



CROATIAN NATIONAL BANK

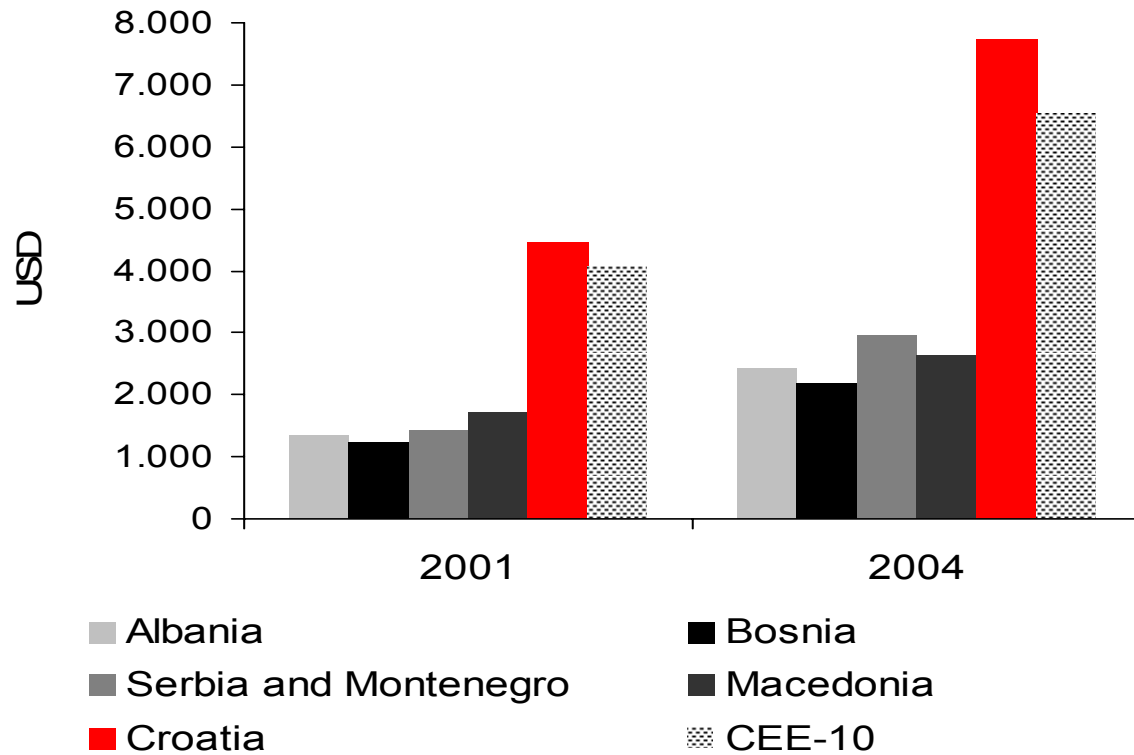
SEE – Where is it, and where does it
go from here?

Boris Vujčić

Overview

- Main economic indicators
- Currency substitution and the choice of monetary policy
- Credit growth – too rapid?
- Current account deficits – too high? Trade too low?
- Accession prospects

GDP per capita



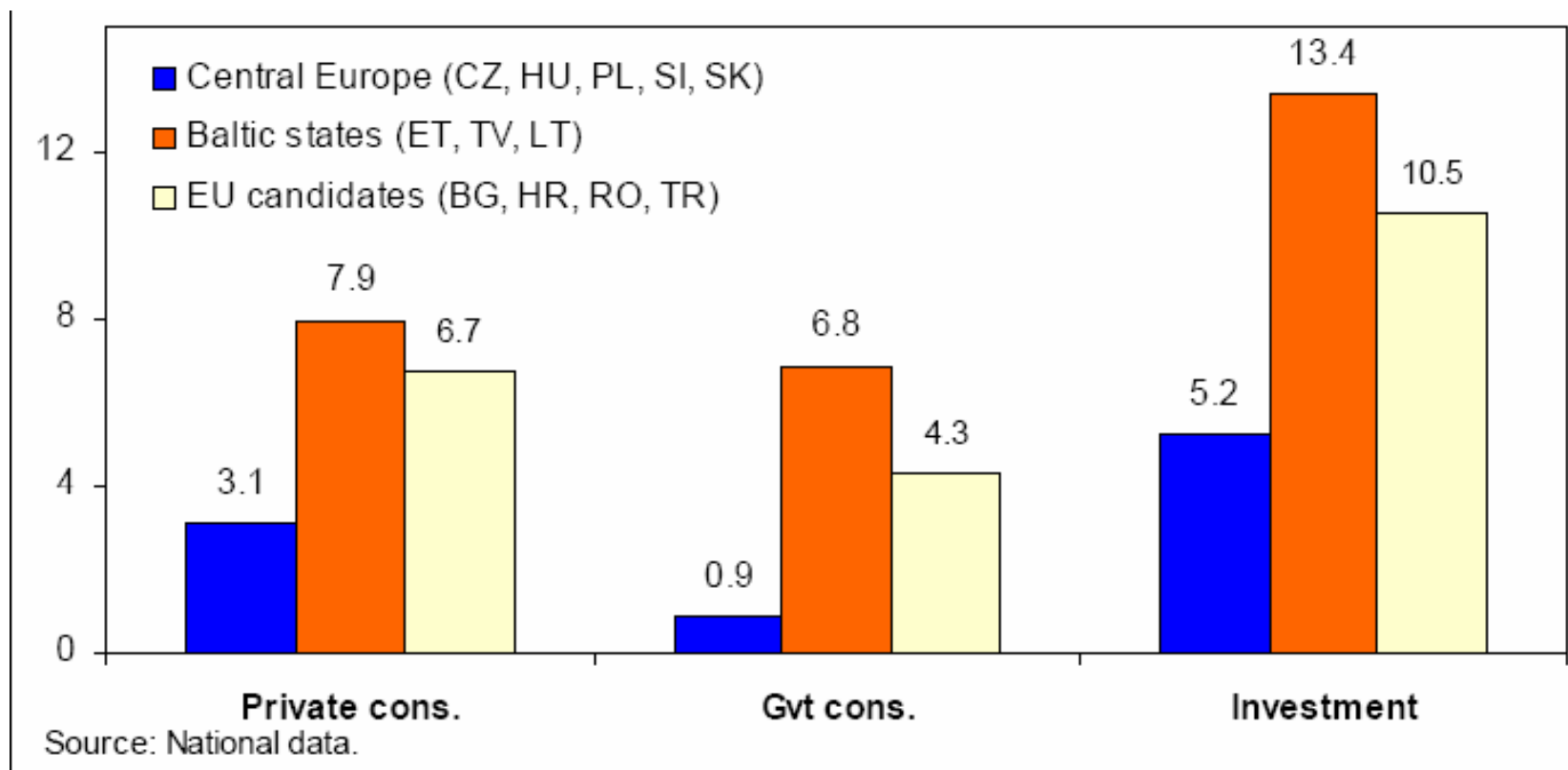
Source: World Bank

Developments in real GDP growth

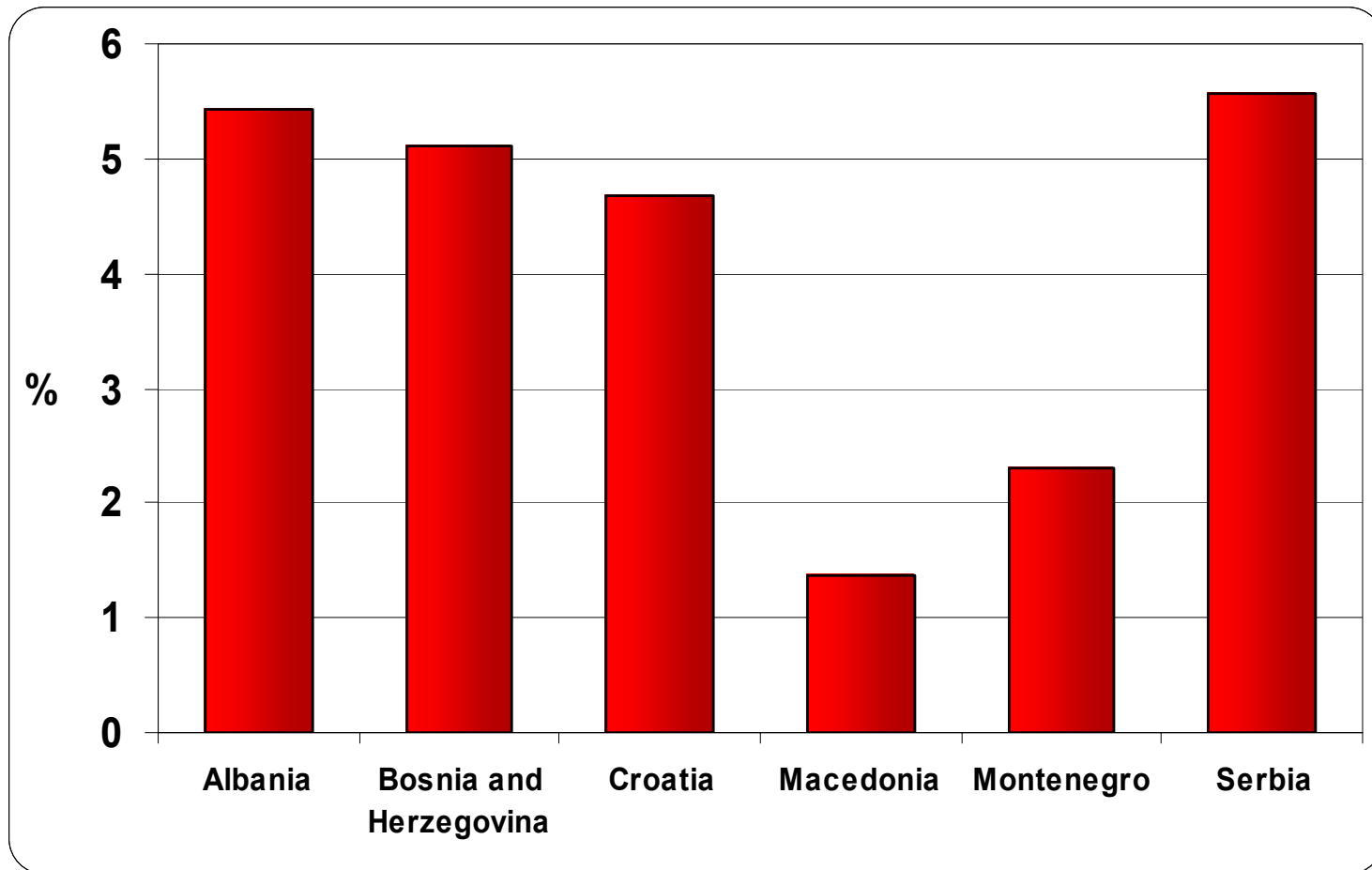
	2003	2004	2005				2006 ²
			Q1	Q2	Q3	Q1-Q4 ²	
Czech Republic	3.2	4.4	5.3	5.8	6.0	6.0	5.1
Hungary	2.9	4.2	4.4	4.3	4.4	4.1	4.3
Poland	3.8	5.3	2.6	2.1	2.7	3.2	4.5
Slovakia	2.7	5.5	5.1	5.1	6.2	6.0	6.1
Slovenia	4.5	4.6	2.9	4.9	4.0	3.9	3.8
Estonia	6.7	7.8	7.0	10.2	10.4	9.8	7.4
Latvia	7.2	8.5	7.3	11.4	11.4	10.2	7.7
Lithuania	10.5	6.7	5.1	7.6	8.3	7.5	6.5
Bulgaria	4.5	5.6	6.0	6.4	4.6	6.0	5.4
Croatia	4.3	3.8	5.1	5.2	4.0	4.3	4.1
Romania	4.9	8.3	5.9	4.1	1.8	5.2	5.0
Turkey	5.8	8.9	4.8	4.2	7.0	5.6	5.0
Albania	6.0	5.9	...	...	...	6.0	6.0
Bosnia-Herzegovina	4.0	5.7	...	...	...	5.4	5.7
Macedonia	2.8	4.1	2.7	4.7	3.9	3.8	4.0
Serbia-Montenegro	2.4	9.3	5.3	6.8	5.6	5.9	4.8
Average³	4.8	6.2	5.0	5.9	5.7	5.8	5.3
New EU members ⁴	5.2	5.9	5.0	6.4	6.7	6.3	5.7
Non-EU countries ⁵	4.3	6.5	5.0	5.2	4.5	5.3	5.0
<i>Memo: Euro area</i>	<i>0.7</i>	<i>2.1</i>	<i>1.2</i>	<i>1.2</i>	<i>1.6</i>	<i>1.3</i>	<i>1.9</i>

Components of domestic demand

Annual growth rates, average for 2004:Q4-2005:Q3



Real GDP growth in SEE average 2001-2005



2005 - preliminary data

Sources: WIIW, CBS

GDP growth rates still below potential

	Potential growth rate	Actual growth rate 2000-04
Estonia	7.2	6.5
Latvia	8.1	7.4
Lithuania	6.5	6.7
Bulgaria	4.9	4.9
Croatia	4.9	4.1
Romania	5.3	5.3
Turkey	6.7	4.3
Albania	6.2	6.0
Bosnia and Herzegovina	5.4	4.9
Macedonia	3.4	1.3
Serbia and Montenegro	4.7	4.8

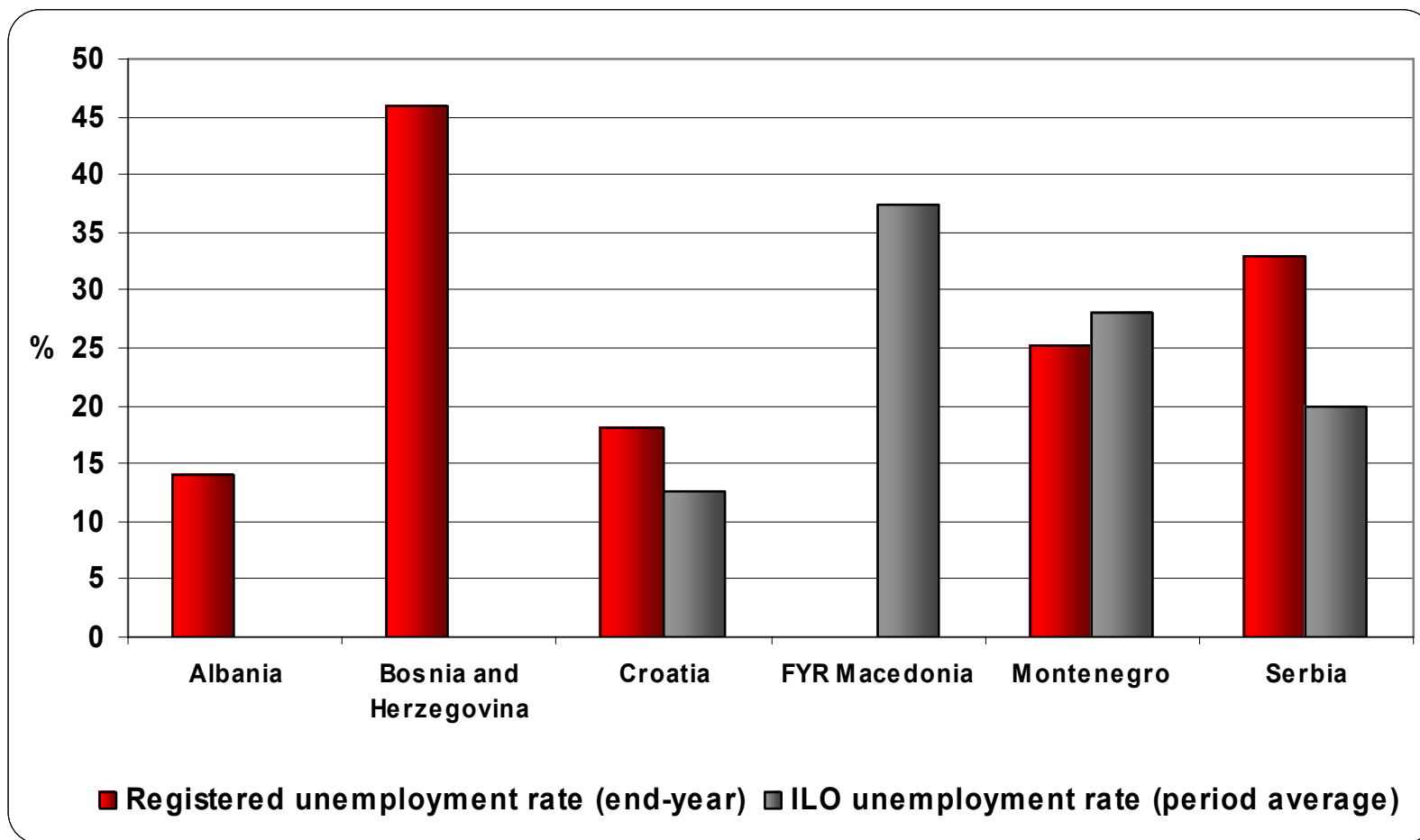
Labour market developments, 2003–05

	Employment ¹			Unemployment rate ²		
	2003	2004	2005	2003	2004	2005
Czech Republic	-1.4	0.1	0.5	7.8	8.3	7.9
Hungary	1.3	-0.7	0.4	5.8	6.0	7.0
Poland	-1.2	0.0	1.0	19.2	18.8	17.8
Slovakia	1.8	-0.3	1.8	17.5	18.2	16.7
Slovenia	-0.2	0.4	0.3	6.5	6.0	5.8
Estonia	1.5	0.0	0.4	10.0	9.7	7.8
Latvia	1.7	1.1	0.9	10.4	9.8	9.7
Lithuania	2.3	-0.1	1.6	12.7	10.9	9.0
Bulgaria	6.3	3.1	1.8	13.6	11.9	10.7
Croatia	2.5	1.6	0.9	14.1	13.8	13.3
Romania	-0.1	0.4	1.6	6.8	7.1	6.5
Turkey	-1.0	3.0	1.2	10.5	10.3	10.3
Albania	0.9	-0.4	0.8	15.2	14.7	14.3
Bosnia-Herzegovina	-0.1	0.3	0.4	41.5	42.6	43.7
Macedonia	-3.3	-3.4	-3.5	36.7	37.2	35.0
Serbia-Montenegro	-1.2	0.2	0.4	31.8	31.7	32.6
Average³	0.6	0.3	0.7	16.3	16.1	15.5

¹ Annual changes, in per cent. ² ILO definition, with the exception of Bosnia and Herzegovina, Macedonia and Serbia and Montenegro (registered unemployment). ³ Unweighted.

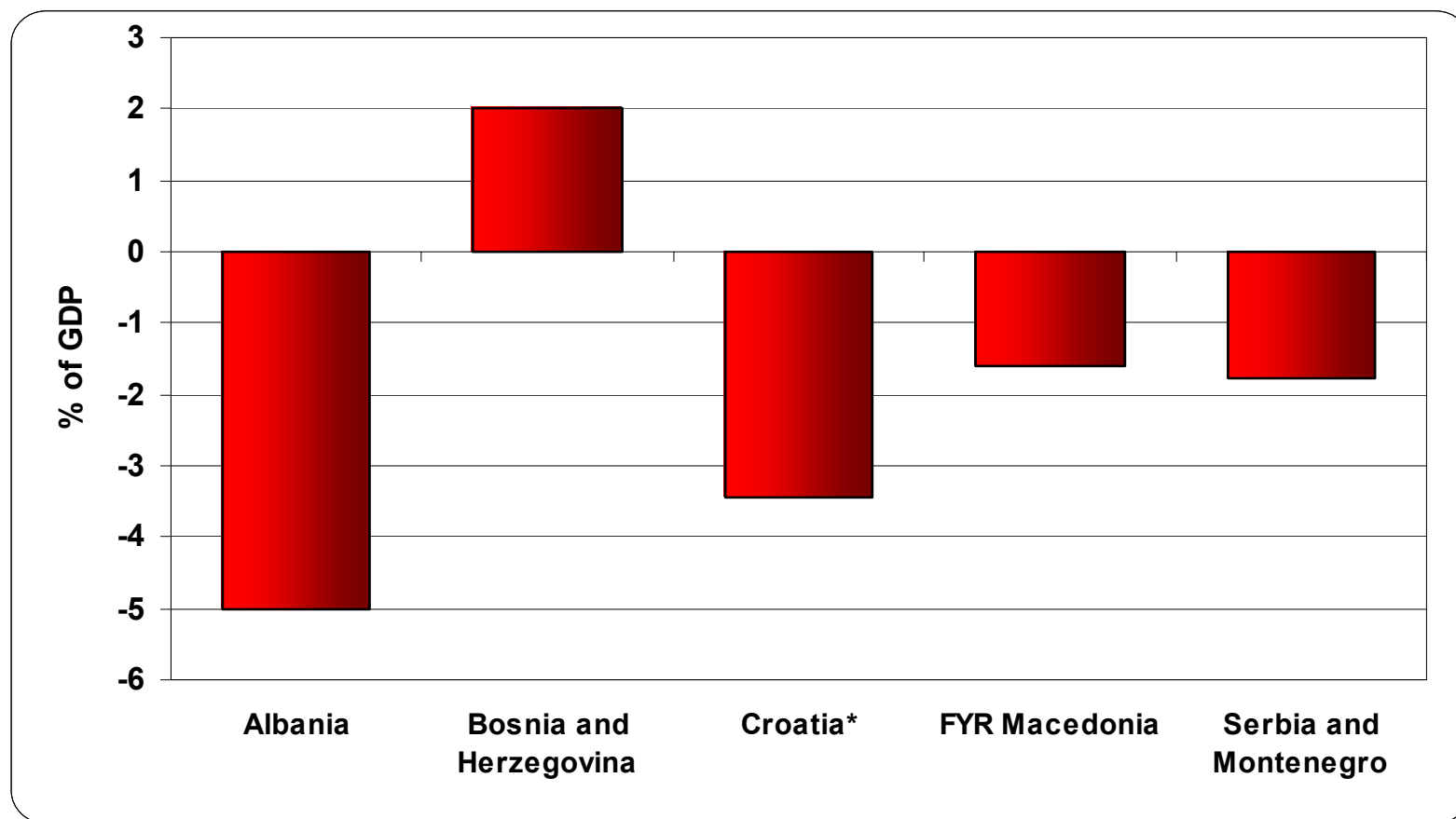
Sources: European Commission, *Economic Forecasts*, Autumn 2005; national data.

Unemployment rates in 2005



Sources: WIIW, CBS

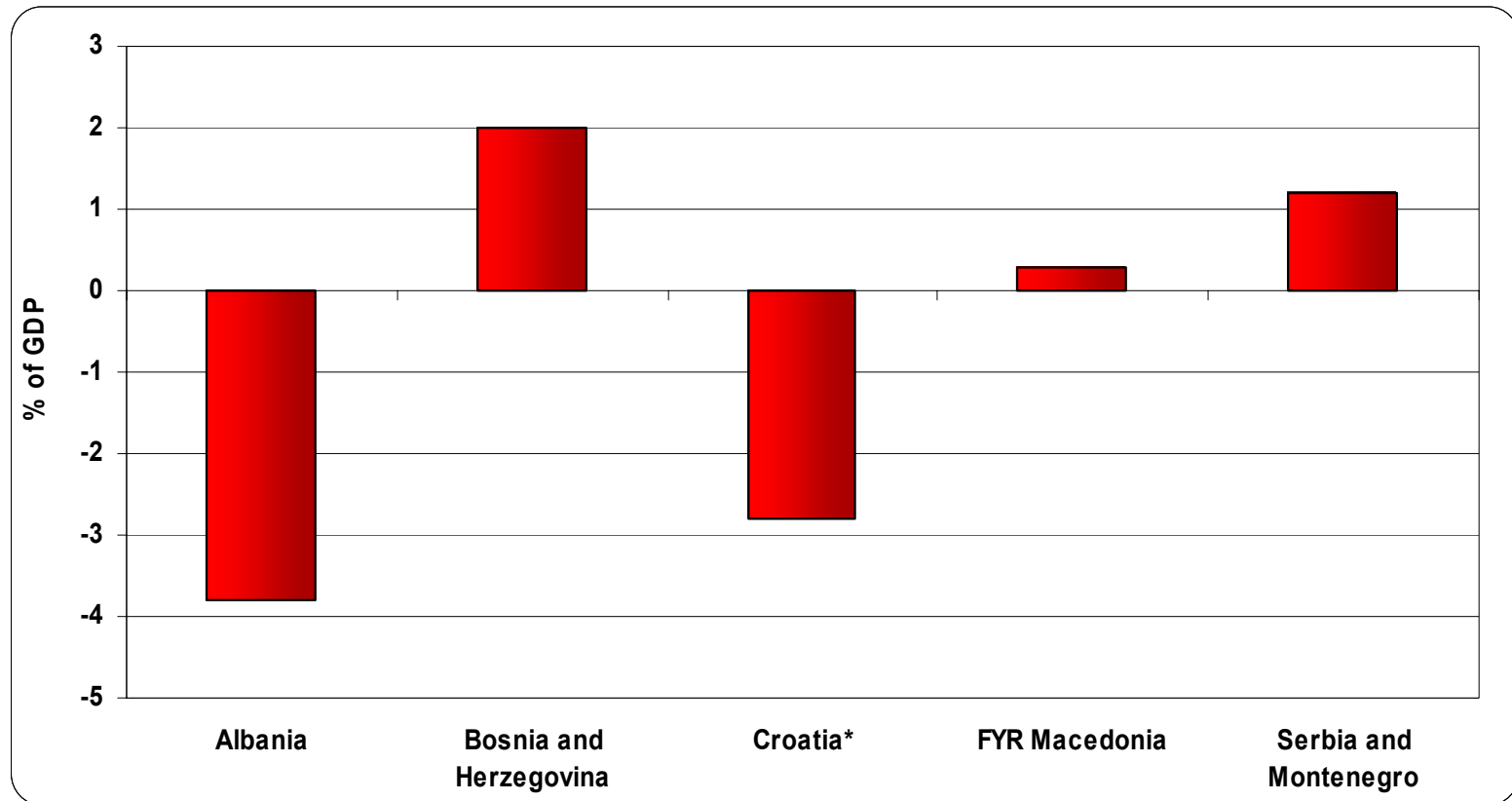
General government balance average 2002-2005



* GFS 2001

Sources: Transition report 2005, EC, MoF

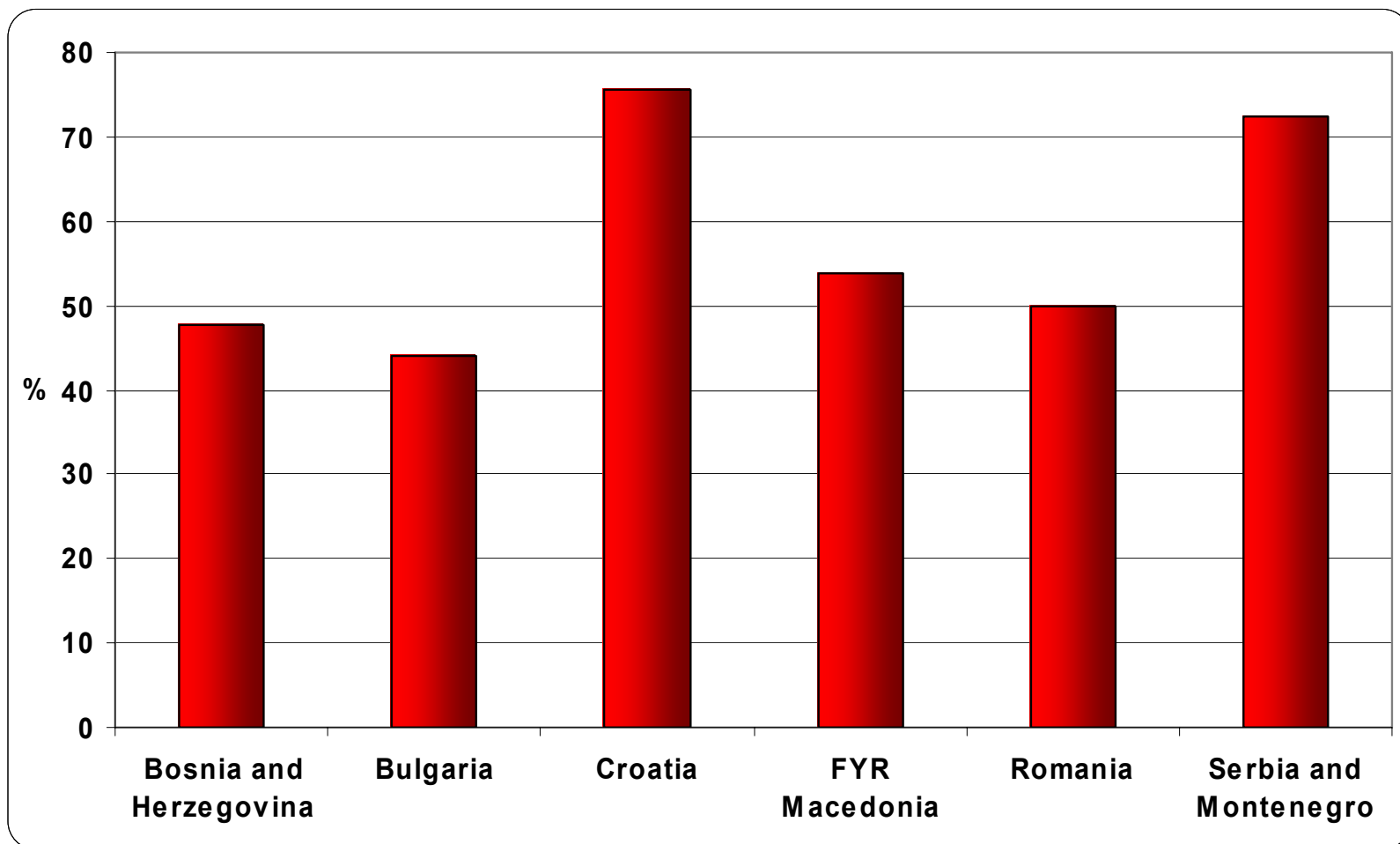
General government balance in 2005



* GFS 2001

Sources: Transition report 2005, EC, MoF

Few degrees of freedom for independent monetary policies: share of f/c deposits in total deposits (2005)

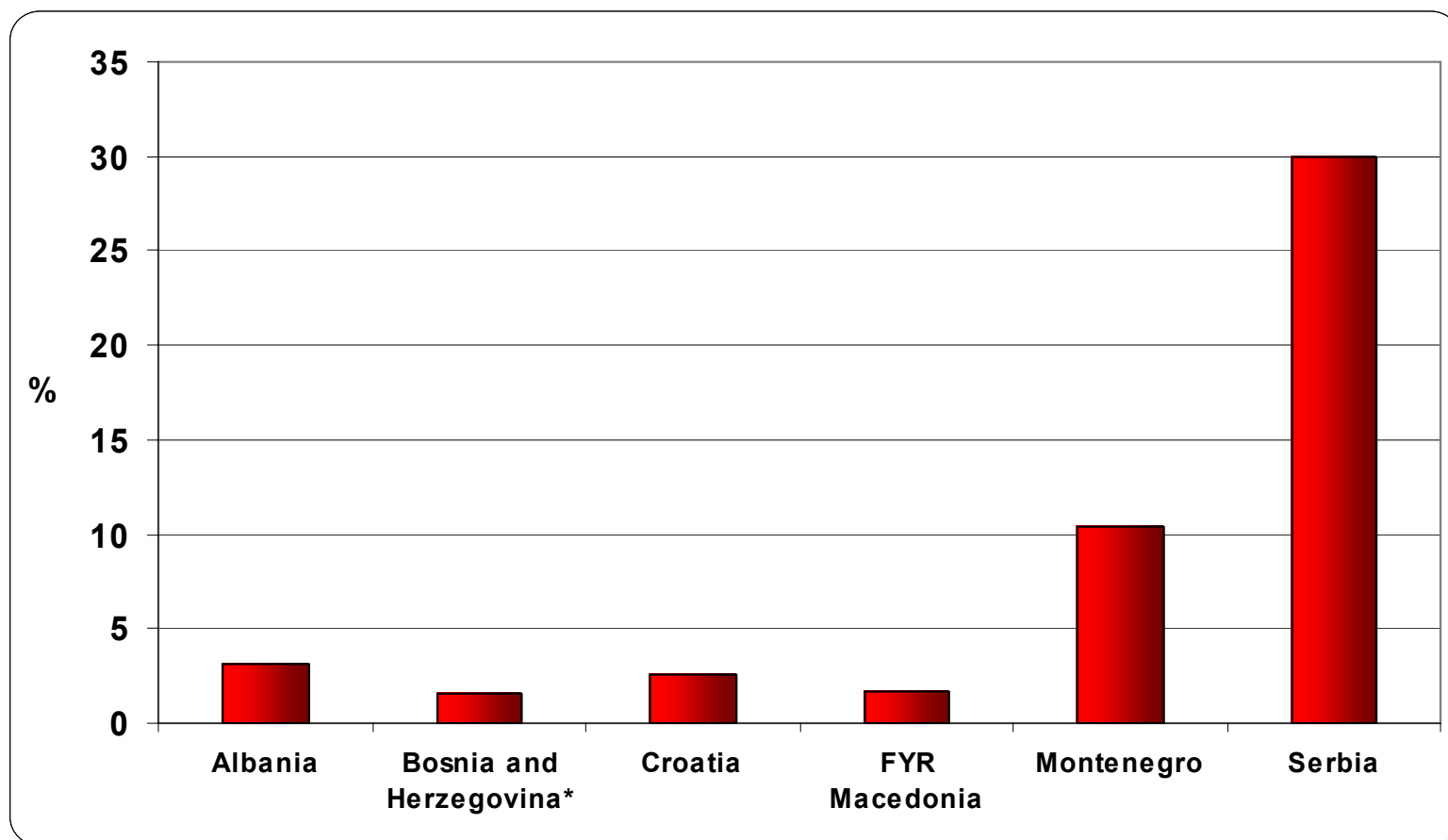


Sources: Central banks' web sites, CNB

Which has a consequence for the choice of the ER (monetary policy) regime

- ❑ Bulgaria – currency board
- ❑ Bosnia and Herzegovina – currency board
- ❑ Croatia – quasi-currency board
- ❑ Macedonia – quasi-currency board
- ❑ Montenegro – full unilateral euroization
- ❑ Romania – inflation targeting
- ❑ Serbia – quasi-currency board (by balance sheet of the CB), but targeting money!?

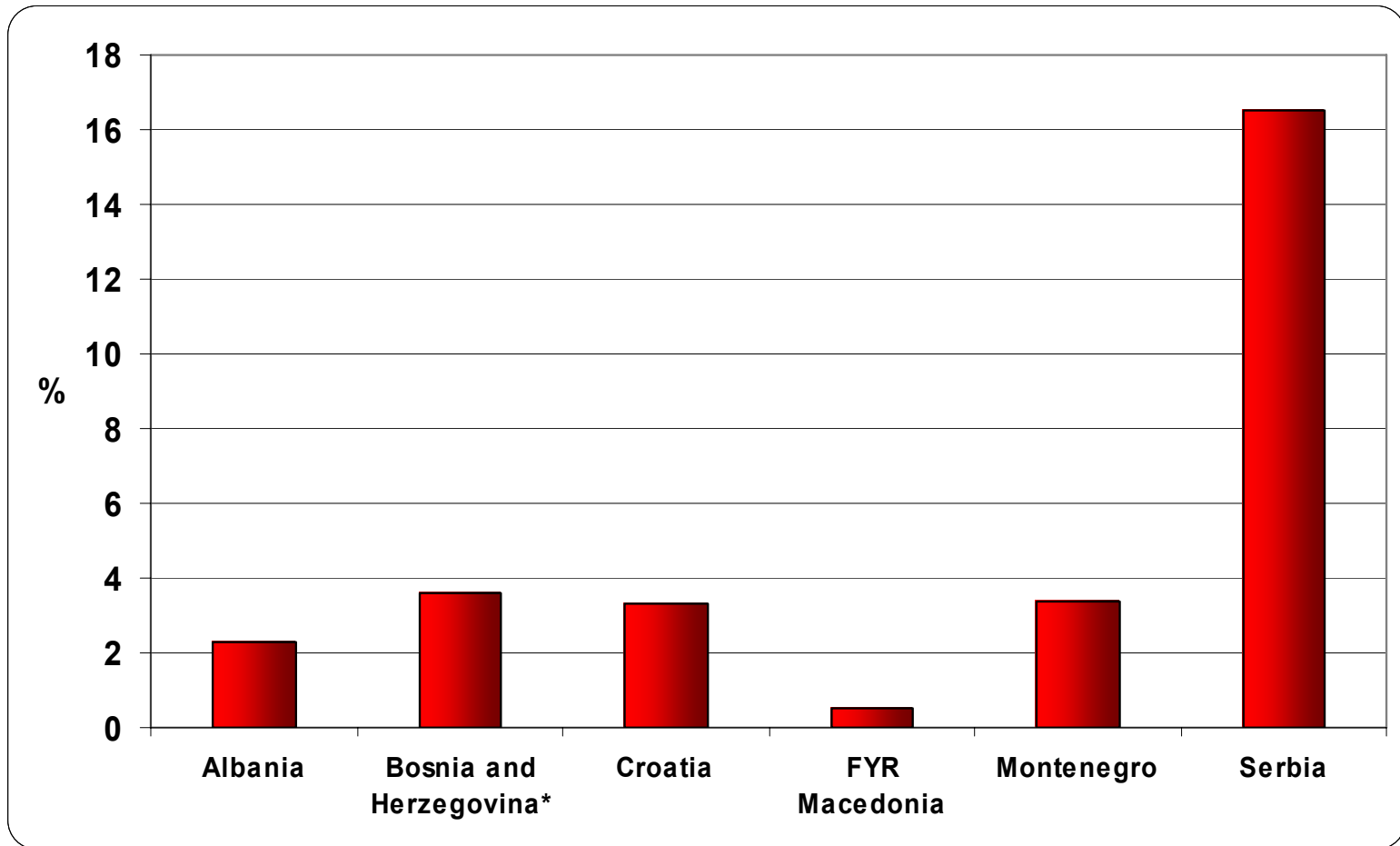
...and results in a good inflation record average 2001-2005



* Preliminary data

Sources: Transition report 2005, Central banks' web sites

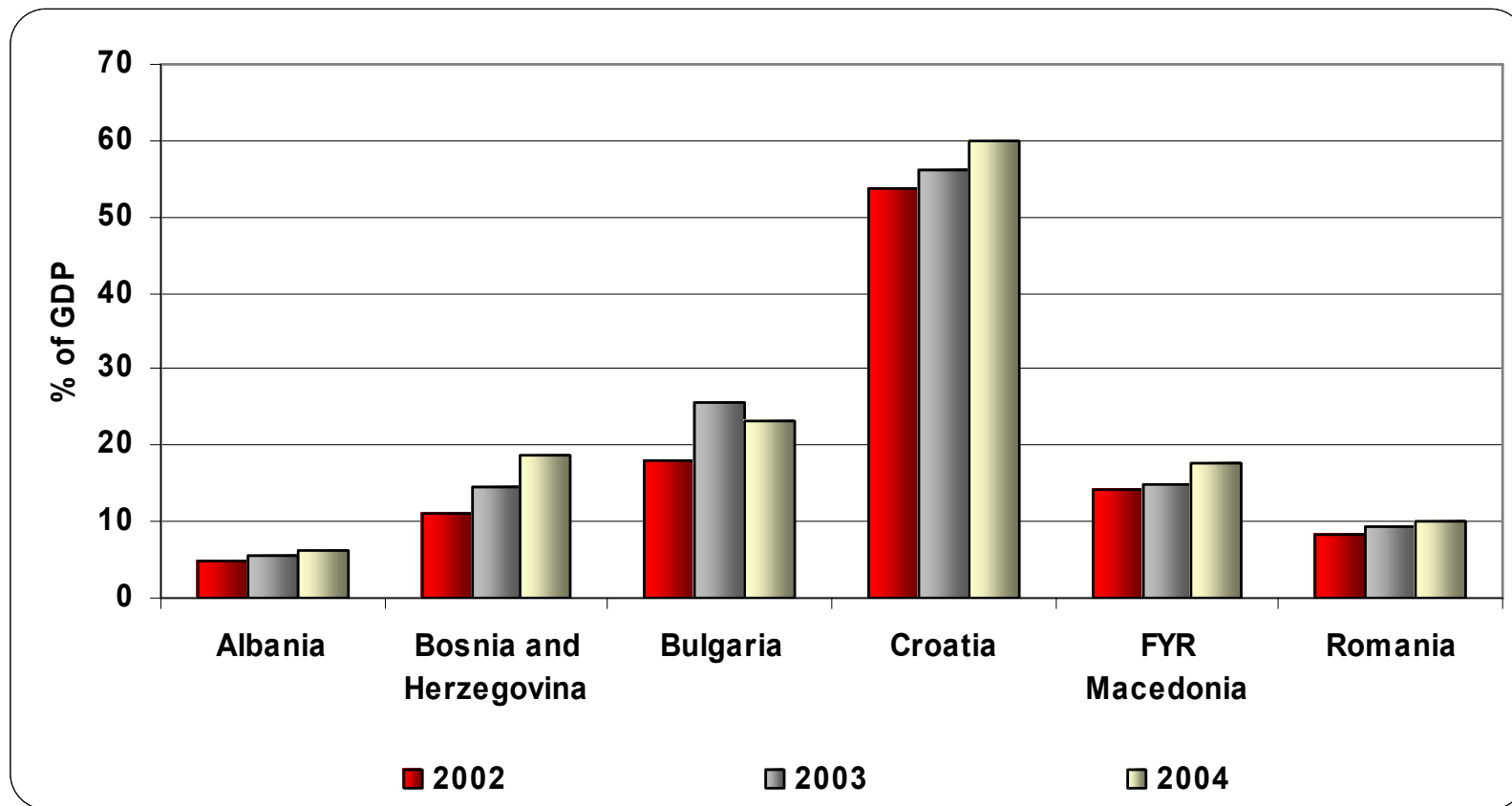
Inflation in 2005 (average)



* Preliminary data

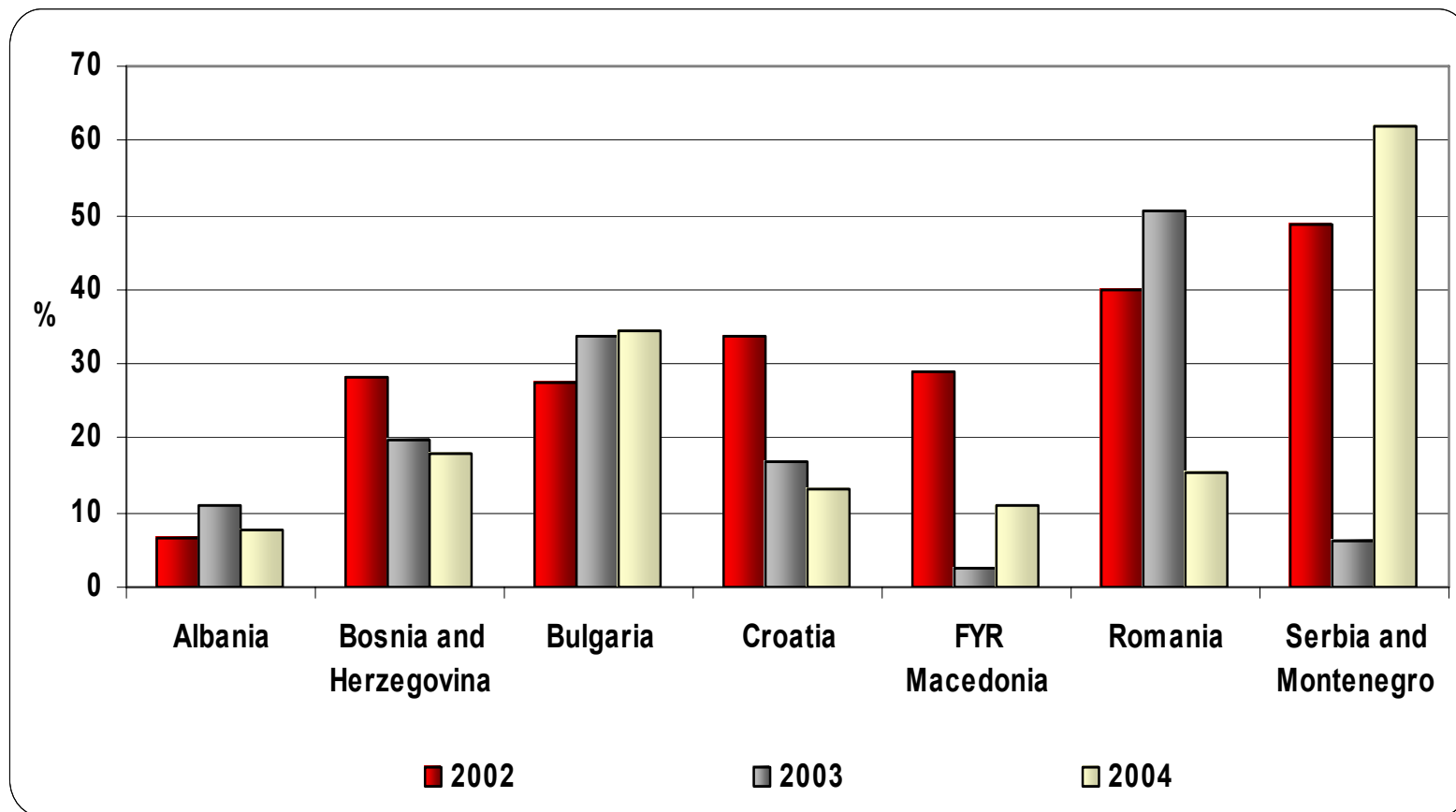
Source: Central banks' web sites

Domestic credit to private sector (% of GDP)



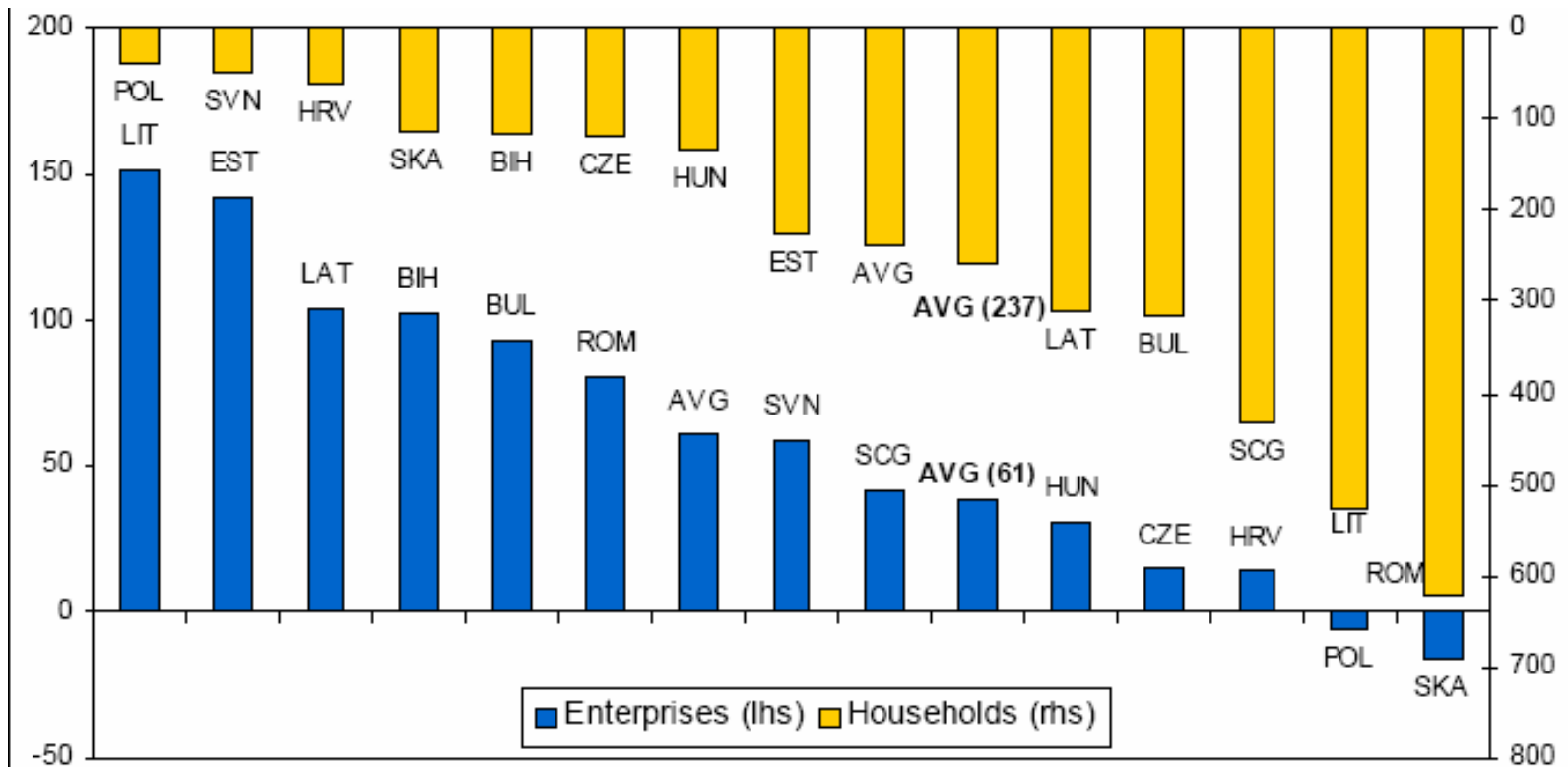
Source: Transition report 2005, CNB

Domestic credit (end-year, % change)



Source: Transition report 2005, CNB

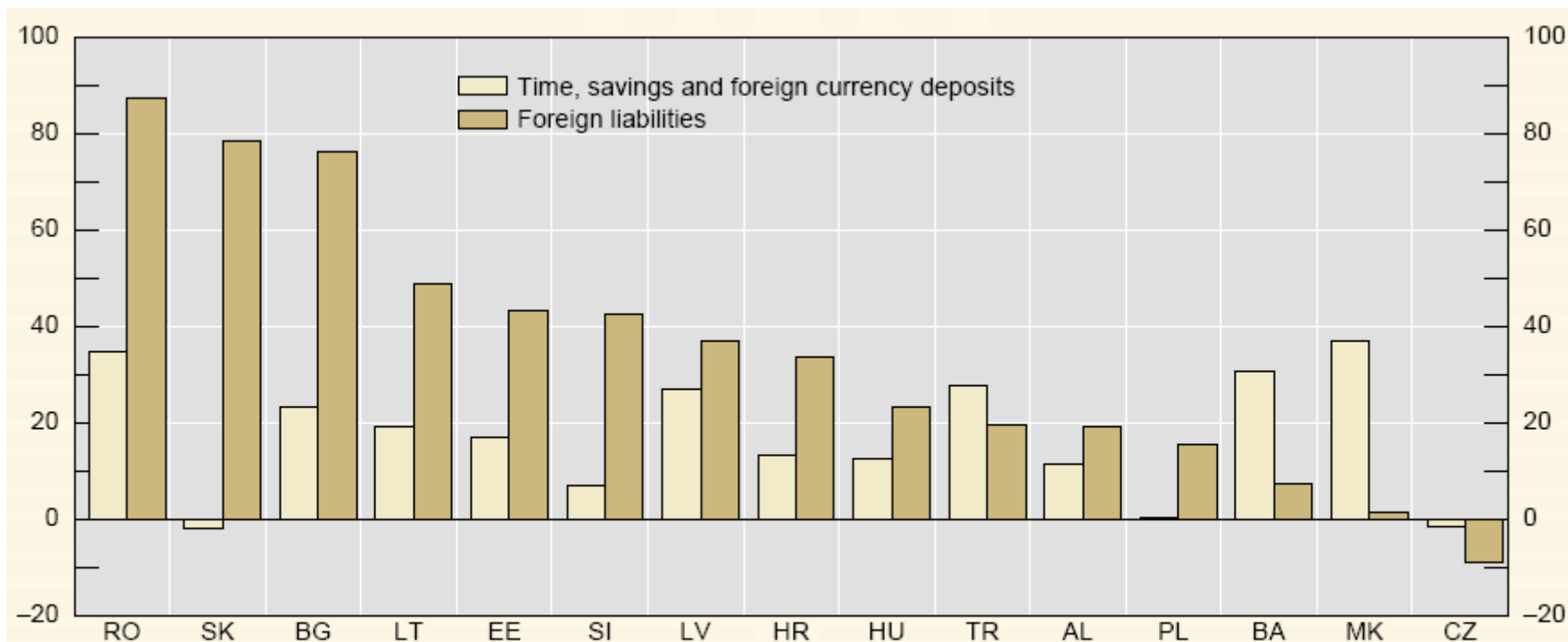
Real credit growth, 2003-05 (cumulative growth rate, in percent)



Source: National data; author's estimates.

Commercial bank liabilities, 2002-05

Annual changes, in per cent, quarterly average



Note: AL = Albania; BA = Bosnia and Herzegovina; BG = Bulgaria; CZ = the Czech Republic; EE = Estonia; HR = Croatia; HU = Hungary; LT = Lithuania; LV = Latvia; MK = Macedonia; PL = Poland; RO = Romania; SI = Slovenia; SK = Slovakia; TR = Turkey.

Sources: IMF; BIS estimates.

Why such a rapid credit growth?

- ❑ GDP and income growth, macro stability
- ❑ Level of intermediation still low except for Croatia where higher than in any of the NMS
- ❑ Initial distortions in composition of banking lending
- ❑ Declining interest rates, narrowing margins due to the competition, foreign entry
- ❑ Built-in exchange rate risk due to high level of currency substitution – high sensitivity to the ER
- ❑ How good are the banks in managing risks? To what extent does foreign ownership help and to what extent does it increase the risk?

External current account balances

	1996–2000	2003	2004	2005 ²	2006 ²
Czech Republic	-4.5	-6.2	-5.2	-2.9	-2.6
Hungary	-8.3	-9.0	-8.8	-8.4	-8.4
Poland	-4.9	-2.1	-4.2	-1.6	-3.5
Slovakia	-6.6	-0.9	-3.4	-6.6	-6.2
Slovenia	-1.2	-0.4	-2.0	-1.6	-1.8
Estonia	-7.8	-12.2	-12.7	-9.9	-7.7
Latvia	-6.8	-8.2	-12.6	-11.1	-10.5
Lithuania	-9.5	-6.9	-8.0	-7.4	-7.1
Bulgaria	1.3	-9.3	-8.5	-14.9	-12.9
Croatia	-6.7	-6.3	-5.2	-6.0	-5.9
Romania	-5.6	-6.0	-8.7	-9.4	-8.1
Turkey	-1.5	-3.3	-5.2	-5.6	-5.3
Albania	-5.4	-6.4	-4.4	-5.6	-5.6
Bosnia-Herzegovina	-12.1 ³	-28.8	-25.6	-24.1	-22.6
Macedonia	-5.4	-6.0	-8.2	-6.5	-5.2
Serbia-Montenegro	-5.4 ³	-8.1	-12.6	-8.5	-9.5
Average⁴	-5.7	-7.5	-8.5	-8.1	-7.7

¹ As a percentage of GDP. ² Estimates and forecasts. ³ 1998–2000. ⁴ Simple average.

Sources: European Commission, *Economic Forecasts*, Autumn 2005; IMF, *World Economic Outlook*.

In most SEE countries, CA deficits can be explained by increased investment

Changes in balance of payments, investment and saving, 2002–04¹

	Current account balance	Investment²	Domestic saving³		<i>Real effective exchange rate⁴</i>
Bulgaria	-0.2	2.8	2.6	(-0.1)	114.9
Croatia	-1.1	1.9	0.8	(1.6)	104.9
Romania	-1.0	0.7	-0.3	(2.1)	109.8
Turkey	-7.5	8.9	1.4	(25.9)	124.5
Albania	-1.7	-3.8	-5.5	(3.0)	95.2
Bosnia-Herzegovina	-0.7	1.5	0.8	(3.8)	90.6
Macedonia	-2.6	7.2	4.6	(7.0)	99.1
Serbia-Montenegro	-8.5	4.0	-4.5	(1.1)	117.7
Average	-2.9	2.9	0.0	(5.6)	108.9

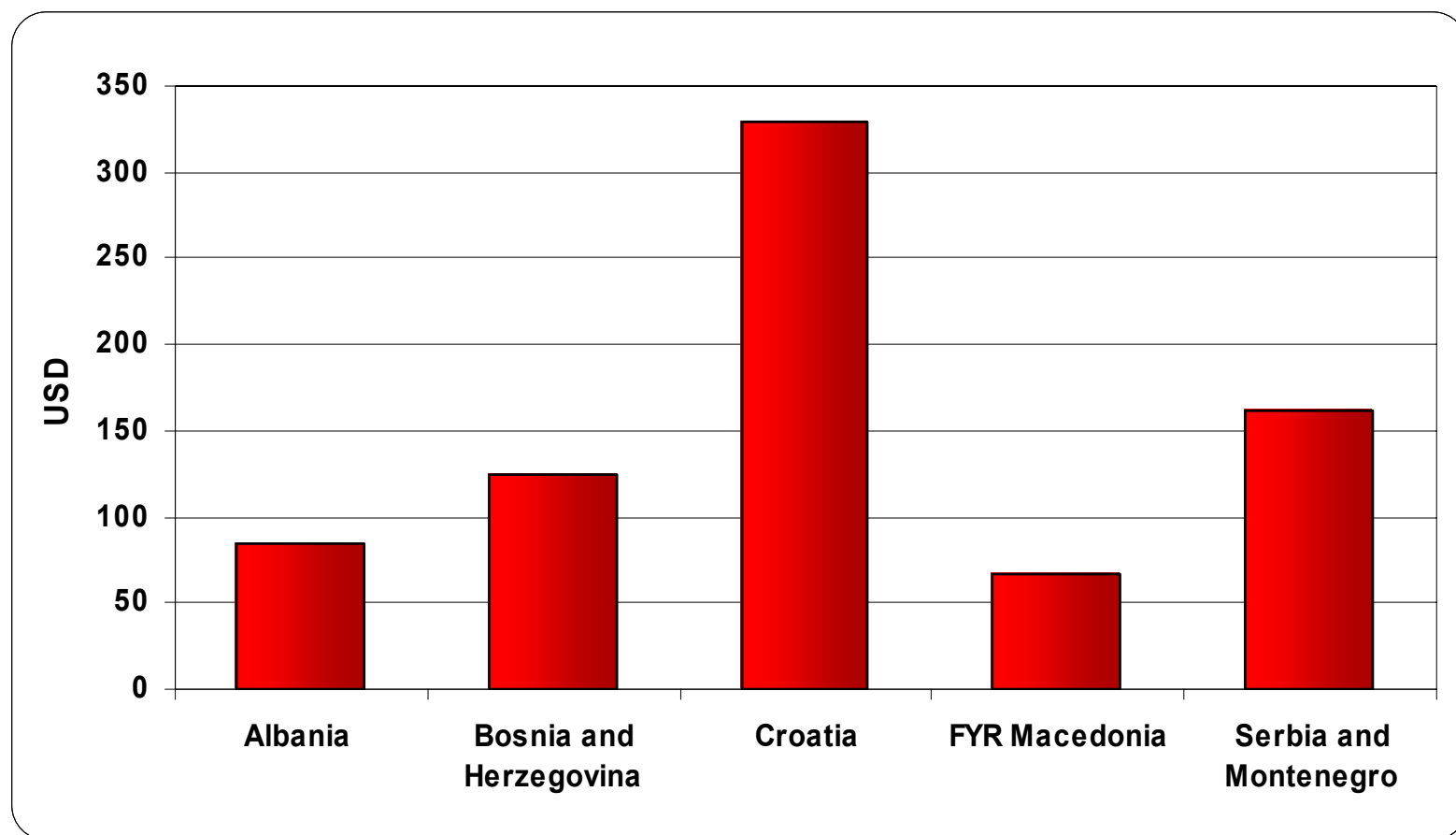
¹ In percentage points of GDP, except real effective exchange rate. ² Including changes in inventories.

³ Numbers in parentheses are changes in government budget balances on a general or central government basis; positive numbers indicate a decrease in the deficit. ⁴ For 2004; in terms of relative consumer prices; 2001 = 100. End of period except for Bosnia-Herzegovina and Macedonia (average of period).

⁵ Average for all the countries except the Czech Republic and Slovakia. ⁶ Average for the Czech Republic and Slovakia.

Sources: IMF, *International Financial Statistics*; IMF country reports; Eurostat; national data.

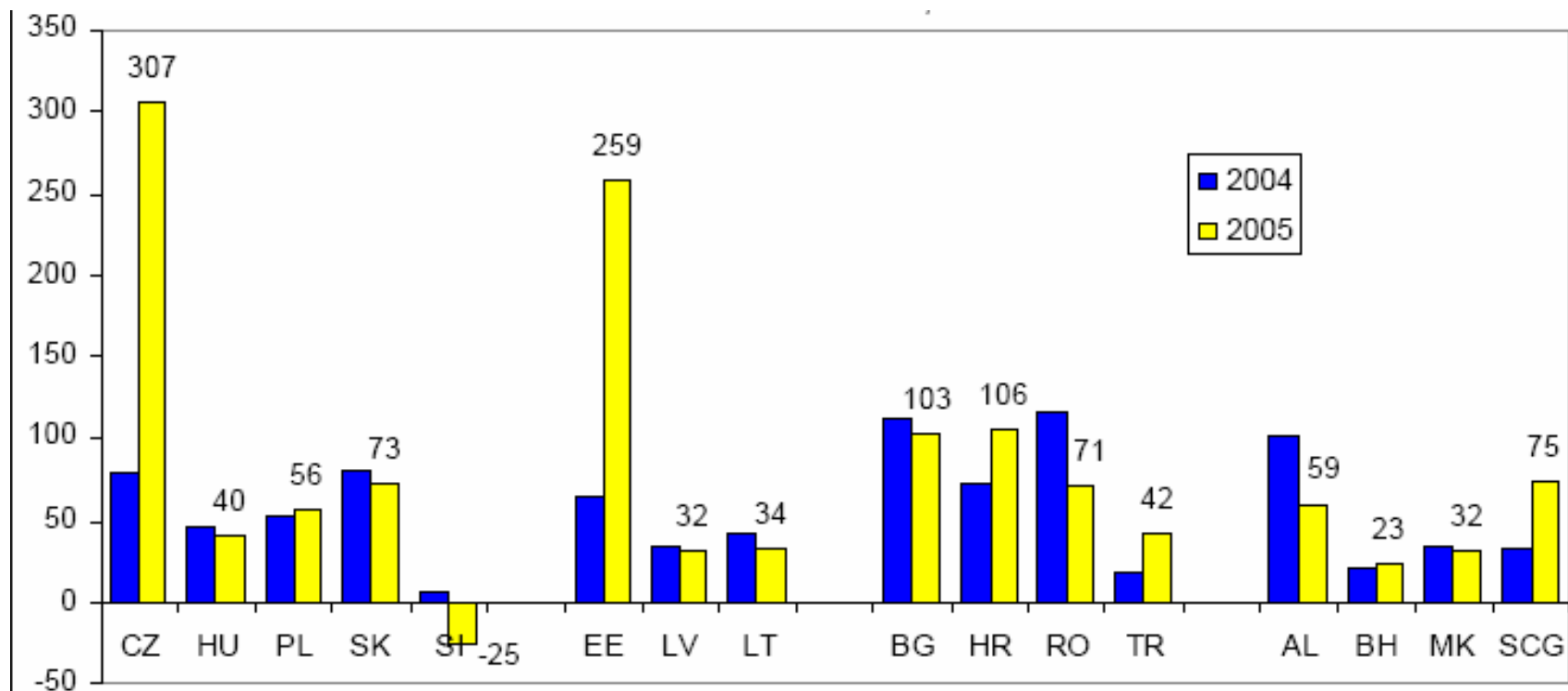
Foreign direct investment, net per capita, average 2003-2005



Sources: Transition report 2005, CNB

FDI inflows and current account deficits

Ratio of FDI to CA deficit, in %



Sources: Eurostat; UN ECE; IMF.

So, should we worry about the current account deficits?

- Need for CA deficits at this stage of development because of the relatively low level of income and need for investment
- Fiscal deficits are not the main drivers of CA deficits
- However, the sustainability depends on many things:
 - on the unwinding of credit growth – will it be self correcting?
 - on the quality/prudence of financial intermediation
 - on the FDI inflows
 - and the overall economic environment
- Where does the money go to, and what can be done with it, can be very country specific?
- Encouraging evidence of quick CA deficit reversals without major growth slowdowns

Trade concentration ratios for the former Yugoslavia republics

Trade concentration ratios	1993	1994	1995	1997	1999
SEE-5	34,5	41,3	43,9	47,9	50,0
APEC		1,6			
ASEAN-6		3,6			
EU-15		1,6			
EU-12		2,1			
Mercusor		12,8			
Andean Community		12,6			

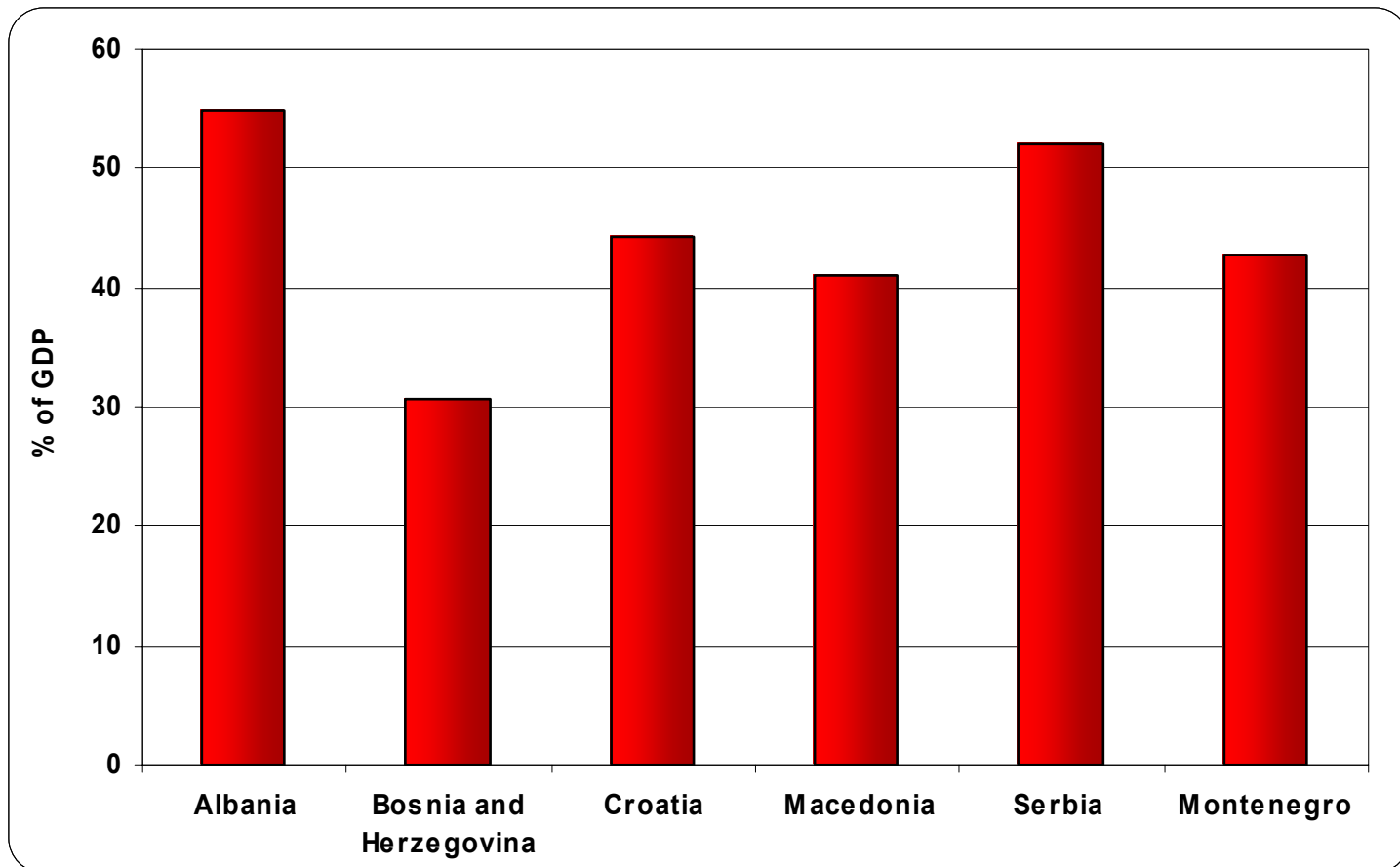
Trade Agreements in Central and East Europe

	WTO	CEFTA	Bilateral agreement with EFTA	Other bilateral agreements	EU Association Agreement
Bulgaria	December 1996	January 1999	July 1993	Czech R, Slovak R, Slovenia	February 1995
Croatia	November 2000	December 2002 signed March 2003 in force	June 2001 signed January 2002 in force	Slovenia, Macedonia, Hungary (2001), Slovak R Czech R, Poland, Turkey	November 2001 signed 2002 in force
Czech R.	January 2000	March 1993	Yes	Bulgaria, Romania	February 1995
Estonia	November 1999	No	Yes	Slovak R, Slovenia	February 1998
Hungary	January 1995	March 1993	Yes	Israel Croatia	February 1994
Latvia	February 1999	No	Yes	Slovak R, Slovenia	February 1998
Lithuania	May 2000	No	Yes	Slovenia	February 1994
Poland	July 1995	March 1993	Yes	...	February 1995
Romania	January 1995	July 1997	Yes	Czech R, Slovak R	February 1995
Slovak R.	January 1995	March 1993	Yes	Bulgaria, Estonia, Israel, Romania	February 1995
Slovenia	July 1995	January 1996	Yes	Bulgaria, Croatia, Estonia, Latvia, Lithuania, Macedonia	June 1996 signed

What are the accession prospects and what does the No vote does to these prospects?

- ❑ One can hope that as EU found a way around the Danish rejection in 1992, or Irish in 1993 it will eventually come around this one as well
- ❑ Likely not to have a decisive impact on enlargement, however impact might be stronger further away the country is from membership
- ❑ Romania and Bulgaria risk small – 2007 or 2008
- ❑ Croatia somewhat higher, but relatively small
- ❑ Turkey's path of negotiations might be more affected, as well as timing for other SEE countries
- ❑ The real economic problem for everyone would be possible prolonged paralysis of reform process in Europe

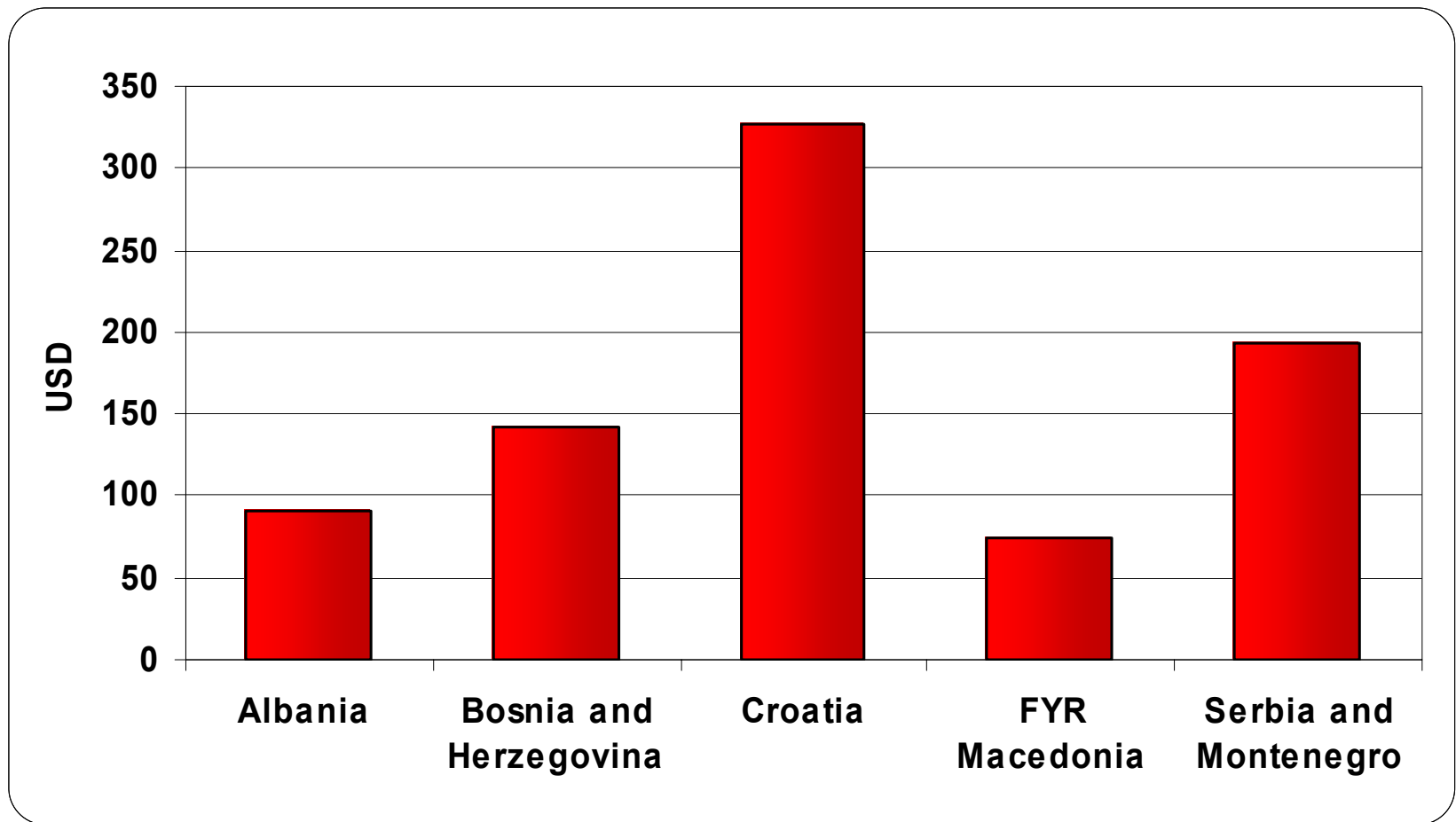
General government debt in 2005



Note: Data for Bosnia and Herzegovina is for 2004.

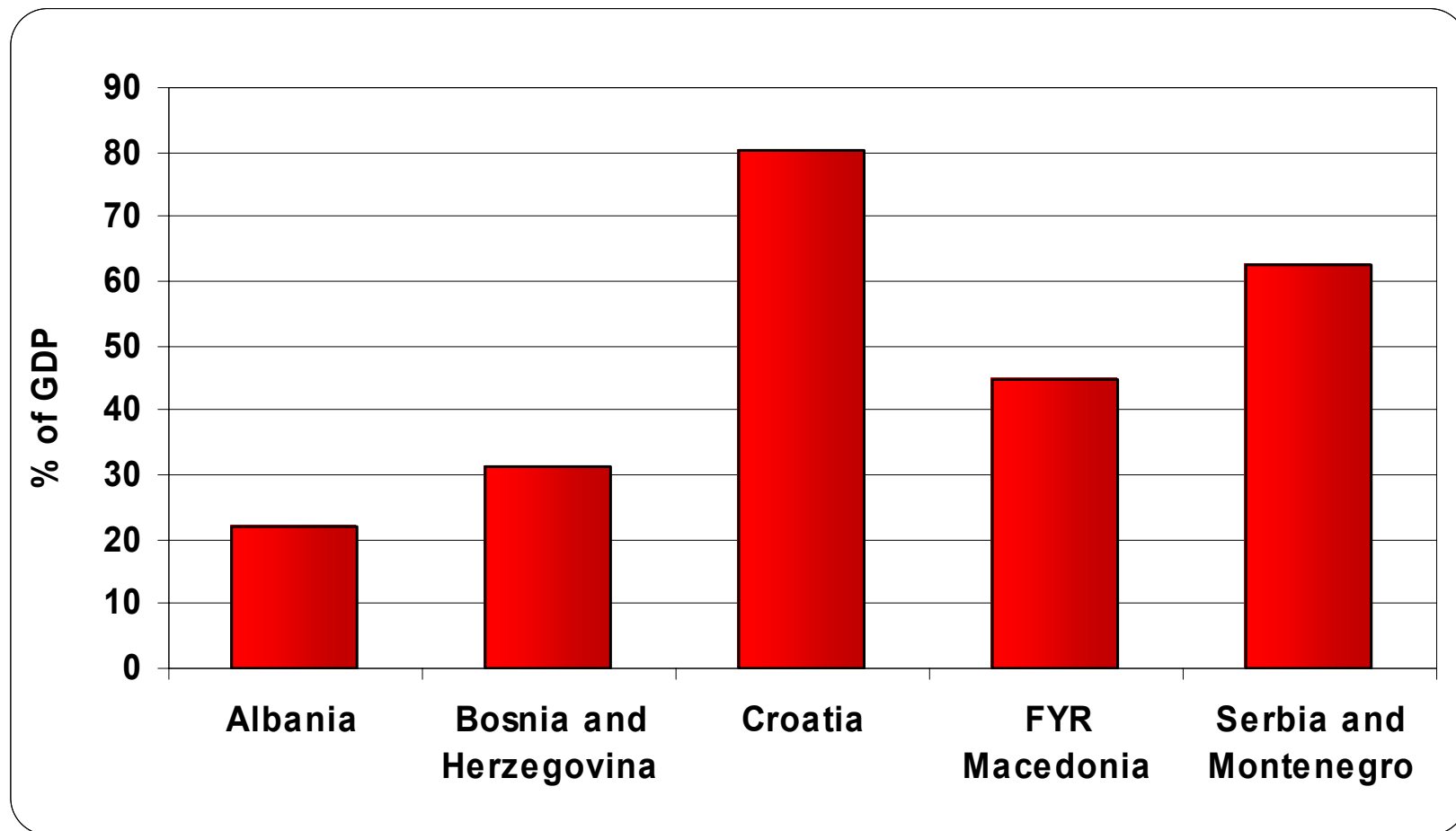
Sources: EC, MoF

Foreign direct investment in 2005, net per capita



Sources: Transition report 2005, CNB

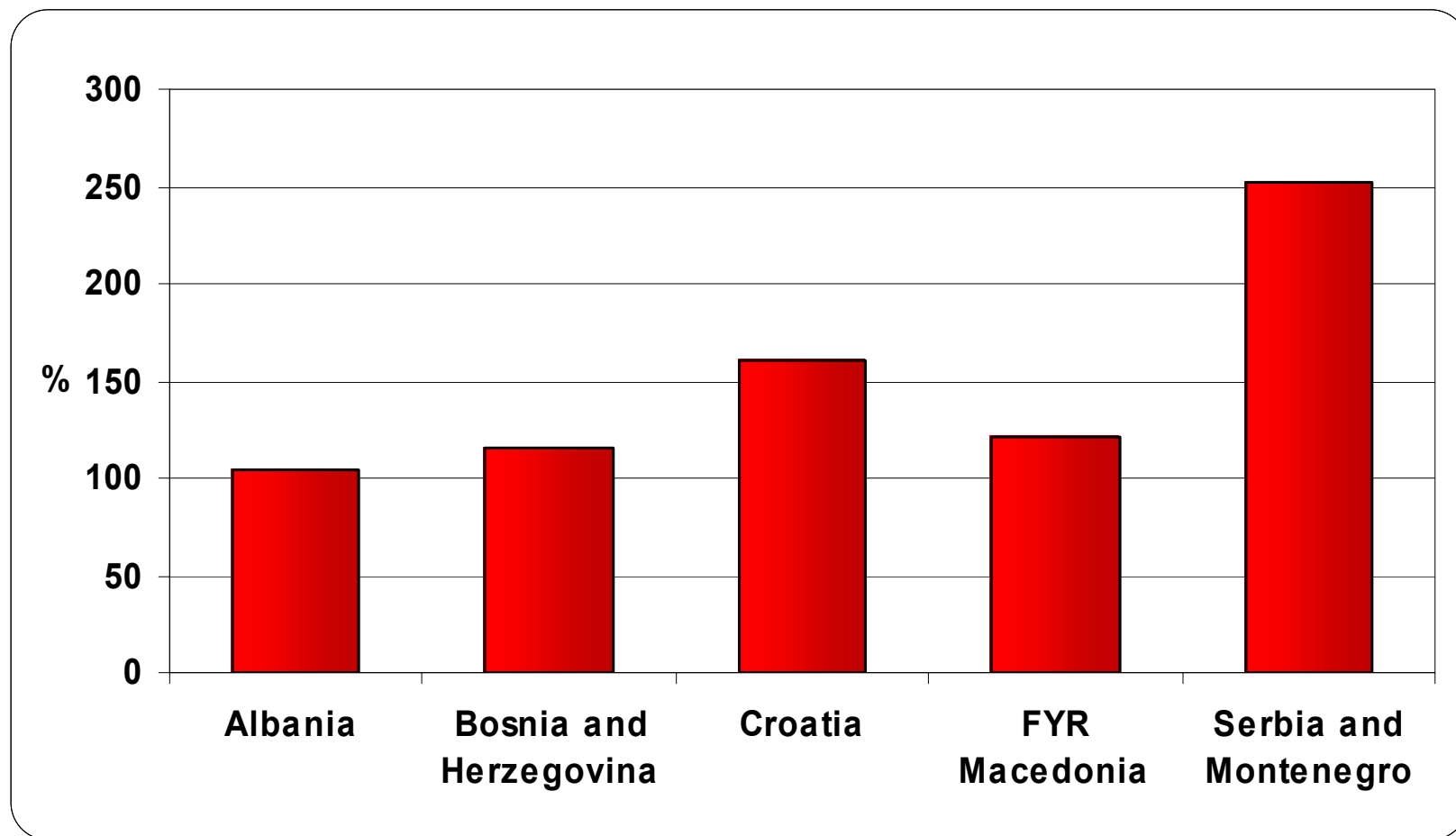
Foreign debt in 2004



Sources: Transition report 2005, CNB

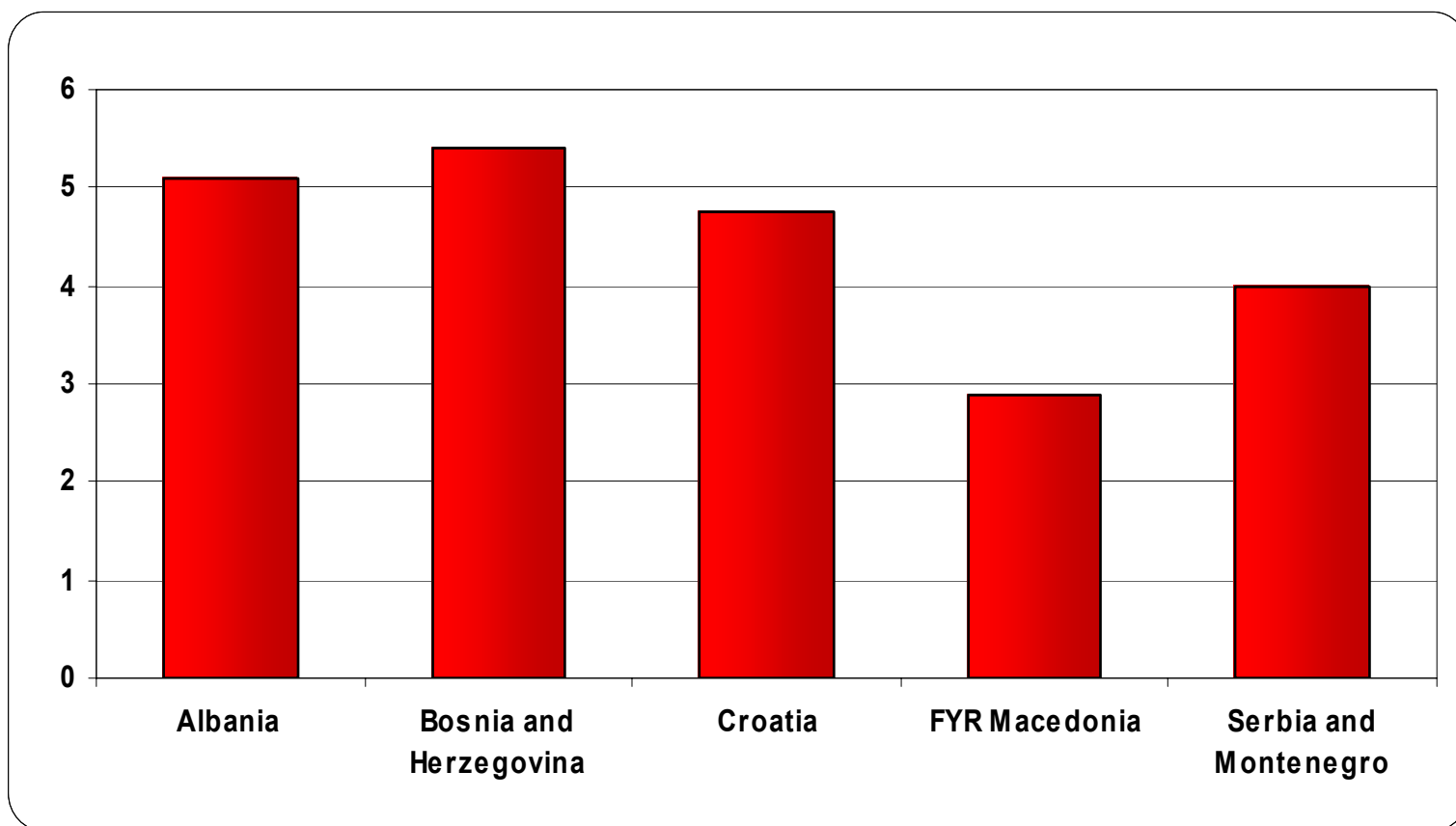
Foreign debt

% of exports of goods and services in 2004



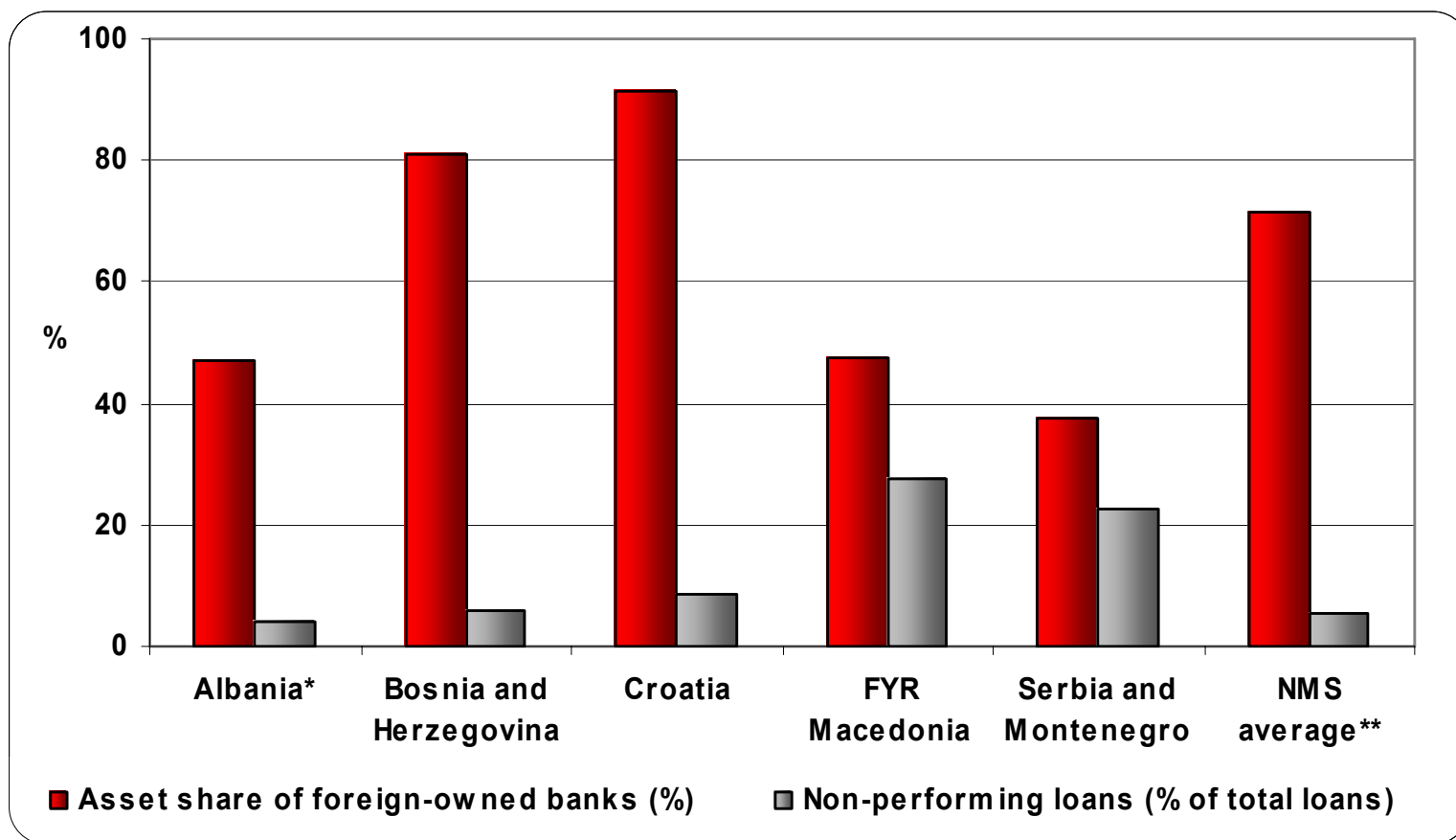
Sources: Transition report 2005, CNB

International reserves in months of imports of goods and services in 2004



Sources: Transition report 2005, CNB

Asset share of foreign-owned banks and non-performing loans in 2004

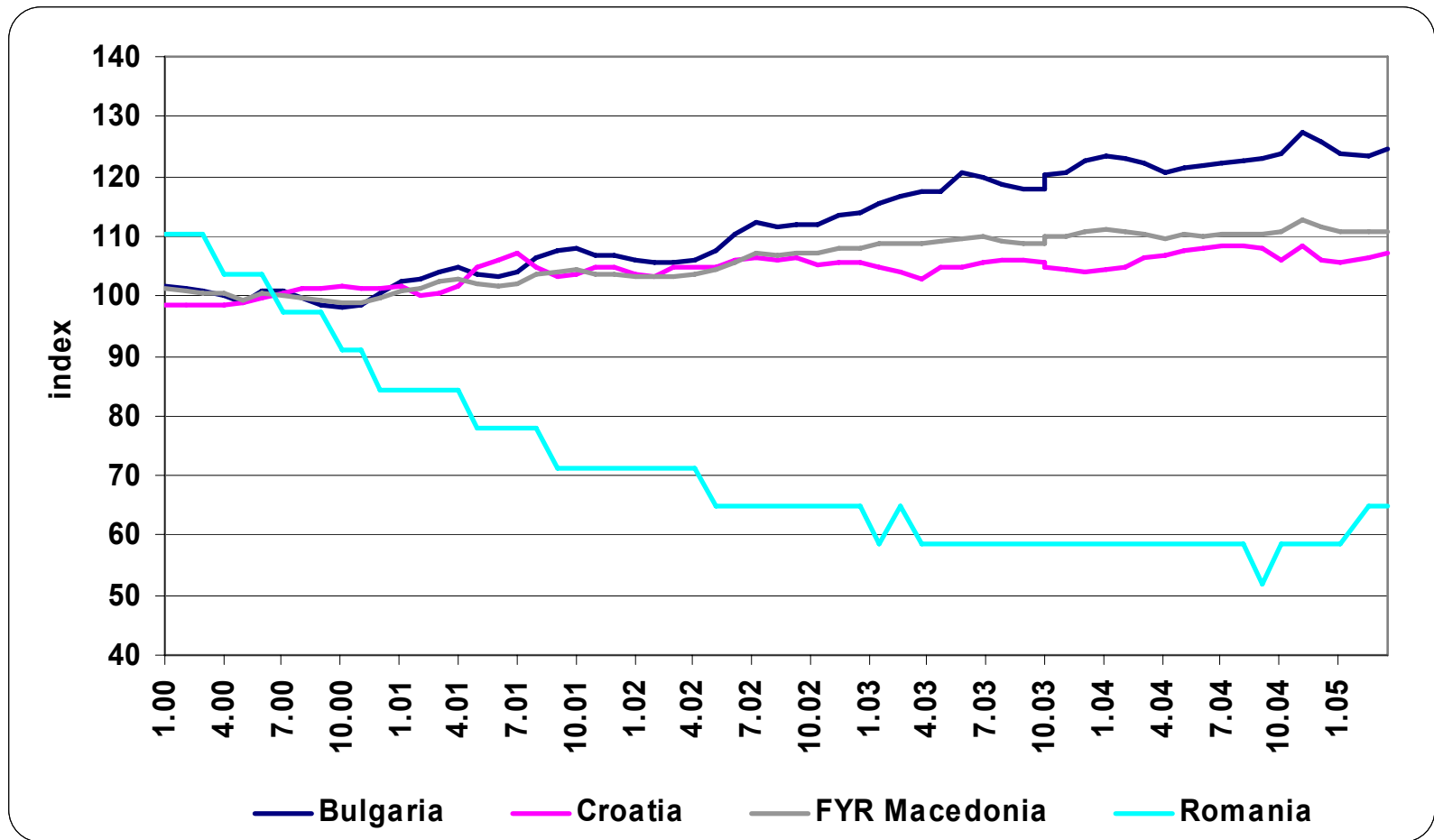


* asset share for 2003

** Malta and Cyprus are not included

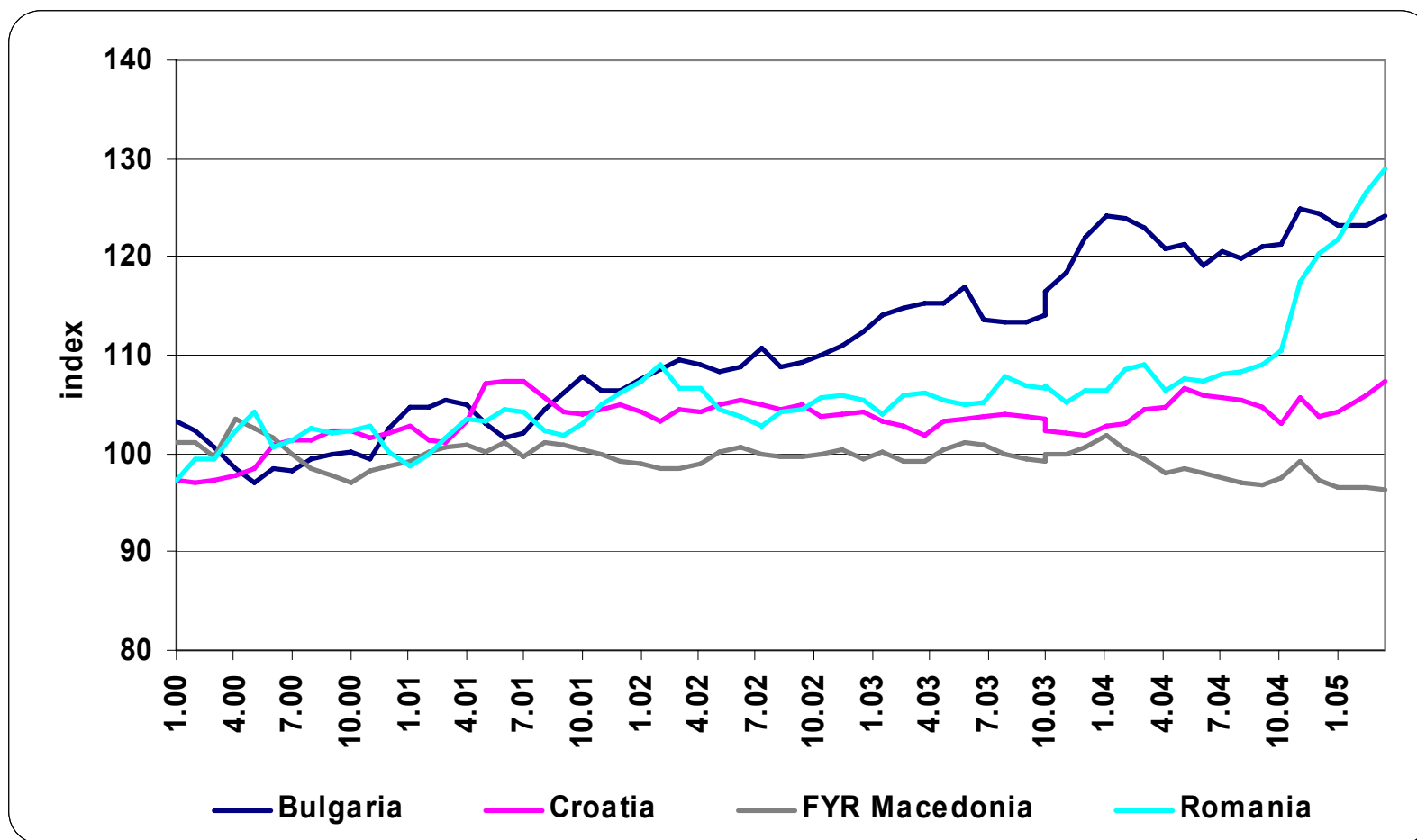
Source: Transition report 2005

Nominal effective exchange rate (2000=100)



Source: IFS

Real effective exchange rate (2000=100)



Source: IFS