



Quarterly Forecast on the Western Balkans and Turkey

Spring 2008



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Regional overview

Western Balkans

Political developments remained lively in course of the first few months of 2008 in the region. First of all, in mid-February Kosovo declared its independence which was considered as an illegal act by Serbia. However, many EU countries have recognised Kosovo's independence yet. Besides, Albania and Croatia were invited to join NATO at the organisation's April Summit. Due to the name dispute with Greece, the former Yugoslav Republic of Macedonia was not invited which resulted in the fall of the Macedonian government. In Croatia, a new government formulated in January with a stable majority.

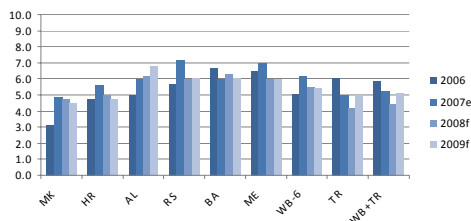
Economic growth accelerated to 6.2% in 2007 from 5.1% in 2006 in the region. In 2008 and 2009 GDP growth is expected to calm down slightly and reach 5.5%. Economic growth is expected to exceed 7% in Montenegro and Serbia as well, and it exceeded 5% in almost all countries (except for the fYR of Macedonia's 4.9%).

The engines of economic growth remained the same, namely consumption and investments boosted these economies. That is not expected to change in this and next year. Wages increase gradually and foreign direct investments also increase due to improving business climate in the WB countries. Besides, credit lending is also vigorous which boosts consumption.

In line with global trends, food and energy prices increased significantly in the WB countries as well. Besides, the extremely warm and dry summer in 2007 had a severe negative impact (via droughts and wildfires) on the domestic food supply in most WB countries. Accordingly, inflation started to accelerate in the second half of 2007 and this trend is expected to continue in the first half of 2008 as well. As a result average inflation is expected to be close to 6% in the region, while it was 2 percentage points lower in 2006. In 2009 inflation will fall back under 5% according to our expectations. Highest inflation can be measured in Serbia, 10.1% in 2007 and it is expected to decline to 8.5% in this year.

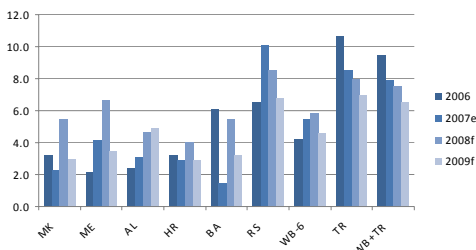
Fiscal positions improved slightly in 2007 in comparison with the previous year. Average budget balance per GDP ratio decreased to 1.4% of GDP, and several countries' budget had a surplus, such as Bosnia and Herzegovina, the fYR of Macedonia and Montenegro. Budget balances improved in line with rapid economic growth and increasing presence of foreign companies due to improving business climate. It is worth mentioning that more and more countries in the region apply low tax rates and /or flat tax regime in order to improve their business climate and enhance economic growth.

Real GDP growth (%)¹



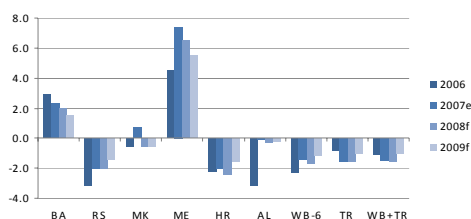
Note: e = estimation, f = forecast; Source: national banks and statistics institutes

Inflation (%)



Source: national banks and statistics institutes

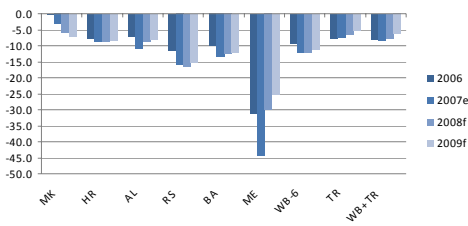
Fiscal balance (% of GDP)



Source: national banks and statistics institutes

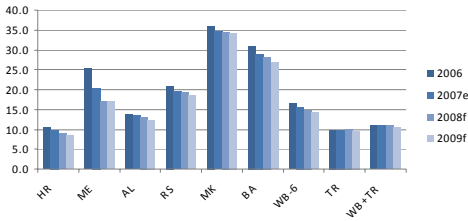
¹ Abbreviations: AL – Albania, BA – Bosnia-Herzegovina, HR – Croatia, MK – FYR of Macedonia, ME – Montenegro, RS – Serbia, WB-6 – Western Balkans (averages weighted by nominal GDP), TR – Turkey, WB+TR – Western Balkans and Turkey

Current account balance (% of GDP)



Source: national banks and statistics institutes

Unemployment (%)



Source: national banks and statistics institutes

Current account deficit deteriorated in all WB countries in course of 2007. Strong domestic demand boosted imports and accordingly foreign trade balance worsened in last year. The deterioration of trade balance contributed primarily to the worsening of the current account balance. Accordingly, current account deficit of the region amounted to 12.1% of GDP. CA deficit exceeded 10% of GDP in four out of the six WB countries. In 2008 and 2009 CA balance is expected to remain on current level due to expected high domestic demand in future years. Montenegro will keep on having the highest current account deficit in next years as well.

Regarding labour markets of the region, slight but gradual improvement is observable in these economies. Unemployment rates are very in high in some cases, such as in Bosnia and Herzegovina, the fYR of Macedonia, Montenegro and Serbia, average unemployment rate decreased by 1 percentage point, to 15.6%. The decrease of the unemployment rate is due to strong economic growth and improving business climate. In the coming years, we expect that unemployment will decrease gradually while, in line with that employment rate will improve further. Besides, one can observe that wages increase rapidly contributing significantly to high consumption in the countries of the region.

Turkey

The Turkish economy has now been growing for 23 consecutive quarters – the longest uninterrupted growth period Turkey has ever achieved. Moreover, economic growth has become much more sustainable, departing from previous boom-bust cycles in three significant ways: growth now is driven by the private sector; it is supported by steady productivity gains; and overall the expansion is dominated by higher value added sectors like automotive and consumer durables rather than traditional sectors such as agriculture and textiles.

In the first quarter of 2008 one can observe conflicting developments in inflation. Year-on-year inflation exceeded 9% in February 2008. The high headline CPI is mainly due to high food and energy prices. The exchange rate weakened significantly in the recent quarter thanks to political developments and external shocks and the 1.74 EUR/TRL rate shifted to above 2.00. We expect a decline of upward pressure on the exchange rate with the rate stabilizing at around the mentioned level.

In 2008-2009 exports will feel the negative effects of weaker external demand which may be partially offset by the weaker exchange rate and positive effect on tradables competitiveness due to low exchange rate pass-through. Altogether we expect that while the gap between the rates of growth of exports and imports will shrink, the trade balance will improve somewhat and this will also be followed by lower current account deficit both in 2008 and 2009.

The unemployment and non-agricultural unemployment rates in 2007 remained unchanged compared to 2006 at 9.9% and 12.6%, respectively. The usual cyclical behaviour in unemployment has been observed in the last year with the summer months producing lower rates increasing in the second half of the year. As the economy is expected to slow down we may assume that the unemployment rate will exceed 10% in 2008.

Albania

Economic growth remained strong despite electricity shortages. Inflation accelerated and current account deficit increased significantly. Labour market figures improved slightly.

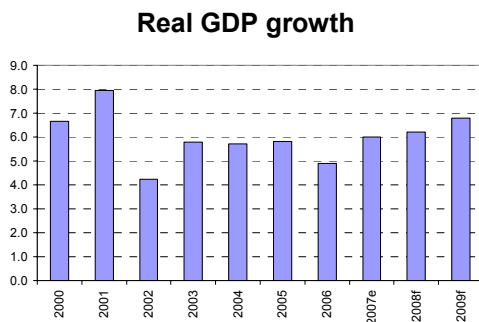
Political developments

The political efforts on joining to the NATO seem to be successful. NATO members decided to extend invitations to Albania, too.

As Kosovo got recognised by many countries, the union of the two Albanian state emerged still informally as the settlement plan prohibits it. Such a union in the future would weaken the importance of Tirana.

The ruling Democratic Party (DP) proposed three substantial changes to the constitution. The first pertains to presidential elections and decrees. The second involves no-confidence motions, while the third proposal limits the mandate of the general prosecutor.

Growth



Source: INSTAT, own forecast

The electricity shortage became a very serious problem that blocks the possible growth of GDP. According to INSTAT, total sources of electric power, during 2007, had a considerable fall by 13.4%. The quantity of electric power generated and imported attained to 5881 GWh. Domestic production of electric power decreased sharply by 46.9%. The total domestic production is 50.1% of total sources.

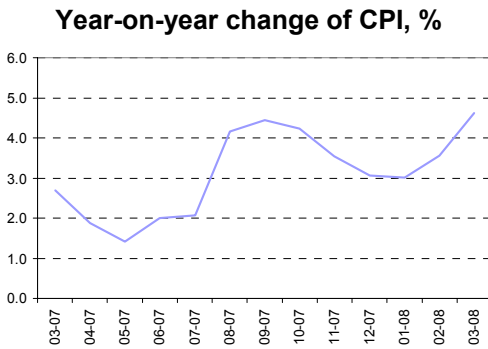
Production in hydro plants is the main source of total domestic production (95.7%) and 47.9% of the total sources. The substantial fall of hydro plants production, by 47.7% is the most significant reason of shortage. Electric power produced by thermo plants decreased by 21.9%. A sharp decrease happened in the production by concession and private plants with 13.7%.

Import of electric power had an impressive rise by 136.2 % from 1242 GWh up to 2934 GWh in 2006. Thus, the share of imported energy jumped up to 49.9% from 18.3%. Export sharply decreased by 83.3% that means almost no export occurred at all. The result is that the local consumption can grow annually only by 1-2%. Hopefully, the contracts with foreign companies on building a coal power plant with 1300 MWatt capacity in Albania will solve the shortage problem till 2009.

The government plans to privatise the energy distributing network, the state oil refinery and other company shares in the next semester.

Because of low level of development the economic growth remains strong in 2008 and 2009 at about 6-7% despite the energy crisis, but cost pressures have added to inflation and fiscal risks from tax cuts are on the horizon. The growth outlook remains positive but serious world market challenges will have to be treated.

Monetary developments



Source: INSTAT

The favourable decreasing trend of year-on-year inflation got broken in the 1st quarter to start an upturn, and presumably it will continue in 2008. Consumer Price Index (CPI), in the 1st quarter increased by 2.4%, while the annual rate in March was 4.6%, what expresses an unfavourable upturn in the inflationary process. The extreme increase of electricity price (23.7% just in March) contributed the most significantly to the rise. Besides, the basic food prices increased extremely, above 10% quarterly (bread, cereals, fat, fruits). The producer price index shows also the speed-up of inflation. Especially chemicals and energy production price contributed to the higher index.

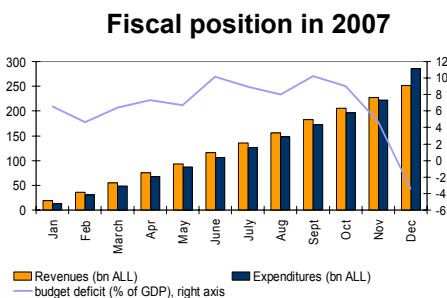
During the 4th quarter 2007, Construction Cost Index went up to 127.2 (Q.IV 1999 = 100) signing a thin increase of 0.3% against the previous quarter. The Construction Cost Index has signed an annual rate of 2.2%. Insignificantly, but construction cost seems to accelerate after a more than one year long slowing down period.

As the inflation risk started to increase, the higher risk premium promise also got expressed in the Tirana Interbank Bid Rates (TRIBOR) for any long maturity in the end of 1st quarter. Thus it resulted in a narrowing margin between bid and offer rate by 50 base points.

There is structural change in credit portfolio relates to the upward trend towards longer-term lending, which consisted of 150 base points or more than total lending. The spread between interest rates of deposits and credits remains high.

The dynamic growth after getting out of electricity shortage and the postponed impact of world market prices in the just starting to increase Albanian economy will accelerate the inflation in 2008 and 2009.

Fiscal policy



Source: Ministry of Finance

According to the latest report of Ministry of Finance, total expenditures were ALL 285.33 bn at the end of December 2007, by 10.24% more than the same period of the last year. Current expenditures were higher by 9.81% than in the same period of the last year, while capital expenditures were by 10.95% higher than in the corresponding period of the last year. Total revenues were ALL 251.64 bn at the end of December 2007, 9.67% more than the same period of the last year. Tax revenues in the end of this month were ALL 228.37 bn, 11.11 % more than the same period of the last year.

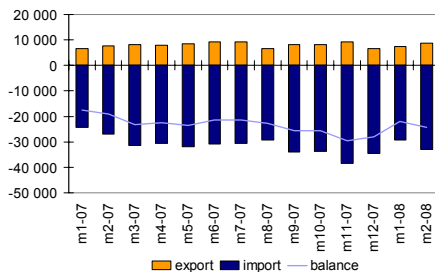
The average weighted yield of treasury bills is: 6.40% for 3-month maturity, 7.41% for 6-month maturity and 8.26% for 12-month maturity treasury bills.

The Albanian public budget balance unexpectedly turned to negative in the last month of 2007 as a result of accelerating inflation and the necessary governmental intervention in electricity shortage. Thus we modified the balance expectations to be thin deficit in 2008 and 2009, still the country get through the energy crisis. In case of 2008, the expectations must take into account the tax cuts and its compensation by increasing speed of FDI inflow, thus the balance can be expected close to zero.

As the government plans to execute large volume privatization in 2008 and 2009, it is very likely to have source for significant decrease in public debt.

External balance

Monthly trade statistics (mn ALL)



Source: INSTAT

Trade speeds up in the 1st semester of 2008. The 1st quarter shows significant opening. During February of 2008, there were exported ALL 8.743 bn commodities, increasing 17.1% just from January of 2008 and shows 13% higher value on year-on-year. The value of import was ALL 32.969 bn, however the trade deficit was ALL 24.227 bn that signalises a threat, as it is 10.9% higher than in January and 26.5% more than a year earlier. The sharp increase of import rooted in the energy shortage that forced the national economy to double the energy import.

For the first three-month period of 2008, the external sector was characterized by current and trade deficit deepening. However, capital influx has been sufficient for compensating the current deficit, enabling an overall positive balance sheet.

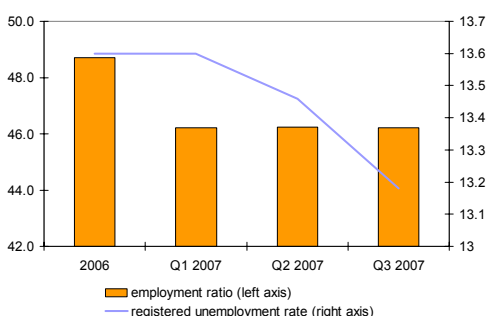
The share of EU in trade increased from last year with 4 percentage points up to 64.6%. The main trade partners are Italy and Greece, although their significance is smoothly decreasing. Share of Italy in export was 81%, while that in import was 44.5%, shares of Greece were 10% and 22.4% respectively.

The main expectable developments for 2008 and 2009 in the external sector: (1) Intensive activity in the external sector, reflected in the increase of income and current expenditures. (2) Considerable growth in merchandise exports and imports. (3) Deepening of the current and trade deficit. (4) Increasing foreign capital inflows in the form of foreign direct investments. (5) Increasing financial liabilities to non-residents, created in the form of increased deposits of non-residents with the banking system. (6) Increasing foreign reserve stock of the monetary authority.

The average 3.1% of tariff level will be cut gradually down to 1% till 2010.

Labour market

Labour market trends (%)



Source: INSTAT, own calculation

In the 3rd quarter of 2007, labour force decreased down to 1077.9 thousands compared with 1078.1 thousands in the previous quarter. The number of employed persons in public sector in the third quarter increased by 300 employees, and the number of employed persons in the non-agriculture private sector increased by 2487 employees especially in transport telecommunication, health and financial activity. During this period, the number of employed persons in the agricultural private sector is the same.

At the end of 3rd quarter, number of registered unemployed persons decreased from 145 143 persons to 142 161, and the unemployment rate went down to 13.18%.

The minimum wage remained the same ALL 14 000 Also the base level of unemployment benefit is the same ALL 5 240.

Until the energy shortage exists, significant increase in employment is not expected. Although, 2008 spring and summer seems to bring favourable weather for production, so in the next quarters,

agricultural employment will increase. In the previous year, the government proved that Albania is not interested in the increase of minimum wage as the country can remain attractive only with very low labour cost. The average nominal wage increase will follow the productivity improvement.

Key macroeconomic indicators, 2006-2009

	2006	2007e	2008f	2009f
Nominal GDP (ALL mn)	896,000	979,000	1,040,000	1,111,000
Real GDP growth (%)	5.0	6.0	6.2	6.8
Private consumption (%)	NA	NA	-	-
Public consumption (%)	NA	NA	-	-
Investments (GFCF, %)	24.7	26.4	27.1	30.5
Exports (%)	13.0	25.0	17.0	15.0
Imports (%)	16.0	27.0	20.0	16.0
Annual average inflation (CPI, %)	2.4	3.1	4.7	4.9
Discount rate (end of period, %)	5.50	6.00	6.25	6.50
Money market rate (3-month Treasury Bill, %)	6.25	6.06	6.38	6.70
Long-term interest rate (10-year gov't bond, %)	NA	NA	-	-
Exchange rate (ALL / EUR, average)	123.1	123.9	122.5	123.0
Exchange rate (ALL / EUR, end of period)	123.8	121.8	123.0	123.5
General government balance / GDP (%)	-3.2	-0.1	-0.3	-0.2
Public debt / GDP (%)	55.7	54.5	53.7	52.4
Trade balance / GDP (goods and services, %)	-23.4	-28.6	-28.9	-27.1
Current account balance / GDP (%)	-7.2	-10.8	-8.5	-8.0
Gross foreign debt / GDP (%)	22.0	22.0	21.5	21.0
Unemployment (%)	13.8	13.5	13.0	12.3
Real ULC growth (%)	NA	NA	-	-

Note: e = estimation, f = forecast. See methodological notes for definitions and details.

Sources: Bank of Albania, INSTAT, IMF

Bosnia and Herzegovina

According to estimations, the budget balance per GDP rate exceeded 2% in 2007 as well, despite fiscal easing. As a result of both external and internal effects, inflation started to accelerate from the last quarter of 2007. Following the improvement of 2006, external imbalances significantly widened again in 2007. In December average net wage increased by 11.1% compared to December 2006. According to the LFS, unemployment slightly decreased and reached 29%.

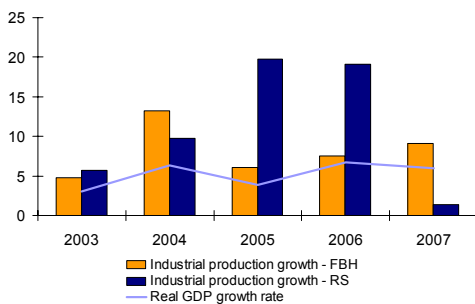
Political developments

Following years of unsuccessful attempts, BH's (Bosnia and Herzegovina) House of Representatives adopted the police reform laws on the 10th of April. The upper house is expected to approve the laws. The approved version was prepared with the help of High Representative Miroslav Lajcak and can be considered as a compromise between the parties. The agreement on the police reform is a key precondition for signing the SAA (Stabilisation and Association Agreement) with the EU, and thus it can be considered as the first milestone of the process of European integration. Signing the SAA can take place in the coming weeks.

Taking into consideration the difficulty of reaching an agreement on the police reform, the lack of compromise is expected in the issue of the constitutional reform as well, but negotiations are supposed to be resumed.

Growth

Real GDP and industrial production growth rate (%)



Source: CBBH

According to the preliminary official data, in 2007 the real GDP growth rate was 6.0%, which is well below the 6.7% rate of 2006. Thus the nominal GDP amounted to KM 20.95 billion in 2007. The slowdown was partly the result of the milder industrial production growth in RS (Republika Srpska), which was only 1.4%, following the robust growth of 19.1% in 2006. In RS, mining increased by 2.7% (20.6% in 2006), manufacturing by 4.1% (21.3% in 2006), while the category of "electricity, gas and water supply" decreased by 5.4% (growth was 9.7% in 2006).

On the other hand, FBH (Federation of Bosnia and Herzegovina) performed a higher growth of industrial production in 2007 compared to the previous year; 9.1% and 7.5% respectively. Mining increased by 10.2% (2.0% in 2006), manufacturing by 13.8% (9.0% in 2006), while electricity, gas and water supply decreased by 5.5% (growth was 6.8% in 2006).

Despite certain slowdown, the 6.0% real growth of 2007 can still be considered high. This growth was a result of the strong domestic demand and the favourable external conditions. Likewise in 2006, in 2007 as well the economic growth was underpinned e.g. by the good performance of the manufacturing industry, the high level of retail sales, investment activity and private consumption. The latter was a result of the strong credit and wage growth as well. The central bank increased its reserve requirements, but credit growth is not expected to slow down significantly. Taking into account the continuation of the above mentioned effects, in 2008 the growth is expected to amount around 6.3%. The firm growth is likely to continue on mid-term as well, despite the fact that due to structural reasons, BH remains quite vulnerable to external conditions.

According to the EBRD, as a result of certain transitional developments, the private sector's share of GDP increased from 55% to 60% in 2007.

Monetary developments

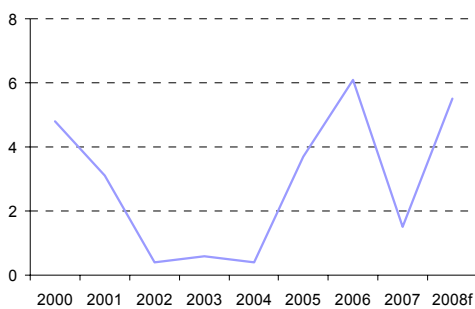
VAT introduction in January 2006 had a one-off effect on inflation and caused a huge base effect for 2007. Following the 6.1% CPI (Consumer Price Index) in 2006, the annual average inflation was 1.5% in 2007 as we expected. However, in the last quarter of 2007 inflation significantly accelerated due to both external and internal factors, thus the annual CPI in December reached 4.9%.

Taking into consideration the disappearing base effect, the high level of credit growth, the generous wage policy, the increasing public and private consumption, the adjustments of regulated prices (e.g. regulated electricity prices were raised in the beginning of this year), all combined with the growing energy and food prices, significant external and domestic inflationary pressure is expected to continue. On the other hand, the currency board regime somewhat helps to underpin price stability. All in all, we expect the average annual CPI to be around 5-6% in 2008.

The central bank decided to raise the required reserve rate from 15% to 18% from the 1st of January. This decision was taken in order to dampen the rapid credit growth, which reached 30.3% in case of households and 31.5% in case of companies in October 2007.

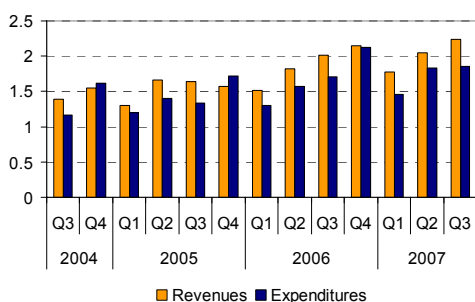
By the end of 2007, the national bank's foreign exchange reserves amounted to KM 6.69 billion, which is a growth of 22.75%, compared to the previous year. This amount of reserves supports the credibility of the currency board regime, even amid the recent international financial environment.

Consumer price index (yoy, avg, %)



Source: CBBH

Consolidated revenues and expenditures of general government (KM, billion)



Source: CBBH

Fiscal policy

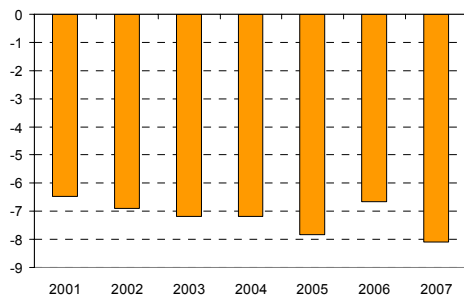
In the first three quarters of 2007 fiscal surplus was 20.6% higher than in the same period a year earlier and reached KM 915.8 million. During this period revenues grew at a higher pace than expenditures; total achieved revenues reached KM 6.06 billion, which is 13.4% higher than in the same period a year ago. As for the current expenditures, it rose by 12.2% compared to the first half of the previous year and amounted to KM 5.14 billion. Likewise the state level, both entities FBH and RS reached surplus; KM 448.7million and KM 207.9 million respectively.

It can be assumed that expenditures continued to accelerate in the fourth quarter, due to wage outflows, social benefits and investment activity, thus the annual surplus was probably lower than in the previous year. According to estimations, the budget balance per GDP still exceeded 2% in 2007. For 2008 further fiscal easing is expected, thus the balance per GDP is expected to be around 2%.

External balance

Following the external balance's improvement in 2006 - which was among many factors the result of the one-off effect of the VAT introduction - trade deficit and current account deficit significantly widened in 2007. However, export of goods increased by 15.05%,

Trade balance of goods (KM, billion)



Source: CBBH

due to favourable domestic and external developments. The export growth was mainly underpinned by the good performance of the metal and machinery sector and wood products. On the other hand, as a result of the already mentioned strong domestic demand, import of goods showed an even higher growth; 18.72% compared to 2006. As a result, in 2007 trade deficit of goods increased by 21.63% and reached KM 8.1 billion, while the export/import coverage was 42.74%.

In the first three quarters of 2007, current account deficit reached KM 1.99 billion, which is 76.44% higher compared to the same period a year ago. The large amount of trade deficit was mainly covered by current transfers that reached a balance of KM 2.35 billion. Due to the favourable conditions and developments for exporters, combined with the somewhat tighter monetary policy, the external deficits may slightly narrow, resulting in 2008 a trade deficit around 33% of GDP and current account deficit per GDP approximately 12.5%.

As for the FDI, following the low level of FDI inflow in 2006, in the first three quarters of 2007 BH gained KM 2.31 billion FDI. Largest part of this inflow was due to the purchase of the telecom operator, Telekom Srpske. 2008 can also show higher levels of FDI inflow, due to some upcoming privatisation transactions, e.g. BH's largest exporter company; Aluminij Mostar.

Labour market

LFS 2007 (BH, %)

	2006	2007
Activity rate	43,1	43,0
Employment rate	29,7	31,2
Unemployment rate	31,1	29,0

Source: CBBH

In the last quarter of 2007 wages continued to grow strongly, thus in BH in December the average net wage increased by 11.1% compared to the same month in 2006. In December 2007 the average net wage was KM 697 in FBH, KM 628 in RS and KM 734 in Brčko District. Compared to the same period in 2006, the growth rate was 10.2%, 14.2% and 7.2% respectively, which represents the trend of decreasing differences. The largest growth was recorded in the budget-financed sectors; in public administration, education and health care.

According to the preliminary data of the 2007 LFS (Labour Force Survey), the unemployment rate decreased slightly compared to the data of 2006; from 31.1% to 29.0%. The unemployment rate shows significant differences between the entities; 31.1% in FBH, 25.2% in RS and 40.0% in Brčko District.

Key macroeconomic indicators, 2006-2009

	2006	2007e	2008f	2008f
Nominal GDP (BAM mn)	19.12	20.95	23.43	25.65
Real GDP growth (%)	6.7	6.0	6.3	6.1
Private consumption (%)	NA	NA	-	-
Public consumption (%)	NA	NA	-	-
Investments (GFCF, %)	NA	NA	-	-
Exports (%)	28.8	14.9	15.1	15.0
Imports (%)	1.0	18.0	16.3	16.4
Annual average inflation (CPI, %)	6.1	1.5	5.5	3.2
Policy rate (end of period, %)	-	-	-	-
Money market rate (3-month Treasury Bill, %)	NA	NA	-	-
Long-term interest rate (10-year gov't bond, %)	NA	NA	-	-
Exchange rate (BAM / EUR, average)	1.956	1.956	1.956	1.956
Exchange rate (BAM / EUR, end of period)	1.956	1.956	1.956	1.956
General government balance / GDP (%)	2.9	2.3	2.0	1.5
Public debt / GDP (%)	21.3	18.5	17.3	16.4
Trade balance / GDP (goods and services, %)	-29.9	-33.9	-32.6	-32.0
Current account balance / GDP (%)	-9.9	-13.3	-12.6	-12.0
Gross foreign debt / GDP (%)	57.0	58.5	59.6	61.1
Unemployment (%)	31.1	29.0	28.2	27.0
Real ULC growth (%)	NA	NA	-	-

Note: f = forecast. See methodological notes for definitions and details.

Sources: Central Bank of BH, Agency for Statistics of BH, IMF, own calculations

Croatia

Structural reforms and EU integration negotiations will accelerate as new government getting warm into. Real growth remains robust, while moderating, driven by manufacturing sector and by domestic demand. Internationally determined inflation pressures influence domestic price developments. Fiscal policy managed to improve significantly budgetary targets. Current account deficit widened but covered by FDI; the external debt is increasing, but structurally favourable. Increase of employment and decrease of unemployment continue.

Political developments

New government of Ivo Sanader (HDZ)

Party	Deputy Prime Ministers	Ministers
HDZ	<ul style="list-style-type: none"> Social affairs, foreign affairs, human rights Economic affairs 	<ul style="list-style-type: none"> Family, war veterans, intergenerational solidarity Economic affairs, labour Foreign affairs Internal affairs Defence Finance Justice Shipping, transport, infrastructure Environmental protection, spatial planning, construction Health, social welfare Culture Science, education, sport Regional development, forestry, water management
HSS	-	<ul style="list-style-type: none"> Tourism
HSLs	<ul style="list-style-type: none"> Internal affairs 	<ul style="list-style-type: none"> Agriculture, fishing and agricultural development
SDSS	<ul style="list-style-type: none"> Regional development, reconstruction, return of refugees 	-
No.	4	15

Note: Croatian Democratic Union (HDZ), Croatian Peasant Party (HSS) and Croatian Social Liberal Party (HSLs), Independent Serbian Democratic Party (SDSS)

The former governing Croatian Democratic Union (HDZ) led by Ivo Sanader after winning elections, on 12 January 2008 formulated new government in coalition with the Croatian Peasant Party (HSS), the Croatian Social Liberal Party (HSLs) and the Independent Democratic Serb Party (SDSS).

The new Croatian government also includes a Serbian politician in the position of deputy prime minister. This can be a positive sign not only for the EU, but also for the neighbour relations and for own minorities.

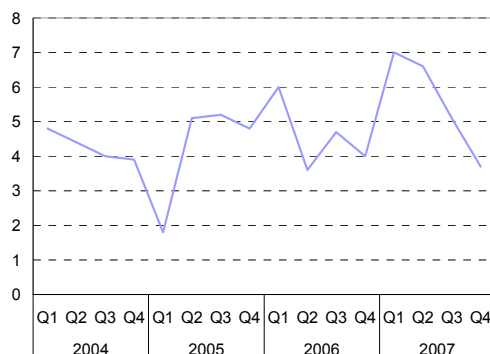
The negotiations with EU are likely to accelerate, while it is expected that due to new coalition partners committed to the countryside the agricultural talks could have new image concerning agricultural policy and territorial issues, and also in the fisheries.

Reforms are likely to continue, as the EU integration is supported by overwhelming majority of the population. However, some politically sensitive areas can cause serious concerns for the coalition. The Prime Minister, Ivo Sanader targeted the judicial system, the public administration and the healthcare as main reform priorities for the new government.

The most possible date of accession seems 2010. The global economic and financial market problems can bring forward the need of structural reforms that might cause external driven political pressures within Croatia.

Growth

Real GDP growth (quarterly, yoy, %)



Source: CROSTAT

In 2007, Croatia realised the highest real growth since 2002. Based on the quarterly estimates, the real GDP for 2007 showed an increase of 5.6 % as compared to 2006. It is slightly under our latest estimation.

The main contributor factors in last year were domestic demand driven by extreme growth of final consumption of private (6.2%) and government sector (3.4). The contribution of external demand improved, while remained still negative. The real growth of gross fixed capital formation proved to be considerably lower as compared with the previous investment boom. While investments were mainly pulled by private sector investment.

The last quarter however shows some warning concerning the growth expectations for the current and next years. Due to worsening global business cycle and seasonal factors, the real GDP

Seasonally adjusted volume indices of industrial production

Groups	Structure (%)	2007 to 2006 (%)
Mining and quarrying	6,74	2,9
Manufacturing	79,33	6,6
Electricity, gas and water supply	13,93	1,7
Intermediate goods	27,49	4,1
Energy	19,87	2,0
Capital goods	14,49	10,5
Durable consumer goods	2,48	13,2
Non-durable consumer goods	35,67	6,0
Total	100,00	5,7

Source: CROSTAT

growth was only 3.7%, as compared with the same period of the previous year, caused mainly by relatively adjusting final consumption expenditures and worse export growth dynamics.

The very poor export growth performance is apparent if comparing the last quarter performance of 2007 with the same period of 2006, even if taking into consideration the base affect. In the same time, import growth remained robust, mainly fuelled by private consumption growth. Improving productivity in export sectors is likely to mean improving exports.

On the production side, seasonally adjusted data of real gross value added growth show that industry (particularly manufacturing), wholesale and retail trade, hotels and restaurants and financial intermediation services did well. Agriculture performed poorly, but this is common regional phenomenon.

In 2007, as compared to 2006, the industrial production in manufacturing increased by 6.6% and in electricity, gas and water supply by 1.7%, while in mining and quarrying increased by 2.9%. The last quarter in 2007 proved to be weak for manufacturing sector, while the other two mentioned performed well.

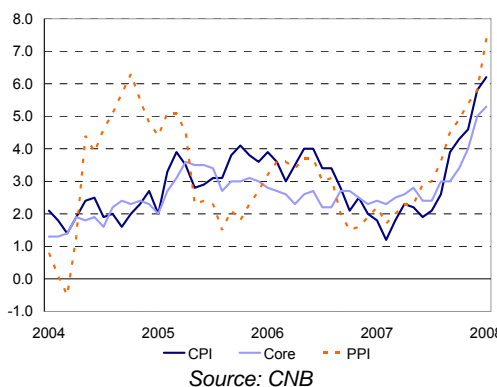
Regarding the main industrial groupings in 2001, energy increased by 5.5%, capital goods by 3.4%, durable consumer goods by 1.3% and non-durable consumer goods by 6.2%, while intermediate goods decreased by 2.2%. The industrial production increased particularly due to above average increase of production of non-durable consumer goods and capital goods.

Tourism sector realised relatively good year in 2007, regarding tourist arrivals (7% growth) and nights spent (6% growth). Domestic and foreign arrivals increased similarly, while foreign arrivals remained dominant. In 2007 the total turnover of hotels and restaurants increased by 14.3%.

Even if there are signs of slowing down due to moderating domestic consumption and export performance, the healthy structure of the growth inspires us to keep our previous estimations for 2008 on 5.0%. 2009 will show slight moderation in the pace of real growth. Domestic demand inspired by credit growth and improving consumer confidence will continue. While risks concerning unfavourable capital market developments still persist.

Monetary developments

Monthly price developments (%)



Fossil fuel price rise, global food price boom have to be taken into consideration as it broke not only the global and regional, but also the Croatian inflation trends regarding all indices.

Prices of goods and services for personal consumption, measured by consumer price indices in February 2008 as compared to February 2007, at the annual level, they increased by 5.8% and on the annual average by 3.6%. (The annual average inflation in 2007 was 2.9%) The acceleration of inflation is true both in case of goods and services, while in case of goods is more apparent.

The main contributors of the annual average inflation for the mentioned period were food (29.1% of the basket, annual inflation 5.4%), alcoholic beverages and tobacco (5.5% of the basket, annual inflation 3.9%) clothing and footwear (8.4% of the basket, annual inflation 5.0%).

Regarding, producer price index (PPI) in March 2008, prices were 7.6% higher as compared to the same month of 2007. (The annual average inflation in 2007 was 3.4%) By MIG grouping, prices of energy and intermediate goods were contributing, while by NKD especially manufacturing production prices proved to be rising considerably.

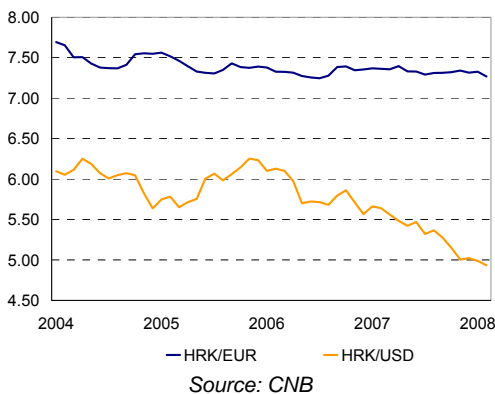
The earlier observable disinflation policies and monetary policy answers has to be rethought, as because of external shocks. Our forecast on inflation for 2008 has to be significantly revised upward, while a lot depends on the current year domestic developments in agriculture and financial markets. We expect 4.0% inflation for the current and significant moderation for 2009.

Much depends on the exchange rate developments, as it is able to keep price-stability relatively low despite significant pressures. The interaction with the INA price formulation another tool softening imported inflation caused by energy price hikes.

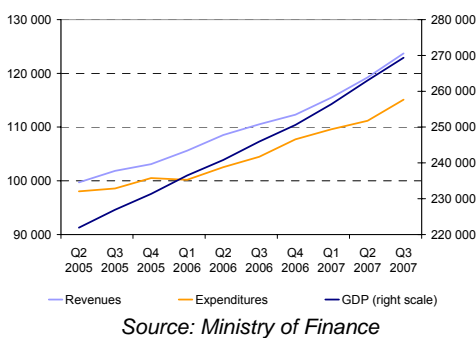
Appreciation of HRK/USD exchange rate continued, while the HRK/EUR is kept relatively stable. The main determinant of it the continuously depreciating USD/EUR exchange rate and CNB interventions in order to keep stable the national currency against the euro.

Our expectations on nominal exchange rates are unchanged as the relative stability against euro is of high priority, however some appreciation will be allowed due to reflection for price shocks coming from the EU. Against the USD further appreciation is expected that is in favour of buffering energy price related inflation pressures.

Monthly exchange rates



Quarterly consolidated budget revenues and expenditures (HRK mn)



Fiscal policy

Croatia managed to keep its budgetary balance under the Maastricht reference level, despite the parliamentary elections, while economic growth was in favour of fiscal policy.

Croatia set new records in collection of tax revenues in 2007, especially concerning profit tax revenues, but also in case of value added tax and excise duties. Health and pension insurance contributions performed also above expectations. On expenditure side, consolidated general government, in the first eleven months of 2007 social transfers mainly on health and pensions, and employee compensations.

By our calculations – taking into consideration the usual behaviour of public finances in the fourth quarters – 2007 can be closed by 2.4% operating balance.

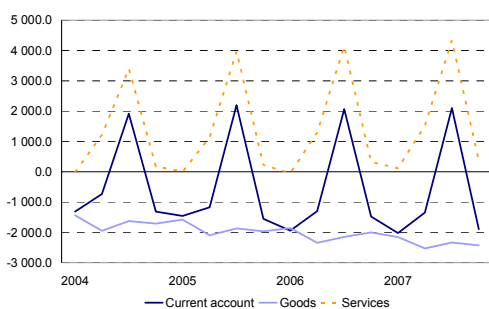
Depending on the data of last month in 2007 and final GDP data, the ESA-95 balance can be even better than last year. This finally can lead to decreasing general government debt.

External balance

The current account deficit widened not only in nominal but in GDP related terms, reaching EUR 3,206 million or 8.6% of the GDP in 2007, as compared with EUR 2,692 in 2006 (higher by 19.1%)

The main reason is the widening merchandise trade deficit (13.1%) Service balance was not able to counteract increasing only by

Current account deficit and its components (million EUR, quarterly)



Source: CNB

10.7%. Only 56% of the merchandise trade deficit increase was offset by service balance improvement. Current transfers almost fully covered income balance deficit.

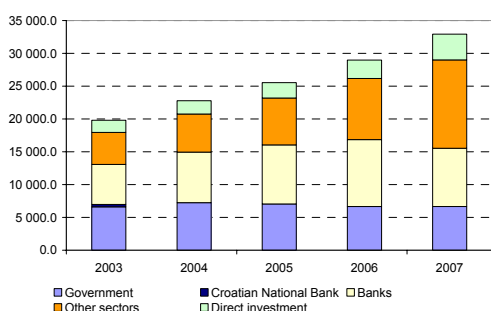
Exports increased by 9.2% in 2007 as compared with 2006, while imports by 10.3%. While exports were driven mainly by exports of intermediate and capital goods, imports by non-durable consumer, intermediate and capital goods. What is favourable that manufacturing (NKD grouping) exports growth (11.8%) exceeded imports growth (10.7%), while the volume is biased towards imports of manufacturing products.

The current account deficit is financed particularly by FDI, as in 2007 FDI was up by more than 30%, reaching EUR 3.6 billion. This is almost 10% of the GDP, completely financing the deficit.

External debt is increasing (in 2007 reached almost 88% of GDP), while its structure seems favourable, as it is in long term debt and related to the private sector of enhanced external relations and increased direct investments. This happened mainly because of increase of direct investment and decrease of domestic banks and government related external debt relative to total external debt.

Our earlier estimations have to be slightly revised. We expect current account deficit rising to 8.7% in 2008 and 8.3% for 2009. The trade balance of goods is expected to be lower due to decreasing import related consumption, while energy imports and capital goods will act differently. Concerning the service balance 2008 can bring negative shocks in connection with the Olympic games and the high level football championship.

Gross external debt by sectors (million EUR)



Source: CNB

Main labour force indicators (%)

	VII-XII 2006	I-III 2007	IV-VI 2007	VI-IX 2007
Activity	49.8	48.2	48.7	49.5
Employment	44.5	42.8	44.2	45.4
Registered unemployment	16.0	16.9	15.1	14.1
ILO unemployment	10.5	11.2	9.1	8.4

Source: CROSTAT, Labour Force Survey

Labour market

Labour market indicators continue to improve in line with favourable processes observed in most significant employer sectors.

Labour survey data show that the activity and employment rates continue increasing slowly even taking into consideration seasonal effects. Unemployment rates - both the registered and the ILO-type ones show decreasing trend.

By more up to date CROSTAT data, number of persons in paid employment increased by 4.4% in January-February 2008, as compared to the same period of the previous year. The main increases were observed in the agriculture sector (5.3%), wholesale and retail trade (7.3%), hotel and restaurants (8%). The employment in service sectors generally increased considerably. Manufacturing managed to employ by 2.7% more. That reflects in line with increasing manufacturing production improving labour productivity. In February 2008 the number of employed reached 1 207 953.

Registered unemployment rate in February was 14.7% to total active population. In the previous year this indicator reached 17.0%. The improving labour indicators are not in cost of wage developments; even the labour productivity developments prove room for manoeuvre.

Average monthly gross earnings were higher by 7.4% nominally in January 2008 year-on-year, while in real terms only by 1.1%. Improving unit labour costs in favour of further demand for labour. Productivity gains seem to remain by the producers causing positive

expectations for growth. Growing wage inflation is a greater concern.

Integration prospects and expected structural reforms will improve employment conditions, while considerable external risks persist. Unemployment is expected to decrease further to 9.0% this year and to 8.5% in 2009.

Key macroeconomic indicators, 2006-2009

	2006	2007	2008f	2009f
Nominal GDP (HRK mln)	250,590	275,078	300,000	325,000
Real GDP growth (%)	4.8	5.6	5.0	4.8
Private consumption (%)	3.5	6.2	4.4	4.1
Public consumption (%)	2.2	3.4	2.7	2.5
Investments (GFCF, %)	10.9	6.5	6.0	5.7
Exports (%)	6.9	5.7	5.4	5.9
Imports (%)	7.3	5.8	5.7	5.8
Annual average inflation (%)	3.2	2.9	4.0	2.9
Policy rate (discount rate, %)	4.50	4.50	4.50	4.50
Short terms (3-month T-bill, %)	3.00	3.60	4.00	3.10
Long-term interest rate (10-year gov't bond, %)	4.4	5.25	4.30	4.20
Exchange rate / EUR (average)	7.32	7.34	7.20	7.10
Exchange rate / EUR (end of period)	7.34	7.32	7.18	7.12
Budget balance / GDP (%)	-2.2	-2.0	-2.4	-1.6
Public debt / GDP (%)	42.1	40.5	40.0	39.0
Trade balance / GDP (goods and services, %)	-7.8	-8.3	-8.5	-8.2
Current account balance / GDP (%)	-7.7	-8.6	-8.7	-8.3
Gross foreign debt / GDP (%)	84.6	87.9	88.3	88.9
Unemployment (%), LFS	10.5	9.8	9.0	8.5
Real ULC growth (%)	0.1	1	0.2	0.3

Note: f = forecast.

Sources: Croatian National Bank, Central Bureau of Statistics of Republic of Croatia, Eurostat, Ministry of Finance of Republic of Croatia

Former Yugoslav Republic of Macedonia

Economic growth accelerated in 2007 and growth prospect remains good. Inflation increases significantly while fiscal budget remains close to balance. Labour market indicators improve while current account deficit is expected to worsen this year.

Political developments

The most important international event of the former Yugoslav Republic of Macedonia in the first months of 2007 was the NATO Summit in Bucharest in early April. In that summit the invitation of the former Yugoslav Republic of Macedonia was postponed due to the name dispute between Greece and the country.

Due to the fact that Greece blocked the invitation of the country to the NATO, the fall of government became certain. Accordingly, the parliament dissolved itself in the second week of April and early elections will be held at the beginning of June.

Regarding EU accession, the EU suggested that accession talks should be started later in 2008.

Growth

Economic growth accelerated in 2007 in comparison with the previous year. In course of the first nine months gross domestic product increased by 5.1% in real terms. We maintain our previous forecast that economic growth reached 4.9% in last year in accordance with our expectation that quarterly economic growth decelerated slightly in the second half of the year.

On the production side agriculture sector performed weakly due to unfavourable weather conditions in Southeast Europe. Summer 2007 was extremely dry and warm and frequent wildfires caused severe problems for the sector and for the economy.

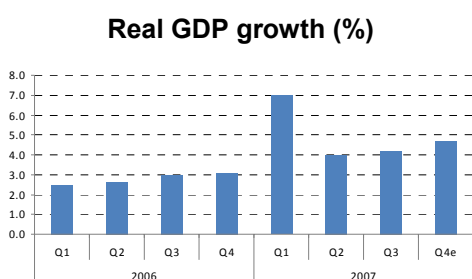
Industry performed relatively well in 2007. Industrial production growth reached 3.7% in which manufacturing grew by 5.2%. Manufacture of fabricated metal products, manufacture of machinery and equipments and manufacture of basic metals represent more than 15% of industrial production and growth rate in these subsectors exceeded 30%.

In the first two months of 2008 industrial production growth accelerated further. It increased by 10% compared to the same months in 2007, while the growth rate of manufacturing was close to 12%.

For 2008 we expect that economic growth remains at current level and real GDP growth rate will reach 4.8% in this year. Regarding 2009 economic growth is expected to remain in the 4-5% range.

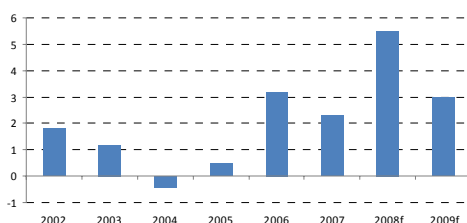
Monetary developments

In the first few months of 2008 inflation accelerated further in the former Yugoslav Republic of Macedonia. Consumer price index increased to 10.2% in March, while annual average inflation was only 2.3% in 2007. Inflation clearly accelerated in the second half of 2007 due to significant growth of food and energy prices. In the third month of this year food and non alcoholic beverages prices were



Source: SSO; Note: e - estimation

Annual average inflation (CPI, %)



Note: f = forecast; Source: SSO

20% higher than those in the corresponding period of the previous year. Regarding energy prices, price increases of gas and liquid fuels reached 23.4% and 33.6% respectively.

The interest rate of Central bank bill increased further to 5.2% in the February 2008 which means that the interest rate was 0.5 percentage points higher than in November 2007. Regarding credit lending to private sector, it increased by almost 40% in course of 2007.

Standard & Poor's credit rating on the former Yugoslav Republic of Macedonia remained the same in the last period, despite the fact that S&P's previously stated that political crisis could put pressure on the ratings of the former Yugoslav Republic of Macedonia. The foreign currency denominated sovereign credit rating of the country kept on being BB+ with stable outlook.

In 2008 we expect that inflation will increase to 5.5% due to significant energy and food price increase. Consumer price index is expected to decrease only in the second half of 2008. In 2009 inflation can decrease to 3%.

Fiscal policy

In accordance with our previous forecast, budget balance remained in surplus in the last month of 2007 despite government's budget plan which indicated 1.1% deficit. The surplus was reached due to the factor that while budget revenues exceeded the planned amount (+3%), expenditures were lower than planned (-1.8%) in course of the year.

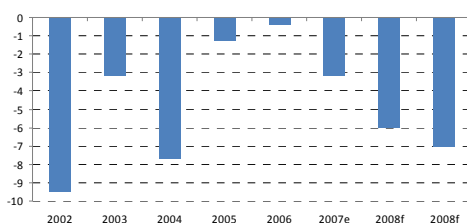
Regarding the revenue side of the budget, it is worth mentioning that profit tax revenues and VAT revenues increased significantly in 2007, namely these two revenues increased by 25.3% and 21% respectively, in comparison with 2006. On the other side of the balance, current expenditures on goods and services and capital expenditures on fixed assets were significantly lower than planned, by 13.7% and 19.7% respectively.

As of January 2008 the government lowered further the already low tax rate on corporate and personal income from 12% to 10%. This step was in line with the plan to make the Macedonian economy more competitive and attractive for foreign investors.

For 2008 the government plans that budget deficit will reach 1.5% of GDP. We expect that the balance will be better again due to higher inflation, poor planning and execution of public spending and increasing tax revenues. Accordingly, we expect that budget will be close to the balance in 2008.

External balance

Current account balance (% of GDP)



Note: f = forecast; Source: SSO, NBRM

Current account balance deteriorated moderately in 2007 due to the worsening trade balance. Current account deficit reached EUR 171 million or 3.2% of GDP, compared to 0.4% in 2006.

Almost 100% of the deterioration of the current account balance can be explained by the worsening trade balance. Foreign trade deficit reached 22.1% of GDP. The balance worsened despite the fact that the growth rate of export was higher (28.3%) than that of import (23.6%). It also means that the openness of the economy increased significantly in course of 2007 and export and import accounted for more than 100% of GDP in last year (114%). Regarding the other

components of the current account, those elements had no significant impact on the evolution of the deficit due to their relatively low share in CA and because these elements remained basically unchanged compared to 2006.

Foreign direct investment continued to finance current account deficit in 2007 as well. FDI amounted to EUR 240 million or 4.5% of GDP. It was slightly lower than that in 2006 (EUR 345 million).

For 2008 we expect that current account balance will deteriorate further due to increasing investment which will boost import of goods. Accordingly, we expect that CA deficit will reach 6% of GDP in this year.

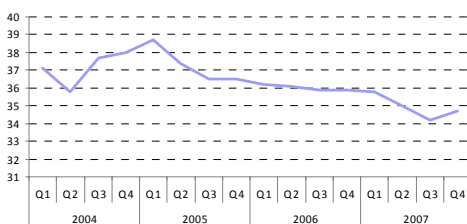
Labour market

In the last quarter of 2007 main labour market figures improved. Employment rate increased to 36.4% from 35.7% in the fourth quarter of 2006. In line with that unemployment rate decreased from 35.9 to 34.7%.

The positive trend was basically due to the improving business climate and relatively high economic growth in the former Yugoslav Republic of Macedonia.

For 2008 we expect that labour market indicators will improve gradually. Accordingly, unemployment rate is expected to decrease to 34% at the end of the year due to solid economic growth.

Unemployment rate (%)



Source: SSO

Key macroeconomic indicators, 2006-2009

	2006	2007e	2008f	2009
Nominal GDP (MKD mn)	303,305	325,500	346,300	346,300
Real GDP growth (%)	3.1	4.9	4.8	4.5
Private consumption (%)	NA	NA	-	-
Public consumption (%)	NA	NA	-	-
Investments (GFCF, %)	NA	NA	-	-
Exports (%)	NA	NA	-	-
Imports (%)	NA	NA	-	-
Annual average inflation (CPI, %)	3.2	2.3	5.5	3.0
Central bank bill (end of period, %)	5.7	4.8	6.5	6.5
Money market rate (3-month Treasury Bill, %)	6.3	5.4	6.0	5.0
Long-term interest rate (10-year gov't bond, %)	NA	NA	-	-
Exchange rate (MKD / EUR, average)	61.2	61.2	61.2	61.2
Exchange rate (MKD / EUR, end of period)	61.2	61.2	61.2	61.2
General government balance / GDP (%)	-0.6	0.7	-0.5	-0.5
Public debt / GDP (GFS, %)	40.6	30.0	28.0	28.0
Trade balance / GDP (goods and services, %)	-20.6	-21.6	-22.0	-22.0
Current account balance / GDP (%)	-0.4	-3.2	-6.0	-7.0
Gross foreign debt / GDP (%)	38.1	37.0	37.5	38.0
Unemployment (%)	36.0	34.7	34.5	34.2
Real ULC growth (%)	10.0	6.0	4.0	4.0

Note: e – estimations, f = forecast. See methodological notes for definitions and details.

Sources: National Bank of the Republic of Macedonia, State Statistical Office of the Republic of Macedonia

Montenegro

After the first presidential election the ruling coalition party became stronger. The new president and the new prime minister seem more pro-western than the previous leaders, but the legal environment does not seem to become more stable. Strong growth prospects, a strong budgetary position and improved prospects for European Union accession relative to other countries in the region are main tendencies in Montenegrin economy. The large current account deficit is the most important risk in medium term.

Political developments

The ruling coalition dominated by the Democratic Party of Socialists (DPS) has a clear majority in parliament and it seems they cemented the dominance of the ruling position in Montenegro, after Filip Vujanovic won the country's first presidential elections since it split from Serbia two years ago.

Vujanovic is supported by the all-powerful Prime Minister and the ruling DPS Democratic Party of Socialists. In his campaigning, Vujanovic has promised Montenegrins speedy integration into the European Union, fresh foreign investment, an efficient justice system and better living standards.

Another important change has taken place in the ruling party in the previous months. Milo Djukanovic agreed to lead the government of Montenegro after Sturanovic who was diagnosed with a rare form of lung cancer in last year.

Djukanovic was Europe's youngest prime minister when he took over 17 years ago. He has served four prime ministerial terms and one as president. He was a strong Milosevic supporter in the early 90's, some of the local analysts say he is the political „godfather” of Montenegro. Other analysts link his comeback with the government's intentions to speed up the privatization process and attract new foreign investors to the tiny Adriatic country with a booming economy.

The Montenegrin government adopted a crucial document related to the country's effort to join the European Union. The National Programme for EU integration, NPI, detailing Montenegro's strategy over the next five years, deals mainly with harmonising the legal and judicial system with EU requirements. It also covers social, economic and other reforms.

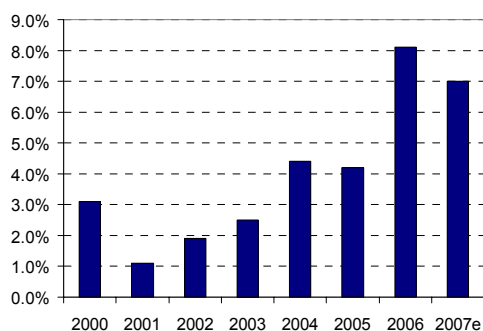
Montenegro would join the EU in 2011 according to Milan Rocen, Minister of Foreign Affairs in a conference early 2008, but local analysts claim it is not expected until 2015.

Growth

The acceleration of economic growth that started in 2006 has continued in the first quarter of 2008. Growth in Montenegro is mostly due to services, financial services and tourism. Economic prospects are favourable. Montenegro's tourist sector will continue to grow. Construction boomed, as did the retail sector, telecommunications, and banking. Growth in other sectors of the economy appears to have exceeded initial projections as well.

On the demand side, there has been a significant worsening of the trade balance and also of the current account. This is just the other

GDP growth rate, %



Source: Monstat ; Note: f - forecast

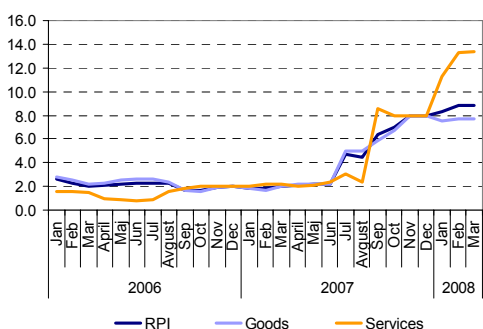
side of the large inflows of foreign investments, or rather investments from abroad. Most of these investments go into real estate, but also into privatisation. Public consumption, on the other hand, is not expanding and it seems that fiscal consolidation has been fully achieved in Montenegro.

The main driving forces are the growing integration of Montenegro with the rest of Europe and the stability afforded by the use of the euro as the country's official currency. These factors play a major role in the favourable development of FDI inflow.

Montenegro's real GDP growth is estimated at 6% in 2008, but the medium-term growth path depends mainly on the improvement of the economy. The challenge for policymakers today is to ensure that similar rates of growth can be maintained in the next years as well, especially in situations when external environment becomes less favourable.

Monetary developments

12-month inflation (Retail Price Index)



Source: MONSTAT

12-month inflation increased significantly in the second half of 2007, and that trend continued in the first few months of 2008 as well. While inflation remained at 2% in course of 2006 and in the first half of 2007, it increased to 8% at the end of the year. In the first three months of 2008 inflation remained above 8%. In March 2008 retail price index reached 8.8% and average inflation was 8.6% in the first quarter. Inflation accelerated mainly due to the general trend of increasing food prices. We expect that inflation will remain high in the first half and it will drop gradually in the second half of 2008. Accordingly, we expect that inflation rate will reach 6.7% in this year and it is expected to decrease further in 2009. In next year inflation can drop back to 3.5% according to our expectations.

Standard & Poor's revised its outlook on the Republic of Montenegro to negative from stable. At the same time, the 'BB+' long-term and 'B' short-term sovereign credit ratings, and the 'AAA' transfer and convertibility assessment, were affirmed. The outlook revision reflects rising macroeconomic imbalances, with Montenegro recording a very high current account deficit (44 % of GDP in 2007).

Growth rates of private sector credit are very high. With about more than 140% and 180% in 2006 and 2007, respectively. Credit expansion exceeded the growth in deposits in 2007, and only a little more than four-fifths of private sector credits were financed by deposits. The remainder tends to be bank credits, typically from the respective mother banks. The question is whether the banks can monitor appropriately the quality of their portfolios.

The Montenegrin financial sector requires close monitoring and supervision, so the Ministry of Finance has prepared the draft banking law. The new law seeks to align the legal framework with the challenges of effective banking supervision and aims at ensuring that the central bank is sufficiently independent and has at its disposal adequate policy instruments to effectively supervise the banking sector.

Fiscal policy

While the general government surplus was at 7% of GDP in 2007, the level of government expenditure remained high (51% of GDP). The general government surplus is expected to decline to a balanced budget by 2010 as the economic boom abates. The fiscal policy framework has been increasingly prudent in recent years. Montenegro's government debt burden is about average compared to the new EU members.

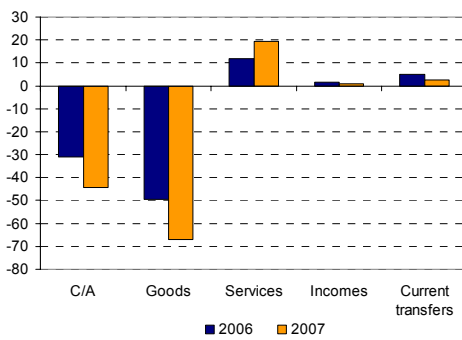
External balance

Current account deficit increased above 40% of GDP in 2007. Imbalances have been fuelled by rising incomes and very fast credit growth. Domestic credit has increased from 20 % of GDP in 2005 to 96 % in 2007, and is likely to reach 120 % of GDP in 2008. On the other hand surge in FDI that began in 2005 generated a major influx of imports, which caused a serious deterioration of the trade balance.

As Montenegro has decided to adopt the euro as its currency, large current account deficits have different implications than they would in countries with fixed or flexible exchange rates. Most importantly, external deficits cannot cause financial crises. Montenegro can currently import more than it exports, because the gap is being financed through the capital account.

Overall the large current account deficit and rapid credit growth indicate serious imbalances in medium term that increase the risk of macroeconomic instability in the coming years. The current account deficit is likely to gradually improve as FDI inflows abate and foreign investments begin to generate export revenues.

Current Account (% of GDP)



Source: CBCG

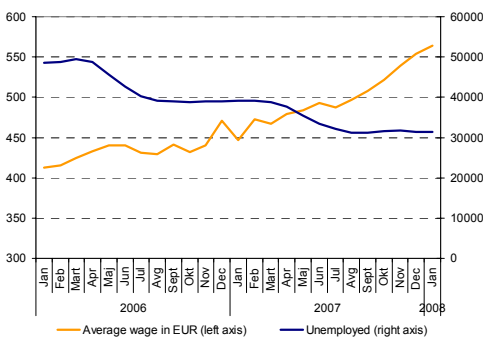
Labour market

Unemployment rate in Montenegro has fallen to 11.8 % in March. According to Employment Agency of Montenegro data, the unemployment rate in the same period last year was 14.7 %. On the other hand, the registered unemployment rate is above 20 percent. The number of employed non-resident workers is 74% higher than that in the same period in the last year.

Average wage in Montenegro in February 2008 was EUR 584, while average wage without taxes and contributions was EUR 399. Compared to January, average wages without taxes and contributions in February increased by 3.4%. Average wages without taxes and contributions in February varied from EUR 119 in Fishing to EUR 893 in Financial Intermediary. Having in mind that costs of living in February 2008, compared to January increased by 0.1%, it means that real wages in Montenegro in February 2008 increased by 3.3%.

Beside the large current account deficit, another main problem is the high unemployment rate, which is the consequence of the collapse of industrial production and of government employment. Also, Montenegro accepted large inflows of refugees and its labour market has difficulty in handling the increased supply of labour. Due to the high GDP growth rate, the registered unemployment rate is likely to decline in medium term. We forecast 17 percent for 2008 and 2009.

Unemployment and wages



Source: Monstat and Employment Bureau

Key macroeconomic indicators, 2006-2009

	2006	2007e	2008f	2009f
GDP nominal (EUR mn)	2003	2278	2510	2740
Real GDP growth (%)	6.5	7.0	6.0	6.0
Private consumption (%)	NA	NA	-	-
Public consumption (%)	NA	NA	-	-
Investments (GFCF, %)	NA	NA	-	-
Exports (%)	NA	NA	-	-
Imports (%)	NA	NA	-	-
Inflation (Retail price index, %)	2.2	4.2	6.7	3.5
Policy rate (discount rate, %)	NA	NA	-	-
Short terms (3-month T-bill, %)	NA	NA	-	-
Long-term interest rate (182 day T-bills, %)	NA	NA	-	-
Exchange rate / EUR (average)	NA	NA	-	-
Exchange rate / EUR (end of period)	NA	NA	-	-
Budget balance / GDP (%)	4.5	7.4	6.5	5.5
Public debt / GDP (%)	45.3	43.0	40.0	40.0
Trade balance / GDP (goods and services, %)	NA	-2.0	-2.6	-3.0
Current account balance / GDP (%)	-31,1	-44,2	-30.0	-25.0
Gross foreign debt / GDP (%)	26.1	32.4	35.0	35.0
Unemployment (%)	25.2	20.5	17.0	17.0
ULC (%)	NA	NA	-	-

Note: f = forecast, e=estimation; Source Statistical Office of Montenegro, ISSP, Eurostat

Serbia

Early elections will take place in May, thus the political turmoil has a significant effect on the Serbian economy. GDP growth may somewhat dampen, however still reaching around 6% in 2008. The internal and external inflation pressure caused sharp growth of prices by the end of 2007 and in the first quarter of this year, thus the central bank tightened monetary policy. Fiscal expenditures accelerated by the end of 2007, and due to the recent political conditions, further fiscal loosening is expected for this year. Due to many factors, external imbalances significantly widened in 2007. Wage growth was rapid in 2007, while there was no major progress concerning the high level of unemployment.

Political developments

In February on the presidential elections, the incumbent president, Boris Tadic received 50.5% of the vote after a very tight race against the Radical Party deputy leader, Tomislav Nikolic. The result of the election represented the dividedness of the Serbian society well.

Kosovo declared its independence on the 17th of February, which Serbia marks as an illegal act. So far most of the EU member states and the USA recognised Kosovo, and as a protest Serbia recalled ambassadors from these countries. Differences among Serbia's coalition became stronger on the issue of Kosovo and EU integration. Acknowledging the differences, Prime Minister Vojislav Kostunica resigned and President Tadic formally dissolved parliament. Early elections will be held on the 11th of May, on the same day as local elections. Political debates focus on the question of Kosovo's independence, and the steps that should be taken as a reaction. Leading EU officials urge stronger EU-Serbian ties in order to keep Serbia on the path leading towards EU accession, instead of isolation.

Growth

Quarterly real GDP growth rate (%)



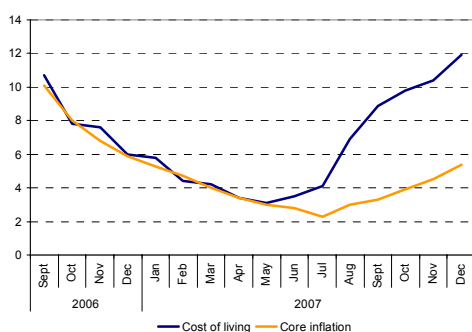
Source: National Bank of Serbia

Following the rapid growth of 8.1% in the first quarter of 2007, economic growth slowed down in the following three quarters (7.5%, 7.2% and 6.2% respectively). This deceleration was partly the result of the slower growth pace of industrial production, milder increase of the construction industry, the contraction of the agriculture sector and as a regulatory factor; the national bank's restrictive credit policy. Still, the real GDP growth is estimated to have reached around 7.2% in 2007.

Industrial production increased by 4.6%, while in this group manufacturing grew by 5.4%. The largest growth was recorded in the sectors of retail trade (22.8%), construction (19.1%), financial intermediation (approximately 20%) and telecommunication (39.7%). Due to the drought, the agriculture sector dropped by 8.1%, thus contributing to the deceleration.

2008 will be marked with political uncertainty, and in addition the tighter monetary policy can dampen the growth. On the other hand, credit growth will still remain relatively high, while real wage growth will most likely accelerate, retail sales will continue to expand and foreign demand can remain favourable. All in all, real GDP growth is expected to amount around 6% this year.

Cost of living, core inflation (annual rate, %)



Source: National Bank of Serbia

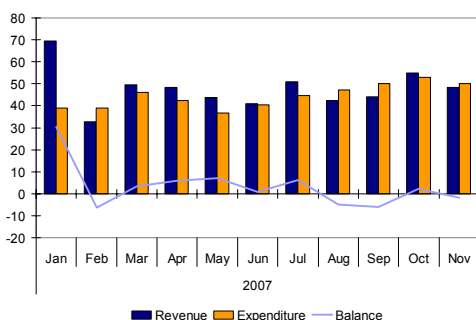
Monetary developments

For 2007 the national bank's core inflation target has been set at $6\pm 2\%$ December-on-December and for 2008 the core inflation objective is set as a band with a 3% lower and 6% upper edge. As a continuation of the inflation slowdown of 2006, in the first half of 2007 price rises remained moderate, due to the appreciation of the dinar, underpinned by capital inflows as well. However, despite the strengthening dinar, from May inflation started to increase due to several factors. Underpinned by expansive fiscal policy, strong credit and wage growth, domestic demand continued to increase. Oil prices and regulated prices also caused/cause inflationary pressure. Due to bad weather conditions, the price of agricultural products and industrial foodstuff increased dynamically from August. As a result of the above mentioned factors, by the end of 2007, the growth of cost of living reached 11.9%, while the core inflation remained in the target band with 5.4%.

In 2008, the internal and external inflation pressure will remain present. The increase of the Serbia's risk premium, the higher inflation expectations, the further growth of oil prices, the fear of further fiscal loosening due to the pre-election period all added up in the sharp growth of inflation. In March 2008 the cost of living index reached 13.6%, compared to the same month in 2007, while the core inflation exceeded the target band and increased to 7%. As a reaction to all these unfavourable developments, the national bank took measures and raised the key interest rate in February by 150 basis points in two steps, while by 300 basis points in March, thus reaching 14.5% by the end of the first quarter.

Partly to mitigate the booming credit growth (especially related to consumption), the national bank introduced administrative measures. All in all, the central bank expects the core inflation to reach the already mentioned yearly target, but probably it will settle at the upper range of the target band by the end of 2008. Serbia's recent situation strengthens the risk of depreciation pressure, but the national bank takes measures to keep the dinar's exchange rate stable.

Public finance (RSD, billion)



Source: National Bank of Serbia

Fiscal policy

Following the interim financing for the January-June 2007 by a decree, the Law on the 2007 budget was adopted in June and came into force on 1st July. By the last quarter of 2007, total consolidated revenues (including grants) reached RSD 281.85 billion, showing a growth of 17,84%, compared to the same quarter in 2006. On the other hand, expenditures reached RSD 343.11 billion, representing a 10.7% increase compared to the same quarter a year earlier, but a 32.1% growth compared to the previous quarter. In the fourth quarter expenditures increased in almost all categories; subsidies by 39.9%, wages by 20.6%, social welfare benefits by 11.9% and capital investment by 34.7% (all in nominal terms).

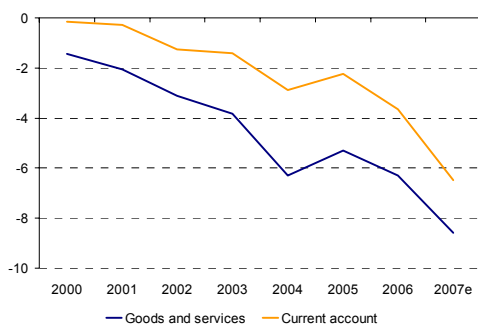
As indicated above, fiscal policy was significantly expansive from the second half of the year and spending remained predominantly social-oriented. As a result, budget deficit amounted to RSD 47.5 billion, which is approximately 2% of the GDP. Moreover, due to the upcoming elections, expenditures may accelerate further and the fiscal deficit can exceed 2% of the GDP in 2008.

According to the data of the central bank, the public debt per GDP

rate decreased from 38.8% to 30.5% in 2007.

External balance

Balance of goods and services and current account (USD, bn)



Source: National Bank of Serbia

As a result of robust wage and credit growth, combined with accelerating fiscal expenditures, domestic demand fuelled the strong increase of imports. By the last quarter, the increased interest payments on rising foreign debt, the lower level of current transfers, the slow structural reforms and the drop of the main export-oriented sectors (metallurgy and agriculture) all added up to a record high current account deficit; reaching 18.9% of the GDP.

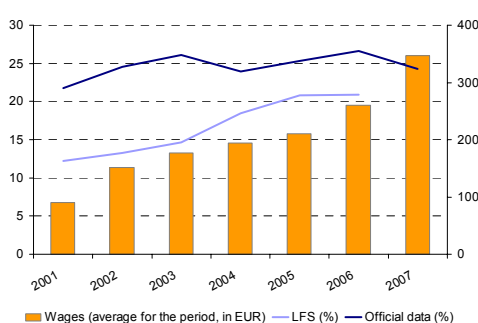
In 2007 imports increased by 36.9% compared to the previous year and reached USD 20.65 billion, while on the other hand, exports also showed a strong annual growth of 34.6%, amounting to USD 11.80 billion. To sum up, in 2007 the trade deficit increased by almost 40%, reaching 20.6% of the GDP, while the current deficit widened by 74%, exceeding 16% of the GDP. As for 2008, the same factors are likely to affect the current account balance, thus, no major improvements are expected.

Following the record high net FDI of 2006 (USD 4.39 billion), in 2007 the inflow remained moderate. In the period of January-November 2007, net FDI reached only USD 1.5 billion. Beside the lower amount of privatisation revenues, another reason of this drop was the high amount of FDI outflow in June (USD 0.7 billion), related to the acquisition of one of Bosnia and Herzegovina's telecom operators, Telekom Srpska. As for 2008, a few bigger privatisation deals can bring somewhat higher FDI inflow compared to the previous year, but the amount is expected to remain moderate. The sales of 51% of the oil and gas company NIS or the privatisation of the mining complex RTB Bor can be named as examples for prominent deals.

In the fourth quarter of 2007, the central bank's foreign exchange reserves reached USD 14.22 billion, increasing by 5.6%, compared to the previous quarter and reaching a comfortable import cover of 8 months.

Labour market

Unemployment rate and wages



Source: National Bank of Serbia

In November total employment decreased by 1.0% year-on-year, and by 2.7% in the corporate sector. In the same period, registered unemployment declined by 14.7%. Unfortunately this drop of registered unemployment was mainly due to certain data transfer. As a negative characteristic, almost half of the unemployed are first-time job seekers. The official unemployment rate in 2007 decreased to 24.3%, while in the end of 2006 the ratio was 26.6%. The Labour Force Survey supposes a lower unemployment rate; 20.9% for 2006, while data for 2007 are not available yet. No significant change is expected concerning the high level of unemployment in 2008.

Although the wage growth mitigated in the second half of the year, the annual growth remained rapid for 2007, particularly in the public sector. According to the statistical bureau, in the period of January-November 2007, net real salaries grew by 21.39% or by 28.55% in nominal terms, compared to the same period a year earlier.

Key macroeconomic indicators, 2006-2009

	2006	2007	2008f	2009f
GDP nominal (RSD bn)	2,060	2,350	2,705	3,065
Real GDP growth (%)	5.7	7.2	6.0	6.1
Private consumption (%)	NA	NA	-	-
Public consumption (%)	NA	NA	-	-
Investments (GFCF, %)	NA	NA	-	-
Exports (%)	32.7	34.6	34.3	34.7
Imports (%)	26.8	36.9	37.2	35.6
Inflation (Retail price index, %)	6.6	10.1	8.5	6.8
Policy rate (%)	14.0	10.0	13.5	11.0
Short-term interest rate (3-month T-bill, %)	13.48	6.44	-	-
Long-term interest rate (RS bonds, %)	5.44	5.53	-	-
Exchange rate (RSD/EUR, average)	84.4	80.3	82.5	82.0
Exchange rate (RSD/EUR, end of period)	79.0	79.2	83.0	82.0
Budget balance / GDP (%)	-3.1	-2.0	-2.0	-1.4
Public debt / GDP (%)	38.8	30.5	27.5	25.6
Trade balance / GDP (goods and services, %)	-19.9	-20.6	-21.1	-20.2
Current account balance / GDP (%)	-11.5	-16.1	-16.5	-15.1
Gross foreign debt / GDP (%)	61.7	61.1	60.8	60.6
Unemployment (%)	20.9	19.6	19.2	18.6
Real ULC (%)	NA	NA	-	-

Note: f = forecast. See methodological notes for definitions and details.

Sources: National Bank of Serbia, Statistical Office of the RS, IMF, own calculations

Turkey

The Turkish economy has been affected by political and external economic shocks, but the results of structural reforms, recent fast growth, sizeable FDI inflows and prudent fiscal policies will help in managing these effects.

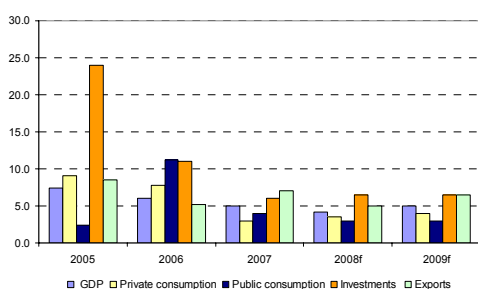
Political developments

The main recent political development has been the increase of the tensions between Turkey's secular elite and the Islamic-oriented ruling party. Turkey's highest court may consider a ban on the country's ruling political party, the AKP, which could result in political stagnation.

The AKP has 330 seats in the 550-seat parliament, and while its members could regroup under a new party, the ban could slow or even derail government policies -- including reforms linked to the entry to the European Union.

Growth

GDP growth and its composition (%)



Note: f = forecast; Eurostat, CBTR

The recent data on the United States and the EU have shown that the turmoil in financial markets started to spread to real sector, which is expected to decrease growth worldwide. The effect of external shocks on Turkey is manifold and different. First, Turkey's risk premium has increased in accordance with rising negative investment sentiment of investors and similar to other emerging economies and there has been a more volatile exchange rate development linked also to the mentioned political tensions.

Besides the exchange rate and risk premia channel the effects of global financial turbulences are to be materialized through the trade and capital flows channel. Concerning the former one, as the main export markets of Turkey are European countries, this may weaken the direct round effects of the US recession, but as the EU is expected to slowdown as well the second round effects will be felt by Turkish exporters.

Concerning the latter. There might be some decline in the borrowing from foreign markets of domestic financial and real sector agents, which may lead to slower increase of domestic demand.

While the Central Bank emphasizes that companies with foreign exchange denominated revenues have hedge against exchange rate risk, this may differ sector by sector and may lead to problems in some unhedged sectors of the economy.

Structural reforms, continued fiscal discipline and the EU entry process have led to a significant improvement in Turkey's growth dynamics in recent years. Not only has the country managed to sustain rapid economic growth but it also appears to be landing softly after a period of prolonged economic expansion. The Turkish economy has now been growing for 23 consecutive quarters – the longest uninterrupted growth period Turkey has ever achieved. Moreover, economic growth has become much more sustainable, departing from previous boom-bust cycles in three significant ways: growth now is driven by the private sector; it is supported by steady productivity gains; and overall the expansion is dominated by higher

value added sectors like automotive and consumer durables rather than traditional sectors such as agriculture and textiles.

Altogether Turkey is vulnerable to slower global growth and external financial pressures. But thanks to recent structural reforms and fast economic growth (the Turkish economy has now been growing for 23 consecutive quarters, which is the longest growth period Turkey has ever achieved) the country has much stronger ground than in previous global downturn cycles, which will slowdown growth but in an orderly way without serious disruptions.

The previous forecast of 4.4% is revised to 4.2% by assuming slow recovery in domestic demand and solid export growth. In the components of domestic demand, private investments may somewhat accelerate as they are partly unaffected by turmoils especially in the areas where export diversification is high. Exports may slowdown somewhat and imports accelerate leading to slower contribution of net exports to growth, but Turkish exports are well protected by the fact that 15% of exports now goes for example to neighbours (including the fast growing Russian economy). In 2009 some acceleration towards 5% of GDP may be expected.

Monetary developments

In the first three quarters of 2007, inflation fell gradually and was 7.1 % in September. But as depicted also in the previous report, in the last quarter of the year, supply-side shocks, including drought and rise in energy prices, and the fiscal policy driven adjustments in administered prices stopped the disinflation trend.

In the first quarter of 2008 one can observe conflicting developments in inflation. On the one hand year-on-year inflation exceeded 9% being 9.1% in February 2008. The high headline CPI is mainly due to high food (which has a very high almost 30% share in the CPI index) and energy (with slightly more than 10% share in the index) prices. These exogenous shocks driven increase in inflation may be temporary as one may expect some reversal in the effect of energy prices, though the food price increases seem to be more persistent.

On the other hand underlying core inflation is at an all-time low of 4.4% and services prices continue to decline. The downward trend observed in services inflation is particularly encouraging, since it may point to a break of long-term inflation rigidity in this product group. Contrary to services inflation goods inflation followed a more volatile course due to external and supply-side factors.

Concerning the expectations for 2008 number of fundamental factors will support disinflation. Due to monetary tightening, domestic demand started to moderate while the expected slowdown in global economic growth is likely to reduce external demand. Second, as described in the last part, the labour market is weak and labour participation rate is well below 50% with nominal wage increases slowing down. As a result, one may forecast a CPI inflation of 6.5% by the end of 2008.

The inflation target is set jointly with the Government in the current monetary policy regime. The policy rate is the main policy instrument of the Central Bank for achieving the inflation target. In this framework, the inflation targeting regime was implemented implicitly between 2002-2005 and has been implemented explicitly

since 2006.

The MPC started the easing in September 2007 by decreasing the short term interest rates by 25 basis points. The moderate rate cuts continued at five successive meetings and short term interest rates were reduced by 225 basis points in total compared to August 2007. But looking at external developments and also higher than expected inflation the MPC will be more cautious with further rate cuts and it may keep rates unchanged for longer period with interest rates eventually declining in the last quarter of the year and reaching 14.50% at the end of 2008.

The exchange rate weakened significantly in the recent quarter thanks to political developments and external shocks and the 1.74 EUR/TRL rate shifted to above 2.00. We expect a decline of upward pressure on the exchange rate with the rate stabilizing at around the mentioned level.

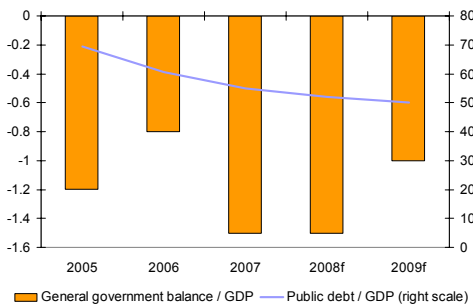
Fiscal policy

In the first half of 2007, fiscal policy was loosened followed by corrective measures leading to a primary surplus of 5% of GDP with and overall deficit of 1.5% of GDP. The substantial primary surplus and strong GDP growth led to a reduction in the debt ratio, from 60,5% of GDP at the end of 2006 to 55% at the end of 2007.

Public sector balances are affected by slowdown in growth, somewhat higher public spending and a slowdown in privatisation, while revenue based reforms are expected to widen the tax base and increase the efficiency of tax collection.

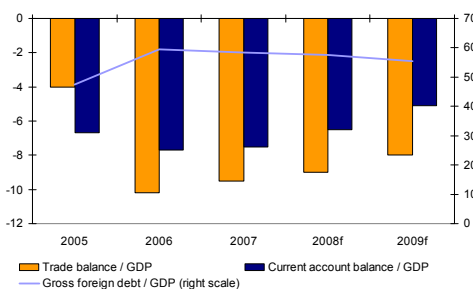
In 2008 some budgetary surplus is projected as a result of gradual fiscal tightening and interest rates lower than in 2007. General government debt is expected to further decline gradually, to 52% in 2008.

Evolution of general government deficit and public debt per GDP (%)



Note: f = forecast; Source: Eurostat

Current account deficit, trade deficit and gross foreign debt



Note: f = forecast; Source: Eurostat, ECB

External balance

In 2007 imports of machinery-equipment accelerated in 2007 together with electrical machinery industry, capital goods, while exports continued to expand owing to productivity gains and on the back of still strong though somewhat weakening external demand.

While exports recorded a high growth rate in dollar terms, real exports grew at a lower pace than real imports in the second half of the year. The strengthening demand for imported goods, particularly automobiles and commercial vehicles and other capital goods, signal that the contribution of net foreign demand to growth will continue to be negative in the last quarter.

Over the last few years, the negative impact of a strong lira has been offset by productivity gains. Turkish exports have remained strong, but because imports have outpaced exports, the current account deficit has remained wide owing to recovering domestic demand and to the rise in global oil prices. A one US \$ rise in energy prices leads to a \$400m widening in Turkey's current account deficit.

In 2008 the growth of imports will remain strong, reflecting the high

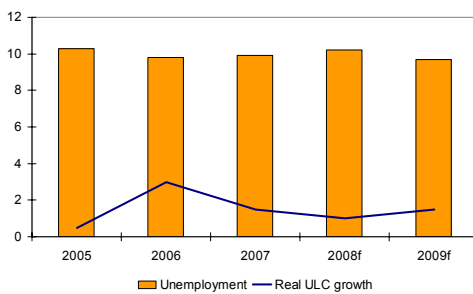
import content of exports, the relatively weak moderation of private consumption and investment growth, while exports will grow somewhat slower owing mainly to the negative real effects of external crisis.

In 2008-2009 exports will feel the negative effects of weaker external demand which may be partially offset by the weaker exchange rate and positive effect on tradables competitiveness due to low exchange rate pass-through. Altogether we expect that while the gap between the rates of growth of exports and imports will shrink, the trade balance will improve somewhat and this will also be followed by lower current account deficit both in 2008 and 2009.

The sharp rise in FDI inflows reflects high international investment confidence on Turkey's long term prospects, an improving business environment in Turkey and the benefits of the EU accession process. FDI inflows were US\$25bn in 2007 which covered about 80% of the current account deficit. The trend may continue in 2008 and 2009 as well.

Labour market

Unemployment and real ULC growth (%)



Note: * = forecast; Source: Eurostat

The unemployment and non-agricultural unemployment rates in 2007 remained unchanged compared to 2006 at 9.9% and 12.6%, respectively. The usual cyclical behaviour in unemployment has been observed in the last year with the summer months producing lower rates increasing in the second half of the year. As the economy is expected to slow down we may assume that the unemployment rate will exceed 10% in 2008 and will decline below the double-digit level in the next year.

The trend of declining agricultural and rising non-agricultural employment was somewhat reversed in the second half of 2007. In the previous report the ongoing structural changes in the relative contribution of agricultural and non-agricultural employment to total has been presented, but surprisingly the employment in non-agricultural sectors comprising industrial, construction and services decelerated in the second half of 2007. This may be due to the evolving effect of the external shocks on the real economy.

Altogether while around 350 000 new jobs were created in the non-agricultural sectors in 2007, the labour force participation rate has remained still very low at 47.8%.

Key macroeconomic indicators, 2006-2009

	2006	2007	2008f	2009f
Nominal GDP (TRL bn)	559.5	643.5	720.2	806.6
Real GDP growth (%)	6.1	5.0	4.2	5.0
Private consumption (%)	7.8	3.0	3.5	4.0
Public consumption (%)	11.2	4.0	3.0	3.0
Investments (GFCF, %)	11.3	6.0	6.5	6.5
Exports (%)	5.2	7.0	5.0	6.5
Imports (%)	6.4	6.0	5.5	6.0
Annual average inflation (%)	10.7	8.5	8.0	7.0
Discount rate (O/N borrowing rate, eop, %)	18.0	15.75	14.25	13.50
Money market rate (3-month Treasury Bill, %)	NA	NA	-	-
Long-term interest rate (10-year gov't bond, %)	NA	NA	-	-
Exchange rate (TRL / EUR, average)	1.80	1.78	2.00	1.80
Exchange rate (TRL / EUR, end of period)	1.89	1.74	1.90	1.75
General government balance / GDP (%)	-0.8	-1.5	-1.5	-1.0
Public debt / GDP (%)	60.5	55.0	52.0	50.0
Trade balance / GDP (goods and services, %)	-10.2	-9.5	-9.0	-8.0
Current account balance / GDP (%)	-7.7	-7.5	-6.5	-5.1
Gross foreign debt / GDP (%)	59.5	58.5	57.5	55.5
Unemployment (%)	9.8	9.9	10.2	9.7
Real ULC growth (%)	3.0	1.5	1.0	1.5

Note: f = forecast. See methodological notes for definitions and details.

Sources: IMF, Eurostat, CBTR

Special topic: Characteristics of Kosovo's Economy

The world's newest county?

Kosovo unilaterally declared its independence on the 17th of February, but its status continues to generate significant turmoil in international, regional and Serbian politics. However, as soon as the debate somewhat chills, Kosovo's ruined economy should gain more attention. With the help of international assistance, Kosovo's economy can be transformed into a healthy and functioning economy in the long run.

It is obvious that international politics remain divided on the issue of Kosovo's status. The declared independence has been recognised by most of the EU member states and the USA. On the other hand, among other states, Serbia and its strongest ally Russia consider the declaration as an illegal act, generating dangerous precedent. It is true, that taking into consideration the international law, Kosovo's status is left unclear, although since the UN's resolution from 1999 Kosovo is de facto independent from Serbia. All in all, after the 17th of February most of the European states will start treating Kosovo as the newest state in the region, and handle it as a country with so called "supervised independence".

The main characteristics of Kosovo' economy

In Kosovo the typical transition and post-war symptoms are still present, with its e.g. unrestructured or closed companies, outdated technology. The province has the lowest GDP level in the region, thus GDP per capita is only around EUR 1 150. Kosovo is still depending on international aid, although from 2006 the economy was able to grow in real terms, despite the decreasing amount of aid inflow. The real GDP growth rate is still below the region's average, but at least the times of stagnation seem to have passed. (See summary table for macroeconomic indicators.)

Generally speaking, Kosovo shows the macroeconomic problems that can be considered typical for South-Eastern Europe, namely the immense trade deficit and unemployment. As a consequence of the basic problems, unemployment is pervasive. Although data are unreliable, unemployment is estimated to range between 35 and 50%, without taking into consideration the grey economy, and youth unemployment is even higher.

As a result of the fact that production in Kosovo is still minor, trade balance performs very high deficit, and e.g. in 2006 exports covered only around 8% of the imports. Trade deficit is partly compensated by the diaspora's remittances and the already mentioned foreign aid. The large group of non-residents also supports the economy with their consumption. However, in the longer run these factors won't provide a stable ground for the economy.

Serbia will continue servicing the external debt, showing this way as well that it does not recognise Kosovo's independence. In the recent years, the inflation and fiscal policy shows the sign of stability. Kosovo uses euro as its currency. Step by step the financial sector, the regulatory and supervisory framework is being built out, and the Banking and Payments Authority of Kosovo (BPK) gradually shifted into a de facto central bank and has been transformed in September 2006 into the Central Banking Authority of Kosovo (CBAK), handling all the regular functions. CBAK recently regulates and supervises recently six banks, nine insurance companies and other financial institutions. The banking sector is growing and developing in many terms.

Among the main problems that enterprises and potential investors must face is the poor infrastructure and a problematic energy supply system. The educational system also needs to be improved, because there is a lack of skilled workforce. Corruption is widespread. Unfortunately landmines are still scattered over Kosovo, including the agricultural and industrial areas. A small and relatively poor market may also be a disadvantage, even if we can speak of creating free trade areas. Beside all these, the ethnic tension will most probably remain present.

Selected macroeconomic indicators of Kosovo (2004-2007)

	2004	2005	2006	2007
GDP (EUR mn)	2 271	2 207	2 273	2 378
GDP per capita (EUR)	1 156	1 105	1 118	1 150
Real GDP growth rate (%)	2.0	-1.0	3.1	3.5
Contribution of foreign assistance to GDP growth (%)	-8.3	-1.8	-1.0	-0.3
Workers' remittances (including pensions, EUR mn)	219	273	352	398
Inflation (CPI, %)	-1.4	-1.4	1.5	2.0
Primary balance of general government budget (% of GDP)	-6.1	-3.2	3.6	6.5
Net FDI (EUR mn)	20	59	222	NA
Exports (goods, EUR mn)	79	71	102	NA
Imports (goods, EUR mn)	1 023	1 093	1 261	NA
Current account (% of GDP)	-32.7	-34.8	-34.6	-38.2
Foreign assistance (% of GDP, excluding capital transfers)	14.8	16.6	14.6	14.2
Unemployment (LFS, %)	39.7	41.4	NA	NA

Source: CBAK, UNDP

Perspectives

It goes without saying, that fiscal and monetary stability is crucial to underpin the economic development. Another key issue is the sustainability of Kosovo's corporate sector, which can be supported by certain opportunities. The province inherited mines and factories from ex-Yugoslavia, but in many cases these are closed or inefficient, thus large financial investments are needed to help these companies to function again. Certain enterprises have already started to be privatised by the Kosovo Trust Agency (KTA), and the first success stories appeared. The enterprises range from mining, wineries, construction companies, glass production factories, warehouses, etc. Kosovo is trying to attract investors by business friendly environment, which is incorporated by one of the lowest tax rates in the region. VAT rate is 15%, but 0% for certain agricultural goods and personal income tax rate is between 0 and 20%.

Certain opportunities ought to be named. In case the infrastructure will be further developed, the province can function as a major crossroad in the region. Kosovo has very good attributes for the agricultural sector, which gave around one third of the GDP in 1995. The province has abundance of raw materials and natural resources. For example large amount of lignite reserves that can be exploited in surface mines, but Kosovo has zinc, lead, copper, nickel, etc. as well. Electric power, mining, metallurgy, construction materials, agriculture are named as priority fields.

- Eszter Vadas -