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NEWS OF THE MONTH

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POLISH GDP GROWTH ON THE RISE

The Central Statistical Office of Poland announced on 29th January 2007, that Polish GDP grew by 5.8% year-on-year, exceeding the already earlier significantly (from 4.2%) upgraded forecast of 5.7%. This growth rate was the sixth highest in the EU-25 in the last year, behind Latvia, Estonia, Lithuania, Slovakia and the Czech Republic. The GDP value at current prices amounted to EUR 272.6 billion.

TENDENCIES OF REAL GDP GROWTH

Poland has been one of the most successful countries of the former communist block since the change of regime, concerning smooth transition from a state-directed economy to a primarily privately owned market economy. GDP growth was steady and quite strong between 1993 and 2000, reaching a peak of 7% in 1995 and an average yearly growth of 5.2%. Thanks to this successful period, Poland became the first country in the region, which exceeded the GDP level of 1989. The economy slowed down in 2000 because of tight monetary policy constraining domestic demand, decreasing investment and the slow rate of export growth to EU and CIS countries. The EU accession coming forth has turned the decelerating trend of real GDP growth. In 2004, the GDP growth exceeded the 5% level as Poles intensively bought goods such as household appliances, cars, building materials and food, because of the fear that prices will dramatically increase after accession. Thus the 6% GDP growth of the first half of 2004 was artificially stimulated. The 2.1 percentage point lower growth rate of 2005 was the result of lower domestic demand and the high statistical reference point. However, in the second half of 2005, consumption and investment started to increase, boosting GDP growth.

Chart 1. Real GDP Growth Rate (%) in Poland 2001-2006

Source: Central Statistical Office of Poland

The momentum of 2005 continued in the last year, increasing GDP growth by 2.5 percentage points. The fourth quarter GDP figure was not published on the 29th January, but expectations are even higher, moving between 6.3% and 6.6%. Even though the high GDP growth rate Poland is one of the poorest countries of the EU. It is at the next to last position ahead Latvia.

COMPOSITION OF GDP GROWTH

Before 1995, GDP growth was led mainly by exports on the demand side. The leading role was taken over by investment activities (increased by 20% annually on average) and domestic demand after 1995. In the depressed period of 2000 and 2001 investment growth decelerated rapidly. The Polish economy overcame the difficulties with help of growing export and accelerating private consumption due to lower inflation accompanied by higher real income. Even thought GDP growth was relatively slow in 2005 because of decreasing domestic demand, in the second half of the year labor market investment accelerated and labor market has improved, which led to increased domestic demand at the end of the year and in 2006 as well. Parallel with the recovery of EU markets, export contributed to GDP growth as well, resulting in a particularly successful fourth quarter (4% growth of GDP).

In 2006, domestic demand took over the role of growth engine from export. Besides increased private consumption, higher investments also contributed to the 5.8% annual GDP growth. Private consumption increased by 5.2% year-on-year, while the annual rate of investment expansion reached 16.7% over the year. The reason of growing private consumption was the improvement achieved on the labor market, as the unemployment rate dropped by 2.8 percentage points in 2006. Rising investment was due to EU funds absorption and modernization processes. The role of net export was neutral concerning economic growth, as domestic consumption drove up imports.

Table 1. Decomposition of GDP Growth on Demand and Supply side

	2001	2002	2003	2004	2005	2006 Q3
Supply side						
Industry	-0.7	-0.5	7.6	10.5	3.9	5.8
Construction	-7.5	-9.0	-2.9	1.8	7.2	14.9
Market services sector	2.3	3.2	2.4	4.2	3.6	10.4
Trade and repair	3.4	4.1	0.4	4.3	3.7	-
Transport, storage, communication	3.0	7.4	3.5	7.6	2.6	-
Non-market services sector	3.5	2.3	4.2	0.9	1.5	-0.2
Demand side						
Final consumption expenditure	2.2	2.9	2.6	4.0	2.6	5.2*
Gross capital formation	-13.4	-7.2	3.3	14.7	1.4	19.3*
Export	3.1	4.8	14.2	14.0	8.0	14.9
Import	-5.3	2.7	9.3	15.2	4.7	15.5

Sources: Central Statistical Office of Poland

Similarly to the demand side there have been different leading branches of economic growth on the supply side. During the throw-back between 2001 and 2002 market and non-market services contributed balanced the downward trend of industry and construction. In the following heightening period industry and transport and storage services grew by respectively 2.5 and 5.4 percentage point higher than the average, while in 2005 construction took the leading role in economic growth. In the third quarter of 2006 market services closed the gap to construction and compensated the negative trend of non-market services and agriculture.

EXPECTATIONS

According to estimations of the Ministry of Finance the positive trend will continue in 2007. The projected annual GDP growth is 5.4%. However, there are different factors which could threaten the blooming Polish economy. In order to close the gap to other EU member sates concerning per capita GDP at purchasing power parity, the country has to continue reforms. One of the most problematic areas is the large and inefficient agricultural sector, employing over one quarter of the work force but contributing only 5% to GDP. This relatively low productivity could be increased by investment in rural infrastructure and education, enabling Polish agriculture to become a leading producer of food in the EU.

The rest of the unprofitable sectors of large heavy industry should be privatized and replaced by service businesses. Besides improving the responsiveness of the supply side of the economy, reforms need to be done in order to increase labor market flexibility. According to the Minister of Economy unemployment rate will fall to 14% from the current 14.8% by the end of 2007, which could further boost domestic demand. Further structural changes are also necessary in the fields of health care, education and pension system and state administration. These reforms could increase fiscal pressures. However, in case budget deficit can be kept low, the potential inflationary pressures can be reduced, which is inevitable in the process of preparing for the entry into the Euro zone. Falling inflation can give more room for further interest rate cuts, thereby increasing investments and economic growth. In case fiscal and structural reforms will be postponed, political uncertainty will increase and the recovery of the EU will slow down, the buoyant Polish economic growth cannot be held on the long term.

FIVE YEARS OF INFLATION TARGETING REGIME IN HUNGARY

Last year, the National Bank of Hungary celebrated the fifth anniversary of introduction inflation targeting in its monetary policy.

BACKGROUND

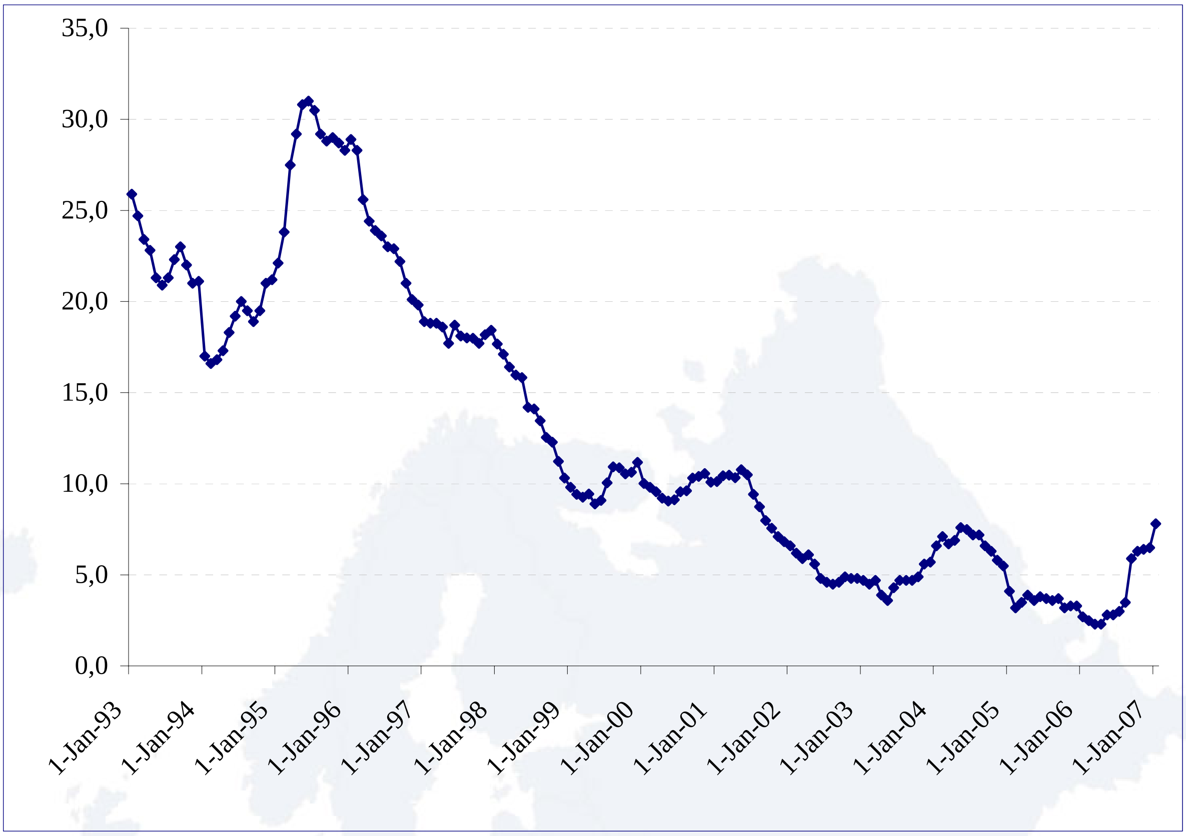
The main task of the central banks is to navigate the inflation level to a moderate level. But not all of the central banks have this single function. Thus, in the modern western countries two kind of central banking have developed. The first group of the national banks has a chief task to create price stability (in the European countries). The other type of central banks has double goal: to reach the price stability and the full-employment as well (in the United States).

In Hungary, the Central Bank follows the firs type of National Banks, and the main goal is to reach the relative price stability. From the transition in 1990, in Hungary, there have been three kind of monetary system.

At the beginning, between the instability of banking and financial system, the monetary authority preferred the fixed exchange rate regime, which it could adjust by time to time to secure the competitiveness of the economy in the new, different and more developed economic situation. This method meant unpredictability and incredibility for the economic actors. Thus, the monetary policy lost its credibility, and expectations jeopardized the main, inflation target.

In this manner, in 1995 the authority changed for crawling peg, which meant a bit flexible system, because the Hungarian currency, the HUF had narrow, +/- 2,25 percentage point, exchange rate band, in which the currency could float freely. The aim was to cool down the inflation and to make credible policy by depreciating the forint from time to time at an announced and well-know time. As the continuous currency depreciating generated a steady inflation expectation, for the late nineties, the Hungarian inflation rate stuck at around 10 percent, as one can see in the *Chart 2*, below.

Chart 2. Development of Inflation in Hungary (monthly)



Source: NBH (MNB), own calculation

If the National Bank wanted to lower the inflation level, it had to make some new steps to orient expectation. It needed to alter the measure of time inconsistency, which issues from the common knowledge, that say, policymakers are tend to generate higher, surprise-inflation to develop the domestic output, and lower home unemployment rate. The best way for varying the time inconsistency is, enhancing the credibility of the national bank, in this way, make a strong anchor, which can orient the expectations of market players. It can be fulfilled by 3 main manners.

The first is to give a steady measure of increasing of a monetary aggregate, which has a close relationship with the inflation. This method has some difficulties, caused by the relatively week relationship between the inflation and the aggregates.

The second possibility is to make a currency board system, where the monetary authority is engaged to keep the in advance given, fixed exchange rate or band to a foreign currency or currency basket. The system has a lot of disadvantages: the imported monetary policy, the slow compliance with the real shocks by the wage and price stickiness.

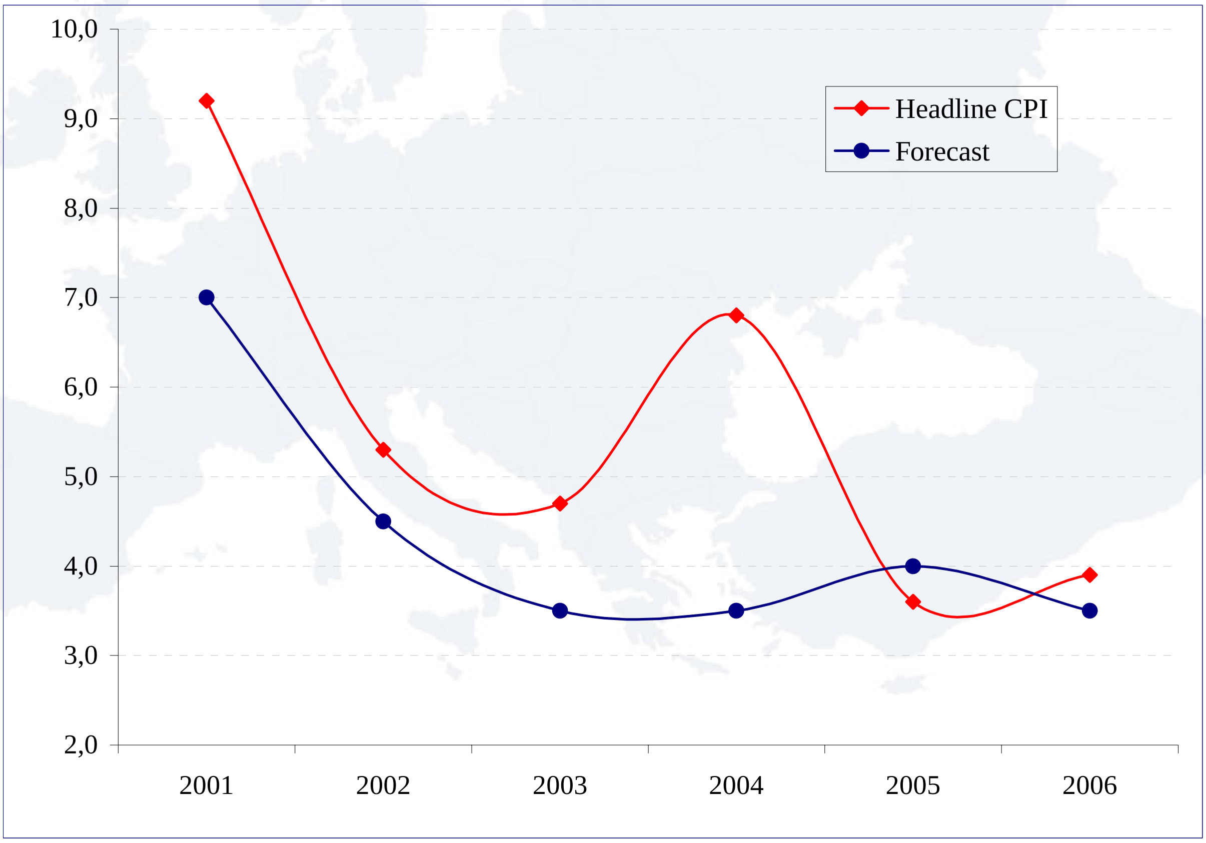
The third way is the inflation targeting system. The National Bank has a direct inflation target, which it tries to reach with a tolerance band. There's no indirect aim. In case the inflation targeting system is successful, the inflation target is able to anchor the inflation expectations. As the main indicator in this system is the expectation, the communication and transparency are more accented in comparison with the other two systems.

Inflation Targeting in Hungary

Inflation targeting system (IT) was introduced in Hungary in July 2001 for making the monetary circumstances to meet Maastricht criteria to be able to introduce euro by 2007. As we can see it in the *Chart 2*, 2001 was the breakpoint of inflation tendency. The consumer price index has been decreasing, thus the change for the inflation targeting systems can be said to be successful at the first sight. This, first success contributed to the increasing of the system's credibility. Next to the introduction of the new monetary method, the Hungarian National Bank tightened the exchange rate fluctuation band from +/-2,25 percentage to +/-15 percentage. After the tightening, the forint started to appreciate, which had also an effect on the disinflation process.

The tendency of the Hungarian inflation from 2001 seems to be pretty good as it has been falling together with the Hungarian economy's stable, balanced middle-sized economic performance. Thus, the cost of the inflation – in this case – should be told to not considerable, which fact is one of the measures that show us the success of the regime. On the other hand, the second success, next to the lowering inflation level, is the better prediction of the future inflation from the Hungarian Nation Bank. Of course, it is true, just in case the monetary authority has the appropriate communication with the market, and could have an effect on it by the developed credibility. The estimated and the deadline inflation can be seen in the *Chart 3*.

Chart 3. Performance of Inflation Targeting Regime 2001-2006



Source: NBH (MNB), own calculation

Although the monetary policy had to face serious changes in the Hungarian economy from 2002, the six years, spent in the inflation targeting system is the proof of the IT's efficiency in the Hungarian monetary circumstances.

From election in 2002 the Hungarian government couldn't make its announced promise about the fiscal indicators, namely: the fiscal and the current account deficit must be lower, year by year. The fiscal imbalances have been lasting till now and the market players have lost their confidence in the government. What could the monetary policy do in this hard situation? It tries to keep the forecasted aim, the inflation target in order not to let market to loose their confidence in the other main institution of the economy. But, as the two big institutions are absolutely depended by each other, of course it's not easy to accomplish the given goal. Though, the government and the National Bank had different preferences about the inflation level, the monetary authority was able to keep its independency, and followed the most important goal, to reach the inflation level, that meets the anchored expectations.

Summarized, the new monetary policy regime, the inflation targeting system was successful in Hungary in lowering the inflation level without any considerable cost of this adjustment.

WHAT IS EXPECTED?

As the Hungarian Nation Bank was able to anchor the market expectation to its goals and was on the right path to reach these aims in the last 6 years, it's predictable, that the system will continue to perform well.

Of course there are many risk factors, such as the biggest one, the fiscal policy, that can have a measurable effect on the success of the monetary policy. Thus, we have to emphasize the importance of the balanced relationship between the fiscal and monetary policy in order to secure the suitable circumstances for the inflation targeting regime. The inflation targeting regime can be successful in Hungary, in case the monetary policy can operate freely.

The other factor is whether the new president of NBH will be able to inherit the built up credibility of the organization by previous era led by Zsigmond Járai, who has got international prestige despite of sometimes specific communication style and the mistake made by shift of the middle of the band. This is crucial in terms of IT regime.

TAJIKISTAN – ECONOMIC AND FISCAL PERFORMANCE

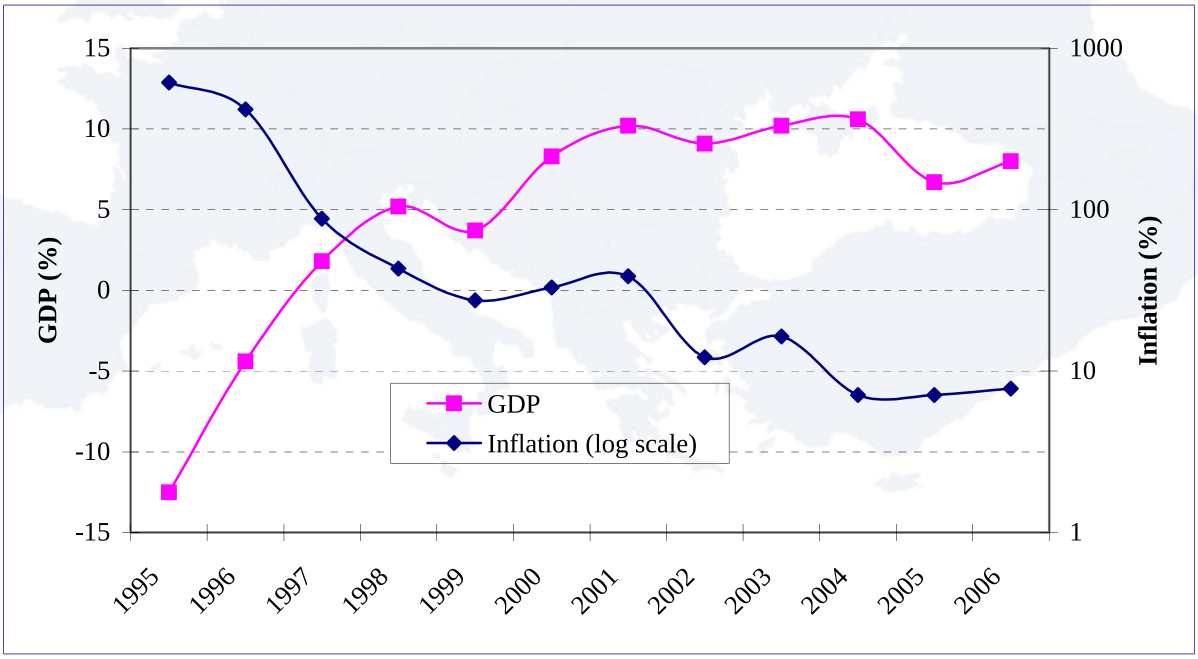
One has little knowledge about the states of the former Soviet Union, but these countries – after having become independent – could offer good opportunities for the business. Therefore, this essay tries to give a general picture – macroeconomic and fiscal situation – of the Republic of Tajikistan, a middle-sized country in Central Asia of 7.3 million inhabitants, bordered by Afghanistan, China, Kyrgyzstan and Uzbekistan. Although the country became independent on 9 September 1991, more notable and positive economic changes could happen only after the civil war ended in 1997.

MAIN MACROECONOMIC INDICATORS OF TAJIKISTAN

In the performance of Tajik economy unstable situation had appeared as a result of transition from command to market economy and the civil war in the early 1990s, which caused notable decline in economic growth. The negative peak was in 1995, when the rate of the decline reached 12.5%. But since the mid of nineties Tajik economy has been performing much better, the country's output has being kept growing. The annual growth rate of the GDP reached 10% in the beginning of the 2000's; but in recent years a little drop can be experienced, as the growth rate decreased below 9% (*Chart 4*) – the IMF estimates "only" a 6% growth rate for this year.

One of the greatest challenges for Tajikistan was to handle the very high hyperinflation coming from the early 1990s – according to IMF, in 1993 the average consumer prices changed by 2600% compared to 1992. In the next few years notable changes happened, as the inflation rate decreased below 10%, and the IMF estimated 7.8% price change for 2006 (*Chart 4*).

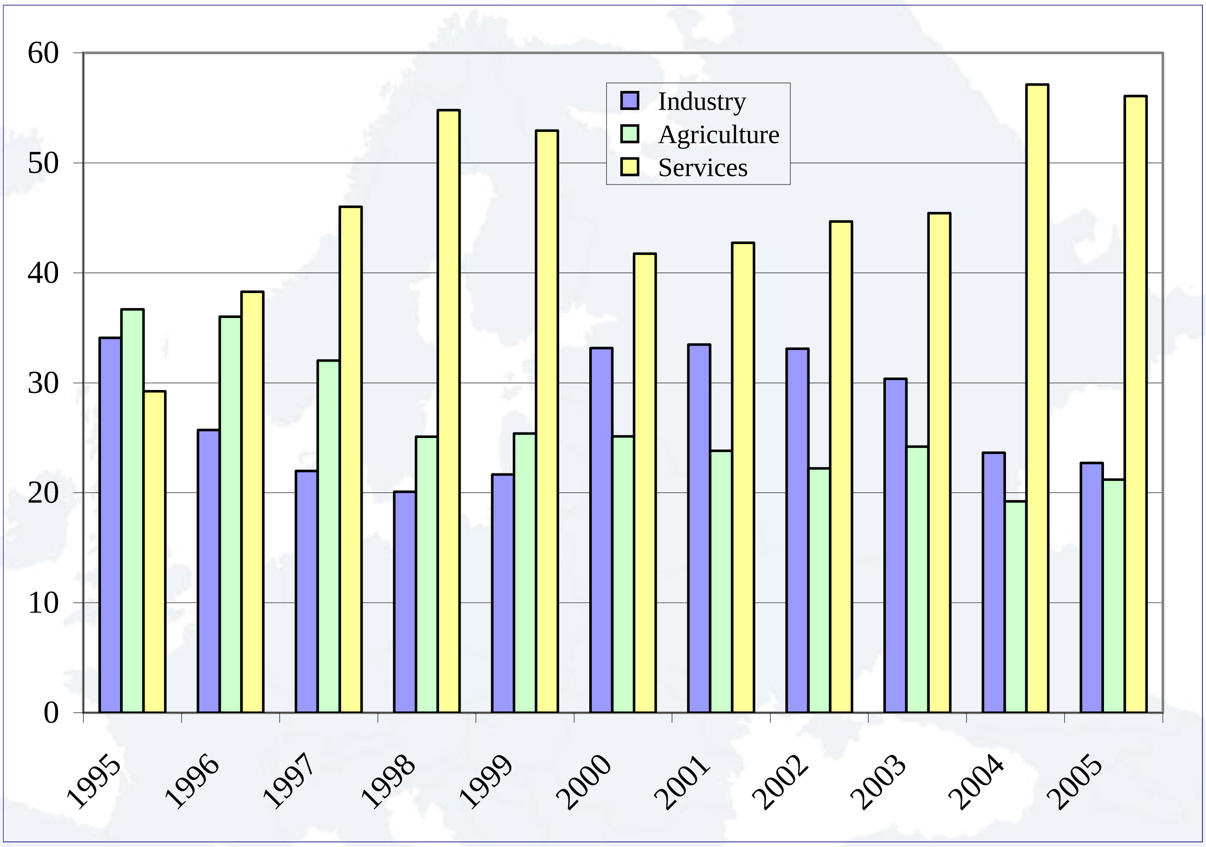
Chart 4. Annual Change of GDP and Inflation, 1995-2006 (%)



Note: data for 2006 is estimation
Source: IMF

The three main sectors' contribution to the country's output indicates that Tajikistan is converging to more developed countries. *Chart 5* describes that both the agricultural and industrial sector lost from their role during the last decade. Although the agriculture's share decreased from 36.6% (1995) to 21.19% (2005), this sector is still almost as important as the industry: there can be found no significant difference between their shares from the country's output. Especially in 2005, as the contribution to the GDP in case of both of them was about 20%. Meanwhile the tertiary sector's importance is growing: from 30% in the year of 1995 and after a big decrease in the end of the 1990s (because of the decline in trade), the rate of services sector in the GDP exceeded the 50% in 2004 – owing to the growing role of the transport and communication branches.

Chart 5. Structure of Output by Main Branches, 1995-2005 (% of GDP)



Source: State Statistical Committee of Tajikistan

But the data above is not as favourable as it seems. The reason for this is that although the share of the agriculture keeps decreasing, the labour employed in this sector continues to increase. While the rate of the agricultural employment was 43.52% in 1988 (according to the data of Asian Development Bank), it increased by 26.23%-point in the last 17 years, and the rate reached the 69.75% in the year of 2005. Beside it, the employed in the industry was below 10% in 2005, and that of the service sector was 21.48% in the same year.

FISCAL SITUATION IN TAJIKISTAN

Tajikistan's fiscal policy developed and changed a lot in the past decade. Looking at the budget balance, it experienced remarkable improvement as the deficit of 7.4% in 1995 shifted into a surplus within 5 years: the surplus was 0.1% of the GDP in 2000, and till 2004 the overall budget balance was above zero. In 2005 Tajikistan experienced again a deficit of 1.6% in 2005.

It is worth analysing the structure of the general government budget. *Table 2* shows that – similarly to most of the countries – the main source of the government's revenue is the tax. The rate of tax revenues exceeds the 80% of the total revenue in the previous three years; the value added tax and the excises are the main sources of this type of budget income. The greater role of the tax revenues can be also stated if we compare this type of income to the country's GDP: according to IMF this rate reached only the 12% in 1998, but it rose to 16.4% in 2006.

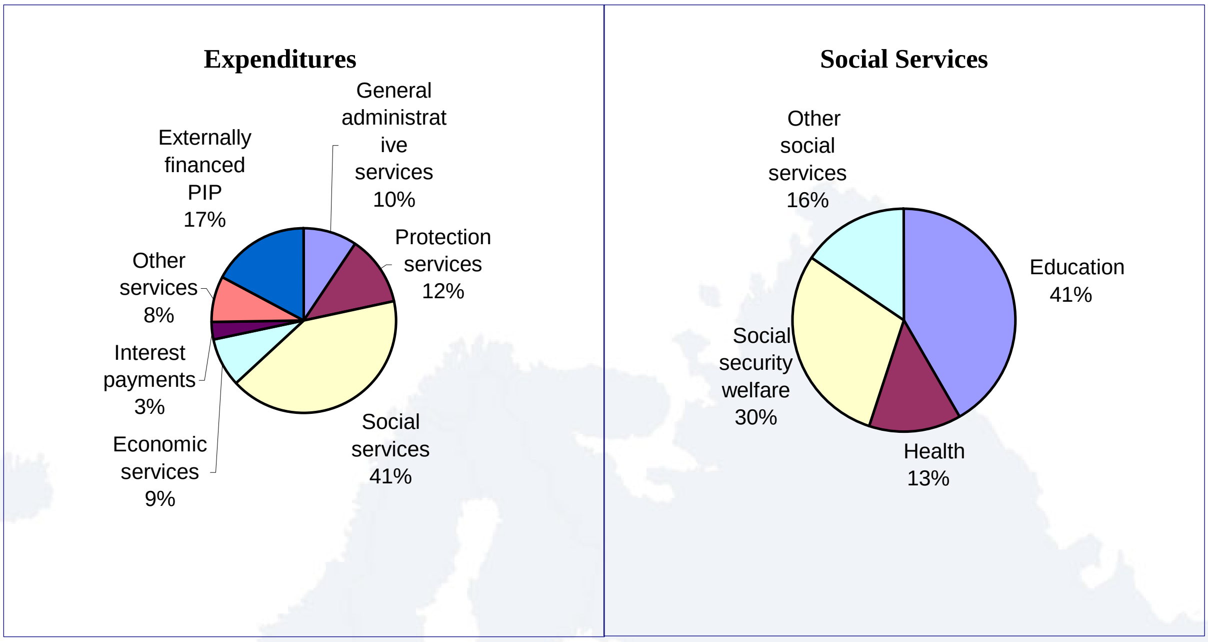
Table 2. Revenues of the General Government, 2004-2006

% of the total revenue	**2004**	**2005**	**2006**
Overall revenues and grants	**100,00**	**100,00**	**100,00**
Total revenues	*96,29*	*95,63*	*97,57*
Tax revenues	**84,60**	**85,20**	**87,74**
Income and profit tax	9,51	10,35	9,96
Payroll taxes	10,87	10,64	10,98
Property taxes	3,08	3,72	4,21
Sales tax and VAT	43,66	45,55	46,49
International trade and operations tax (Excise)	16,76	14,94	16,09
Other taxes	0,72	0,00	0,00
Non-tax revenues	**11,68**	**10,42**	**9,83**
Grants	**3,71**	**4,37**	**2,43**

Source: IMF

On the expenditure side significant changes have happened. The share of social and protection expenses increased in the last three years, the social expenditures reached the 40% of the total general government spending, and the protection one is only 10% of that. It is surprising that the government spends very little on health, only a bit more than 13% of the social expenditures; education and social protection welfare have greater role *(Chart 6)*. Beside the growth of the social expenditures, almost all other types of expenses decreased in the last three years: the obligation of interest payments decreased by 0.5, the economic services by 1 and the group of other services by 8.86 percentage point (the general administrative expenditures decreased as well but only a little).

Chart 6. Structure of Expenditures and Social Services in 2006



Source: own calculation according to IMF data

CONCLUSION

Although the process of transition from command to market economy has a lot of challenges, according to the above-mentioned data and statistics, the Tajik economy shows continuous development in the past 15 years and the tendency projects further favourable development. The economy keeps growing, the role of the services sector is much higher than it was ten years ago, the problem of the hyperinflation seems to be solved, although an annual price change of 7% may be said to be high.

Another problem, which has not been solved yet, is the high rate of the employed in the agricultural sector, despite its share from the country's output keeps decreasing. Many experts think that solving the land reform and the cotton farmers' debt could renew the role of the agriculture.

As we could see in the case of Belarus, in the CIS-countries – also in Tajikistan, the greatest problem is in connection with the tax system, because the tax collection is very complicated, the number of tax avoiders is extremely high and there are many exemptions and "nuisance tax". The state is week. Therefore it is not surprising, that the main changes happened in the revenues of the general government operations, which led to a more modern tax collection, the number of the tax avoiders decreased, and the whole system became more transparent. A new tax code – entered into force in 2005 – helped a lot in solving the problem of the former tax system, since following it a two-tier income tax was introduced, the number of tax concessions was reduced and a taxpayer inspectorate was established.

In spite of these there are still problems to solve. For this a suitable indicator is that almost two-thirds of the Tajik population live below the poverty line (i.e. live from less than USD 2.15 a day) – according to the Asian Development Bank. To handle this problem and to offer a more favourable environment for both domestic and foreign business operations, the Tajik government should solve the problem of weak legislation and of strong corruption. On the Corruption Perceptions Index-rank (made and issued by Transparency International in November 2006) Tajikistan takes the 142nd place – from 163 countries.

An urgent solution is needed, as Tajikistan belongs to the net oil and gas importer countries, since more than 90% of the country's oil and gas consumption comes from abroad. The country is not allowed to follow a protectionist trade policy; therefore to establish the more transparent and safe legislation is essential for the further development of Tajikistan.