

SEE Spotlight

News, research and analysis on south-eastern Europe

Issue No. 6, November 2011

EDITORIAL

The short-term outlook for the SEE economies has taken a significant turn for the worse in recent months. In its latest forecasts, published in October 2011, the EBRD significantly cut its forecasts for growth in the region in 2012 by an average of more than two percentage points relative to the July forecasts. The biggest reductions were in Albania, Romania and Serbia.

The main reason is the worsening crisis in the eurozone, the effects of which are bound to be felt throughout SEE because of the close trade, investment and financial linkages that this region has developed with the eurozone. Vulnerabilities are particularly severe at present, and confidence is low (see "Analysis" section on page 3). Some mitigating factors are also present: most countries have been fiscally prudent throughout the crisis, banking sectors are well-capitalised, and several countries are benefiting from IMF programmes. Nevertheless, the downside risks remain considerable and further downgrades to the 2012 forecasts are a distinct possibility.

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The latest EBRD growth forecasts for the transition region can be found here: http://www.ebrd.com/downloads/news/REP_October_2011_181011_Final.pdf



European Bank

for Reconstruction and Development

RECENT RESEARCH

B. Handjiski and L. Šestović, "Barriers to Trade in Services in the CEFTA region", World Bank Study, August 2011, The World Bank, Washington D.C..

<http://siteresources.worldbank.org/ECAEXT/Resources/BarrierstoTradeinServicesintheCEFTARegion.pdf>

This paper describes the economic importance of the service sector in CEFTA countries and current barriers to trade in services. It focuses on four sectors: construction, land transport, legal services, and information and communication technology services.

M. Nedeljković and B. Urošević, "Determinants of the Dinar-Euro Nominal Exchange Rate", Working Paper Series 18, May 2011, National Bank of Serbia, Belgrade.

http://www.nbs.rs/export/sites/default/internet/english/90/90_0/2011_18_MN_BU_e.pdf.

The paper analyses daily dynamics of the dinar-euro exchange rate between September 2006 and June 2010, showing how the determinants of exchange rate movements have changed after the crisis compared with the period before.

V. Gligorov, K. Ognjenović and H. Vidovic, "Assessment of the Labour Market in Serbia", wiiw Research Reports 371, May 2011, Vienna Institute for International Economic Studies, Vienna.

<http://www.wiiw.ac.at/?action=publ&id=series&value=2>

An analysis of the main characteristics of the Serbian labour market and evaluation of labour market policies undertaken over the past decade. The authors argue that mainly passive and modest labour market policies were adopted to address labour market problems.

N. Čučković, K. Jurlin and V. Vučković, "The Privatisation of Public Utilities in Croatia: an Assessment of the Major Gains and Pains", LSEE Papers on South Eastern Europe, Issue 3, July 2011.

http://www2.lse.ac.uk/europeanInstitute/research/LSEE/PDF%20Files/Publications/Privatisation_HR.pdf.

The focus of the paper is the privatisation of state-owned utility companies in Croatia in the telecoms and oil & gas industries, highlighting the importance of political economy factors as determinants of the welfare gains and losses.

E. Kraft and T. Galac, "Macprudential Regulations of Credit Booms and Busts – The Case of Croatia", and **F. Celeska, V. Gligorova and A. Krstevska**, "Macprudential Regulations of Credit Booms and Busts – the experience of the National Bank of the Republic of Macedonia",

Policy Research Working Papers 5770 and 5772, August 2011, The World Bank, Washington DC.

[http://www-](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822101635/Rendered/PDF/WPS5770.pdf)

[wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822101635/Rendered/PDF/WPS5770.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822101635/Rendered/PDF/WPS5770.pdf).

[http://www-](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822112255/Rendered/PDF/WPS5772.pdf)

[wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822112255/Rendered/PDF/WPS5772.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/08/22/000158349_20110822112255/Rendered/PDF/WPS5772.pdf).

Two papers that analyse the macroprudential measures adopted in Croatia and FYR Macedonia respectively.

RECENT ECONOMIC DEVELOPMENTS

Growth in industrial output remains subdued. Most of the region experienced either relatively modest growth or a downturn in industrial activity. Croatia and FYR Macedonia both reported a decrease in IP of 2.3% y/y in September. This continued the downward trend in Croatia and a reversal in the positive trends of the previous months in FYR Macedonia. Montenegro's IP continued to bounce back strongly after a major slowdown in utility and manufacturing activity in April and May; in August, growth was reported at 18% y/y. After five months of weak performance, IP in Romania rose by 10.3% y/y on the back of strong growth in manufacturing, particularly in the car industry.

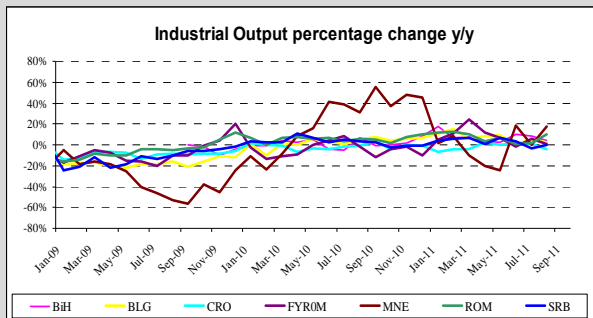
Exports continue to recover, but at slower pace. Most of the countries in the region are reporting a slowdown in the expansion of exports, but for the most part y/y growth in exports remains positive. A major exception is Croatia, where exports contracted again in August, after modest growth in June and July. In August, Bulgaria reported the slowest growth in export activity since November 2010, but growth still remains at a solid 28% y/y. FYR Macedonia reported a surprisingly high jump in August exports, led by metals and metal products. Growth in imports has also slowed down in the region over this period.

Inflationary pressures are falling. Following the upward pressure on prices in the first half of 2011, inflation has been falling in most countries in the region, particularly in Romania and Serbia. After peaking in April at 14.7 per cent, inflation in Serbia is now down to 8.7 per cent, while Romania's has fallen from 8.4 per cent earlier this year to about 3.6 per cent in October. These disinflationary trends and weaker growth expectations have prompted the central banks in these countries to reduce policy rates. Following a series of cuts, Serbia's policy rate was further reduced in November to 10 per cent while Romania's policy rate was cut in November to 6 per cent, the first cut for 18 months. Price indices have remained relatively stable in the rest of the countries in the region.

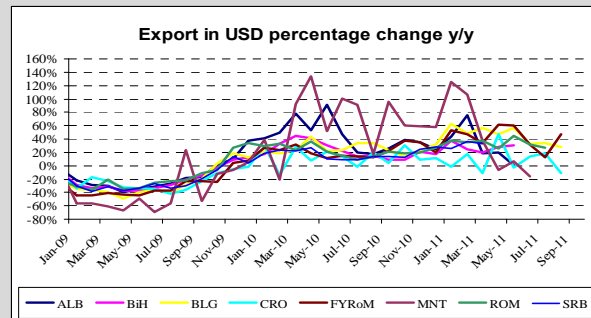
Risk perceptions stabilising again. Credit default swaps (CDS) of the most advanced economies in south-eastern Europe rose sharply in July 2011 due to growing market fears over the unfavourable developments in the Greek sovereign debt crisis. Spreads peaked in October, when Croatia's CDS stood above 500 and Romania and Bulgaria's lingered just below. News over the bailout agreement reached at the end of October and some progress in the resolution of the political impasse on the Greek political scene appears to have calmed market fears of contagion to the rest of the region and spreads in Croatia, Bulgaria and Romania have been falling since. However, the market is highly volatile and further swings may be expected in the coming days and weeks.

SELECTED MACROECONOMIC INDICATORS

Real Economy

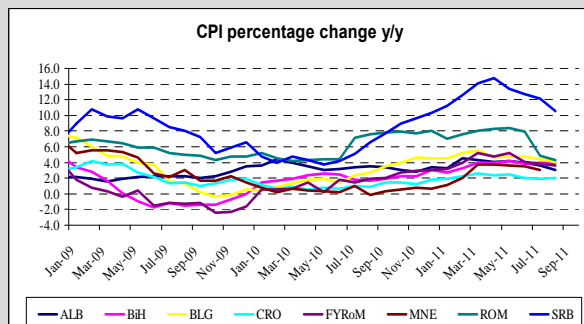


Source: National Authorities.

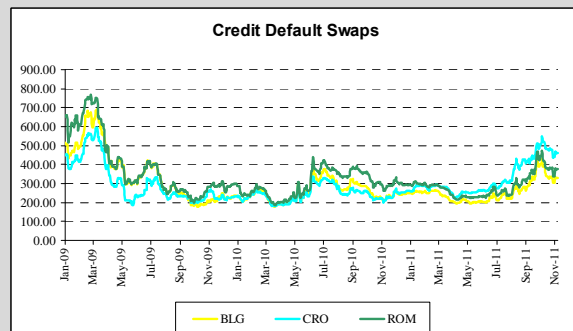


Source: National Authorities via CEIC Data Service.

Inflation and CDS spreads



Source: National Authorities.



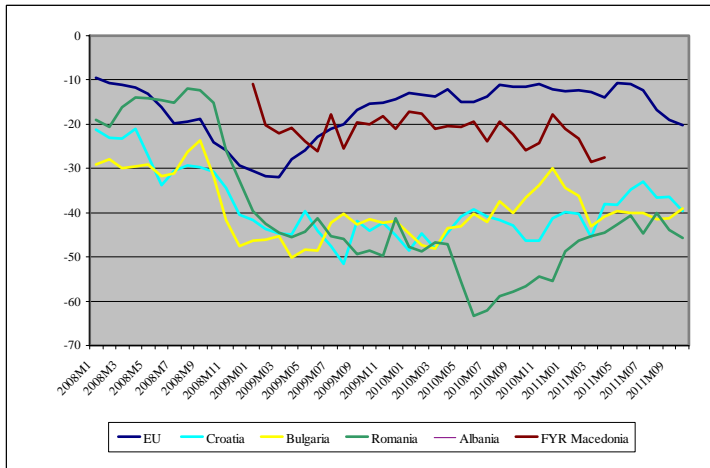
Source: Bloomberg.

Of all the EBRD's sub-regions, south-eastern Europe (SEE) has been the slowest to emerge from the crisis. One reason behind the sluggish recovery is undoubtedly a general lack of confidence throughout the economy. This note looks at the latest consumer confidence indicators for selected SEE countries. These data are useful because they are often more up-to-date than other economic variables and can help to predict short-term trends. The results show that, not only are confidence levels well below the EU average, but they are also steady or falling in recent months. Given the close historical link between these indicators and subsequent economic performance, they provide another reason why the short-term outlook for the region remains bleak.

In the SEE region, consumer confidence indicators are available for all but three countries.¹ In the EU member states, Bulgaria and Romania, and in Croatia (which has completed accession negotiations), the surveys are conducted on a monthly basis according to a methodology established by the European Commission, the Joint Harmonised EU Programme of Business and Consumer Surveys. In Albania and FYR Macedonia, the methodologies are broadly similar but not fully comparable to the other three countries.

Three observations emerge from the data. First, consumer confidence in SEE fell much more drastically during the crisis compared to the EU average. At its trough (mid-2009), the consumer confidence indicators in the EU averaged at about -30 whereas for the countries in the region the index bottomed out at around -50 (see Figure 1 below). Second, the subsequent recovery has been much slower, with the EU average bouncing back already in the second half of 2009 while the indicators for most of the SEE countries lingered around the same low level for all of 2009 and the first half of 2010. Third, while confidence showed some signs of improvement in the second half of 2010 (notwithstanding a big drop in Romania in Q3 2010) and the first half of 2011, it is steady or even falling again in recent months across the whole region, as it is in the EU.

Figure 1. Consumer Confidence Index (2008-2011)



Note: Each confidence indicator is calculated as the simple arithmetic average of the (seasonally adjusted) balances of answers to selected questions from the survey, where the balances represent the difference in the percentages of respondents that responded positively (or indicated improvement) and negatively (worsening) to each question. Data on FYR Macedonia are available only up to April 2011. Data on Albania are quarterly, rather than monthly, and hence are displayed as such. Sources: European Commission DG Economic and Financial Affairs; Albanian and FYR Macedonian Statistical Offices.

¹ Survey data of this type are not available for Bosnia and Herzegovina, Montenegro and Serbia.

We examined the correlation between these confidence indicators and several economic variables.² We found a positive correlation across the region between the level of the consumer confidence indicator and GDP growth in the same quarter. The correlation is strongest in Bulgaria and Croatia and weakest in FYR Macedonia and Albania, which may be due to some of the methodological differences in the construction of the indicators. Second, a cross-country regression analysis shows a positive and statistically significant relationship between current confidence and GDP growth, and between confidence and import growth. The level of confidence also helps predict future credit growth.

These results suggest that no serious recovery will take place soon. The current (early-November) turmoil in Greece and Italy can only add to the overall nervousness of the region, which has strong trade, financial and remittance links with these countries. Confidence in SEE countries is therefore likely to stay at low levels in the short run unless there is a swift resolution to the eurozone crisis and an upturn in its economic prospects.

² The results are available on request. However, the time series are quite short so these results are illustrative only.