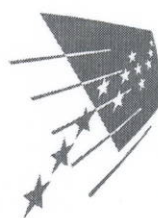




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CANDIDATE AND PRE-ACCESSION COUNTRIES' ECONOMIC QUARTERLY

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*as defined by UNSCR 1244

OVERVIEW

Data from the first quarter of 2011 broadly confirmed the continuing and somewhat firmer recovery, although the pace of growth still varied across pre-accession countries. Rapid economic expansion continued in Turkey and real GDP turned positive in Iceland for the first time since the recession. Signs of acceleration are noticeable in the former Yugoslav Republic of Macedonia and in Serbia, while Albania continued to experience positive, albeit slightly decelerating, growth. However, in Croatia, real GDP contracted again in the first quarter of 2011. With the exception of Turkey, conditions in the labour markets are stabilising and improvements are only very gradual. Consumer price inflation is picking up, largely because of the surge in international commodity prices.

Turkey remains an outlier with 11% year on year domestically-driven GDP growth in the first quarter of 2011, following a steep recovery (8.9%) in 2010.

In the Western Balkans, growth was much more subdued but further consolidated. First quarter 2011 GDP growth data point to accelerating rates (year-on-year) in the former Yugoslav Republic of Macedonia (5.1%) and Serbia (3.4%). Albania continued to register positive growth, as it did throughout the global crisis, though at a slightly decelerating pace (3.4%). Indicators also point to some acceleration compared to 2010 in Bosnia and Herzegovina. Only in Croatia is growth still negative (-0.8%).

In Iceland, real GDP turned positive (3.4%) in the first quarter 2011, after two years of recession, driven by relatively strong investment growth.

While external imbalances had been substantially adjusted in 2010 in most countries, data for the first quarter of 2011 point to some deterioration that may signal a return to pre-crisis patterns. Current account deficits remained relatively stable in Croatia, Serbia, Albania and Montenegro. However, stronger deteriorations occurred in Bosnia and Herzegovina, Kosovo, Iceland, and the former Republic of Macedonia, while the deficit continued to widen in Turkey. These developments were generally driven by a deterioration of trade deficits as imports increased, in line with the expansion of economic activity.

With the exception of Croatia where the unemployment rate further increased in the first quarter 2011 (14.3%), labour market conditions tended to stabilise in the Western Balkans.

Improvements are hampered by severe structural deficiencies in the functioning of labour markets that had led to very high pre-crisis unemployment rates. In Turkey the unemployment rate, which had already substantially decreased in 2010 in tandem with the strong recovery, declined further to 10.8% in March 2011. In Iceland, unemployment rose to 7.8%.

Against a growing current account deficit and strong short term capital inflows, the setting of monetary policy remains highly challenging for the central bank of Turkey. The monetary stance was eased in the first quarter of 2011 in Iceland (the key policy rate fell further to a historical low of 4.1% in May) and in Serbia (after a hike in April, the reference rate was cut in early June and July to reach 11.75%). Inflationary tensions have accelerated in nearly all countries, reflecting the surge in commodity prices and some country-specific features. While consumer price inflation remained contained in Croatia, it reached two digits in Kosovo (10.4%) and Serbia (13.4%) in May. Even if the latter is expected to decelerate, Serbia's targeted inflation range at end 2011 will not be reached. In Albania, although it eased, inflation at 4.2% in May is slightly above the target range. Similarly, in Turkey the CPI increase of 6.2% in June is above the end-year inflation target.

Credit growth still remained moderate in the Western Balkans, even though lending activity was quite robust in Kosovo, continued to recover in Bosnia and Herzegovina and accelerated in Albania. It stayed negative in Iceland (- 3.7%). In contrast, credit growth continued to be very strong in Turkey (36% over the first quarter), significantly outpacing the 25% target set by the authorities and non-performing loans continued to decline. While NPLs have stabilised in Serbia and Montenegro, albeit at very high levels, they rose significantly in Albania, Bosnia and Herzegovina, and Iceland.

According to available data, five out of the nine pre-accession economies achieved lower general government deficits in 2010 than in 2009. In the first quarter of 2011, Turkey continued to post strong fiscal results thanks to surging tax revenues, while Iceland's general government deficit was the lowest since the crisis hit the country. In general, higher fiscal revenues in line with growing activity tend to improve budget balance prospects in the Western Balkans but there are differentiated patterns across countries. In Croatia, fiscal revenues have declined and are significantly greater than expenditures. In Albania, the increase in revenues in the period January-May was very modest while expenditure growth was high, leading to a widening budget deficit.

Candidate and potential candidate countries: Summary table

						ECFIN May Forecast							
	2006	2007	2008	2009	2010	2011	2012	Q4 10	Q1 11	Q2 11	Apr 11	May 11	Jun 11
Gross domestic product (in real terms, annual % change)													
Croatia	4.9	5.1	2.2	-6.0	-1.2	1.1	2.0	-0.6	-0.8	:	n.a.	n.a.	n.a.
The former Yugoslav Republic of Macedonia	5.1	6.2	5.1	-1.0	1.7	2.5	3.3	3.8	5.1	:	n.a.	n.a.	n.a.
Iceland	4.6	6.0	1.4	-6.9	-3.5	1.5	2.5	0.0	3.4	:	n.a.	n.a.	n.a.
Montenegro	8.6	10.7	6.9	-5.7	1.1e	2.4	4.0	:	:	:	n.a.	n.a.	n.a.
Turkey	6.9	4.7	0.7	-4.8	8.9	6.1	5.5	9.2	11.0	:	n.a.	n.a.	n.a.
Albania	5.4	5.9	7.5	3.3	4.1	:	:	5.6	3.4	:	n.a.	n.a.	n.a.
Bosnia and Herzegovina	6.0	6.2	5.7	-3.0	0.9	:	:	:	:	:	n.a.	n.a.	n.a.
Serbia	5.2	6.9	5.5	-3.1	1.8	:	:	1.7	3.4	:	n.a.	n.a.	n.a.
Kosovo*	3.4	6.3	6.9	2.9	4.0	:	:	:	:	:	n.a.	n.a.	n.a.
Unemployment (LFS, in % of workforce)													
Croatia	n.a.	9.6	8.4	9.1	11.8	11.3	9.8	12.1	14.3	:	n.a.	n.a.	n.a.
The former Yugoslav Republic of Macedonia	36.0	34.9	33.8	32.2	32.1	31.4	30.5	30.9	31.2	:	:	:	:
Iceland	2.9	2.3	3.0	7.2	7.5	6.9	6.2	7.4	7.8	:	n.a.	n.a.	n.a.
Montenegro	14.7	11.9	10.7	11.4	12.2	19.4	17.9	12.2	12.4	:	12.2	11.3	:
Turkey	9.9	9.9	11.0	14.1	12.0	10.2	9.8	11.0	11.5	:	:	:	:
Albania	13.9	13.4	12.8	13.0	13.7	:	:	13.5	13.4	:	:	:	:
Bosnia and Herzegovina	44.2	42.9	40.6	42.7	42.7	:	:	42.7	:	:	:	:	:
Serbia	20.9	18.1	13.6	16.1	20.0e	:	:	:	:	:	:	:	:
Kosovo*	44.9	43.6	47.5	45.4	:	:	:	:	:	:	:	:	:
Current account balance (% of GDP)													
Croatia	-6.7	-7.2	-8.9	-5.3	-1.3	-2.2	-2.5	-1.3	-1.4	:	n.a.	n.a.	n.a.
The former Yugoslav Republic of Macedonia	-0.4	-7.1	-12.8	-6.7	-2.8	-3.1	-3.7	-2.8	-4.4	:	n.a.	n.a.	n.a.
Iceland	-23.8	-15.7	-24.5	-11.6	-9.7	-6.2	-5.5	-9.7	-11.8	:	n.a.	n.a.	n.a.
Montenegro	-24.7	-39.6	-51.3	-30.1	-25.7	-27.3	-31.0	-25.7	-23.6	:	n.a.	n.a.	n.a.
Turkey	-6.1	-5.9	-5.6	-2.3	-6.6	-7.7	-8.1	-6.5	-7.9	:	n.a.	n.a.	n.a.
Albania	-6.6	-10.6	-15.4	-15.4	-11.9	:	:	-11.9	-11.8	:	n.a.	n.a.	n.a.
Bosnia and Herzegovina	-8.0	-10.7	-14.2	-6.2	-5.6	:	:	-5.6	-6.7	:	n.a.	n.a.	n.a.
Serbia	-11.7	-16.1	-20.6	-7.4	-7.4	:	:	-7.2	-7.3	:	n.a.	n.a.	n.a.
Kosovo*	-7.2	-10.4	-16.3	-15.4	-16.0	:	:	:	:	:	n.a.	n.a.	n.a.
Inflation (Consumer price index, annual % change)													
Croatia	3.2	2.9	6.1	2.4	1.0	2.8	2.5	1.5	2.2	:	2.4	2.5	:
The former Yugoslav Republic of Macedonia	3.2	2.3	8.3	-0.8	1.6	4.3	3.8	2.9	4.1	4.7	4.8	5.2	4.1
Iceland	6.7	5.1	12.7	12.0	5.4	3.0	2.7	2.8	2.0	3.5	2.8	3.4	4.2
Montenegro	3.0	4.3	7.4	3.4	0.5	3.7	2.2	0.7	2.3	:	3.7	3.6	:
Turkey	9.6	8.8	10.4	6.3	8.6	6.5	5.5	7.4	4.3	:	4.3	7.2	:
Albania	2.4	2.9	3.4	2.3	3.6	:	:	3.1	4.0	:	4.1	4.2	:
Bosnia and Herzegovina	6.1	1.5	7.4	-0.4	2.1	:	:	2.5	3.2	:	4.0	4.2	:
Serbia	n.a.	11.0	8.6	6.6	10.3	:	:	10.3	14.1	:	14.7	13.4	:
Kosovo*	0.6	4.4	9.4	-2.4	3.5	:	:	6.2	9.2	:	10.6	10.4	:
General government balance (% of GDP)													
Croatia	-3.0	-2.5	-1.4	-4.1	-5.2f	-6.0	-5.0	:	:	:	n.a.	n.a.	n.a.
The former Yugoslav Republic of Macedonia	-0.6	0.6	-1.0	-2.7	-2.5	-2.5	-2.2	:	:	:	n.a.	n.a.	n.a.
Iceland	6.3	5.4	-13.5	-10.0	-7.8	-4.9	-3.6	-13.8	-3.5	:	n.a.	n.a.	n.a.
Montenegro	3.4	6.6	0.5	-4.4	-3.7	-3.1	-0.1	-3.0	-1.7	:	n.a.	n.a.	n.a.
Turkey	-0.1	-1.0	-2.2	-5.7	-3.6	-2.8	-2.2	:	:	:	n.a.	n.a.	n.a.
Albania	-3.3	-3.5	-5.5	-7.0	-3.1	:	:	:	:	:	n.a.	n.a.	n.a.
Bosnia and Herzegovina	2.9	1.2	-2.2	-3.6	-3.8	:	:	:	:	:	n.a.	n.a.	n.a.
Serbia	-1.6	-2.0	-2.6	-4.5	-4.8	:	:	-4.8	-0.8	:	n.a.	n.a.	n.a.
Kosovo*	2.5	7.1	-0.1	-0.7	-2.8	:	:	:	:	:	n.a.	n.a.	n.a.

* as defined by UNSCR 1244
Forecast: ECFIN forecast Spring 2011

CROATIA



Key developments

The accession negotiations between the EU and Croatia were closed successfully on 30 June. This should allow for the signature of the Accession Treaty by the end of the year and, following treaty ratification in Croatia and all EU Member States, Croatia's accession to the EU by mid-2013.

From the seven negotiating chapters which were still open at the end of March, two were closed on 19 April, viz. 'Regional Policy' and 'Agriculture'. The chapter on 'Fisheries' was closed on 6 June and the intergovernmental conference on 30 June wrapped up the negotiations by closing the chapters on 'Competition', 'Judiciary and Fundamental Rights', 'Financial and Budgetary Provisions' and 'Other issues'. The European Commission was charged with closely monitoring up to the date of accession Croatia's fulfilment of the commitments undertaken in the negotiations and its continued preparations to assume the responsibilities of EU membership upon accession.

Meanwhile Croatia's economy remained depressed and unemployment reached a new cyclical height in the first quarter.

Real sector

Real GDP contracted again in the first quarter of 2011. The growth rate was -0.8% year-on-year following -0.6% in the preceding quarter. The fall was 0.7% in seasonally-adjusted quarter-on-quarter terms. Significantly, the only GDP component adding to growth was inventories, whereas final demand was sharply lower.

Consumer spending edged down by 0.1% year-on-year following two quarterly increases. The decline in government consumption was more pronounced with 0.9%. Fixed investment fell for a ninth consecutive quarter, although at a decelerating rate (-6.7%). Export volumes, which had increased over the past four quarters, suffered a sharp setback (-11.1%) mainly due to an unfavourable base effect caused by a surge in

ship exports in 2010. Import volumes, which had started to recover in the preceding two quarters, declined by 5.3%. In spite of falling imports, the sharper drop in exports meant that net exports exerted a significant drag on growth for the first time since 2008. Overall, the GDP data point to a renewed weakening of economic activity in the first quarter.

Monthly data indicate, on balance, a stabilisation of economic activity at a low level in the second quarter. The volume of industrial production has started a slight upward trend (+2.7% in April and -0.4% in May, year-on-year) following a softening in the winter months. The trend in retail sales volume is also slightly upward following year-on-year growth rates of 3.7% and 1.0% in April and May, respectively. The declining trend in construction, however, re-accelerated in April when the sector's output was 15.3% lower year-on-year. Exports of goods were 8.9% higher year-on-year in nominal terms in April-May while imports were 4.8% higher.

Labour market

Against the background of an on-going recession, the labour market weakened further in the first quarter of 2011. According to the labour force survey, employment was 5.6% lower year-on-year. The unemployment rate increased from 12.1% in the fourth quarter to 14.3% in the first quarter. In year-on-year terms the unemployment rate was 3.1 percentage points higher and the underlying trend is still rising. The registered unemployment rate stood at 17.5% in May which is 0.2 percentage point higher year-on-year. Labour productivity was 2.7% higher year-on-year in May.

The average nominal gross wage increased 1.9% year-on-year in April. In real terms, however, the average gross wage declined 0.5%.

The preliminary results from a new census show that the country has 4.29 million inhabitants. This is fewer than recorded in 2001, but the data are not comparable since the statistical definition of the total population has changed.

External sector

Revised data from the central bank show that the current account deficit in 2010 corresponded to 1.3% of GDP. This is less than the 1.5% estimated previously and a sharp reduction from the recent peak of 9.2% in 2008. However, the decline of the current account deficit was not extended to the first quarter of 2011 when the deficit registered close to €1.5 billion which is 11% more than in the same quarter of 2010. On a rolling four-quarter basis, the current account deficit edged up to 1.4% of GDP. This widening was due to lower exports of goods (-3.4%) and services (-7.7%), higher imports of goods (+1.0%), higher income payments (+8.5%) and lower transfer receipts (-9.2%). Lower service imports (-14.3%) could only provide partial offset. In the capital account, FDI inflows dropped by 77.6% year-on-year to a modest €129 million in the first quarter.

Croatia's total gross external debt at the end of 2010 has been revised up by €0.6 billion to €46.4 billion. Over the first quarter of 2011 it increased further to €47.1 billion which corresponds to 103.5% of GDP. Gross international reserves amounted to €11.4 billion (25.2% of GDP) at the end of May which is unchanged from the end of March, but up from €10.7 billion at the end of 2010. This means that the rise of the external debt in the first quarter has been matched by the rise in international reserves.

Monetary developments

Headline inflation has risen significantly over the past six months and registered 2.5% in May, up from 1.2% last November. The rise was mainly due to the worldwide price increase for agricultural products, energy and raw materials. Higher commodity prices have spilled over into areas like transport services and processed food, pushing up core inflation to close to 2%. Domestic inflationary pressures, however, have remained contained.

Following stagnation in the previous quarter, broad money (M4) declined 1.5% in the first quarter of 2011. In year-on-year terms it was still 3.3% higher at the end of March. Bank lending to the corporate sector continued to advance moderately and was 6.5% higher year-on-year at the end of March. Household loans declined slightly and were 1.1% lower year-on-year at the end of March, excluding exchange

rate effects. The central bank reduced the discount rate from 9% to 7% in June in response to the gradual downward trend in interest rates on the money and credit markets.

The kuna remained broadly stable against the euro in the second quarter. The nominal exchange rate moved between 7.36 and 7.46 kuna per euro and stood at 7.40 at the end of June compared to 7.38 at the end of March. The central bank did not intervene in the foreign exchange market during the quarter.

Financial sector

Liquidity in the domestic financial system remained ample through April and money market interest rates declined slightly to 0.6%. Interest rates of commercial banks held steady at a relatively high level in the first four months of the year. For instance, interest rates on long-term household loans with a currency clause (i.e. indexed to the value of a foreign currency, typically the euro) stood at 8.2% in March. The overall spread between lending and deposit rates remained slightly above 7%. The stock market index fell by 2.6% in the course of the second quarter in tune with the declining trend in major stock markets abroad. However, the index was still up by 20.3% year-on-year at the end of June thanks to the strong rally last winter.

Fiscal developments

Preliminary data from the Ministry of Finance show that the 2010 budget deficit of general government amounted to 4.9% of GDP (ESA95), i.e. below the 5.2% projected last autumn. The lower-than-projected deficit was the result of public investment expenditure remaining significantly below budget appropriations. For 2011, the budgeted deficit of general government is 5.5% of GDP.

The first five months of 2011 saw a decline in central government revenues of 2.5% year-on-year while the budget projects a decline of 0.3% for 2011 as a whole. Total expenditures decreased by 0.9% while the budget projects an increase of 0.3% for the year as whole. The deficit increased by 11.5% in the January-May period against a budgeted increase of 4.5% for the whole year. This comparison suggests that weaker-than-expected growth has kept revenues below budget, while government spending has been kept well within the budgetary limit. On balance, however, the revenue shortfall has outweighed spending discipline in this period.

TABLE

European Commission, ECFIN-D-1



CROATIA

		2006	2007	2008	2009	2010	ECFIN Forecast		Q4 10	Q1 11	Q2 11	Apr 11	May 11	Jun 11
							2011	2012						
1 Real sector														
Industrial outlook ^{1.1}	Balance	N.A.	70.9	38.0	-33.3	3.0	:	:	16.0	15.0	-8.0	N.A.	N.A.	N.A.
Industrial production ^{1.2}	Ann. % ch	4.5	5.6	1.6	-9.0	-1.4	:	:	-1.6	-4.9	:	2.7	-0.4	:
Gross domestic product ^{1.3}	Ann. % ch	4.9	5.1	2.2	-6.0	-1.2	1.1	2.0	-0.6	-0.8	:	N.A.	N.A.	N.A.
Private consumption ^{1.4}	Ann. % ch	3.2	6.3	0.8	-8.5	-0.9	0.8	1.2	1.2	-0.1	:	N.A.	N.A.	N.A.
Gross fixed capital formation ^{1.5}	Ann. % ch	11.1	7.1	8.2	-11.8	-11.3	-0.5	5.0	-8.0	-6.7	:	N.A.	N.A.	N.A.
Construction index ^{1.6}	Ann. % ch	N.A.	N.A.	11.8	-6.5	-15.9	:	:	-12.8	-8.5	:	-15.3	:	:
Retail sales ^{1.7}	Ann. % ch	N.A.	N.A.	N.A.	-15.3	-1.8	:	:	0.9	-0.4	:	3.7	1.0	:
2 Labour market														
Unemployment ^{2.1}	%	N.A.	9.6	8.4	9.1	11.8	11.3	9.8	12.1	14.3	:	N.A.	N.A.	N.A.
Employment ^{2.2}	Ann. % ch	N.A.	1.8	1.3	-1.9	-4.0	-0.2	1.2	-4.1	-5.6	:	N.A.	N.A.	N.A.
Wages ^{2.3}	Ann. % ch	6.2	6.2	7.1	2.2	-0.4	0.3	0.3	0.5	0.5	:	1.9	:	:
3 External sector														
Exports of goods ^{3.1}	Ann. % ch	16.1	8.8	5.1	-20.2	17.3	:	:	27.4	4.6	:	39.2	-15.8	:
Imports of goods ^{3.2}	Ann. % ch	12.9	11.0	8.9	-25.6	-1.1	:	:	5.4	5.0	:	4.3	5.4	:
Trade balance ^{3.3}	% of GDP	-21.0	-21.7	-22.6	-16.2	-12.9	-14.0	-14.3	-12.9	:	:	N.A.	N.A.	N.A.
Exports goods and services ^{3.4}	% of GDP	42.7	42.1	41.7	35.4	38.3	:	:	38.3	38.0	:	N.A.	N.A.	N.A.
Imports goods and services ^{3.5}	% of GDP	49.8	49.8	49.9	39.4	38.8	:	:	38.8	38.7	:	N.A.	N.A.	N.A.
Current account balance ^{3.6}	% of GDP	-6.7	-7.2	-8.9	-5.3	-1.3	-2.2	-2.5	-1.3	-1.4	:	N.A.	N.A.	N.A.
Direct investment (FDI, net) ^{3.7}	% of GDP	6.4	8.0	6.7	2.7	1.3	:	:	1.3	:	:	N.A.	N.A.	N.A.
International reserves ^{3.8}	mio EUR	8 725.3	9 307.4	9 120.9	10 375.8	10 660.3	:	:	10 660.3	11 423.8	:	11 336.3	:	:
Int. reserves / months imp ^{3.9}	Ratio	6.1	5.9	5.3	8.2	8.5	:	:	8.5	9.0	:	8.9	:	:
4 Monetary Developments														
CPI ^{4.1}	Ann. % ch	3.2	2.9	6.1	2.4	1.0	2.8	2.5	1.5	2.2	:	2.4	2.5	:
Producer prices ^{4.2}	Ann. % ch	:	:	:	-0.4	4.3	:	:	5.1	7.6	:	8.1	7.3	:
Food prices ^{4.3}	Ann. % ch	2.5	3.4	10.0	1.7	-1.5	:	:	0.4	3.4	:	3.3	4.2	:
M4 ^{4.4}	Ann. % ch	14.3	17.9	10.9	1.6	2.7	:	:	4.5	3.6	:	3.1	3.6	:
Exchange rate HRK/EUR ^{4.5}	Value	7.30	7.33	7.22	7.34	7.29	:	:	7.36	7.40	7.39	7.36	7.40	7.41
Nominal eff. exchange rate ^{4.6}	Index	98.7	98.0	96.1	97.2	98.2	:	:	99.37	100.09	:	98.78	:	:
5 Financial indicators														
Interest rate (3 months) ^{5.1}	% p.a.	4.46	5.66	7.19	8.96	2.44	:	:	2.61	2.63	1.66	1.91	1.58	1.50
Bond yield ^{5.2}	% p.a.	N.A.	N.A.	5.9	6.4	5.8	:	:	5.9	5.9	5.3	5.6	5.3	5.0
Stock markets ^{5.3}	Index	2 771	4 673	3 299	1 871	1 990	:	:	1 922	2 275	2 248	2 234	2 279	2 231
Credit growth ^{5.4}	Ann. % ch	22.0	19.4	11.6	5.0	2.9	:	:	6.4	6.0	:	6.6	7.7	:
Deposit growth ^{5.5}	Ann. % ch	51.6	27.2	7.4	-15.2	-19.8	:	:	-13.4	-1.4	:	4.7	6.1	:
Non performing loans ^{5.6}	% of total	N.A.	N.A.	N.A.	N.A.	N.A.	:	:	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
6 Fiscal developments														
General government balance ^{6.1}	% of GDP	-3.0	-2.5	-1.4	-4.1	-5.2f	-6.0	-5.0	:	:	:	N.A.	N.A.	N.A.
General government debt ^{6.2}	% of GDP	35.5	32.9	28.9	35.3	0.0	45.2	48.4	:	:	:	N.A.	N.A.	N.A.

f: ECFIN forecast Spring 2011

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