

Albania



Albania's drive in 2007 to implement reforms needed to get NATO membership followed the signing of a Stabilization and Association Agreement (SAA) with the European Union in 2006. The reform drive was rewarded when Nato's Bucharest summit in 2008 extended an invitation to Albania and Croatia to join the western alliance.

Before that, local government elections at the beginning of 2007 saw the left wing opposition parties winning in most of the towns and cities. But, the right wing ruling coalition, which won the general election in 2005, triumphed in the countryside.

Meanwhile, economic problems continue to bedevil the country. Power shortages in the second half of 2007 caused major problems. But they failed to dent an impressive 6 per cent gross domestic product (GDP) growth figure which looks to be matched both this year and in 2009. The power cuts have prompted new energy projects, which together with planned privatisations will make 2008 an exciting year in Albania

In 2007, inflation stayed within the Bank of Albania's target of 2.9 per cent but, despite stringent monetary policies, the figure is expected to hit 4 per cent both this year and in 2009. Meanwhile, unemployment fell to 13.2 per cent in 2007.

Since coming to power in 2005, the ruling coalition has turned to sales of state owned companies, public private partnerships (PPP) and green field projects to attract foreign investment. Several reforms - such as making it easier to register new companies - have been brought into make Albania more investor friendly. The biggest change came in fiscal policy, where parliament approved a new ten per cent corporate tax, starting in 2008, compared to the previous tax level of twenty per cent.

The completion of the EUR 120 million sale in 2007 of Albtelecom to a consortium led by the Turkish owned Calik group became Albania's first major privatisation of the year. The privatisation package included a license as the country's the third mobile operator, which had been held by Albtelecom. This year is expected to be rich in sales of state owned assets including the Power Distribution Company (OSSH), the Oil Refining and Distribution Company (ARMO), the Insurance Institute (INSIG) and the state shares in AMC (a mobile operator). The sale of these companies should provide revenues worth around 500 million euro for the state budget.

Power cuts in 2007 have pushed energy projects to the top of the government's agenda. PPPs were agreed with the government for the construction and operation of new hydro power installations on the country's main rivers. PPPs also covered the operations of existing thermal power plants such as Vlora. The government has also lobbied hard to have Albania become part of major international energy routes such as pipelines.

Nevertheless, the biggest investment projects are managed by state owned enterprises and funded, either through the budget or with loans from international financial organizations such as the World Bank and the European Bank for Reconstruction and Development with the focus on infrastructure projects. The major share of the spending is going on the highway linking the port of Durres with Kosovo. The total cost is yet to be finally calculated but it is expected to exceed EUR 500 million.

In 2007 exports, mainly of minerals such as chrome, grew but as imports grew by even more, the trade deficit rose. The key driver of the rise in import costs was the import of electricity during the power crisis and the rise in oil prices.

The most successful companies in Albania in 2007 were, once again, the two mobile operators, Vodafone and AMC (part of the Greek, Cosmote group) which continued to enjoy high sales and profit margin levels. The Albanian Power Corporation, Albania's biggest company by turnover, took a major hit during the power crisis and the subsequent rise in imports had a major impact on its profits. Other high revenue sectors in 2007, were the oil industry (extraction, refining, wholesale, retail), cement production and trading and mineral extraction (especially chrome). Turnover levels at construction companies suffered when the issuing of construction permits was temporarily suspended. The problem was resolved in 2008 thanks to an agreement between central and local government.

Banking and insurance continued to grow as major financial groups from the European Union took stakes in the financial services sector. Lending by commercial banks to the economy increased during 2007 by 50 per cent. Raiffeisen Bank Albania, continued to be the undisputed leader in the banking sector thanks to its big branch network and the deposits the Austrian bank took over from the former state owned savings bank. The insurance industry saw double digit revenue growth in 2007.

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Bosnia and Hercegovina



Bosnia and Herzegovina's (BiH) drive for European Union (EU) membership received a boost in June 2008 when the country signed a Stabilisation and Association Agreement (SAA) with Brussels.

The signing of the SAA will have a positive impact on the BiH economy of, which is still not yet a fully independent state given the special powers wielded by the Office of the High Representative (OHR), which is in charge of implementing the provisions of the 1995 Dayton Peace Accord. The head of the OHR is also the EU's Special Representative in BiH.

As the OHR struggles with constitutional and political issues, the main influence on economic growth this year will be the demands of the country's main trading partners in the EU and South-Eastern Europe. The impact of lower growth in the euro zone than in previous years, forecast for 2008 and 2009, will be passed on to BiH, as the demand from BiH's main export markets falls in 2008.

Real Gross Domestic Product (GDP) growth in 2007 reached 6.0 per cent. This growth is the result of a mixture of a generally favourable external environment and a strong expansion of private consumption, driven by fast growth in real wages and consumer borrowing. Wages rose last year at a rate of 10 per cent, while inflation grew by a mere 1.4 per cent. Bank lending grew by about 30 per cent in 2007. Large energy and road projects will boost construction in coming years, and industry should also pick up, as leading metals producers, Aluminijski Mostar and Mittal Steel Zenica, expand capacity. Private consumption can be expected to continue to grow strongly, from a relatively low base, reflecting a further growth in bank lending and rising real wages.

Inflation began accelerating towards the end of 2007 and in early 2008, reaching a year-on-year figure of 8.2 per cent in May as a direct result of high international oil and food prices as well as strong domestic demand pressures. Rapid growth in wages and bank credit, together with increases in prices controlled by the state, contributed to inflationary pressures. Price growth will only partly be held in check by the continued stabilising influence of the BiH's currency board arrangement, established in June 1998, by fixing the national currency rate to the German mark (and subsequently to the euro).

The largest companies in BiH remain those in the telecommunications, power generation and the metallurgical sectors. Elektroprivreda BiH, the state-owned power utility company, retained the first place among Bosnian companies in 2007, a position which it has been holding firmly for years. Aluminijski Mostar, a steel producer, is currently being privatised. The company continues to be one of the largest in the country and has received a number of awards over the years. The privately owned ASA Prevent Grupacija, a holding company with a diverse portfolio, including car dealerships, transport services, leasing and insurance, is also ranked among the

largest companies. State-owned BH Telekom is the largest telecommunications group in the country, offering fixed line, mobile and ISP services. The Government has recently announced plans for its privatisation and the process is currently under way. Another top company is Mittal Steel Zenica, a steel producer owned by the Arcelor-Mittal Group.

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Bulgaria



After eighteen months in the European Union, Bulgaria is enjoying strong economic growth. Nevertheless, popular frustration is growing over the wide gap in standards of living and social protection between Bulgaria and the older member states. At the same time the country has a comparative edge in sectors that are critical for the global economy – energy, transit, food processing and agriculture.

Bulgaria's real gross domestic product (GDP) growth accelerated to 7 per cent year on year in the first quarter of 2008, largely thanks to an expansion in the construction sector and continued growth in industry and services. Preliminary data for the second quarter of 2008 reveal a further pick-up in industrial output and retail sales. Moreover, the impact of the global credit squeeze has been moderate since credit conditions eased boosting private consumption in the fourth quarter of 2007.

The share of the private sector in gross value added (GVA) has risen dramatically since 1989 with financial services, tourism and retail leading the way. Banking has been transformed into a success story during the past decade. Foreign investors from the banking sector have led the drive to improve the quality of management of local banks and increase their profitability.

Modern distribution and retailing are developing fast. Large international players have entered and transformed the retail market. Both Metro and Rewe plan to expand under other brand names. Carrefour (France) and IKEA (Sweden) are to open new outlets in Bulgaria in 2008. Hypermarket and discount store formats are expected to see especially strong growth in the coming years.

While the ratio of state foreign debt to gross domestic product has dwindled to 15 per cent, foreign private debt has surged along with levels of household indebtedness. Although the debt to GDP ratio is well below the EU average, volatile global markets leave no room for complacency given Bulgaria's high current account deficit and prospect of further debt growth. Rigid fiscal policies have yielded unprecedented budget surpluses of as much as 5 per cent of

GDP. But there is a growing need for long-term budget planning, transparent budget allocation procedures and full convergence of monetary and fiscal policies.

Net foreign direct investment (FDI) coverage of the current account balance remained relatively low at 33.7 per cent for the first four months of this year. However it is quite likely that FDI coverage will improve substantially in the course of 2008 and exceed 50 per cent by the end of 2008.

Information and telecommunications technologies retained a strong pace of expansion in 2007 driven by cell-phone operators and internet services mainly. Sales reports for the first half of the year indicate that the market of wireless telecom services grew by nearly 20 per cent in nominal value terms in 2007 to more than EUR 1.1 billion. The cell phone penetration rate is estimated at 132.8 per cent as of the end of December compared to 105.9 per cent a year earlier. This is one of the highest cell-phone usage ratios in Europe.

The closure of the two smaller nuclear power units in Kozloduy at the end of last year has hit the power sector but the main reason for its weak performance is linked to regulatory setbacks and slow progress on a number of state run projects for the redevelopment of power generation facilities and building new capacity.

In contrast to the setbacks in the electricity sector, recent developments in the field of natural gas transits and investments in bio-fuel production look quite encouraging. Russia's Gazprom and Italy's ENI have proposed a large-scale transit project through the Black Sea and the territory of Bulgaria that would by-pass alternative routes in Turkey to South and Southeast Europe. The state natural gas utility, Bulgargaz, seems in a good position to take part in the project although it may cut transit volumes through its existing pipeline network while new revenues will be shared with a company controlled by Gazprom.

Bulgaria has one of the lowest rates of taxation of assets and income. The corporate income tax rate was cut to 10 per cent at the beginning of 2007. This not only attracts high FDI levels but offers an incentive to local companies to be more open to the tax authorities about their business.

Disbursement of EU funds will help kick-start key infrastructure projects, while close monitoring by the EU and the local authorities which are responsible for projects will strengthen anti corruption measures. But the current delay in disbursement means that Bulgaria is likely to remain a net financial contributor to the EU budget in 2008.

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Croatia



Croatia is stepping up its efforts to complete European Union (EU) membership negotiations by 2009 even as uncertainty inside the EU about the enlargement continues.

Parliamentary elections in November 2007 saw the return to power of the, pro European, centrist Croatian Democratic Union (HDZ) led by prime minister Ivo Sanader. The HDZ currently leads a coalition government with the Croatian Peasant Party (HSS) as its main partner.

The elections came in a year in which real gross domestic product (GDP) growth reached 5.7 per cent, primarily thanks to good results at the beginning of the year. However a slowdown in the rise of real GDP started towards the end of the year and this trend continued into 2008. The largest contribution to GDP growth came from personal consumption which rose by 6.2 per cent and investments which grew by 6.5 per cent. Unemployment remained stubbornly high at 11.8 per cent however.

It can be expected that the real GDP growth this year will be hindered by inflation which reached 2.9 per cent last year. Also deteriorating economic conditions in Croatia's main export markets such as Italy and Germany will hurt sales abroad. Credit conditions are tightening following the imposition of a restrictive monetary policy by the Croatian National Bank and as a result of the global credit crunch.

Inflationary pressure mounted in 2008 as prices of commodities such as oil and food grew, starting in the last quarter of last year. However, the consumer price index still shows a lower level of inflation than in most of the other countries in the region. This is a consequence of a stable national currency,

The Zagreb Stock Exchange, the national stock market, is one of the largest by capitalization in the Central European region. As of 31 December 2007 the stock capitalization amounted to EUR 48.1 billion, while the total capitalization amounted to more than EUR 53.8 billion. Overall, there were seven public offerings in 2007, with a total value of over EUR 1.2 billion. The Zagreb Stock Exchange has intensified regional cooperation with stock exchanges in Slovenia and Serbia to make a common blue chip index with Dow Jones.

The largest company by revenues in Croatia is INA, an oil refining and retail group which has held the undisputed number one position over the past few years. Agrokor is in second place with the largest nominal revenue growth among top companies in Croatia. Agrokor is a holding company comprising various horizontally and vertically integrated units, dealing in areas such as retail, food and beverage production and media distribution. The largest net profits in 2007 were reported by the HT group, the former monopoly telecom operator now controlled by Deutsche Telekom. The HT group provides mobile phone services through its T-Mobile division, which is one of the largest companies in the country. It also offers fixed-line operations, internet access and IP television.

It is worth noting that most of the top 10 companies in the ranking are in the private sector; only 3 companies have the state as a majority owner. The three leading sectors are energy and resources, consumer business and telecommunications.

The largest bank by assets is Zagrebacka Banka (part of the UniCredit Group), with the main competitor being Privredna banka Zagreb (part of Intesa Sanpaolo). These two banks held a combined market share of about 41.2 per cent in mid 2007. The banking sector in general is considered to be competitive and stable, with more than 95 per cent of the banks (by total assets) owned by international groups.

The market leader in insurance is Croatia Osiguranje, a state owned company. It has an almost three times larger written premium than Allianz Osiguranje, which is in second place. The third and fourth largest insurance companies are part of the Agram financial group.

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The Czech Republic



The new Czech conservative government led by the Civic Democrats (ODS) was elected in a closely run election in mid 2006 and finally won a decisive vote of confidence in parliament at the start of 2007, albeit, with a wafer thin majority. ODS formed a government coalition with the Christian Democrats (KDU-CSL) and the Green party (SZ).

Some of ODS's reform proposals took time to come to fruition after the election and moves aimed at cutting the budget deficit were finally implemented at the beginning of this year.

These included the reduction of personal income tax rates from the previous 12-32 per cent range to a single flat rate of 15 per cent. This was matched by an increase in the reduced VAT rate from 5 per cent to 9 per cent as well as a mounting excise duty on tobacco and alcohol and new environmental taxes. Changes in the healthcare system included the introduction of a fee for doctors' visits and hospital stays as well as increased charges for medicine. The government has, also, yet to name a date for adopting the euro.

Various external as well as internal factors contributed to the doubling of inflation from 3 per cent in 2007 to an expected 6.8 per cent this year. However, this is likely to be a short-term jump and inflation at around 3 per cent is expected next year. The sharp rise in prices, has hit consumer spending and, in combination with Western Europe's slow down, has resulted in a fall in growth from 6.5 per cent last year to a forecasted 4.5 per cent in 2008. Even though the

mortgage and loan crisis has not had a direct impact on the Czech financial system, real estate prices are more volatile and banks are tightening their lending policies. However, thanks to continuing infrastructural public investments well as demand for residential housing, the construction industry continues to grow. The construction boom is also one of the reasons why SKANSKA CZ and Metrostav have moved into the Czech Top 25 companies.

The country's population is ageing rapidly with the first signs of the burden of pension costs on the working population expected to appear in 2012. Nevertheless, the Czech population has been growing recently, thanks to the combination of a baby boom and immigrants from Slovakia, Ukraine and Vietnam. Despite this short-term, positive development, the Czech Republic has to reform its pay-as-you-go pension system, soon, to avoid critical problems in the future.

With unemployment at a low 5.3 per cent in 2007 and an expected further decline this year, the challenge facing the government is how to increase the labour force by raising the real retirement age to over 63 years of age and to tighten social security provisions. At the same time a reform of the education system is needed to improve employee skills.

Meanwhile the profits of industrial companies and financial institutions, as well as personal income, have also been rising considerably. Škoda Auto, a member of the VW Group, has increased its sales by 10 per cent and it remains the largest domestic company as well as exporter in the Czech Republic. The country has become one of the major producers and exporters of automobiles and car components in Europe. Toyota Peugeot Citroën Automobile (TPCA), a local joint venture between the Japanese and the French vehicle manufacturers, is another producer besides the well established Škoda Auto. Even though 2007 was only the second year of production, TPCA reached tenth place in the Czech TOP 25 companies ratings, based on sales revenues. Hyundai, from South Korea, another automobile producer, began construction of a plant last year. As a result, the car parts producers represented by Bosch maintained their positions in the Czech TOP 25 rankings. Thanks to strong demand from the construction and automotive industries and the global boom, steel companies (Moravia Steel, Arcelor Mittal Ostrava and Trinecke Zelezarny) have also been growing.

Strong exports, dynamic expansion through acquisitions and growth in energy prices have put CEZ, the country's largest electricity company, in second place in the rankings. Other utilities are represented by RWE Transgas (gas), OKD (coal mining) and by the oil and petrochemical processing and distribution companies such as Unipetrol, Čepro, OMV and Shell.

The electronics industry is represented by Foxconn from Taiwan, which plans further expansion in the near future, and Panasonic AVC Networks. Siemens improved its position thanks to a diversified range of products including transportation equipment, measurement and control equipment. The food industry represented by Agrofert Holdings and partially also by the retail stores Makro, Tesco and Ahold, is growing in importance. However, even if the large retailers are well represented thanks to their growing turnover, the industry will struggle to generate adequate profits. Telefónica O2 and T-Mobile represent a strong telecommunications industry. In the Czech TOP 25 transport is represented by the state owned railway, Ceske drahy.

2007 has to be seen as a year of economic growth with the highest standards of living since the Czech Republic was established in 1993. Much of the credit for this goes to foreign investments which on stream during the past two or three years and have had a considerable impact on exports, growth, employment and personal incomes. Strong demand from these big players is also helping mid-size Czech companies to expand.

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Estonia



European Union membership has been positive for Estonia's economy, producing annual growth rates of over 10 per cent for this 1.4 million strong Baltic country – one of the smallest in Central Europe. But a hard shock came in the first quarter of 2008 when growth slowed to a mere 0.1 per cent. In Estonia the growth was powered by high domestic demand and the slow down also reflected a fall in demand at home.

Simple tax policies have become an Estonian trade mark. The government has pledged to cut the flat-rate personal income tax from 26 per cent in 2004 to 18 per cent in 2011. The aim was to have the same rate for personal income tax and VAT. That promise came before the country was hit hard by growing inflation starting at the beginning of 2008. Keeping the election promise would have left people with more money to spend in each successive year. Consequently early in 2008 the government began to consider whether to drop the tax reduction pledge and wait for prices to stabilise.

While the 21 per cent corporate tax rate in 2008 is the same as personal income tax it is levied only on distributed profits while private stock market investors have to pay the full rate on realised profit. But the latter have been losing money recently. In 2007 the Tallinn stock index declined by 13 per cent while by mid July 2008 the total fall had reached 41 per cent compared to January of the previous year. And it is still falling.

Even though the banking sector has been suffering from a collapsing real estate market and the general economic slowdown, Swedbank purchased Hansapank, which is still seen as Estonia's crown jewel. Hansapank is also one of the few businesses in Estonia which can be compared in size to other Central European companies or banks. This is not surprising considering Hansapank's dominant position in the Baltic banking market.

Of the 25 largest companies in the CE Top 500 in Estonia, seven are listed on the Tallinn stock exchange, three are state held entities – the energy company, the railways and the port,

another four are still locally owned and the rest are the subsidiaries or associated companies of multinationals.

The largest Estonian company is Tallink, a passenger cruising business. It is a rare example in Estonia of a company which has actually invested abroad by acquiring a part of a well-known Finnish competitor, the Silja Line in 2006, rather than being bought out itself by an international competitor. The transaction more than doubled the company's revenues. The other top 25 companies which have successfully expanded their operations outside Estonia include the Olympic Entertainment Group, a casino business, and Arco Vara, a real estate company. Both are listed in Tallinn while the Olympic Entertainment Group has also been listed on the Warsaw Stock Exchange.

Estonian Railways, which ranks in the second half of the list, was privatised in 2001 and re-nationalised again in early 2007 after heated political discussions. This is the company which was hardest hit when the government of Estonia decided to remove the Soviet war memorial in Tallinn in April 2007. The decision sparked angry demonstrations by Estonia's Russian speaking minority and Russia's decision to withdraw Russian transit traffic from Estonia in reprisal. It is debateable whether the removal was used merely as an excuse by Russia which is in the process of opening new transit routes through its own territory. No matter what the actual reason, Estonian Railways is facing major challenges right after its own re-nationalisation.

The Estonian Energy company, ranking as the third largest in Estonia, might be one of the next state owned companies to be listed in Tallinn despite the current gloomy mood in the stock market. Currently there are 18 companies listed but not all of them are very liquid. It is possible we may see some de-listings in the future. Once investor confidence returns, it is likely we will see the flotation of some good new companies.

Even though the combined increase in net revenues of the largest companies was around 17 per cent there are several firms where revenues actually fell in 2007. These included infrastructure companies such as Estonian Railways and Tallinn Port as well as several construction companies.

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Hungary



The Hungarian government's austerity measures introduced in the second half of 2006 which were designed to cut the country's alarming budget deficit explains Hungary's modest gross domestic product (GDP) growth of 1.3 per cent in 2007 accompanied by a high, 6.6 per cent inflation rate for the year. But, on aggregate, the largest Hungarian companies, on the CE Top 500 list, managed to achieve better results than their country as a whole, thanks to growing, export driven, industrial output.

Thus the majority of the Hungarian companies on the list increased sales in euro terms in 2007 compared to 2006. Together the combined sales of the 67 companies on the list grew by over 8 per cent in euro terms, which shows significantly stronger growth even in real terms than that of the overall economy.

This can be explained by the fact that many of the Hungarian companies in the top 500, are either major exporters or locally owned multinationals, or the subsidiaries of multinational corporations with strong export sales and with limited exposure to demand on the domestic market. Also the industries strongly represented by the Hungarian companies in the top 500 are the ones which benefited from last year's global economic trends and domestic policy changes. These were the energy sector - primarily the energy distribution companies with strong retail exposure - and agribusiness. Large Hungarian energy retail companies reported a respectable growth in sales mainly thanks to big increases in the government controlled price paid for energy by consumers. Interestingly, the sales of Mol, the national oil company and Hungary's largest enterprise, fell by over 10 per cent in euro terms. This was largely due to reasons specific to the company which sold its gas business and saw a drop in Carbon Hydrogen exploration. Also some energy wholesalers, who were not affected by the retail energy price rises, saw a decline in sales owing to the mild winter and a consequent fall in energy consumption.

Sales growth in the agribusiness came from the sharp global increase in agricultural prices.

Some of the sectors which traditionally weather domestic recessions well and are strong exporters, like Hungary's large pharmaceutical industry, are also strongly represented on the list.

There were industries, however, where even the largest players were hard hit by the strong downturn in the Hungarian economy and the negative trends in the world economy. The real estate, construction and building sectors were badly affected. Two of the three Hungarian

companies in this sector Strabag Építő Zrt. and Vegyépszer, who made it to the regional top 500 list, saw an over 15 per cent drop in sales. This sector's poor performance was a result of cuts in public spending on roads and other large scale infrastructure projects and the global real estate crisis. The real estate crisis may also have had an effect on this sector, even in Hungary.

There were a few surprises however. One, was that the large retail companies, which are usually hard hit in a recession, made it into the top 500. While the volume of retail sales showed a 3 per cent decline last year, some of the sector's largest players like Tesco-Global and Spar Magyarország, which are both on the CE Top 500 list, saw as much as a double digit growth rate in sales compared to 2006. The sales growth reflected a dynamic expansion of retail outlets by some, a consolidation in the sector and a strong increase in consumer prices.

Also the growth of the large Hungarian banks, especially in their overall lending activity, is surprising, given the stagnating domestic economy and the growing interest rates of Hungarian Forint (HUF) denominated loans and the global problems of the sector starting in 2007. At the same time many loans in Hungary are denominated in foreign currencies and these were not affected by the increase in HUF loan interest rate rises. Also, the negative effect of the global credit crisis only started to be felt in the third quarter of last year. It remains to be seen how this will work through to the banking sector's 2008 results.

The majority of the large Hungarian companies in the top 500 surmounted the country's stringent economic conditions in 2007. It remains to be seen, however, how they will cope with the global economic slowdown, rising energy prices, tougher credit conditions, the further strengthening of the forint, which could hurt exporters, and the still modest growth rate of the Hungarian economy.

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KOSOVO

Independence last February made Kosovo Europe's newest state after the failure in 2007 of hard negotiations over the status of the UN administered territory.

The challenges faced by the new state are enormous. Kosovo is one of the poorest countries in Europe, with a GDP of around EUR 1400 per capita in 2007. Real economic growth reached 3.5 per cent, which is impressive given that the year saw a marked fall in foreign aid. Nevertheless the country remains very much dependent on foreign assistance, which is focused on training administrators and institution building. As Kosovo uses the euro for everyday

transactions and state employees are paid in euros, the currency situation will remain unchanged in the wake of independence.

A continuing electricity crisis plagues Kosovo's economy. The power sector suffers from a lack of investment and a chronic failure to collect revenues from clients. Tax revenue is low, reflecting the poor level of economic development and widespread tax avoidance. Sales of state owned assets generate budget incomes but these will decline as more and more state owned companies are sold off. Inflation stood at 4.4 per cent, which was higher than in previous years. Unemployment, estimated at more than 40 per cent, continues to be a serious problem although a growth in business activities and the re-activation of industries will create new jobs. During 2007 remittances from abroad reaching up to 30 per cent of Kosovo's GDP.

During 2007, the Kosovo Trust Agency, which administers state sector companies in Kosovo, pressed on with sales of state enterprises. November 2007 saw the launch of a privatization wave of mainly small and medium size entities aimed at local and foreign investors. Privatization, attracting foreign capital, is the key to the economic development of the country. Still, the process is hampered by many unresolved issues. One is the Trepce industrial complex which towers over Kosovo's economy. Trepce owns mines with vast unexplored reserves of many metals and lignite. There are also related metallurgical industries, all of which once provided jobs for more than 20,000 people. However financial claims by former investors in the combine are blocking its privatization.

In 2007 Kosovo continued to run a large trade deficit. Although exports increased, a rise in industrial output meant that imports increased by even more, deepening the trade deficit. The European Union, the Republic of Macedonia and Serbia, remained Kosovo's main trading partners last year.

The banking sector, especially foreign owned banks, continued to flourish during 2007. The sector attracted investments from Turkish investors including the Turkish Economic Bank (owned by the BNP Paribas group). The National Commercial Bank based in Tirana, also entered the country last year. Procredit and Raiffeisen remained the lead banks in the sector. The insurance companies also saw their business increase.

The entry of a second mobile operator, IPKO owned by Slovenian Telecom was the major development in the telecommunications sector. IPKO, which already had a significant presence in Kosovo through its internet and cable TV service, speedily grew its market share, as a result of the move.

Large state owned companies continued to control a major share of the Kosovo economy such as Kosovo's PTK (Post and Telecommunication) and Pristina Airport which managed to expand. However, the Kosovo Power Corporation (KEK) suffered from a lack of investment and continued to experience major problems.

Despite massive challenges, Kosovo's economic prospects remain positive. The construction sector is starting to show its potential, with some major commercial and residential projects in the Pristina area. Offers of state-owned companies as well as recently privatised

firms, could soon be targeted by foreign investors, and should bring more FDI into the country. Foreign loans (Kosovo applied for membership of the IMF and World Bank in 2008) as well as improvements in the performance of the energy sector thanks to the construction of a new coal powered plant should help to ensure sustained economic growth.

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Latvia



2007 saw Latvia outpacing the world economy with a ‘credit crunch’ of its own before the rest of the world was hit by the same. This affected growth figures underpinned by a booming real estate market and a bank loan funded, construction sector. However overall growth for the year was still impressive at 10.3 per cent. This, nevertheless, marked a dip on 12 per cent growth in 2006. However ,the slow down failed to ease inflation which reached 10.1 per cent by the end of the year. This was mainly driven by wages growing on average by 20 per cent in 2007 and mounting raw material costs.

The roller coaster ride in the economy led to growing popular opposition to the ruling coalition and its most prominent party – the conservative People’s Party. As a result Aigars Kalvitis, the People Party’s prime minister, was replaced in December 2007 by Ivars Godmanis, one of Latvia’s most experienced politicians, from a smaller coalition party, the Latvian Way, a liberal, free market party. The reshuffle left the overall composition of the ruling coalition unchanged. However, it remains fragile and political instability is expected to continue, at least, until local elections next spring and parliamentary elections in the autumn of 2010.

All in all the country entered 2008 in a gloomy mood and, so far, the pessimism seems justified. Annual inflation reached 17.7 per cent in June and GDP growth slowed to 3.3 per cent in the first quarter compared to 8.1 per cent in the same period last year .

These changes have yet to affect the list of largest Latvian businesses compared to 2006. Almost all of the companies concentrate, primarily, on the domestic market apart from Elko, which is one of the largest IT equipment wholesale companies in Central Europe and Liepajas Metalurgs, which sells most of its steel products abroad. Latvia’s fast economic growth helped most of the largest companies to gain ground on their Central European rivals – Latvenergo, the energy producer, climbed from 400th to 278th place while VP, a consumer retail group, from 405th place to 292nd place.

Two companies on the list, Rimi and VP group, clearly show that one of the key drivers in Latvia’s economic boom was domestic demand. These are the largest retail chains in Latvia and together they form a virtual duopoly. Both have been growing very fast, initially through

rapid expansion across the country while 2007 saw rising prices swell their revenue figures. It is likely that the next few years will see more modest growth rates and mounting pressure on margins as consumer incomes shrink and purchases are trimmed. At the same time the retailers' costs will grow in line with inflation.

Latvia's economic 'boom' is reflected in the Latvian banking sector's growth rates. Assets in the 10 largest banks grew by 44 per cent on an annual basis. But this sector is also bracing itself for a rough ride as concern grows at the deteriorating quality of loan portfolios and a sharp reduction in lending activity hurts revenues. At the same time high payroll costs will prove an ever heavier burden as the financial sector is among the highest paying employers in the country.

The remaining companies on the list of largest firms represent different parts of the infrastructure vital for Latvian business. Most of them are closely related to the oil and gas industry and their business volume is growing in line with oil prices along with growing physical volumes – Statoil and Mažeikū Nafta are part of a fuel distribution chain to retail consumers. Oil Logistic serves the flow of oil between Latvian ports and Belarus, while the local energy monopolies – Latvenergo (power generation and distribution) and Latvijas Gaze, (natural gas distribution), which are regulated, can increase their tariffs only on the basis of growing energy costs and operating activities.

A number of the largest Latvian companies are still owned by the government, such as Latvenergo and Latvijas Dzelzceļš (Latvian railways). The privatisation of these is unlikely in the near future as it would need a very strong government capable of withstanding fierce public resistance based on concerns that the deals might be corrupt. These companies, together with the Lattelcom, fixed line telecommunications company, represent the last significant businesses owned by the state. The rest of the economy is almost all in private hands.

Indeed most of the largest Latvian businesses belong to multinational groups. This illustrates the trend in Latvia's corporate ownership structure – the number of locally owned companies is falling year by year as more and companies are bought by foreign buyers.

Author: **Martins Zutis**

Lithuania



Lithuania has taken full advantage of its membership in the European Union (EU) to record one of the highest growth rates in the world. But, the global slowdown and inflationary pressures in this 3.4 million strong, Baltic country have increased the chances of a fall in economic performance.

Gross Domestic Product (GDP) growth for this year and 2009 is set at 5-6 per cent, nevertheless, analysts are painting a modest picture of the economy's prospects. After more than a decade of relatively stable prices, inflation is expected to leap back to double digit figures in 2008.

The greatest challenge facing the coalition government is price stabilization. The growth in the cost of energy and food as well as excise duties is spurring inflation. As the government is unable to influence commodity prices, fiscal policy remains its main weapon in the fight against rising prices. However, decisions taken recently to link minimum wages and welfare payments to inflation could well lead to a price spiral.

High inflation means that Lithuania would find it difficult to join the euro zone before 2012. Moreover, price rises may lead to stagflation as purchasing power is cut. This would put pressure on the Lithuanian litas currency, which is currently pegged to the euro. However, any attempt to change the litas to euro ratio could lead to instability in the financial markets and to a liquidity crisis.

The present parliamentary majority is composed of a fractious coalition of small political parties. However, the politicians were able to agree several important economic decisions. Minimal wages and pensions were increased and personal income tax was cut. It was also decided to consolidate the power sector to raise funds for the construction of a new nuclear power plant and electricity power grid connections with Poland and Sweden.

The consolidation of the electricity sector will create a holding company owning a majority share in the Lithuanian electricity network operator and two electricity distribution companies. The new power company will be third by revenue in the table of the largest Lithuanian companies and it will strengthen the dominant role of the energy sector in the top 25 list. But given the European Union's drive to unbundle electricity production, supply and distribution, the government might be forced to reorganize the electricity market anew.

The 2007 list of 25 largest companies in Lithuania is largely the same as in the previous year. The list is dominated by energy and the consumer retail business. Two of the four largest retailers in Lithuania are still owned by local investors. But the recent acquisition of Palink UAB (the 2nd largest retailer) by the European Coopernic Alliance indicates that the multinationals are watching local companies carefully and further acquisitions can be expected. Only two companies, Lithuanian railways and Lithuanian Energy, on the list are state owned. However the

privatisation process in Lithuania is coming to an end. Out of the top 25 list, only Lithuanian railways (Lietuvos gelezinkeliai AB) is sometimes mentioned as a potential target for privatisation, however, final decisions have yet to be taken.

Only two Lithuanian companies (Mazeikiu nafta and Maxima LT) are on the list of 100 largest companies in Central Europe. And it is unlikely that this will change in the nearest future. Lithuania is seeking to promote and develop small and medium sized businesses (SME) rather than the big firms. Indeed a large part of EU funds are aimed at boosting productivity increases in SMEs. And productivity growth is vital for the Lithuanian economy as this is an area where the country lags behind the EU average.

Author: **Linas Galvel**

The Republic of Macedonia



The key issues on Macedonia's strategic agenda are NATO accession and setting a date for the start of European Union accession negotiations. The country is now a candidate for EU membership and is awaiting a formal invitation to join the NATO alliance, delayed over a dispute with Greece over the country's name.

Parliamentary elections in Macedonia in June 2008 saw the incumbent centre-right party win a mandate to form the government and continue with the reforms in the economy, the social welfare system, and the judiciary. As a result of the June election, Nikola Gruevski, the head of his pro-EU centre-right party, stayed in his post as Prime Minister. Zoran Stavrevski, who had earlier worked with the World Bank, was appointed Deputy Prime Minister responsible for the economy. Macedonia also received plaudits from the The World Bank. The country was ranked fourth by the World Bank's 'Doing Business' bulletin on its 2007 world-wide list of reforming countries. Also, Macedonia's second largest city, Bitola, was selected as the best city for doing business in South Eastern Europe.

Real Gross Domestic Product (GDP) growth of 5.1 per cent in 2007 and a more ambitious goal set for this year show that Macedonia is on the right path to providing a stable and prosperous future for the multicultural community which inhabits its territory.

The figures definitely underpin this optimism. Foreign direct investment (FDI) in 2007 amounted to EUR 240 million. The first six months of 2008 saw FDI already reaching EUR 240 million. This suggests that, by this year's end, FDI will have at least doubled. The most significant investments in the country in 2007 were green field investments in the automotive

industry by Johnson Controls from the US and Johnson Metty from the UK, those of Telekom Austria in telecommunications, and of Hypo Alpe Adria Group in the financial sector. The main attraction for FDI lies in the favourable investment climate, 10 per cent flat tax rate on corporate and personal income, simplified procedures for registering new companies, good functioning of the land registry, and a stable monetary and fiscal policy. Political factors also play a role, with a large measure of consensus between the parties making up the coalition and a reformist government with zero tolerance of corruption and non-performance of those in charge of implementing economic reforms. A sign of this commitment is the Public Procurement Act pushed through by the government, which transposes EU directives enshrining transparent and accountable procedures. In addition, the introduction of the one-stop shop by the customs administration for foreign trade in goods and services has significantly eased bureaucratic procedures hampering business.

The country has also strengthened its financial regulatory systems, having thus reduced the risk of financial crises and scandals. The adoption of the BASEL II guidelines by the Macedonian banking sector and the establishment of a strong and efficient Securities and Exchange Commission have resulted in the strengthening of investors' confidence in the viable and sustainable future growth of the Macedonian economy.

SMEs in Macedonia, which are key drivers of growth and job creation, have started to expand in the region, becoming regional leaders, mostly in the IT business segment. Alkaloid Pharmaceutical Company, which is one of the country's corporate leaders, is developing its strategy of becoming an international rather than a local brand. Alkaloid is planning to expand its activities through a more aggressive research and development programme.

Key sectors propping the economic growth in 2008 will be infrastructural public private partnership (PPP) projects involving Macedonian airports, the construction of a gas production facility, small electric power plants, and highways through PPP concessions. There is also a PPP project in the railway sector, as well as expected further liberalization of the telecommunications sector. Other sectors with a high growth potential are the agricultural sector and tourism. The promotion of Macedonian wine, honey, vegetables, hot springs and thermal waters can boost exports and provide more jobs for people living in the country.

Author: **Lidija Nanuš**

Montenegro



Following a referendum on independence two years ago, the small mountainous Adriatic state of Montenegro, which has used the euro as its currency since 2002, is now set on the course of achieving membership to the European Union (EU) and NATO in the next decade.

Led for almost two decades by Milo Djukanovic, who was reconfirmed in the post in an election last April, Montenegro cleared the first obstacle to full EU membership when it signed a Stability and Association Agreement (SAA) with Brussels in October 2007. The SAA commits Montenegro to the adoption of European Community law and stresses the development of an efficient administration and an independent judiciary. The country has also pledged to combat corruption and organized crime. Montenegro plans to complete the adoption of EU laws in 2012, and has a target date of joining the EU by 2015.

Boosted by major foreign direct investment (FDI) of 1 billion euro in 2007, marking an increase of 56 per cent on 2006, Gross Domestic Product (GDP) grew by 7.0 per cent in 2007. The economy of this small country with a population of 650,000 is expected to grow by 9 per cent this year. In the meanwhile, industrial production in 2007 grew by 0,1 per cent compared to the previous year, while retail inflation rose quickly to 7.7 per cent compared to 2.8 per cent in the previous year.

The privatisation process failed to match the FDI growth as the sale of companies such as Luka Bar, Plantaže, and Institut Simo Milošević, was postponed, and the adoption of further privatisation plans was also delayed.

A lot of investment is, however, going into the tourism sector as banks are financing projects to turn Montenegro into an upscale tourist destination. Indeed, last year the country built on its natural 'wild beauty' brand and was visited by 1.1 million tourists, or 18.8 per cent more than in 2006. For the fourth consecutive year, Montenegro has been ranked among the top three tourist destinations by the World Tourism and Travel Council (WTTC), a leading trade organisation, in terms of growth over the coming decade.

Tourism and aluminium (KAP, the main aluminium producer, is owned by Rusal of Russia) are Montenegro's main strategic sectors, although their performance is threatened by possible power shortages. FDI which is currently flowing in from, among others, the Russian Federation, Great Britain and Hungary, will be focused on tourism and the energy sector. At the moment, as much as half of FDI is pouring into real estate projects and related sectors, while a large part of the remaining inflow has been going into the financial sector, mainly from the Austrian Hypo Alpe-Adria, the French Societe Generale and OTP from Hungary.

The economy was supported by a dynamic and rapidly expanding banking sector in 2007. Compared with the end of the previous year, bank assets doubled, while their capital stock

increased 1.6 times. At the same time, lending increased 2.6 times, loans to private clients went up 2.5 times, and loans to companies by a factor of 3. This increase in lending outstrips similar developments in other countries in the region. Although banking supervision is being strengthened, very rapid credit growth could cause problems if it exceeds the capacity of the banks to underwrite loans prudently and exacerbates asset price inflation. Indeed, the takeoff has been accompanied by remarkably high external current account deficits, with credit mounting to seemingly unsustainable levels.

At the moment, the high external trade deficit does not represent a problem, as it is mostly covered by FDI inflows and is a consequence of accelerated economic development. However, annual external trade deficits measured as a share of GDP in the period 2005-2007 were high. And, if the competitiveness of Montenegrin production does not increase in the long term, then the national debt will grow, and so will the budget deficit.

Nevertheless, Montenegro is a beautiful country and an established tourist destination. The development of services supporting this sector will strengthen the domestic economy and help the balance of trade. It is exactly the potential that promises to cater to foreign demand and help stabilise the economy in the medium term.

The list of leading companies in Montenegro, measured by total revenues, has not changed much in comparison to 2006. The Crnogorski Telekom a.d., Podgorica – Deutsche Telecom Group (Telecommunications) and Kombinat Aluminijuma Podgorica a.d., Podgorica (Process Industries) top the list. Interestingly, these two companies have revenues much bigger than the third, fourth and remaining companies among the top 10. In fact, they have been two leading companies in Montenegro for the last three years, measured by total revenue.

Author: **Danijela Dimovski**

Poland



Poland, the largest of the European Union's new member states, is also one of the fastest growing economies in the OECD. But inflationary pressures are coming to the fore as the pro business government led by the Civic Platform (PO) faces the prospect of seeing monetary and fiscal policy tightened to ensure economic stability.

Real gross domestic product (GDP) growth is expected to reach 5.9 per cent this year and 5.0 per cent in 2009. This trend was inherited from the former Law and Justice (PiS) led administration by the present PO government elected in the autumn of 2007. The PiS led

administration also saw a major drop in the unemployment rate which halved between 2005 and last year.

The greatest challenge facing the new PO government is the shortage of labour. Thus people who have retired early (Poland has one of the lowest labour participation rates in the EU) will have to be enticed back into work even as the privatisation of overmanned state controlled industries should put people back into the labour market.

Nevertheless the shortage of labour is pushing up wages while productivity is failing to match the increase. And it is productivity gains which have explained much of Poland's economic success in the past. Now weak productivity growth is contributing to inflation pressures.

There are still over 1000 wholly or partially state owned companies in Poland. A handful were privatised under the PiS government. The new government has said it will have privatised 740 enterprises by the end of its term in 2011 and is expecting to generate 30bn zlotys worth of revenues as a result.

The table shows that the privatisation has to come first in the energy sector. Not only would this free up labour but also generate funds for badly needed plant expansion and modernisation . Underinvestment in the past, means that the country now faces the prospect of power cuts in the not too distant future even as prices will have to grow to reflect the costs of combating climate change

There are a number of Polish companies in the upper part of the CE Top 500 listing, but a closer look at these companies prompts some, less than optimistic, conclusions. The Polish companies we see in the top 100 are either state owned or foreign controlled multinationals. The companies owned by Polish entrepreneurs are at the 78th position - Tele-Fonika owned by Bogusław Cupiał), at 86th – Boryszew controlled by Roman Karkosik and at 105th PGF owned by Jacek Sz wajkowski. There is progress though as they were at 110th , 87th and 129th place respectively on the previous year's list. It is worth watching the progress of local entrepreneurs, as home grown capital is still relatively weak. There are examples of the cross-border expansion as in the case of Asseco or Comarch, both in the IT sector, but the health of the overall Polish economy would be served by more expansion by local business both at home and abroad.

Poland has now had some six years of continued dynamic growth and this is reflected in the results achieved throughout industry with energy and retail leading the way. Banks and insurance companies are also doing quite well and the credit crunch has yet to affect this segment of the economy. Polish subsidiaries of the major international banks such as Pekao S.A. (Unicredit) or BRE Bank (Commerzbank) are becoming more and more important for their respective parents – also thanks to an appreciating Polish currency which means that their results calculated in euros are becoming more and more impressive. However the giant PKO BP savings bank is failing to use its potential as a regional force – it is now at the 5th position among the CE banks. The PZU Group leads the way in insurance. It is still very strong in the domestic market and has a footprint in the smaller countries in the region. Indeed it could become a significant regional player if it were able to use its financial muscle to gain a greater presence in more key CE markets.

The list shows that construction and real estate companies have yet to make their mark. The locally owned Polimex Mostostal is at 126th position, Skanska Poland, owned by the Swedish building firm is at 155th position and Budimex, controlled by Ferrovial from Spain is at 164th position. These positions could change dramatically over the next few years, if the government is able to get its ambitious road and infrastructure building plans under way.

Polish companies have a unique advantage over their Central European counterparts in that they have a large domestic market where economies of scale should work to their advantage. We have yet to see this advantage being used for cross-border expansion.

Author: **Władysław Szwoch**

Romania



When Romania joined the European Union eighteen months ago it became the second largest market in Central Europe and the 7th in the EU. With a population of 21.6 million it is an emerging economy with one of the highest growth potentials in the region.

Romania's adoption of a controversial flat rate income tax of 16 per cent in 2005 is one of the main factors which has been driving economic growth and foreign investment. But even during the period between 2001 and 2007 Romania saw average 6 per cent annual gross domestic product (GDP) growth. It is likely that growth will exceed this trend in 2008.

The construction sector remained the most dynamic component of GDP, jumping by 37 per cent in the third quarter of last year compared to the same period in 2006. This was due to good weather and the economic boost related to EU accession. Services also rose, thanks to retail sales, mainly, of food products and market services. The high contribution of services to overall economic growth has shielded the Romanian economy from a more pronounced deceleration, as services are less sensitive to boom-and-bust cycles. Industry accelerated as well, albeit at a slower pace - up by 5.1 per cent in the second quarter of 2007 compared to the same period in 2006. The industrial sector should profit from the exchange rate depreciation during the second part of 2007 and the first part of 2008. The high rate of investment in machinery during 2007 should also show up in future increased industrial sector exports.

The last part of 2007 brought a series of unpleasant surprises, as inflation unexpectedly rose to close to 8 per cent in the first quarter of 2008, compared to the same period in the previous year and the new leu (RON) exchange rate depreciated significantly. The sharp rise in

food prices was a consequence of a very poor agricultural year due to a severe drought, the worst to affect the country in more than 60 years. The RON appreciated sharply until July 2007 and then fell, so that, by mid January 2008, the Romanian currency had depreciated by 16 per cent against the euro and by 9 per cent against the US dollar. This reflected worsening foreign investor sentiment towards emerging markets, following the US sub-prime crisis. Also there was a downward revision of Romania's outlook by Standard & Poor's in mid November, generated, basically, by the swelling current account deficit. Nevertheless, the RON is expected to appreciate in the medium term, albeit, at times, amidst higher volatility.

In 2007 Romania played a leading role in the region, in terms of foreign direct investment (FDI), thanks to being able to attract EUR 7.2 billion. This amounted to roughly half of South East Europe's FDI inflows last year. So far, a large share of the FDI has been directed to the Bucharest area and the western part of the country, as the transport infrastructure in these regions facilitates exports to other EU countries. However, there is a growing trend among foreign investors to locate green field projects in the other large cities, where qualified labour is cheap and the infrastructure is to be developed thanks to the EU structural funds available for Romania.

The sustainability of the Romanian current account deficit raises concerns as FDI coverage is low. Recent data shows that FDI coverage dropped from 91 per cent at the end of 2006 to 43 per cent in November 2007. Partly, this is the result of the fact that the Romanian government has sold most of its state owned enterprises, leaving fewer major privatisations deals to be completed in 2008. Consequently, financing of the deficit will be left to volatile capital inflows and the RON will be at the mercy of investor sentiment against a background of worsening global credit market conditions. However, Romania remains a sought after, long term, investment location as the business climate has improved and the legislation has been aligned with the EU's body of law. Foreign investors are free to repatriate 100 per cent of their profit after taxes and they can benefit from Romania's cheaper labour force relative to productivity gains, even compared to similar CE countries. Romania is rich in natural resources, especially oil, gas, salt, gold and silver and non-ferrous metals. Recent geological and geophysical studies have shown there are many mineral deposits and oil reserves (both on land and off shore) with considerable potential, which offer substantial opportunities for investors.

As in 2006, the top ranking Romanian companies are from the energy, manufacturing, and telecommunications sectors. Record oil prices helped Petrom, Romania's main oil company, to boost its net profit by 88 per cent in the first half of 2008. The company now plans to invest considerable resources in the development of renewable energy sources and to further improve its operational efficiency.

Orange and Vodafone, two mobile operators, remain the main telecommunications players. Their operations in Romania are among the most profitable in Europe. Both operators saw double digit revenue increases in 2007, and they stayed far ahead of Zapp and Cosmote, the remaining two mobile operators in terms of market share.

The major fixed telephony company, Romtelecom, is following the other major European incumbent telecoms operators such as Deutsche Telekom, which have started to deploy the next generation networks, offering an integrated service including voice, data and VPN, internet as

well as video services. Romtelecom has said it will spend EUR 500 million on a next generation network, if the regulatory authorities will allow a reasonable return on the investment.

Author: **Patricia Ilisiu**

Serbia



The Serbian Government remains well on track for a rapprochement with the European Union pending ratification of its Stability and Association Agreement (SAA) signed with Brussels in the spring of 2008. Despite the challenging political environment, past seven years of democratic transition have seen Serbia continuously progress in both economic and political spheres.

Overall, Serbia's economy remains buoyant with the GDP growth in 2007 of 7.5%, up on 5.7% in the previous year. Notwithstanding a notable slowdown caused this year's presidential and general elections, the measured EUR729 million in FDI in the 1Q 2008 promises a notable improvement over the previous year's 2 billion Euros (2006: EUR 4.3bn). This is supported further by the fact that the newly elected government, formed largely by the progressive pro-European parties, plans to focus on European integrations, economic growth, development of infrastructure and responsible social politics.

With this in mind, however, Serbia's new government does face a high and ever-rising inflation as one of its main macroeconomic challenges. Increases of energy and food prices are mainly to blame, but, in addition, public spending has to be cut if inflation is to be reined in. Although, the labour market trends show improvement, with the unemployment rate dropping from 20.8% in 2006, to 18.1 per cent last year, social inequalities and uneven regional development pose a notable challenge. The game of balancing the budget spending aimed at development and social programmes, against the strong inflationary pressures is one of the keys to Serbia achieving macroeconomic stability in the medium term.

Despite the strong growth in exports, Serbia continues to record a high current account deficit totalling EUR 5 billion in 2007. Whilst this was partly offset by the increased corporate and household borrowing abroad, FDI and foreign remittances still make up for the positive difference in the balance of payments. Long term, however, the fact that Serbia has had a high current account deficit for four years in a row is of concern. Going forward, better results are expected through entrance of the large strategic investors in the automotive, high-tech industry and energy sector, as well as the higher utilisation of the existing FTAs with Russia, CEFTA region, as well as the EU (as a result of the signed SAA)

Serbia's privatization law decrees that state-owned capital should be phased out by the end of 2008. However, with 802 companies still in state hands, this deadline is bound to be breached. The government is working hard towards finding strategic investors for vital large companies and industry sectors, such as Zastava Kragujevac, a local car manufacturer which most recently signed a break through agreement with the Italian FIAT. This also includes the Energy agreement signed with Russia, which stipulates amongst other things the sale of 51% stake in the state owned oil refining company NIS to Russian Gaspromneft.

Overall, the government continues to implement a series of positive measures aimed at attracting investments. Besides NIS, a lot is expected from the privatization of other large state owned companies. EPS, the state owned electric power company (which also happen to be the biggest corporations in Serbia) seems set for the IPO together with the Telekom Srbija and the Belgrade Airport going forward. The government's plan to facilitate distribution of 15% shares of the largest state owned companies to the general public is prompting their privatization. Other companies on this list include Galenika the state owned pharmaceutical producer to be tendered next year and JAT, the Serbian national carrier (for which the tender was published in July 2008 already).

The list of leading companies in Serbia, measured by total revenues, has not changed much in comparison to 2006. The two state-owned energy sector companies NIS (Oil) and EPS (Electricity) top the list. Interestingly, these two companies combined have the same revenues as the remaining eight companies among the top 10. Including Srbijagas (Natural Gas), the 6th largest company, the energy sector emerges as the absolute leader of the whole economy. There were however a few minor changes in the list. The privately owned Delta Holding (Trade, Production, Services) retained its 3rd position but Telekom Srbija (telecoms) - 5th in 2006 - and US Steel Serbia (steel mills) -4th in 2006 - changed places in 2007. However, telecoms was the most profitable industry in the country, while the highest loss was reported at Železnice Srbije (Serbian Railways).

Author: **Aleksandar Marić**

Slovakia



Last year Slovakia was Europe's fastest developing economy with its 10.4 per cent growth rate putting the country into the Asian growth rate league. Growth is expected to slow to a still impressive 7.5 per cent this year, underpinned by the rapid expansion and modernisation of Slovakia's industrial sector and with a significant contribution of foreign direct investment (FDI)

Euro zone entry planned for January 1, 2009 providing a further boost for FDI which is expected to reach USD 2.7 billion this year putting Slovakia at the top of the European Union's new member state economies. A strong appreciation of the Slovak Koruna (SKK) linked to euro entry has helped dampen inflation which is expected nevertheless to hit 4 per cent this year and slow a little to 3.6 per cent next year. The Slovak economy has also thus far, been sheltered from the fall out from the US sub prime crisis.

Politics has played a major role in these developments. The prime minister, Robert Fico, dubbed a left of centre populist when elected in 2006, has slowed privatisation but opted to keep in place the main reforms implemented by Mikulas Dzurinda, his centre right predecessor.

Much hinges on the automotive industry, given its role as the country's largest investor. Indeed, such is its influence that measured by output per capita, Slovakia is Europe's largest carmaker this year. Three auto manufacturers are in the country: Volkswagen (also producing the Audi Q7 and Porsche Cayenne models), KIA Motors and PCA. With the latter two coming on stream last year, production automotive vehicles rose by 58.4 per cent compared to 2006 boosting overall industrial output for the year by 12.8 per cent - the largest annual increase since 1999. Moreover, the car producers are followed by numerous car components manufacturers such as Mobis Slovakia, part of Hyundai Mobis and which was ranked as 19th in this year's Top 25. The car industry is also well supported by strong steel producers U. S. Steel and Slovalco. As much as a third of Slovakia's exports come from the car industry making the country vulnerable to a possible down turn in demand in Europe. Consumer electronics from factories owned by Sony and Samsung are also contributing to the high growth level.

Over the last few years, Dzurinda's centre right governments used the inflow of foreign investments and the increasing prosperity to start sweeping fiscal reforms. The aim was to reform public finances and prepare for accession to the euro zone. Slovakia thus implemented a flat-rate personal income tax and corporate income tax of 19 per cent in 2004 with the standard VAT rate at the same level. The result was a reduction of the state budget deficit to last year's SKK 23.5 billion (2.5 per cent of GDP) from SKK 70 billion in 2004. Healthcare, social-security and pension system reforms were also launched.

The effects of the reforms are already enhancing living standards. Unemployment rose last year, with real wages rising by over 4 per cent. Incomes rose faster than current expenditure and savings went up by 17 per cent with a near 10 per cent increase in private consumption.

Unemployment while still high at 11.0 per cent in 2007 is expected to fall slightly to 9.3 per cent this year. The first four of the 25 largest non-financial companies in Slovakia in terms of sales were held by foreign investors last year.

Tourism is very important for Slovakia; 32.6 million foreign tourists visited this mountainous country last year, up by 6.7 per cent on 2006 and six times the Slovak population.

A very strong sector for Slovakia is also the utilities represented by numerous companies in the Top 25 – Slovensky plynarensky priemysel, SPP distribucia and eustream for gas, Slovenske elektrarne, Zapadoslovenska energetika, Stredoslovenska energetika, Vychodoslovenska energetika and Slovenska elektrizacna sustava for electricity and Slovnaft, Slovnaft Petrochemicals for the petrochemical industry. The transportation industry is represented in the Top 25 by Zeleznicna spolocnost CARGO, which has operated Slovakian railway cargo services since January 1, 2005, when the passenger and cargo businesses were split.

Also represented in this year's Top 25 for Slovakia are the paper production industry (Mondi SCP) and healthcare support products (Phoenix Zdravotnicke Zasobovani). Also significant are the telecommunications represented by Orange Slovakia, T-Mobile Slovakia and Slovak Telekom. Retail stores are less prominent than in other countries with only Tesco stores making it to this year's Top 25 at the number 9 slot.

Authors: **Eva Blumental, Petra Jirkowska**

Slovenija



Slovenia has been a member of the European Union (EU) since May 2004 and has the highest Gross Domestic Product (GDP) per capita of all the new EU member states. Indeed, Slovenia's GDP is even higher than that of Greece and Portugal. It was also the first of the accession countries to become fully compliant with the EU's Maastricht criteria and to adopt the euro at the beginning of 2007. However, the 2 million strong Slovenia has experienced the highest inflation rate in the euro zone this year.

The Slovenian government is led by Prime Minister Janez Janša, the leader of the Slovenian Democratic Party (SDS) which came to power in the last elections in November 2004. Other coalition members are two right-wing parties - New Slovenia (NSI) and Slovene People's Party (SLS) - and the Democratic Party of Pensioners of Slovenia (DeSUS). The next parliamentary elections are to be held in September 2008

2007 was a good year for the majority of Slovenian enterprises. Most of them saw increased revenues and profits compared to the previous year, and those listed on the Ljubljana Stock Exchange (LJ SE) reported record capitalizations. At the end of 2007, the Slovenian

government successfully floated a minority stake in Nova KMB, the second largest bank, on the LJ SE, which opened the way for other privatizations through the stock market. In the second half of 2007, a tender for the privatisation of Telekom Slovenije attracted interest from both regional and global buyers. A number of management buy-outs (MBO) were also completed, with the MBO of Merkur, a technical equipment retailer, being the largest in Slovenia's history.

However, towards the end of 2007, companies experienced rising fuel prices which put pressure on the prices of other raw materials. At the same time, companies were affected by the strong euro compared to the US dollar (USD), which hampered exports to countries with the USD as their main trading currency. Certain sectors like construction also had problems finding employees in Slovenia and were forced to look for labour abroad. The government implemented tax changes aimed at reducing corporate taxes in Slovenia. However, despite the changes, companies operating in Slovenia continue to carry a relatively high tax burden.

In 2007, Slovenian companies were still focused on markets in the former Yugoslavia. However, some successful acquisitions were made, including in Western Europe. Krka, a pharmaceutical producer, acquired TAD Pharma from Germany, and Kolektor LIV, a producer of sanitary and cleaning equipment, took over Missel Schwab in Germany.

Mercator Group, the largest company in Slovenia, took the 40th position among the CE Top 500. Mercator, a Slovenian retailer, is one of the largest retail chains in the South Eastern Europe, being an important player in Serbia, Croatia, Bosnia and Herzegovina and Montenegro. In 2007, Mercator established a strategic alliance with Presoflex in Croatia and Mex in Montenegro.

The energy sector saw Petrol, Slovenia's largest energy company, in 54th place. Petrol is the second largest Slovenian company by revenue. It has actively pursued acquisitions in the region, and recently established joint ventures with Montenegro Bonus from Montenegro and Europetrol from Croatia. In 2007, there were intensive negotiations with Lukoil on the sale of a stake in Petrol, but the talks failed to reach a conclusion and were formally closed at the end of the year.

Lek and Krka, both pharmaceutical companies, are once again at the top of the list of largest Slovenian companies. Lek is part of the Novartis Group while Krka continues to prosper without a strategic partner, earning the largest net income of all the companies in Slovenia in 2007.

NLB and Nova KBM, Slovenia's largest banks, were positioned among the 50 largest banks in Central Europe. Both are still majority state owned. NLB is making acquisitions throughout the region while Nova KBM focuses mainly on the domestic market. Zavarovalnica Triglav, which is majority state owned, is among the top 10 insurance companies in Central Europe. It continues to enjoy the largest market share in Slovenia with a gross written premium which is approximately 3 times larger than that of its nearest rival - the privately owned Adriatic Slovenica. Zavarovalnica Triglav pursues a growth strategy that is based mainly on acquisitions in South Eastern Europe where it has already become one of the most important players.

Author: **Janez Škrubej**

