



World Bank EU8 Quarterly Economic Report July 2005¹

EU8

HIGHLIGHTS OF THE REPORT

The main report analyzes economic developments in the EU8 in the first half of 2005. In an addendum to the main report, we take stock of performance after one year in the EU—with the retrospective extending to the run up to accession—and look at potential economic policy lessons for the next set of member countries. The special topic examines fiscal risks related to PPPs and institutional implications.

Economic Developments in 2005

- Economic developments in the EU8 returned to “normal” in the first half of 2005 following the EU accession related boost to investment, exports, output growth, and prices. Output growth decelerated across the region (with the exception of Estonia) on the back of some slowdown in export growth and also weaker domestic demand conditions, including notably a surprisingly poor outturn for investments in Poland in the first quarter of the year. Meanwhile, inflation has eased markedly in recent months reflecting largely the jump in the base price level in the run-up to EU accession, relatively firm monetary conditions, and persisting labor market slack despite some recent signs of improved employment. Latvia remains the worrisome outlier with annual inflation at over 6%. Recent current account patterns were little changed, with the Czech Republic changing most—in a favorable direction. Fiscal policy generally looks promising for this year with deficits likely to be lower than expected in the Czech Republic and Poland, but with Hungary once again struggling to remain on track.
- The reform momentum remained weak at best with prospective elections and political maneuvering in several countries. Most of the attention was focused on further tax reforms aimed at lowering labor and other taxes, harmonizing excises, and eliminating the most distortionary taxes, with concrete action on the PIT in two of the Baltic countries (Estonia and Lithuania). Meanwhile, privatization proceeded at an uneven pace with the Czech Republic leading the way, while pressing social expenditure reforms in the largest Visegrad countries made little headway in the current political environments. Slovakia also suffered a setback with the rejection of its higher education reform plan.

Addendum: Lessons from EU accession—One Year After

- Investment, exports, and output growth all received a boost related to EU accession, and the price level jumped as a result of needed adjustments in administered prices and indirect taxes. Nevertheless, these factors all appear temporary in nature, and policy makers should be careful not to allow for unjustified changes in expectations and changes in the policy stance on this account alone.
- Trade expansion was not confined to transactions with old EU members, but was perhaps even more noticeable among the new members themselves and with the rest of the world. Thus, there were few signs of trade diversion—perhaps the result of lower trade barriers both between new members and vis-à-vis the rest of the world, including because of the expiration of the multi-fiber agreement that had contained imports from Asia. The increase in agricultural trade and some services was particularly strong as liberalization affected mainly these sectors.
- Farmers appear to have been the main winners so far, due to a combination of higher prices of agricultural goods and increased sales as well as support under the Common Agricultural Policy.

¹ This report is generally based on information available through end-June, 2005.

- With spreads declining, there were no problems financing even sizable current account deficits. Capital inflows, including FDI, to the NMS gained strength albeit from a slump in the pre-accession period. Meanwhile, cross-border labor mobility remained modest, in part reflecting transitory restrictions in most existing EU member countries.
- Membership of the EU, requirement to prepare regular convergence programs as part of the Euro adoption obligation, and disciplinary effect of the Excessive Deficit Procedure may have facilitated fiscal consolidation where needed (the Visegrad countries), but failure to reform key unsustainable spending programs (notably in the social area) ahead of EU accession (with the exception of Slovakia, and the Czech Republic) pose continued risks for stability and growth.
- The pre-accession period was a crucial window of reform opportunity that seems to close quickly after accession as vested interests again take the upper hand from external forces. Countries that did not take adequate advantage of this opportunity may face an even longer period of catching up to average EU living standards. Access to much larger EU transfers will be no panacea in this regard, including because of limited absorption capacities in the NMS.

Special Topic: PPPs—Fiscal Risks and Institutions

- Private-public partnerships are becoming increasingly popular in the EU8 as countries struggle to meet needs for increased infrastructure investments within tight fiscal space while looking for better allocation of risk between the public and private sectors, more cost effective solutions, and improved service delivery.
- There is little doubt that short-medium term budgetary savings are an important driver behind PPPs, the extent of which seem directly related to countries' difficulties in meeting the Maastricht criteria for euro adoption. Thus, PPPs are most extensive in Hungary, but Poland and the Czech Republic—and to a lesser extent the Slovak Republic—are also looking to expand private sector involvement in the provision of infrastructure.
- It would seem, however, that the benefit of PPPs over traditional public investment in most actual cases is not well established and that the associated fiscal risks are not adequately analyzed, disclosed, and managed. International accounting standards do not yet incorporate such contingent liabilities and as such do not provide much of a push. The report suggests various ways in which national fiscal institutions can be enhanced to deal with these risks, including development of the needed technical capacity for risk analysis and management and higher transparency (disclosure, reporting, auditing, etc.) regarding fiscal risk.

WORLD BANK

Warsaw Office

53 Emilii Plater St, 00-113 Warsaw
 Tel (+48 22) 520 8000, Fax (+48 22) 520 8001, www.worldbank.org.pl
 Daniela Gressani, Country Director Central Europe and Baltic countries
 Thomas Laursen, Lead Economist, Central Europe and Baltic countries
 Marcin Sasin, Country Economist (Poland)
 Emilia Skrok, Country Economist (Czech Republic, Hungary)
 Paulina Bucon, Research Assistant

Bratislava Office

European Business Center
 Suche myto 1
 811 03 Bratislava
 Tel (+421 2) 5752 6721
 Fax (+421 2) 5752 6701
www.worldbank.sk
 Ingrid Brockova, Country Manager
 Anton Marcincin, Country Economist
 (Slovakia, Slovenia)

Vilnius Office

Jogailos St 4
 2001 Vilnius
 Tel (+370 5) 210 7680
 Fax (+370 5) 210 7681
www.worldbank.lt
 Mantas Nocius, Country Manager
 Jekaterina Rojaka, Country
 Economist (Lithuania)

Riga Office

Smilšu St 8, 5th floor
 1162 Riga
 Tel (+371 7) 220 744
 Fax (+371 7) 814 245
www.worldbank.org.lv
 Dina Grube, Country Manager
 Andrejs Jakobsons, Country Economist
 (Latvia, Estonia)

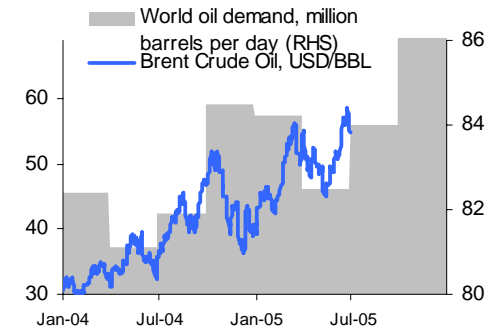
I. EXTERNAL ENVIRONMENT

The external environment remained difficult for the EU8 countries. Oil prices continued rising in the first half of 2005 and the economic recovery in Western Europe continued to sputter. Meanwhile, growth also slowed in other important markets.

Oil prices

Oil prices continued their upward trend since early 2004, rising a further 35% in the first half of 2005 (Chart 1). The main factors underlying the surge in oil prices (soaring demand, shrinking spare capacities, and concerns about the security of oil supplies) are likely to persist for some time suggesting that there will be no near-term respite. Not only are high oil prices affecting inflation and growth prospects in the main global economies, but they are also fueling increases in producer prices in the EU8.

Chart 1. Oil price and demand

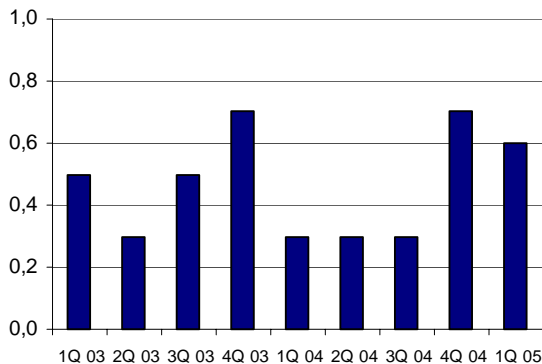


Source: Reuters, IEA

External demand

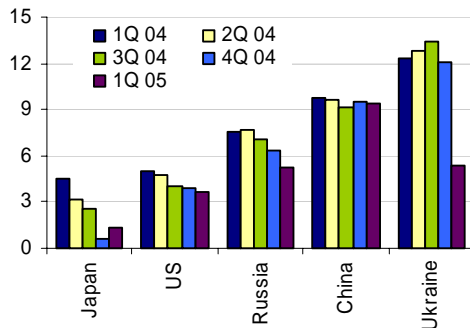
Economic activity in the EU-15 remained weak in the first quarter of 2005 (Chart 2). While output growth has recovered slightly from the very low rates during most of 2004, it is still stuck at an annual rate of no more than 2%. In Germany, the main impulse is coming from exports on the back of a weaker Euro (see below), while domestic demand remains depressed. Output growth in other markets to the East (including Russia and Ukraine) has also moderated significantly, while there are also signs of a slowdown in the U.S. (Charts 3 and 4).

Chart 2. EU15 GDP growth, seasonally adjusted, %, q/q



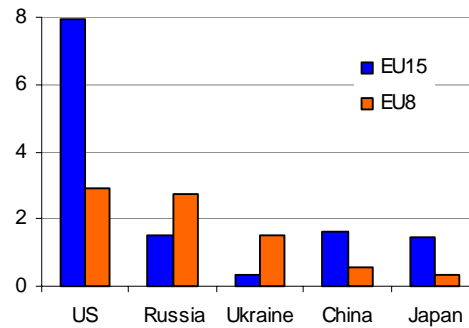
Source: Eurostat

Chart 3. GDP growth rate in selected economies, %, y/y



Source: Eurostat, EIU

Chart 4. EU main export partners, %, 2004



Source: COMEXT

Exchange rate and interest rate developments

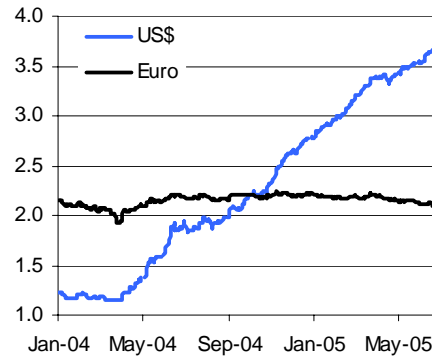
The euro weakened against the U.S. dollar in the first six months of 2005 (Chart 5). This reflects the ongoing growth differential between the U.S. and the Euro-zone, a rising interest differential in favor of the dollar with short term interest rates on the rise in the U.S. and on hold in the Euro-zone (Chart 6), and political uncertainty in Europe following the rejection of the EU constitution by France and the Netherlands. Despite some volatility, EU8 currencies are tracking the Euro closely with exchange rates vis-à-vis the Euro broadly unchanged of the course of the first six months of 2005 (Chart 7).

Chart 5. USD/EUR exchange rate



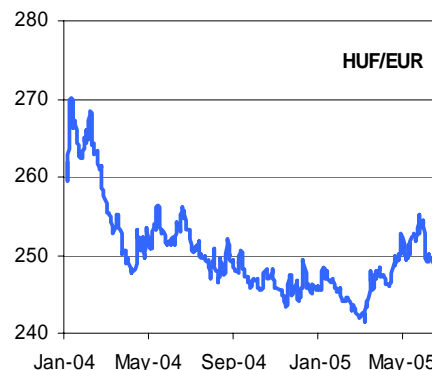
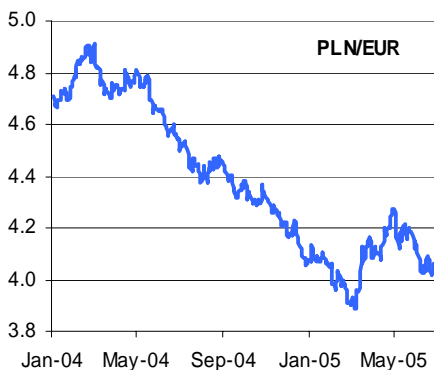
Source: ECB

Chart 6. LIBOR, 6M, %



Source: BBA

Chart 7. Exchange rate developments in Visegrad countries



Source: Reuters

II. OVERVIEW OF EU8

Political Economy Background

While the political environment in the EU8 was relatively stable in the second quarter of 2005, prospective elections and political maneuvering in several countries remained a heavy lid on any new serious reform initiatives. Meanwhile, the rejection of the EU Constitution by France and the Netherlands and failure to reach agreement on the financial perspectives for 2007-13 was unwelcome in the new member countries, who generally support further integration and whose medium-term financial planning is complicated by uncertainty regarding future EU transfers.

There were a few changes on the political scene in the EU8 during the second quarter of 2005. In the Czech Republic, the coalition survived with the instatement of a new Prime Minister - Jiri Paroubek (Social Democrat). In Lithuania, the coalition was shaken by the departure of both the Finance and Economy ministers.

With imminent elections in Poland and also approaching in Hungary and the Czech Republic, the reform momentum has all but stalled in these countries. If anything, recent legislative steps may be in the wrong direction, not least in Poland where the parliament has approved a faster growth in the minimum wage, while several other bills creating additional on- and off- budget spending are on the legislative track. In Slovakia, tensions in the coalition also led to failure to get the tertiary education reform (including introduction of tuition fees) passed in Parliament.

Most of the talk and action in the region is about further lowering of taxes.

- In *Lithuania*, the Seimas finally ratified the personal income tax reform after much back and forth: the flat PIT rate will be lowered gradually from its current level of 33% to 24% in 2008, while the revenue loss will be mitigated through the introduction of a tax on real estate used for commercial purposes by individuals (1% of its value) and a so-called social tax to be imposed on corporate profits on a temporary basis for two years (4% in 2006 and 3% in 2007).
- In *Estonia*, the new government agreed to reduce the PIT rate from its current level of 24% to 20% by 2009.
- In *Poland*, the opposition Civic Platform—which is widely expected to be part of the next government—wants to introduce a flat and uniform tax on both personal and corporate income as well as VAT (similar to Slovakia), probably at a rate of about 15%. *Hungary* has launched an ambitious tax reform proposal aimed at lowering social security taxes and abolishing the local government turnover tax, but it remains unclear how this would be financed (see below). There are also talks of further tax reductions in the *Czech Republic* and *Latvia*, although these remain tentative.

Table 1. Agreed new PIT rates, %

	Estonia	Lithuania
Current rate	24	33
2006	23	27*
2007	22	27
2008	21	24
2009	20	24

Note: * July 1st

Source: national data

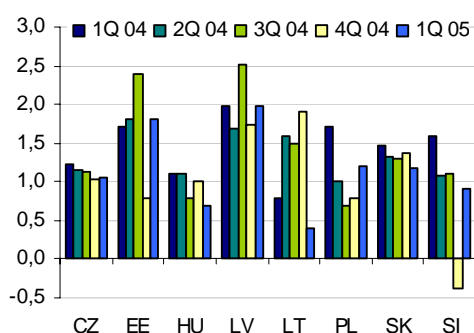
The EU8 countries are generally supportive of further EU integration. The EU Constitution has been ratified by Parliaments in five of the 8 NMS (Lithuania in November 2004, Hungary in December, Slovenia in February 2005, the Slovak Republic in May, and Latvia in June following the rejection of the Constitution in France and the Netherlands. Meanwhile, the Czech Republic, Poland and Estonia have put the process on hold. Several EU8 countries have made good progress in preparing their National Development Plans which will form the basis for absorbing EU transfers during the next budget period 2007-13, but the process is complicated by the failure of the EU to agree on the budget and thus remaining uncertainty about the size and guidelines for the use of future transfers.

Macroeconomic Policies and Developments

Economic developments in the EU8 mostly returned to “normal” in the first half of 2005 following the EU accession-related boost to investment, exports, output growth, and prices. Output growth decelerated across the region (with the exception of Estonia) on the back of some slowdown in exports growth and also weaker domestic demand conditions, including notably a surprisingly poor outturn for investments in Poland in the first quarter of the year. Meanwhile, inflation has eased markedly in recent months reflecting largely the jump in the base price level in the run-up to EU accession, relatively firm monetary conditions², and persisting labor market slack despite some recent signs of improved employment. Latvia remains the worrisome outlier. Recent current account patterns were little changed, with the Czech Republic changing most—in a favorable direction. Fiscal policy generally looks promising for this year with deficits likely to be lower than expected in the Czech Republic and Poland, but with Hungary once again struggling to remain on track.

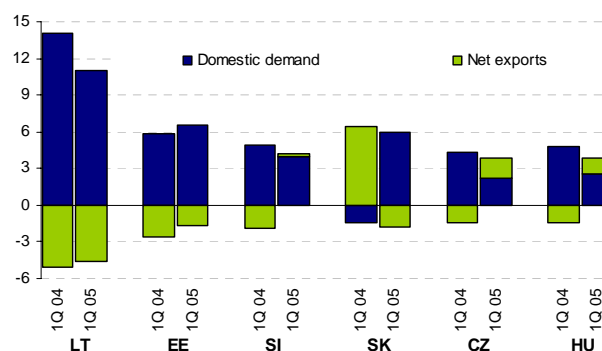
Output growth generally slowed in early 2005. Real GDP growth in the first quarter of 2005 was weaker across the region (except in Estonia), most notably in Poland, Slovenia, and Hungary. Nevertheless, it remained quite robust in most countries, with seasonally adjusted figures holding up well with the exception of Lithuania and to some degree Hungary (Chart 8).

Chart 8. GDP real growth, sa, % q/q



Source: CSOs, staff calculation

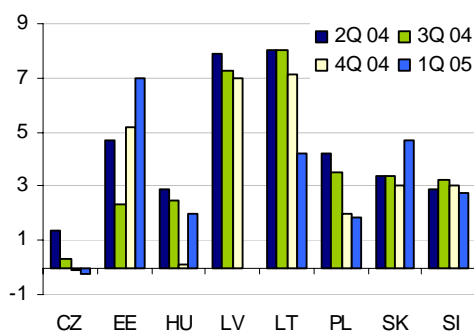
Chart 9. Contributions to GDP growth, 4 quarters cumulative, % points of GDP



Source: CSOs

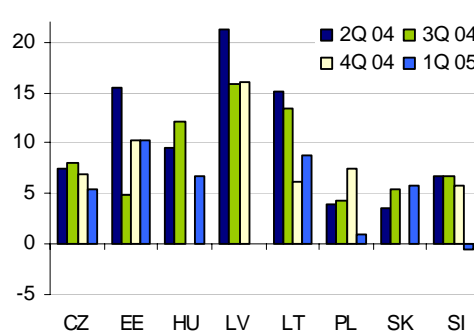
Domestic demand remains the most important contributor to GDP growth in the EU8, with net exports contributing negatively in the Baltic countries and now also Slovakia (Chart 9). The growth pattern has become more balanced in the Czech Republic and Hungary with positive contributions to output growth also from foreign trade. Private consumption is still booming in the Baltic countries (but was the main factor behind the slowdown in output growth in Lithuania) and is also buoyant in Slovakia, while investment dynamics appears to have moderated significantly not least in Poland and Slovenia (Charts 10 and 11).

Chart 10. Consumption real growth, % y/y



Source: CSOs, staff calculations

Chart 11. Fixed Investment real growth, % y/y



Source: CSOs, staff calculations

² Excluding the Baltic countries and Slovenia.

Export growth remained healthy into 2005. Goods exports continued increasing at double digit rates albeit slightly off the pace seen in 2004. As a result, the trade balance improved in most countries, notably in the Czech Republic (which is now near balance for the first time in recent history) but also in Poland and Hungary. Similarly, the external current account deficit narrowed in the Czech Republic and Poland—and to a lesser extent in Hungary and the Baltic countries where deficits remain high—while the deficit is widening rapidly in Slovakia (Table 2).

Table 2. Selected external indicators, 4q moving average, % of GDP

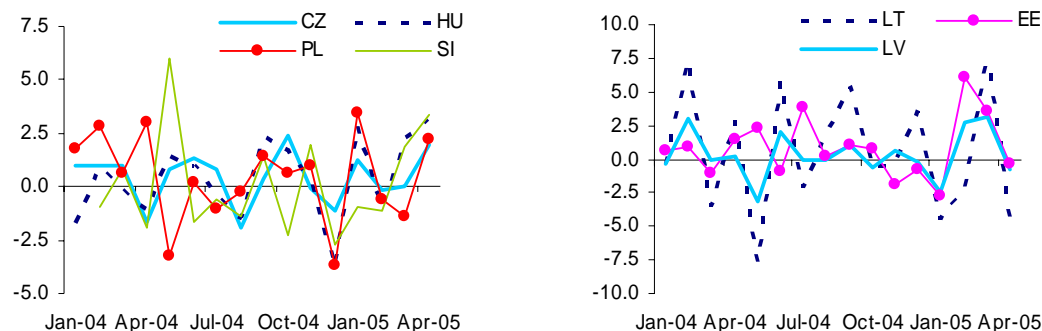
	Current account deficit				FDI gross				FDI net				Portfolio investment			
	2Q 04	3Q 04	4Q 04	1Q 05	2Q 04	3Q 04	4Q 04	1Q 05	2Q 04	3Q 04	4Q 04	1Q 05	2Q 04	3Q 04	4Q 04	1Q 05
Czech Republic	-6.3	-6.4	-5.2	-4.1	2.2	2.3	3.7	3.6	2.4	2.4	4.2	4.1	2.5	3.0	2.3	0.6
Estonia	-13.6	-12.1	-12.7	-12.3	6.6	5.1	6.9	14.0	9.3	7.6	9.3	16.3	5.1	4.0	6.5	3.1
Hungary	-8.7	-9.1	-8.8	-8.8	1.7	3.4	3.6	3.9	3.3	4.8	4.1	4.5	4.0	4.4	6.8	7.9
Latvia	-11.9	-13.0	-12.3	-12.6	2.7	3.6	4.0	4.4	3.5	4.4	4.8	5.1	1.4	1.0	2.0	0.7
Lithuania	-8.1	-8.5	-7.2	-6.8	0.9	2.4	2.3	2.2	1.7	3.4	3.5	3.2	1.3	1.7	0.9	0.6
Poland	-1.9	-2.0	-1.5	-1.0	2.2	1.8	2.2	1.8	2.4	2.0	2.5	2.2	2.9	4.1	4.0	4.2
Slovakia	-1.5	-2.8	-3.5	-4.2	2.9	3.3	3.2	2.4	2.4	3.0	2.9	2.0	2.4	2.5	2.2	2.9
Slovenia	-0.5	-0.8	-0.9	-1.0	-0.5	-0.2	0.1	-0.4	1.0	1.2	1.6	1.1	-2.5	-2.7	-2.4	-3.1

Note: FDI net – difference between outward FDI flows and inward flows

Source: NCBs, staff calculations

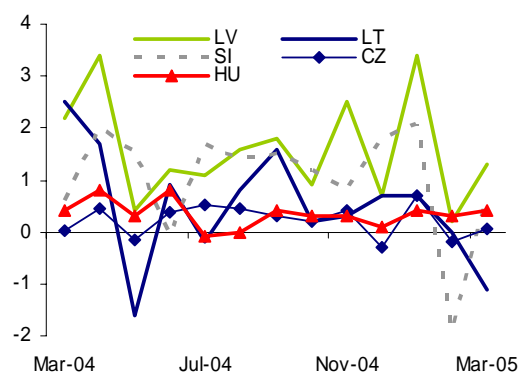
Weaker investment (and to a lesser extent export) dynamics have been mirrored in a sharp slowdown in industrial production growth, while retail sales remain brisk. In the first five months of 2005, industrial production virtually stagnated in Latvia, Poland and Slovakia, and also cooled considerably in most other countries in the region including Lithuania, the Czech Republic, and Hungary (Chart 12). Estonia again stands out favorably. Meanwhile, retail sales remain buoyant—except in Poland, perhaps—underpinned by strong wage growth, expansion of consumption credits (notably in the Baltic countries) and robust domestic consumption (Chart 13).

Chart 12. Industrial production index, SA, %, q/q



Source: CSOs

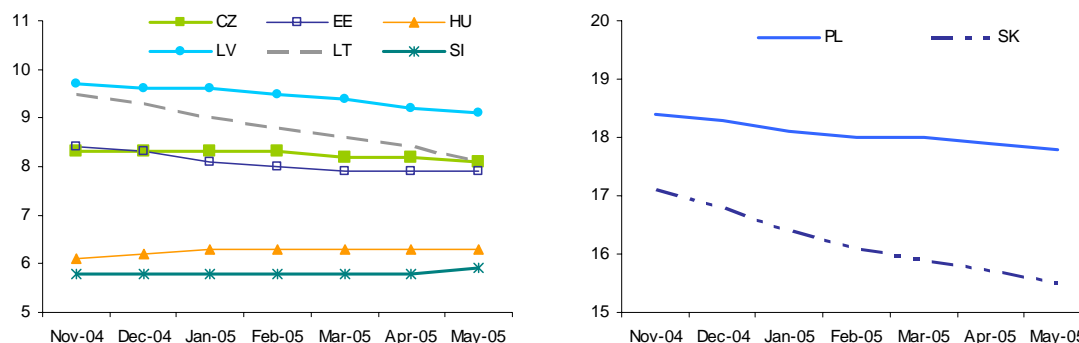
Chart 13. Retail sales, growth, %, SA, q/q



Source: CSOs, staff calculations

Continued robust growth was generally associated with the first real signs of stronger employment. Unemployment eased in several countries in the region through the first half of 2005, most notably in Slovakia but also in Poland and the Baltic region (Chart 14). At the same time, however, labor market performance worsened in Hungary and Slovenia, with unemployment rates edging up from relatively low levels. To a lesser extent, migration may also have helped ease excess labor supply in some countries and for some groups, although data on this remain scarce.

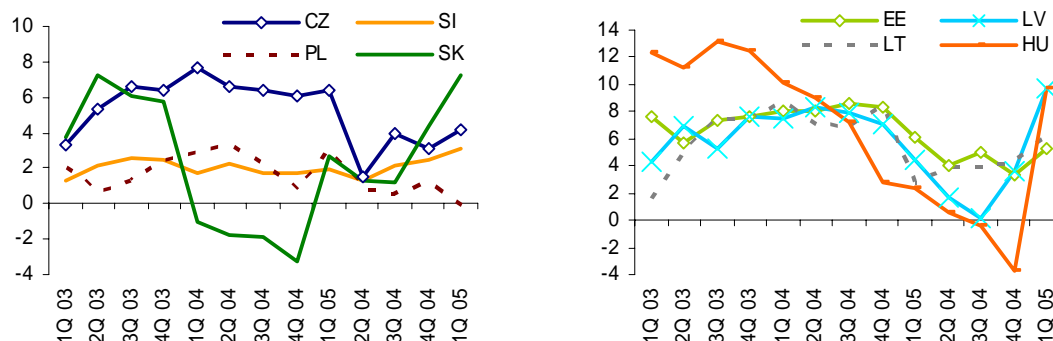
Chart 14. Standardized unemployment rate, SA, %



Source: Eurostat

Concurrently, wage pressures intensified across the region with the exception of Poland. Real wage growth is picking up in most EU8 countries on the back of easing inflation, strong demand conditions, and emerging bottlenecks in the labor markets (Chart 15). The most dramatic rise in wage pressures are felt in Slovakia and Latvia, but other countries—except for Poland—are also experiencing some wage inflation. In Poland, wage pressures remain muted reflecting the still sizeable slack in the labor market. The indexation of minimum wages was changed in June from CPI to a combination of CPI and real output growth ($CPI + \frac{2}{3} \times \text{real GDP growth}$) in a move that is unlikely to help employment prospects at the lower end of the market.

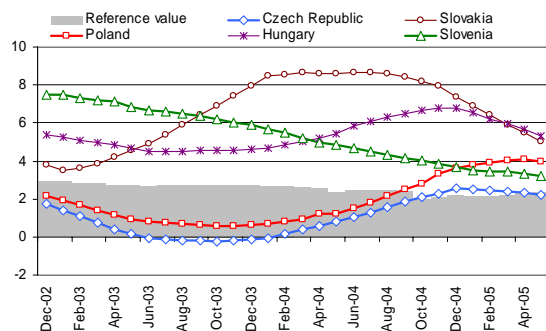
Chart 15. Real wage growth, % q/q



Source: CSOs,

Inflation has moderated in recent months in the Central European countries but pressures are mounting in the Baltic countries. The decline in inflation rates in the Visegrad countries reflects largely a base effect, with potential secondary effects from the jump in the price level around the time of EU accession successfully contained through tighter monetary conditions (Chart 16). As a result, interest rates have been lowered further in recent months (Poland, Hungary, the Czech Republic, and the Slovak Republic). While only the Czech Republic meets the Maastricht reference value, inflation is likely to continue easing in other Central European countries with end-year targets well in sight (Table 3). Further, excluding energy and seasonal food prices, only Hungary remains above the reference value (Chart 17).

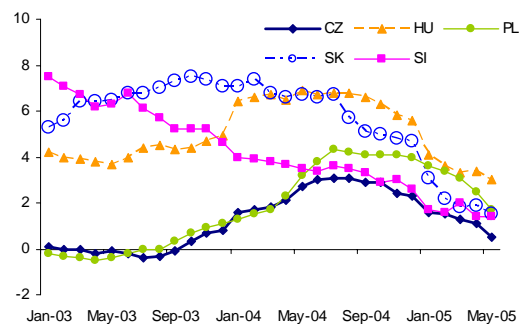
Chart 16. Price developments in the V4 and Slovenia, % yoy



Source: ECB, staff estimations

Note: Reference value is calculated for EU-15 countries until April 2004, and for EU-25 since May 2004

Chart 17. HICP - Overall index excluding energy and seasonal food, % yoy



Source: Eurostat

Table 3. Inflation targets in Visegrad countries

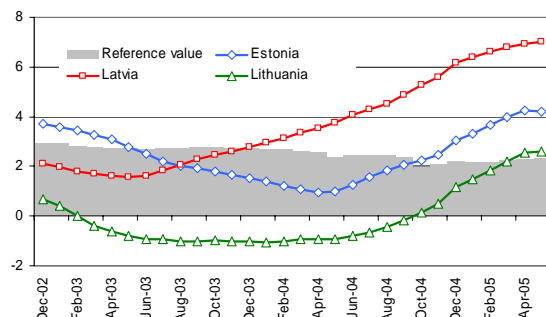
	2005	2006	2007	2008	WB forecast, average 2005
Czech Republic					
target	2-4%		3%		2.0
band			+/-1%		
measure	headline e.o.p.		headline inflation		
Hungary					
target	4%	3.50%	n.a.	n.a.	3.8
band	+/-1%	+/-1%			
measure					
Poland					
target		2.50%			2.1
band		+/-1%			
measure		headline inflation, continuous band			
Slovakia					
target	3.0-4.0%	2.50%	2.00%	2.00%	2.8
band					
measure		HICP e.o.p.			

Source: National authorities, staff estimations

Inflation is becoming more of a concern in the Baltic countries, especially Latvia where it seems stuck at around 7% (Chart 18). This reflects both external factors (rising oil prices and Euro depreciation vis-à-vis the U.S. dollar) and internal factors (rising food prices, rising wages, including in the public sector, and administrative price increases). Failure to control inflation may jeopardize plans to adopt the Euro in early 2007 (Latvia in 2008), with the main concern obviously in Latvia where even the exclusion of energy and seasonal food prices leaves inflation significantly above reference levels (Chart 19).

Strong upward pressure on producer prices in most countries may gradually spill over to consumer prices. PPI inflation is running at around 4% in the Visegrad countries (except Poland, where weaker market conditions appear to be squeezing profits) and even higher in Latvia and Lithuania (Chart 20). Also, pressures to increase minimum wages and pensions (including in Lithuania and Poland) and excises (Estonia) could push up CPI inflation. Latvia is contemplating a reduction of the VAT rate for food products from the current 18% to 5% to reduce inflation, but this would do little to address underlying pressures.

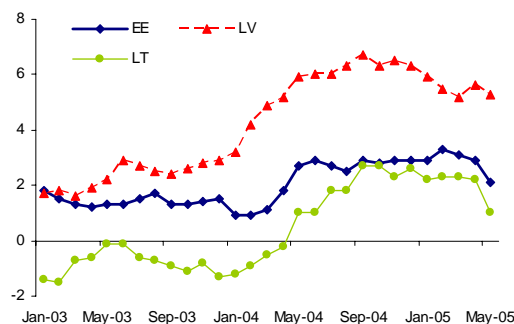
Chart 18. Price developments in the Baltics, % yoy



Source: ECB, staff estimations

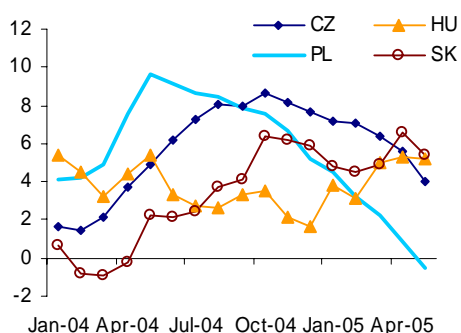
Note: Reference value is calculated for EU-15 countries until April 2004, and for EU-25 since May 2004

Chart 19. HICP - Overall index excluding energy and seasonal food, % yoy

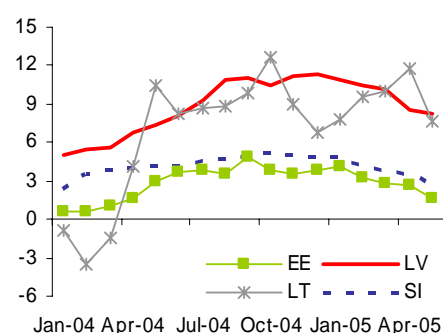


Source: Eurostat

Chart 20. PPI, % yoy

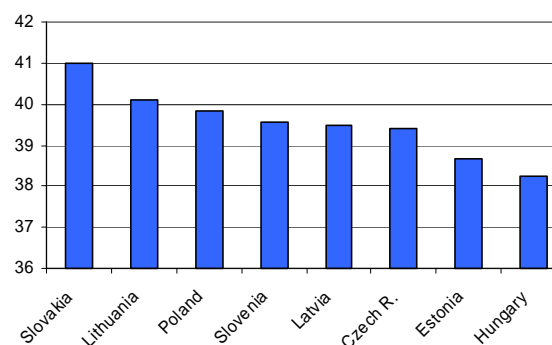


Source: CSOs



Fiscal developments in the EU8 are on track although Hungary continues to struggle. Preliminary results for the first five months of the year suggest that Poland, the Czech Republic, and Slovakia are ahead of targets, while Hungary has already reached its deficit target for the whole year and is introducing emergency measures. In the Baltic countries, revenues are also better than expected (Chart 21) and the consolidated budgets are in surplus in Estonia and Latvia. Supplementary budgets in Lithuania and expected in Latvia will likely spend most of the excess revenues. In Slovenia, a supplementary budget approved in June allocated more funds for the judicial sectors while adjusting the fiscal deficit target for the year down to 1.4% of GDP. The government is also considering further cuts in payroll taxes.

Chart 21. Fulfillment of the revenue plan, Jan-May, %



Source: national authorities, staff calculations

In Poland, the government expects to overshoot its target marginally. Although revenues seem to be holding up well despite the apparent recent weakening of growth, they may still be affected by it which, in combination with pre-election spending pressures, may wipe out any overachievement this year. The state budget assumptions for 2006 suggest anywhere from a further reduction in the deficit by 0.6% of GDP to no further consolidation (Table 4). While no details is available yet on the revenue and expenditure side, the sizeable range probably reflects one scenario with further desired adjustment and the other with no policy changes and spending affected by pension indexation. In any case, it is uncertain whether the new government will go along with the current government's budget plans or opt for a temporary budget covering just the first quarter of 2006 pending a broader review of the

fiscal plans (which at least the Civic Platform argue should be more ambitious in terms of both reforms and deficit reduction, although it is unclear how these objectives can be reconciled in the short term).

While the 2006 macro assumptions regarding economic growth are reasonable and in line with external forecasts, the planned deficit range is somewhat disappointing given the initial announcements of a PLN 30 bn deficit limit. The planned expenditure growth of 1.5%-4.4% in real terms departs from the good practice in 2005 to contain this to 1%, and the upper band of the expenditure range signals a significant and unwarranted increase in government spending. This partially reflects the election cycle; for example, MPs have already arranged a one-off payment to pensioners in May 2006. Furthermore, the assumed growth of tax revenues (7%-10% in nominal terms) may be optimistic as it exceeds both nominal GDP growth (5.3%) and the wage bill increase (4.9%).

Table 4. Poland: State budget 2005-06 forecasts

bn PLN	2005	2006	% GDP	% growth
Revenues	176.3	184.0-189.0	18.7-19.2	4.4-7.2
o/w tax revenues	154.8	165.8-169.8	16.9-17.3	7.1-9.7
Expenditure	209.7	216.0-222.0	22.0-22.6	3.0-5.9
Deficit	33.45	28.0-34.0	2.8-3.4	
GDP nominal	932.2	982.0	100	5.3
% y/y real	3.7	4.0		
Inflation	2.1	1.5		

Note: in 2005 no pension indexation took place
Source: MOF

In Slovakia, the 2006-2007 budget framework envisages further fiscal consolidation in line with previous plans (Table 5). The budget deficit would be reduced to just over 3% of GDP in 2006 (excluding the permitted 80% of pension reform costs) and decline to well within the Maastricht limit in 2007. The government has announced its intention to join the ERM2 before June 2006.

Table 5. Slovakia: Selected budget forecasts 2005-07

	2005	2006	2007
GDP growth, %	4.9	5.3	6.1
Average CPI, %	3.3	2.5	2.0
Labor productivity, real growth, %	4.2	4.3	5.2
Unemployment rate, LFS, %	17.7	17.1	16.8
Wage, real growth, %	4.1	3.9	3.7
Budget deficit (w/o pension reform), in % of GDP	3.4	2.9	1.9
Effect of pension reform, in % of GDP	0.4	1.0	1.1
Total deficit, in % of GDP	3.8	3.9	3.0
Public debt, in % of GDP	36.5	38.1	38.4

Source: Macroeconomic framework for budget 2006, Ministry of Finance of SR

The budget plans include two major risks: first, higher real wage may endanger the inflation target; and, second, the high popularity of the 2nd pension pillar may divert more funds from the budget than assumed.

In Hungary, fiscal policy implementation has continued muddling through. The deficit reached 3.1% of GDP in H1 (86% of the annual deficit target). Yet again, the budget target is in danger of being missed, notwithstanding measures of fiscal restraint introduced during the course of the year. The fiscal package would include:

Revenue side

- extension of already existing mobile phone licences;
- increase in taxes from gambling (from September 2005);
- widening of social security contribution base to include subsidiaries (from October 2005);
- a switch from self-declaration to taxation by levy for VAT on imports from outside the EU (from July 2005);
- stricter control on the import of tobacco;
- raising revenues from utilization and sale of public assets.

The revenue impact of the first four measures above is marginal (about 0.1% of GDP) while the latter could yield 0.55% of GDP.

Expenditure side

- freezing of the emergency reserve (0.6% of GDP in 2005);
- containment of pharmaceutical subsidies through introducing a fixed subsidy scheme based on the active ingredients in case of groups where the subsidy amounts to 100%; and tightening the system of imposing sanctions on unlawful medicine (from July 2005);
- tightening of the use of carry over appropriations.

These measures are quick fixes in nature and may have little impact on the underlying fiscal position.

In the Czech Republic, expenditures have been tightly controlled in 2005 and it seems unlikely that the full amount of the resources carried over from last year can be spent. Thus, the fiscal outcome for the current year is likely to be better than targeted although perhaps worse than in 2004.

Structural Issues and Reform Developments

As discussed above, the reform momentum remained weak at best with prospective elections and political wrangling in several countries. Most of the attention was focused on further tax reforms aimed at lowering labor and other taxes, harmonizing excises, and eliminating the most distortionary taxes, with concrete action on the PIT in two of the Baltic countries (Estonia and Lithuania). Meanwhile, privatization proceeded at an uneven pace with the Czech Republic leading the way, while pressing social expenditure reforms in the largest Visegrad countries made little headway in the current political environments. Slovakia also suffered a setback with the rejection of its higher education reform plan.

The privatization agenda was further advanced:

- In the Czech Republic, a 63% stake in *Unipetrol* was sold to PKN Orlen (Poland) for CZK 13.05bn (about EUR 435m) in May. Further privatization plans this year include Vitkovice Steel and a 56% state stake in coal mining company Severoceske Doly. In April 2005, the Czech government sold its main state-owned telecommunications company Cesky Telecom to Spanish Telefonica for EUR 2.9 billion after long delays, receiving a price twice as high as when the company was offered for sale a couple of years ago.
- In Hungary, *Ferihegy Airport* operator *Budapest Airport*, broadcaster *Antenna Hungaria* and additional shares in the Land Credit and Mortgage Bank (FHB) are being prepared for sale this year. Moreover, the government has announced its intention to privatize the state-owned airline *Malev*. Meanwhile, the sale of the state's remaining 12% stake in the oil and gas company MOL Rt may be postponed.
- In Slovakia, the government is preparing the privatization of the Railway company *Cargo Slovakia* (with an equity value of almost EUR 300 million), although there are various complications (including approval of a new transport policy and future regulation of fees, licenses and access to infrastructure).
- In Lithuania, the Privatization Commission in June approved the sale of *Lithuanian Airlines* to three domestic companies, who have committed to undertake new investment in the airline. Parliament has to approve the contract.
- In Latvia, a new Law on Completion of Privatization, which clarifies the list of strategic enterprises which will not be privatized³, was passed in June. At the same time, gas market liberalization was postponed until 2010.
- In Poland, the government floated Lotos S.A., the second biggest Polish oil company, in preparation for privatization. Preparations for the sale of the biggest gas company PGNiG are also proceeding.

Progress in other reform areas included:

- Latvia in May passed a package of amendments to its Anti Money Laundering legislation.

³ Latvenergo (energy), Latvijas Dzelzceļš (railways), Latvijas Pasts (postal services), Latvijas Gaisa Satiksme (air traffic control), Latvijas Valsts Meži (forestry) and Riga International Airport.

- In Slovakia, the Government in May approved a new draft law on state debt and guarantees under which new state guarantees would need Parliament approval (as part of the annual budget law).
 - In Lithuania, the Government in June approved amendments to the Law on the Acquisition of Agricultural Land, aimed at removing obstacles to the transfer of agricultural land and restrictions on land use. It also approved a long-term strategy on the development of the Lithuanian transport sector aimed at facilitating the transportation of goods and improving labor mobility.
 - In Hungary, the government recently submitted to parliament a "100 Steps Program" that is planned to be implemented largely in 2006. The program contains reforms in the areas of health care, labor market and comprehensive medium term-tax reform. In healthcare, the steps proposed this year include upgrading of emergency services, extension of cancer screening, creation of equal opportunities among family doctor practices, and reforms to the healthcare contribution system (Box 1). Some of these reforms require substantial financing and lack of funds might yield only cosmetic changes. Labor market reform aims to achieve higher social security contributions through the inclusion of a wide range of inactive or undeclared working population into the active labor market.
- Box 1. 21 steps in reforming healthcare in Hungary:**

 1. Establishing emergency wards
 2. Establishing new ambulance helicopter bases
 3. Purchasing new ambulances
 4. Starting the National Cancer Prevention Program
 5. Establishing a new oncology center in Central Hungary
 6. Treating tumor patients at qualified health institutions
 7. Determining the place of treatment based on professional standards
 8. Supporting family doctor practices
 9. Encouraging doctors to prescribe cheaper medicine
 10. Regulating medicine promotion and advertising
 11. Improving services for the disadvantaged
 12. Creating standards of medical care
 13. Determining a system for assigning healthcare services
 14. Creating an individual registering system of healthcare taxpayers
 15. Creating a system that is capable of checking the payments and status of individuals
 16. Establishing effective collection of healthcare contributions
 17. Expanding the circle of healthcare contribution payers
 18. Verification of insurance payments
 19. Basic health service package
 20. Same level of service for every insured individual
 21. Allowances for extra services
- In the Czech Republic, the Government continues reforming public finances in accordance with the public finance reform plan approved in 2003. This plan contained the commitment to cut staff numbers by 2 % annually (on the level of central government, which is around 10 000 positions a year). However, actual staff cuts (in 2004 and 2005) are lagging behind plan. The 2003 reform also contained medium-term fiscal targets and expenditure framework. The 2005 budget is the second based on medium-term expenditure ceilings for the central government. The first state budget draft for 2006 counts on a deficit of Kc76.4bn, or 2.4% of GDP, which is broadly in line with the above mentioned expenditure framework. This has been achieved by containing growth of spending across the majority of budgetary chapters (savings are approaching Kc30bn, or 1% of GDP). A pension reform commission completed the analytical work on the financial results of various reform proposals (submitted by political parties) and now the representatives of political parties are to start negotiations on the main principals of reform. The Commission recommended to further raise the statutory retirement age, to strengthen actuarial fairness of the pension system and to lessen the strong redistribution embedded in the system (promote stronger link between contributions and pension) and last but not least to diversify the pension system so that the pension is not dependent on one source only. These goals can be achieved in many ways, one of which is the introduction of a fully funded pillar combined with parametric changes to the current PAYG system.

World Bank Activities

Poland:

- A second loan for rehabilitation and maintenance of roads (EUR 100 million) was approved in May. This is the second fast disbursing loan using a sector wide approach (SWAp) that is approved for the road sector (the first one was in 2004). Like its predecessor, this loan aims at improvement of national roads and modernization of the national roads agency (GDDKiA), including enhancing its capacity for planning and implementing investments on the basis of economic criteria.

- Two new projects—Post Accession Rural Support Project and Odra River Basin Flood Prevention Project—are in the pipeline and could be approved before the end of the year. The first project is aimed at supporting the less developed rural gminas in their efforts to identify, plan and provide modern and effective social inclusion services, and support the modernization of the farmers' social insurance fund (KRUS) by strengthening its administrative and analytic capacity. The second project would finance the construction of infrastructure in Raciborz and strengthening of existing works around Wroclaw to prevent damage from floods in the Odra River Basin.

Slovakia:

- Further technical assistance loans (for innovation and leadership preparation) are being discussed under the umbrella of the Bank's regional TA facility (SIDEM).

Latvia

- The PSAL Program was been closed in April 2005.
- The Cities Alliance project, providing local development strategies for largest cities, was extended to FY06 to assist Latvia with urban and regional development aspects for the National Development Planning of the 2007-2013 EU programming period.
- Reflecting Latvia's strong economic fundamentals and the fact that it no longer needs to borrow from the Bank, a decision has been taken on closing the Bank's office in Riga by mid-2006. This follows a similar recent decision for the Bank's Lithuania office.

STATISTICAL ANNEX

	2001	2002	2003	2004	Q2 04	Q3 04	Q4 04	Q1 05	Jan-05	Feb-05	Mar-05	Apr-05	May-05
Real GDP, SNA (% , y/y)													
Czech Republic	2.6	1.5	3.2	4.4	4.5	4.6	4.6	4.4					
Estonia	6.5	7.2	6.7	7.8	7.3	8.3	6.6	7.2					
Hungary	3.8	3.5	2.9	4.2	4.5	3.9	4.1	2.9					
Latvia	8.0	6.4	7.5	8.5	7.7	9.1	8.6	7.4					
Lithuania	6.4	6.8	9.7	6.7	7.3	5.8	6.7	5.7					
Poland	1.0	1.4	3.8	5.4	6.1	4.9	4.0	2.1					
Slovakia	3.8	4.6	4.5	5.5	5.5	5.3	5.8	5.1					
Slovenia	2.7	3.3	2.5	4.6	4.9	5.0	4.3	2.6					
Consumption, SNA (% , y/y)													
Czech Republic	3.0	3.3	4.4	0.8	1.4	0.3	-0.1	-0.2					
Estonia	5.2	9.5	7.2	4.3	4.7	2.3	5.2	7.0					
Hungary	5.9	8.9	7.1	1.7	2.9	2.5	0.1	2.0					
Latvia	6.2	6.1	7.0	7.4	7.9	7.3	7.0	n.a.					
Lithuania	2.8	5.0	10.4	8.7	8.0	8.0	7.1	4.7					
Poland	1.7	2.7	2.5	3.4	4.2	3.5	2.0	1.8					
Slovakia	4.8	5.3	0.3	2.9	3.4	3.4	3.0	4.7					
Slovenia	2.7	0.7	2.7	3.0	2.9	3.2	3.1	2.7					
Gross capital formation, SNA (% , y/y)													
Czech Republic	6.3	3.5	1.3	7.8	10.1	8.1	1.2	2.6					
Estonia	12.7	20.0	8.7	5.2	12.7	6.6	8.1	7.5					
Hungary	-7.3	-3.5	1.3	3.7	9.1	4.3	1.8	0.8					
Latvia	29.3	5.8	22.7	22.6	28.9	15.0	16.4	n.a.					
Lithuania	17.8	11.9	15.5	23.0	29.9	24.0	11.0	21.4					
Poland	-12.6	-6.8	3.2	12.1	14.1	13.2	6.9	-3.1					
Slovakia	14.9	2.6	-8.2	13.1	12.5	16.9	18.4	8.0					
Slovenia	-4.3	7.4	10.5	9.1	13.8	7.9	5.1	-2.3					
Gross fixed capital formation, SNA (% , y/y)													
Czech Republic	5.4	3.4	4.7	7.6	7.4	8.0	7.0	5.5					
Estonia	13.0	17.2	8.5	6.0	15.5	4.8	10.2	10.3					
Hungary	5.9	9.3	2.5	7.9	9.6	12.1	0.1	6.8					
Latvia	11.4	13.0	10.9	17.3	21.3	15.8	16.1	n.a.					
Lithuania	13.5	11.1	14.0	12.3	15.0	13.5	6.1	8.8					
Poland	-8.8	-5.8	-0.2	5.3	3.9	4.3	7.4	1.0					
Slovakia	13.6	-0.6	-1.5	2.5	3.5	5.5	0.1	5.8					
Slovenia	4.1	3.1	6.3	6.8	6.8	6.7	5.7	-0.5					
Exports, SNA (% , y/y)													
Czech Republic	11.5	2.1	7.5	21.9	29.5	23.6	23.0	17.9					
Estonia	-0.2	0.8	5.8	16.0	15.5	18.9	10.2	16.2					
Hungary	8.0	3.9	7.8	14.9	19.2	11.2	10.8	6.2					
Latvia	7.5	5.2	5.0	9.3	9.7	12.0	12.2	n.a.					
Lithuania	21.2	19.5	6.9	4.3	6.5	4.2	6.6	9.3					
Poland	3.1	4.8	14.2	10.2	9.6	19.0	-0.5	-3.1					
Slovakia	6.2	5.6	22.5	11.4	16.4	5.1	9.5	7.2					
Slovenia	6.3	6.7	3.2	12.6	14.5	13.3	13.3	8.9					
Imports, SNA (% , y/y)													
Czech Republic	13.0	4.9	7.9	18.4	27.8	19.3	15.5	12.1					
Estonia	2.1	3.8	10.6	14.6	21.5	12.5	12.3	15.4					
Hungary	5.3	6.5	11.0	11.6	17.9	9.5	6.2	4.8					
Latvia	14.5	4.6	13.0	15.6	21.2	11.7	13.3	n.a.					
Lithuania	17.7	17.6	10.2	13.4	15.4	15.7	8.7	12.6					
Poland	-5.3	2.6	9.3	8.7	8.7	18.8	2.3	5.5					
Slovakia	11.0	5.5	13.6	12.7	17.0	9.6	12.3	7.9					
Slovenia	3.0	4.9	6.8	12.4	15.6	12.1	11.6	6.6					

	2001	2002	2003	2004	Q2 04	Q3 04	Q4 04	Q1 05	Jan-05	Feb-05	Mar-05	Apr-05	May-05
Industrial production (% y/y)													
Czech Republic	10.6	4.8	5.8	9.9	12.6	8.8	9.1	4.3	7.2	5.6	0.1	5.7	
Estonia	8.9	8.2	9.8	7.3	7.3	7.4	7.1	6.9	2.5	8.8	9.3	11.3	11.2
Hungary	3.6	2.8	6.4	8.3	10.4	5.9	6.6	1.8	3.4	0.5	1.4	8.8	
Latvia	6.9	5.8	6.5	6.0	6.4	3.9	4.4	0.1	-2.0	1.5	0.8	1.6	
Lithuania	16.0	3.1	16.1	10.8	18.0	7.7	7.6	4.2	6.9	-2.9	8.8	2.0	18.5
Poland	0.6	1.1	8.3	12.3	16.4	9.2	6.2	0.7	4.6	2.3	-3.7	-1.1	0.9
Slovakia	7.1	6.4	5.1	4.2	5.6	3.8	1.2	0.6	4.8	0.0	-3.1	0.3	
Slovenia	2.9	2.4	1.4	4.8	7.4	5.8	2.1	2.6	-0.1	-3.6	-3.8	3.7	
Retail sales (excl. motor vehicles, automotive fuel, %, y/y)													
Czech Republic	3.2	3.2	4.0	3.0	3.4	2.3	3.4	3.2	4.4	1.1	3.9	1.0	
Estonia	14.0	14.4	9.3	15.5	17.0	16.0	16.0	11.0	9.0	10.0	13.0	9.0	11.0
Hungary	4.4	8.7	8.9	5.7	8.0	5.3	3.5	3.4	3.1	2.9	4.0	7.3	
Latvia	3.3	12.1	13.4	12.3	14.0	10.7	11.8	22.7	27.8	22.1	18.8	20.1	
Lithuania	2.3	7.9	11.1	10.7	12.6	8.3	8.3	7.3	7.6	7.4	6.8	3.6	
Poland	0.2	1.9	3.6	7.1	10.9	4.7	-1.0	-0.1	3.2	-1.6	-3.8	-17.4	5.5
Slovakia	4.5	5.8	-5.2	6.2	8.5	9.7	3.6	9.4	7.7	12.5	8.1	6.8	
Slovenia				3.8	5.5	4.1	5.8	8.2	9.2	7.6	7.7	8.3	
Unemployment (% NSA, LFS data)													
Czech Republic	8.1	7.3	7.8	8.3	8.2	8.2	8.2	8.4					
Estonia	12.6	10.3	10.0	9.7	10.0	10.0	8.5	9.5					
Hungary	5.7	5.7	5.9	6.1	5.8	6.1	6.3	7.1					
Latvia	13.1	12.0	10.6	10.4	9.9	10.0	10.3	9.9					
Lithuania	17.4	13.8	12.4	11.4	11.3	10.6	10.6	10.2					
Poland	18.3	19.6	19.7	19.0	19.1	18.2	18.0	18.9					
Slovakia	19.1	18.5	17.4	18.1	18.5	17.5	17.1	17.5					
Slovenia	5.9	5.9	6.7	6.3	6.1	6.0	6.4	6.9					
CPI inflation (% average y/y)													
Czech Republic	4.7	1.8	0.1	2.8	2.6	3.2	3.1	1.6	1.7	1.7	1.5	1.6	1.3
Estonia	5.8	3.6	1.3	3.0	3.2	4.0	4.6	4.6	4.2	4.5	5.0	4.7	2.8
Hungary	9.2	5.3	4.7	6.8	7.3	7.0	5.9	3.6	4.1	3.2	3.5	3.9	3.6
Latvia	2.5	1.9	2.9	6.2	5.8	7.4	7.3	6.7	6.6	6.9	6.4	6.9	6.3
Lithuania	1.3	0.3	-1.2	1.2	0.5	2.4	3.1	3.1	2.9	3.3	3.2	3.2	2.0
Poland	5.5	1.9	0.8	3.5	3.3	4.5	4.4	3.6	3.7	3.6	3.4	3.0	2.5
Slovakia	7.3	3.4	8.5	7.5	8.1	7.5	6.3	2.8	3.2	2.7	2.5	2.7	2.4
Slovenia	8.4	7.5	5.6	3.6	3.7	3.6	3.4	2.6	2.2	2.6	3.1	2.7	2.2
PPI (% y/y)													
Czech Republic	2.9	-0.5	-0.3	5.7	4.9	7.8	8.2	6.9	7.2	7.1	6.4	5.6	4.0
Estonia	4.4	0.4	0.2	2.9	2.8	4.1	3.8	3.3	3.9	3.3	2.8	2.7	1.7
Hungary	5.2	-1.8	2.4	3.5	4.4	2.9	2.4	4.0	3.8	3.1	5.0	5.3	5.2
Latvia	1.7	1.0	3.2	8.6	7.4	10.4	11.0	10.5	10.9	10.4	10.1	11.8	7.6
Lithuania	-3.0	-2.8	-0.5	6.0	7.6	9.2	9.5	9.1	7.8	9.5	10.0	11.8	7.6
Poland	1.6	1.0	2.6	7.0	8.8	8.3	6.5	3.3	4.5	3.2	2.2	0.9	-0.5
Slovakia	6.6	2.1	8.3	2.6	1.4	3.4	6.2	4.7	4.8	4.5	4.9	6.6	5.6
Slovenia	8.9	5.1	2.5	4.3	4.1	4.8	5.0	4.2	4.8	4.1	3.8	3.6	2.6
Exchange rate (nominal, LCU/EUR, period average)													
Czech Republic	34.05	30.82	31.85	31.90	32.04	31.59	31.14	30.02	30.31	29.96	29.78	30.13	30.22
Estonia	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Hungary	256.6	242.9	253.5	251.8	252.1	248.8	246.0	245.1	246.6	243.8	245.0	248.2	252.0
Latvia	0.560	0.581	0.641	0.665	0.654	0.660	0.680	0.696	0.703	0.703	0.703	0.703	0.703
Lithuania	3.581	3.459	3.453	3.453	3.453	3.453	3.453	3.453	3.453	3.453	3.453	3.453	3.453
Poland	3.669	3.853	4.398	4.532	4.690	4.424	4.237	4.029	4.082	3.984	4.021	4.151	4.183
Slovakia	43.30	42.68	41.48	40.03	40.08	40.02	39.47	38.31	38.61	38.05	38.19	39.16	39.04
Slovenia	218.0	226.0	233.8	239.1	238.8	240.0	239.8	239.7	239.8	239.7	239.7	239.7	239.6

	2001	2002	2003	2004	Q2 04	Q3 04	Q4 04	Q1 05	Jan-05	Feb-05	Mar-05	Apr-05	May-05
Exchange rate (nominal, LCU/USD, period average)													
Czech Republic	38.03	32.74	28.21	25.70	26.60	25.86	24.06	22.90	23.10	23.02	22.59	23.29	23.81
Estonia	17.48	16.61	13.86	12.60	12.99	12.81	12.09	11.94	11.92	12.03	11.86	12.09	12.30
Hungary	286.5	257.9	224.3	202.7	209.3	203.6	189.9	187.0	187.8	187.2	185.9	191.7	198.3
Latvia	0.628	0.618	0.571	0.540	0.548	0.545	0.528	0.535	0.534	0.541	0.531	0.543	0.555
Lithuania	4.000	3.677	3.062	2.779	2.863	2.823	2.669	2.626	2.624	2.655	2.654	2.668	2.714
Poland	4.094	4.080	3.889	3.656	3.894	3.623	3.279	3.077	3.103	3.060	3.049	3.205	3.291
Slovakia	48.35	45.33	36.77	32.25	33.27	32.76	30.54	29.16	29.35	29.26	28.89	30.25	30.67
Slovenia	242.7	240.2	207.1	192.3	197.9	196.3	185.3	182.7	182.5	184.2	181.5	185.3	188.5
Real effective exchange rate, CPI based (% , y/y), (negative value= appreciation)													
Czech Republic*	-5.5	-10.6	3.2	-0.2	2.0	-1.9	-2.8	-7.3	-5.9	-7.2	-8.8	-6.7	
Estonia*	2.0	1.9	1.7	1.3	0.8	2.0	2.6	2.1	1.6	2.0	2.6	2.6	0.5
Hungary*	-7.6	-9.1	-1.3	-5.7	-4.6	-8.9	-9.0	-7.1	-8.5	-7.9	-4.8	-3.2	
Latvia*	2.1	3.4	6.0	0.4	-1.8	-1.6	-0.1	1.5	0.8	1.2	2.4	3.1	2.9
Lithuania*	-2.7	2.4	1.9	-1.2	-2.7	-0.7	-0.6	-1.8	-2.0	-2.3	-1.2		
Poland	-11.2	5.4	16.0	2.4	6.9	-2.0	-9.8		-14.4				
Slovakia	-2.6	-2.3	-8.2	-8.1	-7.9	-8.6	-7.4		-5.7				
Slovenia	-0.1	-1.3	0.1	0.9	1.0	1.0	0.8		1.7				
Exports of goods (EUR, %, y/y)													
Czech Republic	18.3	9.3	5.7	27.6	34.3	31.9	33.2		43.2	21.8			
Estonia	7.3	-3.2	11.7	17.6	13.0	23.7	14.4	27.5	37.1	31.7	17.0	31.5	
Hungary	11.8	7.2	4.3	15.7	19.4	14.3	15.9	10.1	11.2	9.7	9.7	16.5	
Latvia	10.5	8.2	5.8	24.2	21.2	30.0	29.4	30.5	29.7	28.7	32.8	29.1	
Lithuania	23.7	14.6	9.3	16.2	17.6	17.5	23.3	22.2	29.2	9.6	28.2	31.8	
Poland	17.1	7.4	9.3	26.0	27.8	26.2	27.8	24.1	34.4	21.8	17.9	10.9	
Slovakia	9.7	8.2	26.8	14.5	20.7	9.6	10.5		15.7	11.5			
Slovenia	9.0	5.9	2.9	11.1	10.9	12.1	13.0	10.4	17.2	7.1	8.0	11.5	
Imports of goods (EUR, %, y/y)													
Czech Republic	16.6	5.7	5.1	23.4	31.2	29.3	24.8		39.5	21.0			
Estonia	4.0	5.8	12.9	17.5	26.5	17.0	16.1	20.8	20.6	28.7	14.8	-6.9	
Hungary	8.2	6.1	5.8	13.4	20.3	12.2	11.2	8.1	13.9	9.1	2.8	0.2	
Latvia	13.0	9.3	8.2	21.4	25.3	21.4	21.8	20.2	27.6	19.9	15.4	-3.6	
Lithuania	19.5	16.4	6.2	12.6	15.5	16.6	9.8	14.1	17.3	11.5	13.8	21.8	
Poland	5.8	3.6	3.2	18.6	29.3	16.5	17.1	16.6	22.0	20.6	9.5	-14.4	
Slovakia	19.2	6.3	13.7	18.9	26.2	17.3	17.3		21.7	22.0			
Slovenia	3.2	2.0	5.7	11.9	15.9	13.2	12.6	8.7	14.3	8.2	5.1	-1.2	
Trade balance (% GDP)													
Czech Republic	-5.0	-3.0	-2.7	-0.8	-1.4	-0.9	-1.1	2.8					
Estonia	-9.6	-15.4	-16.9	-17.5	-22.7	-15.3	-17.6	-11.7					
Hungary	-4.3	-3.2	-4.0	-3.0	-5.5	-3.1	-1.1	-0.9					
Latvia	-16.4	-15.6	-18.0	-20.2	-24.4	-19.6	-18.5	-17.3					
Lithuania	-9.2	-9.4	-9.2	-10.4	-12.6	-9.9	-9.1	-7.6					
Poland	-4.1	-3.8	-2.7	-2.3	-3.1	-2.3	-1.8	-0.6					
Slovakia	-10.2	-8.7	-2.0	-3.5	-3.1	-4.9	-5.5	-3.0					
Slovenia	-3.1	-1.1	-2.2	-3.2	-4.9	-2.1	-4.3	-1.1					
Current account (%GDP)													
Czech Republic	-5.4	-5.6	-6.3	-5.2	-5.4	-7.9	-5.2	2.1					
Estonia	-4.1	-7.3	-12.1	-12.7	-16.9	-5.3	-17.2	-9.7					
Hungary	-6.2	-7.1	-8.8	-8.8	-11.3	-8.9	-7.7	-7.5					
Latvia	-8.9	-7.0	-8.2	-12.3	-19.0	-13.6	-7.7	-10.7					
Lithuania	-4.7	-5.2	-6.9	-7.2	-9.8	-6.7	-4.9	-5.6					
Poland	-2.9	-2.6	-2.2	-1.6	-3.3	-1.8	0.2	0.7					
Slovakia	-8.4	-7.9	-0.8	-3.5	-6.3	-5.0	-3.6	-1.9					
Slovenia	0.2	1.4	-0.4	-0.9	-2.6	-0.1	-1.4	0.2					

	2001	2002	2003	2004	Q2 04	Q3 04	Q4 04	Q1 05	Jan-05	Feb-05	Mar-05	Apr-05	May-05
FDI net (% GDP)													
Czech Republic	9.0	11.2	2.1	3.7	2.2	2.3	3.7	3.6					
Estonia	5.6	2.2	8.4	6.9	6.2	5.1	6.0	14.0					
Hungary	6.9	4.2	0.6	3.6	1.7	3.4	3.6	3.9					
Latvia	1.8	4.1	2.4	4.0	2.7	3.6	4.0	4.4					
Lithuania	3.6	5.0	0.8	2.3	0.9	2.4	2.3	2.2					
Poland	3.1	2.0	1.9	2.2	2.2	1.8	2.2	1.8					
Slovakia	7.4	17.1	2.1	3.2	2.9	3.3	3.1	2.4					
Slovenia	1.1	6.8	-0.5	0.1	n.a.	-0.2	0.2	-0.4					
Net portfolio investment (% GDP)													
Czech Republic	1.5	-1.9	-1.4	2.3	2.5	3.0	2.3	0.6					
Estonia	-0.7	2.0	1.9	6.5	5.1	4.0	6.4	3.1					
Hungary	2.7	2.6	3.6	6.8	4.0	4.4	7.0	7.9					
Latvia	1.5	-2.5	-2.0	2.0	1.4	1.0	2.0	0.7					
Lithuania	2.2	0.1	1.5	0.9	1.3	1.7	0.9	0.6					
Poland	0.6	1.0	1.2	4.0	2.9	4.1	4.0	4.2					
Slovakia	-1.3	2.3	-1.7	2.2	2.4	2.5	2.1	2.9					
Slovenia	0.3	-0.3	-0.9	-2.4	n.a.	-2.7	-2.4	-3.1					
General Government balance (ESA95)													
Czech Republic	-5.9	-6.8	-11.7	-3.0									
Estonia	0.3	1.4	3.1	1.8									
Hungary	-3.7	-8.5	-6.2	-4.5									
Latvia	-2.1	-2.7	-1.5	-0.8									
Lithuania	-2.0	-1.5	-1.9	-2.5									
Poland	-3.9	-3.6	-4.5	-4.8									
Slovakia	-6.0	-5.7	-3.7	-3.3									
Slovenia	-2.8	-2.4	-2.0	-1.9									
General Government revenue (ESA95, % GDP)													
Czech Republic	39.1	40.2	41.6	41.5									
Estonia	37.2	38.0	38.9	39.0									
Hungary	44.3	44.1	43.5	44.8									
Latvia	34.4	33.1	34.2	35.5									
Lithuania	33.2	32.9	32.2	32.2									
Poland	43.8	43.9	44.3	n.a.									
Slovakia	45.5	45.2	35.4	44.7									
Slovenia	45.1	45.7	46.2	45.9									
General Government expenditure (ESA95, % GDP)													
Czech Republic	45.0	46.9	53.2	44.5									
Estonia	36.9	36.6	35.8	37.3									
Hungary	48.7	52.6	49.8	49.2									
Latvia	36.5	35.8	35.7	36.2									
Lithuania	35.2	34.5	34.1	34.7									
Poland	47.6	48.9	48.1	n.a.									
Slovakia	51.5	50.9	39.2	48.0									
Slovenia	47.9	48.1	48.2	47.8									
Public debt (% GDP)													
Czech Republic	27.2	30.7	38.3	37.4									
Estonia	4.4	5.3	5.3	4.9									
Hungary	52.2	55.5	56.9	57.6									
Latvia	14.9	14.1	14.4	14.4									
Lithuania	22.9	22.4	21.4	19.7									
Poland	36.7	41.2	45.4	43.6									
Slovakia	48.7	43.3	42.6	43.6									
Slovenia	28.1	29.5	29.4	29.4									
Oil price (Brent)													
Exchange rate (USD/EUR)	0.90	0.95	1.13	1.24	1.20	1.22	1.30	1.31	1.31	1.30	1.32	1.29	1.27

Note: * weights foreign trade turnover; **LCU/EUR.

Source: Eurostat, WIIW, CSOs, NCBs, World Bank, staff calculations.

FORECASTS

	2005					2006				
	EC	GOV	IMF	OECD	WB	EC	GOV	IMF	OECD	WB
GDP growth (%)										
Czech Republic	4.0	3.6	4.0	4.1	3.8	4.2	3.7	3.9	4.3	
Estonia	6.0	5.7	6.0		5.6	6.2	6.2	5.5		5.5
Hungary	3.9	4.0	3.7	3.6	3.5	3.8	4.2	3.8	3.9	
Latvia	7.2	6.7	7.3		7.0	6.9	6.5	6.2		6.0
Lithuania	6.4	7.0	7.0		6.0	5.9	6.0	6.8		5.7
Poland	4.4	3.7	3.5	4.2	3.6	4.5	4.0	3.7	4.5	4.5
Slovakia	4.9	5.1	4.8	4.8	5.1	5.2	5.4	4.9	5.7	5.1
Slovenia	3.7	3.8	4.0		3.7	4.0	3.9	4.0		
EU15	1.9					2.2				
US	3.6		3.6	3.6		3.0		3.6	3.3	
CPI (%)										
Czech Republic	1.9	3.3	2.5	2.0	2.0	2.6	2.8	2.7	2.5	
Estonia	3.3	3.4	3.7		3.5	2.7	2.7	2.7		3.0
Hungary	3.8	4.5	4.0	3.8	3.8	3.6	4.0	3.8	3.8	
Latvia	5.0	4.3	5.7		5.0	3.6	3.0	5.3		4.0
Lithuania	2.9	2.7	2.9		2.6	2.6	2.1	3.0		2.2
Poland	2.1	2.1	3.1	2.5	2.1	2.3	1.5	2.5	2.6	1.8
Slovakia	3.7	2.8	3.6	2.8	2.8	2.9	2.5	2.8	2.7	2.5
Slovenia	2.6	2.9	2.3		2.9	2.6	2.7	2.0		
EU15	1.8					1.6				
US	2.6		2.7	2.8		2.3		2.4	2.6	
Fiscal deficit (% of GDP)										
Czech Republic	-4.5	-4.7		-4.5	-4.3	-4.0	-3.8		-4.2	
Estonia	0.9	0.0			0.5	0.5	0.0			0.0
Hungary*	-3.9	-3.8		-4.2	-4.0	-4.1	-3.1/(4.1)		-4.1	
Latvia	-1.6	-1.6			-1.6	-1.5	-1.5			-1.5
Lithuania	-2.4	-2.5			-2.6	-1.9	-1.8			-2.0
Poland*	-4.4	-3.4		-4.3	-4.5	-3.8	-2.8/-3.4		-4.0	-4.0
Slovakia	-3.8	-3.4		-3.4	-3.4	-4.0	-2.9		-3.2	
Slovenia	-2.2	-2.1			-2.2	-2.1	-1.8			
EU15	-2.5					-2.5				
US	-3.9			-4.1		-3.8			-3.9	
Gross general government debt (% of GDP)										
Czech Republic	36.4	38.3		43.5		37.0	39.2		44.4	
Estonia	4.3	4.6				4.0	4.3			
Hungary	57.8	55.3		59.4		57.9	53.0		59.4	
Latvia	14.0	14.5				14.3	14.8			
Lithuania	21.2	20.9				20.9	20.3			
Poland	46.8	47.6		52.5		47.6	48.0		54.1	
Slovakia	44.2	36.5		45.6		44.9	38.1		46.6	
Slovenia	30.2	30.7				30.4	30.9			
EU15	65.0					65.1				
US				66.4					69.1	

	2005					2006			
	EC	GOV	IMF	OECD	WB	EC	EC	GOV	IMF
Current account (% of GDP)									
Czech Republic	-4.7	-5.7	-4.8	-4.8	-4.2	-4.6	-5.3	-4.4	-4.5
Estonia	-12.1	-11.3	-11.0		-11.0	-11.2	-10.9	-9.7	-10.0
Hungary	-8.7	-8.5	-8.6	-7.3	-8.7	-8.2	-7.7	-8.1	-6.4
Latvia	-10.5	-9.5	-10.9		-10.0	-10.0	-9.1	-9.8	-9.5
Lithuania	-8.8	-8.0	-9.5		-8.0	-8.5	-8.4	-9.3	-7.5
Poland	-2.1	-1.2	-2.1	-1.3	-0.8	-3.0	-2.2	-2.5	-1.5
Slovakia	-5.0	-4.5	-6.0	-5.7	-4.7	-4.9	-4.7	-4.6	-5.3
Slovenia	-1.0	-0.4	-1.4		-1.0	-0.8	-0.4	-2.2	
EU15	0.2					0.3			
US	-5.9		-5.8	-6.4		-5.8		-5.7	-6.7
Unemployment rate, LFS (%)									
Czech Republic	8.3	10.2		8.3	8.1	8.2	9.8		8.2
Estonia	8.7	9.7				8.2	9.6		
Hungary	6.3	5.9		6.3	6.9	6.2	5.8	6.0	
Latvia	9.4	9.7				9.2	9.3		
Lithuania	10.2	10.9			9.5	9.7	10.3		9.0
Poland	18.3	18.0		18.2	18.2	17.6	17.0	17.3	17.5
Slovakia	17.6	16.8		17.9		16.8	16.3	17.5	
Slovenia	5.9	6.1				5.6	5.9		
EU15	8.0					7.8			
US	5.2			5.1		5.0		4.8	

Note: * HU: GG deficit without effect of pension reform, PL: GOV - state budget deficit (cash)

Source: EC: Spring 2005 Economic Forecasts
GOV: Convergence Programs December 2004
IMF: World Economic Outlook, April 2005
OECD: OECD Economic Outlook May 2005
WB: latest country economist forecast