ICEG EC

CORVINUS
INTERNATIONAL INVESTMENT LTD.

ICEG EC - CORVINUS
SEE Monitor

No. 09.

2006.

TABLE OF CONTENTS

FOREIGN TRADE OF THE SEE COUNTRIES I. – DEVELOPMENT OF FOREIGN TRADE IN THE REGION

Foreign trade plays an important role in case of small, open economies, like the countries of the SEE region. As these countries have to face the consequences of former planned economies, the break up of former Yugoslavia and the subsequent war period, foreign trade could contribute to economic development more. However, unbalanced trade relationships can slow down these economies.

FOREIGN TRADE AT A GLANCE

The share of the SEE countries in the world's total trade is very low. Bulgaria and Romania, the two countries entering the EU in 2007, are a bit ahead in the region. The contribution of Bulgaria to total world export was 0.11%, while Romania reached a share of 0.26% in 2004. In case of import these proportions are 0.15% for Bulgaria and 0.34% for Romania. Croatia represents a middle class, as its share of total world export was 0.09% and of total world import 0.17%. Other SEE countries are lagging behind: their share of world trade is between 0.02% and 0.06%.

However, the figures of trade per capita uncover the real position of Croatia. Between 2002 and 2004 the volume of trade reached 6982 USD per capita compared that of 3025 USD in Bulgaria or approximately 2100 USD in Romania., Bosnia and Herzegovina, or Macedonia. According to this figure only Albania is in a disadvantageous position, as per capita trade amounted to 990 USD in this period.

Each SEE country had a negative trade balance in the last two years and in the first half of 2006. Croatia and Romania had the highest trade deficit varying between 8 and 10 billion USD in the last two years. According to the trade balance of the first half of 2006 both countries will exceed the 10 billion USD mark. The negative trade balance of Bosnia and Herzegovina, Bulgaria, Montenegro and Serbia was limited to 4 to 6 billion USD in the last two years, showing an increasing trend. Based on the figures of July 2006 it can be said that trade deficit will be above 6 billion USD this year. Albania and Macedonia have the smallest negative balance among SEE countries, changing between 1 and 2 billion USD. The trend of trade balance in these countries is stagnating or slowly increasing and it will not exceed 2 billion USD in 2006.

Foreign trade is increasing in each SEE country. In the first half of 2006 export, as well as import increased in the region faster than real GDP growth estimated for this year. Trends are favorable in Bosnia and Herzegovina, where the growth rate of export is 34.6 percentage points higher than the growth rate of import.

TABLE 1. DEVELOPMENT OF FOREIGN TRADE IN THE SEE COUNTRIES[1]

	Albania	Bosnia and Herzegovina	Croatia	Macedonia	Romania	Serbia
2006/2005 export	118	143.3	116.1	107.5	118.8	124.3
2006/2005 import	118.1	108.7	115.2	110.9	125.1	123.9
Estimated real GDP growth (%)	105.2	106	105	103.3	105.8	105*

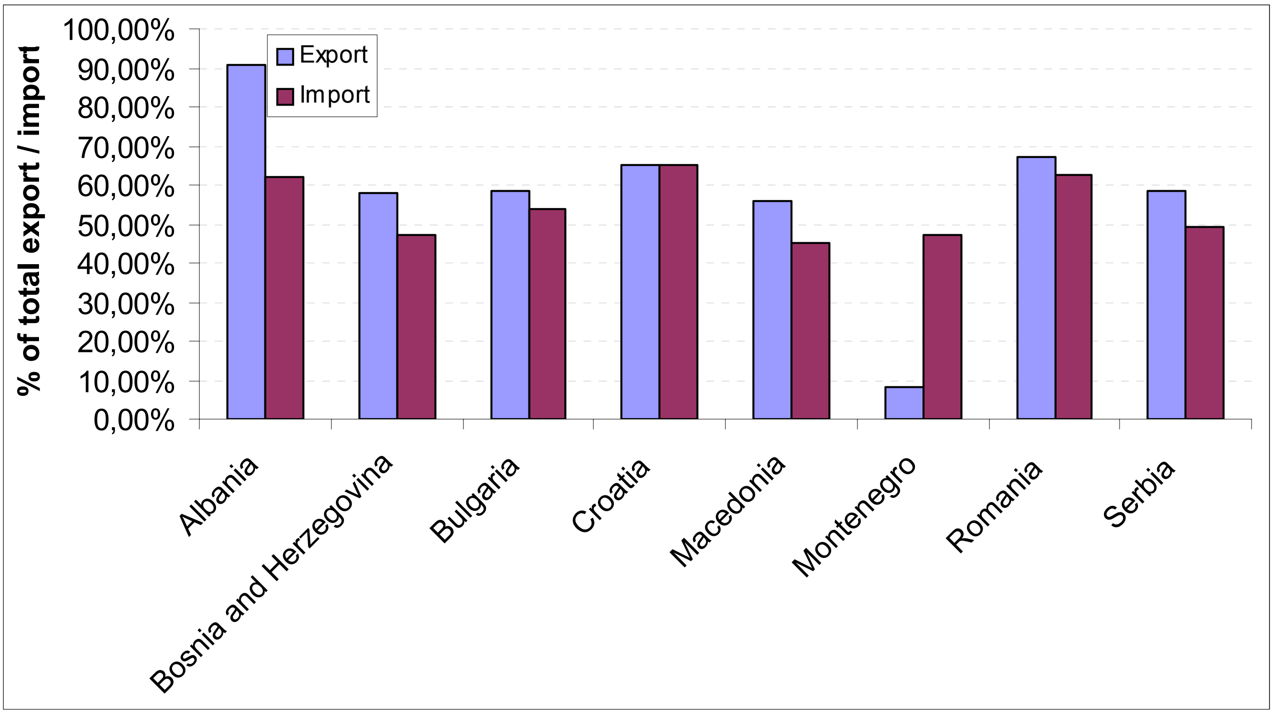
*Source: WTO, National Statistical Offices, *estimation for Serbia and Montenegro*

[1] There is no data available for Bulgaria and Montenegro.

MAIN PARTNERS OF THE REGION

According to Chart 1., the region is over reliant on the EU. Most countries export about 50% of their products to the EU and import also about half of their products from the EU. The relationship with the EU is very unbalanced as the volume of import originating from the EU is about twice as much as the volume of export. Albania is especially dependent on EU consumers as only 10% of its export has a partner other than an EU country. Montenegro seems to have a balanced relationship with the EU concerning exports, however, 40% of Montenegrin export arrives in Serbia, resulting in a similarly unbalanced trade position.

CHART 1. THE SHARE OF EU-25 IN FOREIGN TRADE OF SEE COUNTRIES IN THE FIRST HALF OF 2006



Source: WTO, National Statistical Offices
(Bulgarian data is for 2004 and Montenegrin for 2003)

The region's two biggest partners from the EU are Italy and Greece, representing about 20% of export (with extremes of 75% in case of Albania, or 10% in case of Macedonia) and 10% of import (with extremes of 62% in Albania or 6% in Macedonia). Other EU countries like Hungary, Slovenia, Poland and the Czech Republic have a share of about 1% to 3% from the region's trade. Russia, China, Turkey and Ukraine play an important role in the import of the SEE region, reaching a share of between 3% and 8%, while their share of export is not higher than 1% each. The main import products of these countries are minerals, fuels, electricity, textiles and machinery.

Concerning trade in the region the impression is rather mixed. Bosnia and Herzegovina, Croatia and Serbia and Montenegro have closer relationships concerning foreign trade. Macedonia has closer connections with Croatia and Serbia and Montenegro, but Bulgaria is also an important partner from the region. Bulgaria and Romania are rather separate from these four countries, but have more intensive trade with each other. Albania has the role of the odd country in the region, as it has relatively loose connections with other SEE countries.

TABLE 2. SHARE OF THE TARGET COUNTRY IN EXPORT AND IMPORT (%) IN 2006[2]

Partner country →	Albania		B. and H.		Bulgaria		Croatia		Macedonia		Serbia and Montenegro		Romania	
Albania	-		n.a.		0.75	3.05	0.04	1.63	1.47	1.47	n.a.		0.12	1.43
Bosnia and Herzegovina	0.16	0.07	-		n.a.		18.7	16.8	0.81	0.91	12.39	9.64	n.a.	
Croatia	0.32	0.01	12.22	2.67	0.41	1.59	-		0.8	0.85	5.29	1.03	0.51	0.91
Macedonia	0	0	2.54	0.7	4.92	6.98	5.7	2.08	-		22.01	7.05	0.48	1.77
Montenegro (data of 2005)	1.08	n.a.	4.8	2.45	n.a.		1.37	2.79	n.a.		38.1	28.54	n.a.	

Source: WTO, National Statistical Offices

MAIN FOREIGN TRADE PRODUCTS OF THE SEE COUNTRIES

Concerning imports the region buys machinery (about 20% of imports in each country), mineral fuel and electricity (between 15% and 20% of imports), chemicals and food (both around 10% of imports). In case of export, the structure of products is also similar. However, it is a bigger problem for the development of the region, as countries competing with the same product will pinch each others customers. Main export products of the region are manufactured metal products (between 20 and 30% of exports), row materials (between 5% and 10% of exports), and food (around 8% of exports).

EXPECTATIONS

SEE countries have difficulties in foreign trade because of the lack of productive capacities, and the inability to fulfill high standards of target countries, like EU member states. As a result, the region cannot diversify its supply, and faces huge trade deficits, especially in the trade with the EU. Furthermore, SAP countries could not take full advantage of the asymmetric trade liberalization.

The solution for boosting foreign trade of the region and economic development is twofold. Firstly, it is necessary to develop production capacities of the region with help of EU subsidies. This development should be controlled in order to enable SEE countries to specialize, use synergies and avoid producing the same products. Additionally the revitalization process of CEFTA, recently decided by EU and SEE country leaders, should be paid high attention to. In case of lower requirements of membership, the countries of the SEE region could become members, and form a free trade zone. If so, CEFTA could contribute to the expansion of regional trade, which would strengthen the SEE countries, and prepare them for the competition with developed countries, including the EU, resulting in more balanced foreign trade partnerships.

[2] There is no data available for Bulgaria, Romania and Serbia

Foreign trade of the SEE countries II. – On the way to the creation of the Regional Free Trade Agreement

The trade relations between the countries of the SEE region, namely Albania, Bosnia-Herzegovina, Croatia, Macedonia, Serbia, Montenegro, UNMIK/Kosovo (as defined by UN Security Council Resolution 1244), Bulgaria and Romania, have vigorously developed in the last few years and simultaneously their economic cooperation has also deepened. The prime mover of this spectacular progress is that process which has been carried out under the auspices of the Stability Pact for South East Europe since 2001.

The MoU and the network of the 31 bilateral FTAs

As a first step the countries of the region (with Moldova having joined unilaterally) signed in 2001 a "Memorandum of Understanding on Trade facilitation and liberalisation" (MoU), committed themselves to conclude a network of bilateral free trade agreements before the end of 2002. Specifically the liberalisation process according to MoU had five main requirements:

- all quantitative restrictions and measures having equivalent effect must be abolished,
- import duties have to be eliminated on 90% of the signatories' mutual trade,
- the liberalisation should concern a large majority of goods,
- the transitional period should not exceed 6 years,
- the regulations need to be gradually harmonized with EU legislation.

Since signing the MoU in June 2001, the SEE countries have negotiated and ratified a network of 31 bilateral free trade agreements (FTAs), which improved economic and political relations between the countries. The establishment of the FTAs boosted the trade between the countries: in 2004, the regional trade amounted to 3.5 billion euro, up 33% from the figure of 2.6 billion of 2002. All countries registered increases in their exports to the other countries of the SEE region and these data exceeded in every case (except in the case of Albania) the growth of the given country's exports to the world. In 2004 the exports to the other countries of the SEE region were considerably higher in Croatia (EUR 1066 million), in Romania (EUR 763 million) and in Bulgaria (EUR 727 million) then the same data of the others. Similarly the above-mentioned countries performed also the most dynamic growth in the regional trade beside Bosnia-Herzegovina, which increased its exports to the other countries of the SEE region by 63%.

TABLE 3. INTRA-SEE TRADE, 2002-2004 (MILLIONS OF EUROS)

Country	Exports to SEE region			Exports to the World		
	2002	2004	Growth (%)	2002	2004	Growth (%)
Albania	13	15	15	348	426	22
Bosnia-Herzegovina	164	267	63	874	1174	34
Bulgaria	570	727	28	5942	7204	21
Croatia	839	1066	27	5111	6215	22
Macedonia	421	512	22	1101	1196	9
Moldova	65	98	51	680	967	42
Romania	519	763	47	14634	17560	20
Serbia and Montenegro	60	70	17	1519	1673	10
Total	2651	3518	33	30209	36415	21

Source: Commission calculations based on IMF (DOT) data

The aforementioned export data show that the establishment of the network of the bilateral free trade agreements on the one hand significantly promoted the intra-regional trade but on the other hand the large and growing number of bilateral FTAs has presented a challenge to both the business community that wishes to trade and invest throughout the region and to government agencies such as customs that administer the agreements. Although due to the strengthening regional cooperation the foreign direct investment (FDI) inflow has vigorously increased in the SEE countries in the past few years (e.g. the FDI inflows to the region amounted to EUR 8 billion in 2004, a doubling of the average of the previous years), to ensure keeping this pace in the future the regulations (also in the case of trade) have to be simplified in order to attract more investors with creating a transparent business environment.

TABLE 4. SEE FDI INFLOWS IN MILLIONS OF EUROS

	1999	2000	2001	2002	2003	2004	2005*
Total	3504	4101	5097	4493	7352	8877	8100

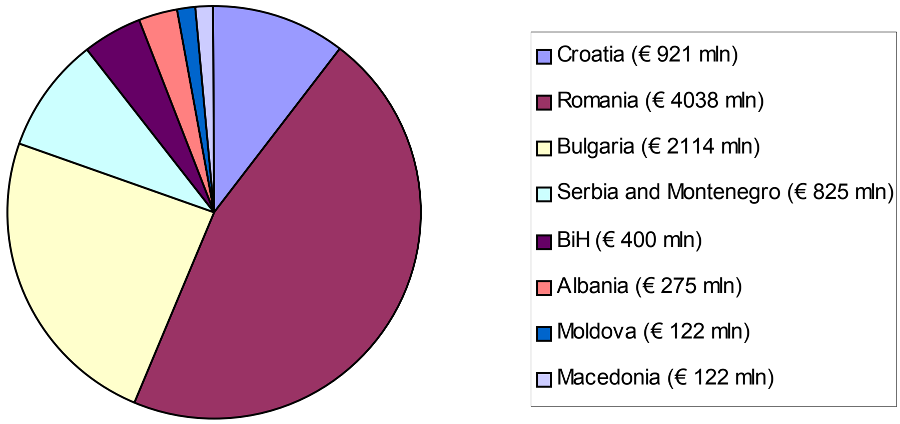
*Source: wiiw database, *: forecast*

There are two conditions that increase the importance of the FDI inflows for the economies of the region. On the one hand its average ratio for the SEE countries has reached 5.125% of GDP in 2004[3] turning the FDI inflow into a major source of growth. On the other hand as the SEE countries rarely invest abroad, net FDI inflows (calculated as gross inflows net of investments abroad) also play a key role in financing foreign trade imbalances stemming from ongoing structural reforms and significant investment demand in transition to free market.

Although the total volume of FDI inflows has dynamically increased during the recent years, their amount is still remained relatively low on global level and the distribution across the region is not appropriate as Romania and Bulgaria accounts for nearly 70% of the total amount (e.g. during 2004 altogether EUR 6152 mln flew in Romania and Bulgaria out of the total amount of EUR 8877 mln). The establishment of the 31 bilateral FTAs promoted the growth of the FDI inflows but at the same time it created a fragmented market in the region that contributed to the evolvement of this unbalanced situation.

[3] *Source: IntelliNews*

FIGURE 1. DISTRIBUTION OF FDI INFLOWS AMONG SEE COUNTRIES IN 2004



Source: wiiw database

As providing investors with a simplified single set of trade rules would make the SEE countries more attractive for inward investment and it would create similar conditions in the field of commerce - which latter would contribute to the moderation of the disproportions in the case of FDI inflows' distribution -, these were important motives to launch the next step of the trade liberalisation process.

ESTABLISHMENT OF THE SINGLE FREE TRADE AGREEMENT

Over the last few years two possible ways of creating a single free trade agreement were considered: the launch of a new agreement or the enlargement of the Central European Free Trade Agreement (CEFTA) to which Bulgaria, Croatia, the FYROM[4] and Romania are already members. Finally at their meeting in Sofia on 10 June 2005, Ministers of Economy of SEE charged the Stability Pact's Trade Working Group (TWG) - which has already played an important role in negotiating and monitoring the implementation of the 31 FTAs – to determine the feasibility of developing a modern and comprehensive single agreement based on the CEFTA to replace the many bilateral agreements. One of the main advantages of such an agreement is that it creates a harmonised trade regime throughout the region, which is compatible with the commitments of the countries to the WTO and EU. On their meeting in Sofia the Ministers also mandated the Investment Compact (which is also an initiative of the Stability Pact) to propose new targets for investment reforms to be implemented in 2006 as well as to determine the feasibility of a regional investment framework to complement the single FTA.

In March 2006 the Trade Working Group reported to the ministers on their discussions and they recommended that the single FTA should be created by the simultaneous enlargement and amendment of the CEFTA. The negotiations for the CEFTA enlargement were officially launched in Bucharest on 6 April on the meeting of the Prime ministers of SEE countries.

---

[4] The FYROM joined CEFTA in February 2006.

The Regional Trade Agreement will extend the existing CEFTA between Bulgaria, Romania, Croatia and Macedonia to cover the other countries of the Western Balkans[5] and hereby create a regional free trade area. It will be based on also the existing bilateral agreements which liberalise more than 90% of trade and almost all trade in industrial goods. At the same time it will modernise the original CEFTA agreement by:

- harmonising rules and regulations (notably with regard to industrial and sanitary-phytosanitary rules)
- improving dispute settlement
- adding new provisions of trade in services, the protection of intellectual property

The future benefits of the participating countries from the creation of the regional free trade area would be the follows:

- when fully implemented, the CEFTA arrangements are expected to create a free trade area encompassing 55 million inhabitants and hence boost intra-regional trade, efficiency and investments
- increased trade promotes economic growth, job creation and reduced unemployment
- the consolidation of the regional market will attract more FDI
- the negotiations will also assist the non-WTO members[6] to prepare for their membership, as the two processes are rooted in the same goals and rules of progressive liberalisation and open trade
- the enlarged CEFTA would be able to function as a unified production pole
- the initiative also helps the countries to prepare for the economic cooperation that is an inherent part of the EU membership
- it assists the countries in building closer commercial, economic and political relations with the EU

Nevertheless it’s firmly emphasized that the creation of the Regional FTA in no way replaces the European perspective, but it rather complements it by preparing the countries for closer economic integration with the EU.

[5] The criteria were lowered on the Zagreb meeting in 2005, so that Bosnia and Herzegovina, Serbia, Montenegro and Moldova could join CEFTA sooner. Despite the fact that the status of Kosovo has not yet been decided, Kosovo also takes part in the negotiations about the future of CEFTA.

[6] Montenegro, BiH and Serbia have been obeservers at the WTO and are currently negotiating their membership

THE EVOLUTION OF WAGES IN ROMANIA

The average level of Romanian wages increased rapidly in the last 1.5 years, but regarding the incomes Romania belongs to the file-closers of the European countries yet. As a consequence of the trend, the wages in the Balkan country have increased in euro by 50% in the aforementioned period, but it means for Romania still only the 41. place on the list of FedEE (Federation of European Employers). The Romanian average hourly wages stand only at the 6% of the Dutch level, which represents the 100% in the list of FedEE.

The level of wages did not develop in a single pace in the last 3 years. The earnings in financial, telecommunications and oil extraction sectors improved faster than the average, while according to the statistics, the purchasing power of wages of employees in the administration, education and in the light industry have not kept in line with the common growth.

The economy of Romania developed significantly in the last years, which was acknowledged by the decision of Commission of European Union on 26 September 2006. The Commission said that Romania (and Bulgaria as well) could access to the EU as planned on 1 January 2007, if they meet all the ten specific reform requirements. The final recommendation becomes due in early October. On the seat held on 26 of September, the Commission identified four areas, which require "urgent attention". These are the followings:

- setting up of fully operational paying agencies accredited for handling direct payments to farmers and operators under the Common Agricultural Policy (Chapter 7),
- setting up a proper integrated administration and control system in agriculture (Chapter 7),
- building up of rendering collection and treatment facilities on TSE and animal by-products (Chapter 7), and
- setting up of tax administration IT systems ready for inter-operability with those of the rest of the Union to enable a correct collection of VAT throughout the EU internal market (Chapter 10).

Romania was among the first countries in the Central and Eastern European countries, which established official relationship with the European Union, and after about 15-20 years after the beginning of the relations, Romania applied for accession to the Community on 22 June 1995. As a consequence of the economic and political improvement in the country, the Commission's May 2006 Comprehensive Monitoring Report pronounced Romania as an acceding country, which fulfils the political criteria for the official EU membership. It also emphasised that Romania is a functioning market economy, and "through the vigorous implementation of its structural reform programme it can fully meet the economic criteria in the near term. The country has also reached a considerable degree of alignment with the '*acquis*'".

In the face of the opinion of the European Commission about the great future of the EU-enlargement with Romania and Bulgaria, the other European members have voiced fears of mass migration and concerns about their ability to implement reforms while keeping state finances in order. On the contrary, people in the two countries think that if someone joins the EU, then suddenly everything will be getting better. The truth is that things probably will not get better quicker or slower than before EU membership. And that is true especially for the living standard in short term. The average wage level in the European Union is much higher than that in. Romania, but the incomes will not come up to the European level in the near future.

According to the economic policies there are two channels for the convergence of wages to the level in a more developed country:

- The flow of the labour - If the employees move into a country with higher wage level.
- The other way is the change of the economic structure of the country – It assumes the terms of the free flow of the labour and capital.

But that needs time, it could occur only in a longer term. Regarding the cases of Portugal, Spain, Greece and Ireland, these countries joined the EU with low average wages, such as now Romania. The Irish wonder has supervened more than a decade after the accession, and in the year of the upswing there were no convergence of the wages.

So it is undoubted that the accession to the European Union goes hand in hand with the higher level earnings in itself. The economic "wonder", and all of the improvements of the economic index numbers depends on the efforts of the certain countries henceforward.

Although it is clear that the significant improvement of the wages needs long term, most economists say that in case of Romania the time period for the accession of the incomes will take not so long than in the countries mentioned above.

According to the economic researchers the net average monthly income in Romania will stand at 335 euros in 2010, which is by 46% higher than the present value, as a consequence of the fast economic improvement in the country in the future henceforward. They forecast that the average wages will improve much faster than the inflation rate in the country, which means that the real-wages will also increase, namely by about 35%.

The Romanian wages grew by 38% in 2005, which was – among other factors – the consequence of the implementation of the common tax rates. It could be also forecast that the wages increase in different measures, which trend has experienced in the last 1.5 years as well.

In Europe the average level of the contributions is 35.6%, while in Romania this value stands at 48,3% counted to the gross earnings in average, from which the employees 17%, the employers 31,3% must pay to the state budget. It means that even in those sectors, in which the wage level and its growth is lower than the average (e.g. light industry, catering trade), it is still worth employing low-qualified workers, and without paying taxes, which phenomenon also disorders the statistical values of the average net incomes in Romania.

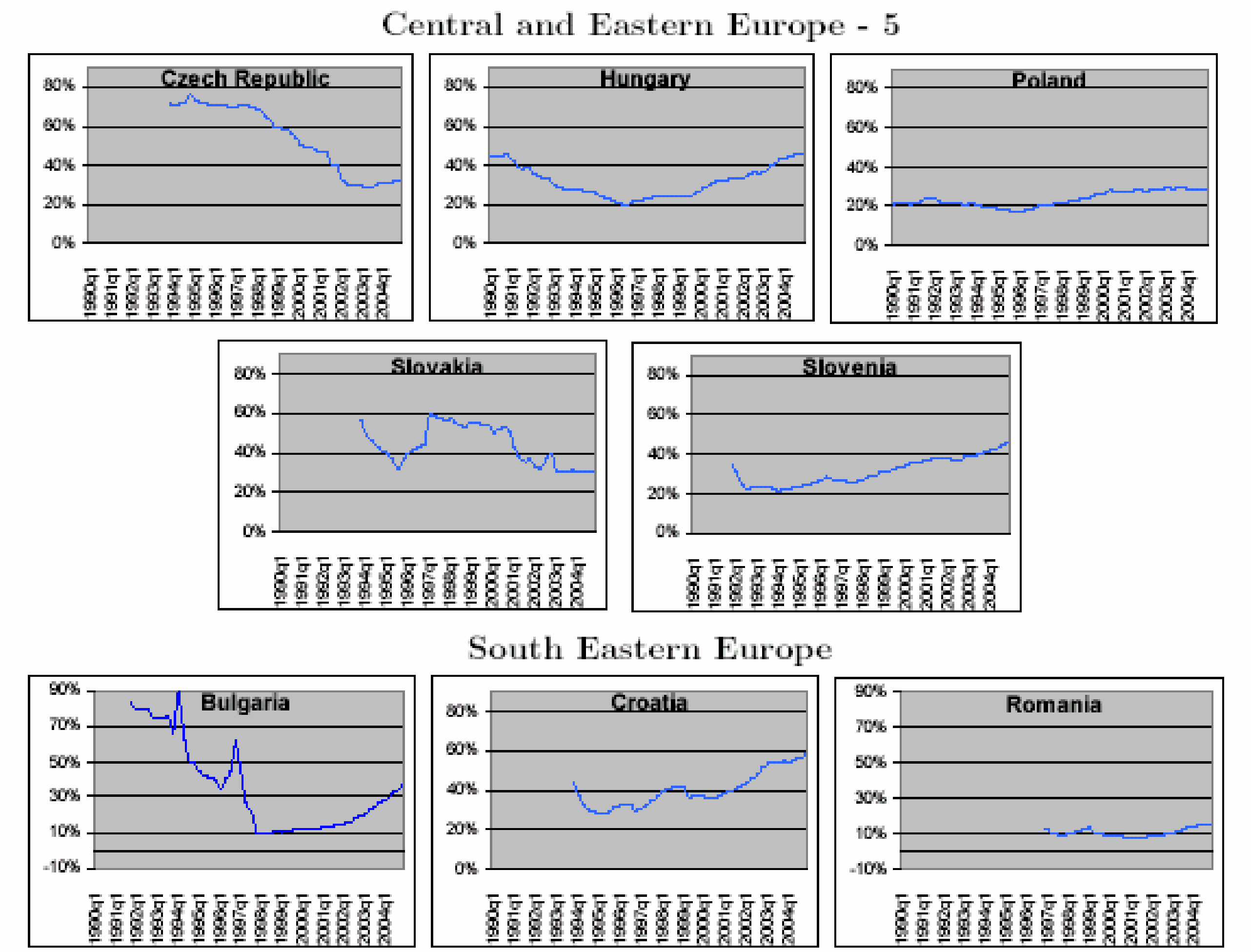
CREDIT BOOM IN THE SEE COUNTRIES

Regarding the time series of credit amount of the South-(SEE) and the Central and Eastern European (CEE) countries, one can realise steady development in this area. The main question is whether that rapid growth in lending is a natural process or we can say, that it has turned to be a credit boom yet.

These emerging, post-socialist countries went through changeful conditions in the last fifteen years on the path to deepening the financial environment and creating a relative financial stability. And the outcome of this hard and sustained process in these economies is the convergence to other developed, Western European countries.

The economies of the region become more and more developed; their national incomes have been growing quite spectacularly, inflation and real interest rate have been decreasing for the financial institutions started to contribute to evolving a sounder banking sector and positive expectations. The catching-up-process keeps going in our days as well, subsequently the credit growth in this area is understood. Falling inflation, growing national income, sound banking system and a lot of other components make investors brought their savings to these countries. Banks offer better conditions for inhabitants to borrowing money from the banking sector.

BANK CREDIT TO PRIVATE SECTOR AS A PERCENTAGE OF GDP, 1990 TO 2004



Source: Adaptation from survey by Balázs Égert, Peter Backé, Tina Zumer. Credit Growth in Central and Eastern Europe 31.July 2006 . Author's calculations based on data drawn from the IFS/IMF.

On the other hand people would like to consume more then before. As they can compare the standard of living in their countries and the developed European countries, the demand was developed for making a similar lifestyle.

To understand the process, we have to emphasise that the financial sector in these counties are bank-based and the capital market is not very developed. The banking sector is mainly foreign-based and concentrated. So the customer's behaviour in these countries is very different from the developed countries, because of the institutional circumstances and the dissident history as well.

MACROECONOMIC AND BANKING SECTOR-RELATED INDICATORS IN SOME RELEVANT COUNTRIES

	HUNGARY						POLAND						CZECH REP.					
	1999	2000	2001	2002	2003	2004[1])	1999	2000	2001	2002	2003	2004[1])	1999	2000	2001	2002	2003	2004[1])
GDP growth (real, %)	4.2	5.2	3.8	3.5	3.0	4.2	4.1	4.0	1.0	1.4	3.8	5.4	1.2	3.9	2.6	1.5	3.2	4.4
CPI inflation (year-end, %)	11.2	10.1	6.8	5.3	5.7	5.5	9.8	8.6	3.4	0.7	1.7	4.5	2.6	4.1	4.2	0.6	1.1	2.8
Exchange rate (HUF/EUR, annual average)	252.8	260.0	256.7	243.0	253.5	251.7	4.23	4.01	3.67	3.86	4.40	4.53	36.88	35.61	34.08	30.81	31.84	31.90
Number of banks (of which foreign-owned, year-end)	43(29)	42(33)	41(31)	37(27)	36(29)	35(0)	77(39)	73(46)	69(46)	59(45)	58(46)	57(44)	42(27)	40(26)	38(26)	37(26)	35(26)	35(26)
Degree of financial intermediation (bank assets/GDP, %)	68.1	68.5	71.2	71.4	78.2	75.8	61.9	65.8	66.4	64.3	64.7	65.3	141.7	144.8	130.2	112.8	101.0	97.1
Share of foreign-owned banks in total banking capital (%)	65.3	66.7	63.0	78.3	81.9	..	49.3	72.5	72.0	70.9	71.6	75.0	27.1	75.4	93.3	94.2	95.9	96.0
Credit (credit volume/GDP, %)	25.1	29.3	29.8	31.5	37.2	..	27.1	28.3	29.0	27.9	28.6	27.3	45.7	43.6	37.9	35.2	35.8	..
Share of nonperforming loans in total loans (%)	4.4	3.2	2.9	3.3	3.1	3.2	13.7	15.5	18.6	22.0	21.8	15.5	21.5	19.1	13.4	8.1	4.9	4.1
Deposits (volume of deposits/GDP, %)	68.1	68.5	68.4	69.3	78.1	..	36.2	37.6	38.5	36.0	35.7	34.6	53.8	53.1	57.1	64.5	62.3	..
Return on equity (ROE, %)	6.6	16.8	22.0	20.0	23.5	29.0	12.9	14.5	12.8	5.2	5.9	..	–4.3	13.1	14.4	27.4	23.7	23.4
Capital adequacy (capital/risk-weighted assets, %)	15.0	15.2	15.6	13.0	11.8	11.2	13.2	12.9	15.1	13.8	13.6	15.6[1])	13.6	14.9	15.4	14.3	14.5	12.7

	SLOVAKIA						BULGARIA						ROMANIA					
	1999	2000	2001	2002	2003	2004[1])	1999	2000	2001	2002	2003	2004[1])	1999	2000	2001	2002	2003	2004[1])
GDP growth (real, %)	1.5	2.0	3.8	4.6	4.5	5.5	2.3	5.4	4.1	4.9	4.5	5.6	–1.2	2.1	5.7	5.0	5.2	8.3
CPI inflation (year-end, %)	14.2	8.3	6.2	3.3	9.3	5.9	6.2	11.4	4.8	3.9	5.6	4.0	54.8	40.7	30.2	17.9	14.1	9.3
Exchange rate (SKK/EUR, annual average)	44.12	42.59	43.31	42.70	41.49	40.05	1.956	1.956	1.956	1.956	1.956	1.956	16296	19956	26027	31255	37556	40532
Number of banks (of which foreign-owned, year-end)	25(11)	23(14)	21(13)	20(15)	21(16)	21(..)[2])	34(22)	35(25)	35(26)	34(26)	35(25)	35(..)	41(26)	41(29)	41(32)	39(32)	38(29)	39(30)
Degree of financial intermediation (bank assets/GDP, %)	91.2	90.7	92.0	92.5	82.0	87.4	34.6	36.5	41.1	45.0	50.3	65.1	34.9	29.2	30.5	31.6	32.7	39.5
Share of foreign-owned banks in total banking assets (%)	37.8	40.6	90.5	95.6	96.3	98.0	28.4	71.5	70.6	72.4	82.2	82.5	47.8	50.9	55.2	56.4	58.3	62.0
Credit (credit volume/GDP, %)	48.6	43.6	33.5	32.1	33.6	..	10.1	11.3	14.0	18.7	26.2	35.4	11.1	9.4	10.2	11.8	16.0	17.9
Share of nonperforming loans in total loans (%)	32.9	26.2	24.3	11.2	9.1	7.8[2])	11.7	8.2	7.0	5.5	4.2	3.5	35.4	3.8	3.4	2.3	8.3	8.1
Deposits (volume of deposits/GDP, %)	60.6	65.3	67.2	70.4	66.6	..	25.7	26.6	32.2	34.9	39.5	..	22.4	20.0	20.4	21.7	21.3	..
Return on equity (ROE, %)	–36.5	25.2	22.7	29.4	27.1	..	20.9	21.9	20.5	15.6	22.8	20.6	–15.3	12.5	21.8	18.3	15.8	17.0
Capital adequacy (capital/risk-weighted assets, %)	12.6	12.5	19.8	21.3	21.6	18.7	41.3	35.5	31.1	25.2	22.2	17.1	17.9	23.8	28.8	25.0	21.1	18.8

	CROATIA						SERBIA					
	1999	2000	2001	2002	2003	2004[1])	1999	2000	2001	2002	2003	2004[1])
GDP growth (real, %)	2.5	–0.9	4.4	5.2	4.3	3.8	–21.0	5.2	5.1	4.5	2.4	8.6
CPI inflation (year-end, %)	4.4	7.4	2.6	2.3	1.7	2.7	36.5	113.5	40.7	14.8	8.1	12.5
Exchange rate (HRK/EUR, annual average)	7.58	7.63	7.47	7.41	7.56	7.50	11.70	15.30	59.44	60.79	65.26	73.00
Number of banks (of which foreign-owned, year-end)	53(13)	43(21)	43(24)	46(23)	41(19)	40(18)	75(3)	81(3)	54(8)	50(12)	47(16)	43(13)
Degree of financial intermediation (bank assets/GDP, %)	66.1	73.3	91.1	98.7	101.1	109.0	79.8	185.0	127.0	36.4	31.5	38.8
Share of foreign-owned banks in total banking assets (%)	39.9	84.1	89.3	90.2	91.0	91.3	..	0.3	2.1	12.8	22.9	37.0
Credit (credit volume/GDP, %)	39.1	39.6	45.6	54.5	58.1	61.0	29.6	56.6	31.7	17.2	16.0	21.5
Share of nonperforming loans in total loans (%)	10.3	9.5	7.3	5.8	5.1	4.5	..	30.9	12.6	24.3	22.5	23.0
Deposits (volume of deposits/GDP, %)	39.6	47.6	63.1	63.7	64.8	..	9.7	14.7	13.4	15.5	17.7	20.7
Return on equity (ROE, %)	4.8	10.7	6.6	15.3	14.5	16.6	..	–78.5	–26.0	–34.5	–1.2	–5.0
Capital adequacy (capital/risk-weighted assets, %)	20.6	21.3	18.5	17.2	16.2	14.1	..	0.6	21.9	30.6	31.3	27.9

Source: ONB, 1 July 2005

We have to take differences between two groups of these, post-communist counties. The first group consists of the Central and Eastern European Economies (CEE), namely the New Member States. In this region, as the new, democratic changes used to happen, the banking sector started to develop. The CEE countries are in a fast catching up process in these days as well. They gross domestic product per capita is reaching the European average slowly and the living standard is growing too. The institutional circumstances are similar like in the EU15-countries.

Thus, the second half of 1990s the credit amount started to grow and it is stable in these days as well is these countries.

As we know that the credit volume in percentage of GDP in the developed European countries is around fifty percent, the data in the above-stated tables are comparable and can be remarked as the emerging countries credit volumes are still relatively low and will be predictable growing.

Regarding the SEE countries, namely Albania, Bosnia-Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, are on the path like the CEE countries ten years ago. Their economies start to revive, the modern, democratic institutions are established and the banking system is getting develop. In these days, an overpowering credit increasing seems to stand out. The credit amount is increasing by a huge, 30-50% every year, besides the stock of credit in relation to gross domestic product is quite low yet (for example Albania 7.2%, Bulgaria 22.2%, Romania 8.2%, Macedonia 19.3%). Because all countries the credit growth started from a very low level.

Expectations

Ignoring other economic indicators, the problem with this enormous increasing in credit demand is wide-ranging. Namely, the balance of payments is going worse, because the big lending is used not for investments what would be useful for the economic growth but for consumption. The population and the government also keep running into debts, they have loans to finance to keep growing their living standard continuously.

On the other hand, in the liberalised market, banks can already compete with each other. Thus, bank’s interest is to offering better conditions for people for lending money. The credit amount in this region has been increasing by around 30 to 50 percent per GDP for ages.

Accordingly, it seems the running in the banking area will keep going on. The credit lending continues to get more enormous.

And there are other problems as well, such as the strong credit growth could fuel domestic demand growth to unsustainable levels and inflationary pressures and overburden bank’s capacities for risk management.

In conclusion, the countries of this region (SEE) are on a very fragile path, because this running might threaten the stability of the banking sector and increase financial sector vulnerabilities in these countries. Even so compare to other economies such as CEE countries, it can be said to be a normal process.

FORMER ISSUE'S TABLE OF CONTENTS:

Number 2006/3.

- Heading to "Europe"? Stabilisation and Association Agreement in Serbia and Montenegro
- Real estate market of Bulgaria
- Albania signed The Stabilisation and Association Agreement
- Tourism sector in Bulgaria

Number 2006/2.

- Bulldozer Initiative – '50 economic reforms in 150 days'
- The Former Yugoslav Republic of Macedonia and the European Integration
- Bulgaria and Romania: One Year to Accession
- Bulgaria faces a lasting demographic crisis

Number 2006/1.

- ICEG EC Quarterly forecast on the Southeast European Countries- Winter 2005
- Balanced budget 2006 is planned in Bulgaria
- VAT introduction in Bosnia and Herzegovina
- Foreign Direct Investment in Serbia

Number 2005/20.

- Business Climate in Southeast European (SEE) countries in comparison with the New Member States
- Romania - Development of the inflation rate
- Tightening of credit expansion in Bulgaria

Number 2005/19.

- Foreign Direct Investments in the Southeast European (SEE) Countries in comparison with the 8 New Member States (NMS8)
- Croatia - on the way on accession
- The role of World Bank credits in the Fyr of Macedonia

Number 2005/18.

- Bulgaria: Inflation rate is the critical issue with regard to joining EMU after EU accession
- Strong sector with strong performance: Tourism in Croatia
- Inflation in Serbia and Montenegro in 2005-2006
- The EU-Albania relations - The present engagement of the SAA

Number 2005/17.

- Intra-regional Trade in Southeast Europe
- Inflation in Bulgaria in 2005 and 2006
- Still High Foreign Direct Investments Inflow in the Romanian Economy
- Deep Overview of FDI Movements in Croatia

Number 2005/16.

- ICEG EUROPEAN CENTER Quarterly Forecast on the Southeast European Countries (Q3 2005) - Outlook for 2005 and 2006
- (Un)employment in the Southeast European Countries I. & II.
- GDP Growth Rate of Bulgaria in the first half of 2005

Number 2005/15.

- Bulgaria and Romania en route to the European Union
- Agricultural Sector in South Eastern European Countries II.
- Romania: Slower Economic Growth in the first half of 2005

Number 2005/13-14.

- The Powerful Nature - The Romanian Floods
- Current Account Development in Bulgaria: Big Problem at First Glance
- VAT Increase in Romania- A Makeshift
- The Start of the Improvement in the Albanian Electricity Sector

Number 2005/12.

- The British EU-Presidency and the Prospect of the Future Enlargement of the EU
- Credit Boom and Increasing External Vulnerability in Bulgaria and Romania
- High ISPA Subsidy for Romania
- A Further Step Towards Europe - Introducing VAT In Bosnia and Herzegovina

Number 2005/11.

- Agricultural Sector in South Eastern European Countries I. - Albania, Bulgaria and Romania
- Balance of Payments in Bosnia and Herzegovina
- New Leu and the Future in Romania
- Croatia's Accession Negotiation with EU - Developments in European Integration

Number 2005/10.

- Tax Regimes in Bulgaria, Croatia and Romania
- The Impacts of General Election on the Economic Policy of Bulgaria
- Worsening Current Account Balance in Romania
- The Attractive Bulgaria - Prominent FDI Inflow in 2004

Number 2005/9.

- EU Begin Talks with Serbia and Montenegro
- Tax Regimes in the FYR of Macedonia and Serbia and Montenegro
- Tax Regimes in Albania and Bosnia-Herzegovina
- Interest Rate Policy in Romania: 10 Percent Off in 5 Months

Number 2005/8.

- More EU Assistance for the Western Balkans
- One Step Closer to EU Membership
- Bulgaria Reached Record GDP Growth in 2004
- The Development of Public and External Debt in Croatia

Number 2005/7.

- South Eastern Europe after EU Enlargement and before Accession
- Bulgaria: Fixed Exchange Rate of Currency Board and the Competitiveness
- Bulgarian Tourism Industry
- Plans on the Albanian Privatisation Process

Number 2005/6.

- Development of Inflation in Southeast European Countries
- IMF versus the Romanian Government
- 8.3% GDP Growth in 2004 in Romania – Positive Signals for Investors
- Higher Inflation and Trade Deficit in Serbia

Number 2005/5.

- Tax Reduction Suggested in Bulgaria
- Croatia: Delays in Starting Accession Negotiations?
- Tourism in Croatia
- Montenegro Wants to Lead its Fortune under its own Hand

Number 2005/4.

- Bulgaria: Record Foreign Trade Deficit in 2004
- Macroeconomic Targets in Romania for 2005
- Montenegro: Budget in 2005
- Albania – EU Accession in 2014?

Number 2005/3.

- World Bank Strategy for 2005-2008 – Assistance for Croatia
- Record Budget Revenues in Bulgaria in 2004 – An Estimated Surplus of the Budget Again
- Montenegro: Economic Policy Focuses on Privatisation
- Macedonia – Status of European Integration One Year after Application

Number 2005/2.

- Origin and Structure of FDI Inflows into Bulgaria and Romania
- Croatia: Stabilisation and Association Agreement will Come into Force on 1 February 2005
- Bank Privatisation in Serbia
- Growing External Imbalances in Romania

Number 2005/1.

- Hungarian Foreign Direct Investment Outflows to the Southeast European Countries
- Western Balkan Countries: Outlook for 2005
- Candidate Countries Performed Well Last Year – Outlook for 2005 Radical Tax Reform in Romania: 16% Flat Tax Rate from 2005