



# UNECE Weekly

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## Economic Survey of Europe 2005 No. 2

UNECE launched its Economic Survey of Europe 2005 No. 2 on 21 July 2005. This issue of the *Survey* provides an update of the macroeconomic situation and the short-term outlook in the UNECE region in summer 2005. In addition, the *Survey* contains a study on the issue of how to sustain growth in a resource-base economy using the specific case of Russia.

As regards the short-term economic outlook, the *Survey* notes that the robust global economic expansion will continue in 2005. The United States and China will continue to act as locomotives for the world economy. Modest growth prospects in

western Europe contrast, however, with the persistent economic dynamism of eastern Europe and the CIS.

The pattern of downside risks for the global economy has, however, changed for the worse in the last few months. These risks centre around the developments in the oil markets, the further widening in the global external imbalances, a sudden and sharp reversal of the increase in housing prices in a number of countries (notably the United States), and a stronger than anticipated rise in long-term interest rates from their current unusually low levels.

### Euro area: the lean years

In the euro area, real GDP is currently expected to increase by only 1.3 per cent in 2005. The rate of economic expansion has been very moderate since the second half of 2004, reflecting the combined effects of higher oil prices and the stronger euro.

The recent weakening of the euro has only partially offset the large appreciation against the dollar since early 2002 and, if not reversed, will have a positive effect on economic activity. The persistent sluggishness of aggregate domestic demand remains, however, the key problem of the euro area. The stance of monetary policy is already very loose and any further lowering of official interest rates, though desirable, would hardly provide much of a boost to economic growth. Finding an appropriate macroeconomic policy mix, with a supportive role to be played by fiscal policy, is now the major challenge.

### The economies of new EU Member States preserve their dynamism

The short-term outlook for the new EU Member States from central Europe and the Baltic region remains generally favourable. Both in 2005 and 2006 the rates of growth in most countries are likely

to remain significantly higher than those of the old EU Member States. In both years the average rates of GDP growth in the EU-10 as a whole will be above 4 per cent.

Restructuring and economic modernization (on the supply side) together with strong investor and consumer confidence (on the demand side) will remain the principal engines of growth in the short run. Macroeconomic policy in the new EU Member States is set to remain moderately supportive of economic growth, and will benefit from the recent changes in the rules of the EU's Stability and Growth Pact, which provide for increased policy flexibility. On the downside, the forecasts of GDP growth are subject to the risk of weakening external demand, especially in western Europe that absorbs the bulk of regional exports.

The re-appearance of high rates of inflation is unlikely in any of the EU-10 countries, but their rates are still generally higher than in the old EU Member States. Large fiscal deficits are another problem, especially in the central European economies. Regardless of the desired timing of their accession to the EMU, these issues will remain the focus of macroeconomic policy in the EU-10 in the short- to medium term.

## South-east Europe: the large current account deficits are in the focus of macroeconomic policy

With domestic demand outpacing aggregate output throughout south-east Europe, the external imbalances of many countries are escalating. These large current account deficits are risky for immature market economies that are susceptible to external shocks. Policymakers in south-east Europe have undertaken various measures to curb the growth of domestic demand in an effort to halt the further expansion of these deficits. However, the ongoing general tightening of macroeconomic policies may have adverse effects on the growth of domestic output in the short run.

Nevertheless, in most parts of south-east Europe, economic growth is expected to remain relatively strong, but at a slightly lower rate than in 2004. GDP in most of south-east Europe is expected to grow at rates between 4 and 6 per cent through 2006.

## Despite some slowdown, strong economic performance will prevail in the CIS

Economic growth in the CIS region is generally set to remain relatively strong through 2005 but its pace is slowing down in some economies. Commodity exporters (especially those specialized in hydrocarbons) continue to benefit from high world market prices and robust demand in some of their main markets. Current trends suggest a continuing rise in real disposable incomes, which are underpinning buoyant domestic demand. Macroeconomic policies are generally set to remain expansionary, providing further support to the growth of the output and real incomes. This, however, is also a source of downside risk, as the loosening of macroeconomic policy during the last few years is not sustainable and has already led to rising inflationary pressures in a number of countries.

In the Russian Federation, the largest CIS economy, the rate of GDP growth will remain in the range between 5 and 6 per cent both in 2005 and 2006. The economies of Belarus and Kazakhstan will continue to grow at even faster rates. In most of the other CIS economies the rates of GDP growth will be between 5 and 8 per cent. However, sustaining the high rates of economic growth in the medium and longer run will require an acceleration in the process of systemic and structural reform.

**Annual changes in real GDP in south-east Europe and the CIS, 2003-2006**  
(Percentage change over the previous year)

	2003	2004	2005 <sup>a</sup>	2006 <sup>a</sup>
<b>South-east Europe</b> .....	5.2	8.0	5.4	5.0
Albania .....	5.7	5.9	6.0	6.0*
Bosnia and Herzegovina .....	3.2	4.0	5.5	5.0*
Bulgaria .....	4.5	5.6	5.2	5.3
Croatia .....	4.3	3.8	3.0*	4.5
Romania .....	5.2	8.3	5.5	5.0
Serbia and Montenegro <sup>b</sup> .....	2.1	8.0	4.5	4.5
The former Yugoslav Republic of Macedonia .....	2.8	2.9	4.0	4.5
Turkey .....	5.8	8.9	5.6	5.0
<b>CIS</b> .....	7.6	8.1	6.2	5.9
Armenia .....	14.0	10.1	8.0	6.0*
Azerbaijan .....	11.2	10.2	14.0	15.0*
Belarus .....	7.0	11.0	9.0	7.5
Georgia .....	11.0	6.2	5.0	5.0*
Kazakhstan .....	9.3	9.4	8.0	8.0
Kyrgyzstan .....	7.0	7.1	4.0*	6.0*
Republic of Moldova <sup>c</sup> .....	6.6	7.3	6.0	6.0
Russian Federation .....	7.3	7.2	5.8	5.6
Tajikistan .....	10.2	10.6	8.3	8.0*
Turkmenistan <sup>d</sup> .....	3.3*	4.5*	5.0*	5.0*
Ukraine .....	9.6	12.1	6.0*	5.0*
Uzbekistan .....	4.4	7.7	5.5*	6.0*
<b>Total above</b> .....	6.9	7.9	6.0	5.7
<i>Memorandum items:</i>				
<b>South-east Europe without Turkey</b> .....	4.5	6.9	5.0	5.0
<b>CIS without Russian Federation</b> .....	8.4	10.1	7.1	6.6
<b>Caucasian CIS countries</b> .....	11.8	9.0	10.0	10.0
<b>Central Asian CIS countries</b> .....	7.1	8.3	6.8	7.0
<b>European CIS countries</b> .....	8.8	11.7	6.8	5.7
<b>Low-income CIS economies</b> .....	7.8	8.3	7.3	7.7

**Source:** National statistics, CIS Statistical Committee; reports by official forecasting agencies; UNECE secretariat estimates.

**Note:** The aggregation was performed using weights based on purchasing power parities. Aggregates shown are: south-east Europe (the 8 countries below that line); CIS (the 12 member countries of the Commonwealth of Independent States). Sub-aggregates are: Caucasian CIS countries: Armenia, Azerbaijan, Georgia; central Asian CIS countries: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan; three European CIS countries: Belarus, Republic of Moldova, Ukraine; low-income CIS economies: Armenia, Azerbaijan, Georgia, Republic of Moldova, Kyrgyzstan, Tajikistan and Uzbekistan. Unless otherwise noted, country forecasts shown are those reported by official forecasting agencies.

<sup>a</sup> Forecasts.

<sup>b</sup> Excluding Kosovo and Metohia.

<sup>c</sup> Excluding Transnistria.

<sup>d</sup> For details on the estimates of GDP growth in Turkmenistan see Box 5.2.1 in *Economic Survey of Europe, 2005, No. 1*, p. 76.

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