

COUNTRY ANALYSES

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4.1. ALBANIA

Major problems

- Corruption and organized crime remain major obstacles to business investment and growth. Effective and systematic anti-corruption measures as well as reforms to increase the efficiency and impartiality of the judiciary and public administration, are needed to improve business confidence and functioning of the public sector.
- Frequent disruptions in electricity generation and supply call for urgent measures aimed at modernization of the sector.

Economic policy

- The 2006 annual average consumer price index of 2.5% did not change significantly from the previous year. Consequently, inflation since 2002 has been within the Bank of Albania's target range of 2% – 4%. In July 2006 it exceeded 3% yoy, but the Bank increased its key interest rates by 25 basis points to dampen inflationary pressures and strong credit growth.
- Fiscal developments in 2006 were marked by the success of revenue administrative reforms. In recognition of the relatively strong demand pressures in the economy Albanian government saved 0.25 percent of GDP of the revenue gains and allocated the balance in a supplementary budget—in accordance with IMF program agreements—between additional investments and tax relief. Combined with half the receipts from the sale of Italian Albanian Bank (0.1 percentage point of GDP), these revenue gains financed a budgeted increase in infrastructure investment and maintenance expenditures of about 0.8 percentage point of GDP; and a cut in the employers' share of the social security tax from 29 percent of wages to 20 percent.
- Following the passing of the law „On banks in the Republic of Albania” by the Albanian Parliament on 18 December 2006, important changes in the financial and banking market activity and their supervision were introduced. The law, which has become effective on 1

June 2007, sets higher standards in banking activity as regards its licensing, organization, supervision and closure. In addition to other important changes, this law provides for the first time for the establishment and management of Credit Registry by the Bank of Albania.

- On 2 February 2007, the IMF completed the second review of Albania's three-year PRGF/EFF program. The Executive Board concluded that the reform progress in Albania is on track but that structural reforms should be stepped up, in particular by accelerating the privatisation efforts and implementing measures to ensure reliable electricity supply.

Macroeconomic performance, entrepreneurship and social policy

- Real GDP increased by 5% in 2006 – although the impact of the power generation disruption in the second half of the year reduced the growth rate by an estimated half a percentage point – driven mainly by domestic consumption and investment, financed by strong remittance inflows and rapidly increasing household credit.
- The current account deficit continued to increase in 2006, as rapidly growing imports, mainly of consumer and investment goods and electricity, outstripped exports. Although a strong growth in remittances – estimated at US\$ 1.5 billion – and a robust growth in tourism revenues have supported the incomes balance of the current account, increased export competitiveness – mainly through more investment and better labour training – is necessary to lower the foreign deficit and reduce the country's reliance on remittances from Albanian workers abroad.
- The labour market situation improved slightly throughout 2006. The unemployment rate (based on officially registered data) declined marginally to 13.8% at the end of the third quarter of 2006. Private sector employment accounted for more than 4/5 of all working people, out of which 71% worked in the agriculture, which continues to have an important function as economic and social buffer, alleviating poverty and unemployment.

Table 4.1. Albania

	2000	2001	2002	2003	2004	2005	2006
Population (million)	3.1	3.2	3.2	3.1	3.2	3.2	3.2
GDP (billion leks)	530.9	610.4	677.7	744.6	780.0	857	937.0
GDP <i>per capita</i> at PPP (USD)	3706.7	4054.9	4216.7	4524.6	4901.2	5301.8	5701.9
GDP (percentage change)	7.3	7.6	4.7	6.0	5.9	5.5	5.0
Private consumption (percentage change)	5.3						
Gross fixed capital formation (percentage change)	21.3	24.9	22.0	22.6			
Export (percentage change)	5.8	25.1	4.9	7.8	8.3	3.1	
Import (percentage change)	6.5	22.1	7.3	6.9	4.6	9.8	
Consumer prices (percentage change)							
(end-year)	4.2	3.5	4.0	2.8	2.2	2.0	2.0
(annual average)	0.0	3.1	5.2	2.3	2.9	2.3	2.5
Producer prices (percentage change)							
(end-year)		-4.0	11.2	5.0	12.3	2.4	0.5
(annual average)	5.0	-5.8	6.5	6.7	12.4	2.5	1.0
General government balance (In per cent of GDP)	-9.1	-8.5	-7.2	-4.3	-5.1	-3.6	-4.1
Trade balance (In millions of USD)	-814	-1027	-1 155	-1 336	-1 586	-1 868	-2 160
Current account balance							
(In millions of USD)	-274	-263	-435	-470	-355	-574	-710
(In per cent of GDP)	-7.4	-6.2	-9.7	-8.0	-4.7	-6.6	-7.4
Exchange rate (lek/USD – end-year)	142.8	135.9	134.0	106.4	92.6	98.1	94.1
Broad money (percentage change)	12.1	11.8	6.7	9.0	10.8	8.4	15.1
Net foreign assets (percentage change)	30.0	21.3	2.2	13.2	34.5	18.1	11.9
Domestic credit (percentage change)	8.6	4.1	6.7	11.0	7.7	13.2	14.6
Net foreign assets of Monetary Authority							
(in billions of leks)	92.34	104.9	114.63	109.77	127.56	147.82	162.77
Lending rate	22.1	19.6	15.3	11.8	11.0	12.0	12.0
Deposit rate	8.3	7.7	8.5	6.5	4.5	3.0	5.0
Gross average monthly earnings in economy							
(percentage change)	14.3	13.0	28.1	10.0	6.0	7.3	6.5
Unemployment (In per cent of labour force)	16.8	16.5	16.2	15.1	14.5	14.7	13.8

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

Growth prospects

- The growth rate of Albanian economy is expected to return to its trend rate of 6 percent in 2007, supported by continued strong performance of exports,

acceleration of growth in services sectors, and by a rise in public investment, including in the road sector. The key risk factors include high current account deficit, excessive reliance of remittances and high credit growth.

4.2. ARMENIA

Major problems

- Despite significant nominal increases in tax revenues over the past two years, the high incidence of tax evasion and exemptions are reflected in the persistently low ratio of tax revenue to GDP. The construction sector – the largest in the – economy, still remains mostly exempt from taxation.
- Continued currency appreciation, vulnerability to commodity prices, an overheated property market and dependence on soft finance from donors and multilateral institutions pose significant risks for the economy in the medium term.
- Improvements in corporate governance, transparency and enhanced competition in the commodity sector are needed to promote access to finance and investment.

Economic policy

- Fiscal policy remained sound in 2006, with an overall deficit of 1.9 percent of GDP – on a cash basis – (compared to the program target of 2.3 percent of GDP). Tax revenues increased by 19 percent in 2006, but the tax-to-GDP ratio remained low, reflecting low buoyancy of VAT revenues. Shortfalls in external financing for investment projects accounted for lower-than programmed total expenditures. In the first two months of 2007, tax revenues and total expenditures grew by 25 percent and 17 percent year-on-year, respectively. However, fiscal policy is set to loosen further in 2007, due to higher expenditure on social and infrastructure programmes in order to meet poverty reduction targets.
- Monetary aggregates grew strongly, but inflation remained subdued. End-of-period inflation increased to 5.2 percent in December 2006, mostly reflecting higher food and energy prices, while average inflation remained below 3 percent. Broad money growth remained high at 33 percent, reflecting monetisation and de-dollarisation. To dampen inflationary pressures, the Central Bank of Armenia raised its repurchase rate by 75 basis points between July and October 2006, to 4.75 percent. It was next lowered to 4.5 percent in April 2007 against the backdrop of easing inflationary pressures. In 2006 the Central Bank shifted its main policy objective from monetary targeting to inflation targeting.
- The privatisation of state-owned assets continued in 2006, but at a lower pace. Only eight enterprises were sold during the first half of 2006, netting US\$ 0.6 million. However, in June 2006 the parliament

approved the privatisation programme for next two years, targeting some 45 medium and large-sized entities.

Macroeconomic performance, entrepreneurship and social policy

- Real GDP increased by 13.4 percent in 2006, the fifth consecutive year of double-digit growth, led by construction, which grew by more than 37 percent. Output growth from services and retail trade also remained strong, rising at double-digit rates. However, industrial output has slowed considerably, recording a 0.9 per cent decline in 2006. Large inflows of remittances and increased government spending on social programmes continue to boost consumption.
- Despite deterioration in the trade balance, the current account deficit remained broadly unchanged due to strong remittances in 2006. Exports increased by only 3 percent, mostly on account of a drop in the export of diamonds and metals. Imports grew by 20 percent, reflecting rising energy and consumer goods prices, strong investment, and an appreciating dram. Net private transfers grew by 46.5 percent on the back of continued inflows to the real estate sector and remittances. Moreover, gross international reserves increased by US\$405 million (to US\$1.1 billion) due to foreign exchange intervention and FDI.
- Banking sector performance is improving, but interest rate spreads remain high. Banks are generally well-capitalized, liquid, and profitable, and the quality of loan portfolios has remained sound. Private credit growth, especially consumer and mortgage loans, remained strong (30% in 2006), but credit to the economy stayed below 10 percent of GDP.

Growth prospects

- The Armenian economy performs very strongly. Prudent macroeconomic policies, large external inflows, and ongoing structural reforms have contributed to the impressive growth performance and decline in poverty of recent years. Strong economic growth is expected to continue in the short term, particularly in construction and services, driven by remittances and supported by large bilateral grant flows. However, sustaining growth and poverty reduction will require continued sound macroeconomic policies as well as structural reforms to diversify the economy, fiscal reforms to finance productivity-enhancing infrastructure and social spending, and financial sector reforms to improve the quality and depth of financial intermediation.

Table 4.2. Armenia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	3.2	3.2	3.2	3.2	3.2	3.2	3.2
GDP (billion drams)	1033	1176	1362	1625	1908	2244	2665
GDP per capita at PPP (USD)	1964.9	2607.4	3005.6	3494.1	3916.9	4494.2	4862.8
GDP (percentage change)	6.0	9.6	12.9	13.0	10.1	14.0	13.4
Private consumption (percentage change)	5.9	15.2	5.8	14.1	16.1	18.7	12.6
Gross fixed capital formation (percentage change)	18.6	19.8	21.0	33.7	12.4	13.9	32.3
Export (percentage change)	16.6	20.8	48.0	37.4	3.7	4.9	5.6
Import (percentage change)	5.1	1.2	13.9	30.4	3.0	4.5	2.3
Consumer prices (percentage change)							
(end-year)	0.4	3.0	2.5	4.0	1.9	-0.2	5.2
(annual average)	-0.8	3.1	1.1	4.8	6.9	0.6	2.9
Producer prices (percentage change)							
(end-year)	0.4	-4.3	0.9	21.1	25.3	-4.0	
(annual average)	0.8	-0.4	2.5	2.9	21.7	7.9	5.8
General government balance (In per cent of GDP)	-6.3	-3.8	-0.6	-1.1	-1.8	-2.6	-2.8
Trade balance (In millions of USD)	-464	-420	-389	-434	-458	-585	-771
Current account balance							
(In millions of USD)	-279	-220	-156	-191	-162	-204	-290
(In per cent of GDP)	-14.6	-10.0	-6.3	-6.8	-4.5	-4.2	-4.5
Exchange rate (dram/USD – end-year)	539.5	555.1	573.3	578.8	533.5	457.8	416.0
Broad money (percentage change)	36.3	10.8	34.0	10.4	22.3	27.8	32.9
Net foreign assets (percentage change)	54.6	12.0	84.8	45.0	12.7	15.5	20.9
Domestic credit (percentage change)	22.2	-3.9	266.8	-9.6	41.1	54.4	30.0
Net foreign assets of Monetary Authority							
(in billions of drams)	182.5	187.2	257.7	234.0	279.4	340.0	389.8
Lending rate	31.57	26.69	21.14	20.8	18.2	17.3	17.2
Deposit rate	18.08	14.90	5.6	6.9	4.9	5.8	5.8
Gross average monthly earnings in economy							
(percentage change)	22.5	5.4	12.2	21.7	22.8	29.5	18.9
Unemployment (In per cent of labour force)	11.7	9.6	10.8	10.1	9.4	7.4	7.4

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

4.3. AZERBAIJAN

Major problems

- The economy remains highly dependent on the energy sector and economic diversification is essential for long-term sustainability.
- Encouraging greater private sector participation would help to advance the development of the financial sector and strengthen the competition among banks.
- The complex tax and customs system, bureaucratic delays and the high level of corruption continue to be the major obstacles to private enterprise, particularly in the non-oil sector.

Economic policy

- The authorities undertook an exceptionally large fiscal relaxation in 2006. Oil revenue increased by 118%; and non-oil revenues increased by 4% of non-oil GDP owing to the buoyancy of tax bases. Wages, pensions, and other current expenditure increased by about 50% and capital expenditure more than tripled, bringing the total expenditure increase to 81% in 2006 compared with 2005. As a result, the non-oil primary deficit reached 33% of non-oil GDP in 2006 compared with only 13% in 2005. Nevertheless as a result of surging oil revenues the general government balance recorded the surplus of about 0.5% of GDP (compared to the deficit of ca. 1% of GDP in 2005).
- In early 2006, the Azerbaijan National Bank (ANB) shifted from a fixed exchange rate to a de facto crawling peg to the U.S. dollar. With limited instrument independence, it undertook large unsterilised purchases of foreign exchange, in order to limit the annual exchange rate appreciation against the dollar to the targeted 5 percent. These policies led to a 133 percent increase in manat base money in 2006. Broad money increased by 86 percent and credit by 64 percent in 2006, fuelling inflation, which reached about 11.4% at the end of 2006 from 5.4% at the end of 2005. In response, the Central Bank raised its refinancing rate from 9% to 9.5% in July 2006 and again to 12% in April 2007. The real exchange rate appreciated by about 10.5% on year in 2006.
- Progress in other structural reforms has been mixed. The authorities put in place a new system of targeted social assistance in mid-2006, brought utilities tariffs closer to cost-recovery and selected petroleum product prices to world market levels in early 2007, and continued active participation in the Extractive Industry Transparency Initiative. However, some key state-owned enterprises operated without approved budgets in 2006, and there has been limited progress in improving budgetary expenditure management and

controls, raising concerns about the quality of the rapidly increasing expenditures. In addition, several international surveys have reported on Azerbaijan's persistent problems with transparency, corruption, and the business climate.

Macroeconomic performance, entrepreneurship and social policy

- Azerbaijan's real GDP growth accelerated to 34.5% in 2006, driven by rapidly increasing oil production and transportation (the sector benefited from increased export opportunities with the opening of the Baku-Tbilisi-Ceyhan pipeline (formally inaugurated on 13 July 2006), the oil sector accounts for more than three-quarters of industry). Non-oil real GDP, excluding oil and gas transportation, grew by about 8%, as non-tradable sectors benefited from ramped up government spending and rapidly growing banking credit. The tradable non-oil sector only grew by about 4% in 2006 compared with 10.4% in 2005, as labour costs increased and the real effective exchange rate appreciated. The officially reported poverty level continued to decline during 2005-06.
- Reforms to improve the business environment have gathered pace, including efforts to simplify registration procedures for business. New investment and competition laws were also under construction during 2006.
- The oil production boom and rising international oil prices have strengthened Azerbaijan's external position. In 2006, the external current account surplus is estimated to have increased to almost 19% of GDP from about 1 percent in 2005. The large current account surplus contributed to a significant increase in gross official reserves (US\$2.5 billion, or 5 months of non-oil imports) and government foreign assets (US\$1.9 billion), which have considerably exceeded public and publicly guaranteed external debt (US\$2.0 billion, or 10 percent of GDP) at end-2006. The current account surplus is expected to increase to 27 percent of GDP in 2007.

Growth prospects

- The short-term growth and external outlooks remain exceptionally favourable (the economy is likely to grow by more than 25% yearly over the medium term), but keeping inflation from increasing further represents a major challenge. While rapidly growing capital expenditure would support non-tradable output growth, rising competitiveness pressures would negatively affect the tradable non-oil sector. As a result, non-oil GDP growth (GDP excluding oil and gas transportation) is projected to decelerate to 7% in 2007. The continuation of the fiscal expansion would fuel domestic demand and liquidity growth. If monetary policy is not tightened, inflation is expected to increase further in 2007.

Table 4.3. Azerbaijan

	2000	2001	2002	2003	2004	2005	2006
Population (million)	8.1	8.1	8.2	8.3	8.3	8.4	8.4
GDP (billion new manats)	5	5	6	7	9	12	18
GDP per capita at PPP (USD)	2550.0	2760.1	3013.8	3372.5	3785.9	4811.0	6171.0
GDP (percentage change)	11.1	9.6	9.7	11.5	10.2	26.4	34.5
Private consumption (percentage change)	12.1	9.9	13.1	6.0	6.9	21.7	
Gross fixed capital formation (percentage change)	2.6	20.6	64.8	72.6	13.0	14.6	
Export (percentage change)		34.1	14.0	9.2	-9.0	70.9	
Import (percentage change)		33.0	48.4	45.6	-9.5	21.9	
Consumer prices (percentage change)							
(end-year)	2.2	1.5	2.0	3.6	10.4	5.5	11.0
(annual average)	1.8	1.5	2.8	2.2	6.7	9.6	8.5
Producer prices (percentage change)							
(end-year)	14.5	-4.4	-5.2	11.2	21.9	10.8	
(annual average)	27.4	1.8	-2.3	16.1	12.9	10.6	
General government balance (In per cent of GDP)	-0.6	1.4	-0.5	-1.2	0.8	-0.7	0.5
Trade balance (In millions of USD)	319	614	299	-98	162	3309	7745
Current account balance							
(In millions of USD)	-187	-050	-770	-2 020	-2 586	167	3707
(In per cent of GDP)	-3.6	-0.9	-12.3	-27.8	-29.8	1.3	18.8
Exchange rate (new manat/USD - end-year)	0.9	0.9	1.0	1.0	1.0	0.9	0.9
Broad money (percentage change)	18.3	-3.4	16.2	27.9	31.9	15.8	44.2
Net foreign assets (percentage change)	90.4	15.8	-20	6.3	47.9	6.8	89.0
Domestic credit (percentage change)	17.6	-38.1	85.9	26.1	39.5	50.3	78.1
Net foreign assets of Monetary Authority							
(in billions of new manats)	620.5	854.0	709.9	790.9	1 055.0	1082.1	2181.2
Lending rate	19.7	19.7	17.4	15.5	15.7	17.0	17.7
Deposit rate	12.2	9.0	9.0	9.5	9.2	8.5	10.6
Gross average monthly earnings in economy							
(percentage change)	20.2	17.3	21.2	21.4	26.2	21.9	19.8
Unemployment (In per cent of labour force)	1.2	1.3	1.3	1.4	1.5	1.4	1.3

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

4.4. BELARUS

Major problems

- To enhance the role of the private sector, it is necessary to facilitate the entry of new businesses and accelerate both the commercialization and privatisation of existing SOE. Extensive restructuring of enterprises and the wider use of energy efficient technologies is crucial to ensure sustainable growth in the medium term.
- In case of Belarus macroeconomic data may not tell the whole story. While the quality of statistics is generally good, extensive state controls over the economy—notably on prices—complicate the assessment of economic developments and of the impact of policy actions.

Economic policy

- After a deficit in 2005, the 2006 consolidated budget recorded a surplus of 1.4% of GDP in 2006. Revenues continued to be buoyant, supported by the favourable external environment. The turnover tax was reduced from 3.9 to 3.0% of enterprise revenue in 2006, and a new method of VAT distribution between the regions – proportional to population – was introduced. The National Development Fund financed from profits of key exporters and other highly profitable state controlled enterprises, was created in 2006.
- While officially targeting the Russian rouble, the National Bank of the Republic of Belarus (NBRB) has maintained a stable exchange rate vis-à-vis the U.S. dollar, which facilitated further gradual de-dollarisation and rapid increases in international reserves in 2005 and 2006. The refinance rate was reduced by 600 basis points in 2005 and by a further 50 in June 2006. Reserve requirements were also lowered twice in 2005 and 2006, by one percentage point each time. These developments triggered an increase in liquidity that the NBRB sterilized to a large extent, in a context of further remonetisation.
- The privatisation process remains stalled. Although commercialization has slowly continued, the majority of incorporated enterprises remain state-owned. Shares in nine entities were sold in 2005, out of 203 prepared for this process. Another 30 enterprises have been prepared for sale in 2006, but none were sold by November. At the same time, a presidential decree to renationalise 82 formerly privatised loss-making enterprises was signed in August 2006.

Macroeconomic performance, entrepreneurship and social policy

- The gross domestic product increased by 9.9% in 2006 compared to 9.4% in 2005. High quantitative economic

growth rates are supported by the favourable external environment and government policies that have stimulated domestic demand. In 2006, the rate of growth of the fixed capital expenditure was estimated to be particularly strong, growing at about 31%, supported by a surge in lending. Private consumption also increased in line with the continued growth in household incomes. From the supply-side the industry of Belarus is traditionally driving the country's economic growth. Industrial output rose by 11.3%, up from the 10.5% growth registered in 2005, while growth in the agricultural sector accelerated to 6.1% from 1.7% in 2005.

- Despite the hike in CPI of 1.8% in November 2006, ample production capacity has allowed twelve-month inflation to decline steadily over past year, to 6.6% percent in December 2006. However, rising unit labour costs, tighter capacity utilization in many sectors, a high and increasing ratio of Producer Price Index to Consumer Price Index inflation, and estimates of underlying inflation suggest a build-up in inflation pressures. Low inflation also reflects, in part, administrative controls over price formation.
- The trade deficit increased significantly to an estimated 6.5 per cent of GDP in 2006. Exports continued to be buoyant on the back of high commodity prices and strong demand from Russia. However, imports expanded at a faster rate than exports, reflecting rapid growth in real income and an appreciating real exchange rate. The current account recorded a deficit for the year as a whole, as the surplus in services did not offset the widening trade deficit. Capital inflows, in particular loans to the banking sector, increased significantly in 2006, which helped to finance the current account deficit. Official reserves (excluding gold) decreased by 3.5 per cent over 2006.
- The economy remains heavily regulated. The government imposes various targets on enterprises, relating for example to wage growth, production and export. Regulations usually take the form of „recommendation”, such as recommended lending rates for banks (including private banks) or recommended price and wages increases.

Growth prospects

- The doubling of imported gas prices in 2007 will have a negative effect on the economy in the short term. The trade deficit is expected to widen and inflationary pressures to increase. The diminished gains from oil trade will further aggravate the difficulties. Due all this facts, the growth rate is expected to decrease to 6.5% in 2007.

Table 4.4. Belarus

	2000	2001	2002	2003	2004	2005	2006
Population (million)	10.0	10.0	9.9	9.9	9.9	9.8	9.7
GDP (billion BYR)	9 134	17 173	26 138	36 565	49 992	65 067	79 231
GDP per capita at PPP (USD)	4835.1	5204.7	5592.2	6143.9	7076.1	8002.5	8862.1
GDP (percentage change)	5.8	4.7	5.0	7.0	11.4	9.4	9.9
Private consumption (percentage change)	8.0	17.9	11.4	7.4	9.6	14.8	22.6
Gross fixed capital formation (percentage change)	2.3	-3.5	6.0	20.8	20.9	20.0	31.4
Export (percentage change)	23.9	2.2	5.5	23.7	47.5	14.1	23.5
Import (percentage change)	29.5	5.9	10.3	15.1	45.7	0.3	33.6
Consumer prices (percentage change)							
(end-year)	107.5	46.1	34.8	27.5	14.4	8.0	6.6
(annual average)	168.6	61.1	42.6	29.0	18.1	10.3	7.0
Producer prices (percentage change)							
(end-year)	168.0	71.8.0	40.4	28.7	18.8	10.0	9.0
(annual average)	185.6	39.0	43.0	29.0	24.1	12.1	8.3
General government balance (In per cent of GDP)	0.3	-1.9	-1.8	-1.4	0.0	-0.7	1.4
Trade balance (In millions of USD)	-838	-807	-914	-1256	-2184	-491	-2398
Current account balance							
(In millions of USD)	-338	-411	-326	-434	-1194	-510	-1512
(In per cent of GDP)	-2.7	-3.3	-2.2	-2.4	-5.2	1.7	-4.1
Exchange rate (BYR/USD - end-year)	717.0	1580	1920	2156	2170	2152	2140
Broad money (percentage change)	219.3	58.9	51.5	56.0	44.1	42.2	29.6
Net foreign assets (percentage change)	395.0	52.0	55.1	39.1	15.9	49.7	-46.9
Domestic credit (percentage change)	190.8	72.9	55.6	72.2	30.8	33.5	52.2
Net foreign assets of Monetary Authority							
(in billions of BYR)	423.5	706.2	1439.9	1277.8	2056.5	3009.2	3480.44
Lending rate	67.7	47.0	36.9	24.0	16.9	11.4	8.8
Deposit rate	37.6	34.2	26.9	17.4	12.7	9.2	7.7
Gross average monthly earnings in economy							
(percentage change)	200.9	112.0	54.0	30.1	38.6	33.4	27.4
Unemployment (In per cent of labour force)	2.1	2.3	3.0	3.2	1.9	1.9	1.9

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

4.5. BOSNIA and HERZEGOVINA

Major problems

- While the reform of the financial sector has generally been successful, government expenditure is set to continue to increase from an already high level of around 50% of GDP, at the same time as efficiency in public spending remains comparatively low. The law on war veterans, which was adopted in the Federation in early September 2006, is one factor creating upward spending pressures.
- The mechanism on how to divide the collected indirect tax revenues between different levels of government in Bosnia and Hercegovina (BH) continued to be a contentious issue. Funds were blocked in the single account several times during 2006, resulting in delays of transfer of funds to the entities and the Brcko district.
- Renewed momentum in privatisation and enterprise restructuring is needed to ensure an increase in private sector profitability and maintenance of output and export growth.

Economic policy

- The consolidated budget balance posted a surplus of 0.8% in 2005 and remained close to balance in 2006. This improvement over previous years stemmed from stronger sales and excise tax revenues and a reduction in expenditures. In 2006, revenue inflows were unexpectedly strong, mainly as a result of higher than expected indirect taxation revenues after the introduction of VAT in January. However, much of this increase (relative to the previous sales taxes) is temporary and unlikely to be repeated in future years. This allowed for a tiny budget deficit of around 0.2% in 2006, despite the fact that substantial growth in expenditures took place at different levels of government. The downward trend of public external debt continued. The debt stock amounted to 27.2% of GDP at end 2005 and had decreased to around 24% of GDP in September 2006. Private external debt rose in 2005 and is estimated to represent around 30% of total external debt.
- Monetary policy continues to be guided by a strict currency board arrangement.
- Privatisation has proceeded at a slow pace, especially in the Federation, where only 14 companies were sold. More progress was made in the Republika Srpska (RS), including the sale of a 54% stake in *Banja Luka Brewery* to *Altima Partners of London*. By mid-2006 the amount of capital remaining to be privatised in the RS was estimated to be close to 50%, while in the Federation it was around 60%. A major privatisation in the

telecommunication sector was also launched in August 2006 with the announcement by the RS government of a tender for 65% of the state owned *Telekom Srpske*.

Macroeconomic performance, entrepreneurship and social policy

- After growing 5.8 per cent in 2005, the economy is estimated to have recorded a similar increase in 2006. Lack of detailed and reliable data hampers the analysis of drivers of growth. However, formalisation of the shadow economy after the introduction of VAT has been added to official growth during the year. Another development driving economic growth has been further increases in industrial production, especially in the RS (by 19.1% in 2006). Exports continued to grow, reflecting increasing access by BH producers to regional and EU markets.
- The introduction of VAT in January 2006 and higher oil prices gave a temporary upward impetus to inflation. After several years of very low single-digit inflation, the rate in both entities of BH rose during 2006 but remained in single-digit levels throughout the year in both cases. During the first three months of 2007 inflation dropped as the VAT effects subsided and inflation reached 0.6% in the RS and 1.9% in the Federation in February year-on-year.
- BH continues to record very high trade and current account deficits. The latter is estimated to have fallen significantly during 2006, although this is subject to considerable uncertainty. The deficit is fully covered by a combination of capital transfers, foreign direct investment (FDI) and other capital inflows.
- Inflows of foreign direct investment (FDI) weakened from 5.2% of GDP in 2005 to 3.7% of GDP in 2006. The finalisation of a few large transactions, such as the sale of RS telecom, was postponed to 2007 and is likely to impact this year's total inflows positively. FDI remains intimately linked to the privatisation process. Investment inflows via the banking sector continued to grow. Together with other types of trade credits they constituted an increasingly important source of financing of the current account deficit. However, the absolute total size of these inflows decreased during 2006 in parallel with the decrease in the size of the current account deficit. Net foreign reserves continued to increase, from around 4 months of imports in 2005 to 5 months of imports in 2006.
- Official unemployment declined to 41% in September 2006, compared to 42% in December 2005. The nominal decline was however partly due to a revision of registration methods and does not necessarily reflect an increased number of jobs. Official statistics do not correctly reflect unemployment levels. Labour Force Survey conducted in

Table 4.5. Bosnia and Herzegovina

	2000	2001	2002	2003	2004	2005	2006
Population (million)	4.3	4.3	4.3	3.4	3.8	3.8	3.8
GDP (million KM)	10 054	12 137	12 806	13 492	14 678	15 791	17 750
GDP per capita at PPP (USD)	5698.8	6058.6	6442.6	6815.2	7386.7	7928.5	5698.8
GDP (percentage change)	5.5	4.4	5.3	3.0	6.0	5.8	6.0
Private consumption (percentage change)							
Gross fixed capital formation (percentage change)	20.6	18.9	20.4	19.9			
Export (percentage change)	64.7	4.6					
Import (percentage change)	8.8	7.3					
Consumer prices (annual average – percentage change)							
Federation		1.9	-0.2	0.2	-0.3	2.1	7.5
Republika Srpska		7.0	1.7	1.8	2.2	2.7	7.0
Consumer prices (end-year – percentage change)							
Federation		0.3	-0.7	0.3	-0.3	4.4	6.6
Republika Srpska		2.2	2.4	1.3	2.2	3.7	4.7
General government balance (In per cent of GDP)	-5.5	-4.5	-3.3	-2.2	-0.6	0.8	-0.2
Trade balance (In millions of USD)	-1 655	-2073	-3327	-4152	-4572	-4990	-4277
Current account balance							
(In millions of USD)	-621	-888	-1209	-1945	-2109	-2425	-1457
(In per cent of GDP)	-13.1	-16.0	-19.6	-25.0	-22.6	-23.7	-12.8
Exchange rate (KM/USD – end-year)		1.96	1.96	1.96	1.96	1.96	1.96
Broad money (percentage change)	-15.8	89.3	8.6	8.4	24.3	18.2	24.7
Net foreign assets (percentage change)	10.0	-1.6	27.6	19.8	18.0	9.8	39.4
Domestic credit (percentage change)		5.2	28.2	19.8	18.0	27.6	20.6
Net foreign assets of Monetary Authority							
(in billions of KM)	1004	2737	2512	2821	3507	4252	5480
Lending rate	14.7		4.53	4.03	3.72	3.56	3.69
Deposit rate	12.9	6.8	6.9	9.4	10.28	9.61	8.01
Gross average monthly earnings in economy							
(percentage change)		11.1	14.0	18.8	6.6		
Unemployment (In per cent of labour force)	39.6	40.2	41.0	42.1	42.9	42.0	41.0

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

April 2006 estimated unemployment to be around 30% of the labour force, while participation rate was estimated to be only 43%.

Growth prospects

- In recent years, BH has managed to depend less and less on aid, and growth rates have held up well. The

outlook is for continued growth in the region of 5-6 per cent a year, allied to low inflation. However, the main risks to this generally positive outlook lie in the small appetite of public officials for serious reform, and difficulties and sensitivities related to the imminent reforms of the outdated constitutional set up established by the Dayton Peace Agreement.

4.6. BULGARIA

Major problems

- Although some progress has been made in introducing reforms to strengthen the judiciary, completion of the legal and administrative enforcement of legislation combating crime, corruption and fraud would bring about significant improvements in the business environment.
- The government needs to establish transparent procedures and fast review mechanism for the appeals of past privatisation and the awarding of concession agreements, where massive delays in courts have occurred.

Economic policy

- The general government surplus reached 3.3% of GDP in 2006, up from around 2% of GDP in 2005. Strong revenue growth and improved tax collection limited the effect of the 6-percentage-point reduction in pension contributions in 2006 on the revenue-to-GDP ratio. At the same time, expenditure restraint – especially as regards current primary spending – and lower interest payments helped reduce the expenditure-to-GDP ratio by almost 3% of GDP. In line with strong GDP growth and fiscal surpluses, general government gross debt is expected to drop to below 20% of GDP in 2008.
- Economic circumstances clearly warrant a policy bias in favour of prudence, especially given Bulgaria's aspirations for early participation in ERMII. In the absence of independent monetary policy under the currency board arrangement, and given the even greater degree of financial integration following accession, the burden falls on fiscal policy to help manage the risks accompanying macro imbalances. At the same time, however, the fixed exchange rate requires sustained structural reforms to enhance the flexibility of the economy.
- Significant progress has been made in privatising infrastructure. In May 2006 the government signed an agreement with the Czech energy company CEZ, for the sale of the Varna power plant for over 300 millions of euro. Two smaller hydropower plants have been sold to local investors. In June 2006 the government approved the sale of 70% of *Bulgarian River Shipping Corporation to Chimimport*. In the same month the government launched a tender for the purchase of national airline.

Macroeconomic performance, entrepreneurship and social policy

- Real GDP growth remained robust in 2006 at around 6%, mainly driven by strong domestic demand. Relatively strong employment growth and higher real

incomes continued boosting private consumption, which increased by around 7%, up from about 6% in 2005. Consumption expenditures were mainly driven by rapid growth of credit to the private sector, rising incomes and employment. On the back of very high FDI inflows of above 16% of GDP, gross fixed capital formation remained buoyant and increased by around 17.5% in 2006. However, the composition of growth remained fairly unbalanced with a strong negative contribution from net exports, mainly because of high import growth and lower exports of services.

- Merchandise export growth picked up again in 2006, but remained below import growth. As a result, the trade deficit widened further to around 21.6% of GDP. A fall in the surplus in the services balance (due to lower growth of tourism revenues), lower current transfers and lower net incomes from abroad further added to the increase in the current account deficit. Net borrowing vis-à-vis the rest of the world thus increased to around 15% of GDP in 2006, up from around 11% in 2005. The financing of the current account deficit has been supported in the short term by very strong flows of net foreign direct investment (FDI), which covered 73 per cent of the deficit in 2005 and 114 per cent in 2006. About a third of the large flows of FDI are investments in real estate and construction.
- Strong private sector job creation, which was also boosted by a reduction in pension contributions, and an increase in participation rates led to higher-than expected employment growth of around 4.5% in 2006. An increasingly tight labour market will entail certain upward pressures on nominal wage growth. However, in line with a substantial increase in the investment ratio and ongoing economic restructuring, labour productivity growth is projected to accelerate steadily from around 3.5% in 2005 to 5% in 2008. This will mitigate the effect of the increase in wages on nominal unit labour costs. HICP inflation increased from an average 6% in 2005 to 7.4% in 2006, mainly owing to higher excise duties on alcohol and tobacco. Thanks to lower oil prices HICP inflation decreased during the year, but seasonally higher food prices caused a slight re-acceleration to 6.5% at the end of the year.

Growth prospects

- Underlying economic trends are expected to remain largely unchanged in 2007 and 2008, with real GDP growing at around 6% in both years. The catching-up of the Bulgarian economy will continue to be supported by strong investment growth, both to expand capacity and to upgrade the existing capital stock. Moreover, absorption of EU Structural Funds starting in 2007 will give a boost to

Table 4.6. Bulgaria

	2000	2001	2002	2003	2004	2005	2006
Population (million)	8.1	8.1	8.0	7.8	7.8	7.8	7.7
GDP (million leva)	26 753	29 709	32 324	34 725	38 008	42 797	49 091
GDP per capita at PPP (USD)	6026.2	6465.8	6947.7	7493.9	8188.3	8948.7	9798.9
GDP (percentage change)	5.4	4.1	4.8	4.5	5.7	6.2	6.1
Private consumption (percentage change)	4.9	4.5	3.9	7.1	4.9	5.5	7.1
Gross fixed capital formation (percentage change)	15.4	19.9	9.3	13.9	13.5	23.3	17.6
Export (percentage change)	16.6	8.5	6.2	8.0	13.0	8.5	9.0
Import (percentage change)	18.6	13.0	4.7	15.3	14.1	13.1	15.2
Consumer prices (percentage change)							
(end-year)	11.4	4.8	4.4	5.6	4.0	6.5	6.5
(annual average)	10.4	7.5	5.8	2.3	6.1	5.0	7.3
Producer prices (percentage change)							
(end-year)	14.7	-3.3	6.3	4.3	5.2	9.6	5.1
(annual average)	17.3	5.8	1.3	6.9	6.0	6.9	6.9
General government balance (In per cent of GDP)	-1.0	1.9	0.1	-0.9	2.2	1.9	3.3
Trade balance (In millions of USD)	-1175	-1581	-1595	-2518	-3643	-5 399	-6810
Current account balance							
(In millions of USD)	-702	-984	-827	-1856	-1416	-3133	-4667
(In per cent of GDP)	-5.6	-7.2	-5.3	-9.3	-5.9	-11.5	-14.8
Exchange rate (leva/USD - end-year)	2.1	2.2	1.9	1.5	1.4	1.7	1.5
Broad money (percentage change)	12.2	49.3	13.5	21.2	23.3	24.4	26.8
Net foreign assets (percentage change)	27.9	5.3	2.7	1.3	15.1	19.1	46.1
Domestic credit (percentage change)	31.4	25.5	27.0	32.4	33.3	35.1	17.1
Net foreign assets of Monetary Authority							
(in billions of leva)	7.44	7.94	8.95	10.38	13.08	14.27	17.33
Lending rate	11.5	11.1	9.3	9.1	8.8	8.6	8.9
Deposit rate	3.1	2.9	2.8	2.9	3.1	3.1	3.2
Gross average monthly earnings in economy							
(percentage change)	15.9	11.7	4.2	9.2	9.1	4.3	4.6
Unemployment (In per cent of labour force)	16.4	19.2	17.8	13.7	12.0	10.1	8.9

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

investment in public infrastructure. The main vulnerability is however the external position, with persistently high current account deficits giving some cause for concern. The government must maintain a tight fiscal policy, and further

fiscal tightening may be necessary to help offset the sustained excessive buoyancy of domestic demand and enable the government to help manage the consequences of an unexpected external shock.

4.7. CROATIA

Major problems

- Despite some reform of the pension and care system, comprehensive changes need to be implemented to restore fiscal sustainability.
- An inefficient judicial system has continued to undermine the enforcement of property and creditor rights.
- State intervention remains significant and damaging. State aid, mostly to specific sectors such as shipbuilding and railways represented ca. 3% of GDP.

Economic policy

- The revised budget 2006, adopted in July, foresees a reduction of the consolidated general government deficit to 3% of GDP in 2006 in GFS terms. According to the fiscal framework presented in the 2006 Pre-Accession Programme, this translates into a planned deficit of 2.2% in ESA 95 terms, down from 3.9% in 2005. Fiscal developments in 2006 were marked by relatively strong growth of tax revenues, and some moderation of spending on a cash basis. According to preliminary data for 2006 released by the Ministry of Finance for the consolidated general government, total revenues increased by 8.9% year-on-year, driven by a particularly strong increase in direct tax revenues (19.2%). Total spending (without net acquisitions of non-financial assets) grew by 7.2%. Particularly strong increases were recorded for spending on subsidies (9.4%) and on goods and services (22.3%). By end-2006, the stock of general government debt had grown by 0.9% year-on-year, reaching 41.2% of GDP. This does not include the stock of issued state guarantees of 5.7% of GDP and the debt of the State Development Bank (HBOR) of 3.1% of GDP at end-2006.
- After a decreasing trend in the inflation rate from 2002 onwards, the average consumer price inflation rate increased in 2005 to 3.3 per cent, decreased to 3.2 per cent in 2006 and is estimated to stay at that level in 2007. The Central Bank remains committed to tight monetary policies, mainly aimed at exchange rate stability and the containment of credit expansion.
- After regaining some momentum in 2005, the privatisation process slowed and fell short of the authorities' policy objective in 2006. Reconfirmed in second half of 2005, the objective was to sell 50% of companies with minority state ownership by June 2006 (almost 500 enterprises). However, by this date only 55 companies were sold. Factors delaying the privatisation process included legal problems, a lack of investor interest and unrealistic sale conditions.

Macroeconomic performance, entrepreneurship and social policy

- In the fourth quarter of 2006, real GDP growth accelerated to 4.8% year-on-year, bringing the annual growth rate in 2006 to 4.8%, up from 4.3% in 2005. In the fourth quarter, net exports contributed more strongly to growth, while the impact of domestic demand was weaker than in previous quarters.
- The current account deficit increased to about 7.7% of GDP in euro terms in 2006. It may go even higher in 2007. Inward current transfers are also expected to rise as the EU accession process progresses. According to data by the Statistical Office for the year 2006, merchandise exports grew stronger (15.6%) than imports (11.9%), although Imports of goods and services grew slightly stronger (7.3%) than exports (6.9%), leading to a negative contribution of net exports to growth. In January, exports were 3.3% lower compared to the same month a year ago, while imports grew by 4.6%. Thus, the merchandise trade deficit increased by 14% year-on-year. The net inflow of FDI increased to around 7.8% of GDP in 2006, thus fully financing the current account deficit.
- At end-January 2007, official reserve assets of the Croatian National Bank stood at a comfortable level of EUR 9,172 million, reflecting a nominal increase of around 20% as compared to January 2006, and equivalent to around 5.5 months of 2006 imports of goods and services. During 2006, external debt continued to grow to EUR 29,000 million at year-end, or around 86% of GDP. The growth of external debt was mainly driven by an acceleration of external borrowing of the corporate sector (30.7% year-on-year). The government and the Central Bank have stepped up efforts to mitigate this vulnerability in recent years. The government has increased the proportion of domestically sourced financing. However, external debt owed by banks and other sectors has more than offset the decrease in the government's external debt. The share of corporate debt increased, largely because of the Central Bank's decision to limit foreign borrowing by banks, which encouraged large private sector companies to borrow abroad directly, in many cases from the parent banks of the foreign-owned financial institutions in Croatia. The annual growth of foreign borrowing of the banking sector slowed to 13.2%, while the government sector reduced its outstanding foreign indebtedness by 5.5%.

Growth prospects

- Recently published high frequency indicators suggest a continuation of relatively strong growth in the beginning of 2007. In January, industrial production

Table 4.7. Croatia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	4.4	4.5	4.5	4.3	4.4	4.4	4.4
GDP (billion kuna)	152.5	166	181	198	215	231	251
GDP per capita at PPP (USD)	9543.5	10077.9	10811.2	11633.4	12426.5	13341.9	14368.4
GDP (percentage change)	2.9	4.4	5.6	5.3	4.3	4.3	4.8
Private consumption (percentage change)	4.2	4.4	7.7	4.6	4.8	3.4	3.5
Gross fixed capital formation (percentage change)	-3.8	7.1	13.9	24.7	5.0	4.9	10.9
Export (percentage change)	12.0	8.1	1.3	11.4	5.7	4.6	6.9
Import (percentage change)	3.7	9.8	13.4	12.1	4.6	3.5	7.3
Consumer prices (percentage change)							
(end-year)	7.4	2.6	2.7	2.1	2.7	3.6	2.0
(annual average)	6.2	4.9	2.3	1.8	2.1	3.3	3.2
Producer prices (percentage change)							
(end-year)	11.2	-3.1	0.2	1.0	4.8	2.7	1.9
(annual average)	9.7	3.6	-0.4	1.9	3.5	3.0	2.9
General government balance (In per cent of GDP)	-7.1	-6.8	-4.9	-6.2	-4.8	-4.0	-3.0
Trade balance (In millions of USD)	-3204	-4012	-4545	-7908	-8350	-9346	-11 014
Current account balance							
(In millions of USD)	-461	-727	-1915	-2132	-1841	-2588	-3447
(In per cent of GDP)	-2.5	-3.5	-7.1	-6.5	-5.1	-6.6	-8.1
Exchange rate (kuna/USD – end-year)	8.2	8.3	7.8	6.1	5.6	6.2	5.4
Broad money (percentage change)	28.9	45.2	30.2	11.0	8.6	10.5	18.0
Net foreign assets (percentage change)	73.8	11.1	-29.8	38.0	6.9	26.6	19.7
Domestic credit (percentage change)	8.9	23.0	6.0	12.3	11.8	19.2	18.9
Net foreign assets of Monetary Authority							
(in billions of kuna)	28.7	39.3	42.0	50.1	49.3	54.9	64.1
Lending rate	12.0	9.5	10.9	11.5	11.4	9.9	9.1
Deposit rate	3.7	3.2	1.6	1.7	1.7	1.6	3.0
Gross average monthly earnings in economy							
(percentage change)	7.0	3.9	6.0	4.8	6.4	4.4	6.2
Unemployment (In per cent of labour force)	16.1	16.4	14.5	14.4	13.8	12.3	11.7

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

accelerated to 9.1% growth year-on-year (3% in December), but slowed somewhat to 5.7% in February. Construction output posted a strong rise of almost 14% in January, up from an annual average growth of 9.4% in 2006. Consequently, the economy is on course for strong growth over the short- to medium-term, while the anchor of EU accession talks should provide a strong impetus for further reforms. Nevertheless, the authorities face a number of

significant macroeconomic challenges and risks. Further progress in fiscal consolidation is essential for macroeconomic stability, but will be increasingly difficult to achieve given the pressures for higher government spending in the election year. The rapid expansion in recent years in domestic credit and the growing external indebtedness of commercial banks have helped to raise external debt to levels that will require careful monitoring.

4.8. CZECH REPUBLIC

Major problems

- A large pre-election fiscal relaxation had led to a reversal of the recent favourable trend in public finances in 2006. The pro-cyclical fiscal stimulus, with the economy set to register another year of robust growth, was untimely. Moreover, the absence of structural fiscal reforms in the pension and health care system pose significant risks to the economic outlook over the medium term.
- Further reform of the judicial system, especially bankruptcy administration and the reduction in the overall level of bureaucracy are needed to make significant improvements to the business environment. It takes on average nine years to liquidate a bankrupt firm, compared with an average of 3.5 years in neighbouring countries.

Economic policy

- The government deficit fell to 3.5% of GDP in 2006, below the annual target of 3.8% of GDP set out in the consolidation path of the July 2004 Council Recommendation of the Excessive Deficit Procedure (EDP). However, this is mainly due to stronger growth than previously anticipated rather than sustainable spending cuts. Moreover, fiscal policy turned expansionary, and the general government deficit is estimated to have risen to over 4% of GDP again in 2007, reflecting pre-election tax cuts and increases in social transfers for pensions and health care. A large social spending package in the budget for 2007 is expected to rise mandatory spending in the coming years.
- Monetary policy has been tightened gradually, as the CNB has attempted to strike a balance between the risk of rising resource pressures, continuing productivity gains, and the strengthening koruna. The policy rate was raised in steps from a historic low of 1.75% in the summer of 2005 to 2.5% in January 2007. The Czech Republic was expected to join the European Union's Exchange Rate Mechanism II (ERM II) in mid-2007 and to adopt the euro in 2010. However, given the lack of political resolve and in the absence of further fiscal consolidation, these dates have now been dropped. In March 2007, the CNB announced a downward revision of the inflation target to 2%, effective from January 2010. In spite of the revision of the CPI basket at the beginning of 2007, which will reduce, measured inflation by up to a third of a percentage point, the move may imply monetary tightening given the overall outlook.
- Progress in liberalisation and privatisation has slowed markedly largely after the general elections held in June

2006 resulted in a hung parliament and a continuing political impasse. In particular, high profile cases of privatisation have been thrown into question. However, only a limited number of state assets in major companies remain to be privatised: stakes in brewery *Budvar*, Czech Airlines, *Ceska Posta* and railway company *Ceske Drah*.

Macroeconomic performance, entrepreneurship and social policy

- The Czech economy continued to grow strongly in 2006, at about 6% of GDP, equalling the record level of 2005. The main impetus was provided by domestic demand, in particular gross fixed capital formation – underpinned by low interest rates, increasing real incomes and rapid credit growth – with a declining contribution from net exports. Private consumption also raised strongly on the back of increasing employment, rising salaries, cuts in direct taxation and expanding consumer credit. Mortgage lending also grew rapidly helped by low interest rates. The increase in consumer spending contributed to a strong rise in imports, which reduced the contribution of net exports. On the supply side, the main contribution to the economic expansion continued to come from manufacturing, particularly transport related, as well as trade and commercial services.
- Increases in regulated prices and changes in indirect taxes have pushed headline inflation closer to the 3 percent target in 2006, but the underlying inflationary pressures have remained subdued. Lingering slack in the labour market and inflows of migrant workers kept wage inflation moderate, which, coupled with strong productivity gains, helped contain labour costs. There are no apparent signs of the second-round effects from increases in energy and other regulated prices, which, together with well-anchored expectations, underscores the strong credibility of the Czech National Bank (CNB).
- Although the koruna has continued to strengthen, both in nominal and real effective terms, this has not hindered the gradual rise in export market shares. The trade account has turned into a surplus during 2005-06. The evolution of the trade balance is driven by an expansion in production capacity boosted by past foreign direct investment (FDI) flows. The income deficit remains high, mainly reflecting FDI earnings, which are to a large extent re-invested in the country. Profit repatriation has kept the current account in deficit, but at a moderate level. This external position is expected to continue to be strong over the medium term.

Table 4.8. Czech Republic

	2000	2001	2002	2003	2004	2005	2006
Population (million)	10.3	10.3	10.3	10.3	10.3	10.3	10.3
GDP (billion korunas)	1 984	2 352	2 464	2 577	2 781	2 978	3 239
GDP per capita at PPP (USD)	15653.9	16500.8	17146.6	18140.6	19432.3	21191.9	23100.2
GDP (percentage change)	3.3	2.5	1.9	3.6	4.2	6.1	6.1
Private consumption (percentage change)	2.5	2.3	2.2	6.0	2.5	2.8	4.0
Gross fixed capital formation (percentage change)	5.3	5.8	2.1	4.7	5.3	3.7	6.6
Export (percentage change)	17.0	12.3	3.7	7.5	21.4	11.1	14.7
Import (percentage change)	17.0	13.6	4.1	7.9	18.4	4.8	14.7
Consumer prices (percentage change)							
(end-year)	3.9	4.8	1.8	1.0	2.8	2.2	1.8
(annual average)	2.8	3.7	1.1	0.2	2.8	1.8	2.5
Producer prices (percentage change)							
(end-year)	5.0	0.8	-0.2	0.9	7.7	-0.3	
(annual average)	4.9	2.9	-0.5	-0.3	5.7	3.0	1.5
General government balance (In per cent of GDP)	-4.0	-5.8	-6.8	-6.6	-2.9	-3.6	-3.5
Trade balance (In millions of USD)	-3131	-3068	-2179	-2473	-1029	1685	1700
Current account balance							
(In millions of USD)	-2 718	-3273	-4166	-5690	-6511	-2575	-5916
(In per cent of GDP)	-5.3	-5.3	-5.5	-6.2	-6.0	-2.1	-4.2
Exchange rate (koruna/USD - end-year)	38.6	36.3	30.1	25.7	22.4	24.6	22.7
Broad money (percentage change)	13.8	13.0	3.5	6.9	4.4	8.0	8.6
Net foreign assets (percentage change)	6.6	4.6	14.4	-10.7	1.1	24.7	-9.6
Domestic credit (percentage change)	10.6	7.7	-3.2	21.9	0.1	4.6	20.5
Net foreign assets of Monetary Authority							
(in billions of korunas)	507.4	536.6	720.1	690.65	657.63	811.71	740.63
Lending rate	5.42	4.69	2.63	2.08	2.56	2.17	2.55
Deposit rate	3.42	2.87	2.00	1.33	1.28	1.17	1.19
Gross average monthly earnings in economy							
(percentage change)	7.0	8.6	7.5	7.0	6.6	5.5	6.6
Unemployment (In per cent of labour force)	8.7	8.0	7.5	8.3	8.4	7.9	6.7

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

Growth prospects

The exceptional growth of the previous two years is expected to moderate in 2007 and 2008 to just below 5% of GDP while the pattern of growth is expected to stay broadly similar. Domestic demand should provide the greater stimulus whereas the growth contribution of the

external balance is likely to be partly affected by an appreciating koruna. Risks to growth are broadly balanced, with the upside risks stemming from external factors (lower oil prices and stronger recovery in the euro zone) offsetting the downside risks to confidence, in view of the uncertain political prospects.

4.9. ESTONIA

Major problems

- High trade deficit and high current account deficit may undermine macroeconomic stability in the medium term..
- Accelerating inflation may force the government to further postpone the date of entry into the euro zone.

Economic policy

- Since 2001, general government balance has recorded a surplus. In 2006, the surplus equalled 3.8% of GDP and it was greater than in 2005 (2.3% of GDP).
- The date of joining the EMU, expected in January 2007, was rescheduled, mainly due to high inflation. However, under the currency board regime, the authorities have little control over inflation.
- The business climate in Estonia is still improving, although it is one of the best in all the transition countries. In May 2006, the government adopted amendments to the Competition Act as regards tax exemption system and the ownership concentration limits. This brought Estonia's competition policy much closer to the EU standards.
- More than 20% of population lives below the poverty line, defined as 60% of the median of household disposable incomes (in Western European countries this number is about 15%). The poverty is concentrated in rural areas and concerns mainly the youngest and the oldest people. Income inequalities in Estonia are one of the highest among the transition countries.

Macroeconomic performance, entrepreneurship and social performance

- In 2000s, Estonia has developed very rapidly: economic growth rate in this period exceeded 7% annually. In 2006, GDP grew by 11.4% and this was the highest yearly growth rate during the whole transition period. Rapid economic growth was caused by both internal

and external factors. Private consumption and investment increased by 15.7% and 19.7% respectively whereas exports grew by 10.0%. The fastest growing sectors include construction, financial services, manufacturing, and the real estate. Rapid growth of consumption and investment was caused by an increase in employment, higher real wages, and credit expansion.

- The situation in the labour market has been improving. In 2006, the unemployment rate fell to 6.4%, from 7.9% in 2005, and was less than half of the level registered in 2000 (13.6%).
- In 2006, CPI inflation accelerated to 4.4% (annual average) or 5.1% (end-year), from 4.1% or 3.6%, respectively, in 2005. The increase in the price level was mainly caused by both demand-side (consumption) and supply-side factors (higher oil prices).
- The current account deficit widened in 2006 to 14.9% of GDP, from 10.3% of GDP in 2005. High current account deficit is partly the result of a strong import growth (14.7% in 2006) and partly the result of transferring abroad the profits gained on FDI. Trade deficit increased by nearly 1 billion USD in 2006.
- Estonia continued to attract relatively high FDI inflows. In 2006, foreign companies invested more than 560 million USD, equivalent of 23% of current account deficit. Cumulative FDI inflow in the period 1989-2006 amounted to 6,857 million USD.

Growth prospects

- According to the IMF forecast, the Estonian economy will slow down to 9.9% in 2007 and 7.9% in 2008. The delay in joining EMU should not negatively influence the future economic growth. However, the economy can be adversely affected by unfavourable demographic tendencies (high emigration of workers and the resulting labour shortage). The future inflation will mostly be shaped by the rapid catching up process and behaviour of oil and gas prices.

EST

Table 4.9. Estonia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	1.4	1.4	1.4	1.4	1.4	1.3	1.3
GDP (krooni million)	95491	108218	121372	132904	146694	173062	204556
GDP per capita at PPP (USD)	9745	10663	11684	12779	14221	16127	18216
Real GDP (% change)	10.8	7.7	8.0	7.1	8.1	10.5	11.4
Individual Consumption (% change)	9.6	7.4	11.2	6.9	6.9	8.2	15.7
Investment (% change)	19.3	9.7	24.1	7.0	13.5	12.7	19.7
Exports (% change)	27.8	2.0	1.7	7.6	17.1	21.5	10.0
Imports (% change)	27.7	3.5	6.0	10.6	15.2	15.9	14.7
CPI Inflation (% change)							
(end of period)	5.0	4.2	2.6	1.2	5.0	3.6	5.1
(average)	4.0	5.8	3.6	1.3	3.0	4.1	4.4
PPI Inflation (% change)							
(end of period)	6.0	1.7	1.4	0.3	3.9	2.2	5.9
(average)	4.9	4.4	0.4	0.2	2.9	2.1	4.5
General Government Balance (% of GDP)	-0.6	0.3	0.4	2.0	2.3	2.3	3.8
Trade balance (USD million)	-767	-788	-1089	-1553	-1966	-1845	-2739
Current Account Balance							
(USD million)	-294	-339	-716	-1116	-1432	-1446	-2446
(% of GDP)	-5.2	-5.5	-9.8	-11.6	-12.3	-10.3	-14.9
Kroon/USD Exchange Rate (average)	17.0	17.5	16.6	13.9	12.6	12.4	12.5
Broad Money Supply (M2) (% change)	25.1	23.7	11.1	10.9	15.8	42.0	28.2
Net Foreign Assets (% change)	13.4	35.0	-36.9	-113.8	-966.4	8.7	-139.6
Domestic Credit (% change)	27.2	24.4	27.6	28.7	29.2	32.1	41.9
Net Foreign Assets of Monetary Authorities							
USD million)	916	834	903	1241	1637	2050	2662
Money Market Rate (average)	5.7	5.3	3.9	2.9	2.5	2.4	3.2
Deposit Rate (average)	3.8	4.0	2.7	2.4	2.2	2.1	2.8
Average Gross Monthly Salary (USD)	287.36	315.31	367.79	483.65	573.40	639.58	750.14
Unemployment Rate (%)	13.6	12.6	10.3	10.0	9.6	7.9	6.4

Source: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*; Estonia's Statistical Office data.

4.10. GEORGIA

Major problems

- Despite significant progress, infrastructure deficiencies remain the main obstacles to sustainable growth. Privatisations in the energy and telecommunications sectors should increase capital spending and improve performance.
- A combination of strong domestic demand, high energy prices and capital inflows means, that containing inflationary pressure is a major challenge necessitating better public expenditure management.

Economic policy

- Fiscal performance in 2006 was more expansionary than planned. The end-September fiscal performance criteria were met. However, in contrast to the commitment to limit the annual deficit below program levels in order to further reduce inflationary pressures, spending overruns of almost one percent of GDP—mainly capital and military expenditures—were only partly offset by higher than programmed revenues (improved tax collection and progress in tackling corruption). The general government deficit of 1.7% of GDP exceeded the indicative program target by 0.4 percent of GDP. Privatization proceeds fell short of the programmed level, due to delays in several major privatization projects. Therefore, the government accumulated fewer deposits in the banking system than programmed and the end-December indicative targets were breached. While some of the delayed privatization proceeds materialized during the first weeks of 2007, projected proceeds from the sale of an energy company were revised downwards significantly.
- Despite the fiscal overspending, monetary policy was on track during 2006. High oil prices, extra government spending and strong capital inflows have meanwhile increased inflationary pressures. Inflation reached 14.5 per cent in July 2006, well above the target of 6 per cent set by the Central Bank, but decreased to about 8.9 per cent by the end of 2006. To help lower inflation, the Central Bank allowed the lari to appreciate in nominal terms against the US dollar during 2006, reflecting foreign currency inflows (partly related to the IPO of Bank of Georgia at the London Stock Exchange). The NBG intervened heavily in the foreign exchange market to prevent what was perceived to be a temporary surge in foreign exchange inflows from influencing the exchange rate. To limit the resulting reserve money growth, which was aggravated by the fiscal overspending, the National Bank of Georgia sold its modest stock of treasury bills and placed a large amount of short-term central bank certificates during the last days of 2006. Due to these

efforts, the deviation from the end-December indicative reserve money target was small. Credit growth, partly funded by rising foreign liabilities of commercial banks, slowed down during the fourth quarter.

- Progress in structural reforms has continued, albeit more slowly than anticipated in some areas. The poverty alleviation program was introduced in September instead of June 2006 (the term agreed with IMF under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility). Significant progress however, has been made in the ongoing large-scale privatisation. Since August 2005, 243 SOE have been privatised, with another 137 prepared for sale. In May 2006 the *Danish Greenoak Group*, which already owns Batumi Oil Terminal, won a management contract to lease and operate the Batumi seaport for 49 years for US\$ 92 million.

Macroeconomic performance, entrepreneurship and social policy

- Despite economic sanctions imposed by Russia in 2006, Georgia's economic growth continues to be impressive last year. The economy grew significantly by an estimated 9.4% in 2006, although down slightly from the 9.6% in 2005. This strong performance was largely due to a combination of macroeconomic stability, and the dramatically improved business environment as reflected in the World Bank's 2006 Doing Business survey which named Georgia the number one reformer in the world. On the supply side, the main contribution to the economic expansion came from industry and construction, where output in the first nine months of the year rose by about 20 per cent and 12 per cent, respectively. However, agricultural production fell by 18.1 per cent in the same period, partly because of unfavourable weather conditions.
- The trade deficit widened dramatically by about 80% in dollar terms during 2006 compared with 2005. While exports grew by about 20%, imports (mainly of investment goods related to pipeline Baku-Tbilisi-Ceyhan construction) grew by about 43% during this period. Export growth was also negatively affected by a Russian trade embargo on Georgian wine and mineral water, which took effect in March 2006. Wine was Georgia's second most important export in 2005, accounting for 9.2% of total exports. This decreased to 4.2% at the end of November 2006. The current account however has been broadly stable compared to projections. Strong tourism receipts, reflecting a sharp increase in tourists from Armenia, partly offset higher-than-expected import volume growth, mainly in durable goods. The external debt position has also improved significantly, supported by debt relief agreements with

Table 4.10. Georgia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	4.7	4.7	4.6	4.6	4.5	4.5	4.4
GDP (million laris)	6 013	6 674	7 456	8 565	9 824	11 621	13 784
GDP per capita at PPP (USD)	1991.6	2151.6	2325.4	2655.1	2908.9	3272.2	3555.3
GDP (percentage change)	1.9	4.7	5.5	11.1	5.9	9.6	9.4
Private consumption (percentage change)	14.3	- 8.0	4.4	1.7	10.1		
Gross fixed capital formation (percentage change)	18.2	18.5	18.4	15.3	15.1		
Export (percentage change)	26.6	0.1	9.1	25.8	19.7	16.9	20.0
Import (percentage change)	13.2	6.9	5.8	35.4	38.2	17.7	43.0
Consumer prices (percentage change)							
(end-year)	4.6	3.4	6.0	7.0	7.5	6.4	8.8
(annual average)	4.0	4.7	5.6	4.8	5.7	8.4	9.2
Producer prices (percentage change)							
(end-year)	2.4	8.9	1.6	5.4	0.7	8.2	
(annual average)	5.8	3.6	6.0	2.3	3.8	7.2	
General government balance (In per cent of GDP)	- 4.1	- 2.0	- 1.7	- 2.9	2.3	- 1.5	- 1.7
Trade balance (In millions of USD)	- 409	- 458	- 475	- 598	- 719	- 932	- 1671
Current account balance							
(In millions of USD)	- 135	- 209	- 205	- 289	- 430	- 346	- 742
(In per cent of GDP)	- 4.4	- 6.5	- 6.0	- 7.4	- 8.4	- 5.4	- 9.5
Exchange rate (lari/USD - end-year)	1.97	2.07	2.19	2.1	1.8	1.8	1.7
Broad money (percentage change)	39.0	18.5	14.8	22.7	43.6	26.4	39.3
Net foreign assets (percentage change)	-4.9	- 19.5	0.2	19.1	18.7	- 43.1	548.8
Domestic credit (percentage change)	18.7	4.0	- 50.4	15.5	7.4	39.8	35.3
Net foreign assets of Monetary Authority							
(in billions of laris)	216.1	337.2	422.6	407.1	705.7	859.1	1599.8
Lending rate	32.75	27.25	31.83	32.27	31.23	21.63	18.75
Deposit rate	10.17	7.75	9.82	9.3	7.2	7.6	11.4
Gross average monthly earnings in economy							
(percentage change)	9.8	30.8	20.0	10.4	19.9	22.5	
Unemployment (In per cent of labour force)	10.3	11.1	11.9	10.7	12.5	13.8	

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

all bilateral creditors. The ratio of public external debt to GDP fell to 22% in 2006 from 27% in 2005.

- The National Bank of Georgia has improved the legal framework and further strengthened requirements for financial reporting by commercial banks during 2006. The law on commercial bank activities has been amended to improve the transparency of ownership and corporate governance of banks. In March 2006 the restriction under which one shareholder (or a group of joint shareholders) could hold more than 25% of voting shares was abolished.

Growth prospects

- Georgia's ability to shoulder the loss of its main export market while continuing to grow at an impressive rate underlines the success of the government's reform path. GDP growth is expected to remain in the range of 7 - 9% a year in the short term, driven mainly by industrial output, construction and investment activities related to

the South Caucasus gas pipeline, and despite the expected negative effect of the Russian trade embargo and increase in gas prices. The government's success in creating a better business environment has been instrumental in attracting both foreign and domestic investors. Annual FDI flows projected at around \$1 billion over the next 2 years should help to underpin sustained strong growth over the medium term. The government's ambitious plans to move ahead with further improvements in the business environment will increase the economy's resilience to potential swings in investor sentiments and should be complemented by initiatives in the areas of property rights and the judiciary. Nevertheless, continued tight monetary policy and a more flexible exchange rate are needed to reduce inflation further. The policy tightening last year was effective in putting inflation on a downward path. For the future, it will be important that the NBG reduces its foreign exchange market interventions in response to continued external inflows.

4.11. HUNGARY

Major problems

- Sustained fiscal consolidation will reduce vulnerabilities and stimulate growth. Even if the Convergence Program will be fully implemented, the sizable 2009 fiscal deficit, the high public debt-to-GDP ratio, and a large government and tax wedge will continue to undermine stability and growth. The uncertainties with respect to the future of the ad hoc taxes and the pace of reform could dampen incentives for employment and investment
- Access to Europe's product, financial, and labour markets has created the foundation for rapid growth with stability, a process from which Hungary has already achieved substantial gains. But realizing the continuing potential of this opportunity requires sound public finances and the business environment for firms to operate competitively in the euro zone. The political window opportunity for reform could close prematurely. It remains imperative that this window and the space provided by the markets' goodwill be used now to fundamentally reorient fiscal affairs and ensure continued competitiveness.

Economic policy

- The government deficit increased to 9.2% of GDP in 2006, up from 7.8% in 2005, both excluding the second pension pillar. The fiscal deterioration was due to significant slippages on the expenditure side. A collapse of public finances was prevented by the introduction of stringent fiscal austerity measures and tax increases.
- Inflationary pressures motivated the Central Bank to increase the reference rate to 8 per cent in October 2006, up from 6 per cent in June 2006. However, the reference rate is expected to decrease once inflation falls in the later part of the year. The forint has appreciated against the euro by almost 10 per cent since July last year, partly on the back of an improving fiscal outlook, and market participants are beginning to anticipate policy rate reductions. Factors favouring a rate cut include tightening monetary conditions, output growth likely to remain below potential, significant fiscal consolidation under way, and no evident signs of inflation being embedded in wage contracts. Nevertheless, one-time price increases generated by the fiscal measures may not have peaked, and the risk of inflation persistence cannot be ruled out.
- Hungary may be falling behind regional peers in maintaining its overall business climate. Within central and eastern Europe, Hungary has been at the lower end of the international competitiveness rankings. These rankings show Hungary to be falling behind: business

indicators are not necessarily becoming worse; other countries have made a more proactive effort to improve their business operating conditions. The administrative burden adds to the disadvantaged position of Hungarian firms on account of high labour taxes. In this context, the government's recent initiative, „In tune with business,” takes the right steps. These include simplification of regulatory requirements and public procurement procedures.

Macroeconomic performance, entrepreneurship and social policy

- In 2006, GDP growth slightly decreased to 3.9% from 4.2% in 2005. The domestic deceleration was mainly driven by a marked decline in private investment and in government consumption; household consumption also decelerated, although to a lesser extent (mainly due to higher expenditure taxes) Confidence indicators showed a strong deterioration after the adoption of a fiscal consolidation package in summer 2006. Net exports were the primary driver of GDP growth reflecting a spectacular 18% expansion of exports along with a smaller but still significant increase in imports of 12.6%.
- Employment is projected to stagnate over the next two years as a result of downsizing measures in the public sector and relatively unfavourable cyclical conditions. Recently adopted regulatory measures should support the increasing trend in the labour force. Consequently, the unemployment rate, which rose to 7.5% in 2006, is projected to continue increasing above the EU average in 2007. The employment rate – at around 57.5% – is well below the EU average. This largely reflects a generous benefit system, low labour mobility and weak incentives to seek employment.
- Consumer price inflation (HICP) rose to an annual average of 4% from 3.5% in 2005, mainly resulting from the large increase in administered prices in the second half of the year. Inflation is projected to peak above 8% in the first half of 2007 and to start decreasing thereafter. The expected annual average inflation rate is 7.5%. The disinflation in the second half of 2007 should result on the one hand from the progressive running-out of the major one-shot impact of fiscal measures introduced in the second half of 2006 (VAT hike, cuts of price subsidies), and on the other hand from the recent appreciation of the forint back to its January 2006 level.
- The current account deficit was around 7.4% of GDP in 2005. It narrowed to an estimated 5.8% of GDP in 2006, mainly on the basis of a smaller trade deficit. Net foreign direct investment reached around 2.7% 2006. The current account deficit is expected to decline to 5 percent of GDP in 2007. The overall financial account is

Table 4.11. Hungary

	2000	2001	2002	2003	2004	2005	2006
Population (million)	10.2	10.2	10.2	10.1	10.1	10.1	10.1
GDP (billion forints)	13 272	14 990	16 915	18 936	20 712	22 027	23 562
GDP per capita at PPP (USD)	12961.8	13876.4	14694.2	15564.2	16884.2	18145.2	19559.4
GDP (percentage change)	5.2	4.3	3.8	3.4	5.2	4.1	3.9
Private consumption (percentage change)	5.0	5.8	9.7	7.8	3.2	3.8	1.2
Gross fixed capital formation (percentage change)	7.7	5.1	10.1	2.1	7.7	5.6	- 1.8
Export (percentage change)	21.0	8.0	3.9	6.2	15.7	11.6	18.0
Import (percentage change)	19.4	5.3	6.8	9.3	14.1	6.8	12.6
Consumer prices (percentage change)							
(end-year)	9.8	9.2	5.3	5.7	5.5	3.3	6.8
(annual average)	9.9	8.6	4.5	4.7	6.8	3.6	3.9
Producer prices (percentage change)							
(end-year)	12.4	- 0.6	- 1.3	6.2	1.6	4.7	9.2
(annual average)	10.8	5.7	- 1.1	2.4	3.5	4.3	8.3
General government balance (In per cent of GDP)	- 2.9	- 3.5	- 8.4	- 7.2	- 6.5	- 7.8	- 9.2
Trade balance (In millions of USD)	- 2930	- 2234	- 2076	- 3271	- 3082	- 1961	- 524
Current account balance							
(In millions of USD)	- 2 876	- 3201	- 4643	- 7205	- 8767	- 8128	- 6528
(In per cent of GDP)	- 6.2	- 6.1	- 7.1	- 8.5	- 8.6	- 7.4	- 5.8
Exchange rate (forint/USD - end-year)	282.5	286.6	249.5	224.4	202.7	199.6	210.4
Broad money (percentage change)	11.1	14.0	18.9	13.6	9.9	13.0	11.9
Net foreign assets (percentage change)	6.6	15.9	- 25.3	28.7	10.5	21.8	24.8
Domestic credit (percentage change)	30.5	6.2	21.2	19.8	11.9	23.4	15.9
Net foreign assets of Monetary Authority							
(in billions of forints)	10 989	10 830	9574	2834	2887	3967	4104
Lending rate	11.0	12.0	9.7	11.2	11.0	7.4	9.2
Deposit rate	9.6	9.3	7.5	8.7	9.1	5.2	7.4
Gross average monthly earnings in economy							
(percentage change)	13.5	18.2	18.3	12.0	6.2	8.7	8.2
Unemployment (In per cent of labour force)	6.4	5.7	5.8	5.9	6.3	7.3	7.5

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

also projected to decline but may remain closer to 7% GDP if increased unclassified outflows in the balance of payments (net errors and omissions) reflect genuine obligations to foreigners. Debt creating flows should fall to 3.5% of GDP. The external debt-to-GDP ratio (including inter-company loans) is expected to decline from 94% in 2006, mainly due to the stronger currency. The size of external reserves and the conservative structure of public debt provide good buffers.

Growth prospects

- Although the Hungarian economy has benefited from a sound banking sector, sustained market-oriented reforms and a large stock of foreign investments, the

medium-term outlook will be affected by the fiscal difficulties and the impact of the government's fiscal austerity measures. If persistent reforms in the health care, education and administration sectors lead to a smaller fiscal deficit and a reduced tax burden in the long term, they are likely to improve Hungary's international competitiveness. Nevertheless, the short-term effects of the measures will reduce the purchasing power of consumers, increase costs for enterprises and may delay some investments in infrastructure. Hence, the economic slowdown is expected to continue in 2007 when real GDP growth is forecast to fall to 2.4% when the full effect of tighter fiscal measures is expected to be seen on domestic demand.

4.12. KAZAKHSTAN

Major problems

- Banking regulation and supervision should be strengthened as the sector is increasingly vulnerable to shocks and fiscal policy may need to be tightened to stem further inflationary pressures.
- Increased availability of financing through development institutions could reduce the corporate sector's demand for funding through the issuance of equity and debt securities, thereby impeding the development of the capital market.

Economic policy

- Fiscal policy remains prudent, although the acceleration of public spending will require additional monetary tightening and exchange rate appreciation to keep inflation from rising. The general government surplus widened further to 6.4% of GDP in 2006 from 5.3% in 2005, while accommodating an increase in expenditures of over 30% in real terms. The rapid growth in spending reflected the buoyancy of tax revenues as oil revenues continued to surge. Non-oil revenues also rose sharply because of improved tax collection. The budget for 2007 forecasts the overall fiscal surplus to stay at a high level. In July 2006, the National Fund of the Republic of Kazakhstan (NFRK) was fully integrated with the budget. Under this new arrangement, all oil revenues will accrue to the NFRK, which will then transfer part of the funds to finance investment and programmes for human capital development.
- The National Bank of Kazakhstan (NBK) has taken a number of steps to tighten monetary conditions over the past year to stem inflationary pressures and dampen growth, which remained extremely buoyant in the first half of 2006. Reserve requirements were broadened and raised in mid-2006, the NBK's deposit rate was increased by 100 basis points, and issuance of NBK notes has been stepped up, reflected in higher yields. The NBK also permitted substantial nominal appreciation of the tenge in the first half of 2006 and again since February of this year. Despite these measures, however, money growth rates are very high.
- In early 2006 a presidential decree was issued establishing the state holding company – *Samruk*, which will be responsible for improving corporate governance in large SOE. Stakes in several major companies in the telecommunications, postal service, electricity transmission, railways as well as oil and gas sectors have subsequently been transferred to *Samruk*. In March 2006 *Kazyna*, the Sustainable Development Fund, was established to manage existing state-owned development institutions such as Development Bank of Kazakhstan.

Macroeconomic performance, entrepreneurship and social policy

- Kazakhstan's rapid economic growth continues. A favourable external environment and sound economic management set the stage for a seventh consecutive year of impressive performance in 2006. Real GDP grew by 10.6%, employment expanded further, and per capita income reached almost five times the 1999 level in dollar terms. High oil prices and impressive gains in tax administration led to buoyant growth in oil and non-oil revenues, permitting a further substantial increase in savings in the National Fund (NFRK) as well as continued sizable expansion in budgetary expenditures. Large foreign exchange inflows—related to buoyant oil and non-oil exports, direct investment, and a sharp acceleration in external borrowing by the banking sector—boosted official reserves to \$19 billion at the end of the year, equivalent to 7 months of imports.
- Inflation remains on an upward trend – the consumer price index increased from 7.6% yoy in December 2005 to 8.6% in December 2006. The prices may rise again in response to the 30% wage increase awarded to public sector employees at the start of the year. Moreover, the banking sector's vulnerability to shocks has risen. Fuelled by the \$18 billion external borrowing by banks last year, credit growth has accelerated to almost triple digits, with especially rapid expansion in real estate lending and consumer loans. A reduction in external creditors' appetite for Kazakhstan exposure, or a sharp decline in the quality of loan portfolios were the credit cycle to turn, could disrupt banking activity and carry consequences for the real economy. Thus, policy measures to lower inflation and mitigate banking sector risks are needed to ensure a continued favourable macroeconomic outlook.
- The current account showed a small surplus in 2006 after a deficit of 1.3% of GDP in 2005. A record trade balance surplus of 22.8 per cent of GDP due to high commodity prices was offset by a further increase in income payments associated with foreign direct investment (FDI) in the hydrocarbon sector and an increase in imports of services, also linked to investments in the hydrocarbon sector.

Growth prospects

- Deceleration of real GDP growth to 9 per cent is expected in 2007, reflecting the decline in oil prices, constraints on hydrocarbon production and the tightening of monetary policy in the second half of 2006. Nevertheless, intensified structural reforms will help sustain strong economic performance over the medium term. Early WTO accession, customs

Table 4.12. Kazakhstan

	2000	2001	2002	2003	2004	2005	2006
Population (million)	14.8	14.8	14.4	15.0	15.1	15.1	15.1
GDP billion tenges)	2600	3251	3776	4612	5870	7457	9739
GDP per capita at PPP (USD)	4600.5	5352.1	5972.8	6629.6	7411.2	8344.7	9293.5
GDP (percentage change)	9.8	13.5	9.5	9.2	9.4	9.7	10.6
Private consumption (percentage change)	1.2	7.8	2.7	11.8	13.9	11.4	
Gross fixed capital formation (percentage change)	16.1	25.3	10.0	8.0	22.5	11.9	18.0
Export (percentage change)	28.7	-1.8	22.6	5.5	10.5	1.4	45.3
Import (percentage change)	26.1	0.3	4.3	-4.1	14.5	13.3	43.8
Consumer prices (percentage change)							
(end-year)	9.6	6.4	6.2	6.4	6.7	7.5	8.4
(annual average)	13.3	8.3	5.9	6.4	6.9	7.6	8.6
Producer prices (percentage change)	19.4	-14.1	11.9	5.9	23.8	23.7	
(annual average)	38.0	0.0	0.2	9.5	16.0	20.3	18.4
General government balance (In per cent of GDP)	-1.0	1.8	1.0	2.0	1.9	5.3	6.4
Trade balance (In millions of USD)	2 168	983	1987	3679	6785	10 322	14 574
Current account balance							
(In millions of USD)	366	-1390	-1024	-273	335	-724	768
(In per cent of GDP)	2.0	-6.3	-4.2	-0.9	0.8	-1.3	1.0
Exchange rate (tenge/USD – end-year)	142.3	147.1	153.6	149.6	136.0	132.9	126.1
Broad money (percentage change)	14.7	40.2	30.1	34.2	68.2	26.3	79.9
Net foreign assets (percentage change)	17.8	65.4	42.5	46.1	45.3	-15.1	91.4
Domestic credit (percentage change)	57.3	18.0	30.2	38.1	81.1	52.3	82.0
Net foreign assets of Monetary Authority							
(in billions of tenges)	302.9	565.8	788.1	1777.6	1672.4	2038.7	4219.3
Lending rate	14.0	9.0	7.5	7.0	7.0	8.0	9.0
Deposit rate	15.6	12.8	11.0	10.9	9.3	9.1	10.1
Gross average monthly earnings in economy							
(percentage change)		20.4	17.5	13.8	22.5	20.3	
Unemployment (In per cent of labour force)	12.2	11.0	9.3	8.8	8.4	8.1	7.9

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

administration reform, and further progress in enhancing regional trade will help secure productivity gains. The program underway to streamline commercialization and privatization of state enterprises through the formation of *Samruk* and *Kazyna* should facilitate enterprise restructuring and enhance

competition policy, areas where Kazakhstan's ranking in international structural reform indicators is relatively weak. A key risk over the medium term is the rapid credit expansion, funded through the accumulation of external liabilities of banks, and the resulting construction and real estate boom.

4.13. KYRGYZ REPUBLIC

Major problems

- Tax cut has been a good policy decision, but corruption in public administration and in the judiciary remains a key concern.
- Further debt relief should reinforce macroeconomic stability, but long-term growth requires greater improvement in the business environment and in the quality of public institutions

Economic policy

- Despite various tax cuts introduced at the beginning of the year (income tax was set at the uniform rate of 10%, profit tax was reduced from 20% to 10%, VAT on farm output was temporarily suspended and payroll tax was reduced from 31% to 29%), the fiscal deficit for 2006 is estimated to have further narrowed to 2% of GDP, compared with 3.9% of GDP in 2005. This smaller deficit is due to lower interest payments in the wake of the 2005 Paris Club debt rescheduling and an increase in customs revenues (owing to a surge in imported goods).
- Since early 2006, monetary policy has been conducted in an environment of stronger-than-expected foreign exchange receipts and continued re-monetisation. Sizable unsterilised intervention has sparked a 40 percent increase in reserve money well above the limits agreed in the IMF programme. Despite this intervention, mirrored in a rise in gross foreign exchange reserves to \$690 million (4 months of projected 2007 imports of goods and services), the som has appreciated by 4.7 percent against the dollar since the beginning of the year in real terms, and it has appreciated by nearly 5 percent since end-2004. Private sector credit has grown rapidly in the year-to-date, albeit from a low base. The National Bank of Kyrgyz Republic has gradually increased policy interest rates, which are now positive in real terms.
- The electricity sector's quasi-fiscal deficit (defined as the cost of production minus cash revenues) declined to 7.6% of GDP in 2006, what was in line with targets agreed with the IMF and mainly reflected improved cash collection.
- The privatization of *Kyrgyz Telecom*, the main telecommunications service operator, remains on hold, although the government has restated its intention to resume this process. Partly, it could be due to the problem with last transactions in this sector – sale of privately owned *BiTel*, the largest mobile operator, to a Kazakh investor in April 2005. The legality of this transaction was challenged by a Kyrgyz court in December 2005.

Macroeconomic performance, entrepreneurship and social policy

- Real GDP grew by 2.7% in 2006, after a small contraction last year due to disruptions caused by the political events in March and April of that year and a sharp decline in production from the *Kumtor* gold mine (accounting for ca. 6% of GDP). This change was partly reflecting stronger investment and the impact of significant remittances. The growth rate would be probably higher, but a further drop in gold output due to accident at the *Kumtor* mine in July 2006, lowered it by approximately 1 percentage point.
- Inflation (5.1% in the 12 months ending December) has remained in line with the program agreed with IMF mission. The growth of price level is expected to remain below the 5% end-year target during the next three years.
- The current account deficit widened further, from 8% of GDP in 2005 to 20% of GDP in 2006. This development partly reflects one-off factors relating to the *Kumtor* gold mine, in particular increased imports of gold mining equipment in 2006. The deficit is financed by a rise in the net capital and financial account balance, and inflow of remittances from workers living abroad (these accounted for as much as 17% of GDP in 2006). Part of the current account deterioration reflects a revision in the statistical series on shuttle trade, which was mirrored by a large increase in net financial capital inflows including errors and omissions. After a record US\$ 131 million of net foreign direct investment inflows in 2004, inflows dipped to US\$ 43 million in 2005 but bounced back to US\$ 108 million during 2006.
- According to the ASAIID Kyrgyzstan National pool conducted in March 2006, the most pressing issues for individuals are unemployment and poverty. Preliminary data suggest that while the poverty rate declined from 50% in 2003 to 42% in 2006, the level of unemployment (labour force survey data) increased to over 10% of the labour force. A draft development strategy for 2006-2010 emphasises the importance of countering unemployment, underemployment and rural poverty. The authorities have assigned the State Committee on Migration and Employment as a key coordinating agency for implementing labour market policies.

Growth prospects

- The Kyrgyz Republic has a good potential for rapid economic growth in the coming years. However, it will be essential to maintain macroeconomic stability, deepen economic reforms and diversify the economy to reduce its vulnerability to external shocks. Fully exploiting this potential would also hinge importantly on stabilizing the political situation, asserting the rule of

Table 4.13. Kyrgyz Republic

	2000	2001	2002	2003	2004	2005	2006
Population (million)	4.7	4.8	5.0	5.0	5.1	5.1	5.1
GDP (billion soms)	65.4	73.9	75.4	83.9	94.4	100.9	113.2
GDP per capita at PPP (USD)	1559.5	1668.2	1683.9	1823.5	1987.4	2010.2	2150.1
GDP (percentage change)	5.3	5.4	0.0	7.0	7.0	-0.2	2.7
Private consumption (percentage change)	-4.2	1.6	4.2	22.1	7.5	3.2	
Gross fixed capital formation (percentage change)	53.7	-3.2	-7.4	-6.4	7.4	10.2	
Export (percentage change)	10.5	-3.2	8.1	5.3	12.8	-9.8	18.3
Import (percentage change)	-9.1	-13.8	13.1	16.0	16.3	1.0	67.6
Consumer prices (percentage change)							
(end-year)	9.5	3.8	3.4	5.6	2.8	4.9	5.1
(annual average)	18.7	6.9	2.1	2.7	4.1	4.3	5.6
Producer prices (percentage change)							
(end-year)	31.5	11.2	7.5	13.5	5.3	6.0	10.4
(annual average)	5.0	11.9	4.8	4.6	9.0	2.6	15.3
General government balance (In per cent of GDP)	-9.6	-5.6	-5.3	-5.2	-4.5	-3.9	-2.0
Trade balance (In millions of USD)	4	31	-74	-133	-171	-419	-921
Current account balance							
(In millions of USD)	-78	-24	-49	-81	-75	-198	-554
(In per cent of GDP)	-5.7	-1.6	-3.1	-4.2	-3.4	-8.1	-19.7
Exchange rate (som/USD - end-year)	47.8	48.3	46.9	43.7	42.6	41	40.2
Broad money (percentage change)	10.2	3.0	38.1	33.4	32.1	10.0	51.5
Net foreign assets (percentage change)	25.0	126.3	35.6	64.3	94.7	6.9	44.6
Domestic credit (percentage change)	-4.6	-18.6	18.9	10.9	-18.8	19.6	39.7
Net foreign assets of Monetary Authority							
(in billions of soms)	12 687	13 632	14 620	17 179	23 540	25 305	31 199
Lending rate	51.9	37.3	24.8	21.7	29.3	26.6	27.6
Deposit rate	18.4	12.5	5.9	5.0	6.7	5.8	5.1
Gross average monthly earnings in economy							
(percentage change)	14.4	18.6	15.8	13.7	16.9	14.5	14.4
Unemployment (In per cent of labour force)	5.6	7.8	8.6	8.9	9.0	9.7	10.7

Sources: IMF, World Economic Outlook Database, April 2007; EBRD, Transition Update, May 2007.

law, and continuing to tackle deep-seated governance issues. In this vein, the average real GDP growth of 5.5% during the period 2006–11 is projected by majority of international institutions. The growth would be on the back of a recovery in gold output from the problems experienced in 2005–06 and the coming on stream of new mines, as well as sustained increases in the non gold manufacturing and services sectors underpinned by

productivity gains and new investment. Nevertheless, the renewed political upheaval of spring 2007 confirmed concerns about political and legal instability in the country. While its short term impact on the economy is likely to be small, it may undermine long-term growth by affecting foreign investment and postponing much needed improvements in the business environment, including the quality of public institutions.

4.14. LATVIA

Major problems

- High trade deficit and high current account deficit may undermine macroeconomic stability in the medium term perspective.
- Rapid inflation can complicate the process of accession to the euro zone.

Economic policy

- The modest general government surplus observed in 2005 turned into a deficit of 1.5% of GDP in 2006. The deterioration of public finance was mainly caused by a very sharp increase in public spending in the 4th quarter of 2006. During the first three quarters of 2006 general government balance was still positive due to increased revenues from VAT, excise tax, and social security system.
- Central bank continued to follow a restrictive monetary policy under a fixed exchange rate regime, aimed at reducing inflation. In 2006, interest rates increased and the key discount rate stood at 5.0% in the end of the year.
- In 2006, railway restructuring has been continued. In May 2006, Latvia accessed the European Agreement on Main International Railway Lines. This agreement helps to construct and develop the common European railway network. Railway transport in Latvia is characterized by good legal regulations. The share of private sector is increasing. However, further investments in infrastructure are needed. 30% of main railway lines should be modernized. The rail traffic control systems in 25% of the lines do not fulfil the EU safety standards.

Macroeconomic performance, entrepreneurship and social performance

- In 2000s, Latvia's economy has developed very rapidly at the level exceeding 6% annually. In 2006, real GDP grew by 11.9% and it was the highest economic growth rate during the whole transition period. Rapid development of Latvia's economy was mainly fuelled by

high domestic demand. In 2006, private consumption grew by 19.8% and investment by 18.3% whereas exports grew by only 5.3%. The rapid growth of consumption and investment has been caused by a combination of factors, including credit expansion, an increase in employment and higher disposable incomes. The best economic situation was observed in trade, commercial services, transport, communications, and manufacturing sectors.

- The situation in the labour market has been rapidly improving. In 2006, the unemployment rate fell to 4.4%, from 8,7% in 2005, and well below double-digit figures registered in 2000-2004..
- Inflation remains high. In 2006, CPI inflation equalled 6.7% (annual average) or 6.8% (end-year) whereas, in 2005, it amounted to 6.2% or 7.0% respectively. High inflation results from strong domestic demand and the increase in regulated prices.
- In 2006, Latvia's external position deteriorated significantly. Current account deficit increased from 1,971 million USD (12.3% of GDP) in 2005 to 3,761 million USD (21.1% of GDP) in 2006. Trade deficit increased from 2,967 million USD to 4,941 million USD in the same period. Higher deficit was mainly caused by the increase in consumption due to credit expansion as well as by less favourable terms of trade. Moreover, exports grew only slightly in 2006 due to the deterioration in country's competitiveness and higher domestic demand for several exportable goods, e.g. wood.
- In 2006, FDI inflow was 840 million USD, covering 22% of current account deficit. Cumulative FDI inflow in the period 1989-2006 equalled 5,054 million USD.

Growth prospects

- According to the IMF forecast, economic growth in Latvia will slow down somewhat to 10.5% in 2007 and 7.0% in 2008. Internal demand will be high due to credit expansion, the increase of real wages, and the inflow of EU funds. The economy will, however, vulnerable to increasing labour shortages.

Table 4.14. Latvia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	2.4	2.4	2.3	2.3	2.3	2.3	2.3
GDP (lat million)	4751	5220	5758	6393	7421	8937	11034
GDP per capita at PPP (USD)	7889	8777	9583	10555	11855	13540	15549
Real GDP (% change)	6.9	8.0	6.5	7.2	8.6	10.2	11.9
Individual Consumption (% change)	6.8	7.3	7.4	8.2	9.5	11.5	19.8
Investment (% change)	10.2	11.4	13.0	12.3	23.8	23.6	18.3
Exports (% change)	11.3	7.5	5.4	5.2	9.4	20.3	5.3
Imports (% change)	3.1	14.3	4.7	13.1	16.6	14.8	17.5
CPI Inflation (% change)							
(end of period)	1.9	3.0	1.5	3.6	7.3	7.0	6.8
(average)	2.4	2.6	2.5	1.9	2.9	6.2	6.7
PPI Inflation (% change)							
(end of period)	1.0	1.8	0.8	4.1	11.3	6.8	7.2
(average)	0.6	1.7	1.0	3.2	8.6	7.8	7.8
General Government Balance (% of GDP)	-2.8	-2.1	-2.3	-1.2	-0.9	0.2	-1.5
Trade balance (USD million)	-1044	-1335	-1479	-2013	-2781	-2967	-4941
Current Account Balance							
(USD million)	-372	-626	-625	-920	-1766	-1971	-3761
(% of GDP)	-4.8	-7.5	-6.7	-8.2	-12.8	-12.3	-21.1
Lat/USD Exchange Rate (average)	0.6	0.6	0.6	0.6	0.5	0.6	0.6
Broad Money Supply (M2) (% change)	27.9	20.8	21.0	21.1	27.0	36.1	30.0
Net Foreign Assets (% change)	52.9	-1.0	-31.9	-78.5	-406.8	-471.5	-98.6
Domestic Credit (% change)	44.3	36.2	39.8	39.2	40.2	63.2	60.0
Net Foreign Assets of Monetary Authorities							
(USD million)	936	1243	1284	1465	1977	2488	4377
Discount Rate (end of period)	3.5	3.5	3.0	3.0	4.0	4.0	5.0
Deposit Rate (average)	4.4	5.2	3.2	3.0	3.3	2.8	3.5
Average Gross Monthly Salary (USD)	247.12	253.18	279.94	336.25	390.43	434.51	539.43
Unemployment Rate (%)	14.4	13.1	12.4	10.6	10.4	8.7	4.4

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*; Latvia's Statistical Office data.

4.15. LITHUANIA

Major problems

- High trade deficit and high current account deficit may undermine macroeconomic stability in the medium term perspective.
- Accelerating inflation can complicate the process of accession to the euro zone. However, under the currency board regime, the authorities have only limited control over inflation which is partly caused by rapid productivity gains in production of tradeable goods.
- Energy sector and industrial production are highly dependent on oil and gas imports from Russia. The only oil refinery in the Baltic states, Mazeikiu Nafta, is located in Lithuania. The output of Mazeikiu Nafta along with the output of the export terminal Butinge contribute to 2-3% of Lithuanian GDP and 30% of its exports. Lithuanian exports was disturbed recently by technical problems with the pipeline supplying the Russian oil. Hence, the diversification of oil and gas suppliers is necessary.

Economic policy

- In 2000s, Lithuania has recorded a fiscal deficit. In 2006, general government deficit was moderate and equalled 0.3% of GDP. Reduced deficit was partly a result of higher tax revenues resulting from rapid economic growth.
- Monetary policy continued to be guided by strict currency board arrangement.
- The banking sector is highly concentrated. The largest 3 banks (SEB Vilniaus Bankas, Hansabankas, and Nord/LB) control over $\frac{2}{3}$ of total assets. Foreign capital, mainly from Scandinavian countries, controls almost 90% of total capital in the banking sector.
- The most important problems facing entrepreneurs are administrative red-tape and political corruption.

Macroeconomic performance, entrepreneurship and social performance

- In 2000s, Lithuanian economy has developed rapidly at the rate greater than 4% annually. In 2006, real GDP grew by 7.5%. It was a very similar result to that in the years 2004-2005 when GDP growth rate amounted to

7.3% and 7.6% respectively. High economic growth was fuelled by high internal and external demand. In 2006, consumption increased by 12.6%, investment by 12.7%, and exports grew by 14.0%. From the supply side, during the 1st half of 2006, best economic performance was recorded in manufacturing, construction, and services.

- In 2006, GDP per capita at PPP equalled 15,858 USD. Lithuania was at the 6th position as regards per capita income among all the 28 post-socialist countries.
- CPI inflation accelerated in 2006 to 3.7% (annual average) or 4.5% (end-year) whereas, from 2.7% or 3.1%, respectively, in 2005. Apart from catching-up factors, higher inflation was also caused by the increase of food and utilities prices.
- Current account deficit increased from 1,815 million USD (7.0% of GDP) in 2005 to 2,684 million USD (9.0% of GDP) in 2006. Trade deficit increased from 2,843 million USD to 4,169 million USD in the same period. The deterioration of the trade balance results, on the one hand, from the increase in imports (16.0% in 2006) due to greater consumption, and, on the other hand, from the decrease of exports due to production disruption in the oil refinery Mazeikiu Nafta.
- In 2006, FDI inflow was 803 million USD, which accounted for 30% of current account deficit. Cumulative FDI inflow in the period 1989-2006 amounted to 5,676 million USD.
- In 2006, the unemployment rate fell further down to 5.6%, from 8.3% in 2005. The improvement in the labour market has been impressive, as still in 2000-2001 unemployment in Lithuania was among the highest in all transformation countries and stood at 16-17%. The fall in unemployment was mainly caused by huge labour emigration (especially among the young workers) as well as by the improving situation in the domestic labour market due to fast economic growth.

Growth prospects

- According to the IMF forecast, the rate of economic growth will be maintained at 7.0% in 2007 and 6.5% in 2008. Economic growth will be fuelled by the strong domestic demand and the improvement in economy's competitiveness due to the inflow of EU funds.

L I T

Table 4.15. Lithuania

	2000	2001	2002	2003	2004	2005	2006
Population (million)	3.5	3.5	3.5	3.5	3.4	3.4	3.4
GDP (litai million)	45674	48585	51971	56804	62587	71200	81974
GDP per capita at PPP (USD)	8730	9583	10443	11830	13078	14569	15858
Real GDP (% change)	4.1	6.6	6.9	10.3	7.3	7.6	7.5
Individual Consumption (% change)	5.9	3.7	5.8	11.1	9.7	10.4	12.6
Investment (% change)	-9.0	13.5	8.7	11.4	12.3	11.2	12.7
Exports (% change)	9.9	21.2	19.5	6.9	4.2	14.3	14.0
Imports (% change)	4.8	17.6	17.7	10.3	14.8	15.9	16.0
CPI Inflation (% change)							
(end of period)	1.5	2.1	-1.0	-1.3	2.9	3.1	4.5
(average)	1.0	1.5	0.3	-1.2	1.2	2.7	3.7
PPI Inflation (% change)							
(end of period)	2.6	-7.8	1.9	-0.2	6.8	13.5	2.8
(average)	16.0	-3.0	-2.8	-0.5	6.0	11.5	7.4
General Government Balance (% of GDP)	-2.5	-2.0	-1.4	-1.2	-1.5	-0.5	-0.3
Trade balance (USD million)	-1104	-1108	-1337	-1704	-2382	-2843	-4169
Current Account Balance							
(USD million)	-675	-574	-734	-1278	-1724	-1815	-2684
(% of GDP)	-5.9	-4.7	-5.2	-6.9	-7.7	-7.0	-9.0
Litas/USD Exchange Rate (average)	4.0	4.0	3.7	3.1	2.8	2.7	2.7
Broad Money Supply (M2) (% change)	16.5	21.4	16.9	18.2	24.1	32.9	23.8
Net Foreign Assets (% change)	46.8	19.7	8.9	-4.5	0.7	-40.9	-27.5 ^a
Domestic Credit (% change)	15.7	25.6	22.7	37.8	32.0	56.1	34.9
Net Foreign Assets of Monetary Authorities							
(USD million)	1344	1657	2158	3087	3246	3983	4348 ^a
Money Market Rate (average)	3.6	3.4	2.2	1.8	1.5	2.0	2.8
Deposit Rate (average)	1.0	0.8	0.3	0.2	0.2	0.3	0.3
Average Gross Monthly Salary (USD)	242.70	245.58	275.74	350.41	413.27	460.06	545.13
Unemployment Rate (%)	16.4	17.4	13.8	12.4	11.4	8.3	5.6

^a 3rd quarter.

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*; Lithuania's Statistical Office data.

4.16. MACEDONIA

Major problems

- Very high unemployment poses a serious threat to social and political stability..
- High trade deficit makes the economy very dependent on inflows of remittances from Macedonian citizens working abroad.
- Political tensions continue between ethnic groups (large Albanian minority).

Economic policy

- In 2006, general government deficit equalled 0.6% of GDP (in 2004 and 2005, public sector recorded the surplus of 0.7% and 0.3% of GDP respectively).
- The government reformed taxes in order to unify and reduce CIT and PIT rates. Since January 2007, these rates has been equal to 12%, and from January 2008 they should be further reduced to 10%. The government has also cancelled the reinvested profits tax and introduced further tax allowances for foreign investors operating in special economic zones.
- In March 2006, the government sold the majority stake in a monopoly power distribution company ESM to the Austrian investor EVN AG for 225 million EUR. EVN AG plans to invest 96 million EUR in ESM during the next 3 years.
- In February 2006, Macedonia joined CEFTA. In January 2006, Macedonia signed an agreement with Kosovo on further trade liberalization, resulting in significant reductions of trade barriers.

Macroeconomic performance, entrepreneurship and social performance

- In 2006, economic growth rate was 4.0%. The pace of economic growth was similar to that in two previous years (4.1% in 2004 and 3.8% in 2005). Individual consumption was the main source of economic growth. High consumption resulted from higher real wages,

credit expansion, and the increase in remittances from abroad. Investments, both domestic and foreign, were low.

- The unemployment in Macedonia is one of the highest among all the post-socialist countries. Since 1994, i.e. during almost the whole transition period, the unemployment rate has persisted at levels well exceeding 30% and has not exhibited any clearly decreasing tendency. In 2006, the unemployment rate was 35.9%. However, the actual level of unemployment may be lower, as labour market statistics do not take into account people working in the informal sector of the economy.
- In 2006, CPI inflation equalled 3.2% (annual average) or 2.9% (end-year) and was higher than in 2005 when the respective indices amounted to 0.5% or 1.2%.
- Trade deficit increased from 1,057 million USD in 2005 to 1,285 million USD in 2006. Current account deficit is much lower and revealed a decreasing tendency. It fell from 81 million USD (1.4% of GDP) in 2005 to 24 million USD (0.4% of GDP) in 2006. Low current account deficit as compared with trade deficit results from high amount of money transferred to the country by Macedonian citizens working abroad. In 2006, the amount of remittances was equal to 19% of GDP.
- The cumulative FDI inflow in the period 1989-2006 equalled 1,628 million USD. In 2006, FDI inflow was 350 million USD. However, 75% of this amount is linked with privatization. In 2006, FDI financed the whole current account deficit.

Growth prospects

- According to the IMF forecast, the Macedonian economy will speed up to 4.5% in 2007 and 2008. However, unstable political situation and the uncertainty as regards further situation in neighbouring Kosovo may negatively influence future economic development.

Table 4.16. Macedonia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	2.0	2.0	2.0	2.0	2.0	2.0	2.0
GDP (denar million)	236389	233841	243970	251486	265256	284226	305082
GDP per capita at PPP (USD)	6060	5905	6043	6331	6763	7221	7707
Real GDP (% change)	4.5	-4.5	0.9	2.8	4.1	3.8	4.0
Individual Consumption (% change)	21.7	-6.3	14.9	5.9			
Investment (% change)	8.9	-8.8	16.5	3.6			
Exports (% change)	31.9	-12.6	-6.5	14.6			
Imports (% change)	34.9	-11.4	7.5	8.4			
CPI Inflation (% change)							
(end of period)	6.1	3.7	1.1	2.6	-1.9	1.2	2.9
(average)	5.8	5.5	1.8	1.2	-0.4	0.5	3.2
PPI Inflation (% change)							
(end of period)	7.9	-2.5	1.1	-0.2	1.3	2.9	2.5
(average)	8.9	2.0	-0.9	-0.3	0.9	3.0	2.8
General Government Balance (% of GDP)	2.5	-6.3	-5.6	-0.1	0.7	0.3	-0.6
Trade balance (USD million)	-690	-526	-804	-848	-1112	-1057	-1285
Current Account Balance							
(USD million)	-69	-244	-358	-149	-415	-81	-24
(% of GDP)	-1.9	-7.1	-9.5	-3.2	-7.8	-1.4	-0.4
Denar/USD Exchange Rate (average)	65.9	68.1	64.7	54.3	50.0	48.5	48.7
Broad Money Supply (M2) (% change)	24.4	66.3	-8.0	18.4	16.1	17.7	18.4
Net Foreign Assets (% change)	68.4	-43.4	115.1	-1.2	4.4	30.3	22.4
Domestic Credit (% change)	-10.7	-11.5	28.8	14.1	20.0	16.7	14.3
Net Foreign Assets of Monetary Authorities							
(USD million)	727	1043	708	844	899	1405	1794
Bank Rate (end of period)	7.9	10.7	10.7	6.5	6.5	6.5	6.5
Deposit Rate (average)	11.2	10.0	9.6	8.0	6.5	6.6	
Average Gross Monthly Salary (% change)	5.5	3.6	6.9	4.8	3.5	3.8	6.3
Unemployment Rate (%)	32.1	30.5	31.9	36.7	37.2	37.3	35.9

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.17. MOLDOVA

Major problems

- Persistent inflation is among the highest in all transformation countries.
- High current account deficit and high trade deficit are becoming a constraint on faster economic growth.
- Low per capita income and widespread poverty.

Economic policy

- In 2006, fiscal policy was less restrictive. After several years of surpluses, the public sector recorded a small deficit of 0.3% of GDP. Direct tax rate cuts were compensated by higher incomes from indirect taxes.
- According to the new bank law, price stability is the only target of the central bank. But significant increases in the price of Russian gas hampered the realization of this target.
- The planned privatization for the years 2006 and 2007 includes 333 companies, e.g. the telecommunication operator Moldtelecom, the bank Banca de Economii, and wine and tobacco producers. However, in 2006, the actual privatization was very slow and opaque.
- In May 2006, the Poverty Reduction and Growth Facility Programme was agreed with IMF. This program obliged the government to reform e.g. public finance and administration as well as enterprise restructuring.
- In the 1st half of 2006, the price of gas imported from Russia doubled. As the result, the gas regulator ANRE increased proportionally the prices for end-customers. This was in line with the government policy of cost-based energy prices.
- In June 2006, the third mobile phone license were issued to the existing fixed-line operator Moldtelecom.
- In May 2006, the Italian bank Veneto Banca bought the small Moldavian bank Eximbank.

Macroeconomic performance, entrepreneurship and social performance

- In 2006, the Moldavian economy slowed down significantly. In 2006, GDP grew by 4.0%. This growth rate is lower than in 2001-2005, when GDP grew at the rate exceeding 6% annually. Economic slowdown results from trade restrictions introduced by Russia. Russia

placed a ban on importing Moldavian wines and agricultural products, and doubled the price of gas exported to Moldova. As the result, industrial production fell by 6.9% in 2006 (in 2000s, it was growing at the rate exceeding 7% annually). The main sources of economic growth were investments (growth rate of 15.1% in 2006) and individual consumption (growth rate of 7.0% in 2006). Exports increased at a moderate pace (2.8%).

- Moldova is the poorest country in Europe. Its GDP per capita at PPP amounted only to 2,818 USD in 2006. Among transformation countries, only three Central Asian republics report lower GDP per capita levels (Uzbekistan, Kyrgyzstan, and Tajikistan).
- The unemployment rate rose from 6.4% in 2005 to 7.3% in 2006, but the quality and reliability of labour market statistics may be questioned..
- CPI inflation increased from 12.0% (annual average) or 10.2% (end-year) in 2005 to 12.8% (annual average) or 14.0% (end-year) in 2006. PPI inflation increased more strongly. PPI rose in 2005-2006 from 5.3% (annual average) or 7.0% (end-year) to 12.2% (annual average) or 13.1% (end-year). A two-fold increase in PPI inflation resulted mainly from higher prices of gas imported from Russia.
- Current account deficit increased from 241 million USD (8.1% of GDP) in 2005 to 399 million USD (11.9% of GDP) in 2006. Trade deficit increased to 1,591 million USD (ca 50% of GDP) in 2006. The deterioration of trade balance results mainly from Russian restrictions on international trade with Moldova. Remittances from Moldavians working abroad are the main source of financing the current account deficit.
- In 2006, FDI inflow was 223 million USD. FDI financed 56% of current account deficit. Cumulative FDI inflow in the period 1989-2006 equalled 1,281 million USD.

Growth prospects

- According to the IMF forecast, the Moldavian economy will slightly speed up to 4.5% in 2007 and 5.0% in 2008. Growth may improve due to several agreements that Moldova managed to sign with Russia, including in particular a 5-year agreement on gas supplies and on the elimination of wine exports bans.

Table 4.17. Moldova

	2000	2001	2002	2003	2004	2005	2006
Population (million)	3.6	3.6	3.6	3.6	3.4	3.4	3.4
GDP (lei million)	16020	19052	22556	27619	32032	37652	42570
GDP per capita at PPP (USD)	1562	1702	1870	2041	2262	2658	2818
Real GDP (% change)	2.1	6.1	7.8	6.6	7.4	7.5	4.0
Individual Consumption (% change)	27.6	6.1	5.9	18.5	6.2	10.1	7.0
Investment (% change)	-0.7	5.2	1.1	13.5	10.5	11.0	15.1
Exports (% change)	6.8	15.7	18.9	19.2	11.0	17.7	2.8
Imports (% change)	29.8	11.1	15.8	28.7	3.6	18.1	10.3
CPI Inflation (% change)							
(end of period)	18.4	6.3	4.4	15.7	12.5	10.2	14.0
(average)	31.1	9.6	5.2	11.6	12.5	12.0	12.8
PPI Inflation (% change)							
(end of period)	24.3	5.7	6.7	9.2	4.9	7.0	13.1
(average)	28.5	12.3	4.7	7.8	5.6	5.3	12.2
General Government Balance (% of GDP)	-1.8	-0.3	-2.2	1.0	0.4	1.5	-0.3
Trade balance (USD million)	-294	-313	-378	-623	-754	-1192	-1591
Current Account Balance							
(USD million)	-98	-25	-67	-130	-58	-241	-399
(% of GDP)	-7.6	-1.7	-4.0	-6.6	-2.2	-8.1	-11.9
Leu/USD Exchange Rate (average)	12.4	12.9	13.6	13.9	12.3	12.6	13.1
Broad Money Supply (M2) (% change)	38.8	37.8	30.4	24.4	44.7	36.7	12.2
Net Foreign Assets (% change)	517.7	16.5	48.6	43.8	75.1	50.0	28.5
Domestic Credit (% change)	14.4	29.6	25.2	24.3	25.8	15.8	27.5
Net Foreign Assets of Monetary Authorities							
(USD million)	231	234	275	288	496	609	762
Money Market Rate (average)	20.8	11.0	5.1	11.5	13.2	5.9	9.5
Deposit Rate (average)	24.9	20.9	14.2	12.6	15.1	13.2	11.9
Average Gross Monthly Salary (% change)	33.9	33.3	27.2	28.8	23.8	19.5	28.6
Unemployment Rate (%)	8.5	7.3	6.8	7.9	8.0	6.4	7.3

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.18. MONTENEGRO

Major problems

- High trade deficit and high current account deficit, mostly due to higher domestic demand.
- High unemployment may cause some social unrest and is a source of political uncertainty.

Economic policy

- In 2000s, general government deficit has been decreasing. In 2006, the deficit equalled 0.3% of GDP whereas in 2005 it amounted to 1.7% of GDP and in 2000 – 6.9% of GDP. The favourable general government balance was mainly achieved due to high tax revenues, especially from VAT.
- The country does not have its own currency. In 1999, German Mark was introduced as the supplementary currency to the existing Yugoslavian Dinar. Since 2000, German Mark had been the only legal tender. In 2002, the euro became the official currency. Monetary policy is efficient as regards preventing inflation. Montenegro does not plan to introduce its own currency.
- In April 2006, the bank reserve requirement rate was reduced from 23% to 19% for short-term deposits.
- The privatization of Montenegro's state owned enterprises is quite advanced. In 2006, the privatization of the steel mill Niksic was started. Four companies participated in a bid for 67% shares of Niksic. The British company MN Speciality Steels was chosen as a strategic investor.

Macroeconomic performance, entrepreneurship and social performance

- In 2006, real GDP grew by 6.3%. The growth rate was higher than in 2000-2005 when GDP growth rate

equalled between -0.2% (negative growth rate) and 4.1% annually.

- Montenegro is one of the poorest European countries. In 2006, its GDP per capita at PPP was 3,426 USD.
- The unemployment rate is still quite high, at 19.7% in 2006, but sharply down from 27,3% in 2005. Overall, the situation in the labour market improved markedly since 2000, when unemployment exceeded 37%.
- Inflation is quite low. In 2006, CPI inflation was 3.0% (annual average) or 2.8% (end-year). In 2005, the analogous CPI indices were 2.6% and 2.5%.
- In 2006, both trade and current account balances strongly deteriorated. Current account deficit increased from 180 million USD (8.6% of GDP) in 2005 to 657 million USD (29.1% of GDP) in 2006. Trade deficit increased from 640 million USD to 1,197 million USD in the analogous period.
- In 2006, FDI inflow amounted to 550 million USD. FDI financed more than 80% of the current account deficit. High FDI are stimulated by the privatization process as well as the investments in banking and greenfield sectors. The cumulative FDI inflow for the period 1989-2006 equalled 1,226 million USD.

Growth prospects

- According to official and EBRD projections, the rate of economic growth will equal 6.0% in 2007. Vienna Institute gives a less optimistic forecast at the level of 5.0%. Montenegro has sufficient potential to be able to develop rapidly in the next years. Many reputable foreign investors operate in Montenegro that can positively influence the subsequent growth rate and the future FDI inflow. High current account deficit will probably be eliminated because Montenegro is characterised by liberal international trade policy and it has a huge potential for exporting tourist services.

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Table 4.18. Montenegro

	2000	2001	2002	2003	2004	2005	2006
Population (million)	0.7	0.7	0.7	0.7	0.7	0.7	0.7
GDP (dinars billion)	1.0	1.2	1.3	1.4	1.5	1.6	1.8
GDP per capita (USD)	1432	1688	1857	2381	2889	3147	3426
Real GDP (% change)	3.1	-0.2	1.7	1.5	3.7	4.1	6.3
Individual Consumption (% change)							
Investment (% change)							
Exports (% change)							
Imports (% change)							
CPI Inflation (% change)							
(end of period)	22.5	26.6	9.3	6.0	1.6	2.5	2.8
(average)	97.1	22.6	18.2	6.7	2.2	2.6	3.0
PPI Inflation (% change)							
(end of period)							
(average)	16.5	14.5	4.6	2.9	5.8	2.1	
General Government Balance (% of GDP)	-6.9	-4.0	-3.8	-4.9	-2.6	-1.7	-0.3
Trade balance (USD million)	-193	-436	-402	-405	-518	-640	-1197
Current Account Balance							
(USD million)	-43	-169	-158	-116	-149	-180	-657
(% of GDP)	-4.5	-15.2	-12.9	-7.4	-7.8	-8.6	-29.1
Dinar/USD Exchange Rate (average)	1.1	1.1	1.1	0.9	0.8	0.8	0.8
Broad Money Supply (M2) (% change)					16.3	49.6	87.4
Net Foreign Assets (% change)				-48.3	-35.1	419.7	38.3
Domestic Credit (% change)					42.4	10.6	135.9
Net Foreign Assets of Monetary Authorities							
(USD million)			52	57	75	215	412
Treasury Bill Rate (average)					9.0	1.0	0.5
Deposit Rate (average)			5.3	4.9	4.8	5.0	5.4
Average Gross Monthly Salary (% change)	-96.0	16.8	30.5	17.8	12.2	7.6	
Unemployment Rate (%)	37.3	36.5	36.7	33.5	31.3	27.3	19.7

Sources: IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.19. POLAND

Major problems

- Administrative barriers remain high in comparison to the rest of CEE countries. According to the World Bank's 2006 Doing Business report, the minimum capital requirements for starting business in Poland is almost four times higher (relative to per capita income) compared to the rest of the region. Similarly, it takes much longer to obtain licences, register property or enforce a contract in Poland than elsewhere in the region.
- Clear, market-oriented restructuring plans for sectors, which remain under state influence, are needed to improve enterprise performance and ensure continuing economic growth.

Economic policy

- The prospects for public finances have improved since the 2006 autumn forecast as a result of much better than expected growth leading to higher revenues. Additionally, expenditure plans were not fully executed. At present, the 2006 general government deficit is estimated at 3.9% of GDP compared to an earlier prediction of 4.2% (pension reform costs included). In particular, the central government deficit was much lower than budgeted and revenues from social contributions were higher than projected. Expenditures turned out lower because of smaller-than-expected absorption of EU funds, which resulted in less investment. The lower-than budgeted social expenditure caused by a sharp decline in registered unemployment also contributed to the expenditure savings. Gross total government debt increased from 47.1% of GDP in 2005 to 47.8% of GDP in 2006, owing to lower privatisation receipts and higher state contributions to the pension system.
- Poland's ability to adapt institutions to attract more investment will ensure that it takes full advantage of EU membership. Significant improvements have already been made through greater flexibility in employment contracts, relative moderate corporate taxation, and better provisions for protecting equity investors. However, Poland has weak ratings in other areas-such as registering new businesses and closing old ones, enforcing contracts, combating corruption, and resolving legal issues quickly-and this needs improvement. Another key issue, particularly as demand for land and real estate rises, is to adapt zoning and regional plans to increase land availability. Experiences of earlier EU members show that those that did not create conditions for strong private supply responses to rising property prices encountered higher inflation and bottlenecks to growth.
- The reform process has slowed since Poland's accession to EU and was brought to a near standstill following the last elections in autumn 2005. Gross privatisation revenues in 2005 were around 1 billion euro, well below the figure raised in 2004. The only major privatisation undertaken in 2006 has been the sale of chemical companies *Zachem* and *Sarzyna*. The new government's policies towards key economic sector remain unclear, and only changes limit to new people posted in largest state owned and state controlled enterprises.

Macroeconomic performance, entrepreneurship and social policy

- At 6.1%, GDP growth in 2006 surprised positively compared to previous expectations (5.3% in the Commission services' autumn 2006 forecast) and growth rate in 2005. Economic activity accelerated markedly in the final quarter of 2006 when economic growth reached 6.3% yoy on the back of a strong pick-up in investments. A mild winter allowed continuing construction activities and drove up gross fixed capital formation by 14.1% in 2006 as a whole. Despite significant investment growth, the economy's overall performance was mainly due to high private consumption. Domestic demand grew by a strong 6.6% in 2006, also thanks to strong public consumption. On the supply side, the main contribution to the economic expansion came from industry – the industrial output grew by 7.7% – and construction expanded by 14.6% in 2006.
- Labour market conditions improved substantially in 2006. Employment grew by 3.4%, and is expected to stay on an upward trend over the forecast horizon, though the employment rate will remain low, at 56.5% in 2008. Employment growth translated into a lower unemployment rate, which declined to 11.8% in February 2007 from 15.1% a year earlier, but remains the highest in the EU. However, part of the decrease in the unemployment rate is due to a falling participation rate associated with outward labour migration and early retirement. Unit labour costs fell by 0.7% in 2006. Despite strong productivity growth in the manufacturing sector, rapid wage growth in the non-manufacturing sector will probably increase unit labour costs in the whole economy by about 1.5% in 2007 and 0.5% in 2008.
- HICP inflation fell to 1.3% in 2006 despite relatively high food prices. Planned excise duty hikes and higher wage demands, fuelled partly by labour shortages in certain segments of the market, will put upward pressure on inflation in 2007 and 2008. The annual consumer price index increased to 2.5% cent in March 2007, matching the Central Bank's 2.5% cent target rate. In response to inflationary pressures stimulated by fast economic growth and wage increases, the Monetary Policy Council increased the policy rate from 4% to 4.25% in April 2007. This move came after a long series of policy rate cuts; between March 2005 and

Table 4.19. Poland

	2000	2001	2002	2003	2004	2005	2006
Population (million)	38.6	38.6	38.2	38.2	38.2	38.1	38.0
GDP (billion zlotys)	745	780	809	843	925	983	1058
GDP per capita at PPP (USD)	10437.5	10865.5	11217.4	11902.2	12893.4	13741.1	14880.2
GDP (percentage change)	4.0	1.0	1.4	3.8	5.3	3.6	6.1
Private consumption (percentage change)	3.0	2.3	3.4	2.0	4.4	2.0	5.2
Gross fixed capital formation (percentage change)	2.7	-9.7	-7.2	3.3	14.7	1.4	14.1
Export (percentage change)	23.2	3.1	4.8	14.2	14.0	8.0	14.5
Import (percentage change)	15.5	-5.3	2.7	9.3	15.2	4.7	15.8
Consumer prices (percentage change)							
(end-year)	8.5	3.6	0.8	1.7	4.4	0.7	1.4
(annual average)	10.1	5.5	1.7	0.7	3.5	2.1	1.0
Producer prices (percentage change)							
(end-year)	5.7	-0.3	2.3	3.7	5.4	0.2	2.4
(annual average)	7.9	1.7	1.2	2.7	7.1	0.8	2.2
General government balance (In per cent of GDP)	-1.8	-5.1	-5.0	-6.3	-5.7	-4.3	-3.9
Trade balance (In millions of USD)	-13 168	-11 675	-7249	-5725	-5622	-2766	-4953
Current account balance							
(In millions of USD)	-9981	-5376	-5011	-4599	-10 677	-5105	-7926
(In per cent of GDP)	-5.8	-2.8	-2.5	-2.1	-4.2	-1.7	-2.3
Exchange rate (zloty/USD - end-year)	4.3	4.1	4.1	3.9	3.7	3.2	3.1
Broad money (percentage change)	11.8	9.2	-2.6	5.6	7.3	11.0	15.8
Net foreign assets (percentage change)	19.2	1.7	-1.4	2.7	4.9	19.6	
Domestic credit (percentage change)	20.2	9.3	2.1	7.9	3.3	13.0	21.8
Net foreign assets of Monetary Authority							
(in billions of zlotys)	26 290	25 937	28 130	32 780	29 852	43 571	
Lending rate	19.0	11.5	6.8	5.3	6.5	4.5	4.0
Deposit rate	14.3	7.9	4.2	2.9	3.7	2.7	2.5
Gross average monthly earnings in economy							
(percentage change)	11.4	8.0	3.5	3.2	4.0	4.0	4.1
Unemployment (In per cent of labour force)	16.4	19.1	20.2	19.7	18.2	16.9	12.2

Sources: IMF, *World Economic Outlook Database*, April 2007; EBRD, *Transition Update*, May 2007.

February 2006 the Monetary Policy Council reduced the policy rate in seven steps from 6.5% to 4%, an historical low. The zloty has appreciated against the euro by almost five per cent since September 2005.

- The current account deficit in 2006 amounted to €6.3 billion, which constituted 2.3% cent of GDP. This was above the 1.7% deficit in 2005. Exports rose in 2006 by 14.5% while imports were up by 15.8%, confirming the continued growth of domestic demand. The contribution of net exports to GDP growth turned negative (-0.5%), which can be explained by rising investment- and consumption-driven imports. Foreign Direct Investment increased from €7.7 billion in 2005 to a record-breaking €11 billion in 2006, supported by stronger economic growth and EU membership. External debt was at around 49% of GDP at the end of 2006. International reserves remained at around 4.1 months of imports of goods and services in the first quarter of 2007. The current account deficit was covered comfortably by inflows of FDI, complemented by sizeable portfolio inflows.

Growth prospects

- GDP growth is likely to grow at 6.1% in 2007, moderating to 5.5% in 2008. Domestic demand is expected to be the main driving force in both years. Investment growth is anticipated to remain strong over the forecast period, contributing to rising potential GDP growth, while private consumption should remain robust. This outlook is underpinned by short-term indicators, which point to industrial production, retail sales and construction activity reaching historically high levels in the first quarter of 2007. The political situation remains the key source of uncertainty in the near future. Slowdown in privatisation, political appointments to state-owned companies and lack of reforms and coherent policies towards government-controlled sectors may hamper restructuring. Fiscal reforms will become increasingly urgent, as the costs of pension reform have to be included in the headline general government deficit, while any slowdown in growth will expose structural weaknesses in government finances.

4.20. ROMANIA

Major problems

- High trade deficit and high current account deficit.
- Political instability caused by the conflict between president and prime minister, as well as still widespread corruption may hamper growth prospects in the medium term

Economic policy

- In 2006, the officially reported public sector deficit increased somewhat to 1.9% of GDP from 1.4% in 2005. The deterioration of general government balance was partly a result of higher public investments in infrastructure and the increase of state pensions and public sector wages.
- Privatization of less valuable firms runs slowly. In July 2006, the government owned less than 700 enterprises. In the 1st half of 2006, 41 companies were privatized. Until the end of 2006, 31 companies should have been privatized and 43 companies should have been liquidated.
- In June 2006, the Italian company Enel won the bid for 67.5% shares of the energy company Electrica Muntenia Sud for 820 million EUR.
- The full liberalisation of the gas market for institutional buyers was introduced in January 2007, and for individual buyers – in July 2007.
- Since 1 September 2006, Romanian leu has become a fully convertible currency.

Macroeconomic performance, entrepreneurship and social performance

- During 2000s, the Romanian economy has been growing at rates varying between 2.1% and 8.4%. In 2006, the growth rate reached 7.7% and was much faster than in 2005 (4.1%). The acceleration of growth is mainly fuelled by rapid increases of individual

consumption and investments. Consumption and investments grew by 9.8% and 13.0% in 2005 whereas, in 2006, by 16.9% and 19.7% respectively. By contrast, exports grew at a moderate pace of 9.7%, and the contribution of net exports to growth in 2006 was negative.

- Since 2002, the situation in the labour market has been improving systematically. In 2006, the unemployment rate fell to 5.2%, from 5.9% in 2005.
- CPI inflation decreased between 2005 and 2006. CPI equalled 9.5% (annual average) or 8.6% (end-year) in 2005 whereas, in 2006, it equalled 6.6% or 4.9% respectively. Lower inflation results from currency appreciation and the fall in the prices of agricultural products, and postponing the increase of regulated prices. The central bank's official inflation target for 2007 is 4%.
- Current account deficit increased from 10,054 million USD (10.2% of GDP) in 2005 to 13,754 million USD (11.3% of GDP) in 2006. Trade deficit increased from 9,873 million USD to 14,770 million USD in the analogous period.
- In 2006, FDI inflow equalled 11,430 million USD. FDI financed 83% of the current account deficit. The cumulative FDI inflow for the period 1989-2006 amounted to 36 billion USD. With this result, Romania is located at the 4th position among all the 28 post-socialist countries as regards the cumulative FDI inflow.

Growth prospects

- According to the IMF forecast, the Romanian economy will slow down to 6.5% in 2007 and 4.8% in 2008. Economic growth will be fuelled by higher investments due to EU accession and by continuing privatization and restructuring of the economy. Sound monetary and fiscal policies are necessary for eliminating inflationary pressures, increasing country's competitiveness and reducing external imbalances.

Table 4.20. Romania

	2000	2001	2002	2003	2004	2005	2006
Population (million)	22.4	22.4	21.8	21.7	21.7	21.7	21.7
GDP (lei million)	80377	116769	151475	197565	246372	287186	342418
GDP per capita at PPP (USD)	5974	6496	6974	7521	8417	9056	9869
Real GDP (% change)	2.1	5.7	5.1	5.2	8.4	4.1	7.7
Individual Consumption (% change)	-0.8	6.9	5.3	8.5	14.1	9.8	16.9
Investment (% change)	5.5	10.1	8.2	8.6	10.8	13.0	19.7
Exports (% change)	23.4	12.1	17.5	8.4	13.9	7.6	9.7
Imports (% change)	27.1	18.4	12.0	16.0	22.1	17.2	14.8
CPI Inflation (% change)							
(end of period)	40.7	30.3	17.8	14.1	9.3	8.6	4.9
(average)	45.7	34.5	22.5	15.3	11.9	9.5	6.6
PPI Inflation (% change)							
(end of period)	50.3	32.6	20.1	20.0	16.3	10.4	11.6
(average)	53.4	40.3	24.5	19.6	18.6	12.3	11.4
General Government Balance (% of GDP)	-4.6	-3.3	-2.0	-1.5	-1.5	-1.4	-1.9
Trade balance (USD million)	-1684	-2969	-2613	-4465	-6611	-9873	-14770
Current Account Balance							
(USD million)	-1347	-2349	-1573	-3455	-6333	-10054	-13754
(% of GDP)	-3.6	-5.8	-3.4	-5.8	-8.4	-10.2	-11.3
Leu/USD Exchange Rate (average)	2.2	2.9	3.3	3.3	3.3	2.9	2.8
Broad Money Supply (M2) (% change)	38.0	46.2	38.1	23.3	39.9	33.9	29.4
Net Foreign Assets (% change)	124.6	44.1	35.8	-2.7	54.8	-46.0	-1.4
Domestic Credit (% change)	10.9	34.9	38.7	49.0	33.0	43.7	53.0
Net Foreign Assets of Monetary Authorities							
(USD million)	4058	4608	6748	8617	12007	13535	17590
Bank Rate (end of period)	35.0	35.0	29.0	18.8	20.3	9.6	8.6
Deposit Rate (end of period)	32.4	26.2	18.4	10.8	11.3	6.2	4.8
Average Gross Monthly Salary (% change)	46.9	48.9	27.3	23.6	22.5	17.0	18.9
Unemployment Rate (%)	7.1	6.6	8.4	7.0	6.3	5.9	5.2

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.21. RUSSIAN FEDERATION

Major problems

High level of production capacity in the absence of sufficient investment may produce bottlenecks.

Excessive and still increasing reliance on oil and gas sectors makes the economy vulnerable to external shocks.

Business environment is not favourable and needs urgent reforms to improve the functioning of public institutions, reduce level of corruption, and cut bureaucracy and administrative barriers.

Economic policy

Since 2002, general government surplus has increased systematically. In 2006, the surplus was 9.2%, more than 1 percentage point higher than in 2005. However, fiscal policy becomes more expansionary. The improvement in general government balance results mainly from higher oil prices. Non-oil general government balance is negative and increased from -5.9% of GDP in 2005 to -6.9% of GDP in 2006. This reflects the fact that oil revenues are used to cut taxes and to increase in public spending.

Since July 2006, the Russian rouble has become a fully convertible currency.

Russia has made significant progress as regards WTO membership negotiations. The agreement was reached with all member states except the USA, where many issues are not resolved (e.g. protection of intellectual property rights, agricultural trade, energy prices).

In 2006 Russia introduced numerous trade barriers for political reasons, including the ban on imports of Moldavian and Georgian wines, and of Polish meat. Russia also used gas exports as an instrument of political pressure and increased prices of gas exported to Ukraine, Georgia, Moldova and Belarus.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP grew by 6.7%, slightly more than in 2005 (6.4%), but less than in 2003-2004 (7.2%). The main source of economic growth was individual consumption (growth rate of 11.2% in 2006) and investments (13.9%).

Exports grew only moderately (7.2%), limited by capacity constraints in extractive industries.

The Russian economy is working at a high level of production capacity utilization, as the result of a long period of high economic growth and low investments. Output constraints are becoming particularly evident in the oil and gas sector. Crude oil production in 2006 increased by less than 3% whereas at the beginning of 2000, it increased by 10% annually. This implies that the contribution of the energy sector to GDP is decreasing. Capacity constraints caused high imports growth (21.7% in 2006).

The situation at the labour market has been improving. Unemployment rate decreased from 7.7% in 2005 to 6.9% in 2006. In big cities, unemployment actually does not exist (unemployment rate in Moscow is 0.8% and in Sankt Petersburg - 2.2%). Russia admits many immigrant workers, mainly from other CIS countries.

Inflation was successfully reduced to a one-digit level. In 2006, CPI dropped to 9.7% (annual average) or 9.0% (end-year) whereas, from 12.7% or 10.9%, respectively, in 2005.

Current account surplus increased from 69,401 million USD (9.1% of GDP) in 2005 to 94,467 million USD (9.7% of GDP) in 2006. Trade surplus rose from 103,418 million USD to 124,306 million USD in 2005-2006. The balance of payments was improved on the back of higher prices of energy resources and other primary commodities (especially in the 1st half of 2006).

Growth prospects

According to the IMF forecast, the economic growth will remain high at the level of 6.4% in 2007 and 5.9% in 2008. Main drivers of growth will still be rapidly growing consumption and investments. The expected expansionary fiscal policy due to forthcoming elections and the resulting higher public sector wages and implementation of many national investment projects will also give a stimulus to further growth. However, long-term growth will depend on structural reforms, expansion of non-oil and non-gas sectors, and the reduction of economic capacity constraints.

Table 4.21. Russia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	145.2	144.4	145.0	144.9	144.9	144.1	143.4
GDP (rouble billion)	7306	8944	10831	13243	17048	21615	26621
GDP per capita at PPP (USD)	7067	7637	8197	8995	9972	10984	12096
Real GDP (% change)	10.0	5.1	4.7	7.3	7.2	6.4	6.7
Individual Consumption (% change)	7.3	9.5	8.5	7.5	12.1	12.7	11.2
Investment (% change)	21.5	10.2	2.8	12.8	12.6	8.3	13.9
Exports (% change)	9.4	4.2	10.3	12.5	11.8	6.4	7.2
Imports (% change)	31.5	18.7	14.6	17.7	23.3	17.0	21.7
CPI Inflation (% change)							
(end of period)	20.1	18.6	15.0	12.0	11.7	10.9	9.0
(average)	20.8	21.6	15.7	13.7	10.9	12.7	9.7
PPI Inflation (% change)							
(end of period)	31.6	10.7	17.1	12.5	28.8	13.4	10.4
(average)	46.6	19.2	14.0	16.6	22.0	18.2	12.6
General Government Balance (% of GDP)	3.2	2.7	0.6	1.1	5.0	8.1	9.2
Trade balance (USD million)	60171	48120	46335	60493	85825	103418	124306
Current Account Balance							
(USD million)	46839	33934	29116	35845	58592	69401	94467
(% of GDP)	18.0	11.1	8.4	8.3	10.1	9.1	9.7
Rouble/USD Exchange Rate (average)	28.1	29.2	31.3	30.7	28.8	28.3	27.2
Broad Money Supply (M2) (% change)	62.4	40.9	32.4	50.5	33.7	36.3	40.5
Net Foreign Assets (% change)	639.1	50.9	44.4	32.9	53.1	51.6	42.3
Domestic Credit (% change)	12.1	27.0	26.5	26.5	18.7	2.7	28.4
Net Foreign Assets of Monetary Authorities							
(USD million)	30182	40307	51539	77906	125305	196391	297411
Refinancing Rate (end of period)	25.0	25.0	21.0	16.0	13.0	12.0	11.0
Deposit Rate (average)	6.5	4.9	5.0	4.5	3.8	4.0	4.1
Average Gross Monthly Salary (% change)	39.2	47.3	36.7	24.4	24.0	25.3	25.4
Unemployment Rate (%)	10.2	8.7	9.0	8.7	7.6	7.7	6.9

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.22. SERBIA

Major problems

- High trade deficit and high current account deficit.
- High unemployment.
- Political uncertainty over the future of Kosovo.

Economic policy

In 2006, the general government surplus was 2.7% of GDP, i.e. ca 2 percentage points higher than in 2005. Subsidies to state-owned companies are falling gradually. The massive public investment program involving 1 billion EUR accepted by the former government, however, poses a threat to the stability of state budget.

In May 2006, the European Union suspended negotiations with Serbia on the candidate country status, due to the fact that Serbia did not comply with the decision of International Justice Tribunal.

About 100 state-owned companies were privatised in the 1st half of 2006. The small-scale privatization may be finished until 2007.

The government prepares the privatization plan for several major companies. In August 2006, the government decided to sell 25% shares of Naftna Industrija Srbija with the option allowing the investor to increase its stake in the Serbian company to 49% until end-2009. In September 2006, the process of privatization of the mining and smelting company RTB Bor was started. However, the privatization of other large enterprises runs more slowly than planned.

The sale of telecommunication company Mobi63 to the Norwegian firm Telenor of Norway for more than 1.5 billion EUR was the biggest privatization in 2006. Competition in the telecommunication sector is expected to increase because, in 2006, the government announced the tender for another licence in the 3G telecommunications sector.

The government privatized several banks, e.g. Panonska Banka, Niška Banka, Vojvodjanska Banka, and Nacionalna Stedionica Banka. As the result, the state

participation in the banking sector decreased from 32% to 21% between mid-2005 and mid-2006.

Macroeconomic performance, entrepreneurship and social performance

After several years of buoyant growth, the Serbian economy slowed down somewhat to 5.4% in 2006. Rapid economic growth results from both internal and external factors. In the 1st half of 2006, exports grew by 20% year-over-year. Metal and tobacco industries, i.e. the industries characterised by high FDI inflow during the past years, showed best economic performance.

Unemployment is persistently high since the late 1990s. The unemployment rate in 2006 rose again to 33.2%, and is at the highest level since the break up of former Yugoslavia.

Inflation measured by the annual average CPI index declined from 17.2% in 2005 to 12.5% in 2006. The fall of the end-year CPI index was more spectacular – from 17.5% to 6.6%, respectively.

Current account deficit increased from 10.0% of GDP in 2005 to 12.9% of GDP in 2006, mostly as a result of rapidly growing trade deficit which rose from 5,563 million USD to 6,200 million USD in the same period. Even though remittances from the residents working abroad helped to reduce the imbalance, the current account deficit remains substantial.

FDI inflow was 4,400 million USD in 2006. FDI financed the whole current account deficit. The cumulative FDI inflow in the period 1989-2006 equalled 9,837 million USD.

Growth prospects

According to the IMF forecast, the economic growth rate will be maintained at the level of 5.0% in 2007 and 5.5% in 2008. Despite a huge growth potential, the forecasts for the Serbian economy are highly uncertain. This is mainly due to unstable situation in Kosovo. The possible political crisis would negatively influence foreign investments and the future growth rate.

Table 4.22. Serbia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	7.5	7.5	7.5	7.5	7.5	7.5	7.5
GDP (dinar billion)	398	784	1020	1172	1431	1750	2113
GDP per capita at PPP (USD)	4212	4541	4831	5067	5711	6248	6771
Real GDP (% change)	4.5	4.8	4.2	2.5	8.4	6.2	5.4
Individual Consumption (% change)							
Investment (% change)							
Exports (% change)							
Imports (% change)							
CPI Inflation (% change)							
(end of period)	113.5	39.0	14.2	7.6	13.4	17.5	6.6
(average)	60.4	91.1	21.2	11.3	9.5	17.2	12.5
PPI Inflation (% change)							
(end of period)							
(average)	44.5						
General Government Balance (% of GDP)	-1.0	-4.9	-8.3	-3.4	0.0	0.9	2.7
Trade balance (USD million)	-1788	-2834	-4111	-5565	-6643	-5563	-6200
Current Account Balance							
(USD million)	-327	-528	-2502	-3122	-3302	-2418	-3700
(% of GDP)	-5.1	-5.0	-17.5	-16.4	-14.8	-10.0	-12.9
Dinar/USD Exchange Rate (average)	54.9	66.8	64.2	57.5	58.7	67.2	67.0
Broad Money Supply (M2) (% change)	76.1	107.0	62.9	12.6	17.1	31.4	47.3
Net Foreign Assets (% change)		-9.4	241.1	13.7	-5.5	36.1	86.0
Domestic Credit (% change)	203.1	19.8	-32.7	23.4	52.6	40.7	3.8
Net Foreign Assets of Monetary Authorities							
(USD million)	6234	4037	2280	3561	4241	5865	11991
Bank Rate (end of period)		18.7	9.7	10.6	17.2	19.2	15.4
Deposit Rate (average)	6.3	4.1	2.6	2.7	3.6	3.7	5.1
Average Gross Monthly Salary (% change)	91.1	129.6	51.7	25.3	23.7	24.1	24.4
Unemployment Rate (%)	25.6	26.8	29.0	31.7	31.6	32.4	33.2

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.23. SLOVAKIA

Major problems

- Growing fiscal deficit and accelerating inflation pose threat to macroeconomic stability.
- Continuously high unemployment is a source of support for political populism.
- High trade deficit and high current account deficit.
- Suspension of the privatization.

Economic policy

General government deficit rose from 2.8% of GDP in 2005 to 3.4% of GDP in 2006.

Slovakia declared the introduction of euro in 2009. Aiming at meeting the convergence criteria, the central bank tightened the monetary policy responding higher inflation. The key central bank rate increased from 3.0% at the end of 2005 to 4.8% at the end of 2006.

New government suspended the privatization of economy in mid-2006 (including some started privatizations) and decided to maintain the state control in strategic companies. The opportunity cost of this decision is about 50 billion korunas (3.5% of GDP) expressed in terms of lost budget revenues. Some large privatization projects were suspended (e.g. railway operator ZSKK Cargo, 6 heat plants, and 3 energy distributors). Several other privatizations started by the former government (e.g. the Bratislava stock exchange, an arm producer, several bus operators and hospitals) may also be cancelled.

However, some privatizations were completed before the government implemented the new strategy. For example, in April 2006, the sale of 66% shares of the energy company Slovenske Elektrarne to the Italian company ENEL for 840 million EUR was finished. The sale of 66% shares of the international airport in Kosice to the Austrian company TwoOne is also almost completed.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP accelerated to 8.2% from 6.0% in 2005. The main factor of economic growth has been exports, especially car exports resulting from high foreign investments in the motor industry during the past years. The dynamics of consumption and investments is decreasing. In 2006, consumption grew by 6.3% (in 2005: 7.0%), and investments by 8.7% (in 2005: 13.8%). The slowdown in domestic demand has mostly been caused by restrictive monetary policy and interest rates hikes.

Unemployment remains one of the main concerns for the authorities. The unemployment rate in end-2006 was 13.3%, and has been declining only slowly from the highs of 18-19% in the beginning of 2000s..

In 2006, inflation remained high. Although the end-year CPI index in 2006 was lower than in 2005 (a decrease from 3.9% to 3.7%), however, the annual average CPI index increased from 2.7% to 4.5%.

Current account deficit decreased from 4,090 million USD (8.6% of GDP) in 2005 to 3,956 million USD (7.0% of GDP) in 2006. However, the level of the deficit still remains high. Trade deficit increased considerably: from 2,376 million USD in 2005 to 3,500 million USD in 2006.

FDI inflow was 3,500 million USD in 2006. FDI financed 88% of the current account deficit. Cumulative FDI inflow in the period 1989-2006 equalled 17,246 million USD.

Growth prospects

According to the IMF forecast, the economic growth rate will be maintained at 8.2% in 2007 and 7.5% in 2008. However, the real growth rate will depend on the government policy. Slovakia has officially announced its intention to join the euro area in January 2009. This implies the necessity to reduce inflation and budget deficit. Restrictive fiscal and monetary policies and a slow pace of privatization may reduce the growth rate in the medium term perspective.

Table 4.23. Slovakia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	5.4	5.4	5.4	5.4	5.4	5.4	5.4
GDP (koruna billion)	941	1021	1111	1213	1355	1471	1632
GDP per capita at PPP (USD)	11393	12033	12737	13538	14666	16024	17559
Real GDP (% change)	0.7	3.2	4.1	4.2	5.4	6.0	8.2
Individual Consumption (% change)	-0.8	5.2	5.2	0.2	4.2	7.0	6.3
Investment (% change)	-7.2	12.9	0.3	-2.3	5.0	13.8	8.7
Exports (% change)	13.7	6.8	4.7	15.9	7.9	13.5	20.0
Imports (% change)	10.5	13.5	4.6	7.6	8.8	15.5	17.8
CPI Inflation (% change)							
(end of period)	8.4	6.5	3.4	9.3	5.9	3.9	3.7
(average)	12.0	7.3	3.3	8.5	7.5	2.7	4.5
PPI Inflation (% change)							
(end of period)	8.9	3.8	2.1	9.6	3.4	5.9	
(average)	9.8	6.6	2.2	8.9	3.4	3.9	8.3
General Government Balance (% of GDP)	-12.2	-6.5	-7.7	-2.7	-2.4	-2.8	-3.4
Trade balance (USD million)	-904	-2125	-2117	-637	-1536	-2376	-3500
Current Account Balance							
(USD million)	-702	-1746	-1924	-276	-1507	-4090	-3956
(% of GDP)	-3.4	-8.3	-7.8	-0.8	-3.6	-8.6	-7.0
Koruna/USD Exchange Rate (average)	46.2	48.4	45.3	36.8	32.3	31.0	29.6
Broad Money Supply (M2) (% change)	15.4	11.9	3.4	-4.9	9.5	7.3	14.5
Net Foreign Assets (% change)	54.6	9.5	34.9	-15.3	0.4	-22.6	-2.0
Domestic Credit (% change)	9.1	13.3	-12.7	9.3	6.9	12.0	10.8
Net Foreign Assets of Monetary Authorities							
(USD million)	4405	4959	8410	10861	15805	20944	11752
Bank Rate (end of period)	8.8	7.8	6.5	6.0	4.0	3.0	4.8
Deposit Rate (average)	8.5	6.5	6.7	5.3	4.1	2.4	3.6
Average Gross Monthly Salary (USD)	248.29	255.71	298.08	390.64	490.59	556.90	631.75
Unemployment Rate (%)	18.0	18.7	17.9	17.4	17.1	15.3	13.3

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*; Slovakia's Statistical Office data.

4.24. SLOVENIA

Major problems

- Unfavourable demographic trends put pressure on public finances. Pension system has to be reformed because otherwise pension expenditures may be a serious problem for the budget.
- Large-scale privatization lags behind.

Economic policy

In 2006, the general government deficit stood at 1.4% of GDP, slightly less than in 2005 (1,5%). The fiscal situation in Slovenia has been improving since the beginning of 2000s, but the rapidly growing number of pensioners may destabilize public finances in future.

In November 2006, the government approved the tax reform program. However, the reforms of public spending are also needed.

The progress in large-scale privatization is slow. The government approved a new privatization formula. According to it, 25% + 1 shares of privatized entities will remain in the state hands, 1% of shares will be listed on the stock exchange, and the remaining part may be sold to a strategic investor. In July 2006, the government divided enterprises into three groups depending on the planned date of their privatization (24 months, 30 months, or not specific date).

The number of registered enterprises increased by almost 15% between mid-2005 and mid-2006. This is partly the result of the new simplified regulations concerning registration of firms.

Telecommunication reform is in progress. The portability of mobile telecommunication numbers was introduced in January 2006, and the portability of fixed-line numbers – in May 2006. In February 2006, Telecommunication Office ordered three largest mobile phone operators (Mobitel, Simobil, and Vega) to make available their network to other smaller companies. In August 2006, M Mobil, the new mobile phone operator,

entered the industry. The market share of the largest company, Mobitel, decreased to 72%.

On 1 January 2007, Slovenia entered the euro area and introduced the euro as a legal tender on its territory. The changeover to the common European currency was smooth and successful.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP grew by 5.2%, i.e. by 1.2 percentage point higher than in 2005. The main sources of economic growth were investments (an increase by 11.9% in 2006) and exports (10.0%). Individual consumption was growing more sluggishly (3.3%).

Slovenia is the richest country among all 28 post-socialist countries as regards per capita income. In 2006, GDP per capita at PPP reached 23,843 USD.

During 2000s, unemployment has been low at the level of 6-7%. In 2006, the unemployment rate was 6.0%, and declined from 7,2% in 2005.

Inflation remains stable and under control. In 2006, the CPI index was 2.5% (annual average) or 2.8% (end-year), compared to 2.5% or 2.3%, respectively, in 2005.

Current account deficit in 2006 was less than 2.5% of GDP, slightly more than in 2005 (2.0% of GDP), mostly due a higher trade deficit which increased from 1,258 million USD in 2005 to 1,426 million USD in 2006.

In 2006, Slovenia recorded an outflow of FDI equal to 377 million USD. Cumulated FDI inflow in the period 1989-2006 amounted to 2,652 million USD.

Growth prospects

According to the IMF forecast, the rate of economic growth will slightly decrease to 4.5% in 2007 and 4.0% in 2008. Inflation and fiscal deficit should be maintained at low levels. However, in 2007, a small and temporary increase in inflation is possible due to the price rounding after the introduction of euro. Sustainable economic growth requires carrying out further structural reforms.

Table 4.24. Slovenia

	2000	2001	2002	2003	2004	2005	2006
Population (million)	2.0	2.0	2.0	2.0	2.0	2.0	2.0
GDP (tolar million)	20974	22099	23673	24876	26257	27626	29737
GDP per capita at PPP (USD)	16852	17680	18601	19486	20863	22261	23843
Real GDP (% change)	4.1	2.7	3.5	2.7	4.4	4.0	5.2
Individual Consumption (% change)	0.7	2.3	1.3	3.5	2.6	3.4	3.3
Investment (% change)	1.8	0.4	0.9	7.1	7.9	1.5	11.9
Exports (% change)	13.2	6.3	6.7	3.1	12.5	10.5	10.0
Imports (% change)	7.3	3.0	4.8	6.7	13.4	7.0	10.4
CPI Inflation (% change)							
(end of period)	8.9	7.0	7.2	4.6	3.2	2.3	2.8
(average)	8.9	8.4	7.5	5.6	3.6	2.5	2.5
PPI Inflation (% change)							
(end of period)	9.2	7.5	3.7	2.1	4.9	1.8	2.8
(average)	7.6	9.0	5.2	2.6	4.3	2.7	2.3
General Government Balance (% of GDP)	-3.8	-4.1	-2.5	-2.8	-2.3	-1.5	-1.4
Trade balance (USD million)	-1139	-615	-248	-622	-1258	-1258	-1426
Current Account Balance							
(USD million)	-548	37	244	-215	-892	-682	-942
(% of GDP)	-2.8	0.2	1.1	-0.8	-2.7	-2.0	-2.5
Tolar/USD Exchange Rate (average)	222.7	242.7	240.2	207.1	192.4	192.7	192.7
Broad Money Supply (M2) (% change)	17.1	29.9	11.0	6.2	6.6	7.8	7.6
Net Foreign Assets (% change)	19.5	78.8	-2.6	-13.5	-24.2	-46.9	-115.5
Domestic Credit (% change)	16.7	16.9	14.1	14.4	24.1	20.2	21.7
Net Foreign Assets of Monetary Authorities							
(USD million)	3323	4624	6578	7941	8077	8498	6755
Central Bank Rate (end of period)	11.0	12.0	10.5	7.3	5.0	5.0	4.5
Deposit Rate (average)	10.1	9.8	8.2	6.0	3.8	3.2	2.8
Average Gross Monthly Salary (USD)					1089.20	1153.94	1402.84
Unemployment Rate (%)	6.6	7.0	6.5	6.7	6.5	7.2	6.0

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*; Slovenia's Statistical Office data.

4.25. TAJIKISTAN

Major problems

Restructuring and privatization of key economic sectors is necessary. The government should introduce clear rules of running businesses. The diversification of the economy structure is also needed because the Tajik economy is very dependent on world market tendencies in two sectors: aluminium and cotton.

Economic policy

Since 2003, general government deficit has deteriorated, exceeding 5% of GDP in 2006. Low monetization of the economy (ca 10% of GDP) reduces the effectiveness of monetary policy.

In January 2006, government announced the end of small-scale privatization. In May, government declared that the large aluminium mill Tadaz, yielding 50% of country's industrial output, will not be privatized in 2007 as expected.

Tajikistan participates in several infrastructure investments in cooperation with China, Russia, and Iran, such as the construction of Aznob north-south tunnel (cooperation with Iran) and the construction of hydroelectric power station Sangtuda (with Iran and Russia).

Russian company Rusal agreed to invest 1 billion USD in finishing the construction of hydroelectric power station Rogun. Rogun will produce the energy for the planned aluminium works with capacity of more than 200 thousand tonnes aluminium per year.

In June 2006, Tajikistan signed the agreement with China on a 600 million USD loan. This funds will be spent on construction of a motorway linking the centre of the country with Uzbek border and to construct the north-south energy line.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP grew by 7.0%, somewhat faster than in 2005 (6.7%), but by less than in 2003-2004, when the

economy was growing at double digit rates. Individual consumption, stimulated by higher wages and remittances from abroad, was the most important source of economic growth. In 2006, Tajik citizens working abroad transferred to the country the amount of 1.2 billion USD (42% of GDP). Among fastest growing sectors were construction, energy sector, and services.

Tajikistan is the poorest country among all the 28 post-socialist countries as regards per capita income. In 2006, GDP per capita at PPP reached 1,501 USD. However, the degree of poverty is falling. According to a report from January 2006, the share of population living below the poverty line (equal to 2.15 USD per day) decreased from 81% in 1999 to 64% in 2003.

In 2006, CPI inflation accelerated to 9.2% (annual average) or 12.7% (end-year) from 7.0% or 7.1%, respectively, in 2005. Higher inflation results partly from the increase of incomes and consumption which exceeds the increase of production (especially in agriculture), and partly from higher prices of food and energy resources.

Current account deficit slightly increased from 3.4% of GDP in 2005 to 3.9% of GDP in 2006. Trade deficit rose from 319 million USD to 372 million USD in 2005-2006.

In 2006, FDI inflow was 60 million USD which covered 55% of current account deficit. Cumulative FDI inflow in the period 1989-2006 equalled 591 million USD.

Growth prospects

According to the IMF forecast, the Tajik economy will expand at a high rate of up to 7.5% in 2007 and 8.0% in 2008. Rapid economic growth will be stimulated by rapidly increasing household incomes supported by increased inflows of remittances from abroad. Joint investments with China, Russia, and Iran, especially in transport and the energy sector, will also stimulate economic growth. The major risk factor for the Tajik economy is its high dependence on the tendencies in the world market for aluminium and cotton, as well as on the remittances from abroad. The latter may fall if Russia imposes restrictions on labour migrations.

TAJIK

Table 4.25. Tajikistan

	2000	2001	2002	2003	2004	2005	2006
Population (million)	6.2	6.2	6.3	6.4	6.4	6.5	6.6
GDP (sometri million)	1807	2512	3345	4758	6158	7201	9272
GDP per capita at PPP (USD)	797	892	984	1100	1243	1359	1501
Real GDP (% change)	8.3	10.2	9.1	10.2	10.6	6.7	7.0
Individual Consumption (% change)	-0.2	1.6	9.3	16.2			
Investment (% change)	-27.7	59.0	18.1	16.2			
Exports (% change)	18.3	-15.9	11.2	10.2			
Imports (% change)	21.5	-5.5	7.3	5.0			
CPI Inflation (% change)							
(end of period)	60.8	12.5	14.5	13.7	5.7	7.1	12.7
(average)	32.9	38.6	12.2	16.3	7.1	7.0	9.2
PPI Inflation (% change)							
(end of period)	33.9	9.4	19.0	14.1	15.1	5.6	
(average)	43.5	28.7	10.1	15.0	17.1	10.7	
General Government Balance (% of GDP)	-5.6	-3.2	-2.5	-1.8	-2.4	-2.9	-5.1
Trade balance (USD million)	-43	-104	-94	-103	-151	-319	-372
Current Account Balance							
(USD million)	-60	-52	-43	-20	-82	-78	-110
(% of GDP)	-6.0	-5.0	-3.6	-1.3	-4.0	-3.4	-3.9
Sometri/USD Exchange Rate (average)	1.8	2.4	2.8	3.1	3.0	3.1	3.3
Broad Money Supply (M2) (% change)	70.1	40.0	39.7	29.3	14.3	25.8	25.6
Net Foreign Assets (% change)	-45.1	-36.6	-7.6	30.3	-139.7	63.5	192.0
Domestic Credit (% change)	14.5	95.0	14.0	-6.5	52.7	16.1	2.3
Net Foreign Assets of Monetary Authorities							
(USD million)	101	108	106	132	195	236	266
Refinancing Rate (average)	20.6	20.0	24.8	15.0	10.0	9.0	12.0
Deposit Rate (average)	1.3	5.2	9.2	9.7	9.8	9.8	9.1
Average Gross Monthly Salary (% change)	25.8	50.6	38.6	36.9	36.3	43.1	
Unemployment Rate (%)	2.7	2.3	2.5	2.2	2.2	2.3	

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.26. TURKMENISTAN

Major problems

The Turkmen economy is not a market economy. Government directly controls and regulates the operation of state owned enterprises, and the private sector is insignificant.

The main problems have been the same for many years: suspended large-scale privatization, double exchange rate, state control of prices and international trade, poor performance of public services sectors, such as education and healthcare.

Economic policy

A modest fiscal surplus was maintained. In 2006, the government managed to maintain a modest fiscal surplus of 0.6% of GDP. The surplus results from the reduction in public spending, including on education, healthcare, and pensions. The considerable part of government revenues, mainly from exports of energy resources, goes to special funds and is not included in budget revenues.

Turkmenistan applies a double foreign exchange rate: a fixed official rate and a market rate.

In 2006, there was no progress in privatization nor in liberalization of international trade and exchange rates. The energy, telecommunications, and transport sectors are officially excluded from privatization until 2020.

In March 2006, the Commission of European Parliament accepted an interim trade agreement with Turkmenistan on energy co-operation. However, the final agreement was not signed because of concerns on Turkmenistan's record in complying with human rights standards.

In April 2006, Turkmenistan signed an agreement with China on the construction of a gas pipeline to China. Another agreement was signed with five EU member states on the construction of a 3,300 km gas pipeline Nabucco from Central Asia to Turkey and to the EU. In September 2006, Turkmenistan signed a new contract on gas exports to Russia.

In January 2006, new pension law was adopted. Maternity and sick payments were limited, state pensions were reduced (or even cancelled as in the case of 100,000 people), the pensionable age was increased from 55 to 57 years for women and from 60 to 62 years for men.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP increased by 9.0%, although official data show the growth rate exceeding 20%. Rapid economic growth results mainly from high gas and oil prices, but also from several big investment projects. However, in 2006, gas production increased only by 5.2%, and the oil production by 0.5%. The situation in agriculture has further deteriorated, especially as regards cotton and wheat production.

In 2006, inflation remained still relatively high, with CPI index equal to 10.5% (annual average) or 11.7% (end-year), roughly at a similar level as in 2005 (10.7% or 10.4%, respectively). High inflation results mainly from increasing food prices.

Current account surplus almost doubled: from 7.4% of GDP in 2005 to 12.7% of GDP in 2006. Trade surplus increased from 1,302 million USD to 1,963 million USD in the same period. The strong external position results from high gas and oil prices.

In 2006, FDI inflow was 300 million USD. Cumulative FDI inflow in the period 1989-2006 equalled 2,595 million USD.

Growth prospects

According to the IMF forecast, rapid economic growth will be maintained at about 10.0% in 2007 and 2008. However, the lack of reforms and a deteriorating situation in agriculture will sooner or later negatively affect the economic growth. High dependency of Turkmen economy on the exports of two energy resources implies that the economy is highly vulnerable to shocks in gas and oil prices that increases the uncertainty as regards the future development.

Table 4.26. Turkmenistan

	2000	2001	2002	2003	2004	2005	2006
Population (million)	5.4	5.6	5.8	6.2	6.5	6.5	6.5
GDP (manat billion)	26115	36054	45240	59406	73817	89307	113599
GDP per capita at PPP (USD)	3621	4392	5093	5999	6965	7740	8548
Real GDP (% change) ^a	18.6	20.4	15.8	17.1	14.7	9.0	9.0
Individual Consumption (% change)	18.1	45.8	-10.1	2.8			
Investment (% change)	13.8	26.0	9.0				
Exports (% change)	92.6	4.8	13.0	4.0			
Imports (% change)	14.9	20.1	-3.7	4.3			
CPI Inflation (% change)							
(end of period)	7.4	11.7	7.8	3.1	9.0	10.4	11.7
(average)	8.3	11.6	8.8	5.6	5.9	10.7	10.5
PPI Inflation (% change)							
(end of period)							
(average)							
General Government Balance (% of GDP)	-0.3	0.6	0.2	-1.3	0.0	0.9	0.6
Trade balance (USD million)	766	515	1030	886	706	1302	1963
Current Account Balance							
(USD million)	411	116	583	305	84	616	1295
(% of GDP)	13.6	3.2	13.0	5.2	1.2	7.4	12.7
Manat/USD Exchange Rate (average)	8478.6	9827.9	10097.5	10033.5	10375.0	11015.2	10881.9
Broad Money Supply (M3) (% change)	94.6	16.7	1.5	40.9	13.4	27.2	17.7
Net Foreign Assets (% change)							
Domestic Credit (% change)	24.4	7.7	-2.9	-0.6	3.6	0.6	3.0
Net Foreign Assets of Monetary Authorities							
(USD million)							
Refinancing Rate (end of period)	20.0	12.0	12.0	10.0	5.0	5.0	
Deposit Rate (end of period)	22.8	16.9	17.8	15.4	11.3	8.6	
Average Gross Monthly Salary (% change)	80.4	47.1	8.2	84.2	5.7	21.6	
Unemployment Rate (%)	27.9	28.8	29.3	29.8	30.2		

^a Official data till 2003. IMF estimates from 2004.

Sources: IMF, *World Economic Outlook Database*, April 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.27. UKRAINE

Major problems

- Accelerating inflation.
- High dependency of the economy on world metal prices and on the prices of Russian gas.

Economic policy

In 2006, the public sector recorded a deficit of 1.9% of GDP. Strong economic growth generated higher than expected VAT and PIT revenues, whereas CIT revenues were below target.

In 2006, privatization has slowed down. Privatization revenues amounted to 60 million USD between January and September, much less than expected (416 million USD in the whole year). In order to increase privatization revenues, government decided to sell 48 additional enterprises, including the insurance company Oranta and several ore mines.

In February 2006, the Italian bank Banca Intesa signed the agreement for the purchase of 85% shares of the Ukrainian bank UkrSotbank (the 6th largest) for 1.3 billion USD. In April 2006, the government sold 51% shares of UkrSibbank (the 4th largest) to BNP Paribas. Several smaller banks were also privatized. In mid-2006, foreign capital controlled a quarter of the Ukrainian banking sector.

Ukraine managed to achieve some progress in accession negotiations with WTO. In the first half of 2006, some most difficult bilateral agreements were concluded, including the accession protocol with USA and the accession protocol with Australia.

In 2006, the average price of Russian gas was reached 95 USD per 1000 m³ and was about twice as high as in 2005. Further price rises are expected in 2007, especially for gas from Turkmenistan. The end-customers bore a small part of the price increase; the majority was absorbed by a state monopolist Naftogaz Ukrainy.

Macroeconomic performance, entrepreneurship and social performance

In 2006, the Ukrainian economy expanded fast, with real GDP growth rate at 7.1%, much higher than in 2005 (2.7%). Although the price of Russian gas increased, Ukraine achieved rapid economic growth. The main sources of economic growth were individual consumption and investment, which increased by 14.4% and 18.7%, respectively. Exports fell for the second consecutive year despite the increase in the world prices of metals, the main Ukrainian export commodity (in 2006, exports decreased by 4.9%). The best economic performance was observed in retail trade, transport, and telecommunication. Industrial production grew by 6.2%, partly due to higher metal prices.

The labour market situation improves gradually. In 2006, the unemployment rate fell to 2.7% from 3.1% in 2005.

The annual average CPI inflation decreased from 13.5% in 2005 to 9.1% in 2006. However, the end-year CPI inflation increased from 10.3% to 11.6% in the same period. High inflation results partly from the increase in public utilities prices due to higher gas prices.

Current account surplus from 2005 turned into a deficit of 1.5% of GDP in 2006. Trade deficit increased from 1,135 million USD in 2005 to 5,194 million USD in 2006. The deterioration of trade deficit results from the decrease in exports as well as from higher gas prices.

In 2006, FDI inflow equalled 5,336 million USD. FDI financed the whole current account deficit. Cumulative FDI inflow in the period 1989-2006 equalled 21,451 million USD.

Growth prospects

According to the IMF forecast, the Ukrainian economy will slow down to 5.0% in 2007 and 4.6% in 2008. The future growth prospects are uncertain because of unstable political situation and high dependence of the economy on world metal prices and the prices of Russian gas. Further increases in the price of gas can foster future inflation and have an adverse supply effect on growth.

Table 4.27. Ukraine

	2000	2001	2002	2003	2004	2005	2006
Population (million)	48.9	48.5	48.0	47.6	47.3	47.1	47.1
GDP (hryvnia million)	170070	204190	225810	267344	345113	440977	535664
GDP per capita at PPP (USD)	4130	4661	5036	5680	6595	7023	7637
Real GDP (% change)	5.9	9.2	5.2	9.6	12.1	2.7	7.1
Individual Consumption (% change)	2.3	9.0	9.5	11.5	13.1	16.6	14.4
Investment (% change)	12.4	6.2	3.4	22.5	20.5	-0.3	18.7
Exports (% change)	21.5	3.5	7.4	10.3	21.3	-11.2	-4.9
Imports (% change)	23.8	6.0	3.3	16.4	15.5	2.1	6.5
CPI Inflation (% change)							
(end of period)	25.8	6.1	-0.6	8.2	12.3	10.3	11.6
(average)	28.2	12.0	0.8	5.2	9.0	13.5	9.1
PPI Inflation (% change)							
(end of period)	20.6	0.9	5.7	11.1	24.1	9.5	14.0
(average)	20.8	8.7	3.0	7.6	20.4	16.8	12.0
General Government Balance (% of GDP)	-1.1	-0.9	0.1	-0.7	-6.2	-2.3	-1.9
Trade balance (USD million)	779	198	710	-269	3741	-1135	-5194
Current Account Balance							
(USD million)	1481	1402	3173	2891	6804	2531	-1617
(% of GDP)	4.7	3.7	7.5	5.8	14.8	2.9	-1.5
Hryvnia/USD Exchange Rate (average)	5.4	5.4	5.3	5.3	5.3	5.1	5.1
Broad Money Supply (M2) (% change)	45.3	43.2	42.3	46.9	32.8	39.4	35.0
Net Foreign Assets (% change)	93.2	1725.4	83.6	89.1	72.5	86.5	-18.5
Domestic Credit (% change)	23.1	21.9	28.0	38.4	24.8	34.3	57.6
Net Foreign Assets of Monetary Authorities							
(USD million)	1652	3209	4630	7235	10120	19590	22919
Refinancing Rate (end of period)	27.0	12.5	7.0	7.0	9.0	9.5	8.5
Deposit Rate (average)	13.7	11.0	7.9	7.0	7.8	8.6	7.6
Average Gross Monthly Salary (% change)	29.2	35.2	20.9	22.9	27.9	36.4	40.2
Unemployment Rate (%)	4.2	3.7	3.8	3.6	3.5	3.1	2.7

Sources: IMF, *World Economic Outlook Database*, April 2007; IMF, *International Financial Statistics*, May 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

4.28. UZBEKISTAN

Major problems

High inflation and high dependency of the economy on international cotton and gold prices.

The government should remove international trade restrictions, facilitate the access to foreign currency, and conduct structural reforms in order to develop private enterprise.

Economic policy

Since 2003, a slight fiscal surplus has been maintained. In 2006, it equalled 0.4% of GDP. The favourable fiscal outcome results partly from a tight tax policy.

Monetary policy was expansionary. The broad money aggregate M3 grew by 37.0% in 2006. The refinancing rate was reduced from 16.0% in the end of 2005 to 14.0% in the end of 2006.

Government allows the currency to depreciate systematically. The exchange rate increased from 360.7 som/USD in 2000 to 1,219.8 som/USD in 2006.

Tariff and non-tariff trade barriers remain high. Access to foreign currency is restricted for many companies, especially for importers of consumer goods who have to apply for foreign currency allocations several months in advance. Since May 2006, new customs regulations have imposed additional burdens on importers. In many cases, the imported goods have to stay at the border for long periods before they can be released to domestic use.

The privatization of collective farms (shirkats) is continued. About 80% of shirkats were transformed into private lease-holdings until mid-2006. The remaining 20% should be restructured in 2007. The reform should provide positive stimulus to the agriculture production.

Banking sector is highly concentrated, with two major state banks (NBU and Asaka Bank) controlling about 75% of the total credit emission. However, the progress in restructuring and privatizing large banks is slow and hesitant. The privatization of NBU was delayed until 2009.

In January 2006, new anti-money-laundering law came into effect.

Macroeconomic performance, entrepreneurship and social performance

In 2006, real GDP grew by 7.2%, a similar pace as in 2005, on the back of high prices of cotton and gold, two main export products of Uzbekistan. High remittances from Uzbek citizens working abroad, especially in Russia and Kazakhstan, also contributed to growth through higher consumer spending. Investments increased by 6.9% in 2006, mainly as a result of big investment projects realized by Russian and Chinese companies in hydrocarbon and telecommunication sectors.

Uzbekistan remains a very poor country. In 2006, GDP per capita at PPP equalled 2,283 USD. As regards per capita income, Uzbekistan is ranked at the 26th position among all the 28 post-socialist countries (only Kyrgyzstan and Tajikistan recorded lower income).

Inflation is still high and. In 2006, CPI index decelerated slightly to 16.9% (annual average) or 15.2% (end-year) from 21.0% or 18.8%, respectively, in 2005. The inflationary pressures result mostly from expansionary monetary policy.

Since 2003, Uzbekistan has recorded high trade and current account surpluses. In 2006, the current account reached 12.0% of GDP, somewhat less than in 2005 (13.0% of GDP). Trade surplus amounted to 2,055 million USD in 2006 and 1,447 million USD in 2005.

In 2006, FDI inflow was 164 million USD. FDI come mainly from Russia and Asian countries and are caused by big investment projects realized in hydrocarbon, telecommunication, and uranium mining sectors. Cumulative FDI inflow in the period 1989-2006 equalled 1,356 million USD.

Growth prospects

According to the IMF forecast, rapid economic growth will be maintained at the rate of 7.7% in 2007 and 7.5% in 2008. Growth will be fuelled mainly by favourable cotton and gold prices as well as by remittances from abroad. However, the excessive reliance on cotton and metal processing sectors makes the Uzbek economy vulnerable to external shocks.

Table 4.28. Uzbekistan

	2000	2001	2002	2003	2004	2005	2006
Population (million)	24.7	24.9	25.6	26.0	26.0	26.0	26.0
GDP (som billion)	3256	4925	7450	9838	12261	15210	19616
GDP per capita at PPP (USD)	1524	1605	1677	1761	1926	2096	2283
Real GDP (% change)	3.8	4.2	4.0	4.2	7.7	7.0	7.2
Individual Consumption (% change)	-1.0	-5.6					
Investment (% change)	1.0	4.0	3.6	0.5			6.9
Exports (% change)	3.3	2.3	-8.8	2.8			
Imports (% change)	-3.8	9.6	-12.6	-1.7			
CPI Inflation (% change)							
(end of period)	46.2	58.2	24.4	7.7	15.5	18.8	15.2
(average)	49.5	47.5	44.3	14.8	8.8	21.0	16.9
PPI Inflation (% change)							
(end of period)	70.2	44.0	12.2	8.0	6.5	28.1	24.0
(average)	61.1	42.2					
General Government Balance (% of GDP)	-2.5	-1.3	-1.9	0.1	0.6	1.3	0.4
Trade balance (USD million)	494	186	200	835	1202	1447	2055
Current Account Balance							
(USD million)	218	-113	128	880	1214	1950	3136
(% of GDP)	2.4	-1.5	1.2	8.7	9.9	13.0	12.0
Som/USD Exchange Rate (average)	360.7	646.3	885.0	995.5	999.2	1072.3	1219.8
Broad Money Supply (M3) (% change)	43.3	54.3	29.7	27.1	47.8	54.3	37.0
Net Foreign Assets (% change)							
Domestic Credit (% change)	88.8	90.8	40.9	-0.6	2.1	3.1	-31.3
Net Foreign Assets of Monetary Authorities							
(USD million)							
Refinancing Rate (end of period)	26.8	26.8	34.5	20.0	20.0	16.0	14.0
Deposit Rate (end of period)	18.8	21.2	26.0	20.3	16.1	15.5	
Average Gross Monthly Salary (% change)	47.4	58.2	111.8	28.2	62.7	47.7	45.2
Unemployment Rate (%)	0.4	0.4	0.4	0.3	0.4	0.7	0.8

Sources: IMF, *World Economic Outlook Database*, April 2007; EBRD, *Transition Report 2006*; EBRD, *Transition Report Update 2007*.

