PART ONE

CURRENT ECONOMIC DEVELOPMENTS AND OUTLOOK

CHAPTER 1

THE ECE ECONOMIES IN AUTUMN 2000

The current situation and outlook in the ECE economies – i.e. in Europe, the CIS and North America – is better than at any time in the last decade. The dynamism of the world economy has stimulated growth in western Europe via foreign trade and the close links between western and central Europe have similarly boosted economic growth in the latter. In western Europe, GDP is expected to increase on average by 3.4 per cent this year and to slow down slightly to about 3 per cent in 2001 as a result of tighter monetary policy, the rise in oil prices and weaker economic growth in the United States. In the latter, "a soft landing", from 5 per cent growth in 2000 to some 3.4 per cent is still the central forecast. In the transition economies economic growth has been much stronger than expected and should average somewhat over 5 per cent in 2000, slowing to just over 4 per cent in 2001. Although there are still large differences among the transition economies, all of them should have positive growth this year and again in 2001. The principal risk to this relatively optimistic outlook would be a more rapid adjustment than currently forecast to the considerable imbalances which have built up in the United States – an abrupt fall in asset prices and the dollar would have negative effects on the rest of the world. The rise in oil prices has also added to uncertainty, but it is assumed that they will fall back to the OPEC target range in early 2001. The risks of an upsurge of inflation in western Europe appear to be very low and there is therefore no need for a further tightening of monetary policy which would unnecessarily threaten economic growth both in western Europe itself and in many of the transition economies.

1.1 The global context and the situation in western Europe

(i) The global context

(a) Overview

The strengthening of global economic activity in 1999 continued in the first half of 2000. In fact, the international business cycle gained more momentum than expected at the beginning of this year and in late summer the forecast for world output growth in 2000 was raised half a percentage point to 4¾ per cent.[1] If achieved, this will be the best performance in a decade. As usual, there is a strong correlation between changes in world output and world trade. The volume of world trade is forecast to increase by some 10 per cent in 2000, up from 5 per cent in 1999.

This favourable performance is due largely to the continued rapid expansion of the United States economy, which has led to a very strong growth in its demand for imports. This, in turn, has contributed to the strengthening of cyclical growth forces in both developed and developing countries and especially to the strong recovery of the Asian economies from the financial crises of 1997.

The growth performance of the Asian emerging economies contrasts with the continuing weak economic performance in Japan. The latter has emerged from recession in the first half of 2000 but a sustained recovery is still not ensured. The main driving force of economic growth has been the recovery of business investment against the backdrop of improving export demand and rising corporate profits. Consumer confidence has strengthened but spending behaviour has remained relatively cautious. In view of the stronger cyclical growth, the Bank of Japan raised the overnight call rate to 0.25 per cent in August 2000, following 17 months of a "zero-interest rate" policy. But falling consumer prices suggest that there are still lingering deflationary pressures, which would suggest the need for a further easing of monetary policy. There are, however, doubts concerning the effectiveness of monetary policy in the presence of interest rates which are already very low (the "liquidity trap" phenomenon). In October 2000, the government announced a new package of fiscal measures to support economic activity – the tenth package in the past decade – which is designed to offset an anticipated shortfall of government spending in the first months of 2001. Government debt has risen rapidly in recent years and now corresponds to some 110 per cent of GDP. This will narrowly circumscribe the scope for expansionary fiscal policy in the future.

[1] IMF, *World Economic Outlook* (Washington, D.C.), September 2000.

There has also been a general recovery in Latin America, although economic activity remains weak in a number of countries. Argentina has suffered from a disappointing economic performance against the background of an austerity policy and an erosion of price competitiveness due to the appreciation of the peso which is pegged to the dollar in a currency board.

The considerable dynamism of the world economy, via foreign trade, has also stimulated domestic activity in western Europe and the transition economies of central and eastern Europe. As a result of the closer economic linkages within the region, foreign trade has also led to mutually reinforcing economic growth between western and eastern Europe.

Short-term economic prospects, however, have become more uncertain in recent months and there are increasing indications that the global business cycle may have passed its peak. The reasons for this include the further tightening of monetary policy in the United States and western Europe during the course of 2000 and the unexpectedly sharp and sustained rise in international oil prices.

The increased uncertainty in the macroeconomic environment has also been reflected in greater volatility in the financial markets. Prices in international equity markets, notably for technology stocks, have fallen significantly against a background of weaker than expected corporate sales and earnings in the third quarter of 2000 – a development which continued in October.

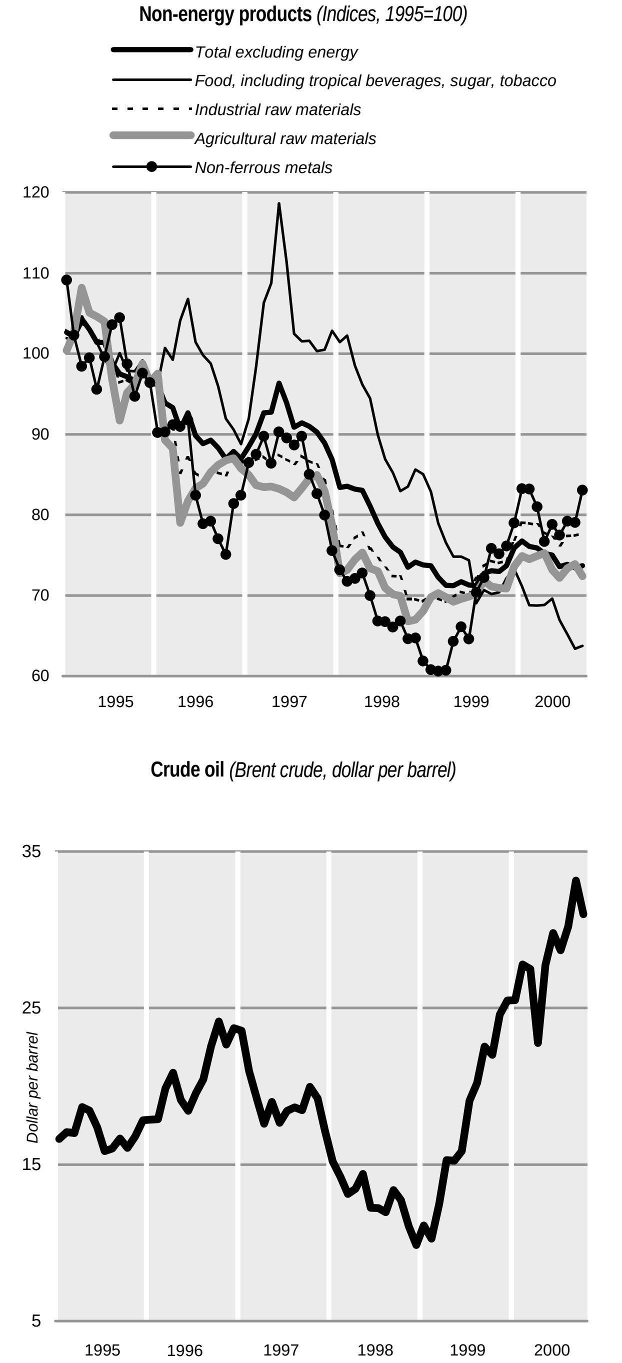
(b) The surge in oil prices

The marked rise in crude oil prices in 1999 continued in the first nine months of 2000 (chart 1.1.1). Oil prices fell briefly in April 2000, but recovered quickly thereafter despite three increases in OPEC production quotas between March and September, which led to an increase in world oil supply of some 14 per cent compared with the beginning of the year.

Nevertheless, against a background of low inventories of both crude oil and petroleum products, a tight demand-supply balance (mirrored in a very high utilization rate of global petroleum processing capacity), oil prices (Brent crude) rose to $38 per barrel in early September, a 10-year high. Immediately following the decision of the United States government in late September to release 30 million barrels[2] from its strategic petroleum reserve, and with indications that OPEC stood ready to increase supply, prices fell temporarily to $28 per barrel. But by mid-October, with the lingering crisis in the Middle East, crude oil prices had risen to around $31, an increase of more than 200 per cent compared with the average price of about $10 per barrel in February 1999. The approach of winter in the northern hemisphere and the associated seasonal increase in demand for heating oil has underpinned the high prices. Given that stocks of heating oil have fallen

CHART 1.1.1

World commodity prices, January 1995-October 2000
(Indices, dollars)



Source: Hamburg Institute for Economic Research (HWWA); IMF, *International Financial Statistics*; United States Department of Energy (www.eia.doe.gov).

Note: Average monthly prices. Indices calculated on the basis of current dollar prices. Last observation for non-energy products: September 2000; for crude oil prices: average prices for first four weeks of October 2000

2 This corresponds to some 1¾ per cent of the projected United States crude oil demand for the fourth quarter of 2000.

to very low levels in the United States,[3] oil prices are expected to remain high for the rest of 2000 and in early 2001.

The sharp rise in oil prices has led to a deterioration in the terms of trade of the oil importing countries and a loss in real incomes. This, in turn, will restrain the growth of domestic demand, other things being equal. To some degree, the adverse terms of trade effect will be offset by the rise in import demand from the oil exporting countries made possible by the surge in their oil revenues. But this will also depend on their absorptive capacity and other economic policy priorities such as foreign debt reduction and their need to rebuild foreign reserves.

It is important, however, to put the recent surge in oil prices into perspective. During the first oil price shock, the oil price (Brent crude) rose on average by 204 per cent between 1973 and 1974. During the second oil shock, there was a cumulative increase in prices by 166 per cent in 1980 compared with 1978. The recent surge in oil prices is likely to imply an average increase of some 125 per cent in 2000 compared with 1998. It should also be stressed that oil prices had fallen sharply to an exceptionally low level in 1998 as a result of the pronounced global economic slowdown. The average price in 1998 was $12.7 per barrel compared with an average of $19 in the period 1990-1997. Thus, the low prices of 1998 constituted a large windfall gain for oil importers which could not – and should not – have been expected to last for long.

In any case, the economic effects of the current price shock are much reduced compared with the previous ones not only because the price increase itself is much smaller but also because, under the impact of the first two shocks, higher taxation of energy products and the introduction of more efficient production technologies, there has been a decline in energy intensity (i.e. the use of energy per unit of real GDP) in the industrialized countries by about 50 per cent since the mid-1970s.

Model simulations suggest that an increase in oil prices by $10 per barrel could reduce the growth rate of real GDP in the industrialized countries, on average, by about 0.4 of a percentage point.[4] The adverse effect will be significantly larger, however, for the oil-importing developing countries. The average oil price for the first 10 months of 2000 was somewhat more than $28, an increase of some $10 over the preceding year. For the euro area, however, the price effect will be amplified by depreciation of the euro against the dollar, which could amount to some 12.5 per cent on average in 2000.

In contrast to developments in the international oil markets, prices for non-energy commodities have so far remained relatively subdued in the course of 2000, despite the robust global economic recovery (chart 1.1.1). In the main, this reflects the slow adjustment of supply to the fall in demand in 1997-1998 and ongoing investments in perennial crops and in new metal plants. As a result, there is on overhang of stocks which limits the scope for price increases. This problem has been especially severe for food (including tropical beverages and sugar) for which prices have fallen in the course of this year. Prices of non-ferrous metals and agricultural raw materials were broadly stable in 2000 after recovering from the trough of 1998-1999.

(c) United States

In the United States, economic activity continued to increase at a brisk rate in the first half of 2000 with demand outpacing supply as in recent years. But the rate of expansion slowed down more abruptly than expected in the third quarter. Real GDP rose by only 0.7 per cent compared with the preceding quarter, when it increased by 1.4 per cent (table 1.1.1). Although stronger than expected, this slowdown is broadly in line with general expectations that the economy is poised for a “soft landing” after a long period of buoyant growth. The weakening of economic activity reflects in the main the lagged effects of tighter monetary policy, the loss of real income due to the rise in oil prices, and the strong dollar. The cyclical downturn had already been signalled by the Purchasing Managers’ Index which fell below the threshold of 50 per cent in August and September (chart 1.1.2). Also the composite leading indicators have been declining since May and capacity utilization rates in manufacturing industry fell slightly in the third quarter of 2000.

The slowdown of economic growth in the third quarter reflects a pronounced weakening of total domestic demand, especially of fixed investment and a decline in government expenditures. Business investment in equipment and software remained strong but the buoyancy of the two preceding quarters was no longer present. Residential investment fell sharply compared with the second quarter and the growth of expenditures on industrial buildings slowed down to near stagnation. Changes in inventory accumulation provided only minor support to domestic demand after contributing significantly to economic growth in the second quarter. Private consumption was the mainstay of economic growth in the third quarter, reflecting a rebound in demand for consumer durables. A slowdown in real disposable income was more than offset by a fall in savings. The savings ratio became negative (-0.2 per cent), down from an already very low 0.3 per cent in the second quarter. Consumer confidence rose to an all-time high at the beginning of 2000 but was quite volatile thereafter, although remaining at a very high level (chart 1.1.2).

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[3] These low stock piles reflect partly low refining margins until early 2000. Also, tight capacity in the presence of a very strong demand for gasoline during the summer 2000 prevented the usual build-up of heating oil inventories ahead of winter.

[4] IMF, op. cit., p. 9. The OECD estimates that a $10 oil price increase will reduce real GDP by a cumulative 0.4 of a percentage point over two years after the shock in the United States and western Europe. The impact is about twice as large (0.9 of a percentage point) in Japan. OECD, *Economic Outlook* (Paris), December 1999, p. 9, box I.2.

TABLE 1.1.1

Quarterly changes in real GDP, 1999 QIII-2000 QIII
(Percentage change)

	Over preceding quarter					*Over same period of preceding year*				
	1999		*2000*			*1999*		*2000*		
	QIII	*QIV*	*QI*	*QII*	*QIII*	*QIII*	*QIV*	*QI*	*QII*	*QIII*
France	1.0	1.0	0.7	0.7	..	3.1	3.4	3.5	3.4	..
Germany	0.9	0.8	0.8	1.1	..	1.6	2.4	2.3	3.6	..
Italy	0.7	0.5	1.1	0.3	..	1.3	2.2	3.0	2.6	..
United Kingdom	1.0	0.7	0.5	0.9	0.7	2.3	2.9	3.0	3.2	2.9
4 countries above	0.9	0.7	0.8	0.8	..	2.0	2.7	2.9	3.2	..
Canada	1.6	1.2	1.2	1.1	..	5.2	4.9	5.0	5.3	..
United States	1.4	2.0	1.2	1.4	0.7	4.3	5.0	5.3	6.1	5.3
Japan	-1.0	-1.6	2.5	1.0	..	1.0	-0.2	0.7	0.8	..
7 major economies	0.8	0.9	1.3	1.1	..	3.0	3.3	3.7	4.2	..
Memorandum items:										
Euro area	0.9	0.9	0.9	0.8	..	2.4	3.1	3.3	3.5	..
European Union	0.9	0.9	0.9	0.8	..	2.4	3.0	3.2	3.4	..
Western Europe	0.9	0.9	0.8	0.8	..	2.3	3.0	3.2	3.5	..

Source: National statistics.

Note: Data are seasonally adjusted. Euro area: excludes Ireland, Luxembourg and Portugal. European Union: euro area plus Denmark, Sweden and United Kingdom. Western Europe: EU, Norway and Switzerland.

Export growth has remained very strong, with the demand effects associated with the global economic upturn more than offsetting the loss in price competitiveness due to the strong dollar. The growth of imports slowed down somewhat in the third quarter but the rate of expansion (an increase by more than 3 per cent over the preceding quarter) was still quite high. Changes in real net exports subtracted only ¼ of a percentage point from economic growth in the third quarter, down from about 1 percentage point in the two preceding quarters.

Inflation has edged upwards in the course of 2000, mainly because of higher energy prices. Core inflation (which excludes prices of food and energy) remained quite moderate during the first eight months but edged up noticeably in September. The annual inflation rate was 3.5 per cent in September, while core inflation was 2.6 per cent, compared with 1.9 per cent at the beginning of the year. Domestic inflationary pressures have remained moderate, with no signs of labour costs accelerating despite very tight labour markets. Higher labour costs have so far continued to be offset by sizeable gains in productivity. Non-farm employment increased again in the first two quarters and although it fell in August it rose again in September, when the unemployment rate fell again to a very low 3.9 per cent.

The strong dollar has had adverse effects on corporate profitability and exports. Corporate profits growth slowed down in the first two quarters of 2000, but the average masks a decline in the profits of financial corporations. Banks have become increasingly cautious about the economic prospects of firms and, in the face of high levels of corporate debt, have tightened their terms and standards of lending. Also, widening yield spreads (over treasury bills) in the corporate bond market point to increasing caution on the part of investors.

The current account deficit rose to $425 billion (annual rate) in the second quarter of 2000, corresponding to 4.3 per cent of GDP. This compares with an average of 3.7 per cent of GDP in 1999. Virtually all of the deterioration in 2000 was due to the increase of $87 billion (annual rate) in the merchandise trade deficit, of which about half was due to the rise in oil prices.

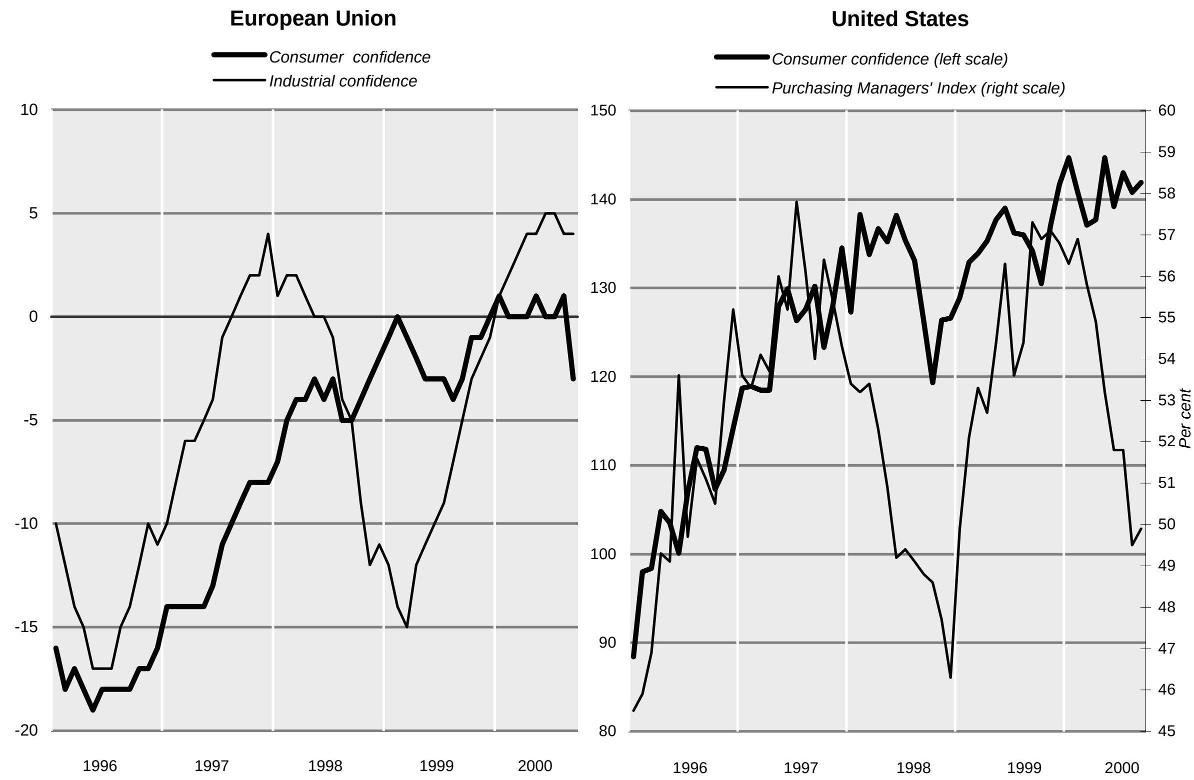
The persistent buoyancy of economic activity has led to tax revenues outpacing government expenditures by a large margin. The federal budget has been in surplus since 1998 and it rose by $100 billion to $237 billion, or 2¼ per cent of GDP, in fiscal year 2000 (which ended on September 30).

Given the continued strength of economic growth, the Federal Open Market Committee (FOMC) decided to further raise the target for the federal funds rate by half a percentage point to 6.5 per cent in May 2000, the total increase since June 1999 thus amounting to 1.75 percentage points. But since May, interest rates have been left unchanged reflecting the FOMC's conviction that the economy is heading for a "soft landing". Short-term interest rates in the money market responded to this earlier tightening of monetary policy but tended to fall slightly in the third quarter (see chart 1.1.6 below).

Real short-term rates, however, were still relatively low in the course of 2000. In the capital markets, yields on 10-year treasury bills have tended to decline despite upward pressures on inflation and very strong growth. This tendency reflects the impact of the United States Treasury's buy-back scheme for bonds and the

CHART 1.1.2

Business and consumer surveys in the European Union and the United States, January 1996-September 2000



Source: Data for the European Union: European Commission, *European Economy*, Supplement B (Luxembourg) and direct communications. Data for the United States: The Conference Board, New York (www.conference-board.org) and National Association of Purchasing Management, Arizona (www.napm.org).

Note: European Union data show net balances between the percentages of respondents giving positive and negative answers to specific questions. For details see any edition of the source. United States: consumer confidence is measured in index form with base year 1995=100. The Purchasing Managers' Index (PMI) is a composite index pertaining to the business situation in manufacturing industry. An index value above (below) 50 per cent indicates that manufacturing industry is generally expanding (contracting). A PMI above (below) 44.5 per cent, over a period of time, indicates that overall economic activity, as measured by real GDP, is generally expanding (contracting).

anticipated fall in the supply of long-term bonds (notably 30-year treasury bills) as a result of the large fiscal surpluses which are projected.

(ii) Western Europe

(a) Output and demand

The west European business cycle maintained strong momentum in the first half of 2000. In the *euro area*,[5] real GDP slowed down marginally to a quarterly rate of 0.8 per cent in the second quarter, following steady growth at 0.9 per cent in the three preceding quarters (table 1.1.1). Real GDP in the first half of 2000 was 3.4 per cent higher than a year earlier. Exports of goods and services continued to be the main sources of growth. Exporters benefited not only from the improved global environment but also from the substantial gains in price competitiveness resulting from the depreciation of the euro. Domestic demand remained strong in the first half of 2000, but its rate of expansion was not accelerating. Nevertheless, consumer and industrial confidence were at high levels in the first half of the year (chart 1.1.2) against the backdrop of favourable economic prospects. Private consumption was supported by gains in aggregate real incomes associated with rising employment, but the growth of real disposable incomes was checked by the sharp rise in energy prices, which put upward pressure on consumer prices. Nevertheless, private consumption continued to expand at a robust rate in the second quarter.

Improved sales prospects, rising capacity utilization rates and relatively low real interest rates have stimulated business fixed investment in machinery and equipment, which continued to expand at a brisk pace. Expenditures on these capital goods rose in real terms by 7.5 per cent in the first half of 2000 compared with the same period of 1999. Construction investment also edged upward further but the overall rate of expansion was restrained by the marked decline of construction in Germany. In sum, total fixed capital formation slowed down between the

[5] Quarterly GDP statistics for the euro area do not include Ireland and Portugal.

first and second quarters, but in the first half of 2000 it was still 5¼ per cent higher than a year earlier.

The acceleration of total domestic demand in the final quarter of 1999 did not continue in the first two quarters of 2000: instead, its growth remained steady at about 0.8 per cent. The relatively strong growth of domestic demand led to a considerable rise in imports, which to a large degree offset the impact of rising exports on domestic output. Changes in real net exports contributed 0.2 of a percentage point to the increase of 0.9 per cent in real GDP in the first quarter of 2000, but in the second quarter real net exports were slightly holding back the overall rate of economic growth. This pattern in GDP growth and the main expenditure items was much the same for the broader aggregate of western Europe.[6]

The cyclical upswing in the euro area (and in western Europe as a whole) in 2000 was especially supported by stronger growth in Germany and Italy, which had lagged significantly behind the average cycle in 1999. But the European averages continue to mask the more dynamic growth rates of the smaller economies (notably Finland, Ireland and the Netherlands) which are at a more advanced stage in their business cycle.

In France, the upswing lost some momentum in the first half of 2000, real GDP rising at a quarterly rate of 0.7 per cent in each of the first two quarters, down from 1 per cent in the last two quarters of 1999. The rate of expansion of private consumption slowed markedly in the second quarter: there were only small gains in real disposable incomes and the fall in the savings ratio which had supported household demand in the first quarter did not continue. Business investment remained strong, but residential investment weakened, apparently in response to rising mortgage rates.

In Germany, stronger private consumption expenditures more than offset a decline in government expenditure and fixed investment in the second quarter. Construction investment fell for the third consecutive quarter following reduced government incentives for residential investment but also reflecting a persistent excess supply of industrial buildings. Business expenditure on machinery and equipment in the second quarter was slightly more than in the first quarter (when it rose by 7 per cent) and there was also an increase in inventory accumulation. Exports remained buoyant against the backdrop of strong international demand for investment goods, which was also reflected in a marked rise in manufacturing output.

In Italy, the pattern of quarterly rates of growth was strongly influenced by the uneven changes in real imports of goods and services which stagnated in the first quarter but rose by 5 per cent in the second quarter of 2000. In the event, real GDP rose by only 0.3 per cent in the second quarter, down from 1.1 per cent in the first quarter of 2000. Exports continued to expand at a robust rate, but changes in real net exports subtracted nearly 1 percentage from the overall growth of total domestic demand in the second quarter, a marked swing from a positive contribution in the previous quarter. Fixed investment remained high, helped in part by government measures to support economically backward regions.

In the other economies of the euro area, the cyclical upturn remained strong but it slowed down from the buoyant rates of expansion in the final two quarters of 1999.

Outside the euro area, the rate of economic expansion in the United Kingdom remained strong in the first three quarters of 2000. The recovery in industrial production, especially in energy-related sectors, underway since mid-1999 was sustained but manufacturing output remained relatively sluggish. Private service industries continued to expand strongly. Real GDP rose by 3.4 per cent in the first three quarters compared with the same period of 1999. Data for the main expenditure items for the second quarter show that the growth in final domestic demand edged upwards because of a rebound in fixed investment and government consumption, and private consumption, supported by a falling savings ratio, remained buoyant throughout the first half of 2000. But there are indications, such as the apparent cooling of the housing market, that the underlying momentum of consumption growth may be easing. Exports have been boosted, notwithstanding the strong exchange rate, by the recovery of the world economy, but as a result of rising imports, changes in real net exports were a drag on the overall level of economic activity in the second quarter of 2000.

(b) Inflation

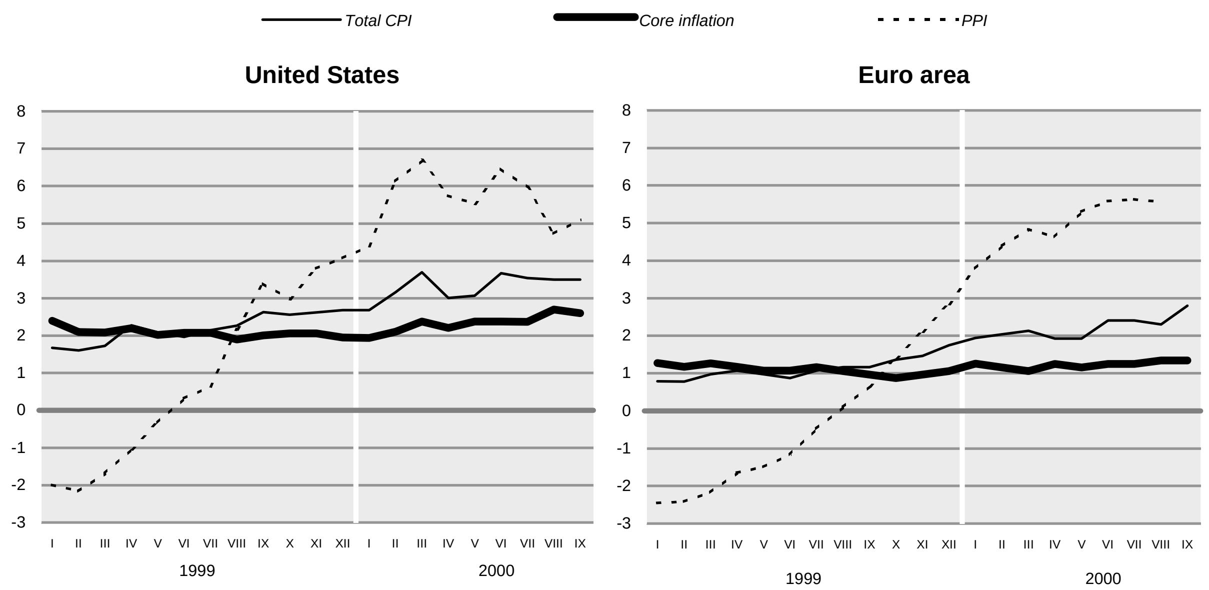
Price developments in western Europe in 2000 were strongly influenced by the large increase in crude oil prices. These fed through via higher prices of petroleum products (notably gasoline and heating oil) to the final consumer. Moreover, the continuing decline of the euro has placed further upward pressure on import prices, notably of international commodity prices (which are traded in dollars) for buyers in the euro area. The same holds for countries, such as Denmark, which have pegged their currencies to the euro. The weakness of the euro and the rise in energy prices also account for much of the pronounced increases in aggregate import and producer prices (chart 1.1.3).

But apart from energy prices, there has so far been relatively little pass-through from higher import and producer prices to consumer prices. Labour cost pressures have also remained moderate. In the euro area, core inflation (which excludes prices of energy and food products as well as alcohol and tobacco) was only 1.4 per cent in September 2000, up by 0.1 of a percentage point from August. In contrast, prices of energy products in September were 16 per cent higher than a year earlier.

[6] Euro area plus Denmark, Sweden, Switzerland and the United Kingdom.

CHART 1.1.3

Consumer and producer price indices for the United States and euro area, January 1999-September 2000
(Percentage change over same month of previous year)



Source: Eurostat and United States Bureau of Labor.

Note: Harmonized index of consumer prices (HICP) for the euro area. The last available data for producer price indices (PPI) in the euro area was August 2000. Producer price indices: for the euro area, industry excluding construction; for the United States, all commodities.

This was the main factor which drove the "headline" inflation rate up to 2.8 per cent in September, half a percentage point more than in August and the highest monthly rate since May 1994. The average inflation rate for the first nine months of 2000 was 2.2 per cent and it can therefore be assumed that the average rate for 2000 will slightly exceed the 2 per cent ceiling of the European Central Bank's (ECB's) inflation target. This compares with an annual inflation rate of 1.1 per cent in 1999. More generally, the low rate of core inflation reflects the combined impact of intense competition at the retail level and continued moderation in the growth of unit labour costs. The combination of liberalization processes and the enforcement of competition rules have also brought consumers lower prices. In telecommunications, for example, residential telephone tariffs for international calls, fell, on average, by 40 per cent between 1997 and 1999 in most EU member states.

The average inflation rate in the euro area masks quite a large variation among the individual member countries. In September 2000, inflation ranged from 2.2 per cent in Austria to 5.5 per cent in Ireland. In Ireland, the effects of the oil price shock and the depreciating euro on domestic prices were amplified by the persistent buoyancy of domestic demand and an increase in tobacco taxes.[7] Core inflation in Ireland was 3.9 per cent in September and given the buoyant demand for labour, wage growth is forecast to outpace inflation by a considerable margin in 2000. This points to the risks of overheating and the emergence of a wage-price spiral. It also suggests that current monetary conditions in the euro area are not appropriate for the Irish economy. Similarly, the economic boom in Spain helped to raise core inflation to 3 per cent in August and September 2000. Core inflation also rose in Portugal, to 3.5 per cent, which is not much different from the headline inflation rate of 3.6 per cent.[8] Despite buoyant economic growth, core inflation has remained low in the Netherlands (1.3 per cent).

Outside the euro area, in the United Kingdom, the main domestic measure of inflation (RPIX) was 2.2 per cent in September 2000, which is below the government's target of 2.5 per cent. Headline inflation rose above 3 per cent, the difference between these two measures reflecting the higher mortgage rates due to the tightening of monetary policy.

(c) Labour markets

The cyclical upswing has led to a further improvement of the situation in the labour markets of

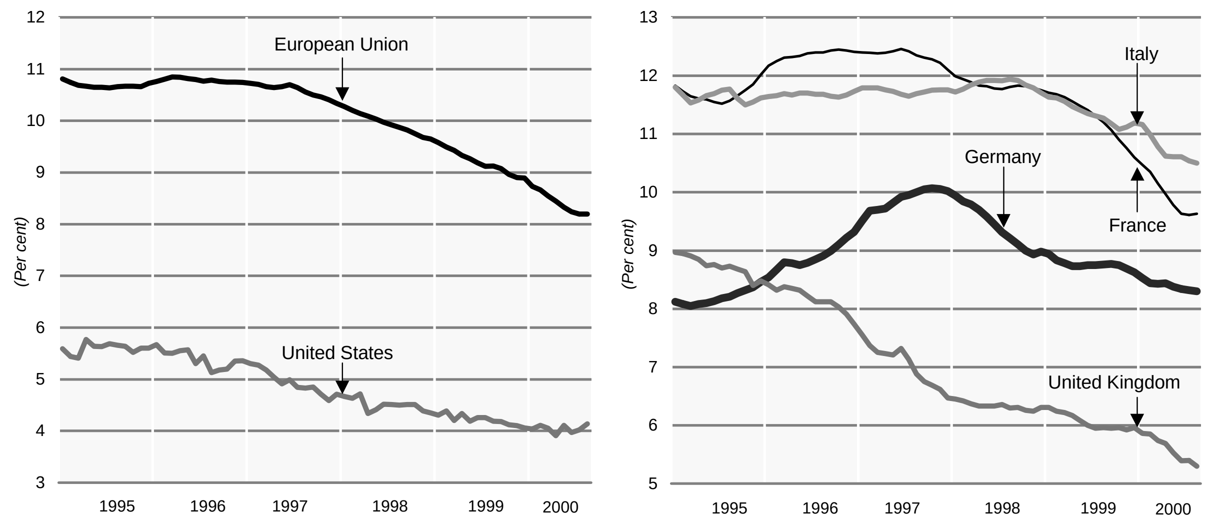
[7] There was an increase in tobacco excise duties, which is estimated to have added almost 1 percentage point to the overall change in the consumer price index in 2000.

[8] This small difference can be explained by the fact that the government maintains price ceilings on energy products (i.e. gasoline and automotive diesel) and in recent years has used excise taxes to offset pre-tax price variations of these products. Banco de Portugal, *Economic Bulletin*, March 2000.

CHART 1.1.4

Unemployment rates in western Europe and the United States, January 1995-August 2000

(Per cent of civilian labour force, monthly data, standardized rate)



Source: National statistics; OECD, *Main Economic Indicators*, various issues; Eurostat New Cronos Database.

western Europe with employment rising and unemployment falling. Employment is forecast to increase by 1.6 per cent this year, the same increase as in 1999. This would mean a cumulative increase in employment by about 6½ per cent between 1995 and 2000. This compares with an equivalent increase of 8 per cent in the United States, where the cyclical upswing appears to have passed its peak this year.

There was some reporting of labour shortages in a number of countries. Such shortages appear to have arisen especially in the information technology sector, where there has been an enormous boom in recent years. But there are also reports of shortages in traditional industries such as construction and textiles in some countries. In France, a shortage of skilled labour in the presence of high unemployment has probably been accentuated by the gradual introduction of the 35-hour work week.[9] One way of coping with such shortages in the short run is to create a more conducive environment for the immigration of skilled foreign labour, such an inflow being tantamount to an increase in output, especially if qualified workers are complementary to capital and less qualified workers.

Against the backdrop of favourable trends in output and employment, the rate of unemployment has fallen in all countries in 2000. The average in the euro area was 9 per cent in August, down from 9.9 per cent in the same month one year earlier. The EU unemployment rate fell by 0.8 of a percentage point to 8.3 per cent over the same period. This is still more than twice as high as the current record low unemployment rate of 3.9 per cent in the United States (chart 1.1.4).

The average numbers mask, however, a much better labour market performance in a number of smaller economies, sustained by robust economic growth and labour market reforms. In the Netherlands, strong demand for labour drove down the unemployment rate to just 2.5 per cent in the summer. Labour markets are now very tight, forcing firms to put more emphasis on labour-saving investment. The long economic boom in Ireland has resulted in the unemployment rate falling to 4.4 per cent in the summer. In Sweden, the rate fell below 6 per cent in August 2000, down from 7.1 per cent 12 months earlier. In Switzerland, where unemployment has been traditionally low, the short upswing has reduced the rate to only 1.7 per cent in September.

Despite these favourable tendencies, some 45 per cent of the unemployed (or 3.8 per cent of the labour force) in the EU had been without a job for more than one year in the second quarter of 2000. This compares with a peak of 50 per cent (or 5.2 per cent of the labour force) in the final quarter of 1997.

Apart from the strengthening of economic growth, the improvements in the labour market in the various countries also partly reflect a more conducive environment for work and hiring created by specific policy measures. These include an increasing number of part-time jobs, fixed term contracts and better supply-side conditions created by tax reforms. Reductions in the lower income tax rates can provide stronger work incentives for low-income (and often less qualified) earners, while reductions in the top marginal rates can weaken the incentives for the better qualified (and often

[9] UN/ECE, *Economic Survey of Europe, 2000 No. 1*, p. 20.

more innovative) persons to seek activity in countries with lower marginal rates such as the United Kingdom and the United States.[10] Reductions in the top corporate tax rates are not only expected to create stronger incentives for fixed investment by domestic firms but also to attract more foreign direct investment and, as a result, lead to the creation of more jobs.

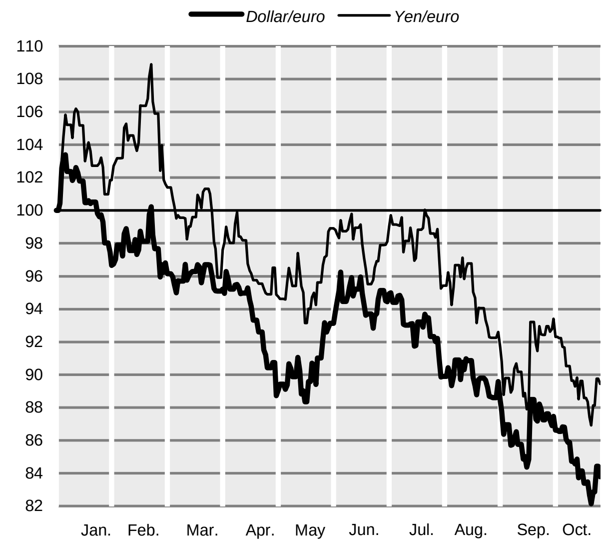
(d) Monetary conditions

Against the background of a strong cyclical recovery in the euro area, the ECB has progressively reversed its accommodative monetary policy in the course of 2000, the main refinancing rate being raised in six steps from 3 per cent to 4.75 per cent between February and early October.[11] The overall stance is now probably broadly neutral. The main motive for the Bank's action was to check the potential effects of rising energy prices on inflationary expectations via possible second-round effects on wages and prices. But the tightening of monetary policy after the summer was also seen to be intended to arrest and reverse the marked weakening of the euro in the foreign exchange markets. In late September, there was joint intervention by the G-7 central banks when the euro fell to $0.87 (chart 1.1.5). But this failed to reverse the underlying market tendency which appears to be influenced by the relatively faster rate of economic growth in the United States and by continued significant net outflows of direct and portfolio investment from the euro area. Selling pressure was accentuated in the course of October and towards the end of the month the euro was being traded for less than 83 cents, the lowest it has ever reached. The news about the unexpectedly strong slowdown of economic growth in the United States in the third quarter of 2000 has recently helped the euro. The real effective exchange rate of the euro in September 2000 was 10.5 per cent below its level 12 months earlier.

CHART 1.1.5

Exchange rates of the euro against the dollar and yen, January 2000-October 2000

(Indices, January 2000=100)



Source: European Central Bank.

Note: Daily values.

The tightening of monetary policy has been reflected in higher interest rates in the money and capital markets and in the lending rates of banks to enterprises and households. Nominal short-term interest rates in the euro area were somewhat more than 5 per cent in the autumn, up by about 2 percentage points from the beginning of the year (chart 1.1.6). Real short-term interest rates, however, were only about 2 per cent in September. Nominal long-term interest rates (yields on 10-year government bonds) have remained broadly unchanged in the course of the year so far, a reflection not only of stable inflationary expectations but also of developments in the United States bond markets (see above). Average *ex-post* real long-term rates were relatively low at about 3 per cent in the autumn.

In the United Kingdom, the Bank of England has held the base lending rate unchanged at 6 per cent since February. Following a pronounced appreciation against the euro in the course of 1999 and in early 2000, sterling weakened markedly in the second quarter, but picked up somewhat in the third quarter. In contrast, sterling depreciated substantially and steadily against the dollar up to the third quarter.

(iii) The short-term outlook

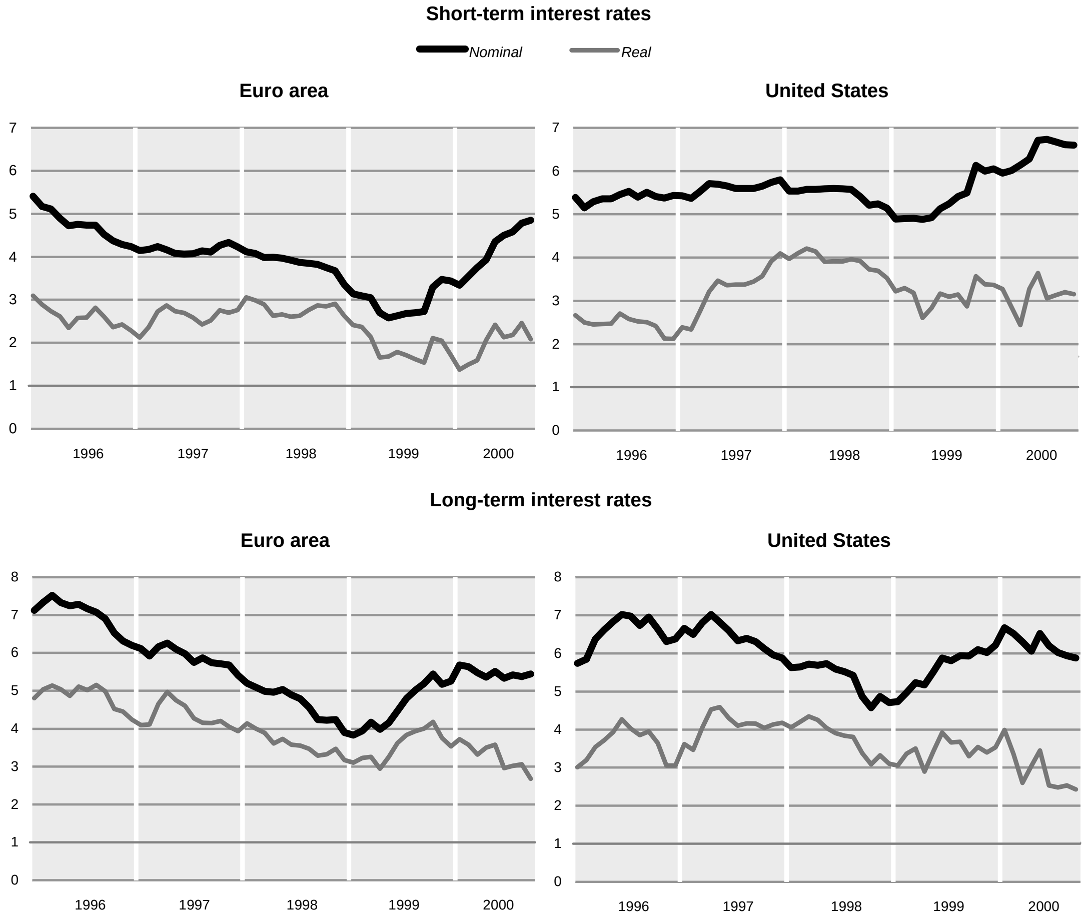
Current forecasts are for a continuation of the cyclical recovery in western Europe, with real GDP expected to increase by about 3 per cent in 2001, down from 3.4 per cent this year (table 1.1.2). The growth forecasts are the same for the euro area. The relatively

[10] In a recent report by the French Senate it was noted that although the number of French persons living abroad is relatively small compared with other advanced economies, the outflow of qualified persons to the Anglo-Saxon countries has accelerated in the 1990s. These decisions to migrate reflect a host of factors, including better job and business opportunities and higher net wages on account of lower income tax rates. Senate de la République Française, *Rapport d'information sur l'expatriation des jeunes Français*, 7 June 2000 (www.senat.fr/rap/r99-388/r99-3880.html).

[11] Since the end of June 2000, the ECB has conducted its main refinancing operations as variable instead of fixed rate tenders. In a fixed rate tender, the central bank decides both the total amount of liquidity to be provided and the cost of refinancing (the repo rate). In the normal case, the aggregate bids for funds will exceed the liquidity to be allotted. This leads to a pro-rata allocation of funds depending on the ratio of total liquidity to be supplied to total bids. But the ECB was faced with a persistent problem of massive overbidding which made it impossible to effectively gauge the underlying liquidity needs of banks. In the variable rate tenders, the ECB determines a minimum bid rate and banks indicate the interest rates they are willing to pay for various amounts of liquidity. The ECB, in turn, decides about the actual total supply of liquidity for a given demand curve. The new system implies that the actual refinancing rate is, in principle, determined in the bidding process. Fixed rate tenders have the advantage that the central bank can provide an unambiguous signal about the level of short-term interest rates to the money markets. In a variable interest rate tender, market forces have a greater bearing on refinancing rates, the mirror image of which is the loss of interest rate leadership by the central bank. So far, however, the average refinancing rate resulting from these variable rate tenders has differed only slightly from the minimum bid rate.

CHART 1.1.6

Short- and long-term interest rates in the euro area and the United States, January 1996-September 2000
(Per cent per annum)



Source: European central bank and OECD.

Note: Average monthly rates. Short-term rates: three-month money markets rates. Long-term rates: yields on 10-year government bonds (treasury bills). Real interest rates: nominal rates less year-on-year inflation rate in the corresponding month. Inflation measure: total HICP for euro area; total CPI for the United States.

mild slowdown expected in 2001 reflects the lagged effects of the progressive tightening of monetary policy and the less supportive global economic environment, notably the weakening of economic growth in the United States, and the rise in oil prices. Some offset to these factors will be provided by tax cuts, notably in France, Germany and Italy. Both private consumption and fixed investment should remain relatively strong, and exports are expected to continue to be an important source of growth in 2001. Current forecasts assume that the gains in price competitiveness associated with the weakness of the euro will be only partly reversed in 2001.

In the United States, the annual growth rate of GDP is expected to slow down from somewhat more than 5 per cent in 2000 to some 3¼ per cent. This is in line with the “soft landing scenario” in which growth of actual output in the United States will fall below the growth of potential output in the continued presence of moderate inflation. Such a development should allow for an orderly unwinding of the existing domestic and external imbalances. The slowdown in economic growth also partly reflects the impact of the progressive tightening of monetary policy. Also the wealth effect, which has supported private consumption in recent years should weaken, given the fall in asset prices. This should at the same time lead to some increase in the personal savings rate.

The short-term economic outlook for the western market economies and the global economy, however, remain subject to a number of important downside risks, which have not diminished in recent months.[12] These risks originate largely in the considerable imbalances which have built up in the United States economy and which, in turn, are reflected in the strong dollar. As a result, the possibility of a hard landing – involving sharp falls in share prices and the dollar – cannot be discarded. Such an outcome would, of course, lead to adverse spillovers in the rest of the world economy.

[12] These are discussed in more detail in UN/ECE, *Economic Survey of Europe, 2000, No. 1*.

TABLE 1.1.2

Real GDP in ECE market economies, 1999-2001
(Percentage change over previous year)

	1999	*2000* [a]	*2001* [a]
Western Europe	2.0	3.4	3.1
4 major countries	2.0	3.0	2.9
France	2.9	3.3	3.3
Germany	1.6	3.0	2.7
Italy	1.4	2.9	2.8
United Kingdom	2.1	3.0	2.7
17 smaller countries	2.2	4.0	3.6
Austria	2.1	3.5	3.2
Belgium	2.7	3.8	3.0
Cyprus	4.5	..	..
Denmark	1.7	2.3	2.3
Finland	4.0	5.0	4.5
Greece	3.2	3.9	3.9
Iceland	4.4	4.0	2.1
Ireland	9.8	9.6	6.9
Israel	2.3	4.0	4.0
Luxembourg	4.9	5.1	5.0
Malta	4.2	..	..
Netherlands	3.9	4.6	4.0
Norway	0.9	2.7	1.5
Portugal	3.0	3.4	3.3
Spain	4.0	4.0	3.5
Sweden	3.8	4.2	3.3
Switzerland	1.5	3.0	2.2
Turkey	-5.0	4.5	4.8
North America	4.3	5.2	3.2
Canada	4.5	4.7	3.0
United States	4.2	5.2	3.2
Total above	3.1	4.3	3.1
Japan	0.2	2.0	2.0
Total above, *including Japan*	2.7	3.9	3.0
Memorandum items:			
European Union	2.4	3.4	3.1
Euro area	2.4	3.4	3.1

Source: OECD national accounts; national statistics and national economic reports.

Note: All aggregates exclude Israel. Growth rates of regional aggregates have been calculated as weighted averages of growth rates in individual countries. Weights were derived from 1996 GDP data converted from national currency units into dollars using 1996 purchasing power parities.

[a] Forecasts.

The unexpectedly large increase in international oil prices, moreover, has further increased the uncertainty surrounding the international economic outlook. Current forecasts assume that the current high level of oil prices will not be sustained in 2001 and that they will fall back to the OPEC target range of $22-$28 per barrel. Sustained high oil prices, however, would lead to a stronger than expected dampening of economic growth and increase the risk that wage earners will demand higher wages to offset the losses in their real incomes. This could trigger a wage-price spiral and a much more restrictive monetary policy than currently anticipated, with subsequent negative effects on levels of economic activity. But there are as yet no signs of such second-round effects in the labour markets. In fact, given that the oil price will fall back as from spring 2001 and that the euro will appreciate somewhat against the dollar, assumptions of virtually all current forecasts, inflation in the euro area should ease towards the ECB's 2 per cent ceiling in 2001. Therefore there does not appear at present to be any need for a further tightening of monetary policy, which, in fact, would pose an unnecessary risk to economic growth. Indeed, the rise in oil prices is not inflationary per se; it constitutes, rather, a one-off increase in the domestic price level, which should be accommodated by monetary policy.

1.2 Transition economies

(i) Introduction

An unexpectedly strong recovery in almost all the ECE transition economies marked the first half of 2000, their aggregate GDP increasing by 6 per cent above the same period of the previous year (table 1.2.1). In all of them (with the exception of Georgia) GDP increased, the first time in 10 years when such a robust economic performance has pervaded the region. Both external and domestic factors underpinned this growth. Strong import demand from western Europe gave a boost to exports from the transition economies while commodity exporters benefited from higher global demand and rising commodity prices. At the same time, progress in systemic transformation (although varying widely among countries) also contributed to the strength of the recovery, notably in the more advanced transition countries.

In many cases, however, the high growth rates merely indicate a recovery from a very low base. Given the enormous output decline in a number of transition economies during the past decade, the current recovery has still had little impact on the living standards of the population. Nevertheless, the economic upturn is most welcome, not least because it raises popular support for, and public confidence in, the market-oriented economic reforms in the transition economies.

Significantly, after a particularly difficult decade of economic and political transformation and a devastating crisis in 1998, one of the highest rates of growth in the region in the first half of 2000 was in Russia where GDP grew 7.5 per cent (year-on-year). Given the size of Russia's economy, this has a considerable influence on the aggregate rate of growth of the ECE transition economies as a whole. The factors behind the strong recovery in Russia are discussed in section 1.2(ii), but it is worth highlighting that, finally, there appear to be signs that economic restructuring has brought about some positive changes in market-oriented behaviour among Russian firms. Somewhat paradoxically, this is happening not so much because of the success of economic policies (the reform process has been one of stop-and-go, and polices have often been flawed) but in spite of a lack of coherent reforms during the past decade.

TABLE 1.2.1

Basic economic indicators for the ECE transition economies, 1998-2001
(Rates of change and shares, per cent)

	GDP (growth rates)						*Industrial output (growth rates)*			*Inflation (per cent change, Dec./Dec.)*			*Unemployment rate (end of period, per cent)*		
			2000												
	1998	*1999*	*April official forecast*	*Jan.-Jun. actual*	*October official forecast*	*2001 official forecast*	*1998*	*1999*	*Jan.-Jun. 2000*	*1998*	*1999*	*2000* [a]	*1998*	*1999*	*Jun. 2000*
Eastern Europe	1.8	1.4	4	4.6	4.2	4.3	1.4	-0.6	9.9	..	..	..	12.6	14.6	14.6*
Albania	8	7.3	8	..	7	8	21.8	16.0	18.4	7.8	-1.0	0.1	17.6	18.2	17.1
Bosnia and Herzegovina [b]	..	..	12	..	12	..	23.8	10.6	15.3	2.2	-0.4	0.5	38.5	39.1	..
Bulgaria	3.5	2.4	4	5.2	4.5	5	-7.9	-12.3	3.2	0.9	6.2	11.0	12.2	16.0	18.2
Croatia	2.5	-0.3	2.6	3.8	2.8	3-4	3.7	-1.4	2.8	5.6	4.6	7.3	18.6	20.8	20.5
Czech Republic	-2.2	-0.2	1.5	3.1	2.7	3	1.6	-3.1	5.0	6.7	2.5	4.2	7.5	9.4	8.7
Hungary	4.9	4.5	5	6.2	6	6	12.5	10.7	21.0	10.4	11.3	9.2	9.1	9.6	8.9
Poland	4.8	4.1	5.2	5.6	5	5.3	3.5	4.3	10.2	8.5	9.9	10.6	10.4	13.0	13.5
Romania	-5.4	-3.2	1.3	2.1	1.5	..	-13.8	-11.2	5.0	40.7	54.9	41.0	10.3	11.5	10.8
Slovakia	4.1	1.9	2	1.7	1.6	3.2	3.8	-3.4	8.3	5.5	14.2	15.4	15.6	19.2	19.1
Slovenia	3.8	5.0	3.75	4.9	4.75	4.5	3.7	-0.5	8.4	6.6	8.1	9.9	14.6	13.0	11.8
The former Yugoslav Republic of Macedonia	2.9	2.7	6	10.4	6	5-6	4.5	-2.6	10.7	-1.1	2.3	..	41.4	47*	..
Yugoslavia [c]	2.5	-19.3	14	..	14	..	3.6	-23.1	19.9	45.7	54.0	65.0	27.2	27.4	26.5
Baltic states	4.7	-2.3	3	3.9	3.6	4.2	6.0	-7.4	3.5	..	..	..	7.3	9.1	9.3
Estonia	4.7	-1.1	3.8-4.0	6.4	5.5	5.5	4.1	-3.9	12.0	6.8	3.9	3.0	5.1	6.7	6.2
Latvia	3.9	0.1	3.5	5.2	4-5	4.4	3.1	-5.4	3.8	2.8	3.3	2.6	9.2	9.1	8.4
Lithuania	5.1	-4.2	2	1.9	2.1	3.5	8.2	-9.9	-0.8	2.4	0.3	1.3	6.9	10.0	11.1
CIS	-3.0	2.9	2.3	7.0	5.8	4.1	-3.1	7.2	10.0	..	..	..	9.0	8.3	7.2
Armenia	7.3	3.3	5.6	2.6	4	6.5	-2.1	5.2	2.9	-1.2	2.1	-2.0	8.9	11.5	11.9
Azerbaijan	10.0	7.4	8	8.5	8	8.5	2.2	3.6	4.7	-7.6	-0.5	1.7	1.4	1.2	1.1
Belarus	8.4	3.4	2-3	4.0	2-3	3-4	12.4	10.3	5.6	181.6	251.3	190.7	2.3	2.0	2.0
Georgia	2.9	2.9	4.2-4.8	-1.8	3	4-5	-1.8	7.4	9.1	10.7	11.1	2.5	4.2	5.6	..
Kazakhstan	-1.9	1.7	3	10.5	5-6	5-6	-2.4	2.7	16.3	1.9	18.1	10.5	3.7	3.9	4.2
Kyrgyzstan	2.1	3.6	4-5	7.4	4-5	5.8	5.3	-1.7	3.3	18.3	39.8	13.0	3.1	3.0	3.2
Republic of Moldova [d]	-6.5	-4.4	2	1.7	–	5	-15.0	-9.0	3.6	18.2	43.8	31.7	1.9	2.1	2.2
Russian Federation	-4.9	3.2	1.5-2.5	7.5	6-7	4	-5.2	8.1	10.3	84.5	36.6	20.2	13.3	12.2	10.1
Tajikistan	5.3	3.7	..	6.5	..	..	8.2	5.6	9.0	2.7	30.1	35.0	2.9	3.1	3.1
Turkmenistan	5.0	16.0	12	14.0	12	12	0.2	15.0	14.0	19.8	..	..	..	..	..
Ukraine	-1.9	-0.4	1	5.0	3.5	3-4	-1.0	4.0	10.8	20.0	19.2	30.3	4.3	4.3	4.3
Uzbekistan	4.4	4.4	5	3.8	5	..	3.6	6.1	6.2	25.9	26.0	..	0.4	0.5	0.7
Total above	-1.1	2.2	3	6.0	5.2	4.2	-0.9	3.4	9.9	..	..	..	..	..	..
Memorandum items:															
CETE-5	3.2	3.1	4.1	4.8	4.4	4.7	4.5	2.8	10.8	..	..	..	10.2	12.5	12.5
SETE-7	-1.5	-3.0	3.6	4.2	3.8	3.3	-7.3	-11.5	6.9	..	..	..	15.4	16.5	16.5*
Former GDR	2.0	..	..	..	..	..	7.6	4.8	..	1.1	0.2	..	17.4	17.7	16.5

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat.

Note: Aggregates are UN/ECE secretariat calculations, using PPPs obtained from the 1996 European Comparison Programme. Output measures are in real terms (constant prices). Forecasts are those of national conjunctural institutes or government forecasts associated with the central budget formulation. Industrial output refers to gross output, not the contribution of industry to GDP. Inflation refers to changes in the consumer price index. Unemployment generally refers to registered unemployment at the end of the period (with the exceptions of the Russian Federation, where it is the Goskomstat estimate according to the ILO definition, and Estonia where it refers to job seekers). Aggregates shown are: *Eastern Europe* (the 12 countries below that line), with sub-aggregates *CETE-5* (central European transition economies: Czech Republic, Hungary, Poland, Slovakia, Slovenia) and *SETE-7* (south-east European transition economies: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, The former Yugoslav Republic of Macedonia and Yugoslavia); *Baltic states* (Estonia, Latvia, Lithuania); and *CIS* (12 member countries of the Commonwealth of Independent States).

a June 2000 over June 1999.

b Data reported by the Statistical Office of the Federation; these exclude the area of Republika Srpska.

c Gross material product instead of GDP. Data for 1999 and 2000 exclude Kosovo and Metohia.

d Excluding Transdniestria.

Whatever the particular effects of policy, one of the undisputed outcomes has been the abolition of administrative control and central planning in Russia and the privatization of a large share of the economy. Notwithstanding the remaining difficulties and restrictions, which are numerous, the dismantling of the command economy has created a degree of economic freedom sufficient for entrepreneurship to begin to develop in recent years on a relatively wide scale. While the amplitude of the present recovery would not have been possible without the existence of underutilized capacities, its broad base suggests that a large number of local manufacturers were capable of taking advantage of the favourable external and domestic economic conditions. The fact that at least some Russian firms are becoming responsive to market signals is an indication of the emergence of market-oriented behaviour and performance at the enterprise level.

The strong economic performance of most of the transition economies during the first half of 2000 was often accompanied by increased inflationary pressures. Despite sharply rising productivity and a predominantly export-driven recovery, rates of consumer price inflation in many countries were higher than expected, mostly due to the cost-push pressures generated by soaring fuel prices. In some cases, the unexpected resurgence of inflation spurred policy changes (principally a tightening of monetary policy), aimed at arresting further hikes. Another negative impact of rising energy prices is the risk to export competitiveness due to the still relatively high-energy intensity of output in the transition economies. So far this adverse effect has been more than offset by productivity gains but it could be a problem if productivity growth slows down. Fiscal developments, however, have been better than expected in most transition economies, not only due to the strength of the recovery but also because of windfall gains related to price sensitive revenue items (such as higher duties and excise taxes).

The effects of the strong recovery on labour markets have varied among countries, reflecting their different cyclical positions as well as differences in the extent of economic transformation. In most countries, however, the economic upturn has not led to a noticeable increase in labour demand, suggesting the existence of slack in factor utilization as well as a further deepening of the process of economic restructuring. Unemployment rates in many cases have increased or remained at precariously high levels.

The first half of 2000 was also marked by a surge of merchandise trade flows from and to the transition economies (table 1.2.2), although in a number of them the level of trade has still not regained its level before the Russian crisis. At the same time, the terms of trade effects of the rise in world commodity prices and the appreciation of the dollar were highly differentiated between the transition economies depending on the composition of their trade. Substantial gains in the relatively small group of commodity exporting CIS countries contrasted with sizeable losses for the net commodity importers (all the east European and Baltic states as well as a number of the CIS countries). Consequently, there were similarly large differences in the development of trade in volume and in value terms, with commodity exporters netting considerable windfall gains, while for some of the east European economies the volume of their exports grew by some 7-10 percentage points more than their current dollar value.

Despite the variable impact of international prices and exchange rates, in general there was some easing of pressure on the external balances during the first half of 2000. In many countries current account deficits narrowed (although for some the opposite was the case) and, in addition, the conditions of access to international capital markets generally continued to improve. Nevertheless, a number of transition economies continue to face external financial constraints on their rates of economic transformation and their prospects for growth.

The autumn of 2000 saw a change of political regime in Yugoslavia, which will undoubtedly have major implications not only for the Yugoslav economy but also for the south-east European region as a whole. Among the first signs of positive change were the partial lifting of sanctions (which should give a boost to all trade flows from and to south-east Europe) and the pledge by the EU and the IFIs of substantial assistance for the reconstruction of the Yugoslav economy. It is clear that the new Yugoslav administration is facing the daunting task of rebuilding and reviving a ruined economy – shattered not only by the air strikes of 1999 but also by the disastrous policies followed by the Milosevic regime – while at the same time launching a programme of market reforms that had been stalled for a decade. Given the severity of Yugoslavia's economic problems, their solution requires not only a major and coherent policy effort by the new government but also very substantial and generous assistance on the part of the international community.

(ii) Output and demand

A prominent feature of the economic performance of the ECE transition economies in the first half of 2000 has been the exceptionally rapid growth of the CIS countries and especially of the Russian Federation: their aggregate GDP rose by 7 per cent year-on-year, with a 7.5 per cent rate of growth in Russia. In eastern Europe aggregate GDP grew by 4.6 per cent and in the Baltic states by almost 4 per cent (table 1.2.1).

An export-driven upturn in manufacturing and mining is leading the recovery in practically all the transition economies, highlighting the importance of these sectors in the process of economic transformation. At the same time, the dependence of some transition economies, particularly in the CIS, on commodity exports is a major source of vulnerability to external shocks. In the present circumstances, exporters and governments are reaping windfall gains from the global demand and soaring world market prices; however, some prudence in the use of these funds is probably advisable against an eventual reversal of these developments.[13]

While external demand has been generally buoyant for all the transition economies, the strength of domestic demand has varied considerably. In the small group of the leading transition economies both private consumption and investment have made sizeable contributions to

[13] For example, by setting aside some of the unanticipated fiscal revenue as a cushion against future external shocks.

TABLE 1.2.2

International trade and external balances of the ECE transition economies, 1998-2000

(Rates of change and shares, per cent)

	Merchandise exports in dollars (growth rates)			*Merchandise imports in dollars (growth rates)*			*Trade balances (per cent of GDP)*			*Current account (per cent of GDP)*		
	1998	*1999*	*2000* [a]	*1998*	*1999*	*2000* [a]	*1998*	*1999*	*2000* [a]	*1998*	*1999*	*2000* [a]
Eastern Europe [b]	9.3	-0.8	14.2	9.0	-2.2	12.0	-10.0	-9.6	-9.4	-4.6	-5.5	-5.4
Albania	50.9	28.3	-11.3	28.2	11.3	14.3	-19.2	-16.9	-18.7	-1.5	-4.2	-9.2
Bosnia and Herzegovina	82.7	47.3	41.1	36.4	14.7	8.7	-42.8	-43.5	-22.8	-26.6	-49.9	-53.1
Bulgaria	-15.1	-5.6	23.8	0.5	9.9	19.8	-6.2	-12.0	-15.5	-0.5	-5.5	-8.1
Croatia	8.9	-6.0	10.9	-7.9	-7.2	–	-17.7	-17.4	-15.9	-7.0	-7.5	-7.7
Czech Republic	15.7	1.9	12.9	4.4	0.3	16.7	-4.4	-3.8	-4.7	-2.4	-1.9	-3.0
Hungary	20.4	8.7	14.1	21.1	9.0	14.1	-5.7	-6.2	-7.5	-4.9	-4.3	-3.6
Poland	2.6	-3.1	11.9	10.9	-2.5	9.7	-11.9	-11.9	-11.6	-4.3	-7.4	-7.4
Romania	-1.5	2.4	27.4	4.9	-12.2	19.8	-8.5	-5.5	-6.3	-7.2	-3.8	-2.9
Slovakia	11.8	-4.9	20.8	11.9	-13.5	10.4	-10.5	-5.1	-2.4	-9.7	-5.5	-1.6
Slovenia	8.1	-5.6	4.3	7.8	-1.4	-2.5	-5.4	-7.0	-7.7	-0.8	-3.9	-2.7
The former Yugoslav Republic of Macedonia	11.0	-9.0	29.0	9.0	-6.1	56.0	-17.2	-17.6	-24.5	-8.8	-3.9	-9.3*
Yugoslavia	6.8	-47.6	12.8	0.1	-31.8	33.8	-11.8	-10.9	-8.7	-7.0	-7.4	-6.5*
Baltic states	3.5	-12.6	22.3	7.5	-13.9	15.0	-22.7	-19.0	-17.2	-11.0	-9.7	-4.9
Estonia	10.3	-9.2	27.5	7.8	-14.0	25.8	-29.7	-22.9	-24.7	-9.2	-5.7	-5.5
Latvia	8.3	-4.9	11.2	17.1	-7.6	10.9	-22.6	-19.5	-16.8	-10.7	-10.3	-5.6
Lithuania	-3.9	-19.3	23.7	2.6	-17.3	8.6	-19.4	-16.9	-13.9	-12.1	-11.2	-4.2
CIS	-15.2	-1.1	48.6	-14.0	-23.8	15.5	6.0	15.2	23.3	-1.7	8.7	16.3
Armenia	-5.2	5.4	16.8	1.1	-11.2	13.5	-36.0	-30.9	-43.3	-21.3	-16.6	-30.2
Azerbaijan	-22.4	53.3	186.0	35.6	-3.9	31.7	-10.6	-2.7	9.1	-30.7	-15.0	-2.4
Belarus	-3.2	-16.2	24.3	-1.6	-22.1	34.1	-12.9	-7.0	-15.9	-7.6	-2.4	-3.3
Georgia	-19.7	23.7	64.0	-6.3	-31.9	2.4	-19.8	-13.3	-10.3	-11.9	-7.1	-3.6
Kazakhstan	-16.3	2.9	105.6	1.1	-15.3	28.9	4.9	12.0	27.0	-5.5	-1.1	6.7
Kyrgyzstan	-15.0	-11.6	4.3	18.7	-28.7	-5.7	-20.5	-12.0	-4.4	-23.2	-15.2	-6.7
Republic of Moldova	-27.8	-26.9	13.3	-12.6	-44.0	40.0	-23.1	-9.6	-25.2	-19.0	-2.0	-10.5
Russian Federation	-16.3	0.5	53.7	-17.9	-29.5	6.8	10.3	22.7	31.1	0.4	13.7	22.2
Tajikistan	-20.0	15.4	31.0	-5.2	-6.7	3.1	-8.7	2.4	17.3	-8.1	4.4	17.7
Turkmenistan	-20.9	99.9	68.6	-14.9	46.7	34.9	-14.6	-8.9	11.0	-33.0	-21.4	2.4
Ukraine	-11.2	-8.4	18.0	-14.3	-19.3	22.3	-5.0	-0.9	-3.1	-3.2	2.8	1.5
Uzbekistan	-20.1	-9.0	-1.9	-25.4	-9.1	12.9	0.6	0.5	-2.0	-0.8	-0.1	-3.4
Total above [b]	-3.5	-1.4	29.3	0.4	-9.7	13.1	-2.7	-0.1	4.6	-3.3	0.2	4.0
Memorandum items:												
CETE-5	11.6	0.6	13.0	11.1	-0.6	11.3	-9.0	-8.7	-8.9	-4.2	-5.6	-5.3
SETE-7 [b]	0.2	-7.1	21.1	2.2	-8.1	15.3	-12.7	-12.5	-11.5	-6.0	-5.1	-5.8

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat; IMF; UN/ECE secretariat calculations.

Note: Foreign trade growth is measured in current dollar values. Trade and current account balances are related to GDP at current prices, converted from national currencies at current dollar exchange rates. Current-price GDP values for the first half of 2000 are in some cases estimated from reported real growth rates and consumer price indices. On regional aggregates, see the note to table 1.2.1.

a January-June.

b Aggregates of current account balances exclude Bosnia and Herzegovina and Yugoslavia.

growth. At the same time domestic demand has remained subdued in a number of countries due to policies or to lags in the transmission of output and productivity gains into real income.

(a) Eastern Europe and the Baltic states

Among the *central European countries*, economic growth in the first half of 2000 exceeded expectations in the Czech Republic, Hungary and Slovenia. Hungary was the fastest growing economy in the region with year-on-year GDP growth rate of 6.2 per cent. Growth accelerated during the second quarter in the Czech Republic and Slovakia mostly due to industrial output. By June GDP growth in the Czech Republic was more than double the expected annual rate and in Slovakia industrial confidence and output increased significantly although growth during the first half-year was below expectations. In the Czech Republic and Hungary the official forecasts of GDP growth for the current year were revised upwards (table 1.2.1), but there was some concern in Hungary that the high growth rate may not be sustained because of lower then expected investment. Although much stronger than in 1999, the Polish economy showed some signs of slowing down in the second quarter of 2000: after growing at 6.2 per cent and 6.0 per cent (year-on-year) during the two preceding quarters respectively, GDP growth decelerated to 5.2 per cent. This pulled down the average for the first half of 2000 to 5.6 per cent and, with a further slowdown expected in the second half of the year, prompted a slight lowering of the forecast for the year as a whole.

Given the strong cyclical upturn in western Europe, economic growth in the central European transition economies has been driven mainly by exports of manufactures. After a year of decline, industrial output in the Czech Republic, Slovakia and Slovenia grew more than GDP growth in the first half of 2000. The rate of growth of industrial production in Hungary almost tripled, from 7.7 per cent to 21 per cent (table 1.2.3). Electrical machinery and optical equipment underpinned these high growth rates with sales increasing by over 63 per cent during the first eight months of 2000 compared with the same period in 1999.[14] In Poland industrial production during the first half of the year rose 10.2 per cent driven by rapid export growth (up 24.7 per cent in volume);[15] preliminary data for July-September, however, point to some deceleration (table 1.2.3). In most of these countries output growth was relatively higher in electrical and optical equipment, but wood products, rubber and plastics, chemicals, and transport equipment also tended to grow more than average. In contrast, the growth of the service sector has tended to be below average,[16] although within the industrial sector, growth rates have been uneven.[17] The construction sector on average has been less buoyant than in previous years: in Poland it has been stagnating since April 2000 (largely due to a slackening in the rate of fixed investment) and in Slovakia it has been in decline for a third consecutive year.

With stronger import demand from western Europe in 2000, export growth has outpaced domestic demand in the central European economies. Thus, in Hungary exports of manufactured goods increased in the first eight months by more than 31 per cent (year-on-year), or about 7.5 percentage points more than the growth of industrial output. Nevertheless, at the same time, domestic sales of manufactured goods in Hungary increased by 12.6 per cent.[18] In Slovenia, the export-led rebound marked a break with the pattern of previous years when domestic demand played a leading role.

Buoyant external demand and growing investment have in general led to a fall in the share of private consumption in GDP in the first half of 2000; government consumption is also expected to be in line with or below the growth of consumer demand. During the first half of 2000, consumer demand in Hungary increased by only 3.4 per cent whereas gross fixed capital formation rose by 6.1 per cent. In Slovenia consumer demand is expected to increase by 2.9 per cent and gross fixed capital formation by 9 per cent for 2000 as a whole.[19] A similar pattern of final demand is also to be seen in the Czech Republic and Slovakia.

In Poland, domestic demand, which has been rising more slowly than GDP since the fourth quarter of 1999, has been gradually weakening in the course of 2000: the year-on-year rates of growth of private consumption and gross fixed capital formation declined from 4.6 per cent and 5.5 per cent in the first quarter to 2.6 per cent and 2.9 per cent, respectively, in the second.[20] Recent changes in the volume of retail trade point to a further, substantial slowdown of private consumption in July-August (table 1.2.4). The tightening of monetary policy in Poland (in particular the increases in interest rates in late 1999 and early 2000) have had a negative impact on both fixed capital investment and personal consumption expenditures, the latter also being affected by the decline in real personal incomes.

During the first half of 2000, output strengthened considerably in the three *Baltic states*: their aggregate GDP increased by 3.9 per cent (year-on-year), following a fall of 2.3 per cent in 1999. However, the pace of recovery from last year's recession has been uneven in the three countries: this is especially the case in the dynamics of domestic demand, particularly of investment.

In Estonia GDP rose 6.4 per cent year-on-year in January-June 2000, the highest rate among the Baltic states, based on surging industrial output (up 12 per cent in the first half of the year), which in turn was due to rapid export growth. The service sector, in the first place transportation, also made a significant contribution to growth.[21] The construction sector was also growing,

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14 Electrical machinery and optical equipment (NACE/ISIC 30-33). During the same period gross output of radio, television and communication equipment (ISIC 32) increased by more than 128 per cent. The growth in demand for this category of manufactured goods was almost evenly divided between the external and internal markets, export sales increasing by 65.7 per cent and domestic sales by 63.5 per cent. A relatively insignificant industry in Hungary 10 years ago, it now accounts for almost 22 per cent of export demand and 8.4 per cent of domestic demand for industrial goods (food and tobacco continue to make up about 25 per cent of domestic demand for industrial goods). Hungarian Central Statistical Office (CSO), Stadat system (www.hsu.hu).

15 The aggregate volume growth of exports of manufactured goods is a weighted average of the changes for SITC Sections 5 to 9. UN/ECE secretariat calculations based on data in CSO, *External Trade* (Warsaw), January-June 2000, p. 196.

16 For example, in Hungary it increased by 2.5 per cent, much less than GDP growth.

17 Thus in Poland, the rise in industrial output in the first half of 2000 was mainly sustained by the manufacturing sector (up 10.7 per cent in the first half of 2000) while mining and quarrying output remained almost flat. CSO, *Statistical Bulletin*, Vol. XLIV, No. 7, August 2000 (Warsaw), p. 30.

18 Hungarian CSO, Stadat system (www.hsu.hu).

19 Institute of Macroeconomic Analysis and Development, *Slovenian Economic Mirror*, Vol. VI, No. 7 (Ljubljana), July 2000.

20 Polish quarterly national accounts statistics; direct communication from the Polish CSO to the UN/ECE secretariat.

21 Rail freight and goods processed through Estonian ports increased by 25 to 30 per cent in this period.

TABLE 1.2.3

GDP and industrial output in the ECE transition economies, 1999-2000
(Percentage change over the same period of the preceding year)

	GDP							Industrial output						
	1999				2000			1999				2000		
	Jan.-Mar.	Jan.-Jun.	Jan.-Sept.	Jan.-Dec.	Jan.-Mar.	Jan.-Jun.	Jan.-Sept.	Jan.-Mar.	Jan.-Jun.	Jan.-Sept.	Jan.-Dec.	Jan.-Mar.	Jan.-Jun.	Jan.-Sept.
Eastern Europe	-0.1	0.4	1.1	1.4	4.8	4.6	..	-4.4	-3.7	-2.3	-0.6	8.5	9.9	10.2[a]
Albania	..	..	..	7.3	..	..	..	26.6	19.4	23.0	16.0	16.8	18.4	18
Bosnia and Herzegovina	..	..	..	..	..	..	..	11.7	9.6	9.3	10.6	17.8	15.3	10.1
Bulgaria	0.8	1.8	3.0	2.4	4.8	5.2	..	-16.2	-13.4	-14.1	-12.3	5.2	3.2	2.0[a]
Croatia	-1.5	-1.1	-1.0	-0.3	4.0	3.8	..	-3.6	-1.9	-2.8	-1.4	3.7	2.8	2.7
Czech Republic	-3.3	-1.6	-0.7	-0.2	4.4	3.1	..	-9.1	-6.6	-5.2	-3.1	4.8	5.0	5.8[a]
Hungary	3.5	3.7	4.0	4.5	6.6	6.2	..	8.2	7.7	8.7	10.7	20.8	21.0	20.9[a]
Poland	1.6	2.4	3.3	4.1	6.0	5.6	..	-2.6	-0.7	1.5	4.3	10.1	10.2	9.2
Romania	-4.5	..	..	-3.2	0.9	2.1	..	-9.6	-9.3	-9.0	-11.2	0.5	5.0	7.5[a]
Slovakia	1.8	2.4	1.8	1.9	1.5	1.7	..	-8.0	-6.6	-5.0	-3.4	4.3	8.3	9.1[a]
Slovenia	2.9	5.2	4.9	5.0	6.3	4.9	..	-2.9	-2.3	-1.7	-0.5	7.2	8.4	7.7
The former Yugoslav Republic of Macedonia	..	..	..	2.7	..	10.4	..	-13.3	-9.7	-2.6	-2.6	10.3	10.7	6.4[a]
Yugoslavia	..	..	..	-19.3	..	..	..	-10.4	-28.2	-26.0	-23.1	-5.0	19.9	18.8
Baltic states	-2.6	-2.2	-2.7	-2.3	4.8	3.9	..	-10.3	-9.7	-8.7	-7.4	6.1	3.5	4.0[a]
Estonia	-3.3	-2.9	-2.1	-1.1	5.2	6.4	..	-12.9	-10.5	-7.4	-3.9	11.6	12.0	11.8
Latvia	-1.5	-1.3	-0.8	0.1	5.5	5.2	..	-13.2	-14.3	-11.6	-5.4	3.6	3.8	3.2[a]
Lithuania	-2.9	-2.4	-4.1	-4.2	4.2	1.9	..	-8.0	-7.3	-8.1	-9.9	4.5	-0.8	1.4
CIS	-2.1	-0.5	1.7	2.9	7.6	7.0	..	-1.2	2.7	5.9	7.2	11.0	10.0	9.9
Armenia	4.6	4.9	6.1	3.3	0.3	2.6	..	-4.4	2.8	7.6	5.2	0.3	2.9	3.9
Azerbaijan	6.2	5.6	6.9	7.4	6.5	8.5	9.9	4.1	2.0	2.8	3.6	3.5	4.7	5.8
Belarus	1.4	2.4	2.4	3.4	6.4	4.0	5.0	3.7	7.0	7.6	10.3	7.5	5.6	8.1
Georgia	3.6	2.6	3.7	2.9	0.6	-1.8	..	-5.7	0.6	1.7	7.4	14.1	9.1	7.2
Kazakhstan	-3.6	-3.3	0.3	1.7	9.2	10.5	..	-4.1	-4.1	–	2.7	15.2	16.3	15.4
Kyrgyzstan	1.2	0.4	3.5	3.6	1.0	7.4	5.7	-4.6	-10.0	-4.6	-1.7	-4.8	3.3	6.7
Republic of Moldova	-7.8	-5.3	-1.7	-4.4	1.0	1.7	..	-27.1	-25.2	-12.8	-9.0	3.3	3.6	2.0
Russian Federation	-2.7	-0.7	1.8	3.2	8.4	7.5	..	-1.6	3.1	7.0	8.1	11.9	10.3	9.7
Tajikistan	2.4	2.4	0.9	3.7	3.8	6.5	10.8	4.4	7.9	6.8	5.6	8.7	9.0	10.1
Turkmenistan	13.3	14.6	14.0	16.0	12.0	14.0	17.0	15.0	18.0	18.0	15.0	14.0	14.0	21.0
Ukraine	-4.7	-3.0	-1.7	-0.4	5.5	5.0	5.0	-2.4	0.2	2.3	4.0	9.7	10.8	11.6
Uzbekistan	2.9	3.8	4.4	4.4	3.0	3.8	4.2	4.7	5.6	5.9	6.1	5.1	6.2	6.4
Total above	-1.4	-0.2	1.4	2.2	6.5	6.0	..	-2.8	-0.5	1.9	3.4	9.8	9.9	10.1[a]
Memorandum items:														
CETE-5	1.0	1.9	2.5	3.1	5.4	4.8	..	-2.8	-1.2	0.4	2.8	10.3	10.8	10.7[a]
SETE-7	-2.8	-3.2	-2.4	-3.0	3.3	4.2	..	-9.8	-11.8	-11.3	-11.5	1.6	6.9	7.9[a]
Former GDR	..	..	..	..	..	..	..	4.6	4.8	5.2	4.8	..	..	..

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat.

Note: Industrial output figures are based on monthly statistical reporting. Because of differences in coverage, monthly cumulative figures for 1999 as a whole differ slightly from reported annual figures for some countries. For these countries reported annual figures have been used. On regional aggregates see the note to table 1.2.1.

a January-August.

albeit not as rapidly. Domestic demand in general was growing more slowly than output (by 3.7 per cent in the first quarter of 2000), but the almost 10 per cent increase in the volume of retail sales suggests an acceleration in private spending during the course of the year (table 1.2.4). Private sector fixed investment has grown faster than GDP since the beginning of the year, but it has not yet fully regained its pre-crisis level.

Latvia's GDP increased 5.2 per cent in the first half of the year. There were signs of some slowing down in the second quarter, and the recovery of gross industrial output (3.8 per cent year-on-year in January-June) was somewhat below expectations.[22] Value added in the construction sector increased by 4.4 per cent, a marked deceleration from the rate in 1999 due mainly to lower public investments. The service sector also contributed to the growth of aggregate output with a 5.1 per cent year-on-year rate of growth. Domestic demand, supported by low interest rates and a more rapid growth of monetary aggregates, was recovering strongly with

[22] However, manufacturing value added in January-June 2000 increased by 5.5 per cent over the same period of the previous year.

TABLE 1.2.4

Retail trade in selected transition economies, 1999-2000
(Percentage change over same period of preceding year)

	1999				2000		
	Jan.-Mar.	*Jan.-Jun.*	*Jan.-Sept.*	*Jan.-Dec.*	*Jan.-Mar.*	*Jan.-Jun.*	*Jan.-Sept.*
Albania	..	..	..	..	..	..	..
Bosnia and Herzegovina	..	..	..	..	24.9	36.1	..
Bulgaria	-4.6	-1.8	-1.4	-6.0	6.7	3.7	3.5[a]
Croatia	-7.1	-7.9	-7.6	-4.6	6.5	11.6	12.9[b]
Czech Republic	1.0	1.6	1.2	2.2	6.6	5.9	5.2[b]
Hungary	2.9	3.9	4.6	6.5	4.2	2.9	3.4[a]
Poland	10.8	13.2	15.3	16.9	10.6	8.1	5.8[a]
Romania	4.6	0.8	-2.6	-5.0	-12.3	-8.8	-8.1[b]
Slovakia	8.8	12.1	10.9	9.8	-1.7	-1.4	-0.3[a]
Slovenia	-5.9	5.5	2.9	2.9	17.7	5.7	6.8[b]
The former Yugoslav Republic of Macedonia	13.3	12.0	15.7	15.5	4.2	8.8	10.4
Yugoslavia	-6.5	-19.5	-20.4	-18.9	-13.6	3.8	5.3[b]
Estonia	3.2	3.3	3.9	5.5	9.0	11.4	11.8
Latvia	25.2	17.1	12.9	12.0	5.6	4.6	5.3[b]
Lithuania	-15.5	-13.4	-13.2	-11.5	8.5	9.7	10.0[a]
Armenia	12.7	14.9	13.6	7.7	7.4	6.3	6.9
Azerbaijan	14.8	13.9	13.7	13.3	9.3	10.0	10.1
Belarus	-3.9	-0.3	1.6	9.7	18.8	10.7	6.1
Georgia	-8.4	4.5	4.5	4.6	9.7	13.2	11.4
Kazakhstan	7.2	3.7	-1.1	3.7	..	0.3	..
Kyrgyzstan	4.8	3.1	1.0	0.9	2.5	6.2	5.5
Republic of Moldova[c]	-33.1	-33.0	-32.7	-27.8	-3.0	5.1	6.4
Russian Federation	-13.7	-12.8	-12.3	-7.7	7.3	7.6	8.3
Tajikistan	49.4	37.8	21.1	4.0	-28.8	-27.0	-22.1
Turkmenistan	23.0	28.0	38.0	37.0	38.0	31.0	33.0
Ukraine	-8.5	-7.2	-6.8	-4.1	9.2	6.5	6.2
Uzbekistan	12.9	11.8	11.0	10.5	5.1	5.3	5.0

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat.

Note: Retail trade covers mainly goods in eastern Europe, the Baltic states and the Russian Federation, goods and catering in other CIS countries. The coverage in the monthly statistics is based on current reporting and may differ from the coverage in the annual statistics.

a January-August.

b January-July.

c Registered enterprises.

gross fixed capital formation rising by some 6 per cent in the first quarter of 2000.

In Lithuania, the recovery has been less robust: after a promising start in the first quarter (GDP was up 4.2 per cent), growth slowed considerably in the second, resulting in an average increase in GDP of 1.9 per cent for the first six months of 2000. A fall in total industrial output in the first half of the year was largely the result of the decline in oil refining, one of Lithuania's major industries.[23] It was only because of trade and especially transport services (the latter backed by vigorous transit cargo)[24] that output remained relatively strong in the first half of the year. With investment sharply down on the last quarter of 1999, construction was also weak. Domestic demand lagged behind GDP growth, leaving exports as the main force behind the economic recovery. Both consumption and investment were depressed as a result of tight fiscal and monetary policies (in particular, rising interest rates), but the pick-up in retail trade in the second quarter may point to some recovery at least in private consumption.

The more favourable international environment has also been beneficial for the transition economies in *south-east Europe*: governments in the region are forecasting high rates of GDP growth in 2000 (tables 1.2.1 and 1.2.2), in some cases the highest of the past decade. However, it remains to be seen whether these economies will manage to build on these favourable trends or whether they will result in just a one-time cyclical recovery. In addition, the south-east European economies are rather heterogeneous: on the one hand, although all of them suffer from numerous economic weaknesses, the nature of their problems varies widely from country to country; on the other hand, the profile of the present recovery also differs across the region.

The relatively high rates of GDP growth in Albania in recent years (as well as a projected 7 per cent growth for 2000) are mostly due to the strong performance of the service sector and, to a lesser extent, of agriculture. Manufacturing industry has a very small share in the country's economy and despite the reported high rates of growth it remains a marginal contributor to the overall growth of output.[25] After a sluggish performance in 1998 and 1999, a strong recovery is underway in The former Yugoslav Republic of Macedonia as well, with GDP rising by a reported 10.4 per cent in the first half of 2000. This turnaround was predominantly export driven, with industrial output growing by 10.7 per cent; output in the service sector has also recovered strongly. During the first half of the year there was a partial recovery in the Yugoslav economy from the steep fall in activity caused by the Kosovo conflict. A substantial share of economic

[23] Recently privatized Mazeikiu Nafta, Lithuania's only oil refinery, has suffered from crude oil supply cuts from Russia.

[24] The Lithuanian port of Klaipeda was the fastest growing port in the Baltics in the first half of 2000 with freight turnover increasing by 43 per cent, to 10.9 million metric tons. In Estonia, Tallinn's port turnover grew by 25 per cent and amounted to 15.7 million tons, whereas the largest Baltic seaport, Latvia's Ventspils, saw a 3 per cent decline, reporting a turnover of 18.1 million tons in January-June 2000. *The Baltic Times*, No. 38(225), 21-27 September 2000 (www.baltictimes.com).

[25] The available statistics on industrial production for Albania are of dubious quality. For example, the monthly, quarterly and annual indices of industrial production in constant prices, published by the Statistical Office of Albania (Institut de la Statistique), are not consistent and it is difficult to draw meaningful conclusions about the actual dynamics of industrial output. Thus, while the reported annual rate of growth for 1998 was 21.8 per cent, the monthly and quarterly fixed-base indices imply growth rates of 1.4 per cent and 15.3 per cent, respectively. At the moment of writing this *Survey*, no annual index for industrial output was available for 1999, but calculations based on the monthly fixed-base series suggest a decline (by 2.8 per cent), while the quarterly fixed-base series points to a significant increase (by 22.2 per cent). Caution is thus obviously needed in assessing the reported monthly and quarterly statistics for 2000 as well.

activity in 2000 was directly or indirectly linked to a major postwar reconstruction effort, but this, however, has put further pressure on the country's public finances, which were already under considerable strain.

The year 2000 will probably mark the end of a three-year period of deep recession in Romania: during January-June, GDP increased by 2.1 per cent and for 2000 as a whole GDP is expected to rise. The export-led recovery of the manufacturing sector has been the principal source of this positive outcome (industrial output has been accelerating since March), although the negative impact of the poor harvest remains to be seen in the data for the second half of the year. Domestic demand, which had been depressed during the past three years, also recovered somewhat in the second quarter of 2000.

Recovery has also been underway in Croatia, largely due to a strong performance of the tourist industry[26] and partly to an upturn in manufacturing exports. The dynamics of domestic demand in the first half of 2000 was uneven: while private consumption recovered faster than GDP (by 5.3 per cent), gross fixed capital formation was down 5.5 per cent from the same period of 1999. The latter reflected a series of austerity measures introduced by the newly elected government (in office since January) to check the unsustainable rise in public spending initiated by the previous administration.

There was a strong economic upturn in Bulgaria in the first half of the year, with GDP growing by 5.2 per cent. This was due to a rapid expansion of services and an export-led recovery in manufacturing industry. However the pace of industrial output was uneven, with only a handful of industries benefiting from the surge in external demand: despite a 23.8 per cent rise in exports in the first half of the year (table 1.2.2), total industrial output increased by just 3.2 per cent. Domestic demand in January-June was also buoyant and grew even faster than GDP (by 5.8 per cent compared with the first half of 1999) mostly driven by a surge in fixed investment (mainly publicly-financed infrastructural projects).

(b) Commonwealth of Independent States

The *European CIS countries* were the fastest growing subregion among the transition economies thanks to the strong economic upturn in Russia. According to preliminary Goskomstat figures, Russia's GDP increased by an unprecedented 7.5 per cent during the first six months of 2000, after growing by 7.0 per cent year-on-year in the second half of 1999. Such rates of economic growth have not been seen in Russia since the 1960s: they are quite unusual for large economies and they came as a surprise not only to most observers but also to the Russian authorities.

Several factors need to be taken into account when interpreting the current rate of Russian growth. The first is the low base of the recovery which in turn resulted from the deep economic collapse which followed the 1998 financial crisis. It was only in the first half of 2000 that aggregate output recovered from this fall. Secondly, the combination of rising oil prices and a rising dollar (export prices of Russian oil being quoted in dollars) have been highly favourable for the Russian economy. Thirdly, domestic suppliers have benefited substantially from the devaluation of the rouble in 1998 which has led to massive import substitution; although this effect has been weakening in 2000, the real exchange rate of the rouble still appears to be very competitive. Finally, there are signs that the Russian recovery is broadly based, not only across the various sectors of economic activity but also among economic agents, with smaller firms making a significant contribution to the strength of the recovery.

Output growth remained very strong in the third quarter of 2000, despite earlier expectations of a slowdown in the second half of the year: gross industrial production increased by 8.5 per cent after expanding by 8.8 per cent in the second and 11.9 per cent during the first quarter of the year.[27] In the first nine months recovery was underway in the overwhelming majority of industrial branches. The largest output gains were in the light industries, printing, pharmaceuticals and medical equipment, and ferrous metallurgy (with increases of some 20 per cent and more). A robust growth of more than 16 per cent has also been reported in chemical and machine-building industries.

Another support to recovery is the upturn in investment: during the period January-September real investment outlays were 17.5 per cent higher than in the same period of 1999.[28] Thanks to this the construction industry, which until recently had been in a deep depression, has started to recover.[29] With a relatively good grain harvest,[30] gross agricultural output has also been on the rise since mid-year which may give a further impetus to economic growth in the remaining months of 2000. Output in the energy sector was also rising albeit at more modest rates: in January-September, the output of electricity and fuel industries increased by 2.1 and 5.3 per cent, respectively.

For much of 1999, Russian growth was driven almost entirely by the increase in net exports while domestic demand was actually subtracting from aggregate output growth. Although lags in reporting the

[26] During the first seven months of 2000, the number of tourist arrivals was 43.7 per cent higher than a year earlier and the number of overnight stays was up by 50.1 per cent. Croatian National Bank, *Monthly Bulletin*, No. 52 (Zagreb), September 2000, p. 11. This has more than offset the losses caused by the Kosovo conflict in 1999.

[27] UN/ECE secretariat calculations, based on Goskomstat statistics.

[28] Russian Federation Goskomstat, *Sotsial'no-ekonomicheskoe polozhenie Rossii* (Moscow), January-September 2000, p. 7.

[29] Construction output grew by 11.7 per cent year-on-year during the first nine months of 2000. Ibid, p. 50.

[30] The Russian authorities expect this year's grain harvest to exceed 70 million tons, compared with 55 million tons in 1999 and 48 million in 1998. Bank of Finland, *Russian & Baltic Economies, The Week in Review*, No. 39, 2000.

national accounts prevent a more comprehensive analysis of the ongoing changes in 2000, there are signs of an upturn in domestic demand as well.[31] As noted earlier, there has been a surprising upsurge in investment (at rates of growth not seen for more than a decade).[32] Having collapsed in 1998-1999 (a cumulative fall of more than 30 per cent), real disposable incomes of the population increased in the first half of 2000 by 8.2 per cent and in August were nearly 10 per cent higher than a year earlier. Real wages (which fell by 22 per cent in 1999) were 25.4 per cent higher in August than 12 months earlier.[33] The recovery in real incomes is mirrored in the dynamics of consumer's expenditure: the volume of retail sales, which started to recover in the final months of 1999, increased by 8.3 per cent in January-September and in September was some 10 per cent higher than a year earlier.[34]

Recovery has also been underway in the rest of the European CIS countries in the first half of 2000. After a decade-long contraction, output increased in both Ukraine and, albeit at a modest rate, in the Republic of Moldova, while in Belarus, according to official statistics, the economy continued to expand for the fifth consecutive year. However, in all three economies, growth was narrowly based and the rate remained below the CIS average.

In Ukraine, the second largest CIS economy, real GDP rose by 5 per cent in the first half of 2000. The pace of the recovery was much stronger than expected thanks mainly to the rebound in some heavy industries (especially ferrous and non-ferrous metals) which was due to strong external demand, particularly from Russia and Asia, and the lagged effect of the real depreciation of the exchange rate in 1999. Import substitution also boosted output in industries such as food, textiles, pharmaceuticals and wood processing. On the other hand, energy production fell sharply, in part because of the chronic payments crisis in this sector. According to preliminary and proxy statistics, there has been a recovery in both private consumption and fixed capital investment.[35]

However, the economic recovery in Ukraine remains fragile as it is based on a distorted production structure. The economy contracted continuously during the past decade, and so substantial excess capacity allowed for a swift recovery in some traditional industries in 2000. Growth, however, will not be sustainable without new investments, the lack of which has been one of the major obstacles to economic restructuring and the efficient functioning of labour markets in Ukraine as well as in other transition economies. The fiscal situation also remains precarious, with low budget revenues, a large external debt, and widespread impoverishment combined with continuing political instability which discourages foreign investment.

In the Republic of Moldova, real GDP fell by nearly 70 per cent between 1989 and 1999, among the worst performances in all the ECE transition economies. In the first half of 2000, a modest recovery was getting underway with GDP increasing by 1.7 per cent thanks to export-led growth in a few industries.[36] Given that both the economy as a whole and the export sector are overly dependent on agriculture, the damage to crops caused by one of the worst droughts in decades is expected to have a negative impact on aggregate output in the second half of 2000. Given the very low and still falling level of real wages, as well as persistent liquidity shortages, domestic demand has remained rather depressed.

In recent years, the economy of Belarus has been shaped by expansionist industrial policies aimed at stimulating employment and local production. In the absence of coherent reforms the side effects of these policies, which were maintained in 2000, include a high rate of inflation (despite numerous price controls) and widespread shortages. During the first half of the year, the main boost to economic growth continued to come from manufacturing industry (thanks in turn to the strong import demand in Russia and other CIS countries for cheap manufactured goods), while agricultural output was falling. In addition, some manufacturing branches appear to have benefited from import substitution effects. According to the official data the volume of retail sales increased sharply in the first quarter but later growth slowed significantly, due to the combined effect of moderate industrial wage growth, high inflation and, probably, a decline in real household incomes in the agricultural sector. Nevertheless, aggregate domestic demand was supported by expansive monetary and fiscal policies and capital investment, mainly in housing, but these have deepened further Belarus' chronic macroeconomic imbalances.

The economies of the *Caucasian rim* have been growing since 1996; in the first half of 2000 the recovery continued in Azerbaijan and, more modestly, in Armenia, but in Georgia real GDP fell because of a record-low harvest. Azerbaijan was again the fastest growing economy in the region (with nine-month GDP up almost 10 per cent on the same period of 1999) thanks to the expansion in oil-related industries and services (such as transport and communications). Furthermore, a good

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[31] The recovery of domestic demand has been slower partly due to the continuing outflow of capital from Russia (section 1.2(vi)).

[32] There is some evidence that a number of Russian manufacturing companies have started to make long-term business plans and, accordingly, to invest in new equipment as well. *Financial Times*, 5 October 2000.

[33] Russian Federation Goskomstat, op. cit, p. 7.

[34] However, the volume of sales in January-September 2000 was still considerably below their level in the same period of 1998, that is, immediately before the financial crisis.

[35] The volume of retail trade increased by 6.2 per cent during the first 9 months (table 1.2.4), while during January-July fixed investment grew by some 20 per cent. PlanEcon, *PlanEcon Report. Developments in the Economies of Central Europe and Russia*, Quarterly Report, Vol. XVI, No. 17 (Washington, D.C.), 6 October 2000, p. 38.

[36] The recovery was basically confined to the food and beverage sectors, which account for some two fifths of total industrial production.

grain harvest, increased cotton exports and a strong revival of some non-oil industries such as metallurgy and engineering also contributed to the outcome. Consumer demand was also strong,[37] underpinned by continued recovery in real wages and expanding employment, despite growing wage arrears in some sectors. After several years of rapid expansion, however, the slowdown in capital investment, which started in 1999, seems to have continued in 2000, mainly due to a moderation in FDI which has been affected by continuing uncertainty about the location and timing of several large oil-related construction projects.

In contrast to Azerbaijan, the *Armenian* economy has performed below expectations in 2000 mostly due to a fall in agricultural output caused by the severe drought. Real GDP and gross industrial output rose by 2.6 per cent and 2.9 per cent, respectively, in the first half of 2000, but these estimates do not reflect the full effect of the poor harvest on the food processing industries. Household demand was weak, as evidenced by the consumer price deflation during the first half of the year (table 1.2.5).[38] Given the economy's relatively low investment ratio, partly a result of its limited access to external financing, capital investment in Armenia has never been the engine of economic recovery that it has been in Azerbaijan.[39] Given the continued depressed state of demand and the low level of business confidence, fixed investment has probably remained weak in 2000.

In Georgia, where export-led growth resumed in autumn 1999, the authorities were expecting a strengthening of the economic recovery in 2000. Indeed, thanks to favourable external demand, there was rapid growth in both industrial output and exports during the first half of the year (tables 1.2.2 and 1.2.3). Agricultural production and food processing, however, which accounts for about one third of GDP, fell sharply due to a severe drought; as a result, according to preliminary estimates, GDP actually shrank by 1.8 per cent in the first half of the year.

In general, the level of economic activity was relatively high in the *central Asian CIS countries* during the first half of 2000. After reporting the worst performance in the region in the first half of 1999, the Kazakh economy embarked on a fast recovery which continued in 2000. Notwithstanding its low starting point, real GDP growth accelerated to 10.5 per cent in the first half of 2000 (up from 9.1 per cent in the first quarter). This robust growth was underpinned by an export-driven increase in the volume of industrial production.[40] In turn, fiscal performance was well above expectations and this allowed the government to eliminate the accumulated pension arrears, to repurchase all of its outstanding debt to the IMF and to continue to reduce other domestic payment arrears.[41] Fixed investment rose by almost a third in January-June stimulated by higher commodity prices and renewed foreign interest in the oil and metals sectors. However, this rapid pace of growth in Kazakhstan may not last as its considerable dependence on commodity exports makes its economy very vulnerable to commodity price swings.

Kyrgyzstan's GDP grew by 7.4 per cent in the first half of 2000. Agriculture continued to be the main source of growth: in the first half gross agricultural output grew by nearly 11 per cent. Industrial production was also up in January-September,[42] due to increased output in power generation as well as in the fuel and textile sectors. The construction sector's output rose sharply (by almost 70 per cent, year-on-year) due to investment in infrastructure, particularly in power stations, transmission lines and transport networks. While the general economic situation in Kyrgyzstan has improved, especially in the second quarter of 2000, the fiscal situation remains difficult.[43] In the first half of 2000, as a result of high debt levels and lower than expected revenues the country incurred external debt service arrears (in addition to existing pension arrears). Although the domestic and external arrears have now been paid and debt-restructuring agreements concluded with most creditors, the external debt problem remains to be addressed.

In Tajikistan, the poorest central Asian CIS country, GDP grew by 6.5 per cent in the first half of 2000. Domestic economic activity, which is still recovering from the civil war and persistent regional rivalries, was stimulated by increased aluminium production. The country has one of the world's largest aluminium smelters, but the plant requires large investment outlays to be able to reach full production. While recent production levels were well below the plant's capacity, aluminium production remains the key industrial activity and aluminium exports provide more than half of the

[37] Retail trade volume increased by 10 per cent in the first nine months of 2000 (table 1.2.4).

[38] Although the volume of retail trade increased by some 7 per cent in the first 9 months of 2000, this was nearly half of the rate of increase in the same period of 1999.

[39] In the period 1997-1999, gross fixed capital formation in Armenia on average amounted to one sixth of GDP whereas in Azerbaijan it was twice as high in relative terms. Over the period 1996-1999, the annual level of real gross fixed capital formation more than quadrupled in Azerbaijan while it increased by just 26 per cent in Armenia. UN/ECE secretariat estimates, based on national statistics.

[40] During the first six months of 2000 gross industrial output was up 16.3 per cent (table 1.2.3); output in the key oil and base metal sectors increased by an estimated 20 and 40 per cent, respectively. Agency of Statistics of the Republic of Kazakhstan, *Sotsial'no-ekonomicheskoe polozhenie Respubliki Kazakhstan* (Astana), July 2000.

[41] IMF, "Kazakhstan repays the IMF ahead of schedule", *News Brief* No. 00/35 (Washington, D.C.), 1 June 2000 and Interfax News Agency as quoted in *Reuters News Service*, 29 September 2000.

[42] Although it fell in the first quarter of the year (table 1.2.3).

[43] The budget deficit, which is primarily financed by borrowing from bilateral creditors and multilateral institutions, reached 12 per cent of GDP in 1999. IMF, "IMF concludes Article IV consultation with Kyrgyz Republic", *Public Information Notice,* No. 00/87 (Washington, D.C.), 13 October 2000.

country's export revenues. In the agricultural sector, a severe drought has affected grain and possibly cotton production; fears have been expressed that food shortages could lead to famine as the wheat harvest is about half of what it was in 1999.

According to the official statistics, Turkmenistan's GDP and industrial output both increased by 14 per cent in the first half of 2000. This expansion was led by a one-third increase in the output of the fuel sector (which represents 60 per cent of all industrial output), thanks to the resumption of gas sales to Russia.[44] Despite unfavourable weather, agricultural output was up 21 per cent over the same period of 1999, with the wheat harvest increasing by almost a third owing to a larger area sown and higher yields.

Economic activity was relatively high in Uzbekistan in the first half of the year: GDP increased by 3.8 per cent, thus continuing the trend of the past two years. According to the official statistics, growth was broadly based and was supported by strong domestic demand: industrial output increased by 6.2 per cent and agricultural output by 7 per cent, while the volume of retail sales grew by 5.3 per cent. The economy, which is in need of deep structural changes, continued to rely on gold and cotton exports to support the import substitution strategy. Rising external debt and low export prices, however, have forced the government to initiate modest changes in its economic policy. The government has adopted a new privatization programme and has opened the possibility of full currency convertibility following the official unification of central bank and commercial exchange rates.[45]

(iii) Costs and prices

Inflationary pressures in most of the transition economies intensified over the first three quarters of 2000, even though strong output growth was predominantly export driven and labour productivity improved considerably, rising faster than wages in many countries. Annualized rates of price inflation[46] were higher than expected in several countries.

The major cause of higher than expected inflation rates was the soaring world market dollar prices of crude oil and natural gas which, compounded by the strong appreciation of the dollar, led to frequent increases in domestic fuel and utility prices.[47] Consequently, this imported inflation, which started to accelerate significantly from mid-1999, either reversed or considerably reduced the rate of disinflation that has prevailed in recent years in most of the transition economies of eastern Europe and the Baltic region. This has been a major setback for the authorities in these countries who were hoping to reduce wage pressures through lower inflationary expectations. Furthermore, given both the social and inflationary impacts of increases in administered energy prices, some governments have sought to postpone or limit previously planned increases in order to prevent even higher rates of inflation. This in turn may fuel inflation in the medium term and/or prolong the completion of the process of price liberalization in the energy sector thus impeding the restructuring and privatization of this sector.

Among the *east European countries*, consumer prices continued to fall in the nine months to September in Albania and increased only very little in Bosnia and Herzegovina (table 1.2.5). As for the rest of the region, disinflation continued only in Romania and Slovakia but only because of weak consumer demand. In Romania, however, the annualized rate remained well above the government's initial target rate of 27 per cent:[48] in addition to a series of tariff and tax increases[49] and higher oil prices, a bad harvest led to a sharp rise in food prices.[50] Rising food prices have also been an important inflationary factor (together with higher import prices) in Bulgaria, Hungary and Poland, with all three economies likely to overshoot their annual inflation targets.[51] However, other factors affecting prices differed between the three countries. In Bulgaria and Poland, the sharp falls in employment combined with moderate real wage growth have kept consumer demand in check. In contrast, consumer demand in Hungary has remained strong thanks to a continuing expansion of credit and a large rise in private sector wages;[52] increases in relative

[44] Output in the natural gas, oil extraction and refining sectors increased by 37, 7 and 3 per cent year-on-year, respectively.

[45] Nevertheless, the currency's black market rate still remains three times the official rate.

[46] Unless specifically qualified, "inflation" in this section refers to the increase in consumer prices.

[47] Most of the forecast or target rates of inflation incorporated in the 2000 budgets were made in mid-1999 when the crude oil prices were some 80 per cent lower than in the third quarter of 2000.

[48] The original target of 27 per cent was considered over-ambitious from the start. In fact, it was increased in the course of the year to a more plausible 40 per cent.

[49] For example, the unification and extension of VAT rates in January and April, respectively, large increases in natural gas and electricity charges in June contributed strongly to the overall increase in consumer prices.

[50] During the course of the first nine months of 2000, food prices in Romania increased by nearly 34 per cent compared with less than 23 per cent in the same period of 1999.

[51] In Bulgaria, the initial target of 2.8 per cent has been increased to 6 per cent (December, year-on-year). Even this new target is likely to be overshot considering that 6.1 per cent has already been achieved in the first nine months. In Poland the initial target (5.4-6.8 per cent) has also been increased to 6-8 per cent. However, this seems to be within reach given the overall slowdown in the third quarter in economic activity. In Hungary the government did not change its initial forecast of 6-7 per cent (annual average) which was based on two basic assumptions: the average crude oil price of $18 per barrel, and the average nominal wage growth of 8.25 per cent. Given the actual increase in both and the annualized rate of inflation reached in the first nine months, the inflation target is very likely to be overshot. In fact the central bank, noting that the core inflation rate (excluding food and energy) rose in line with the headline inflation rate in September, increased interest rates sharply.

[52] Private sector wages increased by 15.1 per cent in the second quarter of 2000. In the same period public sector wages rose by 9.2 per cent, bringing the average nominal wage increase to 13.3 per cent. National Bank of Hungary, *Quarterly Report on Inflation*, September 2000, p. 9.

TABLE 1.2.5

Consumer prices, industrial producer prices and labour costs in industry,[a] 1999-2000
(Percentage change)

	September over previous December		*August over previous December*		*Annual average percentage change*					
	CPI		*PPI*		*Nominal gross wages [b]*		*Real product wages [c]*		*Labour productivity [d]*	
	1999	*2000*	*1999*	*2000*	*1999*	*2000 [e]*	*1999*	*2000 [e]*	*1999*	*2000 [e]*
Albania	-4.3	-2.4	..	..	..	..	..	..	18.5	..
Bosnia and Herzegovina	-2.2	1.3	-14.2	-11.0	15.4	10.3	10.7	9.8	10.4	14.3
Bulgaria	3.8	8.6	-1.0[f]	4.5[f]	5.5	10.9	2.3	..	-4.6	19.8
Croatia	3.3[g]	5.4[g]	2.7	5.2	5.7	5.1	3.2	-3.9	1.5	5.5
Czech Republic	1.8	3.4	2.0	3.3	6.6	7.2	5.5	2.5	0.3	9.6
Hungary	9.4	8.5	3.4	8.4	13.4	15.5	8.1	4.5	9.5	23.3
Poland	6.8	7.1	4.8	5.0	9.0	12.8	3.1	4.6	7.5	21.0
Romania	38.9	29.9	42.0	34.0	44.0	43.7	1.3	-6.5	-5.1	11.6
Slovakia	12.8	7.3	5.3	6.6	7.9	10.5	4.0	–	-0.5	13.4
Slovenia	6.2	7.1	-0.2	5.5	9.3	10.8	7.0	4.4	1.1	9.8
The former Yugoslav Republic of Macedonia	-0.7[f]	1.7[f]	-1.6[f]	2.7[f]	1.2	5.0[h]	1.3	-2.3[h]	-7.6	7.3[h]
Yugoslavia	31.3	52.9	10.3[i]	35.7[i]	23.1	45.8[h]	-14.1	-14.2[h]	-12.6	..
Estonia	2.5	3.1	0.4	3.5	10.6	10.9	12.0	6.5	2.0	13.0
Latvia	1.6	0.8	-1.4	0.4	14.3	9.0	19.1	8.0	-1.3	2.9
Lithuania	0.7	0.7	9.6	2.3	6.5	1.6	3.4	-18.1	-8.5	–
Armenia	0.4	-2.8	2.3	-1.0	20.1	14.4	15.3	14.1	7.5	5.8
Azerbaijan	-1.4	0.5	0.6	6.4	5.8	15.3	7.2	3.4	2.0	4.3
Belarus	136.9	78.5	137.2	106.7	326.4	252.0	-6.4	26.5	9.4	7.1
Georgia	6.7	2.2	..	..	..	..	..	..	..	..
Kazakhstan	13.4	5.7	30.4	8.5	14.8	29.5	-3.5	-15.8	2.6	3.4
Kyrgyzstan	32.4	5.8	34.2	6.1	23.4	19.5	-18.9	-10.2	4.1	0.4
Republic of Moldova	28.6	15.5	43.1	19.4	23.9	33.5	-15.8	-4.7	3.5	2.0
Russian Federation	31.4	14.1	41.1	23.0	42.6	46.5	-10.3	-6.0	8.8	9.1
Tajikistan	40.9	33.1	50.9	14.6	41.7	32.2	-2.7	-13.6	22.6	21.0
Turkmenistan	15.1	..	9.9	..	7.6	..	..	..	12.9	..
Ukraine	10.1	21.6	10.5	14.1	16.1	25.2	-11.5	3.3	13.9	12.6
Uzbekistan	10.2[f]	9.0[f]	16.3	52.9	62.4	56.7	17.7	4.9	5.2	5.5

Source: UN/ECE secretariat estimates, based on national statistics and direct communications from national statistical offices.

a Industry = mining + manufacturing + utilities.

b Average gross wages in industry except in Bosnia and Herzegovina and The former Yugoslav Republic of Macedonia – net wages in industry; in Bulgaria, Estonia and all CIS economies – gross wages in total economy; in Yugoslavia – net wages in total economy.

c Nominal gross wages deflated by producer price index.

d Gross industrial output deflated by industrial employment.

e January-June 2000 over January-June 1999.

f March over previous December.

g August over previous December.

h January-March 2000 over January-March 1999.

i May over previous December.

wages in the service sector (passed through in higher service prices) have also added to inflationary pressures.

In the Czech Republic, the moderate acceleration in consumer prices in the first three quarters of 2000 was mainly due to external shocks. Given the subdued consumer demand the central bank's target range of 3.5-5.5 per cent for the "net" inflation rate[53] in December (year-on-year) is likely to be achieved even if the economic recovery gains momentum. However, compared with most of its neighbours, productivity growth in Czech industry remained modest in the first half of the year, and the somewhat faster growth in producer prices relative to consumer prices in the third quarter suggests that cost pressures are gradually increasing.

In Slovenia, consumer prices accelerated in the course of the first three quarters of 2000. Although, as in the Czech Republic, labour productivity increased relatively modestly,[54] a restrictive incomes policy has

[53] Net inflation excludes regulated prices and indirect taxes on unregulated prices.

[54] In Slovenia, employment growth accelerated in the first half of 2000 and, unlike the situation in the Czech Republic, output recovery was more or less evenly shared between increased employment and improved labour productivity.

dampened the growth in wage costs in 2000, and the unit labour costs remained virtually unchanged over the first half of the year. Therefore, the annual rate of inflation will probably remain within the central bank's target range of 8.8-9.9 per cent for the end of the year. In Croatia, personal expenditure recovered strongly in the first half of 2000, thanks to particularly strong revenues from tourism, which offset the contraction of real household incomes due to declining employment and falling real wages. Nevertheless, the acceleration in consumer prices was kept in check by the strong kuna and the government's decision to lower fuel taxes to cushion the rise in oil prices. However, the growing fiscal deficit and the faster than expected growth in producer prices suggest that inflation could accelerate further.

Among the *Baltic economies*, inflation increased only in Estonia, a reflection of its stronger economic upturn and a significant strengthening of consumer demand. Nevertheless, the inflation rate in Estonia still remained lower than those prevailing in the majority of east European economies. In Latvia, even though personal consumption was recovering, the relatively strong exchange rate[55] offset some of the inflationary effects of rising oil prices. In Lithuania, the combined effect of a sluggish economic recovery, tight fiscal and monetary policies, and the fixed exchange rate (against the dollar), kept the inflation rate very low.

In contrast to most of the east European economies, the inflation rate fell sharply in most of the *CIS economies* as the effects of the Russian financial crisis began to recede.[56] Furthermore, increased exports and tax revenues have reduced the major imbalances in the majority of these economies. In most CIS countries, industrial producer prices have also decelerated although, on average, they still rose much faster than consumer prices. This discrepancy reflects both the extensive use of retail price controls (extreme cases are Belarus and Uzbekistan) and the continued existence of large amounts of overemployment in the unrestructured industries. While the former is likely to intensify the pressure on consumer prices in the near future (postponed inflation), the latter slows the growth of labour productivity and hence impedes any attempt to moderate unit labour costs without squeezing the growth in wages. Therefore, without an acceleration in the pace of microeconomic reforms, these improvements in macroeconomic stabilization in the CIS economies may prove to be short-lived.

(iv) Labour markets

Despite the strong recovery in the majority of transition economies, employment has continued to fall in many countries during the first half of 2000, and especially in eastern Europe (table 1.2.6). In addition, unemployment rates generally remained high throughout the first eight months of 2000. Unemployment increased sharply in the wake of the 1998 Russian crisis as a result of the general economic slowdown; but the main reason for its persistence in 2000 appears to be a deepening of the process of enterprise restructuring in many countries which is often accompanied by job cuts. Other reasons for the sluggish labour demand in many transition economies are the large margins of spare capacity coupled with gains from labour productivity due to x-efficiency gains.[57]

At the end of August 2000, the total number of persons registered as unemployed in the ECE transition economies was over 17 million (some 7.6 million in eastern Europe, 350,000 in the Baltic states and 9.1 million in the CIS countries). The decline in the total since August 1999 (by some 5 per cent) mostly reflects the improvement in Russia since the number of unemployed grew by nearly 7 per cent in eastern Europe and by more than 14 per cent in the Baltic states.

In most *east European countries,* unemployment continued to grow during the first eight months of 2000 and during the winter five countries (Bulgaria, Croatia, the Czech Republic, Romania and Slovakia) reported their highest unemployment rates since the transition started in 1989. There was little improvement in the spring and summer, and in some countries the situation continued to deteriorate.

Slovenia was the only east European country where the growth of employment accelerated in the first half of 2000. Most of the new jobs were in services and construction (where employment grew by 3 and 15 per cent, respectively); in agriculture and industry employment continued to fall. The rate of unemployment declined fairly steadily and in August was 1.6 percentage points lower than a year earlier. Employment also increased in Hungary (by 0.7 per cent) in the first half of 2000[58] and the unemployment rate was falling and in August was 0.6 of a percentage point lower than a year ago.

Despite earlier fears, the unemployment rate in the Czech Republic did not reach the psychologically important double-digit level.[59] It peaked at 9.8 per cent in January 2000 and then declined thereafter to 8.8 per cent

55 The lat is pegged to the SDR which has appreciated against the euro and depreciated against the dollar at a more moderate rate than in most other transition economies.

56 The collapse of the Russian rouble in August 1998 precipitated, with varying lags, reactive devaluations (nominal or effective) in a number of CIS countries.

57 Over the period 1996-1999, the cumulative increase in labour productivity in industry ranged between 11 and 16 per cent in the Czech Republic, Lithuania, Slovakia and Slovenia; in Hungary, Latvia and Poland it grew by some 35 per cent, and in Estonia by more than 40 per cent. During the first half of 2000, the growth of industrial labour productivity accelerated considerably: in most of the east European and Baltic countries it grew at double-digit rates, and in Hungary and Poland the rate exceeded 20 per cent. UN/ECE secretariat calculations on the basis of national statistics.

58 This was a slower rate of increase than in 1999.

59 At the beginning of 2000, there were widespread expectations that due to the ongoing restructuring, banking privatization and a generally weak economic performance, unemployment would rise above 10 per cent in the early months of 2000, and reach 10.5-11 per cent by the end of the year.

TABLE 1.2.6

Total employment and registered unemployment in the transition economies, 1998-2000

(Percentage change over the same period of preceding year; per cent of labour force, end of period)

	Employment [a]				Unemployment			
			QI-QII		1998	1999		2000
	1998	1999	1999	2000	December	August	December	August
Eastern Europe	0.4	-1.4	-0.8	-2.9	12.6	13.8	14.6	14.6*
Albania	-2.0	-1.8	-2.1	-1.7	17.6	18.0[b]	18.2	17.1[b]
Bosnia and Herzegovina [c]	5.9	3.1	4.5	1.1	38.5	39.3	39.1	39.4
Bulgaria	-0.2	-2.6	-4.5	-10.0	12.2	13.6	16.0	18.0
Croatia	6.6	-0.4	-0.5	-2.2	18.6	19.1	20.8	20.8
Czech Republic	-1.5	-3.7	-3.4	-2.4	7.5	9.0	9.4	9.0
Hungary	1.4	3.1	3.6	0.7	9.1	9.4	9.6	8.8
Poland	2.3	-0.6	-0.1	-7.0	10.4	11.9	13.0	13.8
Romania [d]	-1.9	-0.6	-1.2	-0.5	10.3	10.9	11.5	10.1
Slovakia [e]	-1.0	-4.7	-1.7	-2.1	15.6	18.2	19.2	17.4
Slovenia	0.2	1.8	0.8	2.0	14.6	13.3	13.0	11.7
The former Yugoslav Republic of Macedonia	-2.9	1.8	-0.5	0.4	41.4	46.6	47*	..
Yugoslavia [f]	-0.1	-10.3	..	..	27.2	26.6[g]	27.4	26.6[g]
Baltic states	-0.5	-1.2	-1.2	-1.7	7.3	8.3	9.1	9.5
Estonia [h]	-1.3	-4.1	-4.4	-2.1	5.1	6.3	6.7	6.1
Latvia	0.6	-0.5	-1.4	0.6	9.2	9.8	9.1	8.1
Lithuania	-0.8	-0.5	0.2	-3.0	6.9	8.1	10.0	11.8
CIS	-1.1	-0.2	-0.6	-0.2	9.0	8.0	8.3	7.0
Armenia	-2.5	-1.3	-1.8	-1.6	8.9	11.3	11.5	11.4
Azerbaijan	0.2	–	0.1	–	1.4	1.2	1.2	1.1
Belarus	1.1	0.6	1.2	-1.4	2.3	2.1	2.0	2.1
Georgia	2.2	..	..	..	4.2	5.3	5.6	..
Kazakhstan	-5.3	-0.4	-0.3	-4.0	3.7	3.6	3.9	4.0
Kyrgyzstan	0.9	3.5	3.9	0.8	3.1	3.1	3.0	3.1
Republic of Moldova	-0.2	-9.0	-7.7	2.9	1.9	2.4	2.1	2.4
Russian Federation [i]	-1.5	0.5	-0.2	0.7	13.3	11.9	12.2	9.8
Tajikistan	0.3	-3.9	-3.2	-4.7	2.9	3.3	3.1	..
Turkmenistan	1.3	0.7	..	..	..	..	..	..
Ukraine	-1.1	-2.3	-2.4	-2.0	4.3	4.1	4.3	4.2
Uzbekistan	1.4	1.0	1.0	1.0	0.4	0.5	0.5	0.5
Total above	-0.9	-0.4	-0.6	-0.9	..	..	..	..
Memorandum items:								
CETE-5	1.2	-0.9	-0.4	-3.7	10.2	11.7	12.5	12.6
SETE-7	-0.7	-2.1	-1.5	-1.8	15.4	15.6	16.5	20.4*
Russian Federation [j]	..	..	..	..	2.7	1.9	1.7	1.4
Former-GDR	..	..	..	..	17.4	17.6	17.7	17.0

Source: National statistics; direct communications from national statistical offices to UN/ECE secretariat.

a Annual average unless otherwise stated. Regional quarterly aggregates of employment exclude Yugoslavia, Georgia and Turkmenistan.

b June.

c Figures cover only the Muslim-Croat Federation. Data for Republika Srpska are not available.

d Labour force survey employment data.

e End of year employment data.

f Since 1999 excludes Kosovo and Metohia.

g July.

h Unemployment: job seekers.

i Unemployment figures are based on monthly Russian Goskomstat estimates according to the ILO definition, i.e. including all persons not having employment but actively seeking work. The previously published figures have been revised in line with the results of the May 2000 labour force survey.

j Registered unemployment.

in September. The factors behind these developments were the strength of the recovery coupled with active labour market policies.[60] In Poland, despite strong output growth, the labour market continued to worsen during the first eight months of 2000.[61] At 13.8 per cent, the rate of unemployment in August 2000 was almost 2 percentage points higher than a year earlier. The rise in unemployment was mainly due to a wave of mass layoffs caused by restructuring in the coal mining, steel and textile industries as well as the ending of job guarantees in privatized firms.[62] Rising labour productivity has also reduced the demand for labour. The situation has been further aggravated by the fact that members of the baby boom of the first half of 1980s are now beginning to enter the labour market.[63] As in Poland, there was no improvement in the labour market in Slovakia either, despite the growth of industrial output. In the first half of 2000, the decline in employment accelerated, unemployment reached the alarmingly high level of 19.5 per cent in January. The latter subsequently fell to 17.4 per cent in August thanks to a new public works programme launched by the government.[64] This programme, however, is essentially a short-term measure and the reduction in unemployment is likely to be temporary.[65]

The situation in the labour markets of south-east Europe remains very difficult. In Bulgaria, as a result of further layoffs in firms undergoing restructuring, employment fell by some 10 per cent in the first half of 2000, the largest fall among all the transition economies, while the unemployment rate surged to 19 per cent in April. After a slight seasonal fall in the summer, it was still at 18 per cent in August, more than 4 percentage points higher than a year ago. The situation in Croatia also worsened considerably: the decline in employment accelerated and the unemployment rate reached a record 21.7 per cent in March 2000. These developments follow the steps undertaken by the new government to restructure the enterprise sector, accelerate privatization, and implement a tougher policy on bankruptcy. In Albania, the unemployment rate declined in the 12 months to June 2000 but it still stood at 17 per cent. However, the government expects a further reduction as a result of the introduction of projects to boost employment.[66] In Bosnia and Herzegovina, the unemployment rate was broadly unchanged in the 12 months to August 2000, but it remained at 39 per cent of the labour force. Moreover, an increased rate of return of refugees is likely to add further pressure on the labour market.[67] In Romania, where the economy is emerging from a three-year recession, there was some improvement in the labour market. In the first half of 2000, the decline in employment almost came to a halt while unemployment, after peaking at 12.2 per cent in February 2000, began to fall, albeit in part for seasonal reasons, to 10.1 per cent in August.

Regular and consistent data are not available for The former Yugoslav Republic of Macedonia and Yugoslavia, but in both countries there appears to have been a further worsening in 2000.[68] Although accurate estimates are not available, unemployment rates in both countries are undoubtedly very high.

In the *Baltic states*, the situation in the labour markets remains greatly varied, especially as regards unemployment. In Estonia, the fall in employment decelerated notably in the first half of 2000 and the unemployment rate, which peaked at 7.1 per cent in March, declined to 6.1 per cent in August, when it was virtually the same as a year earlier.[69] The improvement was even more pronounced in Latvia where employment resumed moderate growth in the first half

[60] The fall in unemployment may also be partly due to a new scheme providing incentives for early retirement until the year's end, as well as the slower pace of labour shedding in some large enterprises especially in the steel and mining industries due to financial support from the government.

[61] After five years of relatively high growth, employment started to fall slightly in 1999. Recently issued figures by the Polish Central Statistical Office, based on the average paid employment time series (excluding agriculture), indicate that in the first half of 2000, total employment was 7 per cent lower than a year earlier. However, a survey-based measure of employment shows total employment falling by just over 3 per cent in the first half of 2000. *SG Warsaw*, 25 August 2000.

[62] The privatization of many Polish companies in the mid-1990s included contractual clauses limiting layoffs; these have now started to expire.

[63] New entrants to the labour market in 2000 are estimated at around 150,000. *Gazeta Wyborcza* (Warsaw), 23 February 2000.

[64] According to the amended law on employment (in force as of 1 August), Sk2.3 billion (some $45 million) is to be allocated from the state budget to communities with particularly high unemployment for the creation of temporary jobs in public works for the long-term unemployed. As of 15 September, nearly 60,000 such temporary jobs had been created and the number of officially registered unemployed persons had fallen by some 81,000 in August alone. *Reuters Business Briefing*, 4 October 2000.

[65] According to estimates of the National Employment Office, 95 per cent of those now working in public projects will become jobless again before the end of 2000. *CTK Business News*, 21 September 2000.

[66] The Albanian government allocated lek2 billion (some $14 million) from the budget for job creation particularly in public works in 1999 and 2000. According to the Minister of Labour and Social Affairs, nearly 70,000 people have been employed under these projects. *Reuters Business Briefing*, 4 October 2000.

[67] In July 2000 alone, 3,600 refugees from ethnic minorities returned to their pre-war homes, almost four times more than in the same period in 1999. *Oxford Analytica Brief*, 26 September 2000.

[68] In The former Yugoslav Republic of Macedonia, the most recent official data on unemployment refer to August 1999 when the estimated rate of registered unemployment was close to 47 per cent. Since then the number of unemployed has risen steadily and in August 2000 reached some 362,000 persons (a nearly 5 per cent increase). In the first half of 2000, the number of people officially reported as employed in the economy amounted to 315,000. Figures for quarterly employment in Yugoslavia for the first two quarters of 1999 are still not available. Starting from 1999, unemployment data exclude Kosovo and Metohia. Officially reported data show the unemployment rate unchanged between July 1999 and 2000 at 26.6 per cent. However, the number of unemployed increased by 8 per cent over this period reaching some 811,000 persons in July 2000.

[69] It should be kept in mind that the official figures for registered unemployment tend to underestimate the actual levels in the Baltic countries. Unemployment rates in May 2000, derived from labour force surveys based on the ILO definition of unemployment, stood at 13.2 per cent in Estonia (June), 14.4 per cent in Latvia and 14.7 per cent in Lithuania, whereas the registered rates were 6.2, 8.6 and 11.1 per cent, respectively.

of 2000 and unemployment, falling since April 1999, declined to 8.1 per cent of the labour force in August (its lowest level in the three years). In contrast, partly due to a combination of sluggish output growth and enterprise restructuring, the decline in employment accelerated in Lithuania and unemployment rose to a record 11.8 per cent in August, nearly 4 percentage points higher than 12 months earlier.

Statistics for *registered* unemployment rates, which are the only available series for unemployment in most of the *CIS countries*, do not indicate any significant changes in the 12 months to August 2000. The rates varied between 0.5 per cent (Uzbekistan) and 4 per cent (Kazakhstan), the main exception again being Armenia (more than 11 per cent).[70] Russia is an exception to this pattern, with a marked improvement in the labour market situation, due to the strong recovery in output. The growth of employment, which started in the second half of 1999, accelerated during the first six months of 2000 and by mid-year was almost 1 per cent higher than a year earlier. By August, the unemployment rate, which had been falling since February 1999, fell below 10 per cent for the first time since 1996.

(v) International trade

(a) Eastern Europe and the Baltic states

The foreign trade of the east European and Baltic countries has recovered strongly after its slump in late 1998 and early 1999 in the wake of the Russian crisis and a period of slow economic growth in the EU. In the first half of 2000, the *dollar value of exports* of eastern Europe increased by some 14 per cent and that of the Baltic states by 22 per cent, following declines in 1999 (tables 1.2.2 and 1.2.7). Although growing rapidly, the value of the Baltic states' aggregate exports was only slightly above that in January-June 1998, just before the Russian crisis. In *volume terms*, growth rates were some 7-10 percentage points higher than those in value, a reflection of the sharp fall of dollar prices for most of the region's exportable goods. The weakness of the euro – in which most of the region's trade is denominated – relative to the dollar and the low level of inflation in the euro area depressed export values expressed in dollars.[71] Export growth, in both value and volume, was still strong at the start of the third quarter, although there was some slowdown in July-August in several countries (for the performance of individual countries see tables 1.2.2 and 1.2.8).

The main boost to exports has come from the EU, which in 2000 is expected to register its fastest rate of real GDP growth in over a decade. Strong import demand in Germany, the largest single export market for most east European and Baltic countries,[72] was particularly important. The buoyancy of growth in the EU was reflected in the expansion of Czech, Hungarian and Polish export volumes to the EU in January-June 2000 by some 20-22 per cent; the increase for Estonia was probably even larger.[73] For the Baltic countries this expansion secured some gain in market share in the EU, but for the majority of east European countries the recovery of exports was not sufficient to preserve their market shares: according to Eurostat data, in January-April 2000 the 10 transition economies negotiating EU accession accounted for 9.6 per cent of total extra-EU imports, nearly a quarter of a percentage point less than in 1999.[74]

The dollar value of east European exports to the CIS and other transition economies also grew more strongly in the first half of 2000 (by some 15-16 per cent year-on-year). However, the increase among east European countries was relatively modest in absolute terms and did not translate into any significant gain in market share, while the rapid growth of exports to the CIS largely reflected recovery from the low levels to which exports had fallen following the Russian crisis.[75] In fact, despite this strong growth, east European exports to Russia and other CIS countries remained substantially below – some 45–55 per cent – their levels of January-June 1998.[76] The Baltic countries' exports to the CIS, however, continued to fall while their mutual trade and their exports to east European partners grew rapidly (table 1.2.7).

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[70] These figures, however, are misleading both as regards the magnitude and the dynamics of unemployment since a large proportion of the jobless in these countries do not register for various reasons (according to estimates, this proportion varies in different countries between 40 to 80 per cent). For a more detailed discussion see UN/ECE, *Economic Survey of Europe, 1998 No. 3*, p. 70. Thus, in May 2000, unemployment rates calculated on the basis of labour force surveys stood at 10.2 per cent in Russia, 11.4 per cent in Ukraine (June) and, according to some estimates, exceeded 10 per cent in the Republic of Moldova (March) and Kyrgyzstan, compared to rates of 1.4, 4.4, 2.4 and 3.2 per cent, respectively, on the basis of the registration figures. Direct communication from national statistical offices for Russia and Ukraine; TACIS, *Moldovan Economic Trends*, April/June 2000, p. 23; Economist Intelligence Unit, *Country Report. Kyrgyzstan* (London), July 2000.

[71] In the first half of 2000, the euro was on average 13.5 per cent down relative to the dollar, compared with the first half of 1999.

[72] In 1999 Germany accounted for 36-42 per cent of the exports of the Czech Republic, Hungary and Poland and for 16-17 per cent of those of Croatia, Latvia and Lithuania.

[73] Although no reliable volume or unit value indicators by partners and commodities are available, estimates suggest that the export volume growth from Croatia, Latvia, Lithuania and Slovakia to the EU increased by some 20-25 per cent.

[74] Eurostat, *Intra- and Extra-EU Trade*, CD-Rom No. 7, Theme 6: External Trade, 2000.

[75] With the base-period effect decreasing in importance, the year-on-year growth rates have been decelerating: in the first quarter, for instance, east European exports to the CIS grew by 19 per cent, in the second by 12 per cent.

[76] The fastest growth in the dollar value of exports to Russia and the other CIS countries was from Romania (2.3 times) and Hungary (29 per cent). Hungary benefited from an agreement with Gazprom signed in the spring of 1999 under which the latter buys food and pharmaceutical products from Hungarian companies equal in value to its gas shipments (at pre-set levels). Gazprom has since bought $20-$25 million worth of Hungarian products, according to Mr. P. Ballas, deputy state secretary at the Ministry of Foreign Affairs of Hungary. *MTI-ECONEWS*, 22 September 2000, as reported by *Reuters News Service*.

TABLE 1.2.7

Foreign trade of the ECE transition economies by direction, 1998-2000

(Value in billion dollars, growth rates in per cent) [a]

Country or country group [b]	Exports: Value 1999	Exports: Growth rates 1998	Exports: Growth rates 1999	Exports: Growth rates 2000 [c]	Imports: Value 1999	Imports: Growth rates 1998	Imports: Growth rates 1999	Imports: Growth rates 2000 [c]
***Eastern Europe,** to and from:* [d]								
World	115.1	9.2	0.4	14.2	148.5	9.1	-1.4	11.6
ECE transition economies	22.5	-5.0	-15.3	15.3	26.5	-3.9	-3.7	34.1
CIS	4.2	-20.6	-41.7	15.5	11.5	-16.4	-1.7	68.9
Baltic states	0.9	11.8	-0.2	15.8	0.3	22.6	32.1	103.8
Eastern Europe	16.9	1.8	-7.3	15.2	14.5	4.7	-6.3	11.5
Developed market economies	85.3	16.8	5.5	13.8	107.7	13.2	-1.1	6.2
European Union	78.4	17.2	5.2	13.5	94.5	14.1	-1.1	5.4
Developing economies	7.0	-7.3	-0.2	17.0	13.4	9.7	-0.3	11.0
***Baltic states,** to and from:*								
World	7.7	3.4	-12.6	22.3	11.9	7.5	-13.9	15.0
ECE transition economies	2.4	-13.0	-35.1	12.5	3.9	-2.8	-10.8	26.8
CIS	1.1	-23.4	-51.5	-11.2	2.3	-11.3	-14.2	39.9
Baltic states	1.0	11.8	-12.6	26.4	0.7	19.8	-6.4	8.8
Developed market economies	5.0	21.0	5.7	26.8	7.3	13.7	-15.5	9.6
European Union	4.4	20.1	5.3	26.2	6.2	12.0	-15.7	11.2
Developing economies	0.3	13.2	-15.7	26.6	0.7	6.5	-14.5	8.4
***Russian Federation,** to and from:*								
World	71.8	-16.2	0.7	53.7	30.2	-17.9	-30.7	6.8
Intra-CIS	10.7	-17.9	-22.0	48.0	8.3	-20.9	-26.3	42.5
Non-CIS economies	61.1	-15.8	6.1	54.7	21.8	-16.8	-32.3	-5.0
ECE transition economies	11.0	-21.9	5.9	81.5	2.1	-27.7	-45.4	5.4
Baltic states	2.8	-28.0	24.9	107.7	0.3	-33.4	-56.3	1.1
Eastern Europe	8.2	-20.0	0.7	73.5	1.8	-26.3	-43.0	6.1
Developed market economies	35.2	-13.8	1.7	51.3	14.9	-17.0	-32.3	-5.9
European Union	24.0	-17.1	3.5	74.7	10.8	-19.6	-31.4	-13.0
Developing economies	14.9	-15.8	18.3	44.6	4.8	-7.8	-24.6	-6.5
***Other CIS economies,** to and from:*								
World	30.2	-12.9	-4.7	36.7	30.8	-8.7	-4.7	24.4
Intra-CIS	10.8	-22.0	-21.2	40.1	15.6	-14.3	-21.2	31.2
Non-CIS economies	19.4	-4.4	7.9	34.8	15.2	-1.9	7.9	16.8
***ECE transition economies,** to and from:*								
World	227.9	-3.4	-1.3	29.3	228.8	0.5	-9.9	13.6

Source: National statistics and direct communications from national statistical offices to UN/ECE secretariat; for the Russian Federation, State Customs Committee; for CIS economies, CIS Interstate Statistical Committee; for Turkmenistan, *Sotsialno-ekonomicheskoe polozhenie Turkmenistana*, various issues; for Uzbekistan, UN/ECE estimates.

[a] Growth rates are calculated on values expressed in dollars.

[b] The aggregate growth rates for eastern Europe are slightly different from table 1.2.2. "Eastern Europe" in the present table refers to Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. For lack of adequate data, the trade of Bosnia and Herzegovina, The former Yugoslav Republic of Macedonia and Yugoslavia is not covered. In the partner country grouping, "ECE transition economies" cover the east European countries including the successor states of the former SFR of Yugoslavia, the Baltic states and CIS.

[c] January-June over same period of 1999.

[d] The aggregate growth rates for January-June 2000 are calculated taking into account Czech foreign trade data according to the new methodology.

In addition to strong western import demand, other factors were also important for the general rise in exports. In some east European countries and in Estonia, domestic currencies not only depreciated in real terms against the dollar but also remained unchanged or appreciated just slightly against the euro, which strengthened their export competitiveness.[77] Cost competitiveness also improved markedly in a number of countries: wage growth was rather restrained during 1999 while enterprise restructuring and the adoption of new technologies now appear to be boosting productivity (see table 1.2.5 above), resulting in lower unit labour costs, particularly in manufacturing. However, the improvement of productivity tends to be concentrated in just a few industries, thus widening the productivity gap between a relatively small number of highly efficient (mostly

[77] In January-June 2000, the domestic currencies of the east European and Baltic countries, except Romania and Slovakia, depreciated in real terms, year-on-year, against the dollar; against the euro, the currencies of Croatia, Estonia and Slovenia remained unchanged in real terms and those of the Czech Republic and Hungary appreciated moderately, by 4-5 per cent. UN/ECE secretariat computations.

TABLE 1.2.8

Changes in the volume of foreign trade in selected transition economies, 1996-2000
(Per cent)

	Exports						*Imports*					
					2000 [a]						*2000* [a]	
	1996	*1997*	*1998*	*1999*	*Jan.-Mar.*	*Jan.-Jun.*	*1996*	*1997*	*1998*	*1999*	*Jan.-Mar.*	*Jan.-Jun.*
Czech Republic	2.7	14.2	14.4	9.7	27.4	19.2	10.7	7.6	8.5	5.8	13.6	18.2
Hungary	4.6	29.9	22.5	15.9	18.3	21.2	5.5	26.4	24.9	14.3	16.5	18.1
Transition economies	-0.2	25.2	4.7	-9.3	16.3	22.7	2.8	5.3	12.1	6.0	15.4	15.5
European Union	5.7	33.6	24.1	20.6	19.5	22.3	4.0	29.7	23.8	14.6	10.9	12.0
Poland	9.7	13.7	2.3	2.0	25.0	20.4	28.0	22.0	14.3	4.4	16.7	12.8
Transition economies	29.0	35.8	-5.0	-9.3	29.9	21.3	19.3	13.5	12.6	7.8	20.7	16.4
European Union	5.7	11.9	8.5	5.4	24.9	21.2	27.3	25.2	16.2	4.1	18.1	12.6
Slovenia [b]	3.1	11.4	8.4	2.4	12.8	11.8	–	9.6	10.4	7.5	9.8	6.0
Estonia [c]	6.7	51.1	9.6	-4.9	30.8	32.6	..	..	9.5	-10.6	28.6	34.5
Latvia	8.7	20.3	10.1	-2.1	13.9	15.5	..	..	21.3	-3.2	4.6	6.5
Russian Federation	0.1	1.8	-0.3	9.4	9.3	10.0	-1.9	21.1	-11.0	-15.6	22.7	23.1
Non-CIS	3.6	1.8	-0.6	11.3	5.9	7.1	-0.1	31.7	-8.4	-19.4	18.4	19.0
CIS	-15.6	1.9	0.8	1.5	26.3	27.2	-6.2	-1.8	-18.4	-4.8	36.3	35.3

Source: UN/ECE secretariat calculations, based on national foreign trade statistics.

a Over same period of 1999.

b Volume indices for Slovenia as reported by IMAD, *Slovenian Economic Mirror*, Vol. III, 1997; Vol. VI, 2000 and *Spring Report,* 2000.

c Although for basic trade statistics Estonia switched to the "special trade" reporting system as from 1 January 2000, volume indices in this table were calculated on export and import values under the "general trade" reporting system in order to be consistent with the data used in tables 1.2.2 and 1.2.7. According to the data under the "special trade" reporting system, Estonia's export and import volumes grew by 35 and 31 per cent, respectively, in January-March and by 37 and 34 per cent in January-June 2000, year-on-year.

foreign owned) companies, oriented almost entirely towards exports, and the rest of the economy, often dominated by heavily-indebted companies with restricted access to the fresh capital needed for restructuring and successful competition in international markets.[78]

The *total dollar value of imports* of the east European and Baltic countries grew by 12 per cent in January-June 2000, following a 3 per cent decline in 1999.[79] This growth, although less than that of exports, reflected the changing pattern of demand in these economies. On the one hand, imports of consumer and certain capital goods continued to stagnate in the early part of 2000, partly because of relatively weak private expenditure and investment in some countries.[80] On the other hand, since imports tend to be highly correlated with exports (because of the high import content of these countries' exports and their engagement in outward processing trade), imports accelerated in line with the recovery of manufacturing activity and in some countries even outpaced the growth in the value of exports. The volume of imports, however, was generally growing more slowly than exports (tables 1.2.2 and 1.2.8).

The value of imports was considerably inflated by the sharp rise in international oil prices, whereas the average dollar prices for imports of manufactured goods were falling, mainly because of the weakness of the euro.[81] All in all, the year-on-year decline in dollar unit values was less pronounced for imports than for exports: in the first half of 2000, average import prices were only 2-5 per cent below their level of a year earlier, which implies a significant deterioration in the region's terms of trade.

While the strong growth of imported components by east European and Baltic manufacturers have increased the dominance of the EU as a source of imports for these countries, the higher prices for energy were the key factor in raising the share of Russia and other energy-exporting CIS states in total imports. Having fallen to about 7 and 19 per cent in the first half of 1999, the Russian and CIS share in east European and Baltic imports was above 10 and 23 per cent, respectively, in

78 This has resulted in a rather narrow export base in some countries: in Estonia, for instance, mobile phones and their parts, produced by a subsidiary of the Finnish company Elcoteq, accounted for about 25 per cent of total exports in the first half of 2000, while in Slovakia and Slovenia exports of vehicles and spare parts by the VW subsidiary in the former and the Renault subsidiary (Revoz) in the latter accounted for 15-22 per cent of total exports. Although a wider range of foreign investors operate in Hungary, exports of electrical equipment (including office machines and equipment for telecommunications) accounted for one third of total exports in January-June 2000.

79 In some countries, the data for July-August point to a further acceleration of imports due to the increasing bill for fuel imports and also to some pick-up in imports of consumer goods.

80 Protective measures may also have had an influence: for example, the import surcharge, albeit reduced, in Slovakia; and protective import tariffs and/or quotas for agricultural goods in Latvia, Poland and some other countries.

81 Dollar unit values of manufactured goods exported from west European countries – the major sources of imports into eastern Europe and the Baltic states – fell by some 6 per cent between the first halves of 1999 and 2000 (United Nations, *Monthly Bulletin of Statistics*, Vol. 53, No. 9, September 2000), while world energy prices, in dollars, increased some 80 per cent over the same period (Hamburg Institute of Economic Research, direct communication).

January-June 2000, their highest levels since early 1998. Increased purchases within the east European region, mainly of food and agricultural products and some consumer manufactures, resulted in a small increase in the share of intra-trade in the region's total imports.

The *merchandise trade deficit* of the east European and Baltic countries as a whole in January-June 2000 amounted to $19.6 billion, $0.8 billion more than in the first half of 1999. There were some exceptions to this general trend: the deficits were in fact reduced in Croatia, Lithuania, Romania, Slovakia and Slovenia. In the other east European and Baltic countries, the deficits of the Czech Republic and Yugoslavia doubled from between the first halves of 1999 and 2000 and that of Poland widened considerably, by $0.5 billion. The region's aggregate merchandise trade deficit with developed market economies was significantly reduced (from $11.4 billion to $8.7 billion) but in trade with the CIS countries the deficit widened (from $3.4 billion to $6.8 billion) mainly because of the large increase in the value of imports, especially of oil and gas.

(b) International trade of the CIS countries

In contrast to the first half of 1999, favourable external conditions – higher real demand and rising commodity prices – have led to improved export performance by many CIS countries, although since trade in the first half of 1999 was depressed in the wake of the Russian financial crisis, the subsequent recovery somewhat overstates the underlying improvement in CIS trade.

In the first half of 2000, the dollar value of *total merchandise exports from the CIS countries* increased by almost 50 per cent (table 1.2.2). All the CIS countries (except Uzbekistan) shared in this improvement – exports more than doubling in Azerbaijan and Kazakhstan and rising by 50-70 per cent in Georgia, Russia and Turkmenistan. *Total imports* also increased across the board, with the exception of Kyrgyzstan, and were 16 per cent above their level in the same period of 1999. The CIS area's merchandise *trade surplus* more than doubled to about $33 billion, almost exclusively due to a very large surplus in Russia.

The exports of many CIS commodity producing countries (such as Azerbaijan, Kazakhstan, Russia, Tajikistan and Turkmenistan) increased substantially in the first six months of 2000, largely because of windfall gains from higher world commodity prices.[82] In addition, given the global upturn in the real demand for commodities, CIS oil and metal producers were able to increase shipments. Thus the volume of Kazakhstan's oil exports increased by a third while oil revenues more than tripled.[83] In Russia, a small 3 per cent volume increase was accompanied by a more than a doubling of oil export revenues.[84] While Turkmenistan's exports of natural gas increased by over 50 per cent in volume and value (shipped at a fixed contract price with Russia's Gazprom), lower volumes of oil and oil products did not prevent a tripling of export revenues from these commodities.[85] Similarly, in Tajikistan, where aluminium represents more than half the country's exports, the value of exports increased by a third because of the higher aluminium prices.

However, the prices of other commodities such as gold and cotton – key export items in central Asia – were basically unchanged from the first half of 1999. As a result, the export revenues of Kyrgyzstan (where gold makes up 40 per cent of exports) and Uzbekistan (where gold and cotton represent about 70 per cent of exports) were essentially unchanged. In Kyrgyzstan exports rose by 4 per cent despite the lower volumes of food and tobacco products and Uzbekistan's exports were down by 2 per cent – the result of lower cotton exports, only partly offset by increased exports of metals and machinery.

For the remaining CIS countries, exports increased essentially in response to the improvement in the CIS economic growth during the first half of the year. The strong upturn in Russia – the economic engine for its regional neighbours by virtue of it taking one third of total CIS exports – boosted Russia's demand for CIS exports (table 1.2.9) and the export performance of countries that rely heavily on intra-CIS trade (such as Belarus, Georgia, Kazakhstan, the Republic of Moldova, Tajikistan and Ukraine).

While total CIS imports increased by 16 per cent, growth in the first half of 2000 varied substantially among countries, the increases ranging from 3 per cent year-on-year (Georgia and Tajikistan) to 22-40 per cent in Azerbaijan, Belarus, Kazakhstan, the Republic of Moldova, Turkmenistan and Ukraine. Among the countries with the largest increases in total imports, rising imports of energy (Belarus, the Republic of Moldova and Ukraine) and machinery and equipment (Azerbaijan, Kazakhstan and Turkmenistan) accounted for most of the increases.

In the first half of 2000, the dollar value of Russian and other CIS countries' *exports to non-CIS countries* increased by 50 per cent (table 1.2.9). Traditional commodity exporters such as Azerbaijan, Kazakhstan, Russia and Turkmenistan increased their export values by between 55 per cent (Russia) and 238 per cent (Azerbaijan),

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[82] In the first six months of 2000 the price of crude oil was up 65 per cent year-on-year; the prices of base metals also rose considerably: that of aluminium was up by 25 per cent, copper by 23 per cent and nickel by 91 per cent. Russia's natural gas exports fetched over 50 per cent more relative to the first half of 1999. IMF, *International Financial Statistics* (Washington, D.C.), September 2000.

[83] Agency of Statistics of the Republic of Kazakhstan, *Sotsial'no-ekonomicheskoe polozhenie Respubliki Kazakhstan* (Astana), July 2000, p. 39. This increase in shipments was made possible by transit quota increases negotiated with Transneft, the Russian state owned pipeline operator.

[84] Russian Federation Goskomstat, *Sotsial'no-ekonomicheskoe polozhenie Rossii* (Moscow), January-July 2000, p. 103.

[85] Turkmenistanprognoz, *Sotsial'no-ekonomicheskoe polozhenie Turkmenistana* (Ashgabad), January-July 1999 and January-July 2000.

TABLE 1.2.9

CIS countries' trade with CIS and non-CIS countries, 1999-2000
(Value in million dollars, growth rates in per cent)

	Export growth		*Import growth*		*Trade balances*		
	1999	*2000* [a]	*1999*	*2000* [a]	*1999*	*1999* [a]	*2000* [a]
Armenia							
Non-CIS	25.6	20.4	-6.9	18.5	-450	-192	-226
CIS	-29.8	5.8	-23.7	-1.8	-119	-62	-58
Azerbaijan							
Non-CIS	92.0	238.3	5.8	37.8	8	-102	234
CIS	-9.1	59.2	-19.6	19.4	-114	-66	-49
Belarus							
Non-CIS	19.7	27.9	-20.5	11.0	-95	-18	173
CIS	-29.5	22.0	-22.9	47.9	-647	-246	-804
Georgia							
Non-CIS	53.6	86.8	-38.9	4.0	-246	-130	-95
CIS	0.1	39.3	-15.8	-0.1	-118	-67	-49
Kazakhstan							
Non-CIS	26.5	102.6	-8.8	6.7	2 043	574	2 046
CIS	-32.6	113.7	-22.6	55.1	-133	-227	-26
Kyrgyzstan							
Non-CIS	-4.4	1.6	-15.0	-15.3	-70	-12	13
CIS	-20.5	8.4	-41.2	6.1	-76	-32	-32
Republic of Moldova							
Non-CIS	3.0	-2.8	-41.0	65.7	-135	-47	-139
CIS	-41.0	27.0	-48.0	9.2	24	-9	9
Tajikistan							
Non-CIS	-5.1	19.2	-44.0	-55.2	225	53	148
CIS	55.3	45.8	15.4	34.5	-200	-77	-89
Turkmenistan							
Non-CIS	58.0	91.6	84.6	58.7	-280	-138	-128
CIS	221.5	52.3	4.7	-4.4	-11	140	355
Ukraine							
Non-CIS	-1.3	13.3	-24.7	25.3	3 227	1 823	1 812
CIS	-22.6	31.3	-14.6	20.3	-3 491	-1 974	-2 223
Uzbekistan							
Non-CIS	-15.5	-16.1	-7.3	-1.0	-45	80	-78
CIS	10.9	40.8	-13.6	51.5	131	-3	-41
Total above							
Non-CIS	7.9	34.8	-15.9	16.8	4 181	1 891	3 759
CIS	-21.2	40.1	-18.3	31.2	-4 753	-2 622	-3 006
Russian Federation							
Non-CIS	6.1	54.7	-32.3	-5.0	39 283	15 556	30 548
CIS	-22.0	48.0	-26.3	42.5	2 350	990	1 665
CIS total							
Non-CIS	6.5	49.8	-26.4	3.3	43 464	17 447	34 333
CIS	-21.6	44.0	-21.3	34.9	-2 403	-1 633	-1 342

Source: CIS Statistical Committee, *Express-Doklad*, August 2000. For the Russian Federation, Russian Federation State Customs Committee, *Tamozhennaya statistika vneshnei torgovli Rossiiskoi Federatsii*, No. 2 (Moscow), 2000. For Turkmenistan, *Sotsialno-ekonomicheskoe polozhenie Turkmenistana*, various issues. For Uzbekistan, UN/ECE estimates.

a January-June.

reflecting the much higher prices of crude oil, oil products and base metals. In Russia, a 7 per cent increase in export volume was accompanied by a 40 per cent increase in average export prices. In the other CIS countries, non-CIS exports increased between 13 and 28 per cent, except in Kyrgyzstan (where they were flat) and the Republic of Moldova and Uzbekistan where they declined.

CIS countries' *imports from non-CIS* countries rose by 3 per cent. The dollar value of non-CIS imports increased strongly in Armenia, Azerbaijan, the Republic of Moldova, Turkmenistan and Ukraine. Russia's non-CIS imports rose in volume by 20 per cent but were more than offset by lower import unit values.

In the first half of 2000, the value of *intra-CIS trade* increased by some 40 per cent. The increase reflects a recovery from the dramatic decline in mutual trade in the first half of 1999 caused by the Russian financial crisis and the subsequent contraction of import demand for consumption as well as industrial goods. Despite the recent large increases, the dollar value of intraregional trade in the first half of 2000 was still below its pre-crisis level.

The countries with a larger share of the Russian market benefited most from its strong recovery. Belarussian exports – of which 50 per cent goes to Russia – increased by 22 per cent in value. Ukraine's key export items, ferrous metals and chemicals, increased in value by 34 and 46 per cent, respectively,[86] with most of them going to Russia. Kazakhstan's exports doubled, with a quadrupling of wheat exports in volume and value terms and a tripling in the value of crude oil.[87] Turkmenistan's CIS exports were up 50 per cent on the strength of natural gas sales to Russia. Finally, higher energy prices accounted for much of the increase in imports in many CIS countries, particularly Belarus, the Republic of Moldova and Ukraine.

(vi) Current accounts and external financing

There has been a marked improvement in the external financial situation of many transition economies. A number of these countries have been running current account deficits on a scale which has caused concern, but in the first half of 2000 these have diminished, while most of the CIS fuel exporters are now in surplus. With the major exception of Russia, capital inflows have continued at a relatively high level rate, thanks to FDI and improved access to the financial markets. As a result, official reserves have increased, including in countries which in the past have frequently lacked sufficient liquidity. Nevertheless, several economies continue to face serious financial constraints, generally because foreign investment has been discouraged by slow economic reform, the absence of IMF programmes and political uncertainty. Moreover, a number of CIS countries remain in arrears on their obligations to Russia, while Russia has sought arrangements with western creditors.[88]

(a) Current account developments

The increase in international fuel prices has transformed the combined current account of the ECE

[86] Derzhavniy Komitet Statistiki Ukrainy, *Statistical Bulletin* (Kiev), January-July 2000.

[87] Agency of Statistics of the Republic of Kazakhstan, *Sotsial'no-ekonomicheskoe polozhenie Respubliki Kazakhstan* (Astana), July 2000, p. 42.

[88] Russia has reached an agreement with the London Club of commercial bank creditors, which involves write-off and restructuring of Soviet-era debt.

TABLE 1.2.10

Current account balances of the ECE transition economies, 1999-2000
(Million dollars, per cent)

	Million dollars			Per cent of GDP	
		January-June			Jan.-Jun.
	1999	1999	2000	1999	2000
Eastern Europe [a]	-20 333	-10 226	-9 507	-5.5	-5.4
Albania	-155	48	-175	-4.2	-9.2
Bosnia and Herzegovina	-2 191	-1 015	-950*	-49.9	-53.1*
Bulgaria	-686	-456	-428	-5.5	-8.1
Croatia	-1 523	-1 141	-711	-7.5	-7.7
Czech Republic	-1 029	-338	-724	-1.9	-3.0
Hungary	-2 076	-1 220	-826	-4.3	-3.6
Poland	-11 569	-5 001	-5 638	-7.4	-7.4
Romania	-1 296	-796	-432	-3.8	-2.9
Slovakia	-1 083	-731	-156	-5.5	-1.6
Slovenia	-783	-545	-257	-3.9	-2.7
The former Yugoslav Republic of Macedonia	-135	-46	-160*	-3.9	-9.3*
Yugoslavia	-1 220	-500*	-800*	-7.4	-6.5*
Baltic states	-2 134	-952	-546	-9.7	-4.9
Estonia	-294	-157	-135	-5.7	-5.5
Latvia	-646	-229	-186	-10.3	-5.6
Lithuania	-1 194	-565	-225	-11.2	-4.2
CIS	23 732	7 375	23 061	8.7	16.3
Armenia	-307	-122	-198	-16.6	-30.2
Azerbaijan	-600	-485	-49	-15.0	-2.4
Belarus	-257	-38	-132	-2.4	-3.3
Georgia	-195	-123	-50*	-7.1	-3.6*
Kazakhstan	-171	-614	500*	-1.1	6.7*
Kyrgyzstan	-185	-75	-30*	-15.2	-6.7*
Republic of Moldova	-23	-9	-54	-2.0	-10.5
Russian Federation	25 301	8 663	22 964	13.7	22.2
Tajikistan	48	-55	60*	4.4	17.7*
Turkmenistan	-700*	-230*	50*	-21.4*	2.4*
Ukraine	834	443	200*	2.8	1.5*
Uzbekistan	-14	20*	-200*	-0.1	-3.4*
Total above [a]	1 264	-3 802	13 009	0.2	4.0
Memorandum items:					
CETE-5	-16 539	-7 835	-7 601	-5.6	-5.3
SETE-7 [a]	-3 794	-2 391	-1 905	-5.1	-5.8

Source: National balance of payments statistics; IMF for Azerbaijan (1999-2000), Bosnia and Herzegovina (1996-1998); the Economist Intelligence Unit for Yugoslavia.

Note: UN/ECE secretariat estimates for January-June 2000 reflect changes in merchandise trade balances. Estimates for The former Yugoslav Republic of Macedonia, Kazakhstan, Kyrgyzstan and Ukraine also incorporate first quarter 2000 results.

a Aggregates exclude Bosnia and Herzegovina and Yugoslavia.

transition economies.[89] In the first half of 2000, a surplus of $13 billion was reported, compared with a deficit of nearly $4 billion in the same period in 1999 (table 1.2.10). The bulk of this was due to the improved balances of oil exporters, above all Russia. Most non-fuel exporters also reported improved current accounts due to more buoyant external demand (section 1.2(v)). The latter contributed to

TABLE 1.2.11

Trade in goods and services in the ECE transition economies, 1999-2000
(Per cent change, billion dollars)

	Exports (per cent)		Imports (per cent)		Balances (billion dollars)		
		Jan.-Jun.[a]		Jan.-Jun.[a]		Jan.-Jun.	
	1999	2000	1999	2000	1999	1999	2000
Eastern Europe [b]							
Goods and services	-4	11	-3	9	-24.4	-12.0	-11.7
Goods	-3	12	-4	10	-27.4	-12.5	-12.8
Services	-5	4	3	–	2.9	0.6	1.1
Baltic states							
Goods and services	-10	21	-12	12	-2.1	-0.9	-0.5
Goods	-14	26	-13	15	-3.3	-1.4	-1.2
Services	-2	10	-7	-1	1.2	0.6	0.7
3 European CIS [c]							
Goods and services	-11	18	-21	23	0.5	0.5	0.1
Goods	-12	21	-22	23	-1.2	-0.5	-0.9
Services	-7	7	-9	21	1.7	1.0	0.9
Russian Federation							
Goods and services	-3	45	-29	11	32.3	11.6	25.4
Goods	1	51	-31	5	36.2	13.3	28.8
Services	-27	2	-20	29	-3.9	-1.8	-3.4
Asian CIS							
Goods and services	..	..	..	..	..	..	..
Goods	9	67	-12	20	-1.1	-1.2	1.1
Services	..	..	..	..	..	..	..

Source: UN/ECE secretariat, based on national balance of payments statistics.

a Over same period in 1999.

b Excludes Bosnia and Herzegovina and Yugoslavia.

c Belarus, Republic of Moldova and Ukraine.

the surge in the export of goods and services and, indirectly, to the record output growth in the region. Rising fuel prices tended to exacerbate the current account imbalances of fuel importers, but their deficits generally declined nonetheless. Fewer countries were affected by severe constraints on the current account than in 1999.

The dollar value of east European and Baltic exports of goods and services rebounded in the first half of 2000, rising by 11 and 21 per cent, respectively (table 1.2.11). This was also true of imports although the pace of expansion was considerably less. The growth of merchandise trade considerably outpaced that of services, with imports of services stagnating in dollar terms.[90] In eastern Europe, the recent increase in the surplus on services reversed a long-term decline due to growing expenditures on business services. On the other hand, the combined surplus of the Baltic states has risen steadily, due to earnings from transit services between the Baltic ports and the CIS. In the Baltic states the large current

[89] This section is based on balance of payments statistics whereas merchandise trade data based on customs returns are used in section 1.2(v).

[90] As noted in section 1.2(v), the appreciation of the dollar versus the euro implies that the volume growth rates of merchandise trade (and probably services as well) were some 7-10 percentage points greater than those implied by the nominal values in current dollars.

account deficits of 1997-1999 have been roughly halved. In some countries the smaller current account deficits were partly the result of tighter macroeconomic policies. However, there was a further increase in the large current account deficit of Poland, where the merchandise trade and services balance has deteriorated steadily and, until recently, there was also a loss of net receipts from cross-border trade with Russia and other CIS countries. In the Czech Republic the increased deficit was due to a boom in imports which has been attributed to higher fuel prices and the quickening of output growth. A surge in merchandise exports and the resumption of capital inflows has softened the financial constraints that had faced Romania and The former Yugoslav Republic of Macedonia in 1999. In the latter, the current account deficit has reverted to the size prevailing prior to the Kosovo conflict (despite a marked increase in transfers), but in Romania the deficit has continued to fall (in part because of larger transfers).

The record $23 billion current account surplus reported by Russia in the first half of 2000 – a $14 billion increase from the same period of 1999 – resulted entirely from the increased value of merchandise exports. However, the long-term decline in the deficit on services was reversed as spending on foreign travel accelerated. It is notable that the boom in domestic output has occurred despite the huge transfer of resources abroad represented by the current account surplus. In Belarus, the Republic of Moldova and Ukraine the tight financial situation has loosened somewhat with the sharp upturn in exports of goods and services – they rose by some 18 per cent – and a small inflow of funds. As a result, imports of goods and services rebounded and the current accounts deteriorated. In 1999 these countries were subject to a financial squeeze characterized by a collapse of exports, a cessation of capital flows and a narrowing of current account deficits (Ukraine moving to surplus).

Only fragmentary data are available for the Asian CIS countries, but they indicate a general improvement in current account balances, with the fuel exporters, Kazakhstan and Turkmenistan, posting surpluses. Azerbaijan, however, remained in deficit due to the first repatriation of profits by foreign oil companies.

(b) Capital flows

Although the international financial climate continued to improve in 2000,[91] there was little change in the volume of capital flows to eastern Europe and the Baltic states (table 1.2.12). In general, current account deficits were easily financed and most countries increased their official reserves. In eastern Europe net FDI rose to $6.8 billion, almost 70 per cent of the total net inflow of funds. Net portfolio investments rose to $2.3 billion (largely external bond issues), and there was

TABLE 1.2.12

Net capital flows into the ECE transition economies, 1999-2000
(Billion dollars, per cent)

	Capital and financial account flows [a]					*Changes in official reserves* [b] *(billion dollars)*	
	Billion dollars			*Capital flows/GDP*			
		Jan.–Jun.			*Jan.–Jun.*		*Jan.–Jun.*
	1999	*1999*	*2000*	*1999*	*2000*	*1999*	*2000*
Eastern Europe [c]	26.5	10.7	11.2	7.1	6.4	6.2	1.7
Albania	0.3	–	0.2	7.6	9.8	0.1	–
Bosnia and Herzegovina	0.4	-0.2	..	8.2	..	-1.8	..
Bulgaria	1.2	0.4	0.5	9.8	9.1	0.5	0.1
Croatia	2.0	1.1	1.0	9.7	10.7	0.4	0.3
Czech Republic	2.7	0.6	1.5	5.0	6.0	1.7	0.7
Hungary	4.4	1.8	1.0	9.1	4.3	2.3	0.2
Poland	11.7	5.2	4.9	7.5	6.4	0.2	-0.8
Romania	1.5	0.1	0.8	4.3	5.4	0.2	0.4
Slovakia	1.8	1.0	0.9	9.1	9.7	0.7	0.8
Slovenia	0.7	0.5	0.3	3.5	3.6	-0.1	0.1
The former Yugoslav Republic of Macedonia	0.3	0.1	0.2*	8.0	11.1*	0.1	–*
Yugoslavia	..	..	..	..	..	..	..
Baltic states	2.2	1.0	0.7	10.1	6.6	0.1	0.2
Estonia	0.4	0.1	0.1	8.5	5.4	0.1	–
Latvia	0.8	0.4	0.2	12.7	5.7	0.1	–
Lithuania	1.0	0.4	0.4	9.4	7.8	-0.2	0.2
CIS	-21.2	-6.7	..	-7.8	..	2.6	..
Armenia	0.3	0.1	..	17.8	..	–	..
Azerbaijan	0.8	0.7	–	20.7	-0.2	0.2	-0.1
Belarus	0.2	–	0.2	2.1	5.3	–	0.1
Georgia	0.2	0.1	..	6.0	..	–	..
Kazakhstan	0.2	0.2	..	1.6	..	0.1	..
Kyrgyzstan	0.2	0.1	..	20.3	..	0.1	..
Republic of Moldova	0.1	–	0.1	6.5	13.5	0.1	–
Russian Federation	-23.5	-8.0	-13.6	-12.7	-13.2	1.8	9.3
Tajikistan	-0.1	–	..	-5.1	..	–	..
Turkmenistan	0.8*	0.3*	..	23.4*	..	0.1*	..
Ukraine	-0.6	-0.2	0.2[d]	-1.9	3.0[d]	0.3	–[d]
Uzbekistan	0.1	–*	..	0.5	..	0.1	..
Total above [c]	7.6	5.0	..	1.1	..	8.8	..
Memorandum items:							
CETE-5	21.3	9.1	8.6	7.2	6.0	4.8	1.0
SETE-7 [c]	5.2	1.7	2.6	7.0	8.0	1.4	0.7
Russian Federation [e]	-16.0	-6.3	-9.1	-8.7	-8.8	1.8	9.3

Source: UN/ECE secretariat estimates, based on national balance of payments statistics.

a Includes errors and omissions; excludes changes in official reserves.

b A negative sign indicates a decrease in reserves.

c Aggregates exclude Bosnia and Herzegovina and Yugoslavia.

d January-March.

e Excluding errors and omissions.

a further rise in unrecorded capital inflows (errors and omissions, generally reflecting potentially volatile funds). Unrecorded flows have been a major financing item since 1997, especially in Croatia, Poland and Romania. However, the outflow of short-term funds has accelerated, to over $3 billion in January-June. This has been a widespread phenomenon, also observed, for example, in the Baltic states, Kazakhstan and Russia, and may in at least some cases reflect elements of capital

[91] Two years after the Asian crisis, private flows to the emerging market economies are still recovering, and the projected volume for 2000 remains considerably below pre-crisis levels. International Institute of Finance (IIF), *Capital Flows to Emerging Market Economies* (Washington, D.C.), 23 September 2000.

flight. Given the tightness in their external finance positions at various times in 1999, the attraction of new funds has continued to be an important objective in Croatia, Romania, Slovakia and The former Yugoslav Republic of Macedonia.[92]

The easing of the financing situation of Belarus, the Republic of Moldova and Ukraine in the first half of 2000[93] was due mainly to the inflow of potentially volatile funds: the Republic of Moldova attracted relatively large portfolio investments while in Belarus and Ukraine unrecorded capital and short-term flows dominated. These countries lack access to the financial markets and only Ukraine has an IMF programme (although disbursements have been suspended). In Russia financial outflows accelerated in the first half of 2000, fuelled by the huge current account surplus and a small inflow of FDI. Nonetheless, foreign exchange reserves more than doubled to $21.5 billion in the first nine months of the year.[94] In 2000 a much larger share of the current account surplus has been channelled into official reserves, but capital flight still appears to be substantial.

Despite the improvement in the financial market conditions, the volume of new external bonds issued by the transition economies declined to some $5.2 billion in January-October 2000 (table 1.2.13) as most of the financing needs of creditworthy borrowers were met by FDI and portfolio investment in local securities. Polish entities were the most active borrowers, and the country's sole sovereign bond (€600 million) was launched for benchmarking purposes. A €150 million bond signalled Romania's re-entry into the markets after the financial squeeze in 1999, albeit with a very high risk premium. Margins declined in the ECE region, in parallel with those in other emerging market economies. But there were specific factors as well: political change (Croatia), increased oil revenues (Kazakhstan), and, more generally, improved economic performance at the country level. Increased oil revenues also helped Azerbaijan to acquire its first (sub-investment grade) credit rating. Ten transition economies remain unrated by the major credit rating agencies.

FDI flows into the ECE transition economies have increased steadily during the past decade. Estimates for 2000 as a whole suggest a further increase, in contrast to the situation for the emerging market economies as a whole for which a downturn is projected.[95] In the first half of 2000, the transition economies received somewhat more FDI than in the same period in 1999 (table 1.2.14), due to the record amount attracted by central Europe. Annual flows continue to be heavily influenced by privatization activity, except in Estonia and Hungary

TABLE 1.2.13

International bond issues by the ECE transition economies, 1999-2000

(Million dollars, basis points)

	Bond issues		*Margins*	
	1999	*2000 [a]*	*1999*	*2000 [a]*
Bulgaria	54	–	..	..
Croatia	541	482	375	210
Czech Republic	814	–	..	..
Estonia	85	200	..	..
Hungary	2 411	890	71	..
Kazakhstan	300	350	825/710	500
Latvia	237	–	330/225	..
Lithuania	470	340	475/395	281/249
Poland	1 146	1 322	..	82
Romania	–	140	..	587
Slovakia	800	1 114	420/385	217
Slovenia	439	385	87	73
Total	7 297	5 226	..	..

Source: UN/ECE secretariat, based on press reports.

Note: Basis points: 1 per cent equals 100 basis points. Margins on fixed rate sovereign bonds denominated in euros (over French OATS or German Bunds), except for Kazakhstan which are dollars.

[a] January-October, preliminary.

where it has largely run its course. Flows in the second half 2000 have been buoyed by major privatization-related investments including the sale of stakes in national telecommunications companies ($4.3 billion in TPSA of Poland and €1 billion in Slovak Telecom), and by bank privatizations in Croatia and Slovakia.

(vii) Short-term outlook

During the first half of 2000 the rates of economic growth in the ECE transition economies have been higher than expected at the end of last year. The short-term outlook for these countries now looks very favourable for the remainder of 2000 and through 2001. Countries with rapidly growing high-tech industries such as Hungary, and to a lesser degree the Baltic states and other countries bordering the European Union, should reap the benefits of increasing returns. The south-east European transition economies, however, have not benefited much from growth in the high-tech sectors, but this region can also expect relatively high growth rates, at least in the short run, thanks to the more favourable external environment which should support a strengthening of the recovery. The outlook for most of the CIS countries will largely depend on the situation on the world commodity markets.

Given the prevailing expectations that these favourable conditions will continue, many governments have raised their forecasts for GDP growth in 2000 (table 1.2.1). These revisions are especially pronounced in some of the CIS countries, especially Russia, where in October the official forecast for GDP growth in 2000 as a whole was more than triple that made at the beginning of the year. Substantial upward revisions were also reported in Kazakhstan and Ukraine. As a result of all these revisions, aggregate GDP in the CIS is set to grow by close to 6 per cent in 2000; eastern Europe is expected

[92] This policy is also reflected in their issue of international bonds.

[93] However, all three countries remain in arrears to Russia.

[94] The end-September figure inclusive of gold is $25 billion, compared to $12.5 billion at the end of 1999.

[95] Direct equity investment in the emerging market economies is projected to fall by some $19 billion in 2000 to $124 billion. IIF, op. cit.

TABLE 1.2.14

Foreign direct investment[a] in the ECE transition economies, 1997-2000

(Million dollars)

	1997	1998	1999	January-June 1999	January-June 2000[b]
Eastern Europe[c]	9 400	14 270	17 361	5 824	7 018
Albania	48	45	41	15	31
Bosnia and Herzegovina	–	100	60*	30*	30[d]
Bulgaria	505	537	806	286	250
Croatia	530	898	1 408	299	582
Czech Republic	1 300	2 720	5 108	1 430	2 052
Hungary	2 173	2 036	1 944	712	910
Poland (cash basis)	3 077	5 129	6 471	2 210	2 737
Romania	1 215	2 031	1 041	673	257
Slovakia	161	508	330	130	130
Slovenia	375	248	181	51	39
The former Yugoslav Republic of Macedonia	16	118	30	20	30*
Yugoslavia	740	..	..	..	..
Baltic states	1 142	1 863	1 139	627	462
Estonia	267	581	305	208	145
Latvia	521	357	348	157	179
Lithuania	355	926	486	262	139
CIS	10 611	6 733	6 599	3 104	2 353
Armenia	52	221	122	60	60[d]
Azerbaijan	1 115	1 024	510	401	85
Belarus	200	149	225	175	47
Georgia	203	265	82	42	41[d]
Kazakhstan	1 321	1 151	1 584	760	620[e]
Kyrgyzstan	83	109	36	4	-2[e]
Republic of Moldova	76	81	34	6	66
Russian Federation	6 639	2 761	3 309	1 393	1 085
Tajikistan	30	24	21	9	9[d]
Turkmenistan	102	64	60*	30*	30[d]
Ukraine	623	743	496	166	252[e]
Uzbekistan	167	140	121	60*	60[d]
Total above[c]	21 153	22 866	25 098	9 555	9 833
Memorandum items:					
CETE-5	7 087	10 641	14 034	4 532	5 868
SETE-7[c]	2 313	3 629	3 326	1 292	1 150
Poland (accrual basis)	4 908	6 365	7 270	..	..

Source: UN/ECE secretariat, based on national balance of payments statistics; IMF for Bosnia and Herzegovina (1996-1998).

a Inflows into the reporting countries except for Albania and The former Yugoslav Republic of Macedonia, which are net of domestic investments abroad.

b Data for 2000 are preliminary.

c Aggregates exclude Bosnia and Herzegovina and Yugoslavia.

d Estimate, assumed to be the same as in 1999.

e Estimate, twice first quarter value.

to average 4.2 per cent and the GDP growth in the Baltic states should settle down to 3.6 per cent. All in all this suggests an average annual rate of growth for the ECE transition economies as a whole of over 5 per cent, by far the highest rate since the transition process got underway 10 years ago.

The rate of growth of world output is expected to decelerate in 2001, but growth is forecast to remain relatively strong in western Europe and this should sustain the demand for imports from eastern Europe. Commodity exporters are also expected to continue to benefit from strong global demand and relatively high world market prices. Most official forecasts for GDP growth in the transition economies in 2001 reflect this optimism. Moreover, while actual performance in the transition economies has often diverged considerably, the forecasts for 2001 are more homogeneous across countries and subregions (table 1.2.1): average growth rates in eastern Europe, the Baltic states and the CIS are all expected to be slightly above 4 per cent.

In eastern Europe, the 2001 budgets have generally been drafted on the assumption that the current high rates of output growth will be sustained. Some of the countries that in recent years have experienced economic downturns (Bulgaria, Croatia, the Czech Republic) or a deceleration of growth (Slovakia, The former Yugoslav Republic of Macedonia), are expecting an acceleration of GDP growth in 2001. The improvement of the external environment is behind expectations of a continuation of the recovery in the three Baltic countries in 2001: in Estonia and Latvia rates of growth are expected to remain comparable to those in 2000 while in Lithuania the authorities anticipate an end to the period of sluggish growth.

Although the unusually high rate of output growth in Russia in 2000 is unlikely to be sustained for a second year, the authorities are still expecting GDP growth of 4 per cent in 2001. For the rest of the CIS, most of the available official forecasts for GDP growth in 2001 are in the range of 4-6 per cent. It should be borne in mind, however, that the economic prospects of these countries remain highly sensitive to external shocks and movements in world commodity prices. In addition, for some of them there still exists a threat of energy shortages due to supply constraints and high levels of external indebtedness (mostly to Russia), while access to additional external financing remains uncertain. Furthermore, the severe drought which hit agricultural output in some of these countries in 2000, will probably continue to have negative effects on the food processing industries and, eventually, exports.

Since the recent resurgence of inflation in some transition economies was mainly imported from abroad, the prospects for inflation will also depend to some extent on what happens to world commodity prices. So far, high rates of export-led productivity growth have helped to alleviate these inflationary pressures: industrial unit labour costs have declined in most of the east European economies as increases in nominal wages have so far lagged behind the growth in labour productivity. In contrast, relatively slower productivity growth coupled with an accelerated rise in wages has resulted in rising unit labour costs in all the CIS countries. In some of them producer price inflation has been almost double the rate of increase in consumer prices, putting further pressure on consumer prices and wages to rise even further.[96]

96 Rising real wages can have two different effects on the short-term outlook of eastern Europe: on the one hand they can increase consumer demand and hence domestic output but, on the other, they can eventually increase inflationary expectations. Continued productivity growth and a favourable global economic environment would favour the first scenario. Rising commodity prices would favour the second and would likely result in a moderation of growth in 2001 if the central banks decide to respond by tightening monetary policy.

Despite the good prospects for growth, the immediate outlook for the labour markets in central and eastern Europe is not so favourable since most businesses are initially absorbing the current widespread underutilization of labour. Moreover, as the process of enterprise restructuring is still underway in many transition economies, continued labour shedding can be expected to further aggravate the problems of unemployment and weak employment growth.

The balance of payments does not appear to be a constraint on growth in most ECE transition economies. Significant improvements have occurred in the oil-exporting CIS countries, but even in the oil-importing countries, exports have been growing strongly, current account balances have improved and there has been an increase in FDI in the region. Current forecasts suggest little change in current account balances although this scenario depends on the continued buoyancy of west European economic growth and a stabilization of oil prices. Conditions in the financial markets are generally favourable, and most countries hope to maintain (if not increase) current levels of FDI. However, the anticipated fall in privatization revenues in some transition economies (such as Poland) will require a shift to alternative sources of finance.