

19th Economic Forum
Krynica Zdrój, Poland
9-12 September 2009

Report on Transformation

Hard Landing

Central and Eastern Europe
Facing the Global Crisis





Welcome,

Much has already been written on the current economic crisis and the media are repeatedly announcing that it is either coming to an end, or the exact opposite, that it is worsening. Many forecasts have been developed for the global economy and Central and Eastern Europe, as well as analyses, trying to explain why some countries are better at dealing with the crisis while others are less successful. This publication is an attempt to summarise the knowledge of the current economic situation in our region. In our report we have focused on the facts – the most recent economic indicators available relevant to assessing the health of economies in the region, the internal and external risks to their development as well as the measures taken

by governments and central banks to minimise the effects of the global economic slowdown.

We are therefore presenting an economic picture of Central and Eastern Europe as the region grapples with the effect of the global crisis. The economies of the region share many similarities, and most of all, they are facing similar challenges, and are strongly interdependent. Often, today's risks are tomorrow's opportunities. If we take proper advantage of these opportunities, the region will soon return to a path of strong economic growth.

We encourage you to familiarize yourself with this publication.



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Sources of data used in the report:

PricewaterhouseCoopers, www.pwc.com

CIA World Factbook, www.cia.gov

European Bank of Reconstruction and Development (EBRD), www.ebrd.com

International Monetary Fund (IMF), www.imf.org

The World Bank, www.worldbank.org, www.doingbusiness.org

Transparency International, www.transparency.org

Standard & Poor's, www.standardandpoors.com

Statistical offices and central banks of Central & Eastern European countries

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Executive Summary

The global crisis reached the countries of Central and Eastern Europe relatively quickly causing GDP decline and general recession. There is no doubt that after a period of flying high, the landing was exceptionally hard.



The global crisis impacted CEE countries in four different ways.

1. Firstly, exports to Western European countries collapsed.
2. Secondly, a serious reduction in the flow of direct investment became a global problem particularly affecting those countries in the region that in recent years had been accustomed to a large scale FDI influx.
3. Thirdly, a lack of trust in the global financial markets caused a drastic reduction in access to private capital.
4. Eventually, all these factors contributed to the crisis of CEE countries' economies, currency depreciation, unemployment growth, problems in the financial sector and the deterioration of the budget situation affecting both companies and consumers.

The situation varies across the region. In almost all cases GDP is expected to decrease in 2009 but the exact levels will range from a significant drop in the Baltic states and Ukraine to approximately zero growth in Poland. The gravity of the problem is the least serious in Central European countries, slightly larger in the Balkan states, serious in Eastern Europe and dramatic in the Baltic states. The main threats to the economic situation facing CEE countries can be divided into three categories. In terms of external financing, CEE countries (with exception of Hungary where the situation is more difficult) and Russia face relatively insignificant problems, whilst the Balkan and Baltic states, Ukraine, and Belarus have encountered serious challenges. In terms of domestic financial imbalance, again the CEE countries and Russia have been least threatened. Finally, the level of dependence on the performance of foreign economies brings additional risk to Central European countries (with exception of Poland).

Our overall analysis of the threats that CEE countries are currently facing shows that the Ukrainian economy has been affected the most. Major issues requiring serious attention have also been encountered in Romania, Belarus, Lithuania, Serbia and Latvia. The situation in Hungary, Croatia, Estonia and Bulgaria is more favourable but still demanding caution. In comparison, Poland, the Czech Republic, Russia, Slovakia and Slovenia are relatively strong.

Hopefully the severe recession in the CEE region is only temporary. However, surviving the hard times requires dexterity and bravery in shaping the economic policy. Regaining long-term dynamic economic growth will not be realistic without the implementation of a number of difficult reforms that are critical to boost the investment attractiveness and enhance the competitive strengths of the countries in the region.

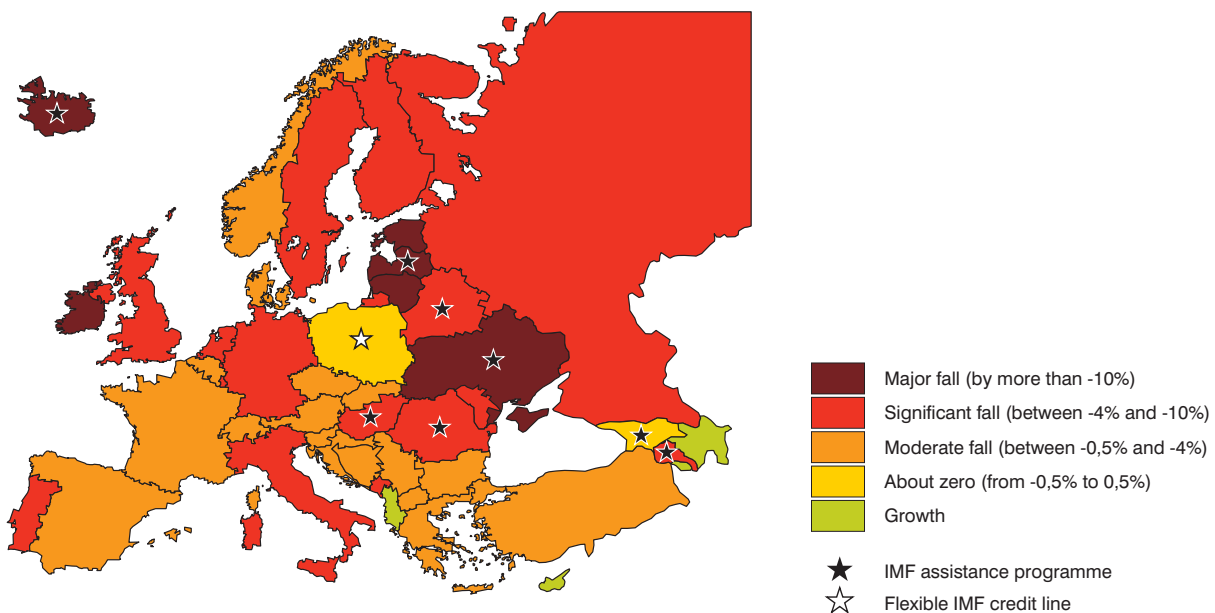
Hard landing

Two years ago there were no signs of the threats facing the region that we see today. After a long and painful process of economic transformation, which started in the early 1990s, the majority of countries in the region now have fully operational market economies. The market became liberalised and open to global competition whereas state-owned companies were privatised. Economic policy became stable and reasonable. The basic institutions of the capital market were founded; the banking sector went through a process of thorough transformation, adjusting to the requirements of a contemporary economy. Labour efficiency and international competitiveness grew, exports increased radically and investments started to flow widely into the region. Additional countries joined the European Union. Obviously progress

was not sufficiently fast everywhere. Some countries still lag behind and thorough reforms should still be implemented in many areas. However, the rapid pace of development recorded in years 2005-2008 suggested that the most difficult times were already behind the CEE countries. These assessments have changed significantly over the past year. It resulted from the fact that the global crisis reached CEE countries relatively fast, bringing the GDP growth of the last few years to a halt and causing a general recession. The real source of the current problems was the financial slump and a deep recession in the US and other major world economies. At the same time there was a sudden increase in risk aversion among global investors, which caused a significant retreat in investment in emerging markets, including, but not limited to, the CEE

region. The region, which previously had the reputation of being “the safe place” for investments came to be defined as the “subprime of global finance” and analysts started to outdo each other in offering pessimistic assessments. So not only the short term growth, but also the foundations of CEE countries’ financial stability were called into question. Official data confirmed this anxiety. The current situation in the region was assessed as more serious than in Western Europe. The average fall in GDP is expected to be even larger in 2009. Some countries approaching the brink of bankruptcy were saved from financial disaster only thanks to the International Monetary Fund’s (IMF) help supported by the World Bank and the European Union. There is no doubt that the period of flying high ended with an exceptionally hard landing.

Scale of the Shock: forecast of cumulated GDP fall, 2009-2010



Source: IMF, EBRD

Prospects for economic growth

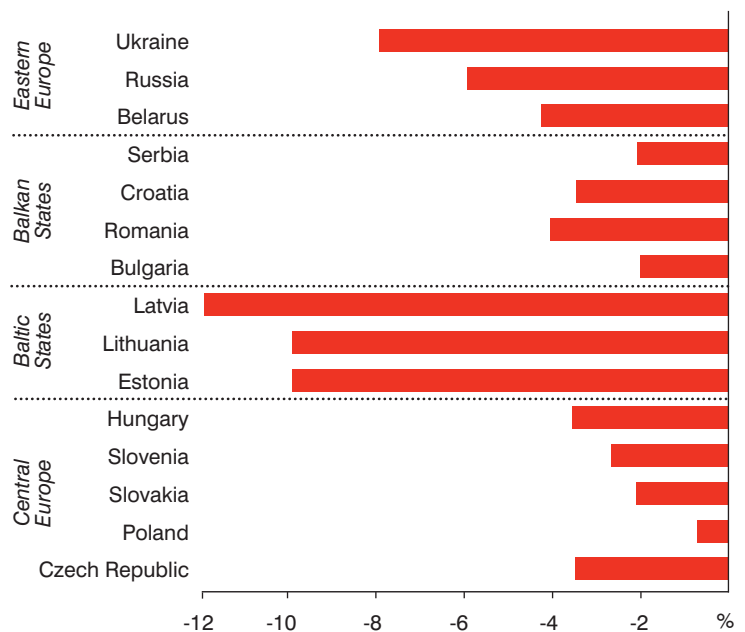
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3. Thirdly, a lack of trust towards the global financial markets caused a drastic reduction in access to private capital.
4. Eventually, all these factors contributed to the crisis of CEE countries' economies, currency depreciation, unemployment growth, problems in the financial sector and the deterioration of the budget situation affecting both companies and consumers.

The situation seems to vary across the region. A decrease in GDP is expected almost everywhere in 2009, but its forecasted scale will vary from a disastrous drop in the Baltic states and Ukraine, to almost zero growth in Poland. The scale of the problem is smallest in the Central European countries where a GDP growth forecast by the IMF is -2.5% (the smallest fall in Poland, the largest in Hungary and the Czech Republic). The situation in the Baltic states, where the IMF expects a fall of -3.0%, is slightly worse.

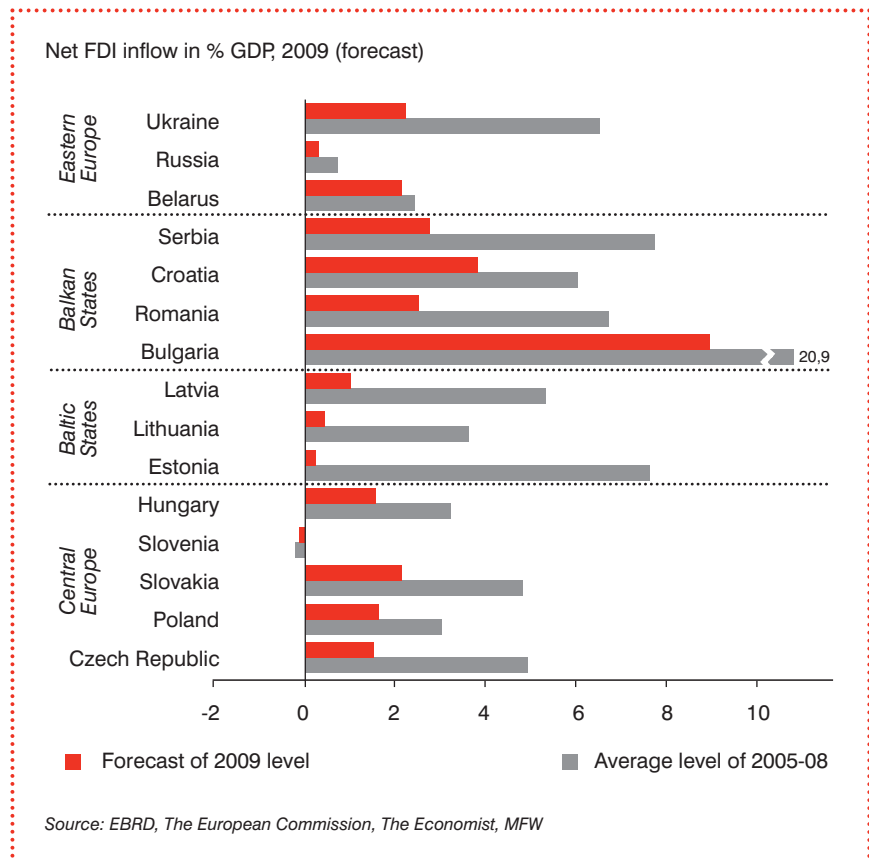
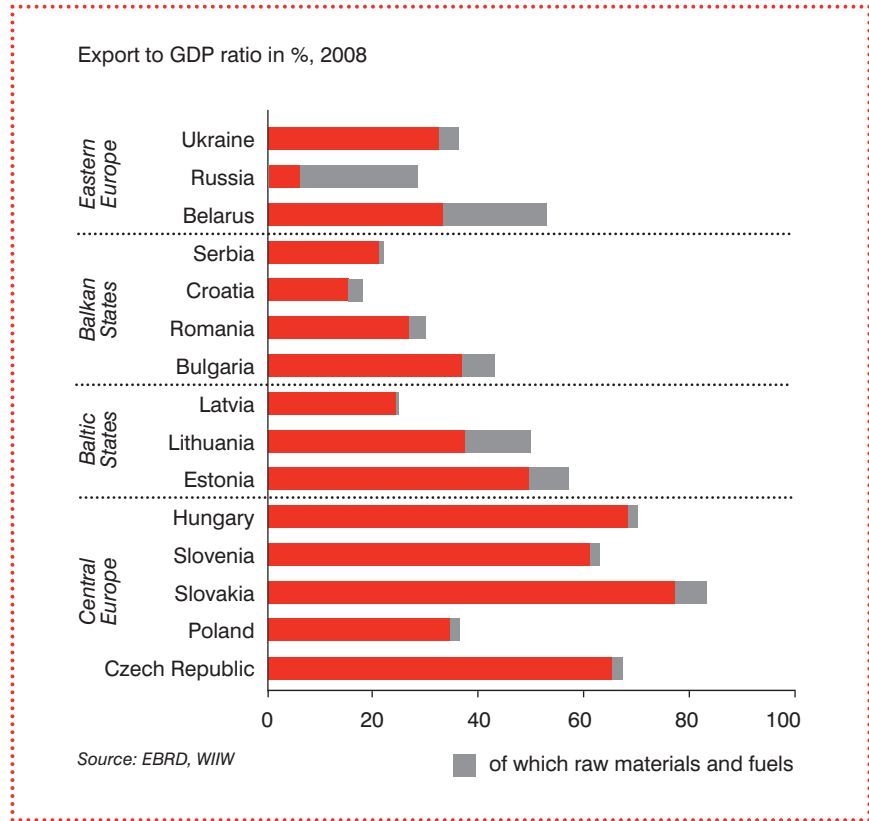
In Eastern Europe forecasts show an average GDP fall of -6.1%. The situation in Russia, which experienced a deep recession due to falling oil prices, is quite different – although it may improve relatively quickly. The situation is also different in Ukraine with the economy on the brink of collapse and Belarus where difficulties similar to those of Ukraine may yet occur on a larger scale. The countries most affected by the crisis are the Baltic states where – after a few years of tiger-like growth – a dramatic reduction in GDP, averaging -10.7%, has taken place

Forecast for GDP change in %, 2009

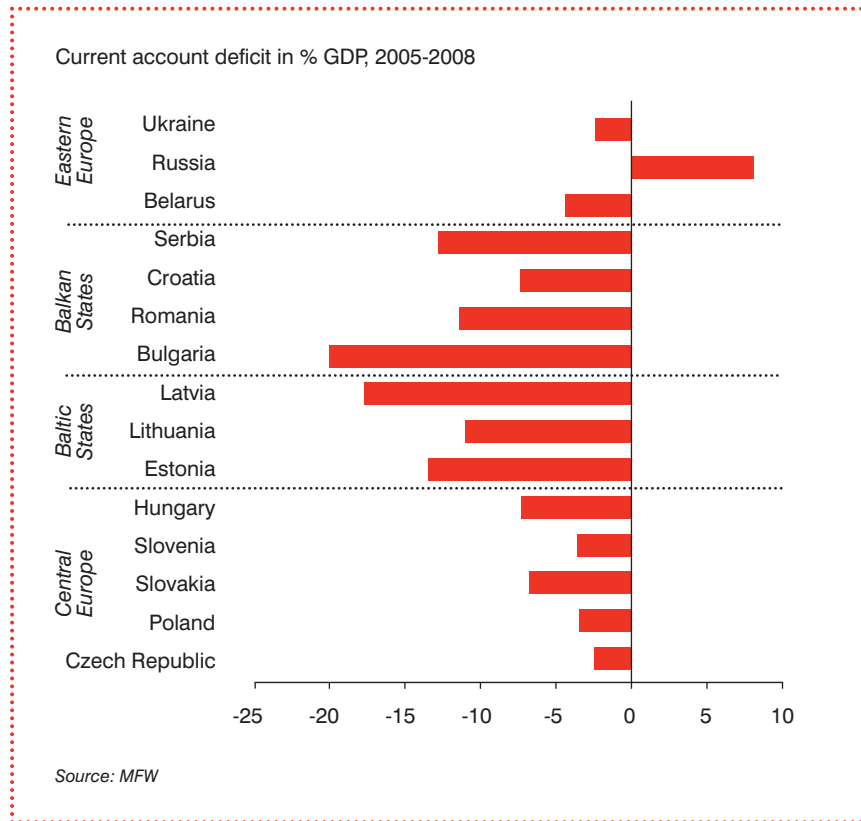


Source: MFW

External risk factors



Access to finance



The third factor affecting the economic situation of CEE countries is the sudden limitation of emerging economies' access to the global financial markets, i.e. to private financing of the balance of payments deficit. The scale of the threat obviously depends on the volume of demand for external capital. The largest one,

measured by the ratio of the current trade deficit to GDP, occurred in recent years in the Baltic and Balkan states. The effect was slightly less visible in Central Europe, Ukraine and Belarus. Russia was the only country in the region to record a large current trade surplus connected with very large revenues from oil and gas exports.

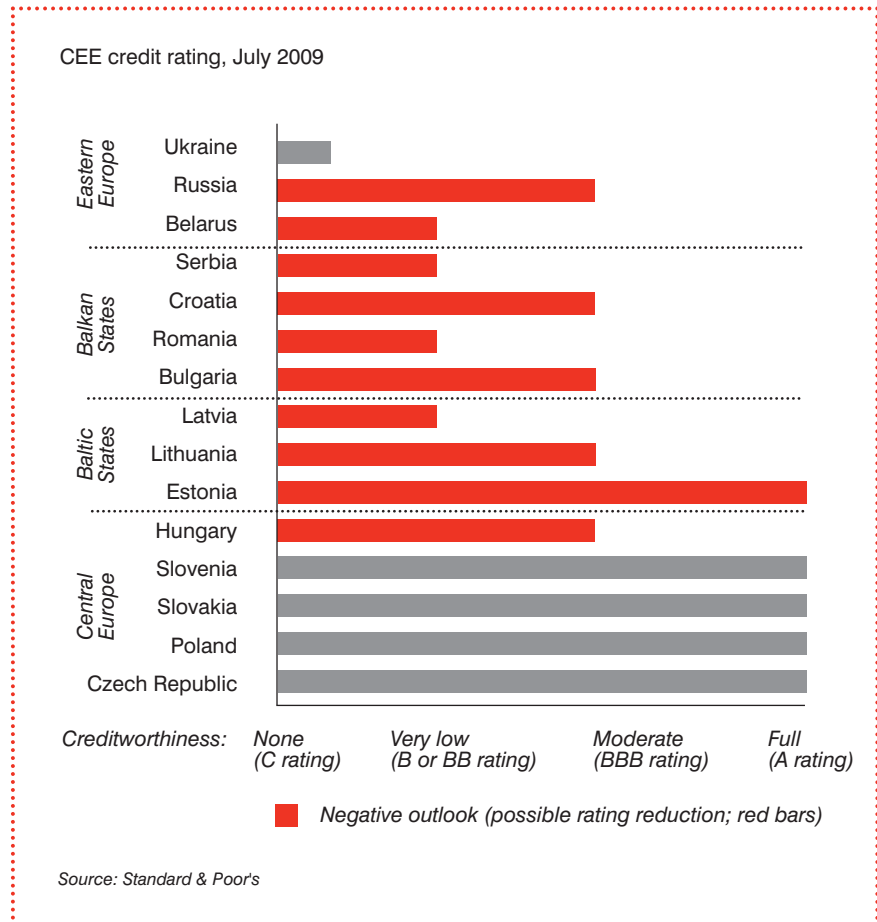
For the majority of countries in the region the recession recorded in 2009 caused a rapid drop in the current trade deficit. However, this happened at the expense of lower domestic demand which consequently deepened the crisis.



The unexpected limiting of access to the global capital markets for developing countries was a serious threat to some CEE economies.

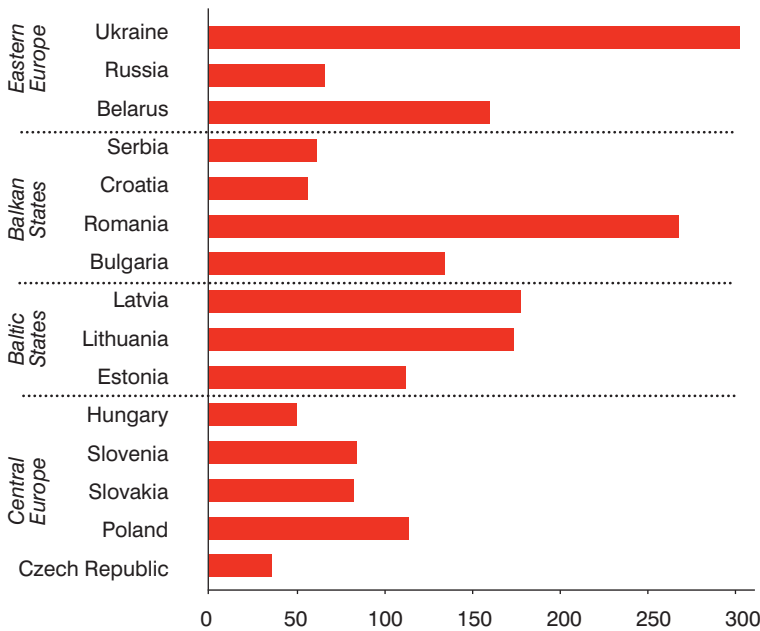
The unexpected limiting of access to the global capital markets for developing countries was a serious threat to some CEE economies. Unable to find the necessary private financing, as many as six countries in the region were forced to request IMF assistance, and had to implement harsh cost-saving programmes as agreed with the Fund (Hungary, Ukraine, Belarus, Latvia, Romania and Serbia). Additionally, Poland decided to request access to an IMF flexible credit line (credit without conditions concerning changes in economic policy).

Although the problem of restricted access to the capital market is common to all countries in the region, their situations differ significantly. Estonia and Central European countries, except Hungary, enjoy the full trust of the market, as confirmed by high credit ratings. It means that they will probably not have any serious issues with financing their capital needs in the market. The credit rating of other countries is limited or low, which means difficulties in finding capital and a very high cost to obtain it. In the case of Ukraine, it currently lacks any financial reliability, Belarus faces a similar situation.



Risk of internal instability

Real growth of domestic credit in %, 2005-08

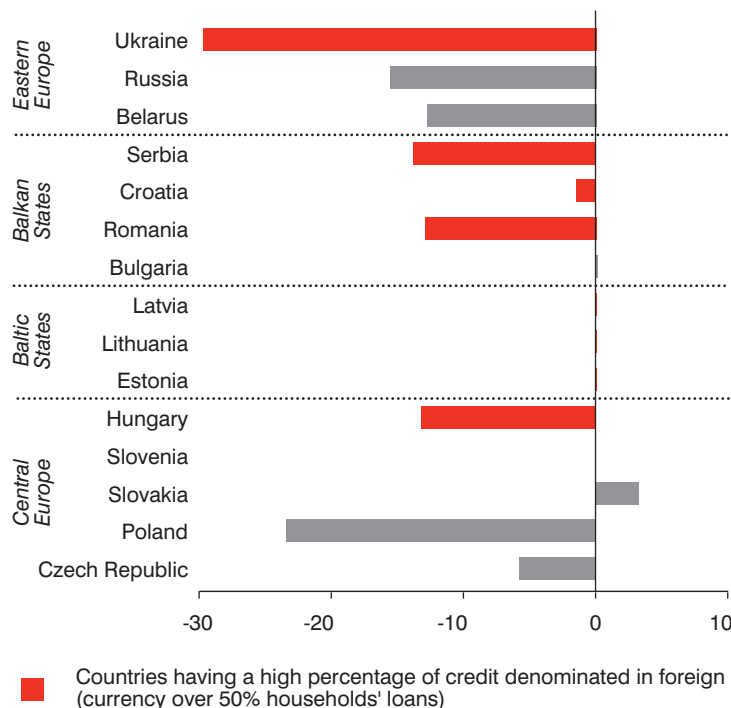


Source: EBRD

The CEE countries also differ in terms of the risk of a serious financial and banking crisis. A good measure of this risk is the scale of growth in domestic credit, which took place in the years before the crisis. Excessively fast growth of domestic credit was possible at the expense of a deterioration in the quality of the banking assets portfolio, which in the case of a recession may soon lead to dangerously high growth in non-performing debts. From this point of view, Ukraine and Romania are in the worst situation, and high risks also exist in the Balkan states and Belarus. A relatively high growth in household debt also occurred in Poland, particularly in 2008.

The threat to banking sector stability depends not only on the scale of excessive credit activity in the pre-crisis period, but on the exposure to the exchange rate risk as well. The difference in the interest rates of loans granted in foreign or domestic currency (characteristic of countries having relatively high inflation and a real strengthening of the exchange rate) led in many countries to a significant part of private and corporate debt to banks being denominated in foreign currencies. In the case of a strong depreciation of the currency, this could lead to a sudden growth of non-performing debts and to losses in the banking sector. This danger mostly affects the Baltic states, the Balkan states (except Bulgaria), Hungary, and Ukraine. In reality a significant depreciation of the currency only occurred in Ukraine, dramatically damaging the banking sector, and also in Poland where it did not have large repercussions due to the limited scale of debt in foreign currencies. The possible departing from a fixed exchange rate policy would put the banking sector in the Baltic states in a particularly difficult situation and a further weakening of currency would be dangerous to Hungary, Serbia, Romania and Croatia.

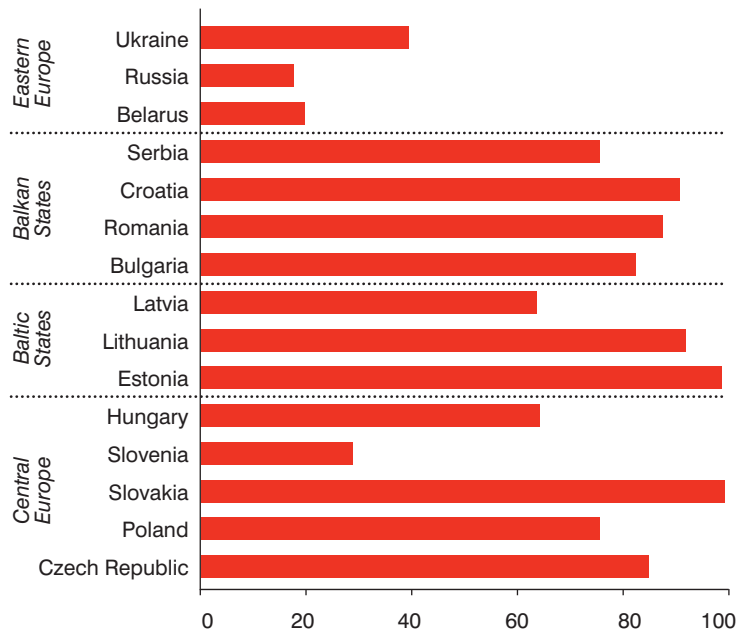
Change of exchange rate against EUR in %, Q2 2009/Q2 2008



Source: MFW

It should be noted that in the majority of CEE countries one may blame the policy of large foreign banking groups at least for some of the current financial trouble. These groups, particularly from Western Europe, control the majority of assets in the region's banking sector. The policy conducted by these groups over last few years was not adequately controlled by domestic financial supervisory institutions. The large share of foreign owners in the total assets of the banking sector, observed in the region (except Eastern Europe and Slovenia), also created a higher risk of domestic banks becoming contaminated with the problems affecting their parent banks in Western Europe and the USA. The problems of the Eastern Europe banks may arise from insufficient supervision and structural weaknesses caused by their links with large companies of the non-financial sector.

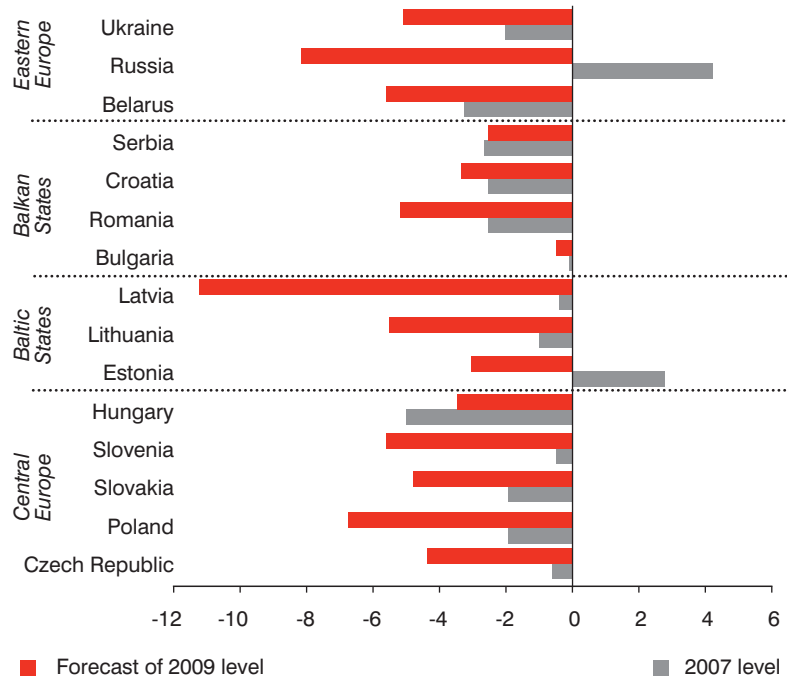
Foreign banks' share of assets in the banking sector, 2007



Source: EBRD

Another threat to the domestic economic balance of CEE countries is the condition of their public finance. In almost all countries one should expect strong deterioration in public finance, which, particularly in the case of Latvia and Russia, may lead to dangerously high deficits. The situation in the majority of countries is mitigated by a relatively low public debt to GDP ratio. It is high only in Hungary (over 70% of GDP), which does, however, implement the adjustment programme agreed with the IMF. In Poland, the level of public debt, although still moderate (at about 50% GDP), may soon become a problem.

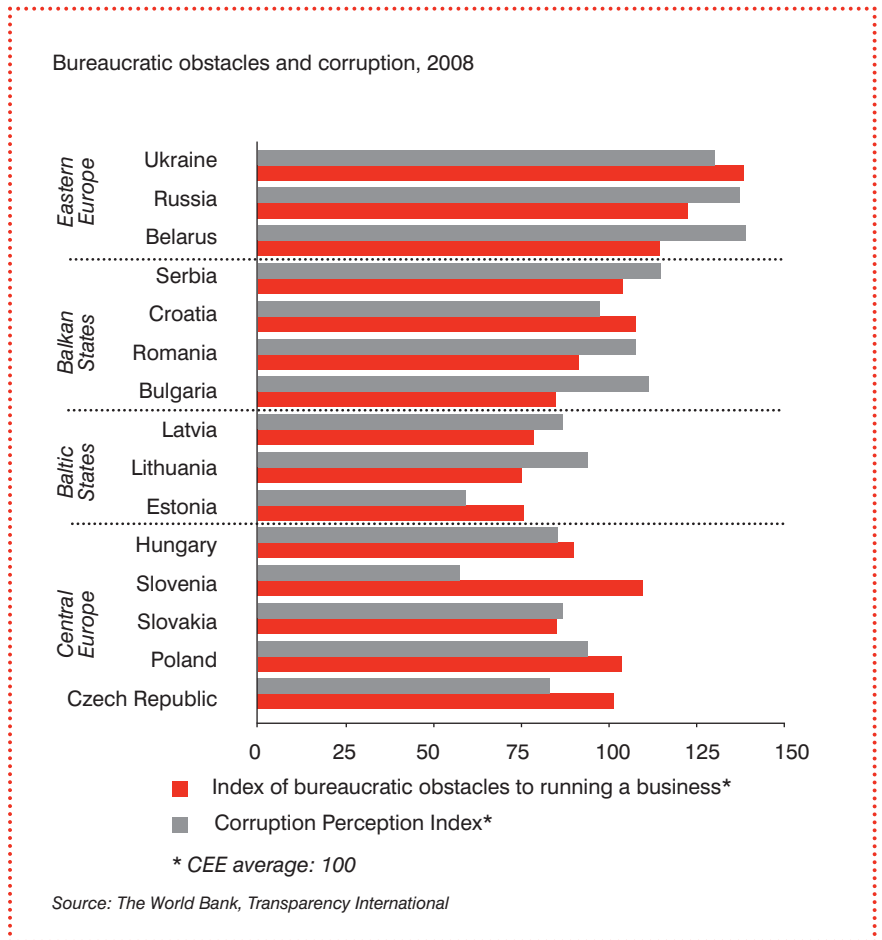
Public sector deficit in % GDP



Source: EBRD, The European Commission, The Economist, MFW

Policies for stimulating economies

The risk of internal financial instability and, to an even larger degree, the threat to financing the capital needs of CEE countries, significantly limit the possibility of actively counteracting the recession by stimulating the economy with macroeconomic policy tools.



As a result, only Russia decided to apply a significant fiscal stimulus package of increased expenditure and limited taxes, jointly amounting to 14 % of GDP. This was done at the expense of the high budget deficit and using a significant amount of currency reserves accumulated during times of high oil prices. In other countries, priorities remain as follows: avoidance of excessive depreciation

of currencies and prevention of significant deterioration in public finance. Alternative non-fiscal methods to stimulate economies by improving the business environment is rarely seen across the region. The room for improvement in this area is particularly big in the Balkan states and in Eastern Europe as well as the Central European countries.

Summary of threats

The main threats to the economic situation in CEE countries may be divided into three areas:

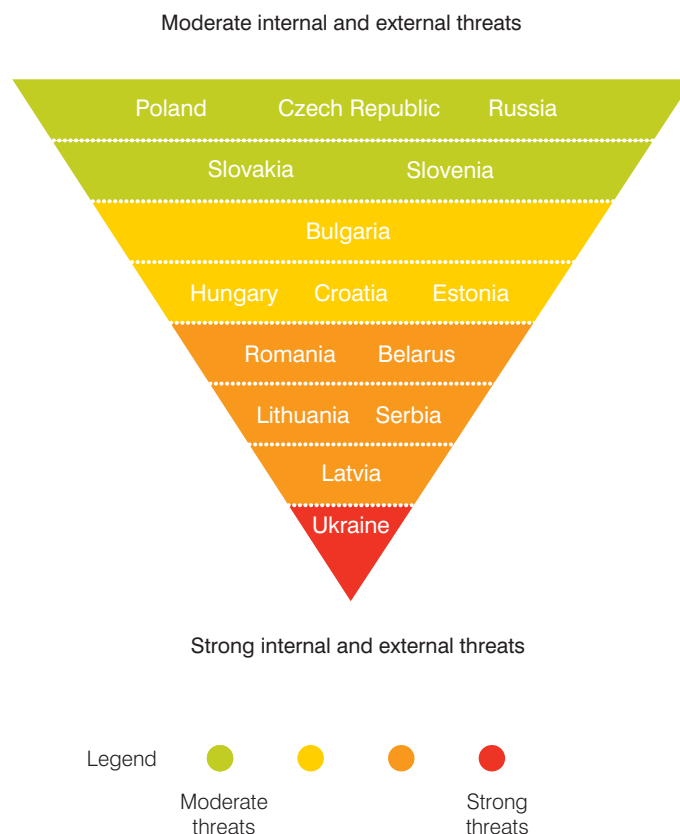
1. Potential difficulties in external financing – the situation is relatively comfortable in Central European countries (only Hungary’s position is more concerning) and Russia, while serious problems threaten the Balkan and Baltic states, Ukraine, and Belarus.
2. Threat of serious internal imbalance (financial crisis) – again, the least threatened are Central European countries and Russia.
3. Dependence on the foreign economic situation – position of all countries in the region looks dangerous, with the worst affected being Central European countries which are strongly integrated with the western part of the European Union (with the exception of Poland).

Summary of threats

	Difficulties in external financing	Threat of internal imbalance	Dependence on foreign economic situation
Czech Republic	●	●	●
Poland	●	●	●
Slovakia	●	●	●
Slovenia	●	●	●
Hungary	●	●	●
Estonia	●	●	●
Lithuania	●	●	●
Latvia	●	●	●
Bulgaria	●	●	●
Romania	●	●	●
Croatia	●	●	●
Serbia	●	●	●
Belarus	●	●	●
Russia	●	●	●
Ukraine	●	●	●

An examination of all the threats that CEE countries have to cope with during the global crisis suggests that currently the most difficult situation is that of Ukraine. Very serious threats, requiring particular deliberation and caution in the economic policy, are faced by Romania, Belarus, Lithuania, Serbia, and Latvia. A slightly easier albeit dangerous situation confronts Hungary, Croatia, Estonia, and Bulgaria. Compared to the above, the problems concerning Poland, the Czech Republic, and Russia as well as Slovakia and Slovenia seem less dangerous.

A deep recession in the CEE region will only be temporary, and following the global crisis, a tendency toward rapid growth will return. Such hope is based on the long-term development assets of the region’s countries. But surviving these difficult times will require dexterity and bravery in economic policy while a return to the rapid long-term economic growth will not be possible without a number of important and difficult reforms that will boost the investment attractiveness and competitive strength of the countries in the region.



Czech Republic

Basic information

	Czech Republic	CEE Region	Region=100
Population, in millions (2008)	10.3	324	3.2
GDP, in billions USD (2008)	217	4 394	4.9
GDP per capita, USD '000 (2008)*	25.4	14.9	170
Exports, % GDP (2008)	67	45	149
Average GDP growth, 2005-2008	5.6	6.0	x
2009 Growth Forecast	-3.5	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

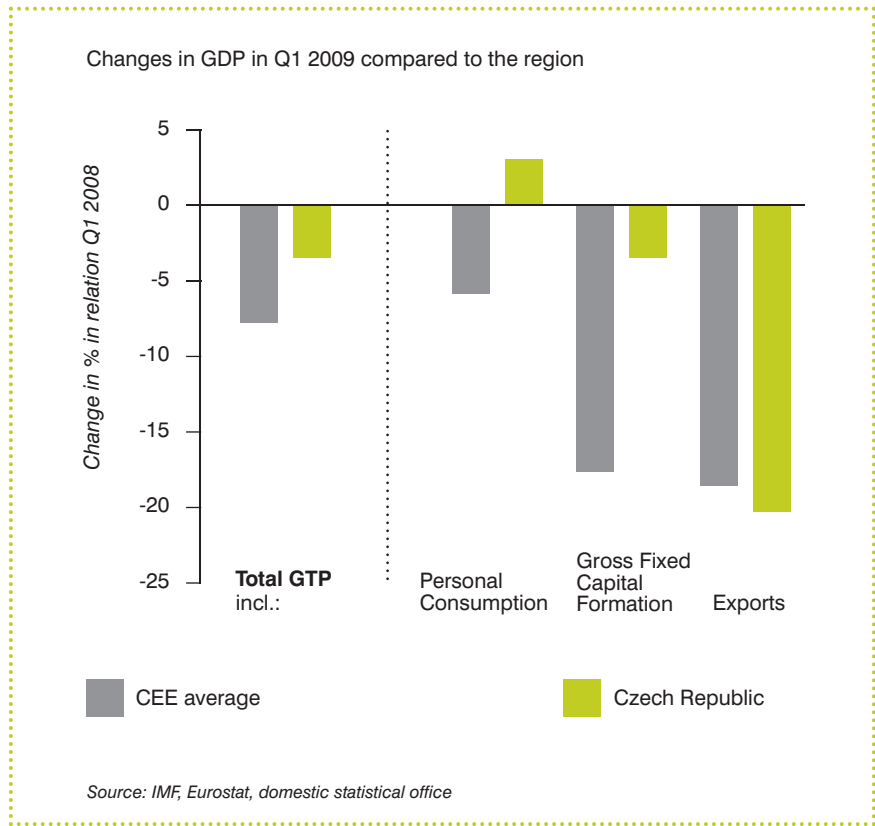
- High productivity and industrial competitiveness
- High investment attractiveness and financial reliability
- Low government debt and low private debt
- No threats to macroeconomic stability
- European Union membership

Weaknesses:

- Strong dependence on exports to Western Europe
- Limited domestic market
- High taxation burdens

General assessment of the economic situation

The Czech economy is currently experiencing a period of severe difficulties and stunted growth resulting mostly from a huge slump in export sales.



According to published data, in the first quarter of 2009 exports declined by -20%, while total domestic demand was maintained at a similar level as last year (the fall in investment is compensated for by growing consumption). This has led to a drop in GDP of -3.4%. The Czech Republic is one of the most export-dependent countries in the region.

Its economy is one of those most closely integrated with the western part of the EU. In such a situation, even the relatively favourable development of its macroeconomic foundations and a highly balanced economy have been unable to prevent a temporary slump in growth. In subsequent quarters a further fall in GDP should be expected.

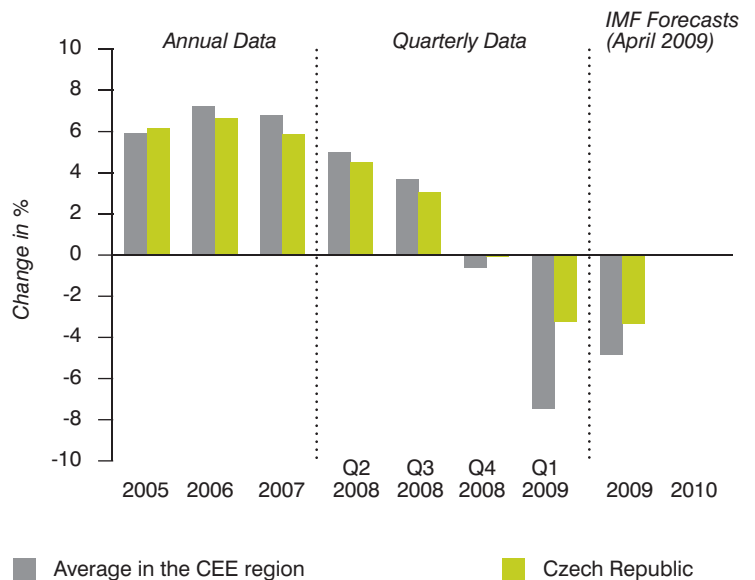


Prospects for economic growth

After a few years of balanced growth based on increasing exports and improved productivity, Czech GDP has lost its dynamism during the last few quarters and started to fall (by -3.4% in the first quarter of 2009). According to current forecasts, a probable drop in GDP in 2009 is estimated at between -3% and -4%. Possible GDP stabilisation is expected only in mid-2010.

The Czech Republic's situation is improved by strong macroeconomic foundations and a robust financial sector. Bearing in mind the very strong dependence on export markets and a relatively small domestic market, it is hard to expect GDP growth until the situation in Western Europe, especially Germany, starts to improve (export to Germany accounts for one third of all Czech exports, and corresponds to almost a quarter of the country's GDP).

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office

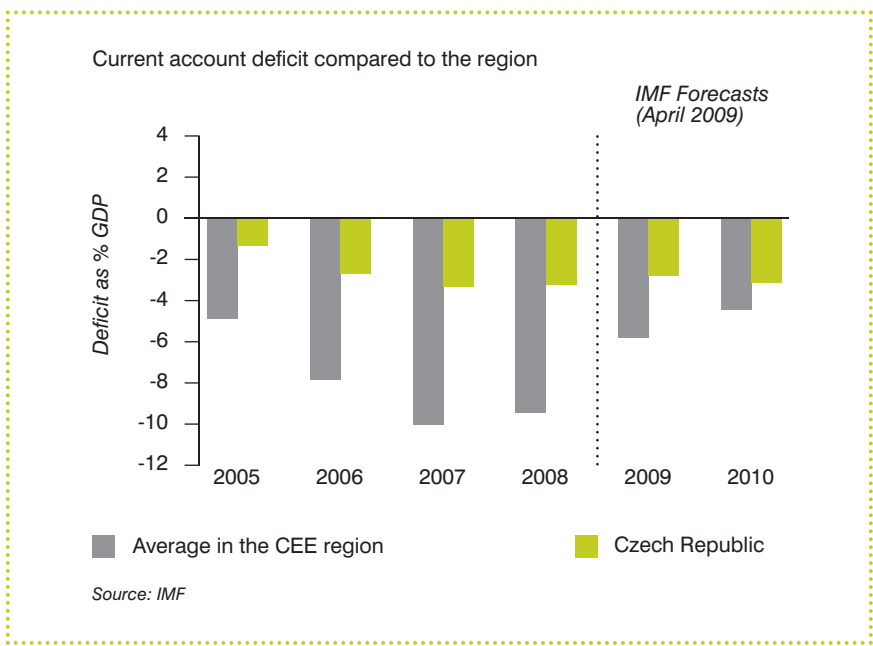


Risk of financial problems: external imbalance

As opposed to most CEE countries, the Czech economy is characterised by a relatively high savings rate. Thanks to this, in order to finance its investment needs the Czech Republic has had to resort to borrowing foreign capital to a lesser degree than other countries. In the pre-crisis years, the current account deficit fluctuated at around -3% of GDP, which was completely safe.

At the same time, the country has received significant foreign direct investments (FDI) – reaching on average almost 5% of GDP p.a. Even in the case of FDI decreasing to zero in 2009, as forecast by the EBRD, the Czech Republic should not have any difficulties in financing its loan needs – the country’s debt is moderate, its financial situation stable, and credit ratings high (A- rating with a stable

outlook, according to Standard & Poor’s classification). This means that there is no risk of external instability.

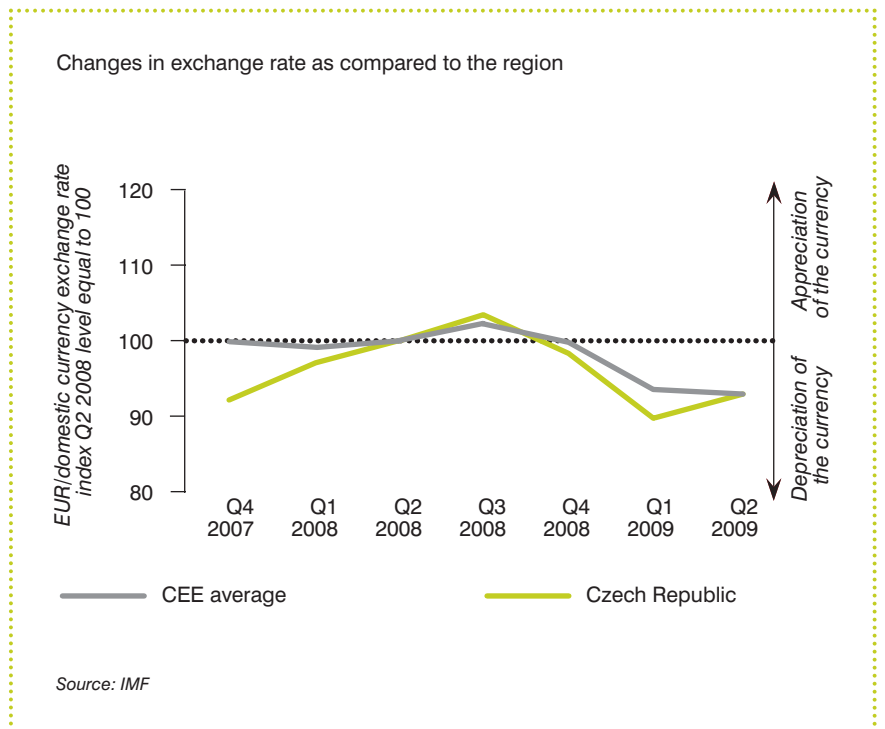


Risk of financial problems: internal instability

The Czech economy in pre-crisis years was characterised by a high level of stability.

Inflation fluctuated around 3-4% with interest rates at a low level and the stable currency. The real value of domestic credit grew by 36% between 2005 and 2008 (the lowest growth ratio in the CEE region; the average real growth of the domestic credit in the region was 126%). The percentage of loans denominated in foreign currencies was low (below 5% for all household loans). The public sector deficit was maintained at a moderate level (about -1% of GDP in 2007-2008), as public debt was (below 30% of GDP). The Czech crown showed a tendency to strengthen, although the decision on a schedule for introduction of the Euro was not taken.

Strong macroeconomic foundations caused the currency to respond to the crisis by showing only a moderate weakening. The banking sector remains strong; however, under the conditions of a global crisis, the high participation of foreign-owned banks in the market (85% of the banking sector's assets) may pose a certain threat. According to the European Commission's assessments, the public sector's deficit may rise in the years 2009-2010 to -5% of GDP, and public debt may rise to 38% of GDP. Generally speaking, the Czech economy is not threatened by any risk of serious internal instability.



Changes regarding taxation and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 19%, PIT 15%, CIT 20%**

Total income in the public sector (2008): **40% of GDP**

Effective rate of total taxation on profits (2008): **49%**
(CEE average: 46%)

Average time devoted by companies to paying taxes (2008):
930 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **90**
(global average: 100; CEE average: 86)

Corruption perception index (2008): **5.2**
(10=no corruption; CEE average: 3.9)

The Czech Republic provides companies with relatively difficult conditions for running a business, with numerous bureaucratic barriers and high tax burdens.

In response to the worsening economic climate, the Czech Republic has introduced relatively small changes to the tax system. VAT rates have remained unchanged; however, certain incentives for businesses have been introduced (including the possibility of a VAT deduction when purchasing cars for business purposes). Personal income tax (PIT) has not changed. The corporate income tax (CIT) rate has been reduced from 21% to 20% as part of a process to reduce it over several years (in 2010, the rate should be reduced to 19%).

More favourable solutions in terms of depreciation were introduced as well; any costs of employee training and resettlement were included, advance income tax payments from small businesses were temporarily suspended, and health insurance contributions were reduced. Companies that experience difficulties may also benefit from a reduction in social insurance contributions. No significant measures have been made in order to facilitate running a business and to reduce bureaucratic barriers.

Poland

Basic information

	Poland	CEE Region	Region=100
Population, in millions (2008)	38.1	324	11.8
GDP, in billions USD (2008)	526	4,394	12.0
GDP per capita, in USD '000 (2008)*	17.5	14.9	117
Export, % GDP (2008)	36	45	81
Average GDP growth, 2005-08	5.3	6.0	x
2009 Growth Forecast	-0.7	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

- Investment attractiveness
- Large domestic market
- Moderate government and private debt
- Moderate threats to macroeconomic stability
- European Union membership

Weaknesses:

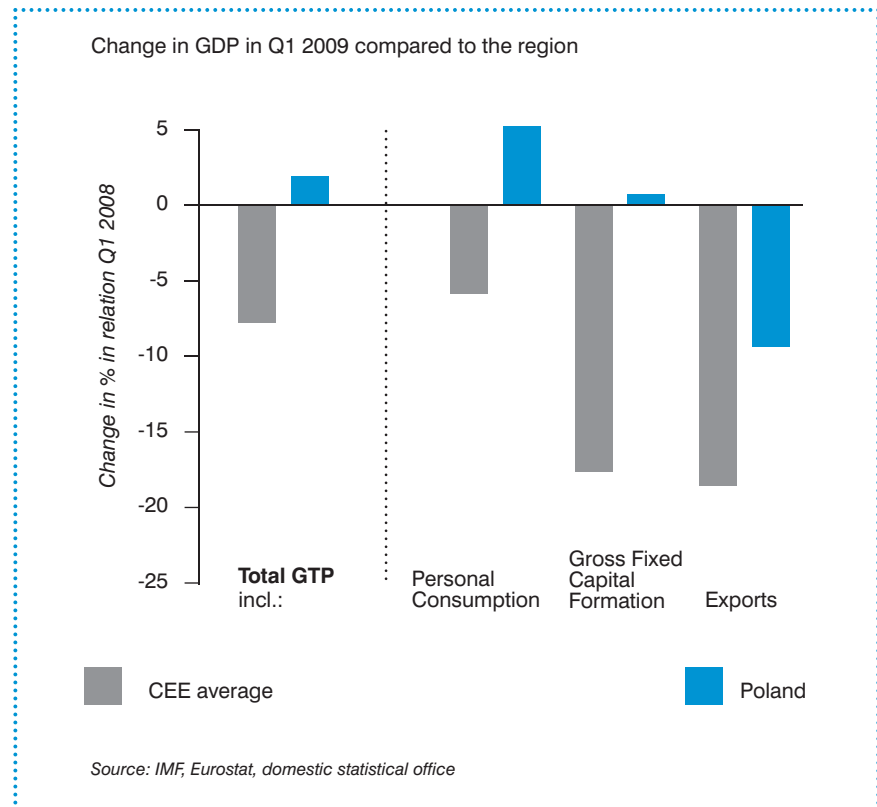
- Difficult conditions for running business
- High tax burden
- Risk of public finance imbalance

General assessment of the economic situation

In spite of the crisis, the Polish economy demonstrates one of the best economic results in the region.

The fall in exports is lower than in the majority of CEE countries (in the first quarter of 2009 exports fell by only -9%). At the same time, domestic demand is still growing, although at a much slower pace than previously. Increasing consumption is accompanied by a stagnation in investments and the serious fall of inventories.

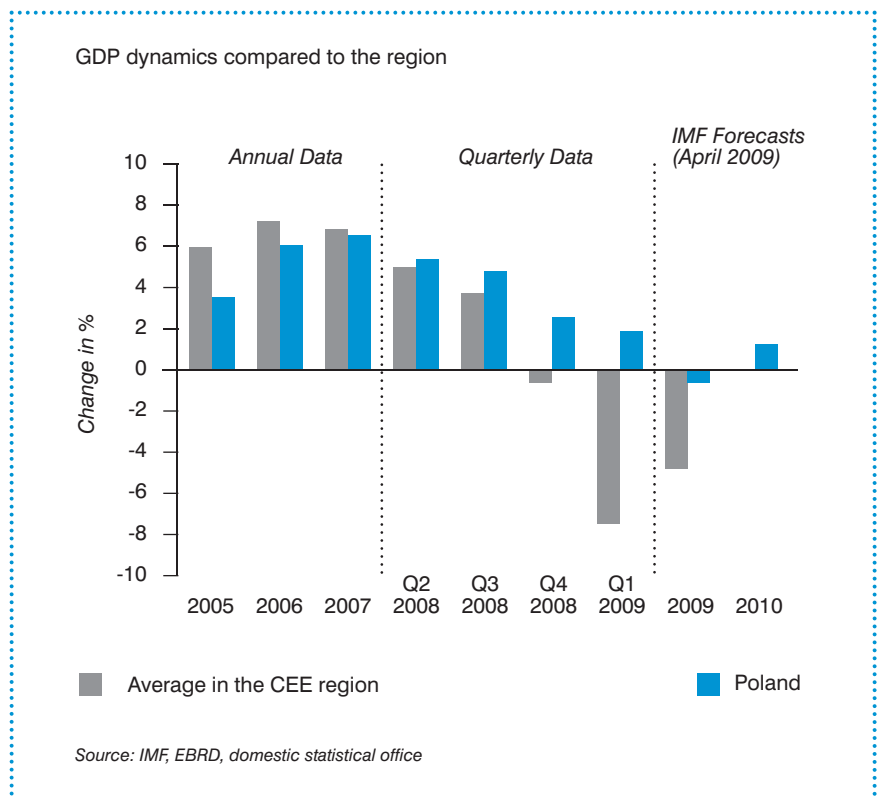
The extent to which the Polish economy is dependent on exports is much smaller than the regional average (particularly among central European countries). At the same time, Poland and Russia are the only countries in the CEE region with large internal markets. Despite certain threats to the macroeconomic stability that appeared in the first months of 2009, the current situation looks relatively safe.





Prospects for economic growth

Prior to the current crisis, Poland had recorded several years of rapid and relatively balanced growth, similar to other countries in the CEE region. The main factors driving the economy were: the inflow of foreign direct investments (FDIs) and the high dynamics of domestic investments leading to a rapid growth in work efficiency and exports. Starting from the second half of 2008, growth in Polish GDP gradually diminished. However, in the first quarter of 2009, GDP continued to grow at 1.9% (according to Eurostat). According to current forecasts, 2009 GDP change is estimated at a low negative level (between 0% and -2%) while a faster growth is expected in the first half of 2010. However, it should be noted that a prolonged recession or economic stagnation in the Western Europe may lengthen the period of economic hardship for Poland, especially due to higher unemployment, and a further slowdown in wages and incomes.



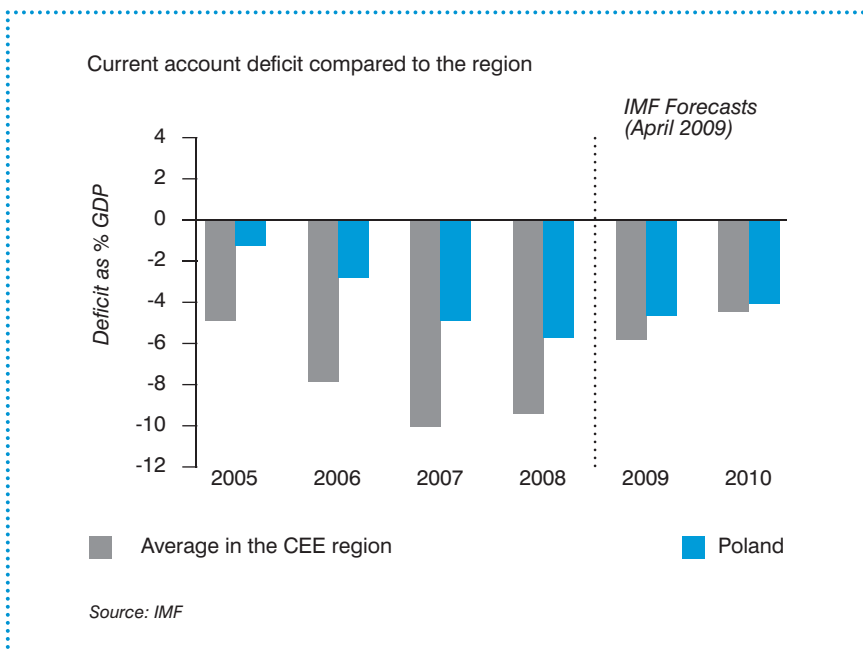


Risk of financial problems: external instability

Compared to the majority of countries in the region, the Polish economy is characterised by a moderate dependence on external financing. It is the result of relatively low rates of investment coupled with moderate saving rates. Before the crisis, the current account deficit was gradually growing to a level of about -5% GDP, but it did not exceed safe limits. Until 2007, this deficit

had been generally covered by the inflow of FDI of USD 15-20 billion, and in 2008 the task of financing was mostly passed to the banking sector. In 2009, EBRD forecasts a decrease in the inflow of FDI below USD 9 billion with a concurrent reduction in access to banking finance due to the global crisis. However, it now appears that the country's relative financial stability and high credit rating

(A- rating with a stable outlook according to Standard & Poor's ratings) will allow a relatively safe funding of credit needs. This translates into a fairly low risk of external instability, additionally reduced by Poland's decision to use a flexible IMF credit line (open credit line of USD 20 bln, which may be used by Poland in the event of a financial turbulence).

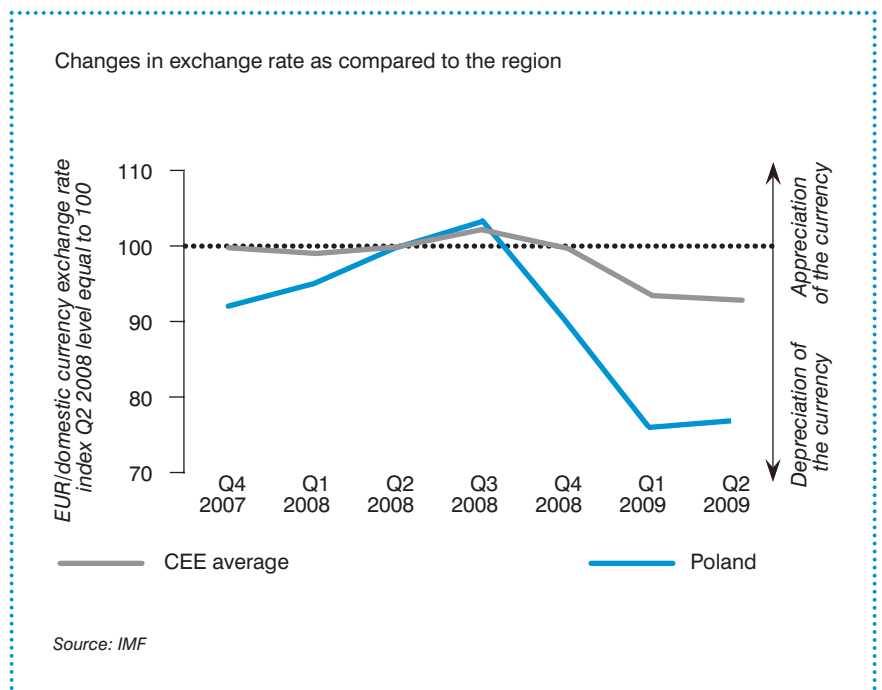


Risk of financial problems: internal instability

Before the crisis, disequilibria in the Polish domestic economy remained at a moderate level, although the scale of potentially dangerous phenomena was gradually rising.

Inflation remained at a low level of 2-4% with a gradually appreciating currency. The real value of domestic credit grew by 115% in 2005-2008 (the regional average was 126%), with the percentage of households' loans denominated in foreign currencies rising to about 40%. Due to a lack of any serious public spending reform, the public sector deficit remained too high (about -4% of the GDP in 2008) as did public debt (48% of GDP). Poland witnessed the appreciation of its currency, yet no decision was taken regarding a timetable for introduction of the Euro. Despite relatively strong macroeconomic foundations, the currency has become significantly weaker in the last year (partly resulted from market speculations).

This caused a number of problems due to the significant percentage of loans denominated in foreign currencies (especially mortgage loans) and the involvement of companies in currency options. At the present time, this situation has calmed down, and the banking sector remains strong and profitable (foreign banks control 75% of banking sector assets). According to the assessment by the European Commission, the public sector deficit may rise to -7% of GDP in the years 2009-2010, and the public debt may grow to 60% of GDP, which will be a serious problem for the public finance. However, it seems that Poland is not threatened by a risk of serious internal instability.



Changes in the scope of taxes and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 22%, PIT 18/32%, CIT 19%**

Total income of the public sector (2008): **39% GDP**

Effective rate of total taxation on profits (2008): **40%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
418 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **92**
(global average: 100; CEE average: 86)

Corruption perception index (2008): **4.6**
(10=no corruption; CEE average: 3.9)

Generally, Poland appears to offer relatively difficult conditions for running a business as many bureaucratic barriers still exists. Tax burdens remain relatively high.

In the years 2007-2009, Poland introduced numerous changes leading to the reduction of tax charges as well as facilitating the administrative obligations related to settlements with the tax authorities. Firstly, the social insurance rates were reduced: from 1 July 2007 (the first stage) and from 1 January 2008 (the second stage). Secondly, with the effect from 1 January 2009 personal income tax rates were reduced and flattened. The change pertains to personal income tax paid on the so-called general terms. As a result, a new taxation scale became binding, comprising only two rates: 18% and 32% (instead of 19%, 30% and 40%). Moreover, at the end of 2008, certain facilitations were introduced in the area of VAT settlements by companies (including shortening of the period of VAT reimbursements).

Such activities were planned before the outbreak of the current crisis, but they have undoubtedly stimulated domestic demand. Currently, there is a debate about a possible growth of tax burdens as a deficit in the state budget increases.

As for running a business, measures to limit bureaucracy and facilitate the activities of entrepreneurs are moderate. Until now, the results have been very modest. In response to a worsening situation on the labour market, the government has introduced a package of legislation to make terms of employment more flexible and provide subsidies for part-time employment in companies experiencing financial problems.

Slovakia

Basic information

	Slovakia	CEE Region	Region=100
Population in millions (2008)	5.4	324	1.7
GDP, in USD billions (2008)	95	4,394	2.2
GDP per capita, in USD '000 (2008)*	22.0	14.9	148
Exports, % GDP (2008)	83	45	184
Average GDP growth, 2005-08	8.0	6.0	x
2009 Growth Forecast	-2.1	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

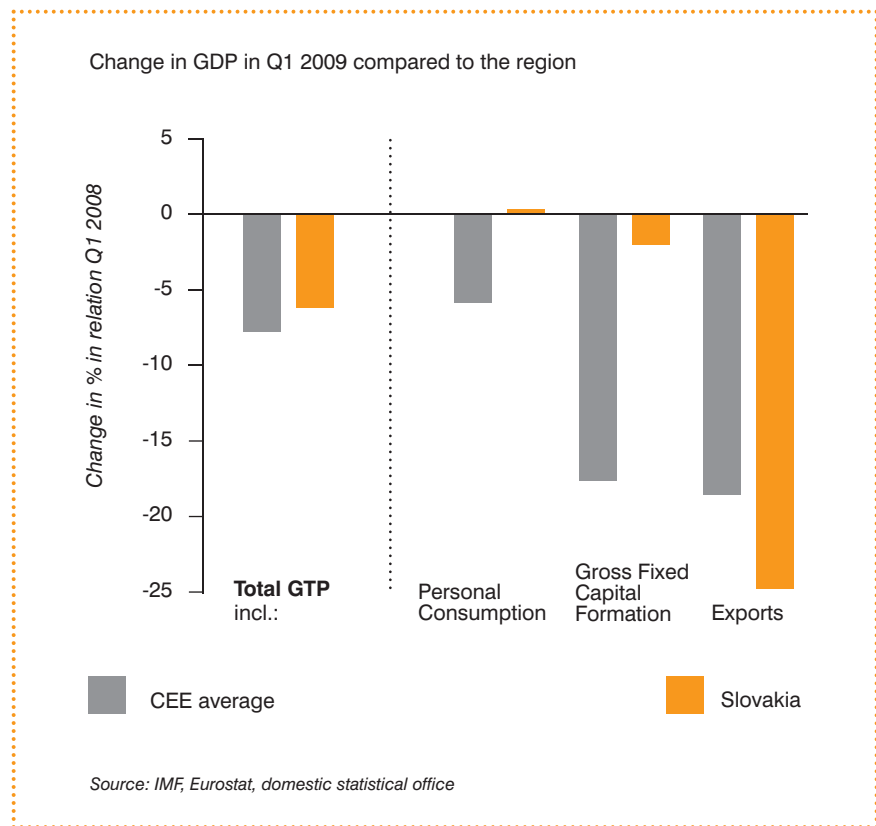
- High productivity and industrial competitiveness
- High investment attractiveness and financial reliability
- Moderate level of government and private debt
- No threats to macroeconomic stability
- European Union membership

Weaknesses:

- Strong dependence on exports
- Strong dependence on automotive industry
- Small domestic market

General assessment of the economic situation

The Slovak economic growth halted unexpectedly and in the first quarter of 2009 the country recorded a drop in GDP of 5.6%.



The main factor influencing the recession phenomenon is a sharp fall in exports (in recent years Slovakia became the country most dependent on exports in the entire CEE region; the automotive industry, suffering serious recession, plays the key role in the Slovak export structure).

Exports decreased by -25%, accompanied by a weak internal demand (the stagnation of consumption and a fall of investment). Recession will probably continue, as suggested by poor results in the industrial output. Although the macroeconomic foundations remain strong, the small domestic market is unable to offset the negative effects of falling exports.

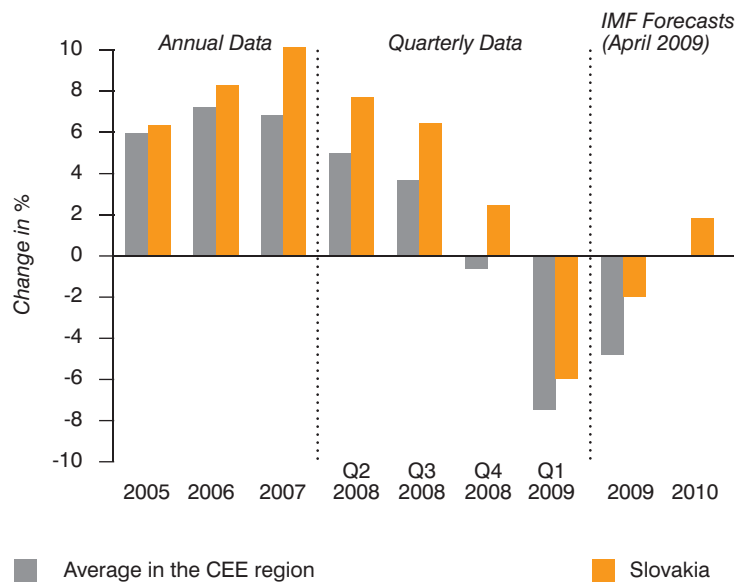


Prospects for economic growth

In the years preceding the crisis, Slovakia's GDP growth rates reached very high levels. The main mechanism driving this growth was a significant inflow of FDI leading to a growth in productivity, exports and production (particularly in the automotive industry). This development, however, was accompanied by a relatively deep financial instability (high current account deficit), meaning a high degree of dependence on the foreign capital imports. This phenomenon lost its importance following the introduction of the Euro currency in January 2009.

According to current forecasts, the total drop in GDP in 2009 is estimated at between -2% and -3% although the unfavourable data for the first quarter may cause a further worsening of the forecasts. The possible stabilisation of GDP is expected only in mid-2010 on the condition that Slovak exports start to recover.

GDP dynamics compared to the region



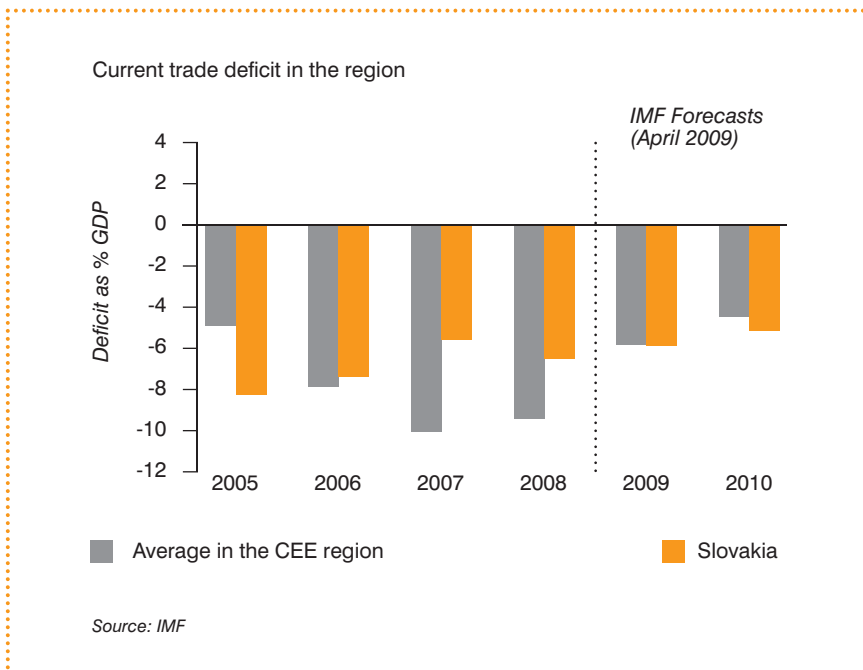
Source: IMF, EBRD, domestic statistical office



Risk of financial problems: internal imbalance

In previous years, the rapid development of the Slovak economy was accompanied by high levels of current account deficit. This meant that the financing of Slovakia's investment needs was, to a large extent, based on imports of foreign capital. In the years preceding the crisis, the current trade deficit was between -7% and -8% of GDP. However, until 2007, the deficit was mostly covered by the inflow of FDI.

Despite a significant fall in the inflow of FDI, as forecasted by the EBRD, Slovakia does not face a risk of financial destabilisation thanks to the introduction of the Euro. Using the European common currency means practically no risk of any external instability. The country's credit rating is high (A rating with a stable outlook according to Standard & Poor's).



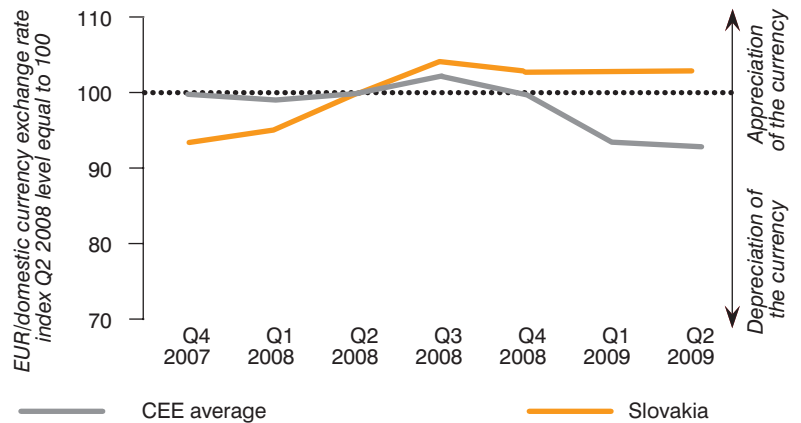
Risk of financial problems: external imbalance

Apart from a significant dependence on foreign financing, the years preceding the crisis were characterised by a high degree of stability in the Slovak economy.

Inflation stood at 3-4% with interest rates at a low level. This allowed the country to fulfil the criteria for Euro adoption in 2007, and to introduce the common European currency in January 2009. The real value of domestic credit grew by 83% in 2005-2008 (CEE region average: 126%), with a low percentage of loans denominated in foreign currencies (fewer than 5% of households' loans). The public sector deficit was maintained at a moderate level (about -2% of GDP in 2007-2008), similarly to public debt (below 30% of GDP). Before the introduction of the Euro, the Slovak crown significantly strengthened.

Entering the Eurozone brought both benefits and costs at the time of the crisis. The benefits included a lack of any serious threat to financial stability, which is particularly important for a country that is strongly dependent on foreign capital. On the other hand, the stable exchange rate did not give the economy a growth impulse, which may come at a time of crisis from a reasonable weakening of the currency. According to the European Commission's assessment, the public sector's deficit in the years 2009-2010 may rise to a level of above -5% of GDP. Due to adopting the Euro, however, Slovakia has avoided a serious increase in public debt and is not threatened by the risk of serious internal instability.

Exchange rate fluctuation as compared to the region



Source: IMF

Changes regarding taxation and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 19%, PIT 19%, CIT 19%**

Total income of public sector (2008): **32% GDP**

Effective rate of total taxation on profits (2008): **47%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
325 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **76**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **5.0**
(10=no corruption; CEE average: 3.9)

Thanks to the reforms conducted in previous years, Slovakia provides companies with relatively favourable conditions for running their business activities. However, the tax burdens are still relatively high.

The government's anti-crisis activities primarily concern tax changes. In particular, personal income tax was temporarily reduced thus increasing the tax-free amount by almost 20% (since personal income tax in Slovakia is a flat tax with tax-exempt amount, this means a reduction in the average effective tax rate). Within the scope of corporate taxation, the possibility of accelerated depreciation was introduced and the period for claiming VAT refunds was shortened (from 60 to 30 days). In addition, the opportunity to benefit from investment tax relief was broadened thanks to lowering the threshold of investments costs entitling companies to apply for the relief.

However, no significant activities have been made to facilitate the conducting of business activity. The present government has not introduced any new reforms, only implemented those prepared between 2002 and 2006 by previous governments.

As part of the struggle against the growth of unemployment, the government expects to support various types of social economy, in particular by employing handicapped people and those discriminated against in the marketplace. The government also foresees a growth in investment in training for the long-term unemployed. Support is also to be given to companies that experience difficulties in getting remuneration payments.

Slovenia

Basic information

	Slovenia	CEE Region	Region=100
Population in millions (2008)	2.0	324	0.6
GDP, in USD billions (2008)	55	4,394	1.2
GDP per capita, in USD '000 (2008)*	29.5	14.9	198
Exports, % GDP (2008)	63	45	140
Average GDP growth, 2005-08	5.1	6.0	x
2009 Growth Forecast	-2.7	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

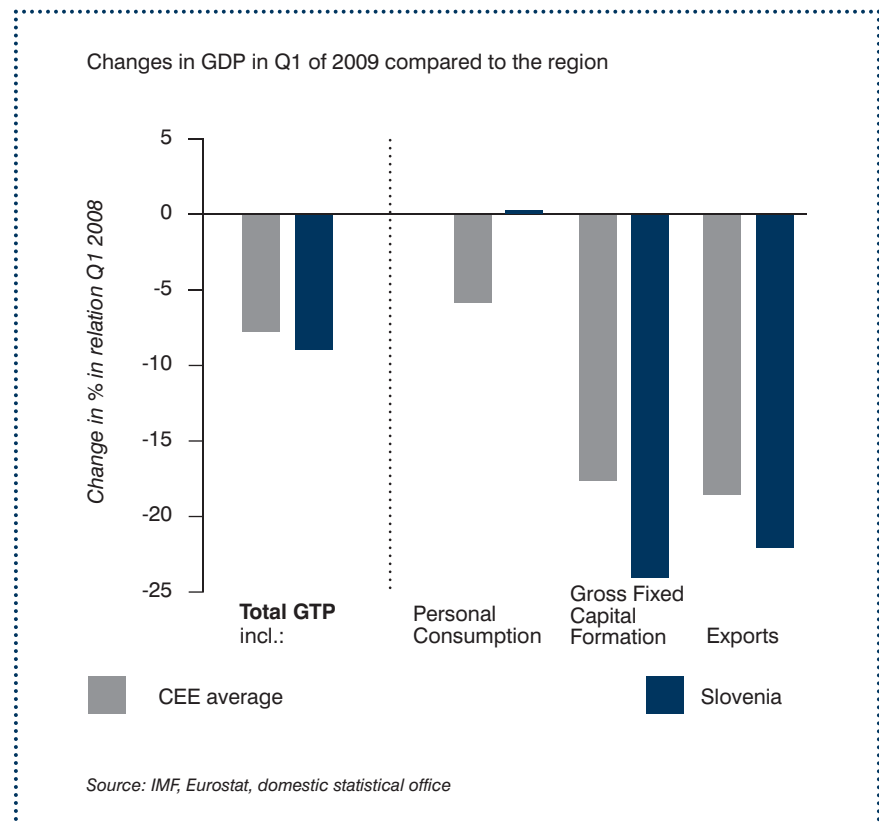
- High financial reliability
- No threats to macroeconomic stability
- Moderate private debt
- European Union membership

Weaknesses:

- Strong dependence on exports to Western Europe
- Small internal market
- High taxation barriers

General assessment of the economic situation

The scale of the drop in GDP in Slovenia recorded in the first quarter of 2009 was very high (-9%). It resulted from the simultaneous occurrence of two phenomena: a slump in both exports and investment dynamics.



The painful collapse of exports (fall by -22%) is not surprising taking into account the small scale of the Slovenian economy and its high dependence on foreign market conditions (19% of Slovenian exports go to Germany and 13% to Italy, i.e. two EU countries deeply affected by the recession).

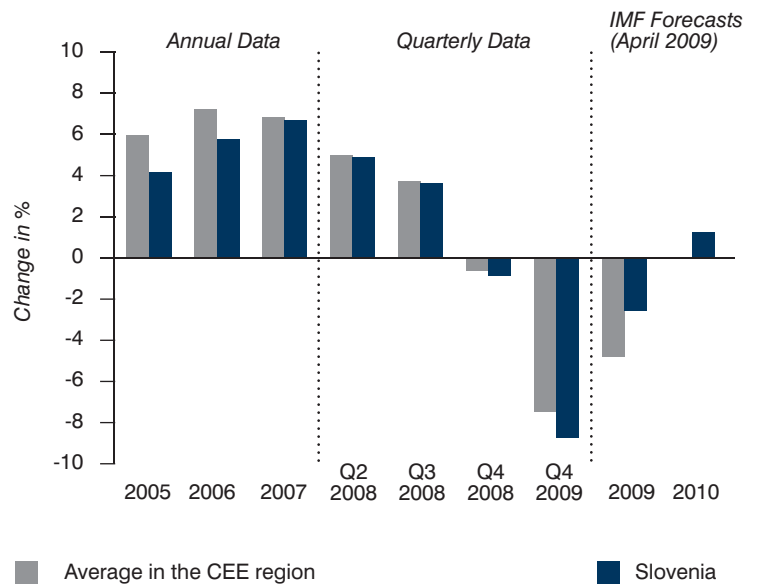
A strong fall in gross fixed capital formation is accompanied by a significant decrease in reserves, which leads to an even stronger fall in total investment. With stagnation in consumption, Slovenia has to face the double problem of a drop in both foreign and domestic demand – and this issue can not be offset by strong macroeconomic foundations and a high stability of the economy



Prospects for economic growth

The years before the crisis were characterized by a rapid growth of Slovenian economy, fuelled mainly by exports and investments, as well as by continuous growth of household income. This development was balanced, mainly due to high rates of domestic savings. The country's fast entry into the Eurozone resulted in the full stability, with both inflation and unemployment at low levels. During the last few quarters, the GDP of Slovenia has lost its dynamism and started falling sharply. According to current forecasts, the total GDP change in 2009 is estimated at between -3% and -4%. GDP is expected to stabilise only in 2010. Big exposure to exports and a small domestic market make it impossible to expect Slovenian GDP growing as long as the situation in Western Europe improves.

GDP dynamics compared to the region



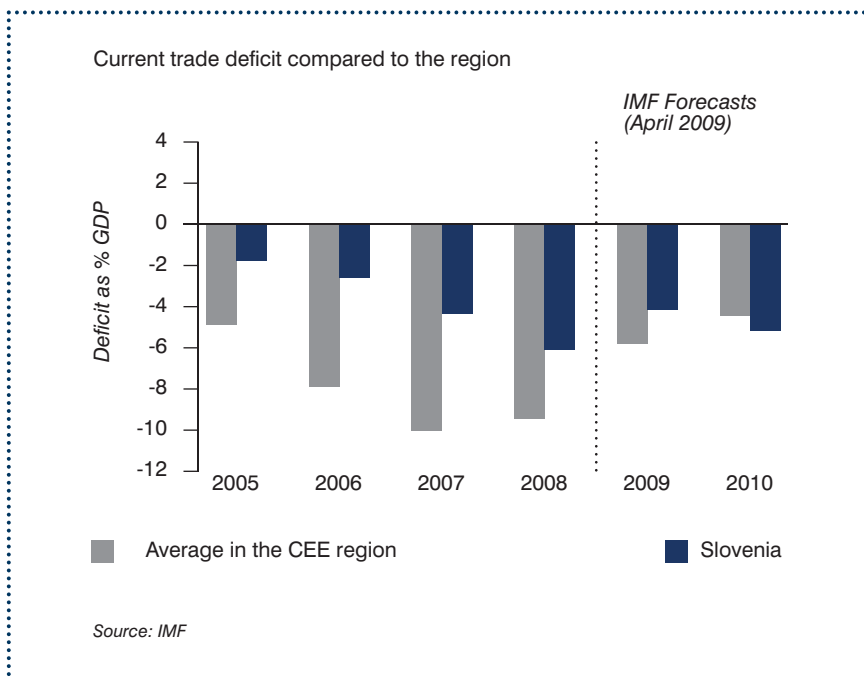
Source: IMF, EBRD, domestic statistical office



Risk of financial problems: external instability

The current account deficit had been continuously growing to -6% of GDP in 2008, despite savings rates being at a relatively high level before the crisis. This meant the growing role of foreign capital in financing investments. Despite a relatively low inflow of FDIs, Slovenia as a Eurozone country did not have any

problems obtaining the necessary capital from the market. The country's credit rating was the highest in the CEE region (AA rating with a stable outlook, according to Standard & Poor's). Currently, Slovenia is not threatened by any risk of external instability, which increases the room for manoeuvre for a economic policy.



Risk of financial problems: internal imbalance

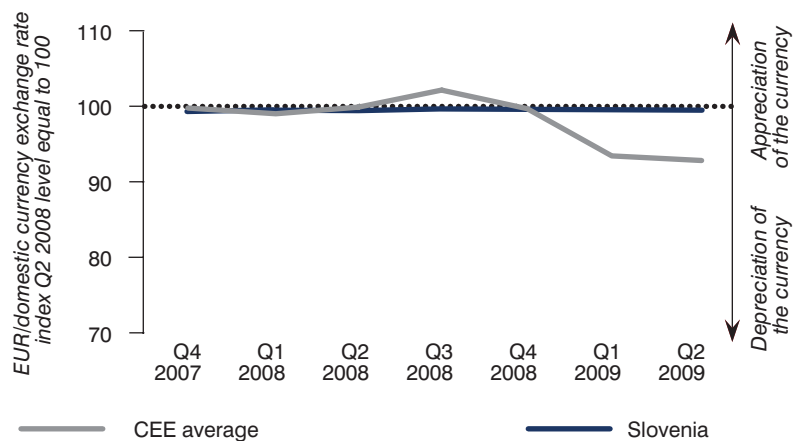
Since Slovenia joined the Eurozone in 2007, its situation has clearly been different from the other countries of the CEE region (apart from Slovakia).

On the one hand, the Central Bank does not have the monetary policy tools to counteract the recession (in particular, it does not have the instruments to weaken the currency). On the other hand, Slovenia may not be afraid of any turbulence caused by a rapid increase in inflation or an exchange rate collapse. Before the crisis, the economic disequilibria were perceived at a relatively low level. Inflation was maintained at 3-5%. The interest rates applied by the European Central Bank were low, and the currency was stable. Between 2005 and 2008, the real value of domestic credit grew by 85% (126% in the CEE region on average).

The public sector deficit remained at a moderate level (about 1% of GDP between 2007 and 2008), similarly to the public debt (below 23% of GDP).

Under the crisis conditions Slovenia – similarly to the majority of Eurozone economies – is facing a threat of deflation. At the same time, the stance of the public finances has worsened. According to the assessments of the European Commission, the public sector deficit may rise above -6% of GDP (in 2009-2010), and public debt may grow as high as to 35% of GDP.

Changes in Exchange rate as compared to the region



Source: IMF

Changes regarding taxation and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 20%, PIT 16-41%, CIT 21%**

Total income of the public sector (2008): **43% PKB**

Effective rate of total taxation on profits (2008): **37%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
260 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **98**
(global average: 100; CEE average: 86)

Corruption perception index (2008): **6.7**
(10=no corruption; CEE average: 3.9)

As global comparisons suggest, despite having the lowest corruption level among the countries of the region, Slovenia offers companies relatively difficult conditions for running their business activities – bureaucratic barriers being the key problem. Tax burdens are relatively high.

In response to the economic crisis, Slovenia introduced a series of measures including cutting the timeline for VAT refund payments, more tax relief on investments and the opportunity to pay obligatory taxes pro rata. At the same time, a programme of a small reduction in corporate income tax rates is continuing – the programme, launched before the crisis, is being extended for four years.

No significant steps were taken in the area of changes to corporate income tax or taxation-related burdens.

Financial tools such as credit guarantees and investment relief prevail among the measures aimed at improving the conditions for running business activities. No significant action was taken to mitigate the high costs of running a business.

Hungary

Basic information

	Hungary	CEE Region	Region=100
Population in millions (2008)	10.1	324	3.1
GDP, in USD billions (2008)	156	4,394	3.6
GDP per capita, in USD '000 (2008)*	19.5	14.9	131
Exports, % GDP (2008)	70	45	155
Average GDP growth, 2005-08	2.4	6.0	x
2009 Growth Forecast	-3.3	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

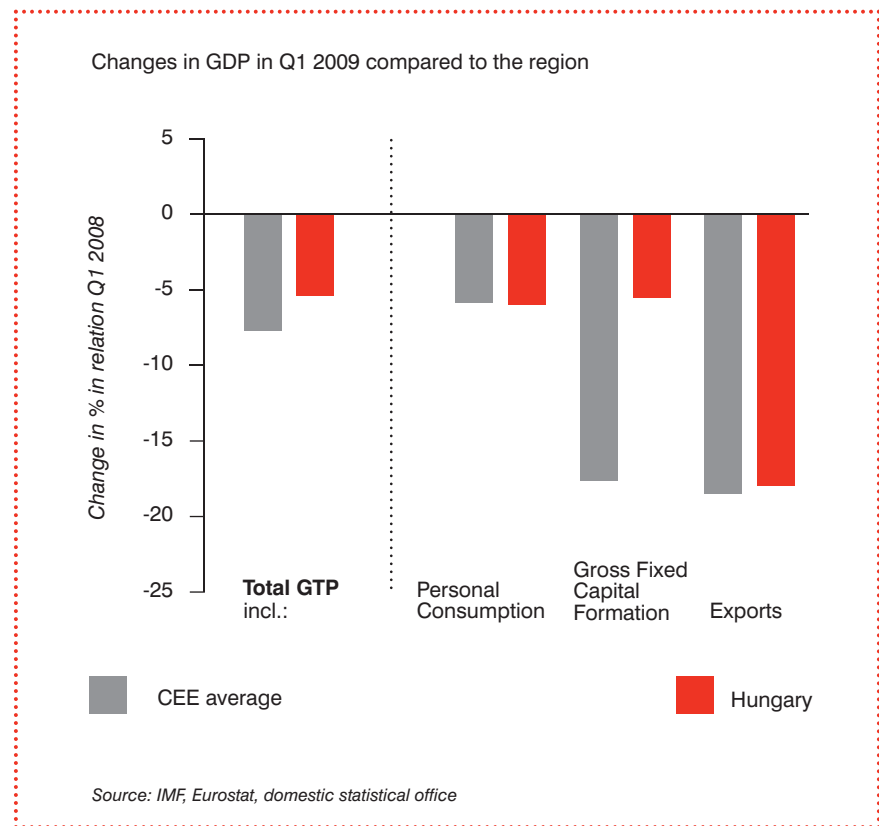
- Modern and competitive industry
- Advanced economy modernization processes
- European Union membership

Weaknesses:

- Serious risk of currency depreciation
- Difficult public finance situation
- Relatively high government debt and private debt
- Small internal market
- Strong dependence on exports

General assessment of the economic situation

Although the Hungarian economic situation is one of the most complicated in the CEE region, the fall in GDP in the first quarter of 2009 was smaller than average and amounted -5.4%.



The country's main problem is that effects of the global crisis have overlapped with Hungary's internal problems the country was already struggling with. As a consequence, Hungary recorded both a serious decrease in export volume (by -18%) as well as consumption and investments decrease (each -6%).

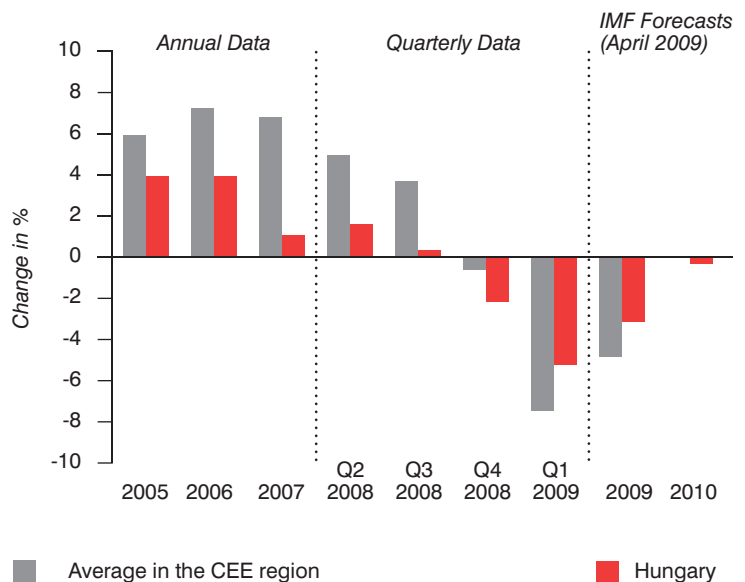
Hungary is one of the CEE countries that is most dependent on exports, and the Hungarian economy is one of the most closely integrated with the western part of the European Union. The above problems overlap with financial stability threats, temporarily calmed down by taking loans from the IMF, the European Union, and the World Bank.



Prospects for economic growth

In contrast to other countries in the region, Hungary had already recorded a serious economic slowdown before the current global crisis – in 2006-2007. This resulted from the program of balancing public finances through savings and tax hikes that limited the domestic demand. As a result, the GDP growth fell in 2007 to 1.1%, which put the country in an extremely difficult situation when low domestic demand was coupled with a drop in exports caused by the global crisis. According to current forecasts, the drop of GDP in 2009 is estimated at between -6% and -7%, with a further decline expected in 2010. A series of additional risks that could make the situation even worse include: a prolonged recession or economic stagnation in Western Europe, a currency collapse, or a serious internal financial crisis.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office

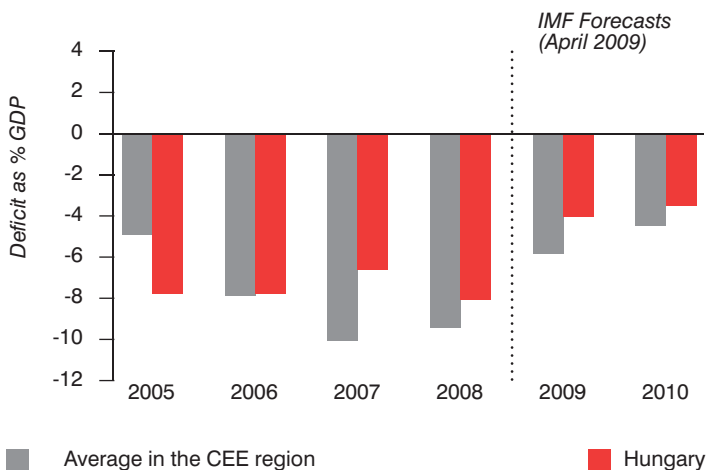


Risk of financial problems: external imbalance

Despite relatively slow GDP growth in the pre-crisis years, the excessive public sector deficit resulted in high demand for foreign capital necessary to fund domestic financing needs. As opposed to the situation in the majority of CEE countries, the deficit was covered by the inflow of FDIs only to a small extent. The increase in the risk aversion caused by the global financial crisis and the limited access to capital that followed led to a serious threat to Hungary at the end of 2008.

In order to avoid insolvency (or at least a sharp exchange rate collapse) it was necessary to request assistance from the IMF, the European Union, and the World Bank. It seems that, so far, the problem has been brought under control. However, the country's image and credit rating has been severely damaged (BBB- rating with negative outlook according to Standard & Poor's, which means a serious risk of the rating being cut further). The risk of economic instability still remains high.

Current account deficit as compared to the region



Source: IMF

Risk of financial problems: internal instability

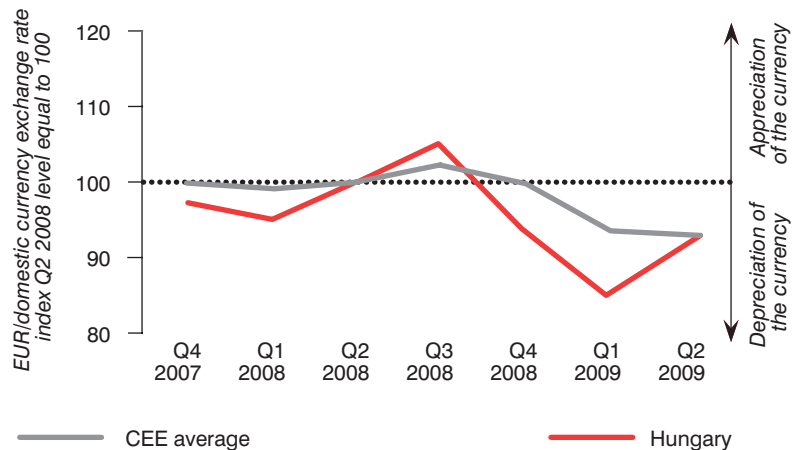
The main reason for the serious internal imbalance in Hungary, even before the current crisis, was the irresponsible budgetary policy conducted until 2006.

As a result, the public finance deficit fluctuated between -8% and -9% of GDP in 2005 and 2006, and public debt exceeded 73% of GDP in 2008. This led to a dangerous discrepancy between fiscal and monetary policies. Due to a relatively high inflation rate (about 8% in 2006 and 2007) and an excessive deficit, the central bank maintained high interest rates on the domestic currency. This, in turn, encouraged households to take foreign currency debts. The real value of domestic credit only grew by 51% between 2005 and 2008 (CEE average: 126%), but the percentage of loans denominated in foreign currencies grew to about 70% of all households' loans.

At the end of 2008 local currency was deeply depreciated which affected credit portfolio quality and posed the threat of huge losses for the banking sector. The situation was even more complex due to the fact that 85% of banking sector assets were under foreign banks' control.

The reason Hungary is experiencing the crisis much more severely than its neighbours are the country's weak macroeconomic foundations. The banking sector's stability is still threatened. According to European Commission assessments, despite continued painful savings, the public deficit will continue in 2009-2010 at a level of -4% of GDP, leading to a public debt growth of up to 82% of GDP.

Exchange rate fluctuation as compared to the region



Source: IMF

Changes regarding taxation and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 25%, PIT 18/36%, CIT 16%**

Total income of the public sector (2008): **47% GDP**

Effective rate of total taxation on profits (2008): **58%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
330 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **80**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **5.1**
(10=no corruption, CEE average: 3.9)

In general, Hungary provides companies with moderately favourable conditions for running their businesses. However, the high tax burdens remain a major problem.

Possibilities to introduce changes into Hungary's taxation policy are limited due to the need to continue both the savings programme started earlier and the operational programme granted by the IMF, the European Union and the World Bank. The basic rate of VAT was increased from 20% to 25%; in addition, a reduced rate of 18% was introduced for basic food products. The rates of excise tax on fuel, energy, tobacco and alcohol were raised significantly, and a luxury tax was introduced (in particular, it applies to immovable properties and luxury goods of a significant value). In contrast to the majority of countries in the region, Hungary was forced to raise the effective rate of personal income tax (by the

gradual increase of the lowest tax stage). The country also decided to cover some additional benefits related to employment by a lump sum tax (previously non-taxable). Also corporate taxes were increased (including a lump-sum tax, flat corporate tax, called EVA, and a share transfer tax for companies owning immovable properties of significant value). For next year, a simplification of taxation for small companies is scheduled (a growth in the corporate income tax rate to 19% with the simultaneous abolition of the solidarity tax of 4%).

There have been no significant measures to facilitate the conducting of business activities and reducing bureaucratic barriers.

Estonia

Basic information

	Estonia	CEE Region	Region=100
Population in millions (2008)	1.3	324	0.4
GDP, in USD billions (2008)	23	4,394	0.5
GDP per capita, in USD '000 (2008)*	20.3	14.9	136
Exports, % GDP (2008)	57	45	126
Average GDP growth, 2005-08	5.6	6.0	x
2009 Growth Forecast	-10.0	-5.0	x

*According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

- High credit rating
- Good business climate
- Advanced economy modernization processes
- European Union membership

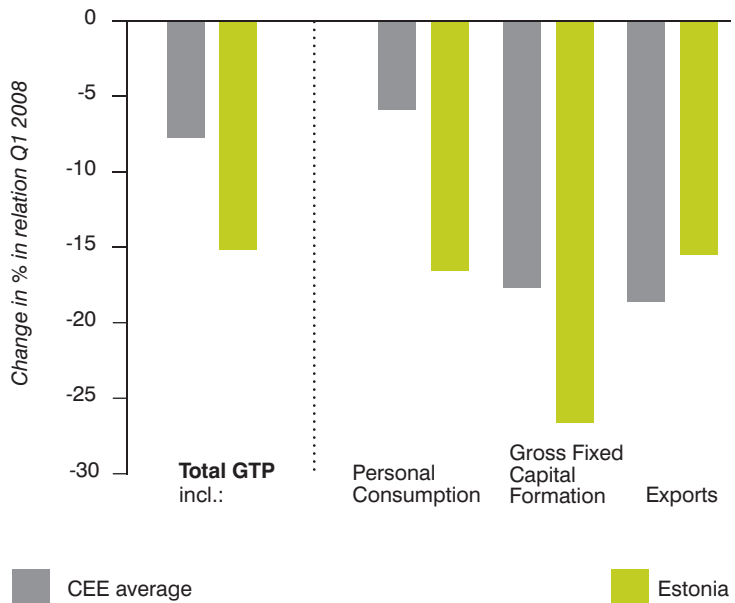
Weaknesses:

- Excessive private debt
- Strong exposure to exchange rate risks
- Small internal market

General assessment of the economic situation

Estonia's economy is facing serious challenges. The main problem being that the Estonian economy was extremely overheated during previous periods.

Changes in GDP in Q1 2009 compared to the CEE region



Source: IMF, Eurostat, domestic statistical office

The economy was dramatically affected not only by the natural slowdown, a part of a boom and a slump cycle, but also by the global financial crisis. Hindered access to external financing made it necessary to tighten economic policy. At the same time, strong economic deleverage has occurred, as a result of the speculative bubble in the financial

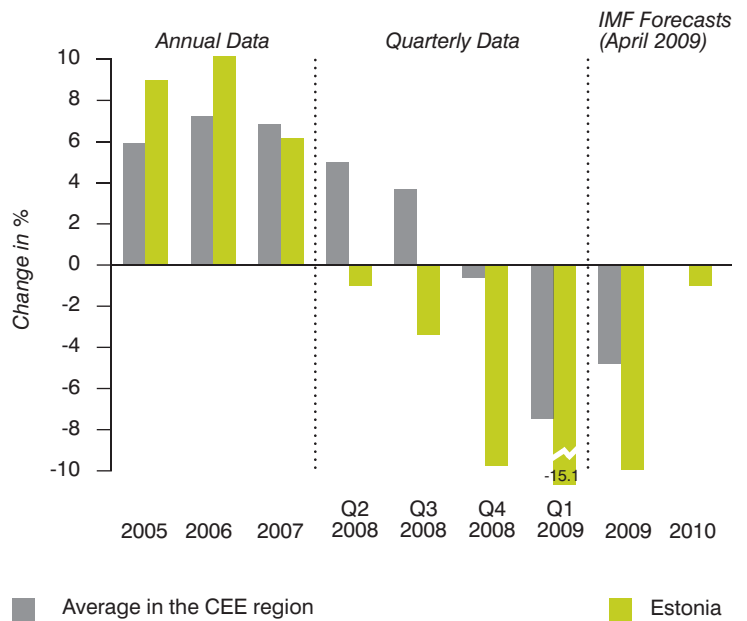
and real estate markets bursting. The main recessionary influence in such a situation has been the decrease in domestic demand (in the first quarter of 2009, a fall in investment of -26.5%, and a fall in consumption of -16.5%), accompanied by a significant drop in exports (by -15.5%). As a result, a deep fall in GDP took place (-15%).



Prospects for economic growth

Similarly to the other Baltic states, the current crisis reached Estonia after several years of extremely high economic development – year-to-year GDP was recorded as 10%. However, this growth was accompanied by excessive imbalances: a growth in the current trade deficit to -18% of GDP in 2007, inflationary pressure, and exceptionally strong growth in domestic credit and private debt. Starting from 2008, as a consequence of the global crisis and the bursting of speculative bubbles in the overheated domestic market, GDP has plummeted. According to current forecasts, the fall in Estonia's GDP in 2009 is estimated at between 10% and 13%, with a further significant drop expected in 2010. The need to depart from a fixed exchange rate may be an additional risk that could make the situation even worse and deepen the banking crisis.

GDP dynamics compared to the CEE region



Source: IMF, EBRD, domestic statistical office



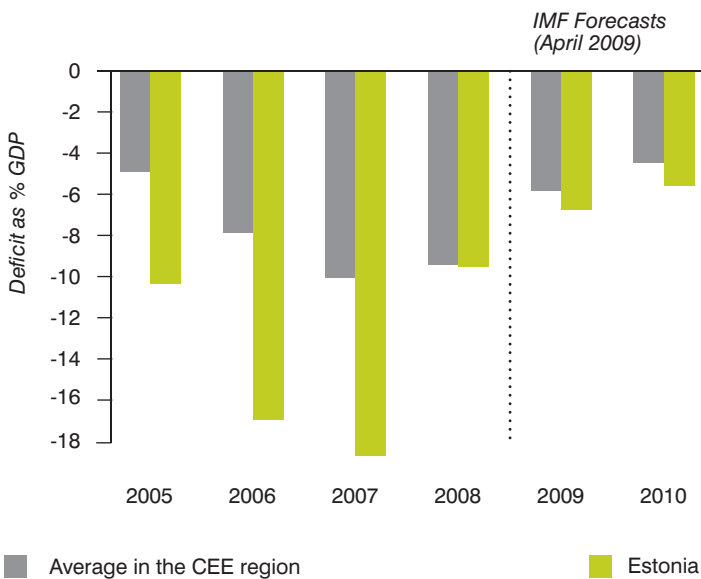
Risk of financial instability: external imbalance

Estonia, similarly to the other Baltic states, has conducted a policy of fixed exchange rates. This approach combined with a fast economic growth and Consumer Price Index (CPI), at a higher level than in Western European countries, has led to an excessive current account deficit. Between 2005 and 2008, the current trade deficit fell from -10% to -18% of GDP. Although financing such deficits in the years

preceding the crisis was only based on the inflow of FDIs to a limited extent, the country had no difficulties in obtaining capital from the loan market. Corporate loans granted by foreign parent banks to local branches became the main source of funding causing credit to grow rapidly (i.e. mainly excessive consumption). However, due to the global financial crisis, an acceptable level of risk decreased,

which resulted in the limited access to capital. Those were factors that posed a serious threat to all the Baltic states at the end of 2008. Nevertheless, Estonia has a strong advantage being a high credit rating (A- rating with a negative outlook according to Standard & Poor's). This means that there is only a low risk of serious external instability.

Current account deficit as compared to the CEE region



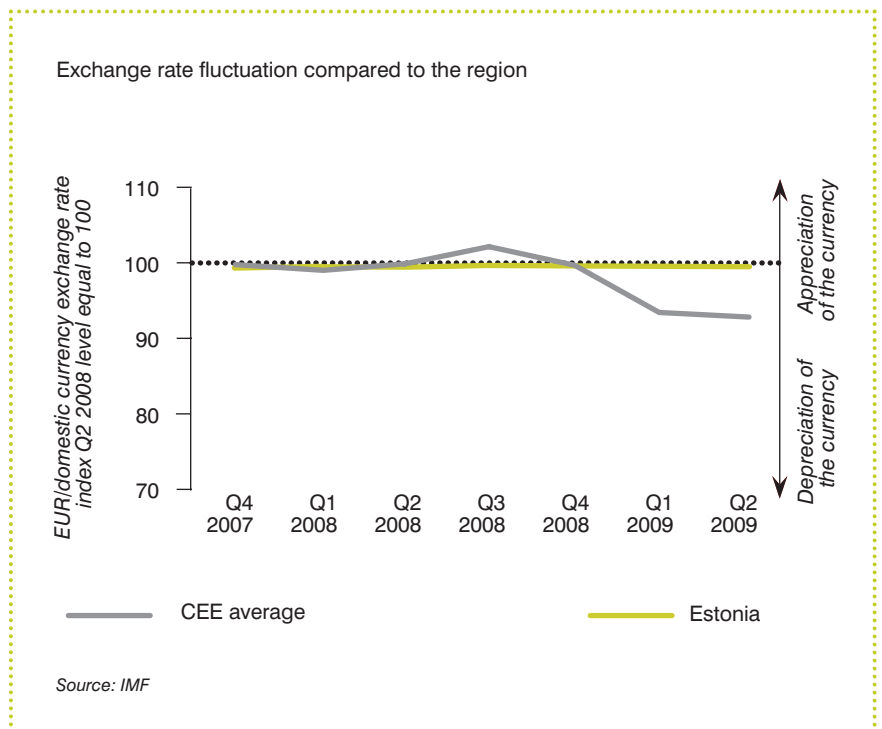
Source: IMF

Risk of financial instability internal imbalance

The main reason for the Estonian imbalance just before the crisis, was extremely high consumption, financed by consumer loans, growing rapidly.

It was partly the result of applying a policy of fixed exchange rates that was meant to maintain low interest rates, despite the fast growth of incomes and relatively high inflation. This encouraged households to take foreign currency debts. The real value of domestic credit grew in 2005-2008 by 113% (126% on average in the region), and the percentage of loans denominated in foreign currencies exceeded 80% of all private loans.

Due to the excessively high inflation, Estonia (similarly to the other Baltic states) did not manage to introduce the Euro currency, which could have secured its currency against the risk of weakening. However, at the same time the country maintained an exceptionally responsible budgetary policy (i.e. a budget surplus and a minimum level of public debt). According to the European Commission, in 2009-2010 the deficit of the public sector will amount to - 4% of GDP. Thus the situation may be considered as relatively safe when compared to the other Baltic states



Changes regarding taxation and conditions for running businesses

Business environment key figures

Basic tax rates (2009): **VAT 20%, PIT 21%, CIT 21%**

Total income of the public sector (2008): **38% GDP**

Effective rate of total taxation on profits (2008): **49%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
81 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **67**
(global average: 100, CEE average: 86)

Corruption perception index (2008) **6.6**
(10=no corruption, CEE average: 3.9)

Due to radical reforms of the 1990s, Estonia offers the most favourable conditions for business activities in the region and its tax burden is moderate.

The difficult budgetary situation in Estonia has resulted in tax increases. The basic VAT rate was raised from 18% to 20%. At the same time, the rates of excise tax for fuel and tobacco products were increased. Although corporate income tax has not been subject to any serious changes, the obligatory labour fund rate has been raised several times. Obligatory retirement fund payments have been temporarily suspended.

No significant activities have been undertaken in order to further improve conditions for conducting business (note: they are considered among the most favourable in the region).

Lithuania

Basic information

	Lithuania	CEE Region	Region=100
Population in millions (2008)	3.4	324	1.0
GDP, in USD billions (2008)	47	4,394	1.1
GDP per capita, in USD '000 (2008)*	18.9	14.9	127
Exports, % GDP (2008)	50	45	110
Average GDP growth, 2005-08	6.9	6.0	x
2009 Growth Forecast	-10.0	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

- Good conditions for running business
- European Union membership

Weaknesses:

- High exposure to exchange rate risk
- Difficult situation of public finance
- Excessive private debt
- Limited internal market

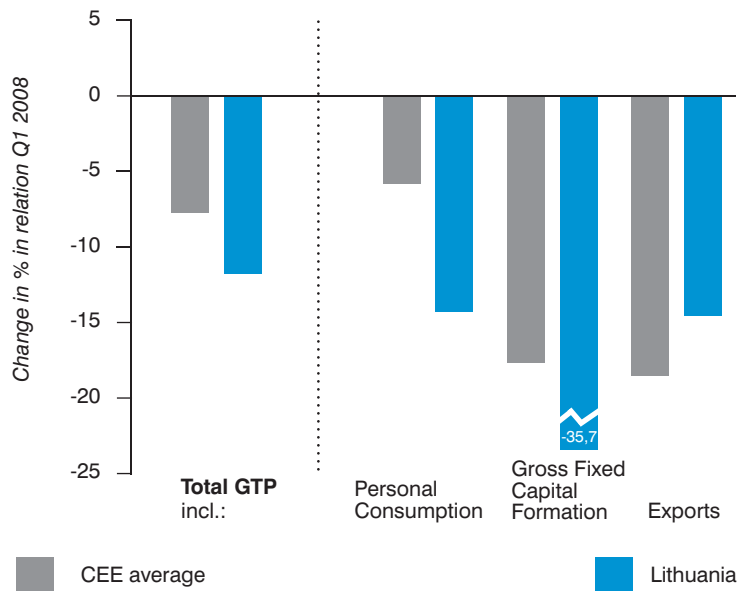
General assessment of the economic situation

Lithuania's economic situation is very difficult, and similar to that of the other Baltic states.

Since the Lithuanian economy had been seriously overheated for several years before the global crisis, the country was threatened by a serious slowdown due to the normal business cycle. This phenomenon overlapped with the effects of the global financial crisis drastically worsening the situation. A limited access to external financing required an abrupt tightening of economic policy.

The burst of the speculative bubble in the financial and real estate markets caused a sudden collapse of domestic demand. Investment fell in the first quarter of 2009 by -35.7%, and individual consumption dropped by -14.3%. This was accompanied by a decrease in exports of -14.5%. As a consequence, the GDP sharply decreased (by -11.8%).

Changes in GDP in Q1 2009 compared to the region



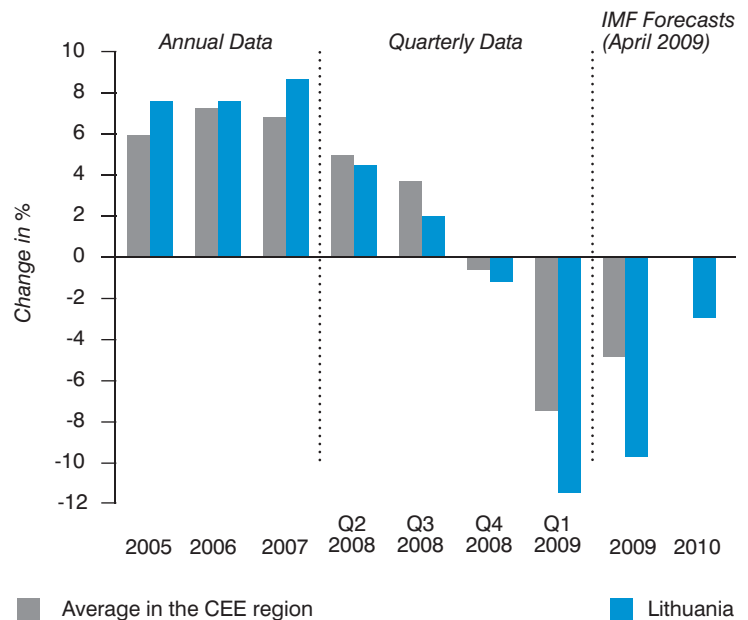
Source: IMF, Eurostat, domestic Statistical Office



Prospects for economic growth

As in the other Baltic States, the crisis in Lithuania came after several years of extremely robust economic development, during which the country recorded a growth rate in GDP of between 8% and 9% yearly. However, this growth was accompanied by excessive imbalances accumulating in several areas: an increase of the current account deficit to -15% of GDP in 2007, inflationary pressure, and an excessive growth of domestic credit. As a consequence of the global crisis and the bursting of the speculative bubble in the overheated economy, Lithuanian GDP began to shrink at an increasing speed, starting from the end of 2008. According to current forecasts, the drop in GDP in 2009 is estimated at between -11% and -15% with the further significant fall expected in 2010. An additional risk is related to a possible departure from the fixed exchange rate policy which could lead to a general banking crisis.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office



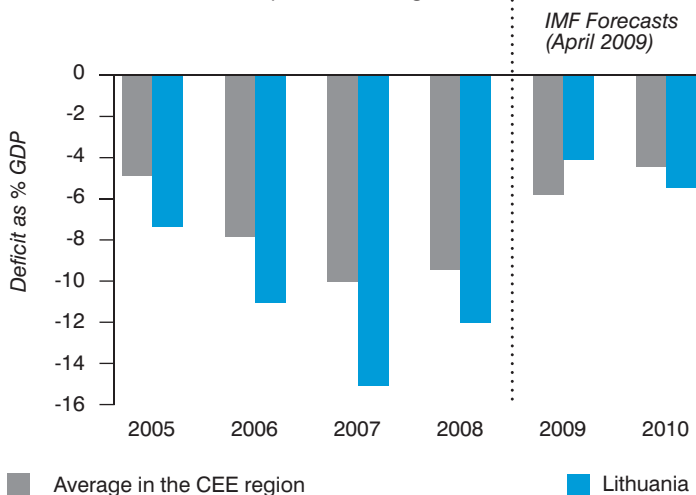
Risk of financial problems: external imbalance

Similarly to the other Baltic states, Lithuania has pursued a policy of fixed interest rates for a number of years. This policy, under conditions of fast economic growth, and inflation at a much higher level than in the Western Europe, led to the emergence of an excessive current account deficit. Financing this deficit in the pre-crisis years was mainly handled by the banking market (loans granted

by foreign parent banks to local branches). This capital was mainly used for funding the fast-growing credit action, fuelling excessive consumption. Between 2005 and 2008, the current account deficit increased from -7% to -15% of GDP. The rapid increase in the risk aversion caused by the global financial crisis, and the limited access to capital that followed, were factors that posed a serious threat

to all the Baltic states at the end of 2008. In the case of Lithuania, an additional problem is its relatively low credit rating (BBB- rating by Standard & Poor's with a high risk of downgrading rating from the investment to speculative category). As a consequence, the threat of major external instability remains very serious, which in an extreme case may lead to a dramatic collapse of the exchange rate.

Current account deficit compared to the region



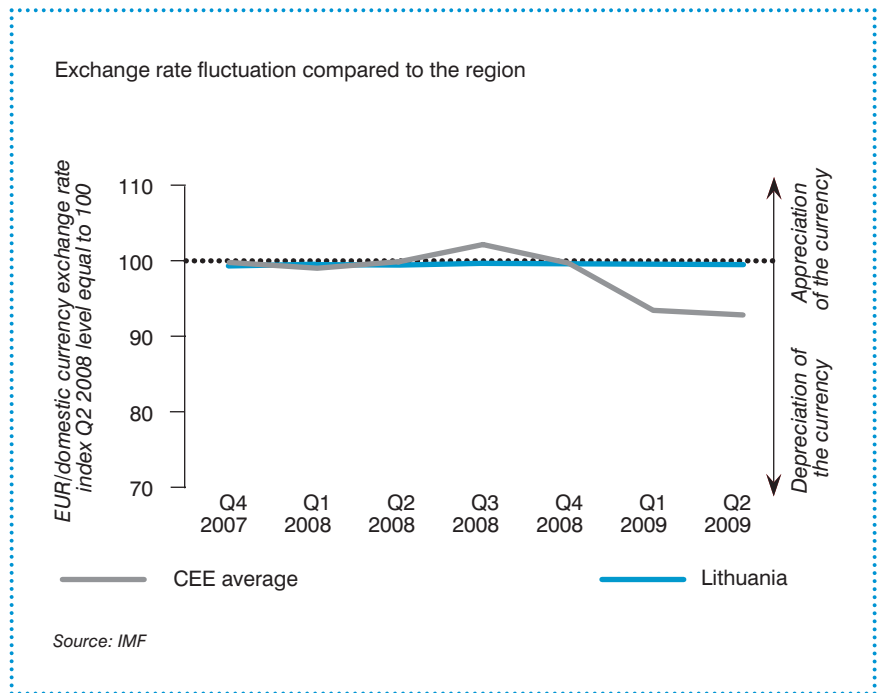
Source: IMF

Risk of financial problems: internal imbalance

In Lithuania, just as in the other Baltic states, the main reason for the emergence of a serious internal imbalance was an excessive consumption growth fuelled by the rapidly expanding consumer credit.

A policy of fixed exchange rates led to continuously low interest rates, despite the fast growth of incomes and relatively high inflation. This encouraged households to take foreign currency loans. The real value of domestic credit grew in 2005-2008 by 175% (the regional average was 126%), and the share of foreign currency loans exceeded 60% of all households' loans. Due to excessive inflation, the Lithuanian application to enter the Eurozone was rejected in 2006. As a result, Lithuania did not manage to protect its currency against

the risk of depreciation. In previous years, the country had a good fiscal stance (a small budget deficit and low levels of public debt). According to the European Commission, in 2009-2010 the deficit in the public sector will increase to -8% of GDP. Lithuania's situation would worsen further if the country was forced to resign from the fixed exchange rate. This could lead to a currency collapse and a rapid worsening of the quality of the credit portfolio (and, as a consequence, to a serious banking crisis).



Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 19%, PIT 15%, CIT 20%**

Total income of public sector (2008): **34% GDP**

Effective rate of the total taxation of profits (2008): **46%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
166 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **67**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **4.6**
(10=no corruption, CEE average: 3.9)

Thanks to radical reforms, Lithuania offers one of the best conditions for doing business in the region, and its tax burdens are moderate.

The difficult budgetary situation in Lithuania has resulted in a number of steps, one of them being an increase in taxes. This is related primarily to indirect taxes. The basic VAT rate increased from 18% to 21%, and the government plans a further rise to 23%. At the same time, reduced VAT rates of 5% and 9% have been abolished. A significant growth in excise duty rates has taken place as well. The corporate income tax rate has also risen (from 15% to 20%).

However, additional relief for investments has been introduced. Although basic personal income tax rate has decreased, at the same time a number of tax exemptions and reliefs have been abolished (PIT in Lithuania is a flat tax, except for a 20% capital tax on dividends). Health insurance contributions have also risen. Increases in income tax and taxes on capital are planned as well as the introduction of a property tax (cadastral tax), capital gains and bank interest taxes. No significant actions were taken to facilitate the conducting of business activities and reducing bureaucratic barriers.

Latvia

Basic information

	Latvia	CEE Region	Region=100
Population in millions (2008)	2.3	324	0.7
GDP, in USD billions (2008)	34	4,394	0.8
GDP per capita, in USD '000 (2008)*	17.1	14.9	115
Exports, % GDP (2008)	25	45	55
Average GDP growth, 2005-08	7.0	6.0	x
2009 Growth Forecast	-12.0	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

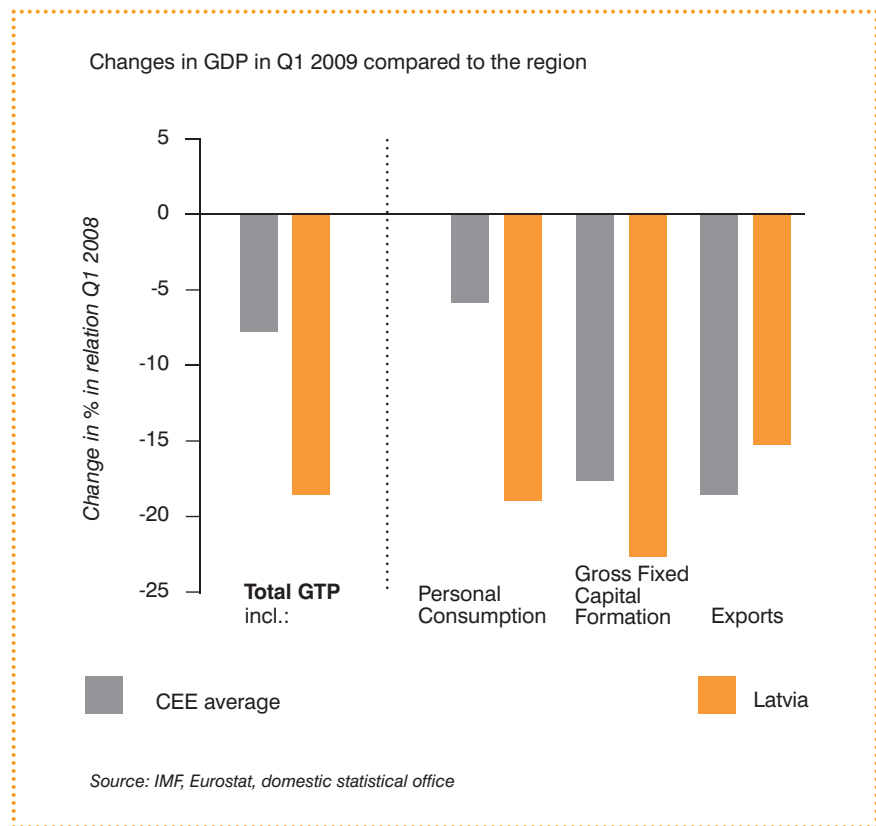
- Good conditions for running business
- European Union membership

Weaknesses:

- Strong exposure to exchange rate risk
- A serious risk of currency collapse
- Difficult public finance situation
- Excessive private debt
- Small internal market

General assessment of the economic situation

The economic situation of Latvia is commonly perceived as the most difficult of all the Baltic states and probably also – together with the Ukraine – as one of the most difficult in the region and, indeed, in the world.



In the pre-crisis period the Latvian economy was strongly overheated, which must have led to a sharp cyclical slowdown of growth and the bursting of the speculative bubble in the financial and real estate markets. This came about together with the global financial crisis and limited access to external financing. As tightening of the economic policy and drastic budget savings were not sufficient to deal with the situation, the country was forced to seek financial assistance from the IMF and the European Union.

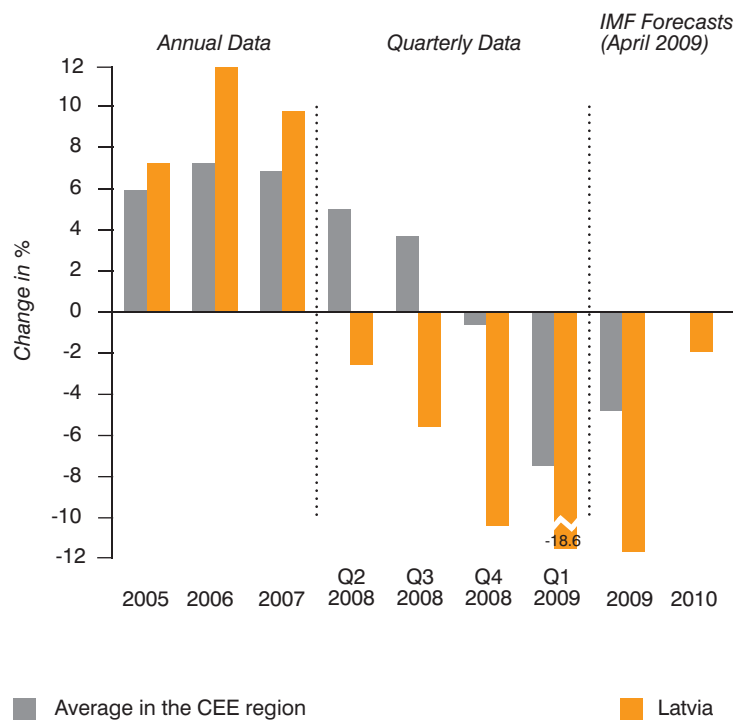
The savings programme caused a sudden slump in the domestic demand. Investment in Q1 of 2009 was down by -22.7% and individual consumption by -19%. This was accompanied by a decrease in exports of -15.2%. As a result, there was a significant drop in GDP (by -18.6%).



Prospects for economic growth

Similarly to the other Baltic states, the crisis stroke Latvia after several years of extremely strong economic growth: Latvia recorded GDP growth rates of between 10% and 12% annually, with a particularly fast-growing personal consumption (growth of between 11% and 21% per year). Such a growth had to be accompanied by a rapid accumulation of excessive imbalances: increase of the current account deficit to -22% of GDP in 2007, high inflationary pressure, an excessive speed of domestic credit expansion. Due to the global crisis and bursting the speculative bubble in the overheated economy, GDP began to decrease rapidly starting from the end of 2008. According to current forecasts, the fall in GDP in 2009 is estimated at between -13% and -17%, with an expected further significant drop in 2010. It is one of the most pessimistic GDP forecasts in the world. Abandoning the fixed exchange rate, that most likely would lead to a general banking crisis, is an additional risk making the situation even worse.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic Statistical Office



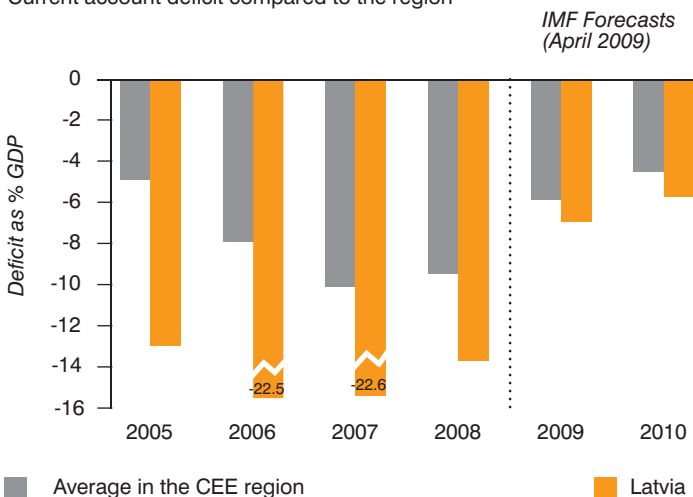
Risk of financial problems: external imbalance

Similarly to the other Baltic states, Latvia has pursued a policy of fixed exchange rates for a number of years. The policy, coupled with the fast economic growth, and inflation at a much higher level than in Western Europe, led to the emergence of an excessive current account deficit. Financing this deficit in the years preceding the crisis was based mainly on the banking market (loans granted by foreign parent banks to local branches). The foreign capital was used to finance

the rapid credit expansion, fuelling the excessive consumption. Between 2005 and 2008, the current account deficit increased from -12% to -22% of GDP. The rapid increase of the risk aversion due to the global financial crisis, posed a serious threat to all the Baltic states at the end of 2008. In the case of Latvia, the limited access to capital quickly led the country to the verge of insolvency from which it was saved by a credit rescue package supplied by the IMF and the

European Union. This has resulted in a drastic worsening of the country's credit rating (BB+ rating with a negative outlook, according to Standard & Poor's, which means that the country has slipped from an investment category to a speculative category). The risk of serious external instability remains very high and, in an extreme case, may lead to a total exchange rate collapse.

Current account deficit compared to the region



Source: IMF

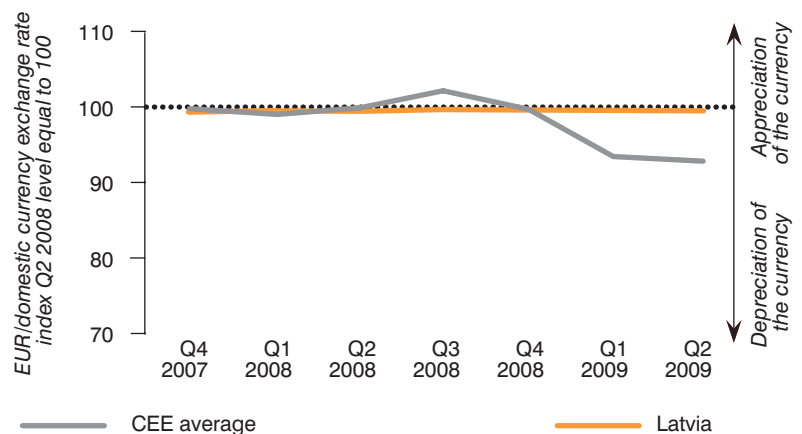
Risk of financial problems: internal imbalance

In Latvia, as in the other Baltic states, the main reason for the serious internal imbalance was an excessive consumption growth between 2005 and 2008.

The imbalance was fuelled by fast credit expansion. One should note that, in the case of Latvia, the scale of the problems was larger than in Lithuania and Estonia. This was partly the result of applying the fixed exchange rate policy for a number of years, which led to the maintenance of low interest rates despite the fast growing of households' incomes and relatively high inflation. This encouraged households to take foreign currency debts. The real value of domestic credit grew in 2005-2008 by 179% (the regional average was 126%), and the share of foreign currency loans exceeded 90% of all households' loans.

Due to the high inflation Latvia did not manage to introduce the Euro and to protect its currency against the risk of weakening. Although the country had a responsible budgetary policy in the past (a small budget deficit and low levels of public debt), according to the European Commission's forecasts the public sector deficit is likely to rise in the years 2009-2010 to -13% of GDP. The situation in Latvia is still very risky, and the country may be forced to abandon the fixed exchange rate policy. This would lead to a severe currency collapse and a sudden worsening of the quality of the credit portfolio (and, in consequence, to a serious banking crisis).

Exchange rate fluctuation rate as compared to the region



Source: IMF

Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 21%, PIT 23%, CIT 15%**

Total income of public sector (2008): **35% GDP**

Effective rate of the total taxation on profits (2008): **33%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008)
279 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **70**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **5.0**
(10=no corruption, CEE average: 3.9)

Due to radical reforms, Latvia has provided companies with one of the best conditions for conducting business in the region; moreover, tax burdens in Latvia are moderate.

Latvia's dramatic financial situation forced the government to raise the tax burden significantly at the time of the crisis (contrary to many other countries). The main rise related to indirect taxes. The basic VAT rate rose from 18% to 21%, and the reduced rate from 5% to 10% (at the same time, the list of goods and services covered by the reduced rate was cut radically). This was accompanied by a significant increase in excise duty tax rates. However, at the same time the personal income tax rate was reduced

from 25% to 23% (personal income tax in Latvia is a flat tax). In order to prevent the loss of deposits from the banking sector, non-residents' capital tax on interest has been suspended. At the same time, a series of corporate income tax measures has been taken (among others, a new timeline for loss clearings and new depreciation rules). However, no serious activities to facilitate the conducting of business activities and reducing bureaucratic barriers have been undertaken.

Bulgaria

Basic information

	Bulgaria	CEE Region	Region=100
Population in millions (2008)	7.7	324	2.4
GDP, in USD billions (2008)	52	4,394	1.2
GDP per capita, in USD '000 (2008)*	12.3	14.9	83
Exports, % GDP (2008)	43	45	95
Average GDP growth, 2005-08	6.2	6.0	x
2009 Growth Forecast	-2.0	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

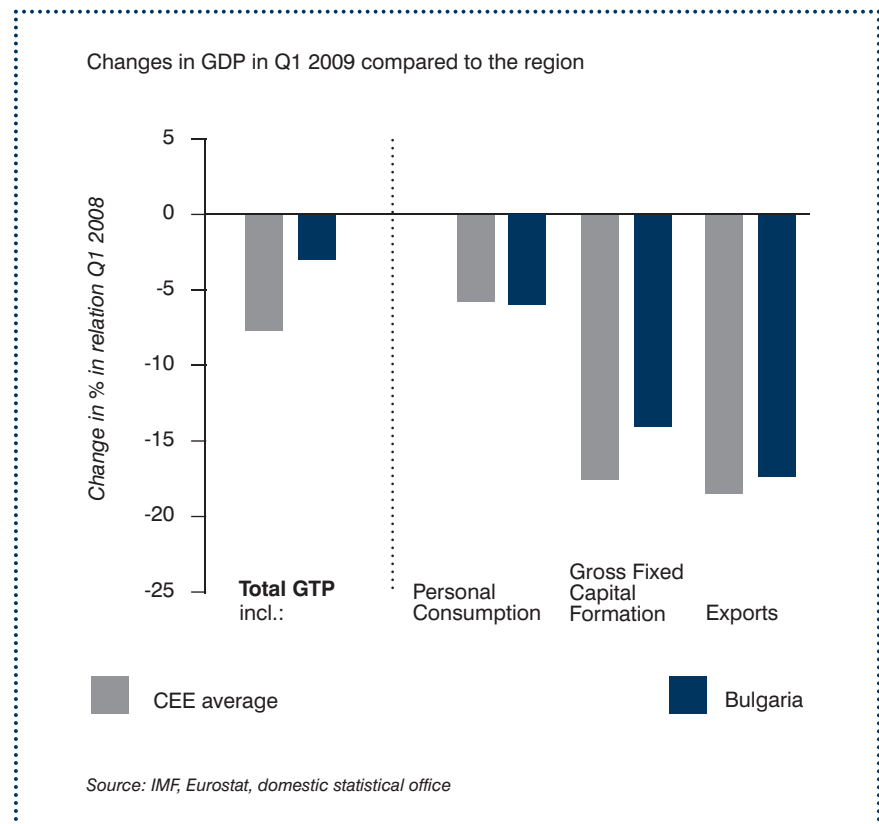
- High investment attractiveness
- European Union Membership

Weaknesses:

- Strong exposure to exchange rate risk
- High dependence on external financing
- Excessive private debt
- Limited internal market

General assessment of the economic situation

Although initially it was believed that Bulgaria's high investment attractiveness combined with its moderate dependence on exports would allow it to overcome the crisis smoothly (similarly to Romania), the reality has turned out to be less positive.



A small domestic market was unable to provide shelter against the crisis, and the worldwide fall of FDI flows resulted in a severe slump of investment. The situation is additionally complicated by a very strong dependence on external financing, weakness in the banking sector, and the speculative bubble in the financial and real estate markets bursting. As in the case of the Baltic states and Romania, already in the pre-crisis period the economy was overheated, and the country was threatened with a serious cyclical slow-down.

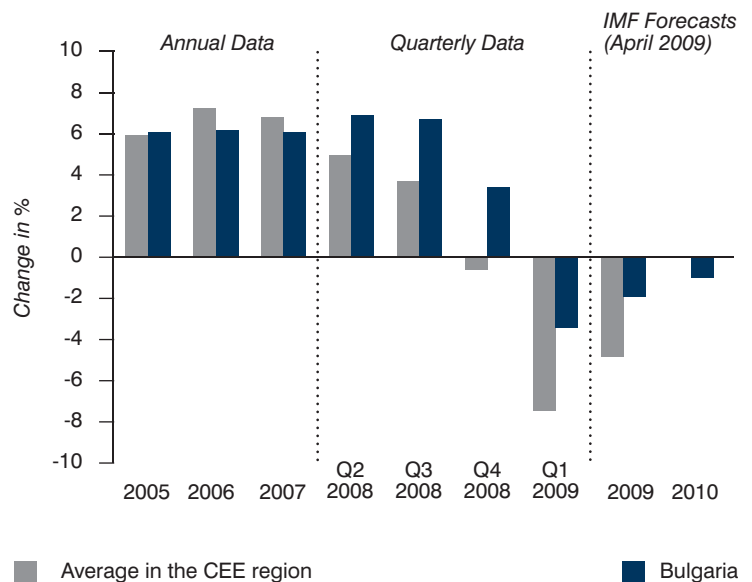
This overlapped with the effects of the global financial crisis, which made the situation much worse. As a consequence, investments fell in the first quarter of 2009 by -14%, and individual consumption declined by -6%. This was accompanied by a fall in exports of -17.4%, which in total reduced the GDP by -3.5%. However, it appears that the recession may deepen, and recovery should not be expected until the situation in Western Europe starts to improve.



Prospects for economic growth

The current crisis reached Bulgaria after several years of a strong economic growth with the country GDP growth rates exceeding 6% annually. The spectacular growth was fuelled by an unusually strong inflow of foreign investments accompanied by an excessively fast consumption growth (similar to the situation in the Baltic states). This led to the emergence of significant imbalances, particularly the growth of the current account deficit to -25% of GDP in 2008, inflationary pressure, and an excessive speed of domestic credit expansion. The global crisis overlapped with problems of overheating; as a result, GDP growth was suddenly brought to a halt at the end of 2008. According to current forecasts, the fall in GDP in 2009 is estimated at between -1% and -3% with a further small fall expected in 2010. An additional risk that may make the situation worse could be related to the possible necessity to depart from the fixed exchange rate which could lead to a banking crisis.

GDP dynamics compared to the region



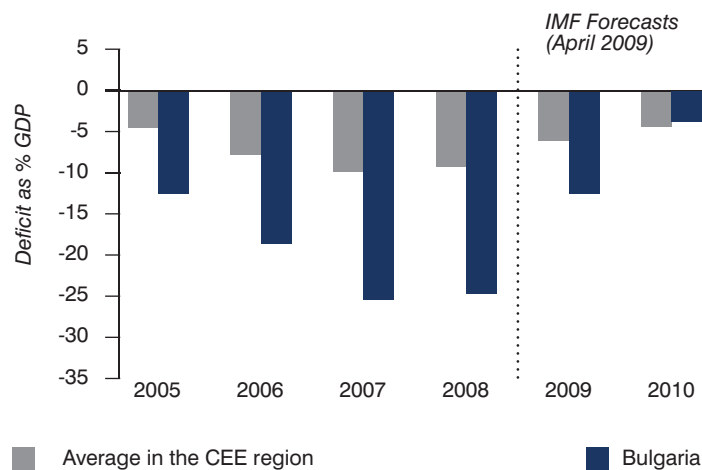
Source: IMF, Eurostat, domestic statistical office

Risk of financial problems: external instability

Similarly to the Baltic states, Bulgaria has been conducting a fixed exchange rate policy for a number of years. Along with fast economic growth and inflation at a level much higher than in Western Europe, this approach has led to the emergence of an excessive current account deficit. Before the crisis, the deficit was financed mainly from the inflow of FDIs. The majority of imported foreign capital was used for financing investments, the side effect being a fast-growing consumption. In 2005-2008, the current account deficit grew from -20% to -25% of GDP. The significant drop in the inflow of FDIs (as forecasted by EBDR), and difficult access to global markets, lead to a sudden increase of problems with funding the deficit. If the problems aggravate, the country may be forced to depart from the fixed exchange rate policy and introduce a drastic savings programme. This may in turn deepen the recession further. An alternative would be to obtain financial assistance from the IMF and the European Union. An additional problem is the country's relatively low credit rating (BBB- rating by Standard & Poor's, with a serious risk of downgrading from investment to speculative category). Bulgaria is still threatened by a serious risk of external instability, which in an extreme case may lead to a collapse of the exchange rate.



Current account deficit compared to the region



Source: IMF

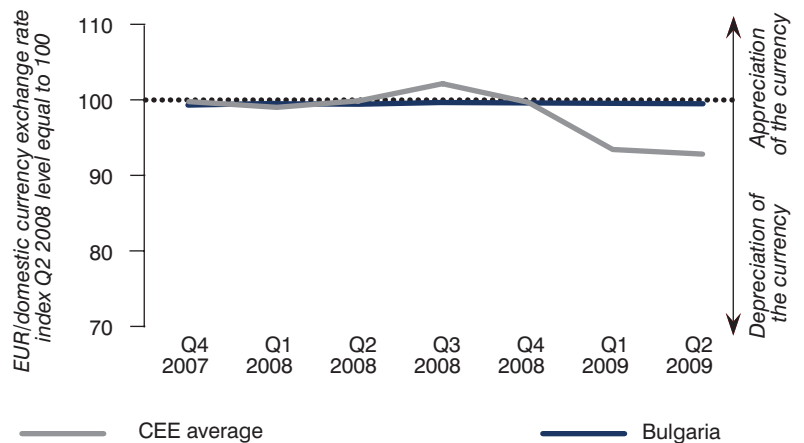
Risk of financial problems: internal imbalance

The main reason for the emergence of serious internal imbalance in Bulgaria was an excessive growth of the domestic demand (particularly in investment), as well as an excessive credit expansion.

It was partly the result of a very strong FDI inflow, exceeding the domestic absorption capacities (the average value of yearly FDI inflows was over 20% of GDP in 2005-2008). On the other hand, the growth of the internal imbalance was also the effect of applying a fixed exchange rate policy for a number of years. The policy led to the maintenance of low interest rates despite the fast growth rate of incomes and relatively high inflation. The real value of domestic credit grew in Bulgaria by 136% between 2005 and 2008 (CEE average: 126%), and the percentage of loans denominated in foreign currencies reached 40% of all households' loans.

According to the European Commission, the public sector deficit will remain close to zero. Bulgaria's situation is complicated by a very high level of financial needs resulting from excessive current account deficit. This means that there is a high risk of departing from the fixed exchange rate, which might lead to a collapse of the currency and a sudden worsening of the quality of the credit portfolio (and, as a consequence, a widespread banking crisis).

Changes in Exchange rate as compared to the region



Source: IMF

Changes regarding taxation and conditions of running a business

Business environment key figures

Basic tax rates (2009): **VAT 20%, PIT 10%, CIT 10%**

Total income of the public sector (2008): **40% GDP**

Effective rate of the total taxation on profits (2008): **35%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
616 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **76**
(global average: 100; CEE average: 86)

Corruption perception index (2008): **3.6**
(10=no corruption, in the CEE region on average 3.9)

Thanks to radical reforms, Bulgaria offers relatively attractive conditions for conducting business activities and moderate tax burdens. However, widespread corruption still remains a problem.

Bulgaria has not introduced a special anti-crisis tax package, and the basic rates of VAT, personal income tax (PIT) and corporate income tax (CIT) remain unchanged. However, in 2009 there were certain changes favourable for taxpayers. Some beneficial changes were implemented for taxpayers, including a five-year CIT exemption in the regions particularly affected by the recession. In order to facilitate running a business,

the depreciation rate for some categories of fixed assets was increased. Also, the possibility of extraordinary reductions in personal income tax was introduced: families paying off mortgages had their taxes lowered, and local taxes were lowered as well. However, no significant measures to improve the conditions of conducting business activities were introduced and no steps have been taken to fight corruption more effectively.

Romania

Basic information

	Romania	CEE Region	Region=100
Population in millions (2008)	21.6	324	6.7
GDP, in USD billions (2008)	200	4,394	4.5
GDP per capita, in USD '000 (2008)*	12.6	14.9	84
Exports, % GDP (2008)	30	45	67
Average GDP growth, 2005-08	6.3	6.0	x
2009 Growth Forecast	-4.1	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

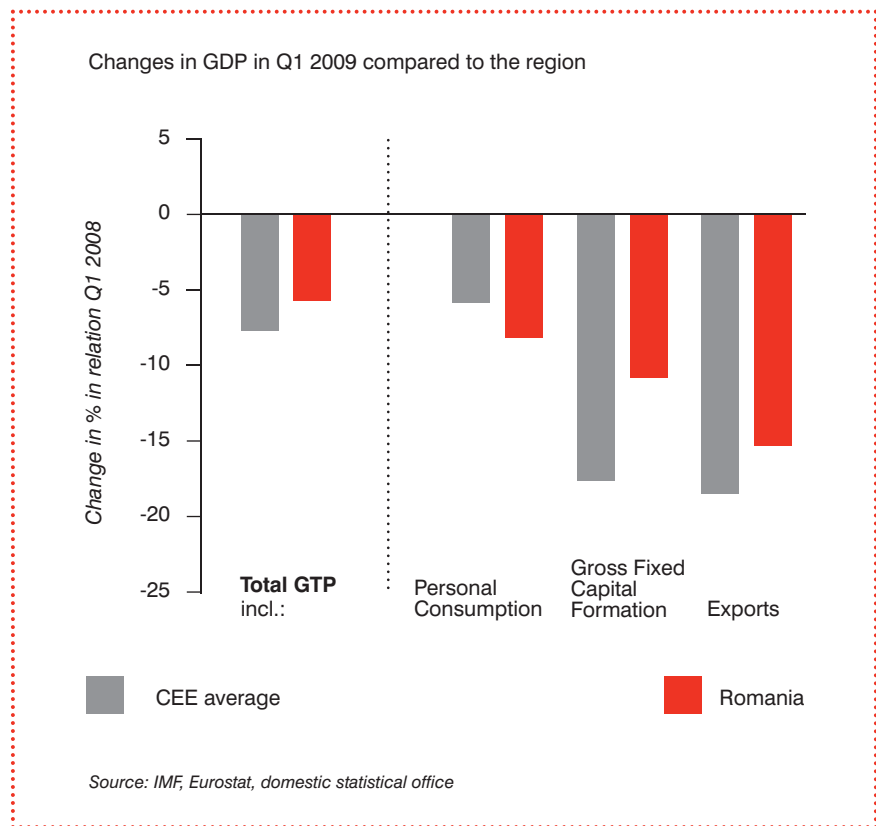
- High investment attractiveness
- European Union membership

Weaknesses:

- Strong exposure to exchange rate risk
- High dependence on external financing
- Excessive private debt.

General assessment of the economic situation

In the case of Romania (similarly to Bulgaria), it has been thought for a long time that the high level of investment attractiveness of the country, combined with its moderate dependence on exports, will help to minimise the effects of the global economic crisis.



The actual course of economic events turned out to be less favourable, although differences in economic policy caused a slightly different map of risk factors in the two countries. The domestic market – although wider than in Bulgaria – turned out to be unable to provide shelter against the crisis. The fall in FDI, common for the whole world, resulted in a significant drop in investment. A strong dependence on external financing, weakness of the banking sector, and the speculative bubble in the financial and real estate property markets bursting, made the situation more complicated.

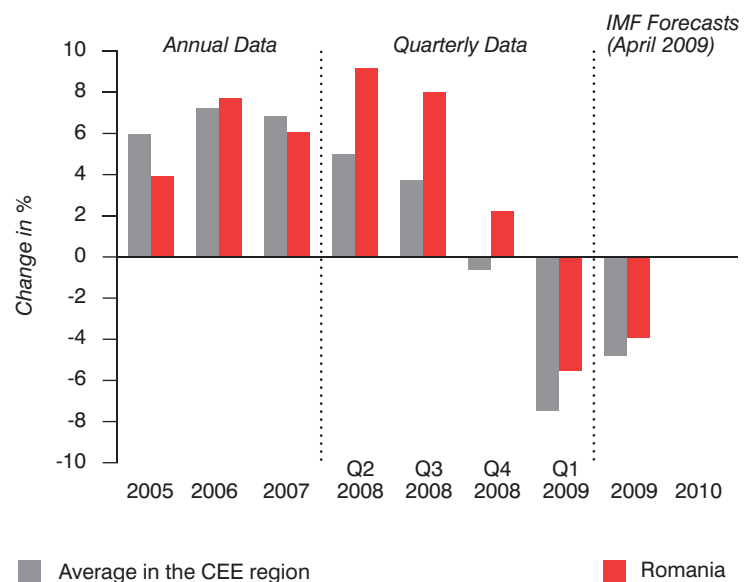
As was the case in Bulgaria, for several years the economy had been seriously overheated, and the country was threatened by a serious cyclical slow-down. This was overlapped by the effects of the global financial crisis which dramatically deteriorated the situation. As a consequence, during the first quarter of 2009 investment fell by -11%, and individual consumption dropped by -8%. This was accompanied by a decline in external demand (exports fell by -15.3%, which was partially limited by depreciation of the currency). As a result, GDP dropped by -5.7%. It appears that the pace of the decline may intensify, and recovery should not be expected until the situation in Western Europe improves.



Prospects for economic growth

Between 2005 and 2008, Romania's economy developed at a rapid pace, with the average GDP growth exceeding 6%. Two strong growth drivers were working simultaneously. One was an inflow of foreign investment, and the other one – a rapid increase in consumption (personal consumption growth between 10% and 13% annually). This led to the excessive built-up of economic imbalances, particularly the increase of the current account deficit (above -13% of GDP in 2008), inflationary pressure, and an extremely fast growth of domestic credit and private debt. The global crisis overlapped with the problems of an overheated market, which halted GDP growth abruptly at the end of 2008. According to current forecasts, the fall in GDP in 2009 was estimated at between -4% and -6%, with zero growth expected in 2010. An additional risk that may make the situation worse would be a further significant weakening of the exchange rate and a banking crisis, which may follow. For now, Romania is protected against such a threat by the financial assistance of the IMF and the European Union.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office



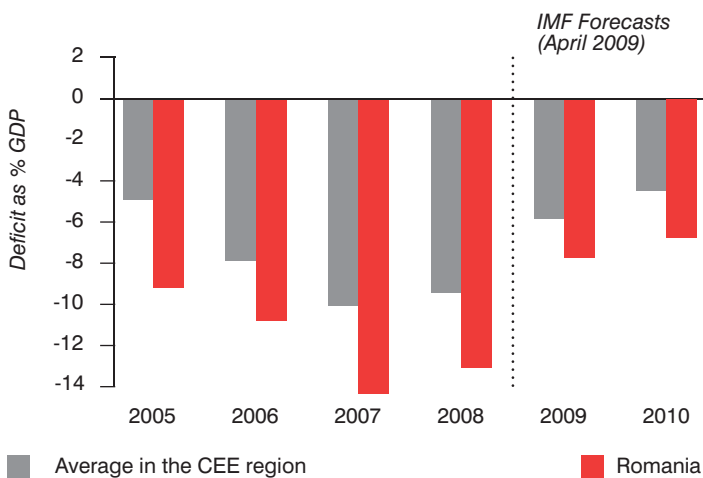
Risk of financial problems: external imbalance

Romania's policy of a floating exchange rate during a period of rapidly growing domestic demand and strong FDI inflows led to a real appreciation of the currency. As a result, the current account deficit increased sizeably, financed partly by the FDIs (as in Bulgaria), and partly by capital

borrowed on the financial markets (especially loans granted to national banks by foreign parent banks). The foreign capital was used both to finance investments and bolster a fast-growing credit portfolio. Between 2005 and 2008, the current account deficit increased from

-9% to -13.5% of GDP. A significant fall of FDI inflows and difficult access to global markets brought a sudden aggravation of problems with funding the deficit. This has forced Romania to apply for IMF and EU financial support.

Current account deficit compared to the region



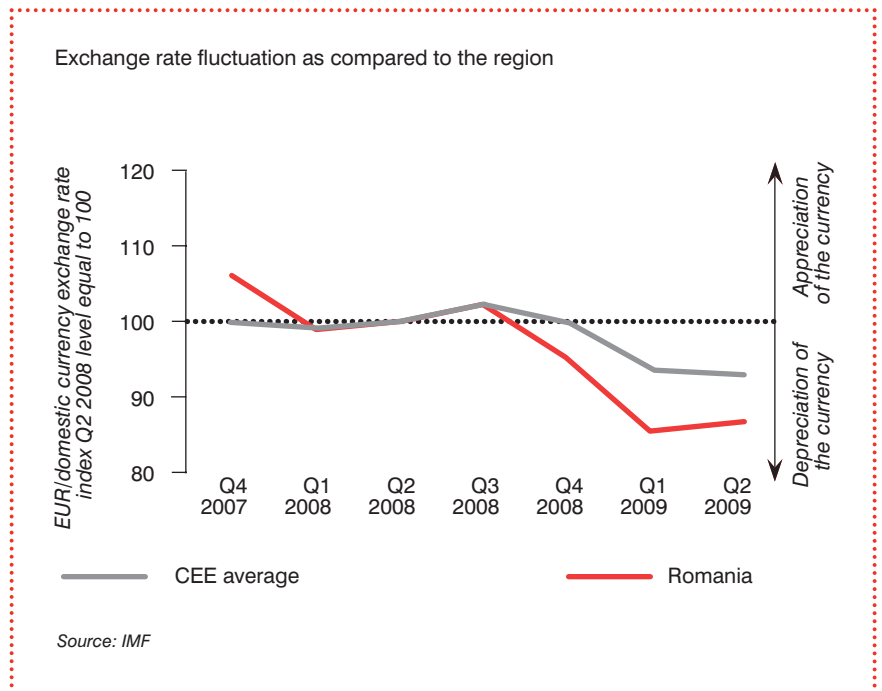
Source: IMF

Risk of financial problems: internal instability

The main reason for the serious internal imbalance in Romania was an excessive dynamics of domestic demand (investment and consumption), as well as an excessive domestic credit expansion.

Significant imports of capital, combined with a relatively high domestic inflation and interest rates, led to a rapid real currency appreciation. This encouraged private entities to apply for credits in foreign currencies. The real value of domestic credit grew in Romania between 2005 and 2008 by as much as 270% (regional average approximately 126%). The percentage of loans denominated in a foreign currency reached 60% of all households' loans. However, the global financial crisis led to a significant depreciation of the national currency, abruptly worsening the situation for borrowers and the banking sector.

At the same time, the public sector deficit grew from -2% of GDP in the years 2006-2007 to over -5% in 2008. According to the European Commission, the public sector deficit will remain at a level of above -5% of GDP in 2009-2010. The situation is complicated by high financing needs caused by an excessive current account deficit. A further strong depreciation of the currency – still possible under these conditions – could put the Romanian banking sector under serious threat.



Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 19%, PIT 16%, CIT 16%**

Total income of the public sector (2008): **30% GDP**

Effective rate of the total taxation on profits (2008): **48%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
202 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **81**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **3.8**
(10=no corruption, in the CEE region on average 3.9)

Generally speaking, Romania offers companies relatively favourable business environment and tax burdens are moderate. However, corruption remains a prevalent problem.

As a result of the crisis Romania has experienced a significant decrease in tax incomes. Until now, this has not caused an increase in interest rates. So far, no changes in basic direct taxes VAT are planned, government representatives claim. However, the rates of excise duty tax on fuel, alcohol and tobacco are being raised. At the same time, a new VAT refund timeline project is under way. As for corporate income tax, the changes that were introduced allow, amongst other things, full depreciation in a shorter time (esp. of the equipment used for research & development purposes). In addition, profits reinvested in Romania are tax-exempt. With respect to personal income tax, revenues from interest on long-term investments and Stock Exchange profits have been temporarily exempt from tax.

At the same time, the government has attempted to limit the development of the black economy and tax evasion by introducing a flat tax for small businesses at the minimum level (tax calculated on the basis of income from 2008, payable also in the case of making a loss in 2009). The minimum tax provoked criticism due to its negative effect on the situation of the majority of companies as their profits and income are falling sharply. The government is currently considering abolishing this tax.

As for conditions for conducting business activities, steps are being taken to improve the access of small companies to bank financing and grants.

Croatia

Basic information

	Croatia	CEE Region	Region=100
Population in millions (2008)	4.4	324	1.4
GDP, in USD billions (2008)	69	4,394	1.6
GDP per capita, in USD '000 (2008)*	18.5	14.9	124
Exports, % GDP (2008)	18	45	40
Average GDP growth, 2005-08	4.2	6.0	x
2009 Growth Forecast	-3.5	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

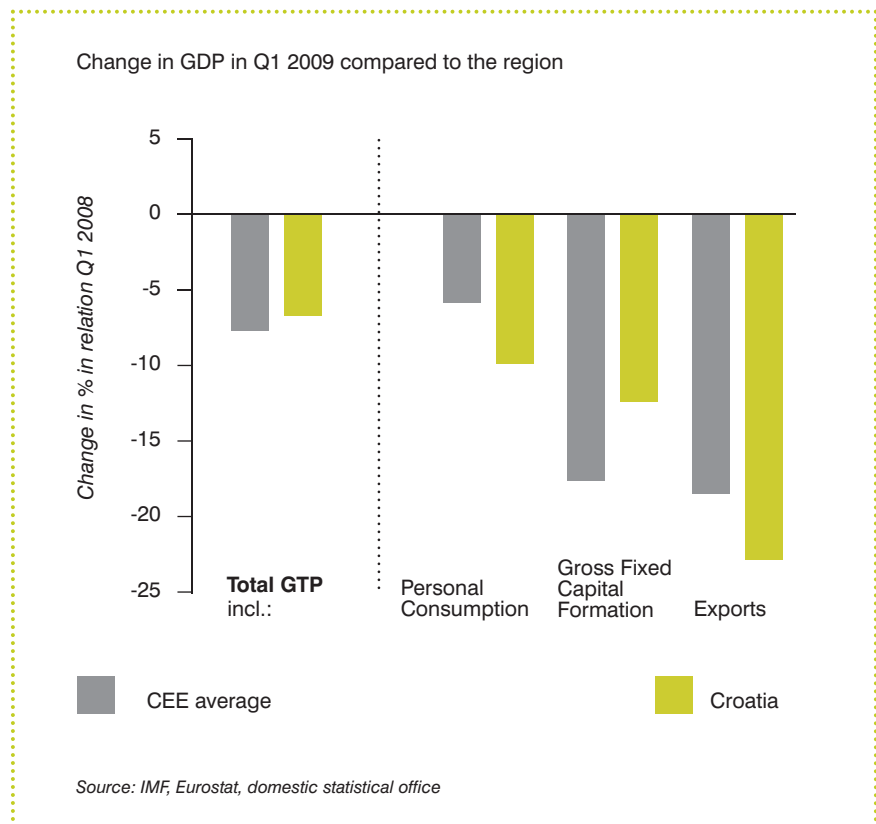
- High investment attractiveness
- Prospect of European Union accession

Weaknesses:

- Limited internal market
- High dependence on external financing
- High dependence on tourism
- Costs of servicing foreign debt

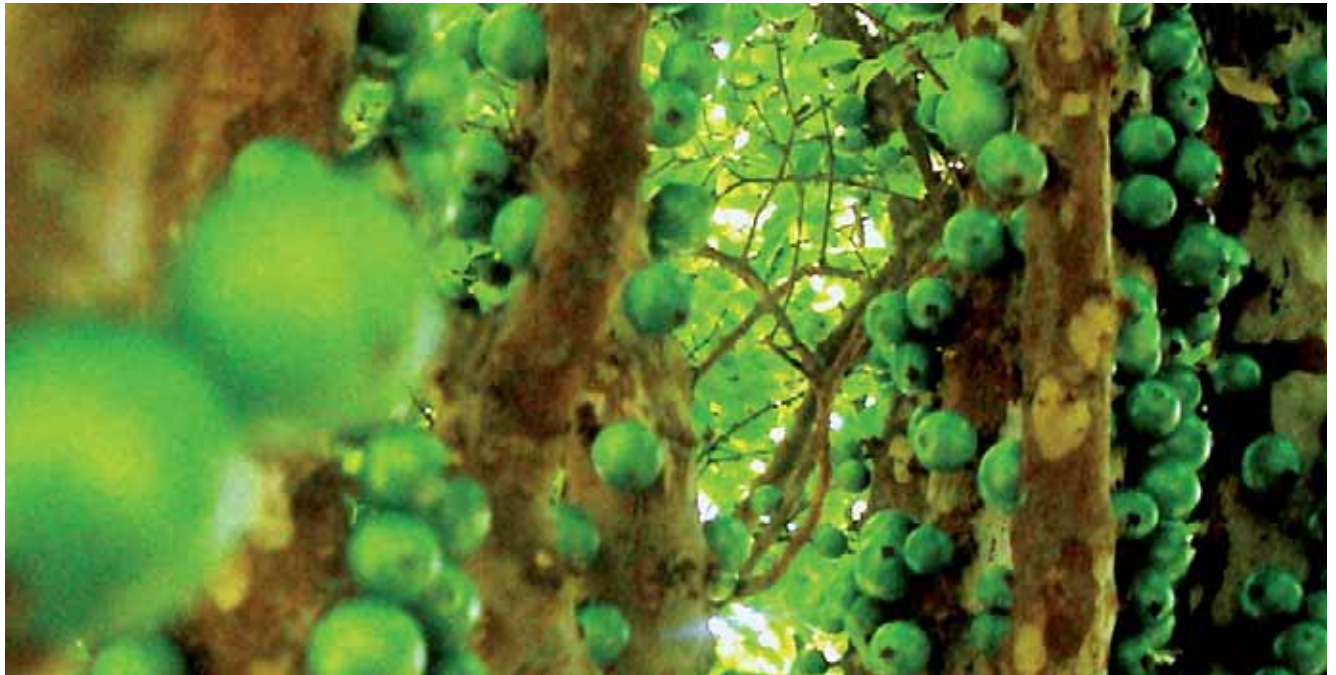
General assessment of the economic situation

In recent years, the economic conditions for growth in Croatia have been more difficult than in Romania and Bulgaria, due to the unfinished EU accession process.



This resulted in Croatia's drop of financial credibility and smaller investment attractiveness – factors of crucial importance in times of limited access to external financing. It also forced the country to conduct more careful macroeconomic policy. Croatia suffers from having a small internal market and significant dependence on exports (particularly of tourist services). The domestic market was unable to provide shelter against the external crisis, and the drop of FDIs resulted in a severe decline in investment.

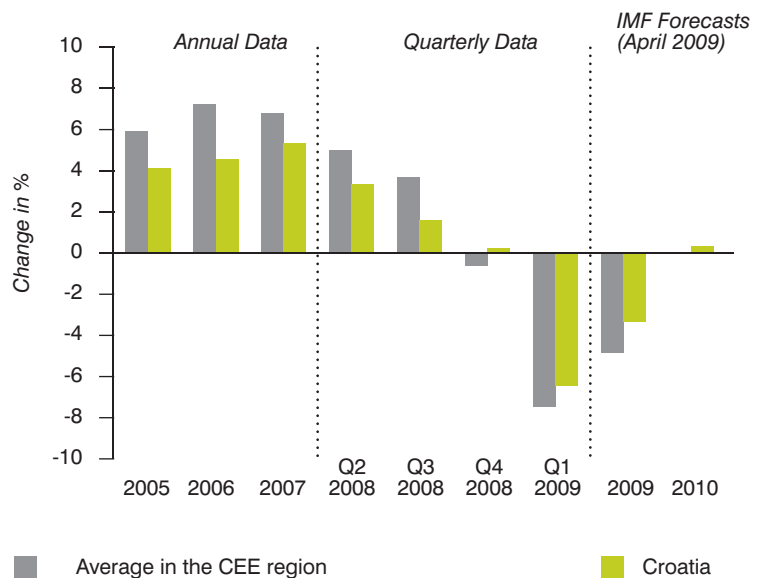
As a consequence, investments in the first quarter of 2009 decreased by -12%, and individual consumption fell by -10%. This was accompanied by a drop in external demand (exports fell by -23%). As a result, GDP decreased by -6.7%. It seems that the scale of decline may increase, and a recovery is unlikely until the situation in Western Europe improves. On the contrary, relatively affordable tourist services in Croatia may prove to be a temporary stabiliser during the crisis.



Prospects for economic growth

In 2005-2008 the Croatian economy's enjoyed a moderate growth in GDP, reaching on average above 4% annually. Despite remaining outside the EU, the country recorded a relatively strong inflow of foreign investment, particularly in the tourism sector. This led to real currency appreciation and the built-up of a relatively high level of current account deficit. A moderately fast growth in consumption did not lead to inflationary pressure. According to current forecasts, the decrease in GDP in 2009 is estimated at between -3% and -4% with a return to growth expected in 2010. The risk that may make the situation worse would be a further significant weakening of the exchange rate, followed by a growth in the costs of servicing foreign debt.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office

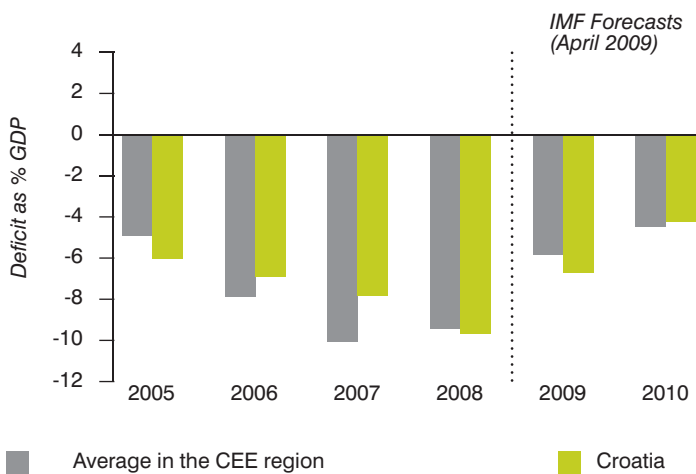


Risk of financial problems: external imbalance

A real strengthening of the exchange rate, caused by the relatively high inflow of FDIs combined with the moderately fast growth of domestic demand, led to an increase in the current account deficit. Between 2005 and 2008, the deficit grew from -5% to -9%. A significant reduction in FDI inflow, as forecasted by EBDR, as well as impeded access to global markets,

caused problems with the deficit financing. A relatively low credit rating of the country is a major problem (BBB- rating by Standard & Poor's, with a serious risk of the rating changing from investment to speculative category). Therefore, Croatia is still threatened by a serious risk of external instability that may force the country to apply for IMF financial support.

Current account deficit compared to the region



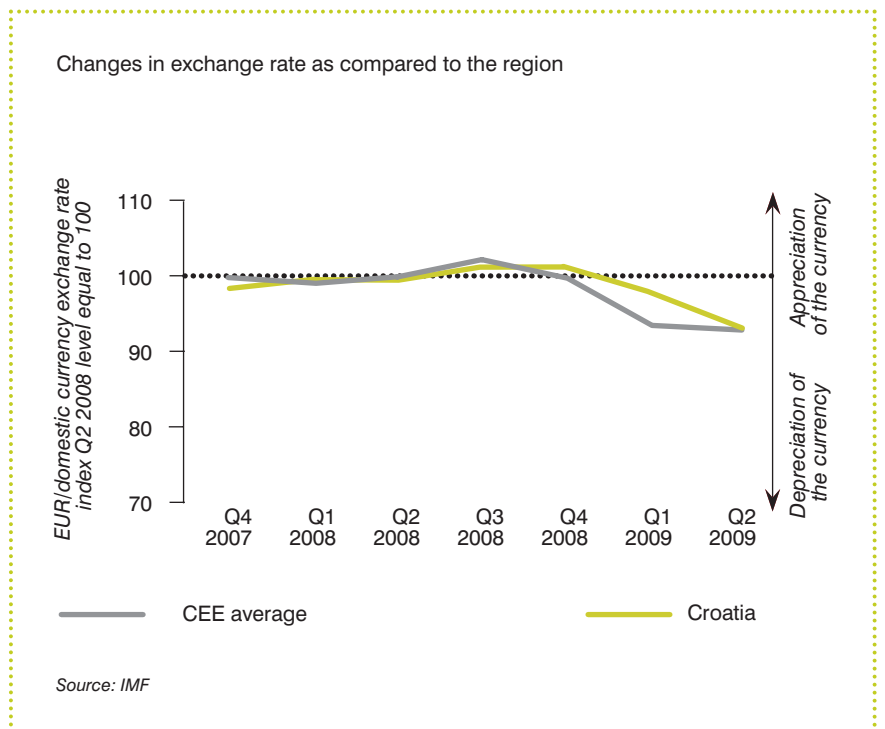
Source: IMF

Risk of financial problems: internal imbalance

Due to the moderate trend in domestic demand and GDP growth in the pre-crisis years, Croatia (in contrast to Bulgaria and Romania) avoided a significant growth of internal imbalance.

Inflation remained at an acceptable level, and the public sector deficit did not exceed -3% of GDP. The real value of domestic credit grew in 2005-2008 by 51% (against the regional average of 126%). Currency appreciation and differences between domestic and global interest rates encouraged households to seek for credits denominated in the foreign currencies, that represent 70% of households' loans. Therefore, the currency depreciation caused by the global crisis had a strong, negative effect on debtors' situation.

The banking sector, however, remains relatively strong as it still benefits from capital injections obtained prior to the outbreak of the current downturn. According to the European Commission, the public sector deficit will remain at a level of -3% of GDP in 2009-2010. Croatia's situation is complicated due to relatively high level of financial needs resulting from the excessive current account deficit. A possible further weakening of the currency may expose the Croatian banking sector to a serious threat.



Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 23%, PIT 0-45%, CIT 20%**

Total income of the public sector (2008): **45% GDP**

Effective rate of the total taxation on profits (2008): **45%**
(CEE average: 46%)

The average time devoted by corporate tax payments (2008):
270 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **96**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **4.4**
(10=no corruption, CEE average: 3.9)

Generally, Croatia offers relatively difficult conditions for conducting business activities.

The public finance problems have forced Croatia to introduce a package of tax changes. The basic VAT rate rose in mid-2009 from 22% to 23%. This was accompanied by an increase in excise tax rates on luxury goods (including cars, boats and aeroplanes), as well as the introduction of taxation of some mobile communication services.

Corporate income tax rates remained formally unchanged; however, for a definite period of time (between 2009 and 2010), an extraordinary income tax (crisis tax), of 2-4% was introduced.

No significant action, such as legal simplifications or reductions in bureaucracy, has been taken to improve the operation of the business environment.

Serbia

Basic information

	Serbia	CEE Region	Region=100
Population in millions (2008)	7.4	324	2.3
GDP, in USD billions (2008)	50	4,394	1.1
GDP per capita, in USD '000 (2008)**	10.8	14.9	72
Exports, % GDP (2008)	22	45	48
Average GDP growth, 2005-08	5.8	6.0	x
2009 Growth Forecast	-2.0	-5.0	x

* Data for Serbia excluding Kosovo

** According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

- Potentially high investment attractiveness

Weaknesses:

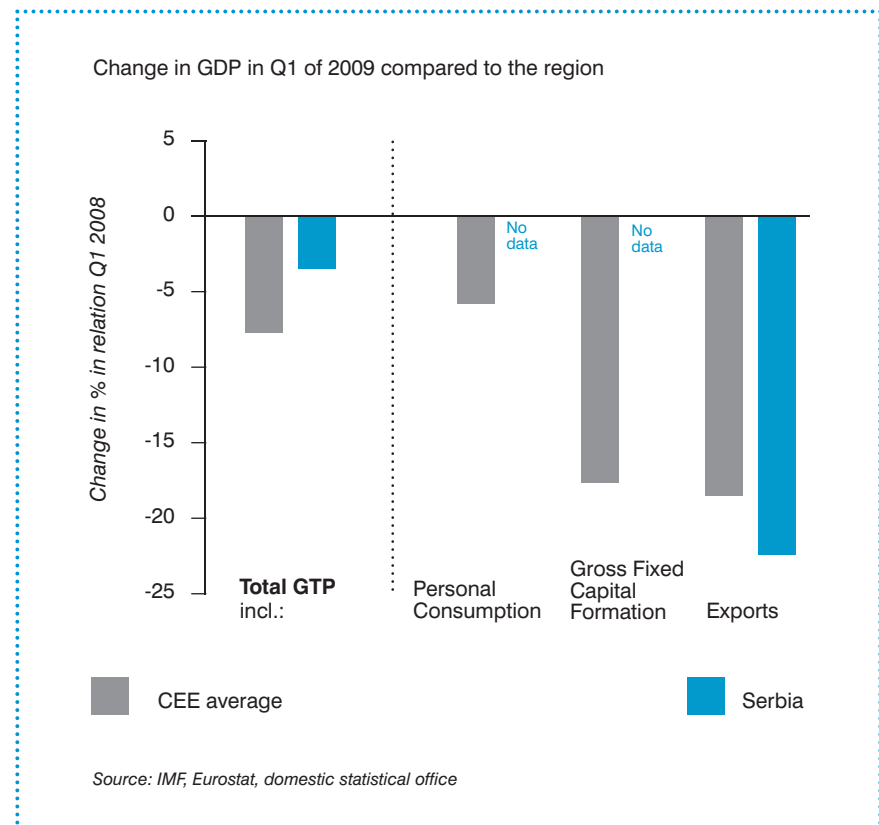
- No clear prospects for EU accession
- Limited internal market
- High dependence on external financing
- Insufficient progress with economic transformation

General assessment of the economic situation

Due to political factors, Serbia has remained on the fringes of the European integration process.

As a result, the country's conditions for development were much tougher than in Romania, Bulgaria (which joined the EU) and Croatia (which is still applying for EU membership). For Serbia, this resulted in lower credibility on the global financial market and lower investment attractiveness, a lack of support from the European Union, and limited opportunities for Serbian goods in the European market. As a consequence, the country is also more exposed to external shocks, and must conduct a more careful macroeconomic policy.

Although there is no detailed statistical data showing the impact of the crisis on the Serbian economy, it is known that it led to a significant drop in exports (an estimate of more than -20%) in the first quarter of 2009, and – consequently – to a -3.5% fall in GDP. Taking into account the relatively small percentage of exports in Serbia's GDP, it may be concluded that total domestic demand has probably fallen as well (by about -2%).

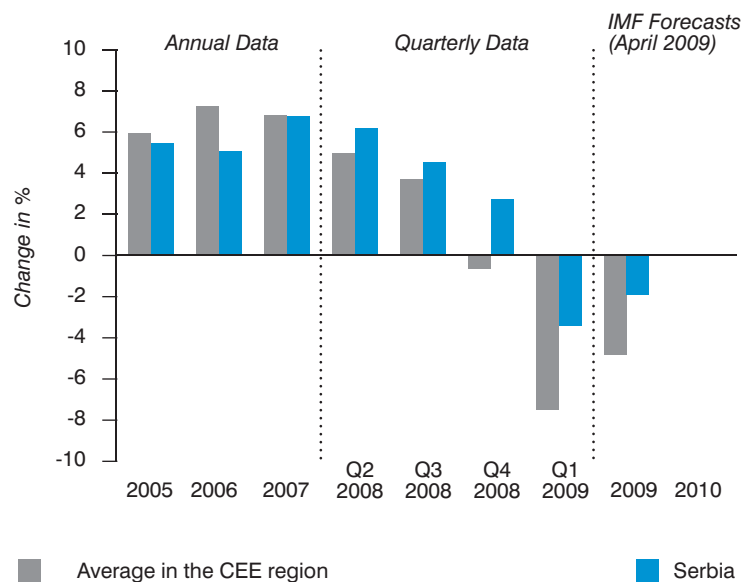




Prospects for economic growth

Between 2005 and 2008, following an extended period of stagnation or decline in production, Serbia's economy started to develop at a relatively rapid rate, with the average GDP growth at almost 6%. Despite a difficult situation in the labour market (an unemployment rate exceeding 30%) and no clear prospect of admission to the European Union, the country recorded an increasing inflow of foreign investment, growth in incomes, improved work productivity, and currency appreciation. The high current account deficit was a consequence of real currency appreciation and acceleration of development, combined with very low level of domestic savings. The outbreak of the global crisis meant instant trouble for the Serbian economy and the country was forced to request assistance from the IMF. According to current forecasts, the fall in GDP in 2009 is estimated at -2%, with zero growth expected in 2010. A serious risk that may make the situation even worse would be a further major weakening of the exchange rate and a destabilisation of the country's finances, encumbered by the high cost of servicing foreign debt.

GDP dynamics compared to the region



Source: IMF, EBDR, national statistical office

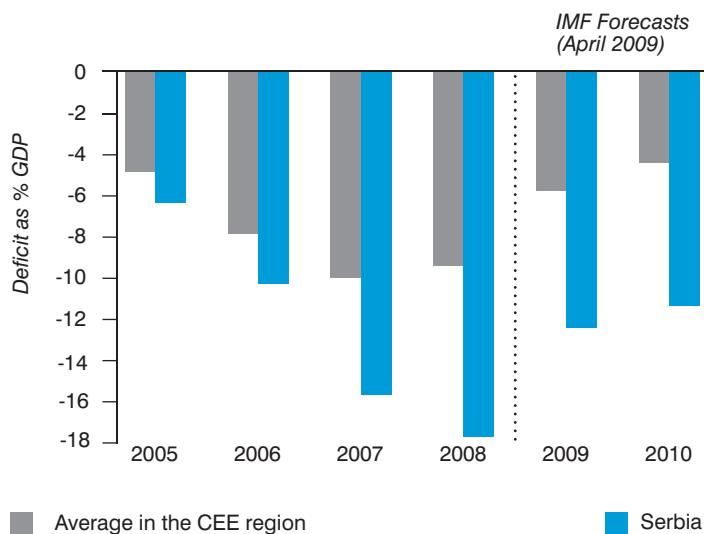


Risk of financial problems: external imbalance

A significant appreciation of the currency (caused by a growing inflow of FDIs and relatively fast growth of domestic demand) has led to a gradual growth in the current account deficit. Between 2005 and 2008, the current account deficit grew from -9% to -17% of GDP. A rapid limitation of access to the global financial market, together with a forecasted significant drop in FDI inflows, left the country in a difficult

situation, forcing Serbia to apply for IMF financial support. This was the only solution given the country's low financial credibility (a BB- rating with a negative outlook according to Standard & Poor's; such a rating is defined as speculative). Despite the assistance package from the IMF, Serbia is still threatened with a serious risk of external instability.

Current account deficit compared to the region



Source: IMF

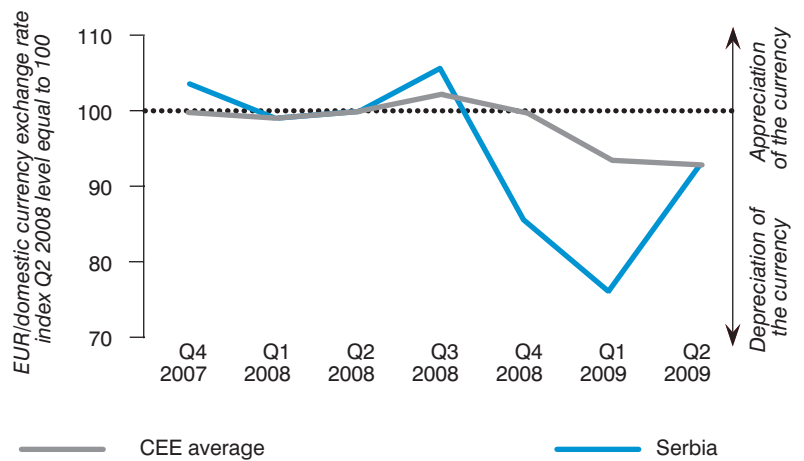
Risk of financial problems: internal imbalance

Regardless of the excessive current account deficit, in past years the Serbian economy was also characterised by relatively high internal imbalances.

Inflation was recorded at an average level exceeding 10%, which forced the central bank to maintain relatively high interest rates. After a number of years of a strong rising trend in public debt, the public sector deficit was restricted to -2% of GDP. The real value of domestic credit grew between 2005 and 2008 by 62% (in the region on average by 126%), with a significant share of loans denominated in the foreign currency.

The global financial crisis led to a deep currency depreciation and affected badly debtors' situation. According to the commitments made to the IMF, the public sector deficit in 2009 should not exceed -3% of GDP. However, it seems doubtful whether, despite cost-saving measures, Serbia will manage to fulfil the promise.

Changes in exchange rate as compared to the region



Source: IMF

Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 18%, PIT 12%, CIT 10%**

Total income of the public sector (2008): **41% GDP**

Effective rate of the total taxation on profits (2008): **34%**
(CEE average: 46%)

The average time devoted to corporate tax payment (2008):
279 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **92**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **3.4**
(10=no corruption, in the CEE region on average 3.9)

It should be noted that conditions for conducting business activities in Serbia are quite difficult. The burdensome bureaucracy is accompanied by a high taxation and a widespread corruption.

Until now, Serbia has made relatively small efforts to change its taxation policies. In order to minimise the consequences of the financial crisis and stimulate investment, temporary personal income tax exemptions were introduced: the exemptions relate to income on interest, capital gains from the transfer of shares, and revenue from farming and forestry. Capital tax on some financial activities was also suspended.

At the same time, there were changes introduced to raise the effective personal income tax rate (abandoning some tax deductions, limiting certain income tax adjustments, increasing the base of the dividend tax). Abandoning the flat tax is also being discussed – in favour of a two-stage progressive PIT.

No significant actions have been taken to facilitate the conducting of business activities and limit the scale of the corruption.

Belarus

Basic information

	Belarus	CEE Region	Region=100
Population in millions (2008)	9.7	324	3.0
GDP, in USD billions (2008)	60	4,394	1.4
GDP per capita, in USD '000 (2008)*	12.3	14.9	82
Exports, % GDP (2008)	53	45	117
Average GDP growth, 2005-08	9.5	6.0	x
2009 Growth Forecast	-4.3	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

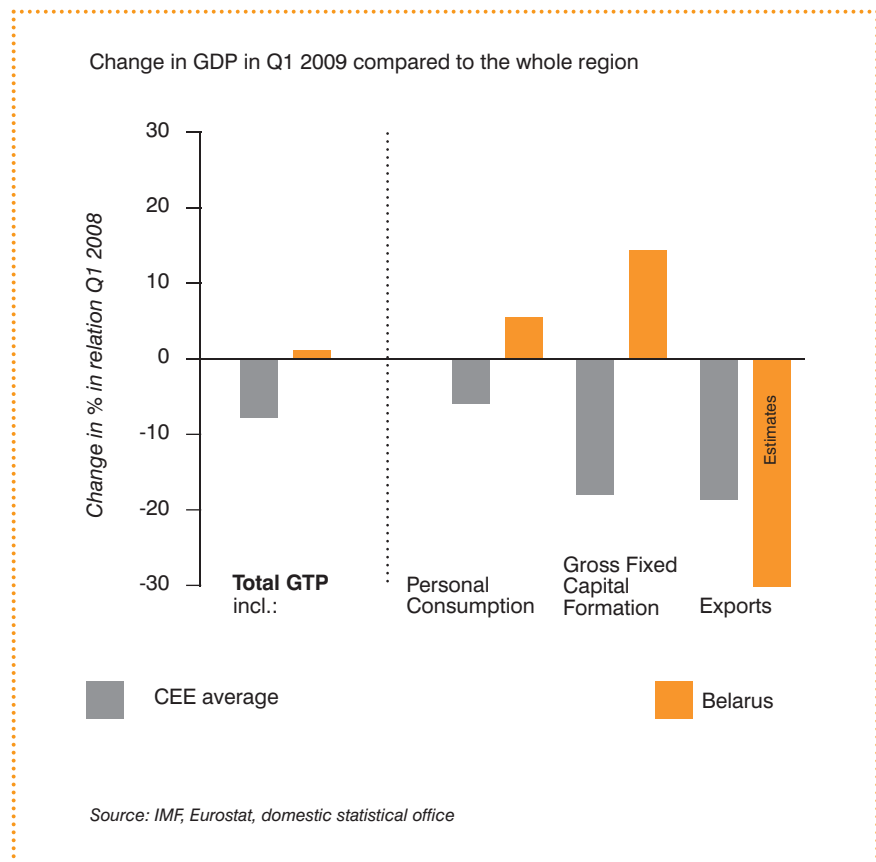
- Potentially high investment attractiveness

Weaknesses:

- Slow progress with the economic transformation
- No prospect of EU membership
- Restricted internal market
- High dependence on external financing
- Low financial credibility
- Difficult conditions for conducting business activities

General assessment of the economic situation

Although the quality of statistical data published by Belarus may be questioned, even incomplete information shows that the country has been seriously affected by the global crisis.



An insufficient commitment to reforms and transformation, weak and unstable economic foundations, combined with a high dependence on the situation in Russia (sales to Russia constitute almost 40% of Belarus's exports), have made the country's economic situation very difficult. According to estimated data, exports in the first quarter of 2009 decreased by about -30%.

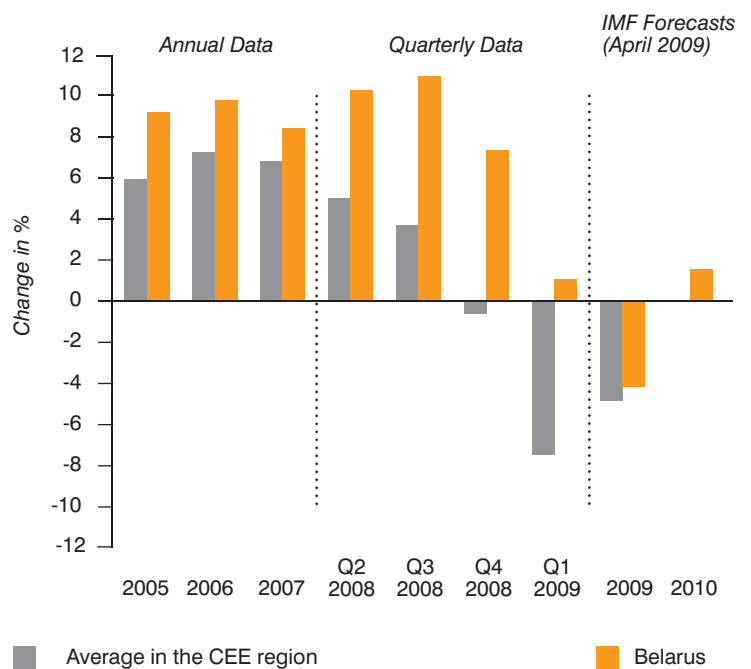
The published data suggests that domestic demand is still rising (investment by 14.5% and consumption by 5.5%). As a consequence, GDP is still rising although at a much slower pace (1%). A certain level of scepticism about the data is recommended, though. Even if these figures reflect the actual situation, the data for the following quarters of the year is likely to show a deep fall in GDP.



Prospects for economic growth

According to published official data, before the crisis Belarus had a high GDP growth rate of 10% annually. There is no doubt that the country was developing at a relatively rapid rate, benefiting from the favourable economic situation created by high economic growth in Russia. At the moment of the outbreak of the global crisis, however, the economy of Belarus found itself in a serious trouble, and had to request support from the IMF. The prospects for growth became drastically worse with the onset of the recession in Russia. In addition, Belarus has a problem with financing its excessive current account deficit. According to current forecasts, the drop in GDP in 2009 is estimated at over -4%. GDP is expected to stagnate in 2010.

GDP dynamics compared to the region



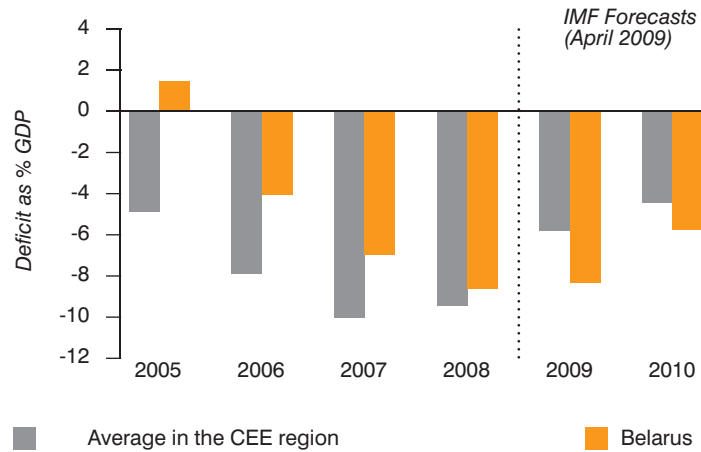
Source: IMF, EBRD, domestic statistical office

Risk of financial problems: external imbalance

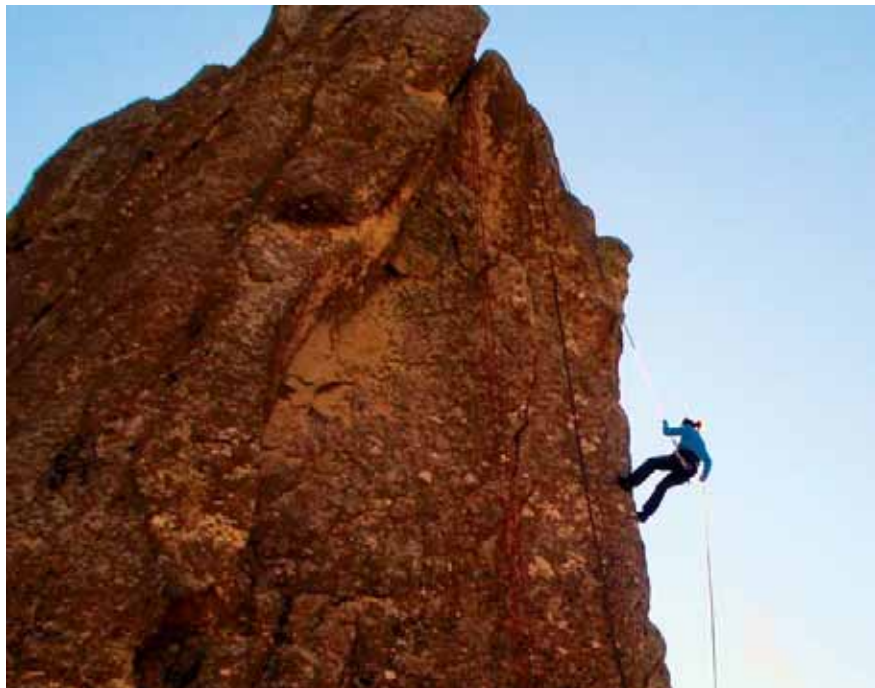
The relatively fast economic growth of Belarus in 2005-2008, and in particular the fast growth of investment demand and consumption, led to a radical deterioration in its external balance. The current account surplus recorded in 2005 turned into a deficit of -8% of GDP in 2008. This deficit was partially financed with FDI inflow (mainly Russian) and in the remaining part by loans and growth of payment arrears to the Russian Federation (which also subsidised exports of energy to Belarus).

The outbreak of the global financial crisis, coupled with the forecast of a significant drop in the FDI inflow and the deterioration in the financial situation in Russia, put the country in difficulties. Belarus was forced to seek financial assistance from the IMF. This was the only solution to the problem of financing the excessive deficit, given the country's very low financial credibility (a B+ rating with a negative outlook, according to Standard & Poor's; such a level of rating is defined as speculative and not investment). Despite the assistance package from the IMF, Belarus is still threatened with a serious risk of external instability.

Current account deficit compared to the region



Source: IMF

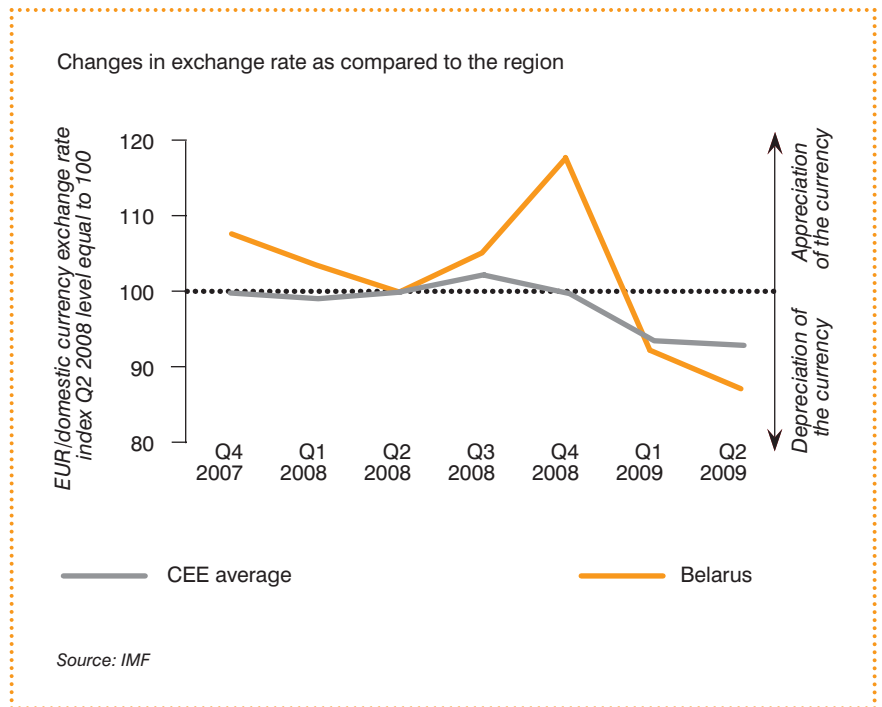


Risk of financial problems: internal instability

Belarus's economy is characterised by relatively high internal imbalances.

The 2005-2008 inflation rate was above 10% on average, which forced the central bank to maintain relatively high interest rates. The real value of domestic credit grew in the years 2005-2008 by 162% (CEE average: 126%). Although officially the budget remained close to a balance, the actual public sector deficit was higher due to transfers to state-owned companies not registered in the budget (according to the IMF, in 2008 the actual deficit was

-5.5% of GDP as opposed to the small surplus presented in the official statistics). The global financial crisis led to significant depreciation of the currency, which translated into the higher inflation. According to the commitments made to the IMF, the actual public sector deficit in 2009 should fall below -3% of GDP. However, it seems doubtful whether Belarus will manage to fulfil this promise.



Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 18%** (+general sales tax 5%), **PIT 15%**, **CIT 24%**

Total income of the public sector (2008): **52% GDP**

Effective rate of the total taxation on profits (2008): **118%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
1188 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **102**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **2.0**
(10=no corruption; CEE average: 3.9)

Conditions for conducting business activities are among the most difficult in the region. Belarus is a country of high tax burdens and widespread corruption.

Belarus has not yet introduced any major changes in its taxation policy in response to the crisis. VAT rates have not been amended, although during times of financial trouble they are likely to increase. In 2009, a flat personal income tax was introduced – it replaced a complicated progressive tax. This change has not brought any radical simplification of the taxation system – there are still many various types of income tax applicable.

Small companies now have the opportunity to benefit from a simplified tax settlement. However, this does not change the fact that the Belarus taxation system is one of the most unclear and burdensome not only the entire region, but in the whole world.

No significant efforts have been made to reduce the bureaucracy or corruption, and to improve the conditions for conducting business activities.

Russian Federation

Basic information

	Russian Federation	CEE Region	Region=100
Population in millions (2008)	142.8	324	44.1
GDP, in USD billions (2008)	1,677	4,394	38.2
GDP per capita, in USD '000 (2008)*	15.9	14.9	107
Exports, % GDP (2008)	28	45	63
Average GDP growth, 2005-08	7.0	6.0	x
2009 Growth Forecast	-6.0	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

- Large natural resources
- High currency reserves accumulated between 2000-2008
- Moderate government debt
- Large internal market

Weaknesses:

- Slow progress in economic transformation
- Excessive dependence on the export of energy resources
- Difficult conditions for conducting business activities

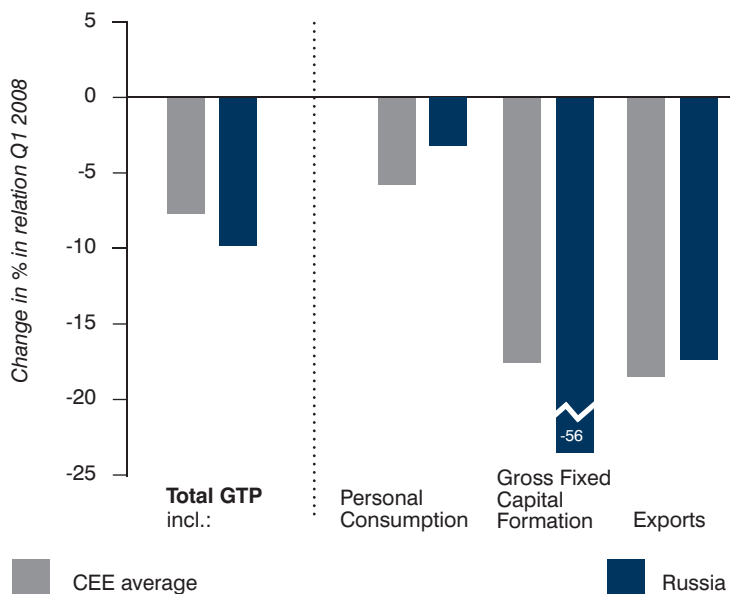


General assessment of the economic situation

The economic crisis took Russia largely by surprise, as only a few months ago a fast rate of economic growth was still expected.

The main sources of the problem were the fall in oil prices since summer 2008 and the decreasing global demand for energy. In addition to diminished exports, Russia encountered internal problems resulting mainly from the weakness of the banking sector and the financial market. As a result, Russia suffered a sudden fall in corporate investment. The impact of the recession was, until now, weakened by the massive government stimulus package. In order to support economic activity, the government is continuously trying to intervene on the market. The published indices show a sudden deterioration in the country's economic situation. Exports in the Q1 of 2009 fell by -14.5%, investment fell by -56%, and personal consumption by -3.2%. According to the published data, the Russian GDP decreased by -9.8%.

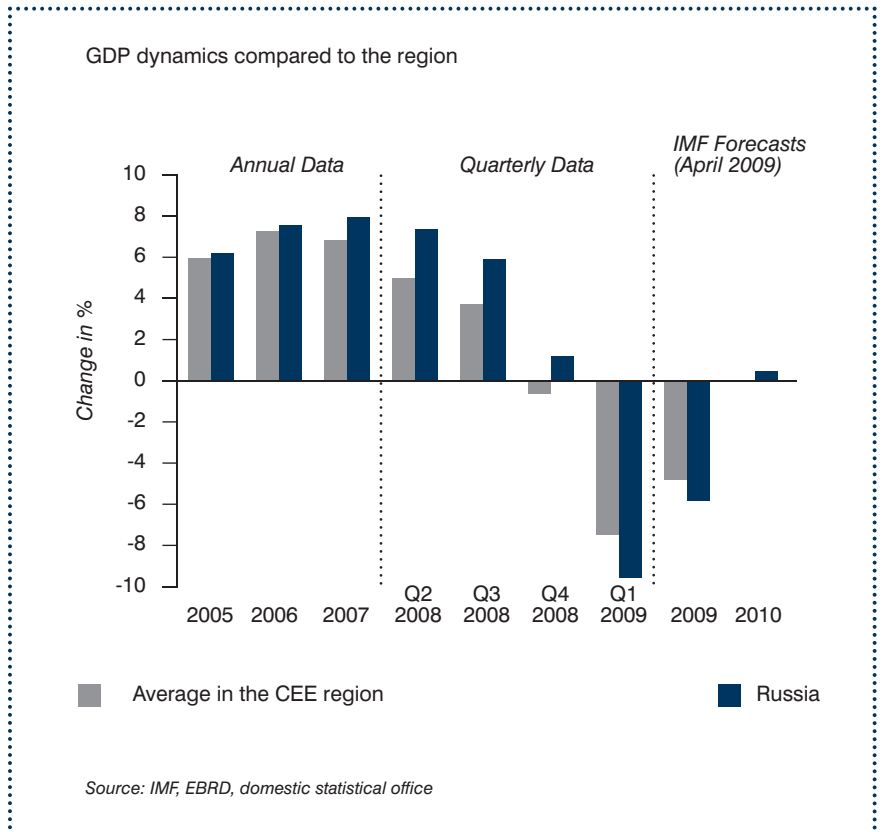
Changes in GDP in Q1 2009 compared to the whole region



Source: IMF, Eurostat, domestic statistical office

Prospects for economic growth

Since a deep crisis in 1998, for many years Russia recorded a rapid economic growth.



Good economic performance was, to a large extent, connected with growing revenues from oil and gas exports. This factor allowed Russia both to maintain a rapid growth in GDP (reaching 7% annually in 2005-2008) and radically improve the country's financial stance. According to the explicit strategy adopted by the government, a certain proportion of the revenue from energy exports was not assigned to current expenditure but put apart as a special fund. As a result, the public sector recorded a large budget surplus, and the central bank acquired very large foreign exchange reserves.

However, those activities turned out to be insufficient to maintain balanced growth. Both personal consumption and investment grew much faster than GDP (at average annual rates of 12% and 16%, respectively), and imports rose at a real rate of over 20% per year. Last year's sudden fall in the price of oil (recorded after many years of growth) has brought this process to a halt, at least for some time.

According to current forecasts, GDP will decrease by between -6% and -7% in 2009, with an expected return to growth in 2010.



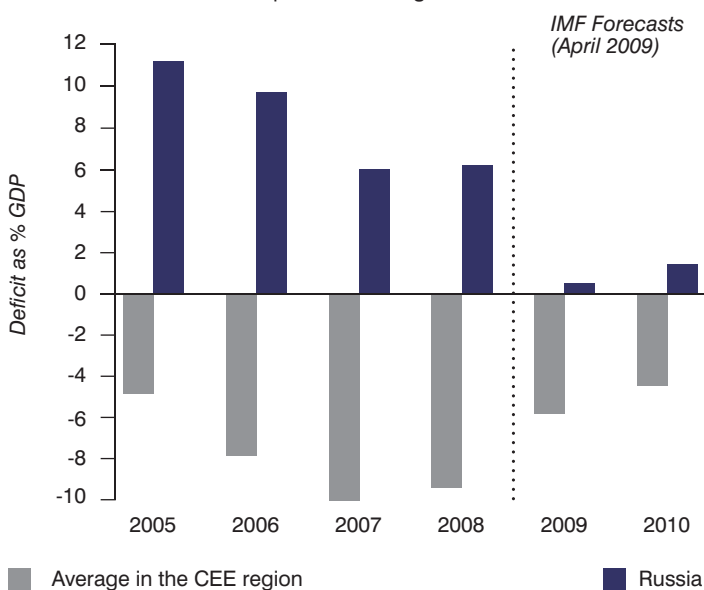
Risk of financial problems: external imbalance

Due to the huge income from the export of energy resources and thanks to the foreign exchange reserves accumulated in previous years, Russia is not currently threatened by any major external imbalance. In former years, the country recorded a current account surplus of between 5% and 11% of GDP. The fall in oil prices, with simultaneous governmental attempts to actively utilize the reserves to counter the recession, led to a very fast weakening

of Russia's financial position. The country's foreign exchange reserves fell by one third within the last half-year period, and a large current account surplus recorded in previous years will probably fall to zero in 2009. The situation is further complicated by forecasted reduction in FDI inflows and a relatively low credit rating of the country (a BBB rating with a negative outlook according to Standard & Poor's, which means

a serious risk of the country being downgraded from an investment category to a speculative category). Significant reserves accumulated in previous years may undoubtedly help Russia to weather the current financial crisis. Nevertheless, if the crisis continues, or if a further significant fall in oil prices occurs, the external balance of the country may be threatened in the long run.

Current account deficit compared to the region



Source: IMF

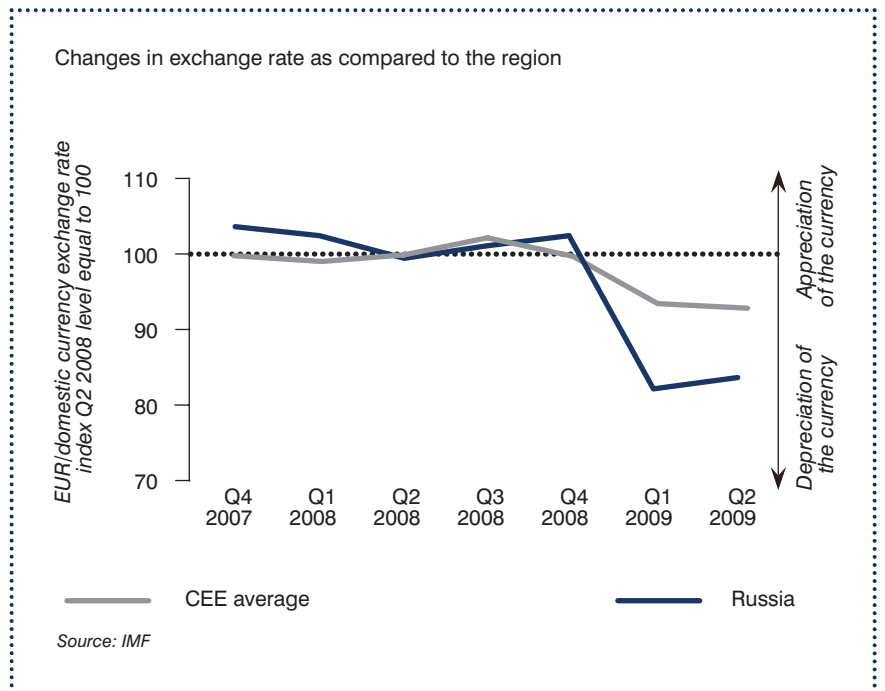
Risk of financial problems: internal imbalance

The economic growth before the crisis led to the emergence of an internal imbalance in Russia.

Despite the tendency of real currency appreciation and a large budget surplus, huge foreign exchange influx connected with the export of energy resources (and, to a large extent, also with foreign investments, particularly in the energy sector) led to strong inflationary pressure. In 2005-2008 the average recorded inflation was at the level of 11% annually. However, the real value of domestic credit in Russia only grew by 66% between 2005 and 2008 (CEE average: 126%). The global crisis led to significant currency depreciation, speeding up of inflation and causing a sudden deterioration in the banking sector situation.

Also, the public finance surplus changed instantly to a large deficit. This resulted from both a fall in tax receipts and the policy adopted by the government to combat the crisis. Russia decided to launch a large package of activities to stimulate the economy, with the total value of the package estimated at 14% of GDP (growth of government expenditure, subsidies to companies and banks and tax reductions).

According to a forecast, the public sector deficit of 2009 will grow to -8% of GDP.



Changes regarding taxation and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 18%, PIT 13%, CIT 20%**

Total income of the public sector (2008): **41% GDP**

Effective rate of the total taxation on profits (2008): **49%**
(CEE average: 46%)

The average time devoted by corporate tax payments (2008):
448 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **109**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **2.1**
(10=no corruption, CEE average: 3.9)

Russia, as opposed to the majority of CEE countries, decided to actively counteract the crisis and stimulate the economy with tax reductions.

VAT rates have not changed; however, imported technical equipment has been exempted from VAT, and certain facilities for settling tax demands have been put forward. The corporate income tax rate has been reduced from 24% to 20% by limiting the portion of tax paid to the federal budget. The regions were thus encouraged to decrease the simplified CIT rate further (for small companies). The government declared its readiness to defer tax payments for companies heavily in debt, or to allow tax payments via an instalment plan.

For individual taxpayers, additional tax deductions related to house building were introduced. The conditions for conducting a business have also changed. A group of 295 companies from key sectors of the economy (including the oil sector) may be supported by government subsidies. At the same time, funds to support small businesses were significantly increased. The government also declared its willingness to reduce bureaucratic barriers – they are considered to be one of the most serious deterrents to business operations in Russia.

Ukraine

Basic information

	Ukraine	CEE Region	Region=100
Population in millions (2008)	46.5	324	14.3
GDP, in USD billions (2008)	180	4,394	4.1
GDP per capita, in USD '000 (2008)*	7.3	14.9	49
Export, % GDP (2008)	36	45	80
Average GDP growth, 2005-08	5.1	6.0	x
2009 Growth Forecast	-8.0	-5.0	x

* According to purchasing power parity

Source: IMF, CIA World Factbook, EBRD

Strengths and weaknesses of the economy

Strengths:

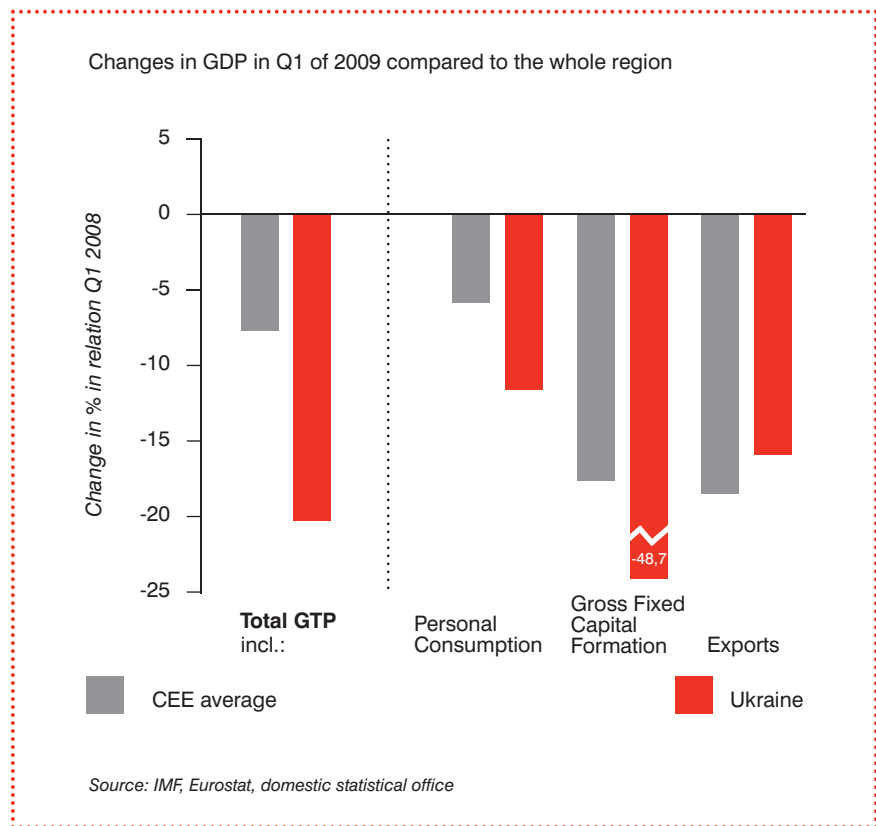
- Potentially high level of investment attractiveness

Weaknesses:

- Slow progress in economic transformation
- No prospect of EU membership
- Political chaos
- High dependence on external financing
- Low financial rating
- Obstacles to running a business

General assessment of the economic situation

Ukraine falls into the group of countries most severely affected by the global crisis. In the case of this country the main issue lies in the overlap of a few extremely unfavourable phenomena.



Firstly, inconsistent economic reforms made the country's economic foundations very weak and its financial sector vulnerable to shocks. Secondly, in the last few years the economy had become overheated, which had to lead to a cyclical slowdown in growth. Thirdly, exports are strongly dependent on the situation in Russia (additional problems arise from constant disputes with Russia about gas supplies). Fourthly, due to a low credit rating, the country is practically deprived of access to global financial markets. Finally, the political chaos makes the situation even more difficult.

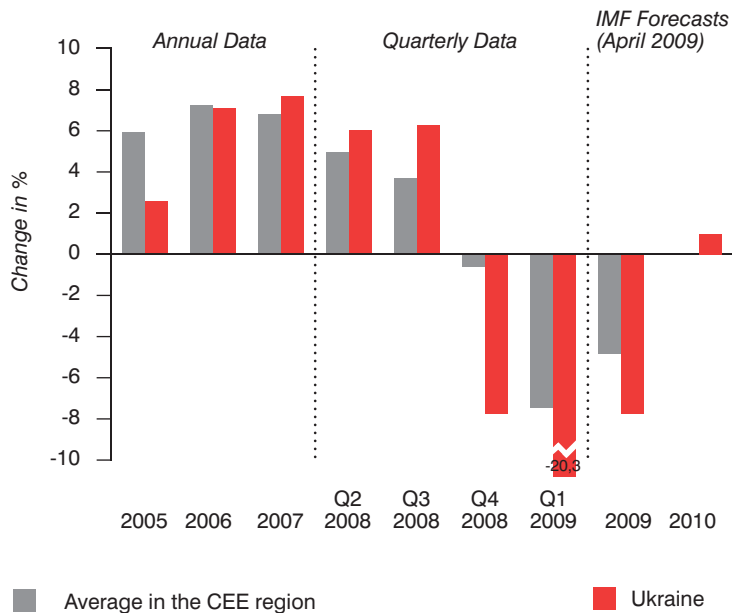
Although the quality of statistical data published by Ukraine is doubtful, even incomplete information suggests that the country is experiencing heavy crisis. Exports in the first quarter of 2009 fell by -16%, investments by -49%, and personal consumption dropped by -11.6%. According to the published data, GDP fell by -20%.



Prospects for economic growth

According to the official data, after many years of stagnation or decreasing production, in 2005-2008 Ukraine recorded relatively high GDP growth rate exceeding 5%. However, the development was heavily imbalanced. The main drivers behind the growth were personal consumption and investments (growing on average by 15% and 13%, respectively). Imports increased proportionally, while exports decreased, which caused a fast accumulation of the external and internal imbalance, eroding the fundamentals of the development. The global crisis quickly changed that obstacle into a real disaster. According to current forecasts, the GDP fall in 2009 was estimated at between -8% and -12%. GDP is expected to stagnate in 2010.

GDP dynamics compared to the region



Source: IMF, EBRD, domestic statistical office

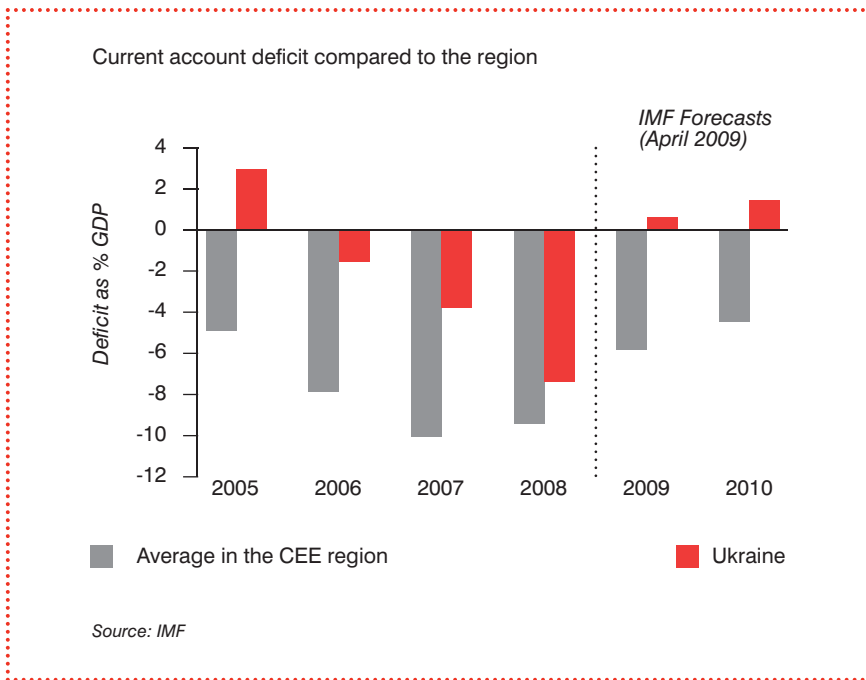


Risk of financial problems: external imbalance

The exceptionally imbalanced nature of the economic growth recorded in 2005-2008 resulted in Ukraine's serious external imbalance, reflected in the rapid deterioration of the current account. The current account surplus recorded in 2005 changed to a deficit of about -7%

GDP in 2008. This deficit was partially financed by relatively big FDI inflows. However, the outbreak of the global financial crisis coupled with a significant fall in FDI inflows, put the country in an extremely difficult situation and forced Ukraine to seek financial

support from the IMF. It was the only solution, given a very low financial credibility (a CCC+ rating according to Standard & Poor's practically means the country's bankruptcy). Despite the rescue package from IMF, Ukraine still faces a serious risk of external instability.



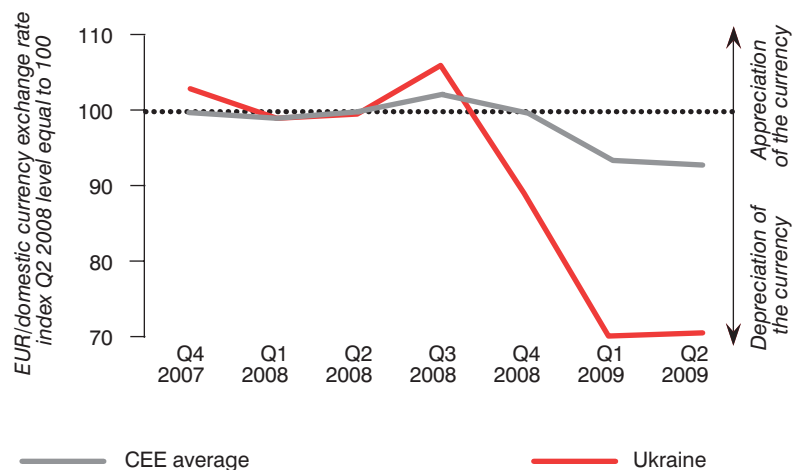
Risk of financial problems: internal imbalance

The Ukrainian economy is characterised by relatively high internal imbalance.

Between 2005 and 2008 inflation was at an average level of over 10%, which forced the central bank to maintain a relatively high level of interest rates. At the same time, real appreciation of the currency resulting from growing capital imports encouraged households to take foreign currency debts. The real value of domestic credit grew in 2005-2008 by as much as 306% (in the region approximately by 126%) and the percentage of loans denominated in foreign currency reached 70% of all households' loans. Although, according to official numbers, the public sector deficit was not high (it did not exceed -2% GDP), its real value being probably higher.

The global financial crisis has led to a currency collapse, which had an immediate inflationary effect, deteriorated debtors' situation and the position situation of the whole banking sector. According to the forecasts, the public sector deficit is expected to grow to -5% of GDP in 2009, on condition that Ukraine delivers its commitment made to the IMF. The situation of Ukraine is still extremely difficult; any further depreciation of its currency would put the entire banking sector in real danger.

Changes in exchange rate as compared to the region



Source: IMF

Changes in the scope of taxes and conditions for running a business

Business environment key figures

Basic tax rates (2009): **VAT 20%, PIT 15%, CIT 25%**

Total income of the public sector (2008): **44% GDP**

Effective rate of the total taxation on profits (2008): **58%**
(CEE average: 46%)

The average time devoted to corporate tax payments (2008):
848 hours/year (CEE average: 424 hours p.a.)

Business activity barriers index (2008): **123**
(global average: 100, CEE average: 86)

Corruption perception index (2008): **2.5**
(10=no corruption, CEE average: 3.9)

Ukraine exposes companies to the most difficult conditions accompanied by high tax burdens and a widespread corruption.

In particular, the difficult economic situation in Ukraine forced the government to undertake a number of tax-related activities intended to avoid excessive growth in the budget deficit.

Although VAT rates have not been increased, the solutions are unfavourable for taxpayers (including e.g. the possibility of a VAT refund in the form of treasury bonds). Concurrently, excise duty rates were increased.

As for corporate income tax, the possibility of deducting losses resulting from devaluation of the hryvnya was limited. Social insurance contributions for employees were increased.

However, no significant efforts have been made to reduce burdensome bureaucracy, corruption, or to improve conditions for running business activities.

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