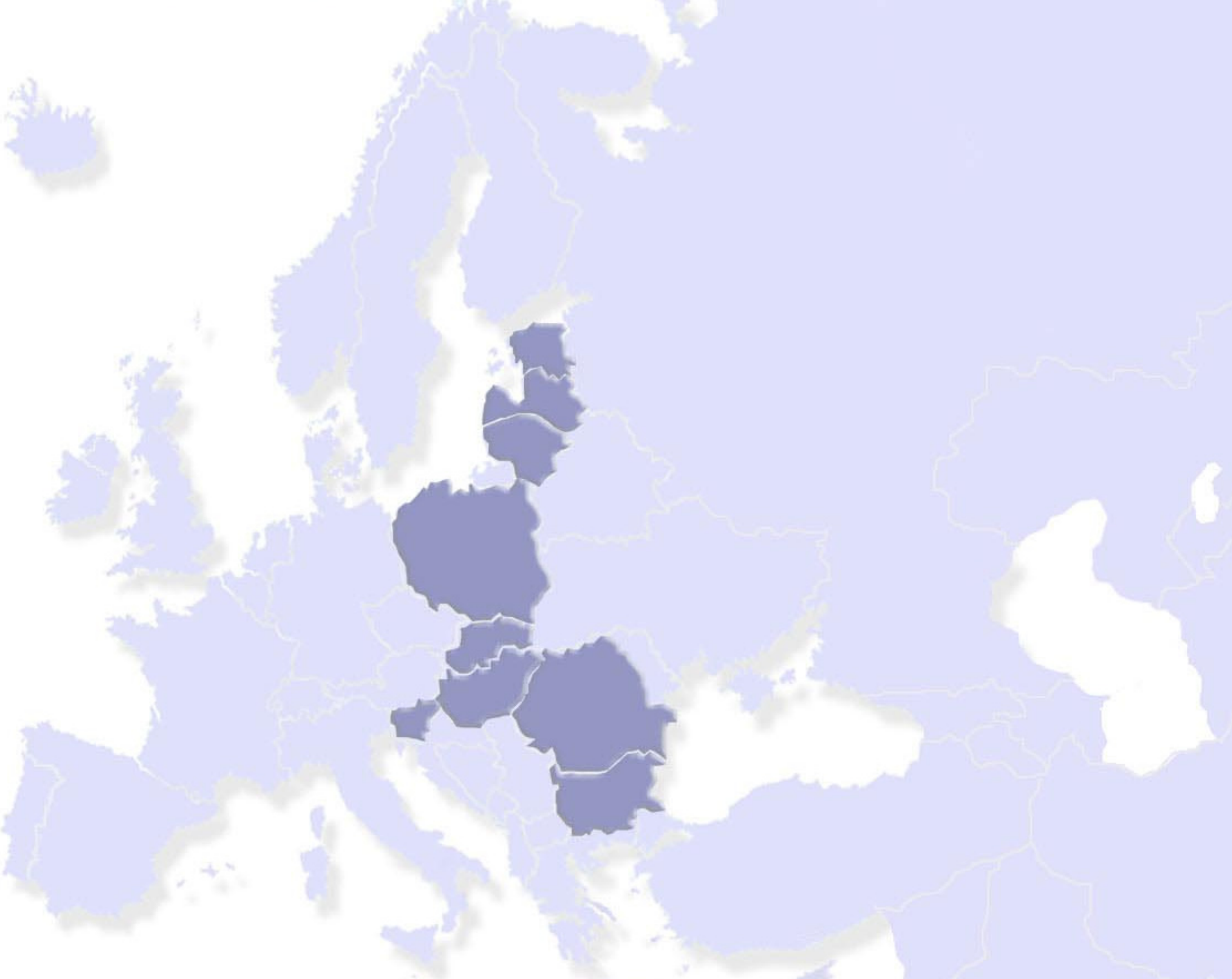
ICEG EUROPEAN CENTER

Quarterly Forecast on the Eastern EU Member States

Summer 2007



Quarterly Forecast on the Eastern EU Member States

Summer 2007

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Company information

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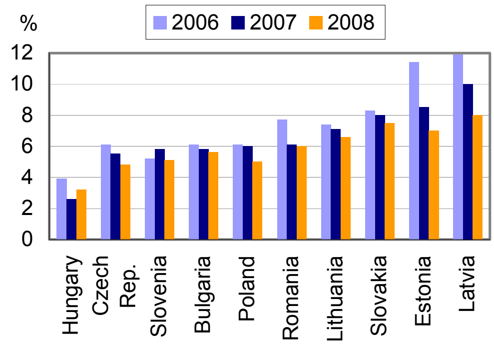
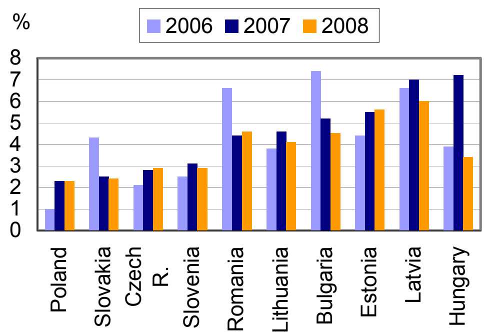


Growth

Economic growth carries on briskly in the region; a number of countries posted higher than expected growth rates in the first quarter. Domestic demand is an important factor in most countries: private consumption is boosted by strong income growth while investments are driven by the favourable business environment, inflowing EU funds, developing real estate sectors and public works. Only Hungary is experiencing sluggish domestic demand in 2007 due to its fiscal stabilisation. The overheated Baltic economies also show signs of cooling, but considerable risks of a hard landing remain in their case.

Export performance is favourable in most countries as demand in main export markets remains strong. Economic growth is expected to reach an average 6.5% in the region this year, while it will decelerate to 5.9% next year. The Baltic states will grow the fastest, at 8-10%; Slovakia is catching up with them. At the bottom end, Hungary will trail the region in 2007-08.

Inflation in the region



Note: harmonised (HICP) rates

Prices and monetary conditions

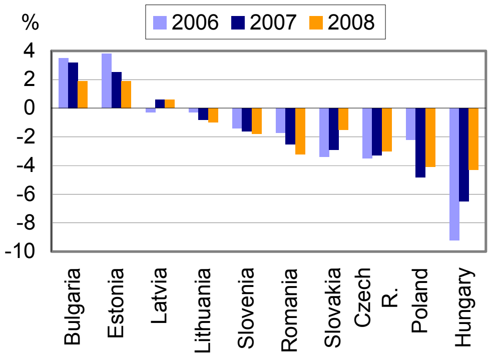
Inflation is a growing concern throughout the region; it is either climbing (Baltic states) or fails to decline (Bulgaria) or is simply above expectations (Czech Republic, Poland). The rise of food prices is a common factor; otherwise, cost pressures stemming from high wage growth and some indirect tax and regulated price increases are typical explanations. As a result, a good deal of this inflation is transitory; however, strong wage growth will keep central bankers of the region on their toes.

As one-off effects fade and monetary conditions get slightly stricter, the average inflation rate of the region will peak at 4.5% this year and it is expected to subside to 3.9% in 2008. Latvia will have the highest inflation rates in 2007-08; Hungarian inflation is expected to fall sharply next year.

Slovakia is poised to become the next entrant to the euro area in 2009. Others postponed their entry (Bulgaria and Czech Republic) or declined to commit to a strict deadline. It may be a dangerous strategy: if economic conditions worsen, these countries will be more exposed to financial market turbulences while the fulfilment of the Maastricht criteria will also become harder for them.

Fiscal policy

Budget balances in the region (% of GDP)



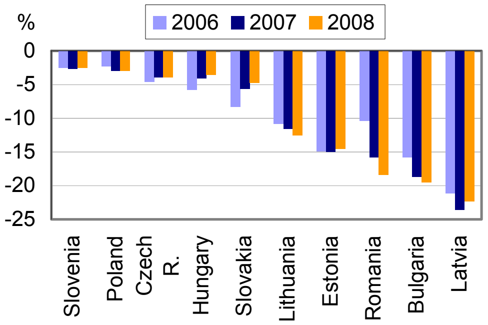
Note: according to ESA methodology

Fiscal policies of Eastern EU Members show a diverse picture. Countries with fixed exchange rates (Bulgaria and the Baltic states) maintain the discipline forced onto them by their currency regime. Hungary is consolidating its massive deficit while the Czech Republic and Slovakia also opted for restrictions to fulfil the 3% deficit criterion needed for the euro. On the other hand, a paralysed Polish government will not summon enough strength for reforms, while Romania may embark on a spending spree before elections in 2008. Hungary may have sent the wrong message to its neighbour by managing to get away with reckless pre-election spending.

The average fiscal position of the region is stable at -1.5% of GDP as country-specific changes cancel out each other.

External balance

Current account balances in the region (% of GDP)



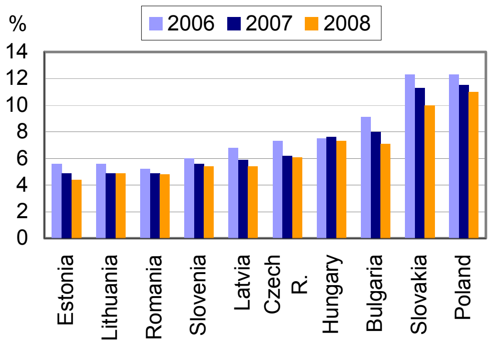
External imbalances remain a concern for a number of countries. The current account deficit is deteriorating in the Baltic states (where the largest deficits are expected for 2007-08), Bulgaria and Romania. Despite a generally good export performance, imports are soaring in fast-growing economies. Rapid income convergence and investments keep import demand strong.

The average current account deficit of the region will exceed 10% in 2007-08; in Latvia, Bulgaria and Romania it will get closer to even 20%. On the other hand, Central Eastern European countries show much smaller external disequilibria.

Foreign direct investments remain strong as investors flock to the region in search of markets and cheap labour. Bulgaria and Romania have become more attractive with EU accession while Slovenia reaps the benefits of entry into the euro area. Regional firms are also flexing their muscles abroad (see the special topic of this report).

Labour market

Unemployment rates in the region



Note: harmonised LFS rates

Robust growth results in rapid job creation in most of the region; unemployment is falling to historic lows. It will fall below 7% on average over 2007-08. On the other hand, tight labour markets are a problem in a growing number of countries, resulting in very fast wage growth. This could eventually feed back into inflation and external imbalances as the experience of the Baltic states shows.

Bulgaria

Economic growth remained above 6% in the first quarter of 2007. Inflation fell to a record low, but disinflation will stop in the second part of the year. Following an enormous budget surplus in the first five months public spending is expected to rise in the second half of the year. Labour market indicators improved as well; only the growing external imbalance is a source of macroeconomic risks. The entry into the ERM-II regime is expected to be postponed to around 2012-13.

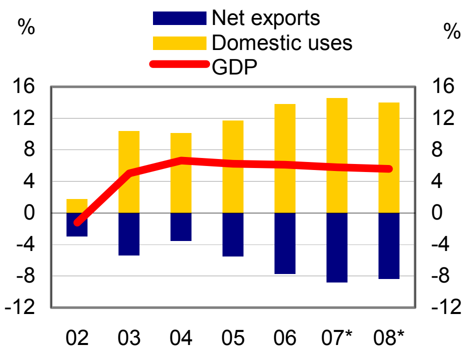
Political developments

Bulgaria held European Parliament elections on 20 May 2007 The turnover was quite low: less than 30%. This figure was even lower than expected; however, it is similar to the turnovers in those countries that joined the EU in 2004. The two largest parties, Citizens for European Development in Bulgaria and the Bulgarian Socialist Party gained 5 seats each out of the 18, while Movements for Rights and Freedoms won 4 seats. The National Movement for Stability and Progress won only one mandate.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: NSI*

In the first quarter of 2007 gross domestic product increased by 6.2%. This rate was higher than in the fourth quarter of 2006; it was also higher than most analysts had expected.

On the demand side, private consumption and investments remained the main engines of the economy. Private consumption growth accelerated to 8.1% due to increasing loans to households and wage rises. Gross fixed capital formation grew by an enormous 35.9% in comparison with the corresponding period of the previous year; therefore investments reached 36.5% of GDP in the first quarter. On the other hand, net exports had a negative contribution to GDP growth since imports of goods and services increased by 13.2%, while exports grew by only 2.2%.

On the production side, industry and services performed well in the first quarter. Gross value added in industry increased by 7.6%, while in services it grew by 8.1%.

In 2007 we expect that GDP growth will remain stable and will reach 5.8%. It will be fuelled by private consumption and investments. Thanks to EU accession which has given an impetus to both consumption (cheap imports) and investments (better business climate) these current tendencies are expected to continue in 2007-08. Next year growth will decelerate slightly to 5.6%.

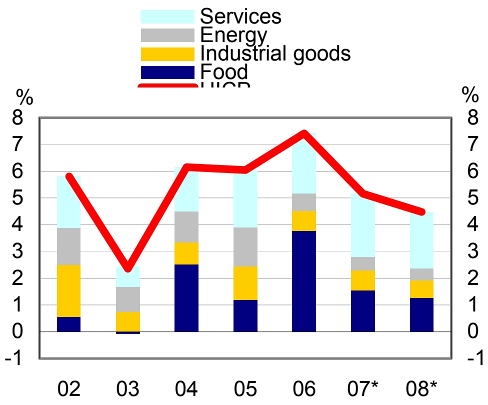
Prices and monetary conditions

In the second quarter of 2007 disinflation stopped; the 12-month harmonised index of consumer prices (HICP) rose to 5.3% by June. During the first half of the year price increases in transport and in restaurants and hotels had a negative impact on disinflation. Besides, growth rates of food and non-alcoholic beverages prices were also higher in June 2007 due to base effects.

Annual average HICP is expected at 5.2% in 2007 due to rising in fuel prices and administered price changes, while it will decline

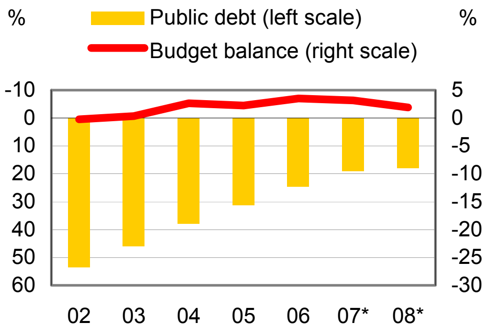
Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: NSI*

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

Source: Eurostat, Ministry of Finance

somewhat in 2008 to 4.5%.

Despite the easing of lending to households last year, the growth rate of loans to households started to accelerate in the first half of 2007. In May claims on households were more than 40% higher than in May 2006, while last year the annual growth rate remained at 30%. Accordingly, the indebtedness of households reached 20% of GDP in May, rising by 2 percentage points in the first five months of the year.

As it was mentioned in our previous report, Bulgaria had an ambitious plan to join the euro area. After EU accession Bulgaria aimed to join ERM-II regime as soon as possible (during the first half of 2007). Now it seems that Bulgaria will not enter the 'ante-chamber of the euro' this year. The EU warned Bulgaria the implications of the necessary policies and that the realisation of convergence would be significantly harder in the ERM-II regime (and later in the euro area as well). Similarly to Romania, the other newly acceded country, Bulgaria is poor but it converges fast to the EU average. Accordingly, the price level will converge as well and inflation is expected to be higher than euro area average.

Bulgaria fulfils most of the Maastricht criteria; only inflation is higher than the reference value. We expect that Bulgaria will join the ERM-II regime in the next year and the euro will be introduced in 2012-13.

Fiscal policy

At the end of May 2007 the budget had a huge surplus, 3.5% of the estimated GDP[1]. This amount is significantly higher than in the corresponding period of the previous year (2.6%). Further improvement of the fiscal balance was mainly due to the dynamic increase of tax revenues. The surplus is even more remarkable considering that Bulgaria paid BGN 252 mn (EUR 129 mn) to the EU budget and slashed the corporate tax rate to 10%. The planned surplus for 2007 was 2.3%; accordingly, the balance exceeded the annual target by May. However, public spending is expected to increase in the second half of the year. For example, pension expenditures will rise from 1 July 2007.

We expect that the budget will reach a surplus of 3.2% in 2007. Further increase of social expenditures will lower the surplus slightly in 2008, to an expected 1.9%.

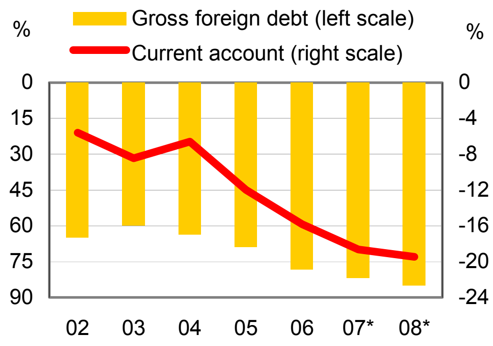
Thanks to the massive budget surplus public debt continued to diminish, and fell to 21% of estimated GDP in May 2007. Back in 2002 public debt exceeded 50%; this drop in the debt-to-GDP ratio reflects the prudence and discipline of fiscal policy. The currency board arrangement in place is a strong disciplining factor on public finances.

External balance

In the first five months of 2007 the current account balance continued to deteriorate. In May its deficit reached EUR 2.6 bn or 9.7% of GDP. The worsening of the balance was basically the consequence of the significant deterioration of the trade balance. During the first five months foreign trade deficit increased to EUR

[1] Government's estimation

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

Sources: BNB, Eurostat

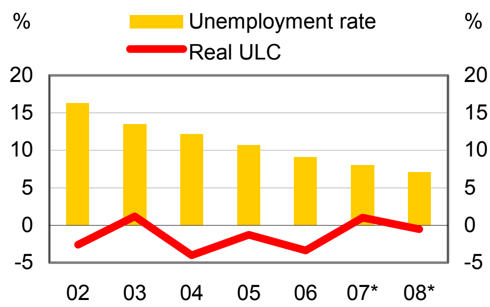
2.7 bn from EUR 1.8 bn in the same period of 2006. The growth rate of imports was significantly higher than that of exports; the development of imports was influenced by soaring investments and private consumption.

The income and current transfers' balances deteriorated as well. The growing current account deficit is one of the main macroeconomic challenges in Bulgaria. However, foreign direct investments can finance a large part of the current account deficit. Last year FDI inflows exceeded 16% of GDP and can reach a similar magnitude in 2007 as well. Between January and May foreign direct investments reached EUR 1.5 bn or 5.7% of GDP, financing almost 60% of the current account deficit. The cut of corporate tax rate, the accession to EU, the lowest wage level in the EU, and an improving overall business climate make Bulgaria an attractive destination for foreign investors.

The deterioration of the current account balance will continue in 2007; its deficit will reach 18.3% of GDP, while the trade deficit can be close to 20%. No significant change is expected for 2008, when the current account deficit can rise to 19.5%. This is why it would be advantageous for Bulgaria to join euro area as soon as possible: the adoption of the single European currency would diminish the risk of a current account crisis.

Labour market

Labour market indicators



*Note: * forecast. Sources: Eurostat, NSI, WIIW*

During the first months of 2007 positive trends have continued in Bulgaria and every labour market indicator showed improvements. The unemployment rate decreased to 7.8% in May 2007 after falling 1.8 percentage points within 12 months; the number of unemployed persons decreased by 65 thousand. In line with the decrease of unemployment, the employment rate rose to 47.2%; up 3 percentage points in May in comparison with the same month of 2006.

Gross average monthly wages increased by an annual 14.5% to reach BGN 396 (EUR 202) in May 2007. This is still the lowest wage level in the entire European Union.

For 2007 we expect that positive tendencies will continue: unemployment will decrease further while the employment rate will climb further thanks to sustained economic growth. This year, unemployment rate is expected to decline to 8.0%; in 2008 it can fall to 7.1%. Strong wage growth this year will raise real unit labour costs by about 1%; in 2008 a slight, 0.5% fall is expected as productivity growth will once again overtake wage growth.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (BGN mn)	42,797	49,091	56,100	63,100
Real GDP growth (%)	6.2	6.1	5.8	5.6
Private consumption (%)	5.5	7.1	8.0	6.5
Public consumption (%)	4.1	1.7	1.0	2.5
Investments (GFCF, %)	23.3	17.6	25.0	20.0
Exports (%)	8.5	9.0	5.0	8.0
Imports (%)	13.1	15.2	14.0	15.0
Annual average inflation (%)	6.0	7.4	5.2	4.5
Policy rate (%)	NA	NA	NA	NA
Money market rate (3-month, %)	3.62	3.69	4.00	3.70
Long-term interest rate (10-year gov't bond, %)	3.87	4.18	3.91	3.70
Exchange rate / EUR (average)	1.96	1.96	1.96	1.96
Exchange rate / EUR (end of period)	1.96	1.96	1.96	1.96
Budget balance / GDP (%)	2.3	3.5	3.2	1.9
Public debt / GDP (%)	31.3	24.7	19.0	18.0
Trade balance / GDP (goods and services, %)	-16.4	-18.6	-19.9	-21.4
Current account balance / GDP (%)	-12.0	-15.8	-18.7	-19.5
Gross foreign debt / GDP (%)	69.0	78.4	82.0	85.0
Unemployment (%)	10.7	9.1	8.0	7.1
Real ULC growth (%)	-1.3	-3.4	1.0	-0.5

Note: f = forecast. See methodological notes for definitions and details.

Sources: Bulgarian National Bank, Eurostat, National Statistical Institute

Czech Republic

High GDP growth is maintained this year helped by domestic consumption, besides net exports. Inflation slightly exceeded expectations; the external balance is favourable. A budgetary reform package has been announced to reduce the deficit below the 3% level required for the adoption of the euro. Adoption of the common currency is planned for 2012.

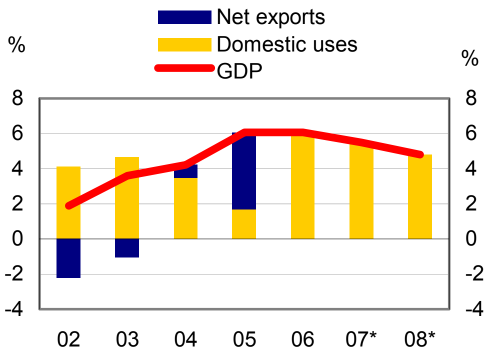
Political developments

Mirek Topolanek's new government agreed on a program, the final aim of which is the introduction of the euro in 2012, and thus fulfilling the Maastricht criteria by 2009. The key challenge is the reduction of the budget deficit below 3%. To achieve this, a budget reform package is being introduced (see box).

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

In the first quarter of 2007, the Czech Republic could maintain its growth performance at the level of the previous year, resulting in a 6.1% growth rate. This is slightly higher than expected given the decreasing tendency of quarterly rates in 2006.

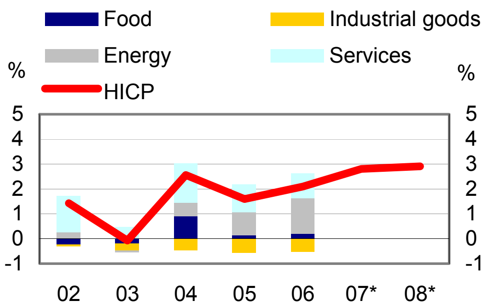
Similarly to 2006, private consumption and gross fixed capital formation (especially spending on equipment) will be the main engines of growth. Until May average gross wages and salaries grew by an annual 6.2% in real terms, and receipts from sales of retail trade grew by 8.1% in April. Both indicators underline the persistent importance of private consumption for GDP growth. Net exports may recover thanks to strong foreign demand. It can even overtake private consumption as the key driver of growth. On the production side industrial output and construction are both decelerating; in May they registered annual growth rates of 7.5% and 1.4% respectively.

In 2007 as a whole, a growth rate of 5.5% is forecasted; restrictive measures of the government will result in a lower public consumption and will squeeze private sector demand as well. Restrictions will also affect the 2008 growth rate which is expected to be 4.8%.

Prices and monetary conditions

Components of inflation

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

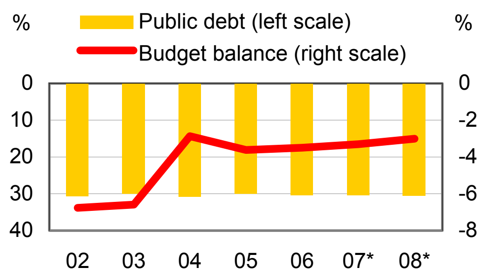
Inflation in June was slightly above the CNB forecast, at 2.5% on an annual basis. Faster fuel and tobacco price increases were mainly responsible for this; the latter is partly connected to a rise in indirect taxes. Some regulated prices increased as well. The inflation rate is expected to stay close to 3% for the year as a whole due to fast wage rises, high economic growth and the weaker than forecasted exchange rate of the koruna. This is a new inflationary factor: in previous years the currency tended to appreciate. Rising inflation of agricultural producer prices is another new phenomenon, though it has a much smaller impact on the overall price level. The 12-month agricultural price index was 12.1% in May.

Inflation and to a lesser extent fiscal problems induced the revision of the Czech Republic's plan to join ERM-II in 2007 and to adopt the euro in 2010. At present, the government plans to join the euro area in 2012.

At the end of June, the two-week repo rate of the Czech National Bank stood at 2.75%. The repo rate was increased in April for the first time since September 2006 by 25 basis points due to upside risks of inflation. Monetary tightening is expected to continue this year with another 25 basis points rise in autumn.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

The Czech Republic plans to fulfil the Maastricht criteria in three years. That requires a minimum 0.5 percentage point reduction of the budget deficit, which reached a 3.5% level in 2006. The government hopes to reach this objective by the introduction of various measures (see box). In some experts' opinion the proposed measures may not reach the critical threshold for reducing the deficit substantially.

As a result of the budget reform package the budget deficit is expected to decrease to 3.3% in 2007. By 2008 the Czech Republic can fulfil the 3% deficit criterion.

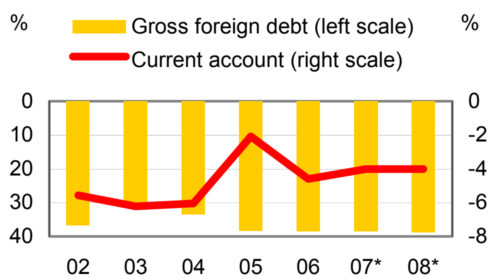
Proceedings from privatisation will contribute to the reduction of general government debt, which stood at 30.4% at the end of 2006, comfortably below the Maastricht reference rate.

Key elements of the budget reform package

- **Reduction of expenditures:** abolishing allowances to families above a certain income level, gradual increase of retirement age, lay-off of 13 thousand public employees.
- **Additional revenues:** introduction of fees for certain health care services, increasing the lower rate of VAT from 5 to 9%, privatisation (sale of minority share in the power company).
- **Tax reform:** simplification of the tax system and reduction certain taxes (e.g. profit tax from 24% to 19% by 2010), unified personal income tax rate of 15% (on cumulated gross wages which include social contributions).

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

Continuing the trend of last year, the income balance pushed the current account in the red in the first five months of 2007. At the same time, both the goods and services trade balances showed surpluses. The Czech Republic was the only Eastern EU Member in 2006 having a trade surplus; the situation will not change in 2007. However, there is a deceleration in the growth rate of exports and imports according to the data of the first five months of 2007. The value of goods exports increased by an annual 12.8% in May; for imports the figure was 10.3%. Return to faster growth in trade value is expected in the second half of 2007 due to strong foreign demand on main export markets.

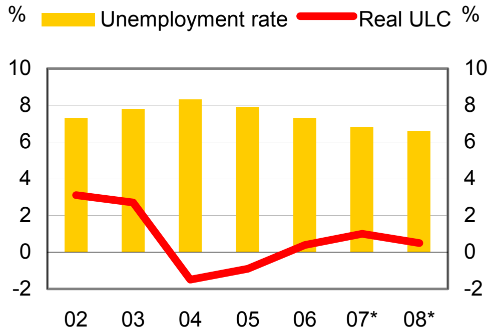
The inflow of FDI now takes the main form of reinvested earnings and may reach similar levels as last year. However, planned privatisation deals may result in a higher FDI inflow by the end of

2007. The impact of inflows connected to EU-funds has remained limited up till now.

The current account deficit is expected to remain stable at 4% of GDP in 2007-08.

Labour market

Labour market indicators



*Note: * forecast. Source: Eurostat*

The harmonised unemployment rate fell further to 6.3% by the end of June 2007 after a 0.2 percentage point reduction since the beginning of the year. The labour market is characterised by growing employment and decreasing unemployment, resulting from robust economic growth. In 2007 as a whole, similar tendencies are expected to continue, though planned lay-offs in the public sector can result in slightly higher unemployment in the short term. Unemployment will remain stable at around 6.1% in 2007-08.

Growth of average wages accelerated further. Real wage growth reached an annual 6.2% in the first half of 2007 after a 3.9% growth in the whole of 2006. Fiscal tightening is expected to slow wage growth later this year and in 2008 as well.

Labour productivity (sales per employee) rose by 5.8% in May on an annual basis, laying the foundations for continuously good export performance. Real unit labour costs will rise only slightly, by 1% in 2007 and 0.5% in 2008.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (CZK bn)	2970.3	3204.1	3380.3	3542.6
Real GDP growth (%)	6.1	6.1	5.5	4.8
Private consumption (%)	2.8	4.6	4.5	3.0
Public consumption (%)	1.0	0.3	0.3	0.2
Investments (GFCF, %)	1.3	7.3	7.0	6.8
Exports (%)	10.4	14.6	15.2	14.3
Imports (%)	4.8	14.2	15.0	14.2
Annual average inflation (%)	1.6	2.1	2.8	2.9
Policy rate (%)	2.0	2.5	3	2.75
Money market rate (3-month, %)	2.17	2.56	2.6	2.8
Long-term interest rate (10-year gov't bond, %)	3.61	3.68	3.8	3.9
Exchange rate / EUR (average)	29.784	28.343	28.040	27.90
Exchange rate / EUR (end of period)	29.005	27.495	28.004	27.80
Budget balance / GDP (%)	-3.6	-3.5	-3.3	-3.0
Public debt / GDP (%)	30.4	30.4	30.4	30.5
Trade balance / GDP (goods and services, %)	2	1.8	2.0	1.8
Current account balance / GDP (%)	-2.1	-4.6	-4.0	-4.0
Gross foreign debt / GDP (%)	38.4	38.5	38.6	38.8
Unemployment (%)	7.9	7.3	6.2	6.1
Real ULC growth (%)	-1.5	0.4	1.0	0.5

Note: f = forecast, e= estimation. See methodological notes for definitions and details.
Sources: Eurostat, CNB (central bank), CSU (statistical office)

Estonia

The economy is on the path of a gradual slowdown but risks persist. Inflation and external imbalances may peak this year while more prudence of banks and borrowers slows credit growth. Tight labour markets remain a concern over the coming years.

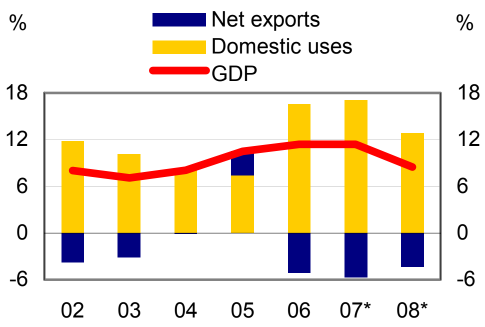
Political developments

Following the removal of the 'Bronze Soldier', a Red Army memorial in Tallinn, riots erupted among native Russians and 'cyber attacks' were launched against Estonian websites. Since then, Estonian-Russian relations have been icy. The economic impact of the events appears to be limited though.

Growth

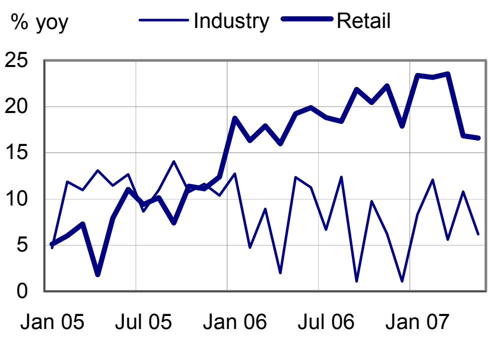
Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Sources: Eurostat, Statistics Estonia*

Industrial production and retail sales volume growth



Source: Statistics Estonia

The slowdown that has been anticipated for a while has finally started. Private consumption was still very strong in the first quarter with a growth rate of 18.1%. However, retail sales lost momentum in the last months, slowing to 16.6% in May. Sales of motor vehicles are also losing momentum, indicating decelerating consumption. Despite strong income growth consumer confidence has dipped and credit growth is easing.

Public consumption is gaining momentum; it rose by an annual 4.1% in the first quarter. On the other hand, investments show the first signs of deceleration. Their growth rate was 18.3% in the first quarter after a stellar 19.7% figure for 2006. New orders in construction are dropping sharply according to business surveys although the number of building permits issued was still rising in the first quarter.

Export growth recovered after its slump at the end of 2006. Its annual growth was only 5.3% in the first quarter due to a strong base, but the annualised quarterly rate was 15.6%. On the other hand, imports continue to roam at 11.2% thanks to improving export and strong domestic demand.

On the production side, industrial production grew by 8.2% in the January-May period. Business confidence indicators are falling; new orders have fallen since December 2006. Labour shortages are a growing concern in industry, although they appear to be easing in construction.

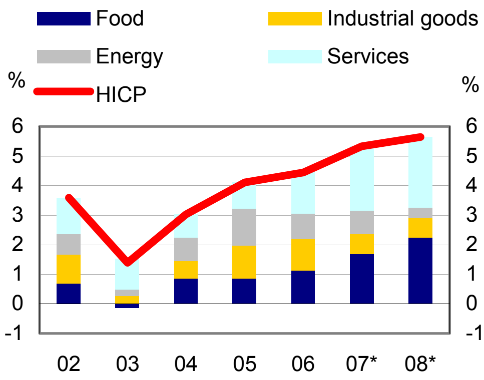
As recent developments support our growth forecast, our estimated growth figures for 2007 and 2008 remain unchanged at 8.5% and 7% respectively. There remain uncertainties in economic developments, however: Eesti Pank (the central bank) warns about the increasing risk of a hard landing scenario, although their baseline forecast is based on a gradual deceleration as well.

Prices and monetary conditions

Inflation did not ease in the first half of the year; the 12-month rate rose against expectations to 5.9% by May and stood at 5.8% in June. Food and services prices are rising particularly fast, while a VAT rise on district heating will add further impetus to price

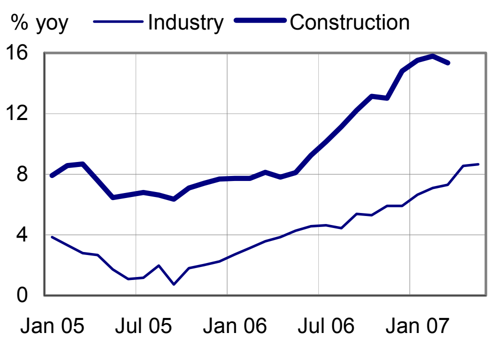
Components of inflation

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Producer price indices for industry and construction



Source: Statistics Estonia

increases in the second half of the year. Strong domestic demand continues to add to inflationary pressures.

Producer prices are also climbing steadily. The construction cost index seemed to have reached its peak at 15.8% in February but the industrial price index is continuing its rise: in May it reached 8.6%.

According to business surveys inflation may have reached its peak. On the other hand, inflationary expectations of households for the next twelve months reached a new height in June. There is some risk that higher inflationary expectations might channel into higher wage claims, deteriorating competitiveness and pushing producer (and consumer) prices even higher. In light of these developments we revise our 2007 inflation forecast to an annual average of 5.5%; some upside risk remains in our expectations.

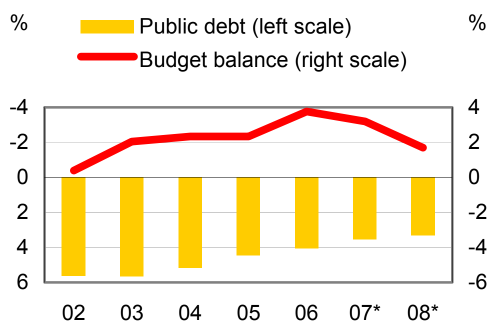
Estonia currently has no target date for euro-area entry. Officials believe that 2011 will be feasible but an explicit schedule was not adopted to prevent exuberance among economic agents. On the other hand, an official target could help soothing economic turbulences.

Bank lending has slowed down: the credit cycle is widely thought to have passed its peak. Foreign investors have become more cautious about the Baltic states; this is also apparent in more stringent lending by mostly foreign-owned banking sector. On the demand side, firms and households seem to have become more wary of the economy: as a result their credit demand eased. The growth rate of the total loan stock was 41% in May (48% for enterprises, 56% for households). With further ECB rate rises in the pipeline and with slowing growth, credit growth is expected to moderate further in the course of the year.

Macroeconomic risks and uncertainties are driving up yields for all maturities. The spread over the 3-month EURIBOR rate widened to 60 basis points by May-June as the TALIBOR interbank rate climbed reached 4.74%. The spread at 10-year maturity exceeded 110 basis points in March, the highest since 2003. Responding to recent developments in Estonia as well as in the Baltic region, Standard & Poor's changed the outlook of Estonia's credit rating from stable to negative early July.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

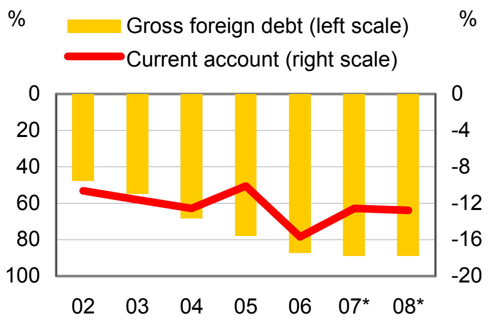
General government revenues grew by an annual 25.5% in the first quarter while expenditures increased by 22.4%. As a result, the budget surplus of the first quarter reached almost EEK 2 bn compared with EEK 1.2 bn a year before.

The government adopted a budget strategy for 2008-11 on 31 May. It targets an aggregate surplus of EEK 4.8 bn over that period while increasing expenditures to foster development and cohesion. The flat rate of income tax will be reduced to 18% by 2011 while the income threshold for exemptions will rise. The budget volume is set to rise by 19% in 2008. The strategy received criticism from Eesti Pank: although surpluses will be maintained, fiscal policy will be looser when taking into account business cycle developments. In June the Riigoku (the parliament) also approved 'vice tax' hikes, raising excise tax rates on tobacco, alcohol and fuels.

Given the track record of Estonian fiscal policy and strong revenue collection we expect the budget to end 2007 with a surplus of 2.5%. By 2008 this surplus could slide back to 1.9%. Public debt was slightly below 4% of GDP in the first quarter of 2007; it is expected to remain in this region over 2007-08.

External balance

External balance indicators (% of GDP)



*Note: * forecast, reverse scale on left axis. Source: Eurostat*

The value of exports rose by just 7.8% in the first quarter of 2007 while imports soared by 30.3%; as a result, the trade balance deteriorated from EUR 330 mn to EUR 457 mn since the first quarter of 2006. This led to a widening current account deficit, which reached EUR 621 mn, the highest quarterly figure ever.

Strong wage growth appears to have left competitiveness unscathed; not counting subcontracting and transit trade, export performance was healthy. As domestic demand decelerates, the trade deficit will stabilise in 2007-08 and the current account balance is expected to improve slightly, to -15% in 2007 and to -14.6% next year.

On the financing side, net FDI inflows reached EUR 148 mn in the first quarter even though outward FDI remained strong.[2] Debt financing through borrowing by foreign-owned banks is still dominant. As a result, gross foreign debt is still on the rise and will exceed 90% by 2008.

Labour market

Labour market indicators

*Note: * forecast. Source: Eurostat*

Employment increased by an annual 1.9% in the first quarter of 2007; the harmonised unemployment rate fell to 5.3% (4.9% adjusted for seasonal effects). Job creation is decelerating as labour supply is approaching its limits and economic growth cools down. We expect unemployment to remain at 4.9% in 2007 and decline to 4.4% next year.

Gross wages and salaries rose by 20.1% in the first quarter while real wages increased by an estimated 13.3%. Labour market pressures are still present: they are easing in construction but are appearing in other sectors. Employers try to act against labour poaching by legally restricting employers' ability to change jobs; the government doubled the quota for the immigration of skilled workers. Still, under such circumstances wage growth will remain strong despite a cooling economy: real unit labour costs are expected to rise by 1.4% this year and by 0.5% in 2008.

[2] The special issue of this paper analyses outward FDI trends from Eastern EU Member States.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (EEK mn)	173,062	204,600	238,600	271,900
Real GDP growth (%)	10.5	11.4	8.5	7.0
Private consumption (%)	8.2	15.7	15.0	10.0
Public consumption (%)	1.1	2.8	2.5	2.5
Investments (GFCF, %)	12.7	19.7	15.0	7.0
Exports (%)	21.5	10.0	9.0	8.0
Imports (%)	15.9	14.7	12.0	8.5
Annual average inflation (%)	4.1	4.4	5.5	5.6
Policy rate (%)	-	-	-	-
Money market rate (3-month, %)	2.59	3.75	5.00	5.00
Long-term interest rate (10-year gov't bond, %)	3.94	4.70	5.20	5.00
Exchange rate / EUR (average)	15.65	15.65	15.65	15.65
Exchange rate / EUR (end of period)	15.65	15.65	15.65	15.65
Budget balance / GDP (%)	2.3	3.8	2.5	1.9
Public debt / GDP (%)	4.4	3.9	3.6	3.5
Trade balance / GDP (goods and services, %)	-6.2	-10.3	-12.1	-12.1
Current account balance / GDP (%)	-10.5	-14.9	-15.0	-14.6
Gross foreign debt / GDP (%)	78.0	85.2	89.4	92.3
Unemployment (%)	7.9	5.6	4.9	4.4
Real ULC growth (%)	-3.6	-1.3	1.4	0.5

Note: f = forecast. See methodological notes for definitions and details.

Sources: Eesti Pank, Eurostat, Statistics Estonia

Hungary

In line with expectations, headline annual GDP-growth decreased to below 3% in the first quarter. Net exports are still on the rise on the back of buoyant foreign demand, but the growth rates of domestic demand components are all in negative territory. With disinflation slowly unfolding cautious interest rate cuts are expected in the rest of the year. The fiscal and external balances are both improving and these developments may well continue into the next year.

Political developments

The second quarter of the year was relatively calm in the political and social scene. Polls refer to increasing popularity of Fidesz, the main opposition party, who of course tried to capitalise on this, by slamming Mr Gyurcsány's cabinet on the occasion of their first full year in power since the previous elections.

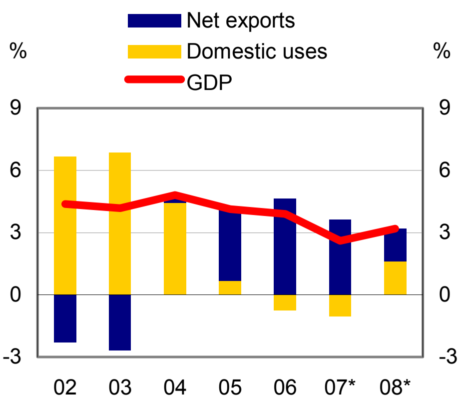
There were minor changes in the government. Minister of internal affairs, József Petrétei was removed from his office, as the police became target of heavy criticism because of their inability to deal with riots back in October 2006 and later in March 2007 adequately. It also became known, that economic minister, János Kóka will resign from his post at the end of the year and will concentrate on rebuilding SZDSZ, the smaller coalition party, the president of which he became at the beginning of 2007. His successor is yet to be announced.

Deepening social segregation was clearly exhibited in disputes over the initiative of Fidesz concerning a popular vote focusing on some of the elements of the convergence program of the Gyurcsány cabinet as well as in the refusal by László Sólyom, the president of the republic to honour Gyula Horn, former foreign minister and prime minister of Hungary with the highest state award.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: KSH (statistical office)*

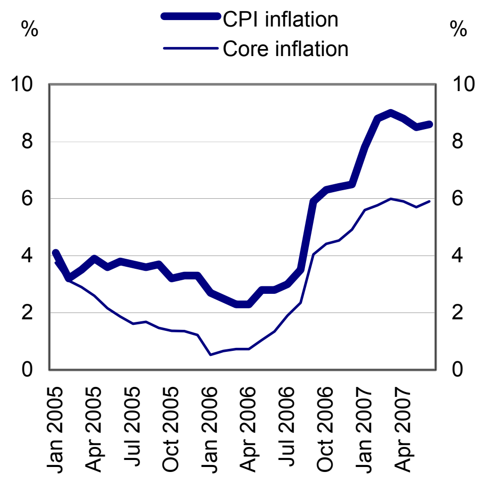
At the same time of the publication of national accounts data for the first quarter the Central Statistical Office (KSH) also revised figures for earlier periods. While these revisions modified our view in case of some important variables, the two main forces that shape the path of economic growth are still favourable external environment and ailing domestic demand. GDP growth in the first quarter was a mere 2.7% compared to the same period of last year, and is the lowest such figure in the last ten years. The components of domestic demand all suffered a drawback: private consumption decreased by 0.8%, public consumption by 7.6% and gross fixed capital formation by 2.3% year-on-year. Exports however expanded at a rate of almost 17.6%, pushing the trade balance further into positive territory.

By observing production developments at a disaggregate level, it is obvious, that the excellent export sales opportunities are the main drivers of manufacturing output growth, while services value added, that are primarily influenced by domestic demand, exhibited dismal growth figures. Domestic demand still suffers from the austerity measures that were introduced to restore fiscal equilibrium. In 2007 these measures will still have decisive effect on the components of domestic demand, and thus private consumption will decrease even further, while only a tiny 1.1% increase is expected in gross fixed capital formation. Net exports, however could be further boosted by strong external demand, and will be the main contribution to an estimated 2.6% rate of GDP growth this year.

The direction of effects will be the opposite next year: external demand will peak out in 2007 and will exhibit gradual deceleration, while a cautious pick-up in domestic demand will take place as the effects of the austerity measures slowly fade away. Thus a moderate increase in domestic demand components will be accompanied by less dynamic improvement in net trade. With quite high uncertainty, we expect a GDP growth of 3.2% for 2008.

Prices and monetary conditions

12-month inflation rates



Source: KSH (statistical office)

12-month CPI-inflation reached its peak at 9% in March, slowly decreased in April and May, but bounced back a bit in June. Food prices and regulated energy prices both increased well above average, they were joined in May by transportation prices. Fiscal austerity measures also had an indirect effect on CPI-inflation through raising the costs of production. While the process of disinflation suffered only a temporary break in June, the rate of 12-month CPI-inflation will remain above 8% until the end of the summer, and a considerable decrease in headline inflation figures are not expected before September. Yet, at the end of the year a faster than expected disinflation could lead to a 12-month rate in the region of 4.5%, while the average annual inflation rate could be 7.2%, somewhat lower than we predicted a quarter before. There are still reasons to assume, that the majority of economic actors assess recent price rises as temporary, and disinflation will continue at a solid rate in 2008 as well. This might result in an annual average inflation rate of 3.4% next year.

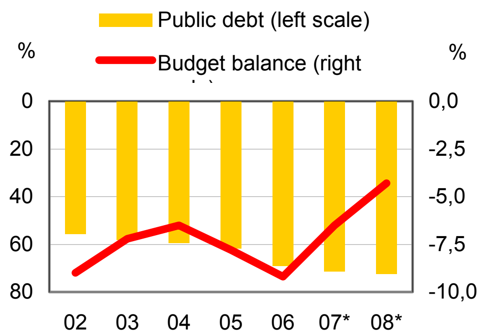
At the end of June the Monetary Council reduced the base rate for the first time since Mr Simor was appointed governor of the central bank. The base rate now stands at 7.75%, and with respect to very favourable external financing conditions, there is room for further monetary easing, even if international interest rates are on the rise. In absence of radical shifts in the exchange rate of the Hungarian forint, the base rate can be further reduced to 7.25% by the end of 2007, and to 6.5% by the end of 2008.

Positive investor sentiment and a somewhat restored credibility of economic policy helped to establish the exchange rate of the forint in the range of 245-250 vis-à-vis the euro. We expect, that the exchange rate will stabilise within this range over our forecast horizon with a median value of 248 against the euro.

Fiscal policy

In the first half of the year the cash-flow based budget deficit reached HUF 1003 billion, or 65% of the amount that was planned for the whole year. Compared to the first half of 2006, revenues were up by 12.5%, while expenditures were 5.4% higher. This mainly reflects favourable changes in the social security funds, where revenues increased by over 23%. At the same time the central government balance has hardly changed. The spectacular increase of fiscal revenues is attributable to more favourable

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Ministry of Finance

macroeconomic conditions (from a fiscal point of view) as well as to the fiscal austerity measures introduced at the end of 2006.

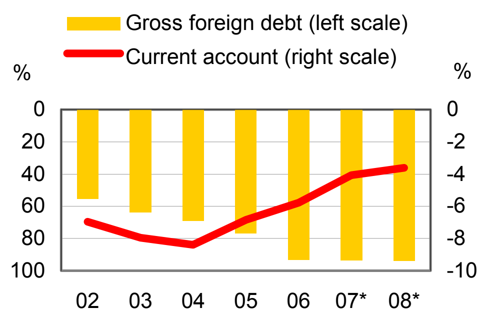
Expenditure cuts have been less remarkable and even in those items, where spending was curtailed, there are doubts whether these developments could be lasting. Nevertheless, the targeted budget deficit for 2007 can be achieved based solely on the observed increase in revenues. We expect a budget deficit of 6.5% of GDP according to ESA methodology.

There can be no additional gains on the revenue side, however, in 2008. Thus the targeted deficit of 4.3% of GDP can only be achieved, if the improvement originates completely from expenditure cuts. This would require a reduction of more than HUF 500 bn (approx. EUR 2 bn) on the expenditure side, that doesn't seem to be realistic given the current circumstances. Without deep structural and institutional reforms spending cuts of such a magnitude will not be feasible.

Even considering the most favourable outcome in fiscal developments, the ratio of the stock of public debt to GDP will rise both this and the next year, and by the end of 2008 it can reach a 72.5%, far in excess the relevant Maastricht criterion of 60%.

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: MNB

The goods and services balance both exhibited a surplus in the first quarter of 2007 together amounting to EUR 268 mn (or 1.2% of GDP). The trend is clearly improving in spite of a less than average surplus in tourism. On the other hand, income on both debt and non-debt exhibited a deteriorating trend, finally resulting in a current account deficit of EUR 1.1 bn in the first quarter.

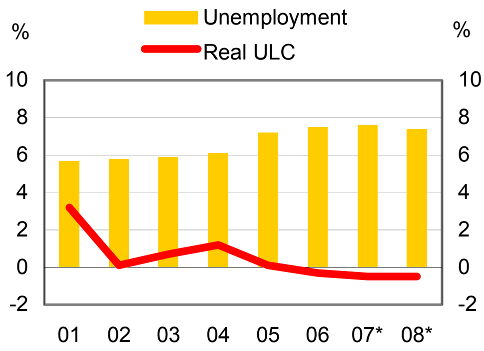
No significant changes in the factors that determine these trends are foreseen this year. Domestic demand remains subdued reducing import needs, while the external environment will be supportive giving a further impetus to exports. The balance of goods and services will improve to 1.9% of GDP in 2007 and to 2.3% of GDP next year. But net income payments to abroad also increase, that will only partially be offset to an improving balance in the EU-related transfers. A current account deficit of 4.1% of GDP is expected for 2007, which can be further reduced to 3.6% of GDP in 2008.

Both inward and outward foreign direct investment was relatively high in the first quarter (the former amounting for 4.4%, the latter to 2.3% of GDP), but due to a sizeable net purchase of foreign equities on part of domestic portfolio investors, non-debt generating financing still remained negative. This will probably turn into net inflows in the rest of the year, but debt-generating capital inflows will be three to four times higher. This financing structure will also prevail next year.

From its end-2006 level of EUR 83.9 bn the stock of gross foreign debt already increased to EUR 88 bn, which is equivalent to 95.2% of GDP. With the structure of external financing, gross foreign debt will increase to close to EUR 95.8 bn by the end of 2007. However, since nominal GDP expressed in euros will increase very significantly (explained by a much stronger forint this year than in 2006), this will only represent 93.7% of GDP, thus the ratio of gross foreign debt to GDP will not increase further. In absence of marked exchange rate changes this ratio could remain at that level even in 2008.

Labour market

Labour market indicators



*Note: * forecast. Source: Eurostat*

It was expected that the fiscal austerity measures will lead to a sudden shift in the unemployment rate, as massive lay-offs from the public sector were envisioned. But the termination of jobs in the public sector was partly offset by job creation in the private sector (most notably in services). This latter, however, could be a result of "whitening": employees, who have not been officially registered so far, were given proper contracts in the wake of stricter labour market controls. This eventually results in a more favourable outlook concerning unemployment: for 2007 we maintain our previous forecast of a 7.6% unemployment rate, but for the next year we project a slight improvement to around 7.3%.

The somewhat unexpectedly high wage dynamics in the beginning of the year suffered a blow in May, and a close to 3% decrease in real disposable incomes seems to be justified for 2007. With the economy slowly recovering in 2008, average monthly real earnings will embark on an upward path again. The rate if this rise will, however, be below that of productivity growth, therefore labour costs will continue decreasing.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (HUF bn)	22,055	23,753	25,400	27,100
Real GDP growth (%)	4.1	3.9	2.6	3.2
Private consumption (%)	3.9	1.9	-0.6	1.0
Public consumption (%)	-0.1	0.2	-4.3	0.7
Investments (GFCF, %)	5.3	-2.1	1.1	3.0
Exports (%)	11.5	17.9	14.8	10.5
Imports (%)	6.9	12.4	11.5	9.6
Annual average inflation (%)	3.6	3.9	7.2	3.4
Policy rate (%)	6.00	8.00	7.25	6.50
Money market rate (3-month, %)	5.94	7.90	7.00	6.10
Long-term interest rate (10-year gov't bond, %)	6.97	6.71	6.00	5.40
Exchange rate / EUR (average)	248.05	264.27	248.99	248.00
Exchange rate / EUR (end of period)	252.73	252.30	248.00	248.00
Budget balance / GDP (%)	-7.8	-9.2	-6.5	-4.3
Public debt / GDP (%)	61.0	69.0	71.5	72.5
Trade balance / GDP (goods and services, %)*	-0.8	0.7	1.9	2.3
Current account balance / GDP (%)*	-6.9	-5.8	-4.1	-3.6
Gross foreign debt / GDP (%)*	76.9	93.3	93.7	93.8
Unemployment (%)	7.2	7.5	7.6	7.3
Real ULC growth (%)	0.1	-0.3	-0.5	-0.5

*Note: f = forecast. * calculated from data in euro. See methodological notes for definitions and details.*
Sources: Eurostat, KSH (statistical office), MNB (central bank), PM (ministry of finance)

Latvia

Growth remains fast although there are some signs of deceleration. Inflation is creeping upwards, the current account deficit remains massive and tight labour markets rapidly drive up labour costs.

Political developments

The referendum on the controversial national security reform failed due to low turnover (23%), although 95% of voters rejected the modifications to the law proposed by the government. These changes would have given lawmakers wide access to confidential criminal and national security records; outgoing President Vaira Vike-Freiberga called the referendum after previously rejecting to sign the new legislation.

The new President, Mr. Valdis Zatlers took the office of highly popular Ms. Vike-Freiberga on 8 July. The former doctor has been criticised before his election for his lack of political experience as well as for accepting pocket payments while practising.

Relations between Latvia and Russia are improving; officials are holding talks on how to reduce queuing on the border. The idea of a transport corridor between Moscow and Ventspils via Riga has also been raised.

Growth

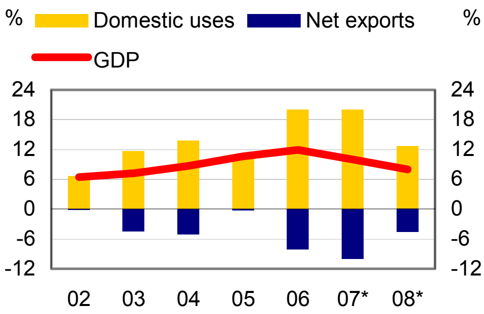
Economic growth remained exceptionally strong with 11.2% in the first quarter; quarterly growth rates show no sign of significant slowdown yet. Private consumption is still roaming at 20.4%, retail sales up 26.4% in the first five months although some deceleration is visible since March and growth of motor vehicles sales also fell sharply in 2007. Household consumption is still supported by income growth and credits, although the anti-inflationary package is beginning to take effect.

Investments were up by 17.9% in the first quarter; quarterly growth rates show deceleration since last autumn, possibly signalling decelerating construction. Exports show a healthy rebound in the first quarter: after stagnating at the end of 2006 they grew by an annualised 15.6% in the first quarter (or 8.4% on a year-on-year basis). However, imports also soared, by 29.5% compared with the first quarter of 2006. On the production side, industrial production has come to a halt, growing only 1.1% in the first five months of the year.

Based on these developments we had to revise our forecasts for 2007-08. GDP growth is adjusted upwards to 10% in 2007 because private consumption and export growth appears to be faster than our previous expectations.

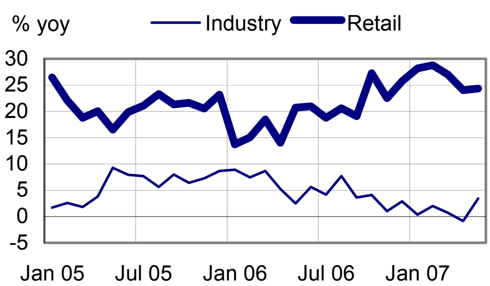
Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Sources: Eurostat, Statistics Latvia*

Growth of industrial production and retail sales

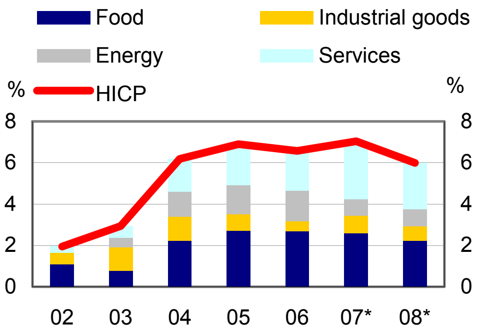


Source: Statistics Latvia

Prices and monetary conditions

Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Inflation is slowly creeping towards double digits: in June the 12-month index of consumer prices reached 8.8%. Food, housing and services prices are rising at double digits. Price increases of industrial products are as low as 3.3% but they are accelerating as well.

Consumer prices are fuelled by both strong demand and rising production costs. The producer price index of industry hit an annual 17.7% in June with both domestic and export prices rising at similar pace. Construction costs were up by a whopping 29.1% in the second quarter; costs for office and residential buildings rose by over 30%. Labour costs in construction were rising by 47.9% in the same period, clearly indicating the tightness of the labour market.

As price increases are not subsiding in the expected manner, our 2007 inflation forecast is revised upwards to 7%. As anti-inflationary measures take effect and the economy decelerates, inflation can recede to 6% in 2008.

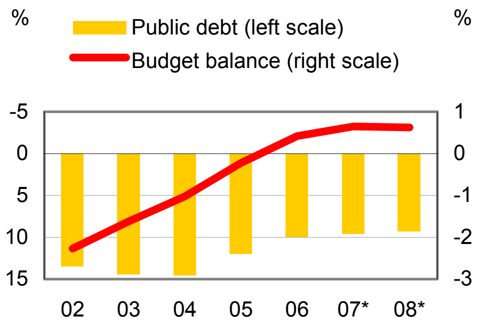
Credit growth is decelerating but is still strong, rising an annual 58% by the end of the first quarter. Loans to households are still increasing at 60%, while credit to enterprises rose by 40%. Rising interest rates and tightening lending conditions are expected to slow credit growth further.

Money markets are calming after the spring turbulences: the 3-month RIGIBOR rate decreased from its 10.3% peak in May to under 6.3% by the second half of July. The evaluation of long-term financial risks is also improving, albeit at a slower pace: the Maastricht reference interest rate for bonds with 10 years remaining maturity peaked at 6.03% in May but came back to 5.62% in June.

The government now plans to introduce the euro around 2012-13, according to a press statement by Prime Minister Aigars Kalvitis.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

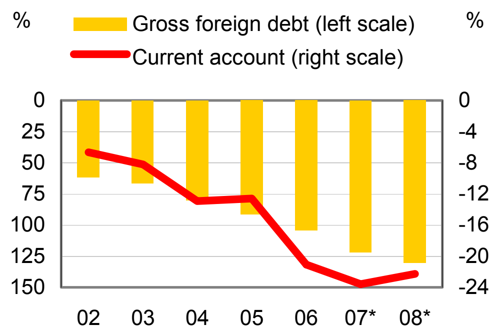
Government revenue collection was strong in the first months of the year. Central government revenues between January and April exceeded last year's value by 27.3%. However, expenditures rose by 33.2% in the same period. Public sector wages and investments were expanding particularly strongly. The budget surplus was LVL 125 mn (EUR EUR 178 mn) in the first quarter based on ESA methodology.

During his visit to Latvia, EU commissioner Joaquín Almunía stressed on 18 July the importance of maintaining budget surpluses in the order of 3-4% to keep the economy in check. Latvian Finance Minister Oskars Spurdzins hinted that such surpluses may not be attained.

We expect the budget to end 2007 with a modest, 0.6% surplus; a similar balance is possible for 2008 as well. Public debt is already around 10% of GDP and will continue to fall slightly in 2007-08 as well.

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast. Source: Eurostat*

The current account deficit is still massive; it amounted to EUR 1.8 bn over the five months, compared with EUR 0.9 bn over the same period in 2006. Imports of goods and services rose by 23.2% at current prices (according to balance of payments) while imports rose by 35.1%.

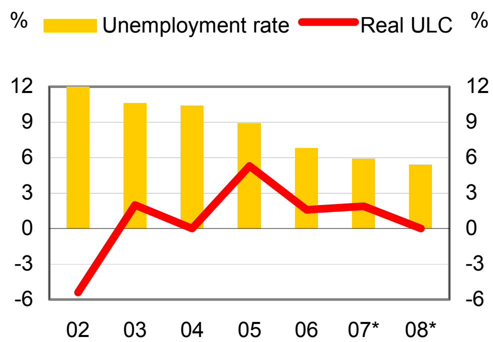
Strong albeit decelerating domestic demand will keep import growth high throughout the year. On the other hand, the fast rise of domestic production costs is detrimental for external competitiveness. Real appreciation of the lat (LVL) is continuing in 2007 although export growth appears to recover in recent months from its 2006 slump.

We expect the current account deficit to peak at 23.6% in 2007; it could come down to 22.3% in 2008. Such an external imbalance remains a major source of concern. Devaluation of the lat is highly improbable, though: an abrupt slowdown of exports due to loss of competitiveness is a more likely scenario.

Net FDI inflows reached EUR 764 mn in the first five months, up from EUR 586 mn a year before. This covered just over 40% of the current account deficit. As usual, the rest was financed mainly by foreign borrowing. As a result, gross foreign debt continues to rise. It is expected to rise gradually to around 130% of GDP by the end of 2008.

Labour market

Labour market indicators



*Note: * forecast. Source: Eurostat*

Strong job creation and increasing pressures are characterising the labour market. The harmonised unemployment rate stood at 6.9% in the first quarter (6.3% with seasonal adjustment, unchanged from the last quarter of 2006). The number of vacancies rose by an annual 26.1% in the first quarter; the rate of vacancies was 2.1% in the whole of the economy.

Labour shortages continue to drive up labour costs. Gross average wages grew by an annual 33% in March 2007; real wage growth was a staggering 24%. Ill-timed policies including public pay rises and rising public sector employment add fuel to the fire.

In our view labour market pressures will persist this year. Labour demand is strong even with decelerating growth. There is limited scope to increasing employment in the short term. Nevertheless, unemployment will fall further to 5.9% in 2007 and 5.4% in 2008 but strong wage growth will continue. This will drive up real unit labour costs by 1.9% this year, although they are expected to stabilise in 2008.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (LVL mn)	9,059	11,265	13,900	16,000
Real GDP growth (%)	10.6	11.9	10.0	8.0
Private consumption (%)	11.5	19.8	18.0	12.0
Public consumption (%)	2.7	4.0	4.0	3.0
Investments (GFCF, %)	23.6	18.3	12.0	9.0
Exports (%)	20.3	5.3	9.0	9.0
Imports (%)	14.8	17.5	22.0	12.0
Annual average inflation (%)	6.9	6.6	7.0	6.0
Policy rate (%)	4.00	5.00	6.00	6.00
Money market rate (3-month, %)	3.16	4.21	6.50	6.00
Long-term interest rate (10-year gov't bond, %)	3.59	4.90	6.00	5.50
Exchange rate / EUR (average)	0.70	0.70	0.70	0.70
Exchange rate / EUR (end of period)	0.70	0.70	0.70	0.70
Budget balance / GDP (%)	-0.2	0.4	0.6	0.6
Public debt / GDP (%)	12.0	10.0	9.6	9.3
Trade balance / GDP (goods and services, %)	-15.2	-21.0	-23.1	-24.0
Current account balance / GDP (%)	-12.6	-21.1	-23.6	-22.3
Gross foreign debt / GDP (%)	91.6	104.4	121.8	130.4
Unemployment (%)	8.9	6.8	5.9	5.4
Real ULC growth (%)	5.3	1.6	1.9	0.0

Note: f = forecast. See methodological notes for definitions and details.

Sources: Latvijas Banka, Eurostat, Statistics Latvia

Lithuania

Somewhat surprisingly, economic growth gained new momentum in the first quarter of 2007. The outlook for the real economy thus improved. Cost pressures, however, exert a further push on inflation, which, in this decade, has not been such high as it is nowadays. Weaker export performance resulted in further deterioration in the external balance, thus the signs of possible overheating are not over yet.

Political developments

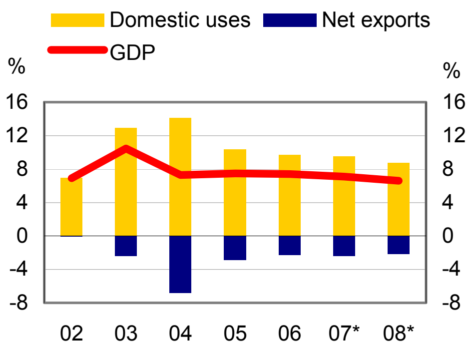
In the middle of May Rimantas Sadzius was appointed as the new finance minister replacing Zigmantas Balcytis, who resigned at the end of March. Sadzius – just as his predecessor – also belongs to the social democrats, and it is expected, that his nomination will not lead to major changes in fiscal policy.

A new law concerning the nuclear energy strategy of Lithuania was passed with an almost unanimous support in the Parliament. This is seen as green light for the construction of a new nuclear power plant, that should replace the inundated Ignalina Plant which is scheduled to be shut down by 2009.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Whereas GDP growth seemed to be clearly moderating throughout 2006, an exceptionally high increase in investments (probably best explained by restoration work in Mazeikiu Nafta, the country's main oil refinery) pushed its rate back to over 8% in the first quarter of 2007. This is also reflected by rampant value added growth in construction. As expected, private consumption (fuelled by high wage and consumer credit growth) remained strong, but a gradually diminishing growth dynamics was also in line with expectations. Export performance was weaker again, which is still due to an earlier accident in Mazeikiu Nafta, mentioned above, that led to severe damage in export capacities. With imports virtually stagnating, the trade balance deteriorated further in the first three months of the year.

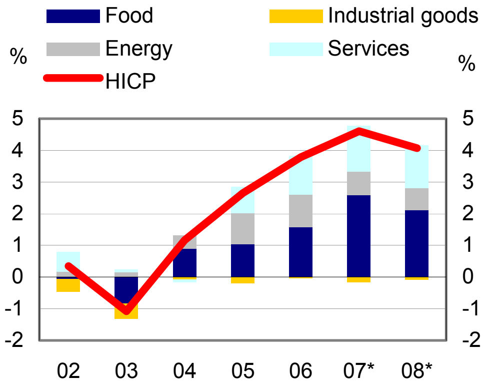
Although private consumption will lose some pace, it will still be strong in the remaining part of the year, backed by higher pensions and wages and an expected further cut (which is planned to take place in January, 2008) in personal income taxes. Its annual growth rate can be close to 10%. This also stands for gross fixed capital formation, which is also boosted by an increased inflow of EU Structural and Cohesion Funds. In the second part of the year we also expect a pick-up in export, once restoration work is completed in Mazeikiu Nafta. The outlook is thus better for this year's economic growth than it was a quarter ago, and consequently we revised our GDP growth projection upward to 7.1%.

2008 will see some moderations in the growth rate of all components in domestic demand: private consumption and gross fixed capital formation will both expand at around 8%. Exports can, however, develop at full steam next year, thus the gap between export and import growth will be reduced. The rate of GDP growth will probably be in the region of 6.6%.

Prices and monetary conditions

Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

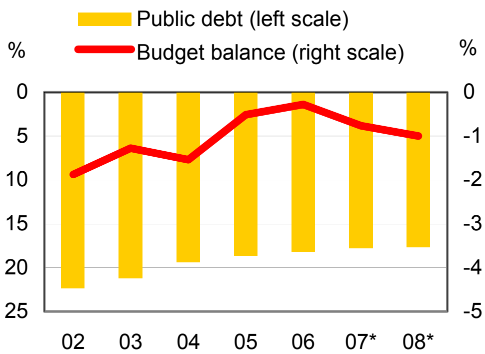
12-month CPI was up 5% in June, within 2007 consumer prices increased by 2.6% altogether (compared to December last year). Food prices increased by 8.2%, energy prices by 6.6% and services prices by 6.1%. It is, however, can be stated without much uncertainty, that the recent rise in inflation reflects the increasing costs of production and not consumption demand. Thus, while energy (and thus utilities) prices will remain high, no further push on consumer prices are expected from the demand side. Even considering this, our projection for annual average CPI inflation is 4.6% this year. We maintain our view, that further energy price rises can not be excluded, thus CPI inflation could only very gradually decelerate in 2008. With most of the risks on the upside, we project a 4.1% CPI inflation for next year. Thus meeting the Maastricht criterion on inflation before 2010 does not seem to be a real possibility for Lithuania.

Short-term yields differentials vis-a-vis euro area securities marginally widened and the 3-month VILIBOR rate increased from 4.16% to 4.90% between the end of March and the end of June. This rise might partly be attributed to the fact, that Latvia's credit rating was downgraded by S&P's recently, and while Lithuania's external vulnerability is not as high as its northern neighbours', it still might suffer from contagion should Latvia become a target of speculation. Otherwise, however, the financial system will remain healthy on our forecast horizon.

Credit growth to households seemed to lose pace until April, but it was outstandingly high in May. New loans to non-financial corporations were, however, smaller in volume between January and May in 2007, than in the corresponding period of last year.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

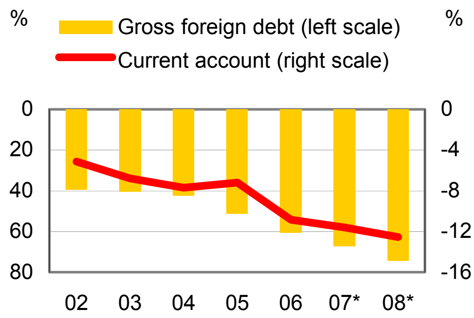
The budget was roughly in balance in the first quarter of 2007. Collection of taxes is still above planned in the case of production and import, and is in line with expectations in the case of taxes on income and wealth. Pension rises led to a significant increase in social benefits on the expenditure side, and considering, that only about 10% of government investments used to take place in the first quarter of the past five years, it seems, that government investments also expand rapidly.

Due to the good performance in the revenue side, the promised further personal income tax cut (from 27% to 24%) could indeed come into effect in January next year. In 2007 fiscal revenues could reach 33.7% of GDP, a 0.4 percentage point rise compared to 2006. An even higher increase in expenditures will lead to a budget deficit of 0.8% of GDP this year. A slight deterioration (higher spending on healthcare, education and defence) will result in a deficit of 1% of GDP next year.

The stock of public debt hardly changed in volume, thus an impressive GDP growth in the first quarter reduced its ratio to GDP below 18%. As the growth of nominal GDP is higher in our current forecast, than it was in the previous, the same projected budget deficit will now be enough to keep the stock of public debt below 18% both this and the next year..

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Source: Lietuvos Bankas

The first quarter's current account deficit reached EUR 768 mn, which is in excess of 12% of GDP. As was already explained in the section on growth, weaker exports (not just in goods but also in services) and stable imports resulted in a further deterioration of the balance of goods and services. On the other hand, the transfer balance was hardly in deficit, since growth in net payments to both direct and portfolio investors (as well as to other creditors) were offset by larger surplus on current transfers, as under the new financial perspective beginning with 2007, Lithuania was able to absorb more EU Funds.

Exports will pick up in both 2007 and 2008, somewhat slowing the deterioration in trade deficit, as the rate of import growth would remain level. Based on the observation of latest developments, however, the terms of trade will also deteriorate somewhat, to the contrary of what we expected a quarter ago. Interest and dividend payments on the stock of the accumulated foreign debt will also further increase, just as income on foreign direct investment. Even considering the higher nominal GDP growth, with these developments at hand we do not see room for improvement in the current account deficit: it will widen to 11.6% of GDP in 2007 and further to 12.5% of GDP by 2008.

Foreign direct investment inflows that accounted for approximately 5.8% of GDP last year were quite negligible in the first quarter of 2007. Coupled with a net outflow in portfolio equity investments, none-debt financing was negative in the first three months of the year. The main source of financing was – and remain to be – mostly short-term credit to the banking sector, the ultimate borrowers are, however, the households and to a lesser extent the non-financial corporate sector. On the forecast horizon debt-generating inflows will clearly dominate over non-debt financing, pushing external indebtedness even higher.

At the end of March the stock of gross foreign debt hit EUR 15.5 bn. That is already EUR 1.1 bn higher than it was a mere three months ago, and is about 63% of GDP. As revaluations do not play significant part in the evolution of the debt stock (when expressed in euros) in the case of Lithuania, it is the structure of financing that is indicative of the evolution of gross foreign debt. Since debt-generating inflows will be more significant than non-debt creating ones, gross foreign debt could increase to EUR 18.3 bn (or 67.4% of GDP) by the end of 2007, and EUR 22.5 bn (74.7% of GDP) by the end of 2008. International reserves will stabilise at a level of approximately EUR 4.5 bn on the forecast horizon.

Labour market

Emigration has finally arrived at a halt, but the labour market nevertheless remains tight. The fast-growing economy creates many new jobs (especially in the services sector) that can not be filled without luring workers from other jobs (sectors), which, of course, keeps wage growth high. Unemployment was around 5% in the first quarter of 2007, and there is no any reason for it to start increasing. We expect a figure just below 5% for this year that could also be repeated in 2008.

Labour market indicators

*Note: * forecast. Source: Eurostat*

Data for the first year show, that average gross monthly earnings rose by close to 21% year-on-year (23% in private and 18% in state employment). Due to the cut in the personal income tax rate in the middle of 2006 net salaries increased at an even higher rate (28% in the whole economy, but above 30% in private employment). Wage growth will be somewhat moderated in the forecast horizon, but even controlling for high productivity growth real unit labour costs will still rise markedly.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (LTL mn)	71,200	81,991	93,900	104,200
Real GDP growth (%)	7.5	7.4	7.1	6.6
Private consumption (%)	9.8	13.6	9.9	8.2
Public consumption (%)	4.9	7.4	5.0	4.3
Investments (GFCF, %)	9.4	11.1	10.1	8.0
Exports (%)	14.3	15.7	8.0	9.1
Imports (%)	15.9	15.7	9.5	9.9
Annual average inflation (%)	2.7	3.8	4.6	4.1
Policy rate (%)	NA	NA	NA	NA
Money market rate (3-month, %)	2.53	3.72	4.50	4.10
Long-term interest rate (10-year gov't bond, %)	3.78	4.28	4.70	4.40
Exchange rate / EUR (average)	3.45	3.45	3.45	3.45
Exchange rate / EUR (end of period)	3.45	3.45	3.45	3.45
Budget balance / GDP (%)	-0.5	-0.3	-0.8	-1.0
Public debt / GDP (%)	18.6	18.2	17.8	17.7
Trade balance / GDP (goods and services, %)	-7.3	-10.3	-11.4	-11.7
Current account balance / GDP (%)	-7.2	-10.8	-11.6	-12.5
Gross foreign debt / GDP (%)	51.3	60.7	67.4	74.7
Unemployment (%)	8.3	5.6	4.9	4.9
Real ULC growth (%)	-2.3	0.2	2.7	1.6

Note: f = forecast. See methodological notes for definitions and details.
Sources: Eurostat, Lietuvos Bankas, Lietuvos Statistikos Departamentas

Poland

The Polish economy is in a favourable situation. Growth hit a historical high in the first quarter and the Maastricht criteria are within easy reach. However, the political climate stymies reforms.

Political developments

After tough negotiations in the June EU summit the Polish government got away with a postponed introduction of the double majority voting system in the EU (from 2009 to 2014) which was perceived to be discriminative against the country. Still, the vehemence of Polish leaders was met with little sympathy elsewhere. On the other hand, Poles are happy with EU membership. According to a survey a record 89% of Poles are pleased with their country's decision to join the European Union three years ago.

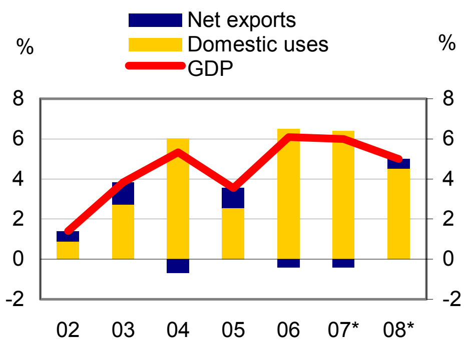
Internal affairs are also problematic for the leader parties. Andrzej Lepper, who was sacked as deputy prime minister and agriculture minister on 9 July amid allegations of corruption, offered his party's support for a provisory government ahead of early parliamentary elections that could be held next spring. Poland's leading opposition party Civic Platform (PO) is against a minority government.

Growth

In the first quarter, gross domestic product surprisingly increased by 7.4%. It was higher than in the same period last year (6.6%), which was also above the market expectations. Economic growth has accelerated without interruption since the second quarter of 2005; quarterly growth rates exceeded an annualised 6% for the last five quarters.

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

The continuation of fast economic growth in Poland was supported by vigorous activity in the world economy and especially the euro area. Still, domestic demand was the main driver of the economy, while net exports remained in negative territory. Import growth was a considerable annual 14.7% in the first quarter, surpassing the 11.8% export growth. Investments picked up to reach a staggering 29.6% in the first quarter. It was boosted by a strong performance of construction (40.1% annual growth in the first quarter of 2007, up from 19.5% in the preceding quarter), which was attributable to a warm winter.

Industry was up 9.1% in the first quarter, boosted by both external demand and domestic sales. Market services also showed good development in the first quarter, increasing by an annual 7.4%.

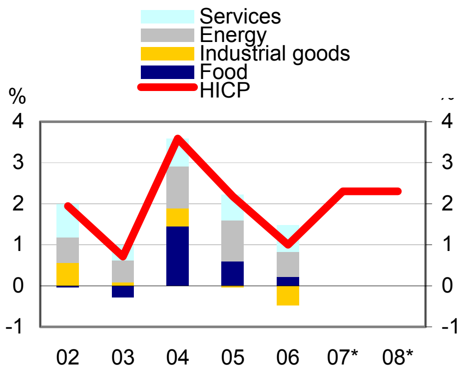
Given the high growth figure in first quarter we revise our GDP forecast upwards to 6% for 2007. In 2008 growth is expected to moderate slightly, to 5%.

Prices and monetary conditions

12-month inflation rate stabilised at 2.3% in April and May, slightly exceeding expectations. Food prices jumped 1.3% in May. Fruit prices growing by 12.5% and vegetable prices growing by 3.8

Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

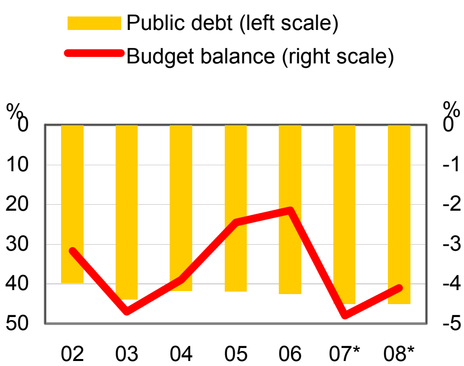
percent compared to the same month of the previous year. Housing costs and fuel prices increased smoothly.

The growth figure of the first quarter confirms that the Polish economy is expanding faster than its potential rate. Moreover, private consumption is unexpectedly strong and the growth of wages and employment can support it in the coming quarters; the latest labour market indicators confirm this view. In addition, we have recently seen some weakness in the Polish zloty. With this in mind we expect stronger inflation pressure this year, especially in the second half of 2007.

Inflation in the past few months has been very close to the central bank's inflation target of 2.5%. The Monetary Policy Council of the central bank decided to raise the policy rate by 25 basis points in June. As the Council 'will be closely monitoring' the trend of wages and the structure of the GDP growth, we think further monetary tightening will take place in 2007. We are calculating with 4.75% policy rate for the end of 2007, and with 4.25% for the end of 2008. Based on the inflationary pressures and the mild tightening of monetary conditions we expect a 2.3% inflation rate for 2007 and 2008 as well.

Fiscal policy

Fiscal indicators (% of GDP)



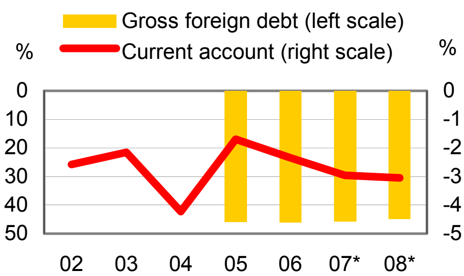
*Note: reverse scale on left axis. * forecast.*
Source: Eurostat

Poland's budget deficit amounted to 14.2% of the annual plan after the five-month period ending May. The growth of revenues was higher than the growth of expenditures. While the expenditures increased by 7.3%, the revenues rose by more than 25% compared to the same period of the previous year. The growth rate of tax revenues from individuals was 39%, and the contribution of corporate taxes also increased significantly. The government could control the expenditures, but it is important to emphasize that the subsidies are growing rapidly. Because of the political conflict in the coalition, the leader parties may intend to increase the level of subsidies to avoid a political downfall.

The current situation of the central budget is still positive. Poland will be close to fulfilling the Maastricht criteria for public finances. The economy is growing rapidly, but according to some analysts this has encouraged the government to put off fiscal reforms. Another reason to think the chance for delay the reforms is relatively high is the debate between the ruling parties.

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*
Sources: Eurostat, NBP, WIIW

The external position remained favourable in Poland, where GDP growth has been more balanced than in other Central Eastern European countries. In the first quarter the current account deficit climbed to 2.8% of GDP.

The year-on-year decrease in the overall trade deficit reflects a drop in the net oil import bill. The surplus of the services balance showed a small decline. The narrowing of the income account deficit is mainly attributable to lower net interest, dividend and profit payments.

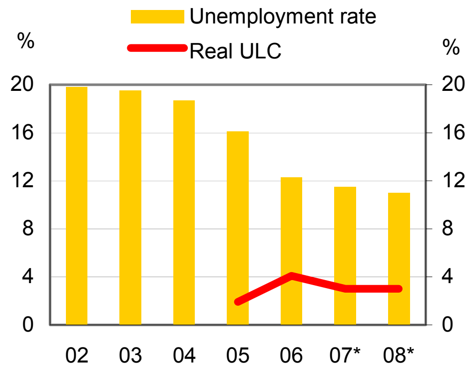
We expect the current account to remain moderate in 2007-08, reaching 3% in both years. The trade deficit will continue to rise slightly to 2% this year and 2.6% in 2008.

Labour market

Although production and sales dynamics have slowed compared to the same period in 2006, growth of employment and fall of unemployment continues. The official unemployment rate in May was 13%, a significant 3.5 percentage point reduction from last year. This means that the number of the jobless fell below 2 million. The register of young job seekers became significantly shorter, while it has widened in the over-50 age group.

The latest figures on labour market point to a continuation of high wage growth. Polish corporate wage growth accelerated to 9.3 percent year-on-year, up from 8.9 percent in May. Presumably the upward trend in wages continues in Poland. Wage growth could rise to 10% by the end of the year. The impact of high capacity utilisation, strong domestic demand and tight labour market in some industries is becoming visible in wage developments.

Labour market indicators



*Note: * forecast. Source: Eurostat*

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (PLN bn)	980.7	1057.8	1122.0	1190.0
Real GDP growth (%)	3.5	6.1	6.0	5.0
Private consumption (%)	1.9	5.2	4.1	3.9
Public consumption (%)	5.3	3.9	3.3	3.0
Investments (GFCF, %)	6.5	15.2	11.5	9.0
Exports (%)	8.0	14.8	11.0	13.5
Imports (%)	4.7	16.0	12.0	11.5
Annual average inflation (%)	2.2	1.0	2.3	2.3
Policy rate (%)	4.5	4.0	4.75	4.25
Money market rate (3-month, %)	4.62	4.20	4.60	4.00
Long-term interest rate (10-year gov't bond, %)	5.34	5.14	5.80	4.80
Exchange rate / EUR (average)	4.02	3.89	3.80	3.80
Exchange rate / EUR (end of period)	3.86	3.90	3.80	3.80
Budget balance / GDP (%)	-2.5	-2.2	-4.8	-4.1
Public debt / GDP (%)	42.0	42.5	45.0	45.0
Trade balance / GDP (goods and services, %)	-0.3	-1.3	-2.0	-2.6
Current account balance / GDP (%)	-1.7	-2.3	-3.0	-3.0
Gross foreign debt / GDP (%)	45.9	46.0	45.7	44.8
Unemployment (%)	16.1	12.3	11.5	11.0
Real ULC growth (%)	1.9	4.1	3.0	3.0

Note: f = forecast, e = estimation. See methodological notes for definitions and details.
Sources: Eurostat, Central Statistical Office of Poland, Narodowy Bank Polski, OECD

Romania

Economic growth decelerated in the first quarter of 2007 but remained high. Inflation fell to a record low. The current account deficit continues to grow, raising questions of sustainability. The fiscal balance will also deteriorate in 2007 due to the increase of public spending on social expenses and infrastructural investments.

Political developments

The suspension of President Basescu in April ended with his re-election at the May referendum with support from three-quarters of voters. After the election the political climate remained unchanged and bickering between the government and the President carried on.

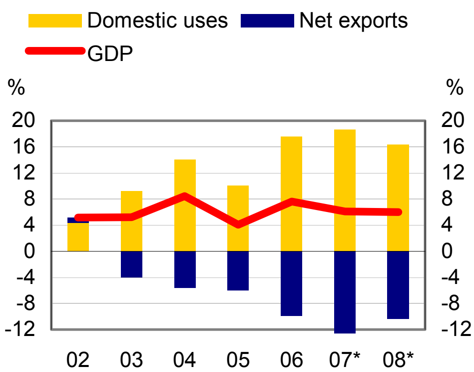
European Parliamentary elections will be the next major event in the political arena. Romania has to hold EP elections this year. They were initially planned for May, but the final date is still not chosen.

Next year local and parliamentary elections will be held in Romania. Parties are getting prepared; the governing party seems to use pension increases to secure the support of about 5 million pensioners. The big question is whether pension increases will be reversed or taxes will be increased or the budget balance will deteriorate after the elections if pensions increase according to government plans.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

In the first quarter of 2007 economic growth decelerated to 6.0%. This rate is the slowest of the last five quarters, and it means that the economy has reached its potential growth rate.

On the demand side, private consumption and investments were the main engines of the economy. The growth of private consumption was 12.1%, while gross fixed capital formation also increased by an enormous 17.2% in the first quarter in comparison with the corresponding period of last year. Gross fixed capital formation was boosted by construction investments. On the other hand, net exports continued to have a negative contribution to GDP growth due to the significant increase of the trade deficit.

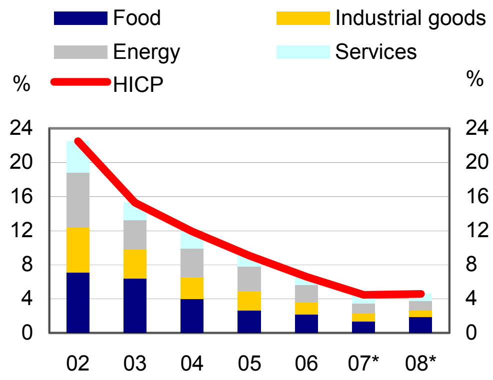
On the production side, the value added of construction reached an outstanding growth (30.7%) in the first quarter of the year, which reflects the significant role of the construction sector in the dynamic growth of the country. Agriculture, industry and services also reached high growth rates: 9.2%, 7.8% and 6.4% respectively.

For 2007 we expect that GDP growth will be close to 6%; slightly lower than in 2006 (7.7%). This deceleration will be the result of the lower growth of private consumption and the dynamically growing imports that will have a negative impact on GDP growth. Consumption and investments will remain the engine of growth. In 2008 economic growth is expected to remain at 6%; however some shifts in its structure are expected. Public spending will increase with the upcoming elections and its contribution to growth will rise. Besides that, we also expect that the utilisation of EU funds will grow, and the positive impact of EU accession on growth will increase over the coming years.

Prices and monetary conditions

Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Since February 2007, when the harmonised index of consumer prices declined to 3.9%, it has remained in the 3.7-3.9% range. There were three factors which contributed positively to the development of inflation. First, there was no significant increase of administered prices. Second, increases of food and fuel prices were moderate. Third, the leu (RON) appreciated significantly: by 7.6% between 1 March and 30 June.

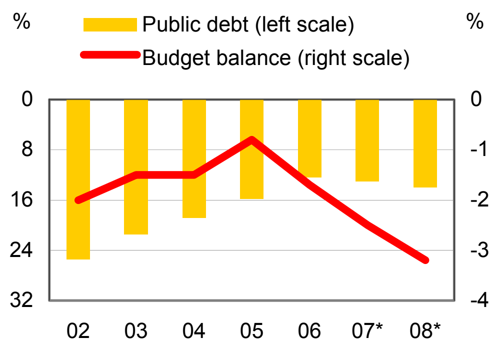
In line with low inflation and strengthening currency, the Board of the National Bank of Romania cut the policy rate from 7.5% to 7% in two steps (2 May and 25 June). This year there have been four interest rate cuts already. Due to the fact that private consumption decelerated, inflationary pressures eased somewhat. However, high wage rises and growing public spending may still fuel price increases. According to the central bank inflation will decrease to 3.7% by the end of this year. This would mean the comfortable achievement of the inflation target (4% ±1 percentage point) for 2007. For 2007 as a whole we expect inflation at 4.4%; in 2008 it will remain broadly stable at 4.6%.

The National Bank of Romania and the government still plan to join ERM-II regime in 2012, accordingly Romania could adopt euro in 2014. This is a different strategy than that of Bulgaria which plans to join ERM-II regime as soon as possible. Romania plans to achieve real convergence before the adoption of the euro.

Regarding the Maastricht criteria, the reduction of inflation under the reference value will be the hardest task to achieve. Romania's unambitious euro introduction strategy makes it possible to realise some real convergence and to decrease inflation rate gradually.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

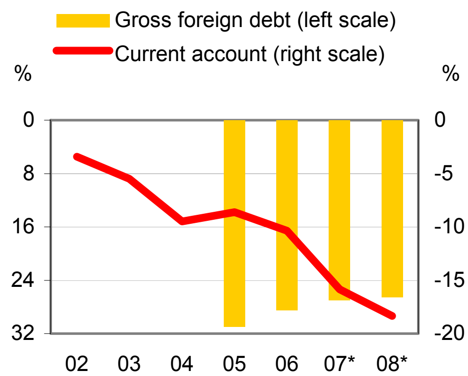
Source: Eurostat

During the first five months of 2007 the consolidated government budget surplus reached RON 606.7 mn or 0.16% of estimated GDP. This surplus was significantly lower than last year, when the surplus reached RON 4.2 bn over the same period. According to government plans the deficit will increase to 2.8% of GDP due to additional spending: infrastructural investments and contribution to the EU budget. We expect that budget deficit will not reach this level: all planned expenditures may not be realised, just like last year. Still, the deficit will be higher than in 2006: it will rise to 2.5% of GDP in 2007.

As of January 2008 the government plans to increase pensions by 43% and to almost double them by 2009. To keep the deficit under the 3% threshold of the Stability and Growth Pact the government should either postpone some major investments or rise taxes in the coming years. However, there are also plans to lower social security contributions by 6 percentage points. These measures will add a fiscal stimulus to growth, but will also heighten inflationary pressures and worsen the budget and external balances. Based on the expected effects of planned fiscal measures we increase our previous forecast on the budget deficit for 2008 to 3.2%.

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

Source: BNR, Eurostat

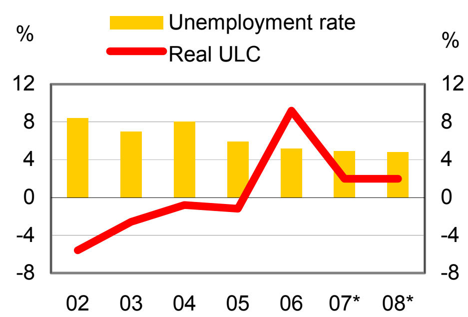
The current account balance deteriorated significantly in the first four months: its deficit reached EUR 4.4 bn, compared with just EUR 2.1 bn in the corresponding period of last year. The significant increase was the result of the widening trade deficit: its deterioration accounted for more than 80% of the rise in the current account deficit. While import of goods increased by 30% in euro terms in that period, the growth of export reached only 14.8%. Accordingly, the trade deficit increased by 78.3% during the first four months of 2007. The significant increase of trade deficit was the result of high private consumption and investments; EU accession and the appreciation of Romanian currency also pushed up the growth of imports.

The incomes balance also worsened (by 64.1%), while services balance remained similar and current transfers balance improved slightly (by 14%).

Compared to the corresponding period of 2006, foreign direct investments fell during the first four months of this year. Net FDI reached EUR 1.6 bn from EUR 2.4 bn a year ago. However, net FDI inflows reached a record high of over EUR 9 bn last year. FDI will be able to finance a significantly lower part of the current account deficit this year; it raises questions whether the external balance is sustainable. In 2007 the current account deficit is expected to reach 15.8% of GDP due to the deterioration of trade balance. There are few indications that high domestic demand cools down in the near future; in fact, most signs (pension changes, wage increases) suggest that it will even grow. As a result, external imbalances can become the biggest macroeconomic challenge for Romania over the next years.

Labour market

Labour market indicators



*Note: * forecast. Source: Eurostat*

The number of unemployed persons declined to 400 thousands by April and the unemployment rate fell to 4.5%, by over 5 percentage points over 12 months. Robust growth and the 'whitening' of the informal sector were the main factors behind growing employment.

In line with improving employment figures, wages rose dynamically as well. In May 2007 gross monthly average wages reached RON 1361 (EUR 414), climbing 22.5% since May 2006.

In 2007 we expect that unemployment will remain under 5% and further whitening of the informal sector is also on the cards. In some sectors companies are facing shortages of skilled labour. Productivity growth will fall short of wage increases; therefore real unit labour costs are expected to rise by 2% in 2007 and in 2008 as well.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (RON mn)	288,000	342,400	385,000	424,500
Real GDP growth (%)	4.1	7.7	6.1	6.0
Private consumption (%)	9.7	13.9	12.0	10.0
Public consumption (%)	8.5	2.5	6.0	7.0
Investments (GFCF, %)	12.6	16.1	16.0	14.0
Exports (%)	8.1	10.6	13.0	14.0
Imports (%)	16.6	22.9	25.0	20.0
Annual average inflation (%)	9.1	6.6	4.4	4.6
Policy rate (end of period, %)	7.50	8.75	7.00	6.00
Money market rate (3-month BUBOR, %)	9.79	8.77	7.70	6.90
Long-term interest rate (10-year gov't bond, %)	-	-	-	-
Exchange rate (RON / EUR, average)	4.05	3.62	3.32	3.25
Exchange rate (RON / EUR, end of period)	3.68	3.38	3.30	3.20
Budget balance / GDP (%)	-0.8	-1.7	-2.5	-3.2
Public debt / GDP (%)	15.8	12.4	13.0	14.0
Trade balance / GDP (goods and services, %)	-10.2	-12.1	-14.0	-14.2
Current account balance / GDP (%)	-8.6	-10.4	-15.8	-18.4
Gross foreign debt / GDP (%)	31.0	28.5	27.0	26.5
Unemployment (%)	5.9	5.2	4.9	4.8
Real ULC growth (%)	-1.2e	9.2e	2.0	2.0

Note: f = forecast, e = estimation; See methodological notes for definitions and details.

Sources: Eurostat, National Bank of Romania, National Institute of Statistics

Slovakia

High growth persists, helped by strong domestic consumption and the start of production by major FDI projects in the automotive sector. The country is on track for adopting the euro in 2009.

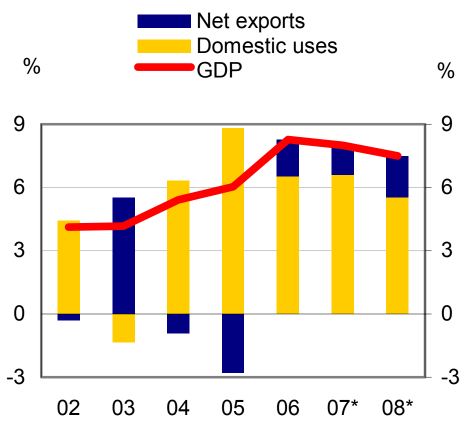
Political developments

The Fico government maintained its high popularity, supported by robust economic growth and some populist economic policies. These had only a small impact on the budget, and seem to be accompanied by expenditure-reducing measures: the finance minister announced a plan of cutting the number of public employees. The government is committed to the 2009 euro adoption, a target that seems feasible.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

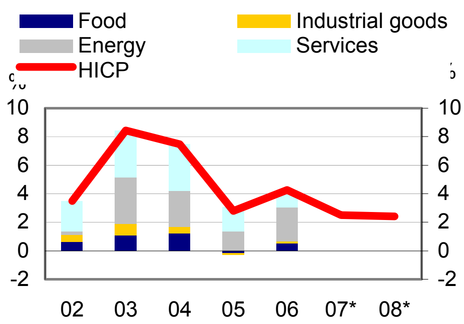
A slightly decelerating trend in GDP growth is indicated by the 9% annual rate in the first quarter of 2007: in the last quarter of 2006 GDP grew by 9.6%. However, this is still the highest growth rate among the Visegrad countries[3] and on par with the Baltic states. Favourable tendencies in the structure of growth persist: while the role of investments and especially private consumption is still significant, net exports' relatively high contribution continued. This is fuelled by the performance of FDI-related car companies. A spectacular 24% exports growth in the first quarter and a 76% rise in the manufacture of transport equipment in the January–May period are good indicators of the impact of local affiliates of automotive companies. However, the expansion of certain services was even more pronounced than that of manufacturing; transport and communications grew particularly strongly.

According to our forecast, a similarly high contribution of exports will persist over the course of this year, and will continue into 2008 as well. This will result in high GDP growth, around 8% in both years.

Prices and monetary conditions

Inflation and its components

(annual HICP-growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Statistics of May indicate further deceleration in inflation: 12-month HICP was 1.5%, which is in line with our forecast for 2007. This is the lowest level of inflation in the history of Slovakia since 1993.

Lower inflation was the result of the developments of (regulated) health service and food prices. However, low inflation is not yet fully translated into consumers' expectations. In April, survey respondents expected a 6.03% of inflation for the coming 12 months, according to the National Bank. Significant appreciation of the koruna (SKK) also helps the downward trend of inflation which is expected to continue throughout the year.

The Bank Board cut the two-week repo rate from 4.5% to 4.25% on 24 April taking into account decreasing inflationary pressures.

The country is on track to adopt the euro in 2009. Slovakia is currently the only country among the Eastern EU Member States

[3] Czech Republic, Hungary, Poland, Slovakia

with a formally set date for the entry into the euro area.

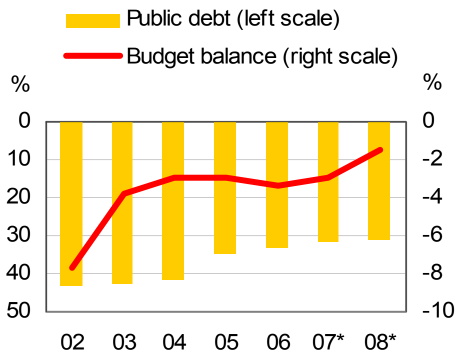
Fiscal policy

The Slovak government plans to reduce the budget deficit this year below the Maastricht threshold level of 3%, which is a condition for adopting the euro in 2009. The deficit was at 3.4% of GDP last year including cost of pension reform. High economic growth and rising employment and wages boosted tax revenues, helping to reach a relatively low deficit last year. Municipalities contributed significantly to the budget deficit last year; the same could happen this year as well. A potential slide in GDP growth also poses some risk to the 2.9% deficit target.

On the other hand, central budget expenditures may be affected positively by the plans of the government to reduce the number of ministries' employees by 20% until the end of the summer, as well as to close down some regional and county-level agencies. Altogether, 29 thousand state employees are planned to be laid off.

In spite of previous government rhetoric there were only marginal modifications in the tax system stepping into force in January 2007. These did not affect the simplicity and efficiency of the tax system and other beneficial effects of the previous fiscal reform. According to government plans, the share of public revenues and expenditures in GDP will be gradually reduced in the coming years. Cuts in public employment are planned with this aim.

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

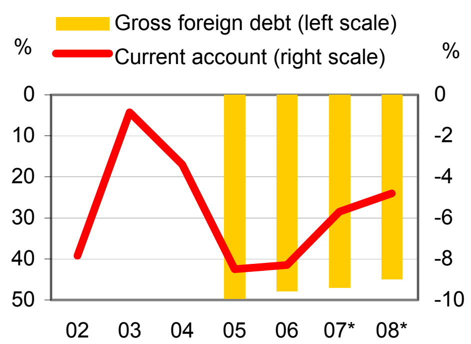
Source: Eurostat

External balance

Significant changes will characterise the composition of the balance of payments this year, due to strong export growth, which surpassed an annual 23%, while imports grew only by 14.9%. As a result, the trade balance deficit was much smaller this May than last year. It contributed to the substantial narrowing of the current account deficit, despite the significant negative effect of increased oil and energy prices on imports.

These developments are mainly due to the start of production and exporting of major FDI projects in the automotive sector (and to a smaller extent, in the electronics sector). The impact of these changes can be traced in the increased openness indicator of the Slovak economy: the export-to-GDP ratio exceeds 75% now; by this measure Slovakia has became the most open economy in the region.

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

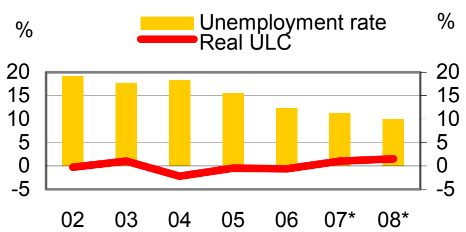
Source: NBS, Eurostat

Labour market

Due to strong economic growth, the registered unemployment rate continued to decrease throughout the year, reaching 8.5% at the end of April. The harmonised unemployment rate stood at 11.5% at the end of the first quarter, also falling substantially since the beginning of the year. However, the share of long-term unemployed is stubbornly high and increasing: it stood at 52.7% in March.

Employment increased further, by more than 2% in the first quarter on a year-on-year basis. The services sector played a key role in job creation. Real wages continued to rise in the first quarter of 2007 as well, by 4.2% compared to 3.9% in the last quarter of 2006.

Labour market indicators



*Note: * forecast. Source: Eurostat*

This year wage growth of the private sector seems to catch up with that of the public sector last year. Telecommunications and manufacturing play the leading role in this respect. These developments are in line with our previous forecast, according to which tightening of the labour market and strong profitability bear the risk of a further, potentially excessive increase in real wages in 2007. Unemployment will fall to 10% by 2008, while real unit labour costs will rise by 1% in 2007 and by 1.5% in 2008.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (SKK bn)	1471.1	1636.3	1767.2	1899.7
Real GDP growth (%)	6.0	8.3	8.0	7.5
Private consumption (%)	7.0	6.1	5.8	5.5
Public consumption (%)	-0.6	4.1	3.5	3.0
Investments (GFCF, %)	17.5	7.3	9.2	6.5
Exports (%)	13.8	20.7	20.0	17.8
Imports (%)	16.6	17.8	16.9	15.8
Annual average inflation (%)	2.8	4.3	2.5	2.4
Policy rate (%)	3	4.75	4.25	4.0
Money market rate (3-month, %)	3.12	4.82	4.65	4.23
Long-term interest rate (10-year gov't bond, %)	3.62	4.15	4.03	4.02
Exchange rate / EUR (average)	38.6	37.23	36.3	36.0
Exchange rate / EUR (end of period)	37.88	34.435	33.0	32.0
Budget balance / GDP (%)	-2.9	-3.4	-2.9	-1.5
Public debt / GDP (%)	34.5	33.1	31.8	31.0
Trade balance / GDP (goods and services, %)	-4.4	-4.6	-4.4	-4.3
Current account balance / GDP (%)	-8.5	-8.25	-5.7	-4.8
Gross foreign debt / GDP (%)	49.8	48.0	47.0	45.0
Unemployment (%)	15.5	12.3	11.3	10.0
Real ULC growth (%)	-0.5	-0.6	1.0	1.5

Note: f = forecast. See methodological notes for definitions and details.

Sources: Eurostat, Slovak National Bank, Slovak Statistical Office

Slovenia

The 'star pupil' hits its own records. Real growth will come close to 6% this year. The beneficial effects of the euro introduction and the tax reform become even more evident.

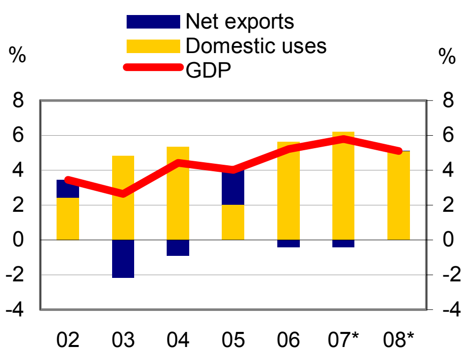
Political developments

The tension between the President and the Prime Minister culminated at the nomination of the next central bank governor. Only the President's third nominee, Marko Kranjec received the approval of the Slovenian Parliament in June 2007. This was not due to the lack of expertise of the earlier candidates; it was a clear sign of the power struggle between the President and the ruling Slovenian Democratic Party (SDS). The opposition Social Democrats (SD) slightly lead in the opinion polls ahead of the SDS. SD's Borut Pahor has good chances of winning the presidential elections in autumn 2007. However, Slovenes will not have too much time for political debates this year because the country has less than six months until it will take over the presidency of the European Union on 1 January 2008. The way how the government will manage holding the EU presidency might influence its chances of re-election next year.

Growth

Structure of growth

(annual GDP growth and growth contributions)



*Note: * forecast. Source: Eurostat*

Economic growth did not lose its momentum in the first months of 2007. Real GDP grew at an excellent high rate of 7.2% in the first quarter of 2007, which is the highest quarterly growth rate since 1999. Gross fixed capital formation was the main engine of growth, increasing by almost 22%. It was fuelled by booming construction activity and a remarkable performance of manufacturing. Foreign trade's contribution to GDP growth was almost neutral, while private consumption rose by 3.3% and public consumption by 2.2% in the first quarter of 2007.

We have raised our growth forecast for 2007 and 2008. We expect that Slovenia's real GDP growth will reach 5.8% in 2007 and slow down slightly to 5.1% in 2008. Investment activity will remain the main contributor to GDP growth in 2007 and 2008. This will be mainly due to the already evident positive effects of tax reforms and investments triggered by the euro-area entry. We expect that public consumption will gain momentum as the parliamentary elections draw near in 2008.

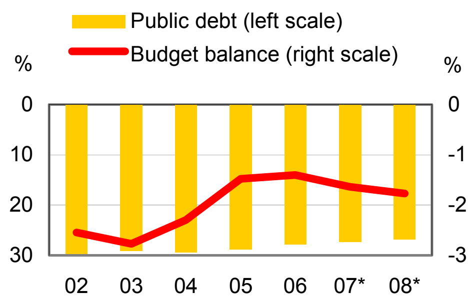
Prices and monetary conditions

Despite initial fears of the Slovenian population, the euro changeover did not bring about a mentionable increase in inflation. 12-month HICP inflation reached 3.1% in May 2007, while the average annual inflation rate stood at 2.7% in the same month. Higher than expected price increases occurred only in some sub-categories; thus higher inflation does not appear to stem from an overheating economy. The highest price increases could be observed in the following sub categories in May 2007: alcohol and tobacco (6.5% in 12 months), food and non-alcoholic beverages (5.7%) and services (4.4%). As food price rises will moderate in the second half of the year and wage growth will continue to lag behind productivity growth, we expect average inflation to reach to 3.1% in 2007. If wage growth will be contained in the election year, inflation is expected to decrease to 2.9% in 2008.

As a full-fledged euro area member Slovenia is represented in all decision making bodies of the European Central bank. Following ex-presidents of the central bank Mitja Gaspari (1 Jan to 31 March) and Andrej Rant (1 April to June 30), Marko Kranjec is representing Slovenia in the ECB's Governing Council.

Fiscal policy

Fiscal indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

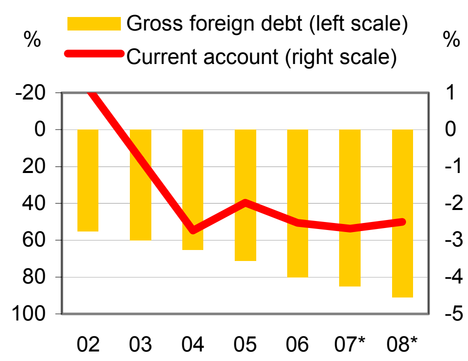
Source: Eurostat

General government revenues and expenditures grew at the same pace, at the annual rate of 7.2% in the first quarter of 2007. The shortfall in revenues caused by the tax reform at the beginning of this year was less than expected. Still, revenues from personal income tax declined as the number of tax brackets were reduced from five to three. However, this was compensated by growing corporate tax revenues. This is remarkable given the fact that corporate income tax rate was reduced by two percentage points as of 1 January 2007.

We expect that combined effects of the tax reform, the costs of EU presidency and a more expansionary fiscal policy in the run-up to the parliamentary elections will widen the general government deficit to 1.6% of GDP in 2007 and to 1.8% in 2008. Public debt will remain fairly stable just below 27% of GDP.

External balance

External balance indicators (% of GDP)



*Note: reverse scale on left axis. * forecast.*

Source: BS, Eurostat

The deficit of the goods balance reached 2.2% of the GDP in the first quarter of 2007. Export of services outpaced services' imports as usual, while the balance of the current transfers improved as the deficit of the income balance rose to EUR 141 mn. The current account deficit reached EUR 176 mn euros (2.3% of GDP) in the first quarter of 2007.

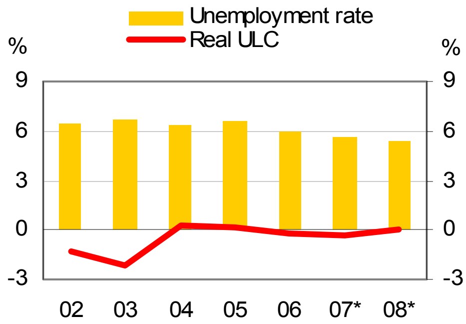
The deficit was almost entirely covered by FDI inflows, which amounted to EUR 174 mn, 3.8 times more than in the same period of last year. Slovenian companies kept on investing in the former Yugoslav republics. As a result, outward FDI rose by more than 150% since the first quarter of 2006. Contrary to almost negligible inward portfolio investments, outward portfolio investment reached a record high EUR 2.4 bn. This was mainly due to the buoyant activity of Slovenian banks and mutual funds.

We expect that FDI inflows will increase in the forthcoming years as a positive side effect of the euro-area membership. Slovenia will remain a net FDI exporter throughout the forecasting horizon. We expect that the current account deficit will be around 2.7% this year, and shrink by 0.2 percentage points in 2008. As the common currency facilitates borrowing from abroad, gross foreign debt will continue to rise, reaching 85% of GDP in 2007 and 91% in 2008.

Labour market

The excellent growth performance and positive effects of the tax reform (fewer tax brackets and lower tax rates) had a favourable

Labour market indicators



*Note: * forecast. Source: Eurostat*

impact on the labour market. According to labour force survey data the unemployment rate was 5.7% in the first quarter of 2007. This shows an impressive 1.2 percentage points improvement in the ILO unemployment rate since the same period of 2006.

Favourable growth prospects and the gradual phasing-out of the payroll tax imply that the labour market situation will continue to improve during the forecasting horizon. Unemployment is expected to fall to 5.6% in 2007 and 5.4% in 2008.

Annual growth of average gross wages was lower than in the same period of last year; it reached 2.8% in real terms in March 2007. Wages grew slower in the public sector than wages in the private sector. Growth of net wages was below labour productivity growth throughout the first quarter. As a result, real unit labour costs will fall slightly (by 0.3%) in 2007 and are expected to remain stable in the coming year.

Key macroeconomic indicators, 2005-2008

	2005	2006	2007f	2008f
Nominal GDP (EUR mn)	27,625	29,736	32,600	35,200
Real GDP growth (%)	4.0	5.2	5.8	5.1
Private consumption (%)	3.4	3.3	3.5	3.0
Public consumption (%)	2.2	3.8	2.1	4.0
Investments (GFCF, %)	1.5	11.9	16.5	10.2
Exports (%)	10.5	10.0	15.4	11.0
Imports (%)	7.0	10.4	15.6	10.7
Annual average inflation (%)	2.5	2.5	3.1	2.9
Policy rate (%)	-	-	-	-
Money market rate (3-month, %)	4.00	3.67	4.15	4.10
Long-term interest rate (10-year gov't bond, %)	3.69	3.90	4.20	4.00
Exchange rate / EUR (average)*	239.6	239.6	-	-
Exchange rate / EUR (end of period)*	239.5	239.6	-	-
Budget balance / GDP (%)	-1.4	-1.4	-1.6	-1.8
Public debt / GDP (%)	28.8	27.8	27.3	26.8
Trade balance / GDP (goods and services, %)	-0.6	-0.8	-0.9	-0.7
Current account balance / GDP (%)	-2.0	-2.5	-2.7	-2.5
Gross foreign debt / GDP (%)	71.0	80.0	85.0	91.0
Unemployment (%)	6.6	6.0	5.6	5.4
Real ULC growth (%)	0.1	-0.2e	-0.3	0.0

*Note: f = forecast, e = estimation. * SIT / EUR before January 2007. See methodological notes for definitions and details.*

Sources: Banka Slovenije, Eurostat, WIIW

Special topic

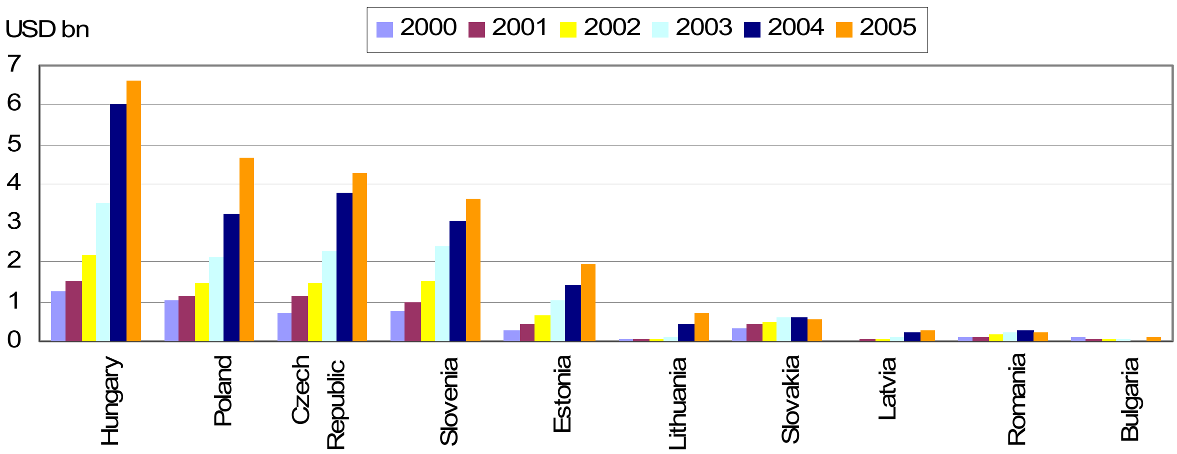
Outward Foreign Direct Investment from the Eastern EU Member States

Outward FDI trends and developments

The economic role of Inward Foreign Direct Investments (IFDI) in the Eastern EU Member States (hence: EU10) is known to be significant in the transition and the accession period. Outward Foreign Direct Investments (OFDI) from the region gained ground in the late nineties. In line with improving economic performance foreign direct investments from the EU10 have been rising gradually since 1997 and gained momentum in most countries – with some exceptions - around 2001. Accelerating globalisation and the transformation process are the main reasons for outward internationalisation of EU10 firms. Most of the countries show considerable advancement considering the Outward FDI Performance Index in the past years, however the share of OFDI is still marginal in comparison to the old EU members. In spite of the relatively rapid growth of OFDI, inward FDI is still much more important for Eastern EU economies.

In view of the fact that the EU10 are different regarding their size, openness and macroeconomic trends, countries show different OFDI developments in the past years. However, despite large differences, EU10 have many similarities in the outward internationalisation process. Internationalisation of small country firms is more likely because of the small size of the domestic market. The more open economies, like Hungary, Estonia or Slovenia are more likely to invest abroad than less open or bigger economies, like Poland. In most cases, where the export/import GDP ratio is higher, inward FDI/GDP and outward FDI/GDP ratio are expected to be higher. In absolute terms the OFDI stock was the highest in the case of Hungary (USD 6.6 bn), followed by Poland (USD 4.6 bn), the Czech Republic (USD 4.2 bn) and Slovenia (USD 3.6 bn) in 2005. Among the Visegrad countries Slovakia's OFDI stock was the lowest (USD 0.5 bn) and in accordance with their development level Romania and Bulgaria realized very low OFDI stocks (USD 0.2 and 0.1 bn). In the Baltic region Estonian OFDI reached the highest value (USD 1.9 bn) in 2005, followed by Lithuania (USD 0.7 bn) and Latvia (USD 0.2 bn).

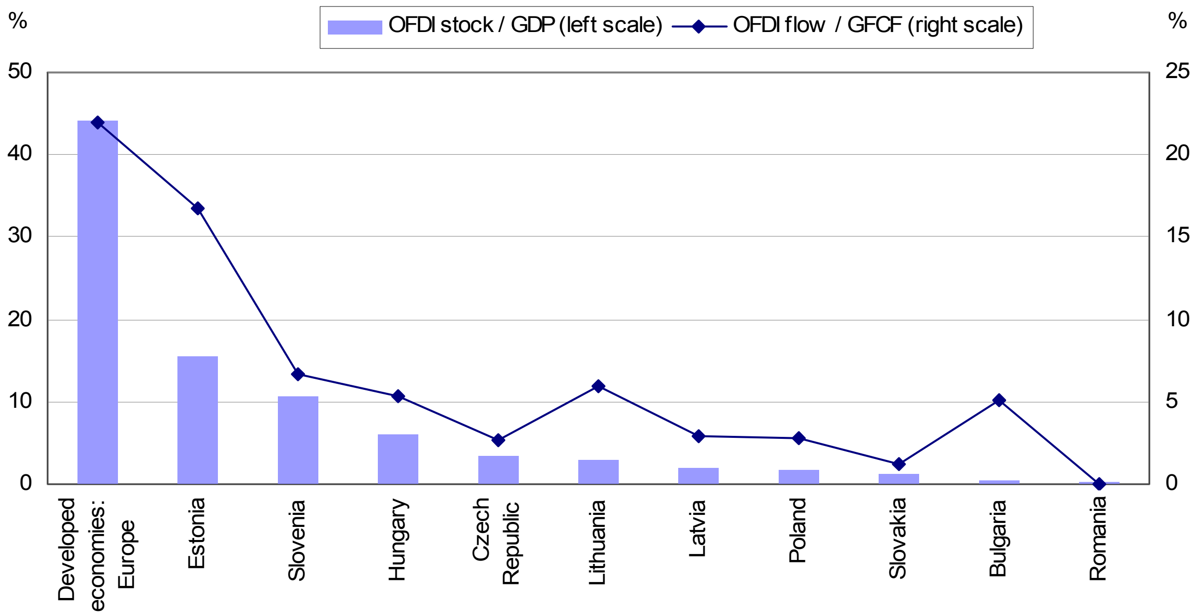
Development of OFDI stocks in the EU10



Source: UNCTAD

Regarding OFDI stocks as percentage of GDP, the best performances are shown by Estonia (15%), Slovenia (10%) and Hungary (6%). Again, in terms of OFDI stock per capita, Slovenia, Estonia and Hungary are the top three countries in the region. OFDI flow (2005) as a percentage of gross fixed capital formation index shows the highest value in the case of Estonia.

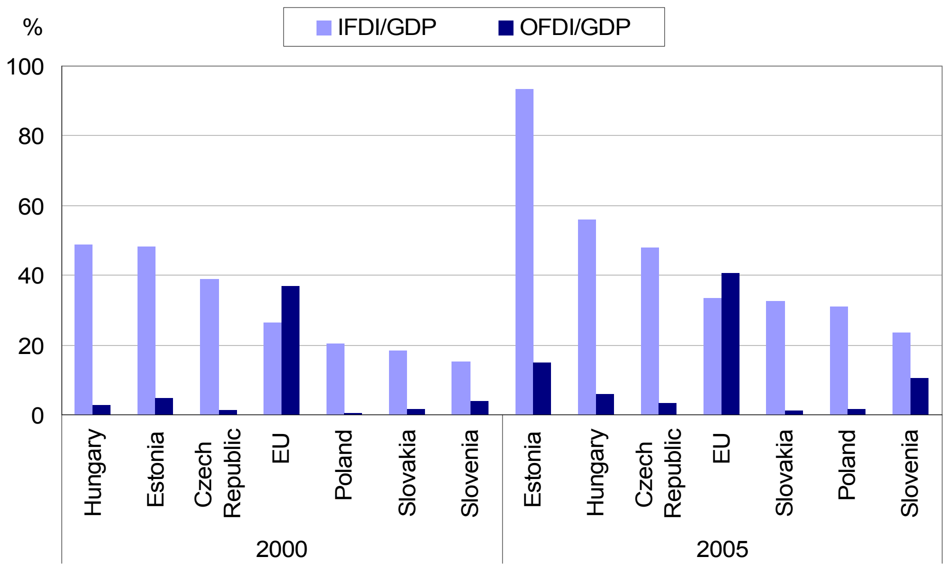
OFDI stock as percentage of GDP and OFDI flow percentage of gross fixed capital formation, 2005



Source: UNCTAD

In most of the Eastern EU members IFDI/GDP ratio is relatively high, but only some countries present relatively high OFDI/GDP ratios. Hungary, Estonia and the Czech Republic have higher IFDI/GDP index than the EU average; the former two countries show relatively high OFDI/GDP values. Although Slovenia attracts relatively low level of FDI, its OFDI/GDP value is considerable in the region. On the contrary, Slovakia, Czech Republic and Poland show relative high IFDI/GDP values (but lower than Estonia and Hungary); their outward FDI performance is fairly low compared with the leading investing countries in the region.

Inward and Outward FDI related to GDP in selected economies



Source: UNCTAD, World Investment Report 2006

The Outward FDI Performance Index measures the world share of an economy's outward FDI as a ratio of its share in world GDP. All countries performed better in 2005 than ten years ago, but some of them - Estonia, Hungary and Slovenia and Lithuania – show considerable improvement over the past ten years. The fact that their FDI grew faster than their share of global GDP means that enterprises from these economies are enhancing firm-specific advantages rapidly and/or increasingly choose to exploit their advantages by establishing foreign affiliates abroad. Despite these OFDI developments, Eastern EU members still lag far behind the group of more developed European economies in terms of OFDI performance.

Development of the OFDI Performance Index in selected economies

Country	Index value 1993-1995	Index value 2003-2005
Estonia	0.09	1.76
Slovenia	-0.04	0.96
Hungary	0.09	0.80
Lithuania	0.02	0.54
Latvia	-1.19	0.38
Czech Republic	0.17	0.37
Poland	0.02	0.19
Bulgaria	-0.06	0.10
Romania	0.01	0.02
Slovakia	0.14	0.01
Ireland	0.78	3.66
Portugal	0.36	1.96

Source: UNCTAD

Geographical distribution and motivations

Economic theory suggests that firms start to invest in countries where they export and have cultural and language similarities, furthermore they prefer to set up affiliates in neighbouring countries. Geographically OFDI from the Central European countries is restricted mainly to the region. Outward investors typically realize investments in countries with lower or similar development level, though more developed European countries as target countries have gained importance recently (for example invetments of Slovenian Gorenje Group in Western European countries like Austria, Germany or France) Ongoing privatizations, trade relations and previous common history, as well as cultural proximity and less foreign competition influence positively the internationalisation of Eastern EU member firms in the region. A noteworthy part of direct investments goes from the Czech Republic to Slovakia or from Slovenia to Croatia. More than half of the Slovenian outward investments have been realized in the former Yugoslavian countries, and half of that was present in Croatia. In 2005 more than 60% of the Estonian OFDI was hosted by Lithuania and Latvia, and almost 15% by Russia. Finland and Cyprus also have become important investment targets for Estonian enterprises. Hungarian investors are also very active in neighbouring countries, particularly in Slovakia, Croatia, Macedonia and Romania. Polish enterprises also prefer neighbouring countries for establishing foreign affiliates.

At this stage of development firms of the CEE region are motivated primarily by market-seeking. Keeping market shares, trade supporting, following the customers are decisive motivations for investors, while cost considerations have gained importance only lately.[4]

Mergers and acquisitions as entry modes gain importance, too. However the total value of M&A remained relatively low in 2006 in relation to the previous year as most of the privatisation deals and large scale restructuring in the more developed economies were completed. The telecommunication and banking sector remained significant in the value of deals for the investors from the Eastern EU members. Hungarian banks, like OTP and Magyar Külkereskedelmi Bank carried out huge deals in the region in the last years, partly due to the privatisation. (see Serbian Niska Banka). Another important target activity is manufacturing and oil and gas extraction (MOL), furthermore pharmaceuticals enterprises tend to carry out more M&A deals. Most Czech investment deals were realised in real estate, leasing and rental services, as well as in manufacturing sector in

[4] Marjan Svetličič, Andreja Jaklič (2006): Outward FDI from new European Member States (frist draft), University of Ljubljana

the last 3 years. Slovenian firms investing abroad concentrated in the services sector, like trade, bank and insurance, but the share of manufacturing sector is also considerable. In the case of Estonia OFDI have been realized principally in the banking and insurance sector (acquisitions of Lithuanian and Latvian banks by Hansapank), in real estate and leasing and rental services.

Foreign investments of EU10 are principally carried out by smaller number of huge enterprises, also called regional multinationals, covering high rate of the total value of OFDI in the region (see Hungarian MOL and OTP or Slovenian Gorenje). Among the top 25-non financial TNCs[5] from Central and Eastern Europe seven enterprises stem from Slovenia, four from Hungary, although the biggest TNCs are Russian originated. Besides regional multinationals a growing number of small and medium sized enterprises (SMEs) invest abroad, mainly from Estonia and Slovenia. Most of the SMEs are often too limited to survive in the national markets; therefore international expansion is the only way for them to develop.

Home effects of OFDI in the region

Foreign direct investment is considered generally positive in the region, while in the case of OFDI scepticism may arise regarding labour, export, productivity and macroeconomic effects. For the reason that the outflow of investments from the new EU members is not so significant compared to more matured economies, the home effect of OFDI are unlikely to be as important as it is the case in big investor countries. Surveys[6] carried out on the issue found that outward FDI from the region has principally brought benefits for the home economies. The most important effect of the abroad investments has been the gain of additional market shares, as well as the increase of exports and production volumes. Only very few companies relocated production because of rising wages at home Furthermore, OFDI typically hasn't crowded out domestic investments. As in theory, companies carrying out investments abroad enhanced their firm-specific advantages because of their improved marketing, management and organisational skills and increased investments in R&D.

Conclusions

The share of OFDI from EU10 is gradually increasing, but it is still far behind the OFDI of more matured European economies. In accordance with theories of FDI, development of OFDI seems to be in correlation with the general development level in the CEE countries. Some smaller economies tend to internationalize through OFDI faster and more intensively (Hungary, Slovenia and Estonia), while some economies realize very low OFDI (Latvia) even when their IFDI flows and stocks are relative high (Slovakia). Enterprises from EU10 realize investments principally in the region and they are mainly motivated by gaining access to new markets. The most active investors are manufacturing firms, banks and financial institutions, as well as companies from trade and communication sectors. In line with economic development the growing importance of OFDI is expected, since firms of the Eastern Member States tend to acquire more firm specific advantages, which enables more opportunities in international markets. Hence, outward FDI is both a symptom and a catalyst of improving international competitiveness.

- Ágnes Magai -

[5] UNCTAD (2006): World Investment Report 2005, The top non-financial TNCs from Central and Eastern Europe, ranked by foreign assets, 2002

[6] Marjan Svetličič, Andreja Jaklič (2002): Outward FDI by Selected Transition Economies; Comparative Evaluation, Competitive Paper www.aueb.gr/deos/EIBA2002.files/**PAPER**S/C173.pdf

Methodological notes

Definitions of variables

Nominal GDP	Gross domestic product (GDP) at current market prices in national currencies. Can be transformed into EUR using average exchange rates. Sources: Eurostat, national statistical offices.
Real GDP growth	Growth rate of GDP, measured at chain-linked volumes at 2000 prices. Sources: Eurostat, national statistical offices.
Private consumption	Growth of final consumption of households and NPISH at constant prices. For further details see: Real GDP growth.
Public consumption	Growth of final consumption of general government at constant prices. For further details see: Real GDP growth.
Investments	Growth of gross fixed capital formation at constant prices. For further details see: Real GDP growth.
Exports	Growth of exports of goods and services at constant prices (national accounts data). For further details see: Real GDP growth.
Imports	Growth of imports of goods and services at constant prices (national accounts data). For further details see: Real GDP growth.
Annual average inflation	Annual average rate of HICP. Sources: Eurostat, national statistical offices.
Policy rate	Rate of the main policy instrument of the national bank, at the end of period. Not available in certain countries with currency boards. Sources: national banks.
Money market rate	3-month interbank offer rate at the end of period. Sources: national banks.
Long-term interest rate	Average interest rate of government bonds with 10 years remaining maturity (Maastricht criterion interest rate). Source: Eurostat.
Exchange rates	Period average and end-of-period exchange rates (national currency per EUR). Sources: national banks.
Budget balance / GDP	General government balance relative to nominal GDP, in national currency. Data follow the ESA95 methodology of Eurostat unless noted otherwise. Source: Eurostat, ministries of finance. WIIW
Public debt / GDP	Stock of general government debt at the end of period, relative to GDP of the respective period. Data follow the ESA95 methodology of Eurostat unless noted otherwise. Source: Eurostat, ministries of finance, WIIW.
Trade balance / GDP	Balance of goods and services. Sources: Eurostat, national banks.
Current account / GDP	Current account balance, relative to nominal GDP of the respective period. Sources: Eurostat, national banks.
Gross foreign debt / GDP	Stock of gross foreign debt at the end of period, relative to GDP of the respective period. Sources: Eurostat, national banks, WIIW.
Unemployment	Unemployment rate according to ILO definition (among the 15-74 years old), calculated from Labour Force Survey data. Some national definitions differ slightly. Sources: Eurostat, national statistical offices.
Real ULC	Real unit labour cost growth: growth of labour compensation at current prices per employee, divided by the growth of gross value added at current prices per the number of employed persons. Sources: Eurostat, national statistical offices.