Baltic Rim Economies
Estonia – Latvia – Lithuania – Poland
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Estonia

GDP forecasts moving upwards

Estonia's ministry of finance recently revised its GDP growth forecast for this year to 6.5% from their previous estimate of 5.9% last spring. Moreover, several international research and development organisations have raised Estonia's GDP forecast due to their stronger than expected economic development. Estonia's current account deficit is expected to be slightly over 10% of GDP and inflation should reach 3.6% this year. According to the ministry of finance, the Estonian economy will expand by 6.6% in 2006. During the years 2007-2009, the Estonian economy should expand at a 6.3% annual rate.

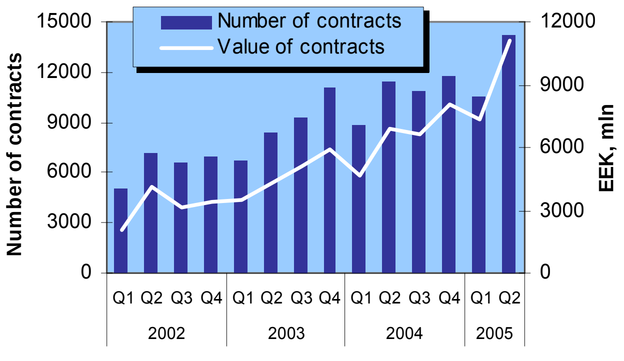
Estonian statistical authorities have recently revised Estonia's GDP data for the years 1993-2004. According to new methodology (regarding the calculation of financial intermediation services), the Estonian economy expanded by 7.8% in 2004 and 6.7% in 2003. These figures are remarkably higher than the previously reported growth rates.

IMF supports Estonia's economic policy

A delegation of the International Monetary Fund (IMF) visited Estonia in July. According to the conclusions from the IMF mission, Estonia has made enormous economic strides since independence due to sound macroeconomic policy and far-reaching structural reforms. As a result, Estonia is rapidly converging to EU levels.

Although the IMF experts supported Estonia's plan to introduce the euro as soon as possible, however, they stressed the great importance of fiscal policy in achieving balanced economic development. Under the current situation Estonia should keep the budget in surplus in order not to accelerate domestic demand and not to generate more inflation pressures. The IMF paid attention to the signs of an overheating real estate sector, fast credit growth and large current account deficit, as possible risks.

Notarised purchase-sale contracts of real estate



Source: Statistical Office of Estonia

A boom in the Estonian real estate market continues. In the second quarter about 16,000 purchase-sale contracts of real estate or movable assets and contracts of building rights were notarised. This is 2,500 more than in the corresponding quarter in 2004. The value of contracts increased by 54% y-o-y to EEK 11.9 bn (EUR 760 mln). More than a half of the contracts were made in Tallinn, and the value of these contracts accounted for more than one third of the total value.

Favourable figures from the second quarter

The growth of Estonia's industrial output accelerated in the second quarter this year, as production increased more than 11% y-o-y. The rapid growth trend in the trade sector also continued since the retail sales volume increased nearly 10% compared to the corresponding quarter in 2004.

According to recent labour force survey data, Estonia's unemployment rate declined sharply in the second quarter, and the number of employed persons recorded the highest value in the last seven years. The unemployment rate was 8.1%, which is the lowest value in the last ten years.

In the second quarter of 2005, the Estonian employees' average gross wage was EUR 530 in a month. The average monthly wage increased by 11.8% y-o-y.

Russia's Ust-Luga SEZ might hit Baltic transit trade

Russia's plan to create a special economic zone (SEZ) in the Ust-Luga port is threatening Estonian transit industry. Ust-Luga is located on the coast between Narva and St. Petersburg, near the Estonian border. The aim of the project is to attract foreign investors and producers by offering them favourable customs and tax incentives. The Ust-Luga SEZ is likely to increase competition on oil and goods transports between Russia and the EU. In case of the Port of Tallinn, for example, more than 80% of the cargo comes from transit.

According to Russia's recent plan, investments in Ust-Luga SEZ would amount to USD 5 bn. The port should handle up to 100 mln tons of cargo by 2015.

Some business highlights

- Aker Finnyards and the Estonian ferry operator Tallink have signed a contract to build a fast passenger ferry, worth around EUR 110 mln, with an option for another similar ferry. The Tallink Group has also signed an agreement with Italian Fincantieri for two new passenger ships worth EUR 90 mln.
- Swedish-based Handelsbanken will open a branch in Tallinn in spring 2006.
- The real estate agency Colliers International will open an office in Estonia in a few months. The company already operates in Riga and Vilnius.
- The Finnish real estate company Citycon has acquired the Rocca al Mare shopping centre in Tallinn for almost EEK 1 bn (EUR 62 mln). The centre has 25,000m^2 of floor space. Citycon also bought neighbouring land for future extension.
- The Finnish leisure travel services provider Holiday Club Finland plans to build a new spa hotel in Tallinn. The project will be implemented together with the Estonian property development company Arco Vara. The new spa includes the largest water park in the Nordic or Baltic countries.
- The Scandinavian IT company WM-data has signed an agreement to acquire Aprote, the Estonian IT company. WM-data is one of the leading Nordic IT companies with its 9,000 employees. The company is listed in the Stockholm bourse.
- Rimi Baltic's net sales in Estonia grew by 21% y-o-y up to EUR 185 mln in the first 6 months. In this period, the sales of Tallinna Kaubamaja Group increased by 34% to EUR 77 mln and the sales of Prisma Hypermarkets by 30% to EUR 36 mln.

Estonia - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	4.4	0.3	7.9	6.5	7.2	6.7	7.8	7.2	Q1/2005
Industrial production (y-o-y %-growth)	4.1	-3.4	14.6	8.9	8.2	11.0	7.9	9.6	1-6/2005
Inflation (CPI, end of period, y-o-y %-change)	6.5	3.9	5.0	4.2	2.7	1.1	5.0	3.8	7/2005
General government budget balance (% of GDP)	-0.3	-3.7	-0.6	0.3	1.4	3.1	1.8		1-12/2004
Gross wage (period average, EUR)	262	284	314	352	393	430	466	530	Q2/2005
Unemployment (% end of period, LFS data)	10.2	12.9	13.9	11.9	11.3	9.3	8.5	8.1	Q2/2005
Exports (EUR million, current prices)	2 252	2 239	3 445	3 698	3 642	4 003	4 747	2 850	1-6/2005
Imports (EUR million, current prices)	3 529	3 224	4 615	4 798	5 079	5 715	6 738	3 697	1-6/2005
Current account (% of GDP)	-8.7	-4.4	-5.5	-5.6	-10.2	-12.1	-12.7	-9.7	Q1/2005

Source: Statistical Office of Estonia, Bank of Estonia, Eurostat, author's calculations

Latvia

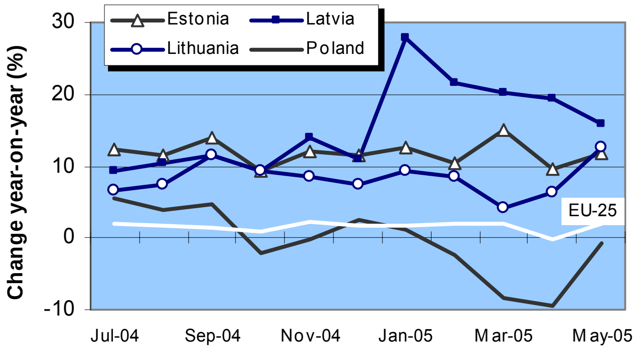
Robust economic growth continues

Latvia's strong economic growth continued over the second quarter of 2005. The significant increase was observed in industrial production, construction, as well as in domestic and foreign trade sectors. In addition, the number of foreign visitors grew rapidly. According to the Bank of Latvia, Latvia's GDP will increase by 7.5% this year. The IMF's recent estimate of 7.75% is even more optimistic.

The growth of industrial production accelerated significantly in the second quarter, since the output volume index increased by 7.8% compared to the corresponding quarter in 2004. However, due to the weak numbers in the first quarter, the six months growth was recorded as 3.8% y-o-y. In the second quarter, the growth of industrial production was based on the notable increase in almost all main industries. The manufacturing of radio, television and communication equipment and the manufacturing of other transport equipment expanded more than 20% y-o-y. Negative growth numbers were observed only in the manufacture of basic metals and textiles. However, during the first six months this year, the manufacture of radio etc. equipment has decreased nearly 20% compared to the first half of 2004.

The value of construction output increased by 16%, at constant prices, in the first half of this year. The growth was mainly based on the increase in the construction of new buildings, which expanded by nearly 30% y-o-y.

Volume of retail trade by monthly



Source: Eurostat

Latvia's retail trade turnover grew by 20.6% (at constant prices) in the first half of 2005 and almost at the same rate within the second quarter. During the first six months, the most rapid increase was noticed in the retailing of textile products and clothing, up by 34% y-o-y. In 2005, the Latvian retail trade sector has grown remarkably faster than the corresponding sectors in Estonia, Lithuania and Poland. Moreover, on the contrary, the aggregate growth of retail sales in the EU-25 countries has been very low during the past twelve months.

Extremely rapid growth in Latvia's foreign trade continues. During the first six months of this year, exports grew by 36% y-o-y, driven by a 57%-increase in the exports of food, non-alcoholic beverages and tobacco, and a 43%-increase in the exports of machinery and equipment. Latvia's imports grew by 23% y-o-y in the same period. The steepest increase in imports was observed in the imports of mineral product, which went up by 81% y-o-y.

Latvian ports' cargo grew slightly in the first half

Latvian ports' handled 29.9 mln tons of cargo during the first six months this year. The total volume increased slightly by 1.2% compared to the first half of 2004. The volume of oil products loaded decreased significantly, but on the other hand, the volume of coal increased. The port of Ventspils handled nearly 15 mln tons of cargo, up by 0.5% y-o-y, and the port of Riga 12 mln tons, up by 3.9% compared to the corresponding period in 2004. Amongst the Baltic ports, the Latvian ports' combined market share was about 45% of the handled cargo in the first half of 2005. Within this period, the volume of cargo decreased by 2.6% in the Estonian ports and by 12.6% y-o-y in the Lithuanian ports.

Passengers served at Riga Airport increased rapidly during the first six months. The number of departures increased by 87% y-o-y up to 411,000.

Gas price hike might delay the Baltics' EMU entry

Price stability is one of the main economic concerns for the Baltic States, as they all aim to enter the eurozone as soon as possible, and they currently fit other EMU criteria quite easily. Although Latvia's current inflation rate (CPI 6.1% in July, still the highest in the EU) is well above the Estonian and Lithuanian ones, the factors behind inflation pressures are quite similar – rapid economic growth, a lending boom, a real estate boom and the rising price of oil. Moreover, Russia's plan to raise the price of gas will fuel inflation.

The Russian parliament has called upon the state-owned gas monopoly, Gazprom, to stop selling gas to the Baltic States at lower prices compared with other European countries. At present, Gazprom's gas price for the Baltic States is around USD 85-95 per 1,000 cubic metres, thus remarkably lower than the price for Germany or Poland, for example. Gazprom is planning a gradual increase in gas prices for Latvia, Lithuania and Estonia over the next three years bringing them closer to the price paid by the other EU countries.

In July, the Bank of Latvia decided to raise the commercial banks' mandatory reserve requirement from 4% to 6% in order to calm the growth of lending and to cool inflation.

Some business highlights

- Latvian banks' aggregate profit increased by 78% to LVL 88 mln (EUR 126 mln) in the first half this year compared to the corresponding period in 2004.
- Latvian government has decided to sell its 38.6%-stake in Ventspils Nafta (VN) through the Riga Stock Exchange.
- Latvian government has decided to pay the EUR 5.1 mln fine, set by the European Commission, for its excess sugar stocks when Latvia joined the EU. The government intends to collect the money back from the companies that held an extra sugar stock for speculative purposes.
- The first Leader Price discounter was opened in Ogre town, close to Riga. The new brand is the first of 15 Leader Markets and larger IKI supermarkets which are planned to be opened in Latvia by the Lithuanian IKI retail chain.
- Latvian Business Bank, a subsidiary of the Bank of Moscow, has acquired a majority stake in Eesti Krediidibank, a small Estonian bank.
- Swedish-Finnish operator TeliaSonera has offered Latvian government EUR 442 mln for their shares in Lattelekom and LMT. However, Latvia's prime minister stated that government is considering buying out TeliaSonera's stake in both companies. The government owns 51% of Lattelekom and 28% of LMT. Correspondingly TeliaSonera owns 49% of Lattelekom and 60% of the LMT shares.
- Scandlines has decided to change its ferry line between Rostock and Latvia from Liepaja to Ventspils. The company also plans to move its Karshamn-Liepaja route to Ventspils.

Latvia - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	4.7	3.3	6.9	8.0	6.4	7.5	8.5	7.4	Q1/2005
Industrial production (y-o-y %-growth)	2.0	-8.8	3.2	6.9	5.8	6.5	6.0	3.8	1-6/2005
Inflation (CPI, end of period, y-o-y %-change)	2.8	3.2	1.8	3.2	1.4	3.6	7.3	6.1	7/2005
General government budget balance (% of GDP)	-0.6	-4.9	-2.8	-2.1	-2.7	-1.5	-0.8		1-12/2004
Gross wage (period average, EUR)	202	225	268	282	297	298	314	344	Q2/2005
Unemployment (% end of period, LFS data)	13.7	13.2	13.3	12.9	11.6	10.3	10.3	9.9	Q1/2005
Exports (EUR million, current prices, average exch. rate)		1 613	2 020	2 232	2 416	2 559	3 175	1 908	1-6/2005
Imports (EUR million, current prices, average exch. rate)		2 758	3 453	3 910	4 284	4 634	5 616	3 042	1-6/2005
Current account (% of GDP)	-9.7	-9.0	-6.4	-7.6	-6.7	-8.2	-12.3	-10.7	Q1/2005

Source: Central Statistical Bureau of Latvia, Bank of Latvia, Eurostat, author's calculations

Lithuania

GDP expanded by 8.2% in the second quarter

According to the first estimate by the Lithuanian statistical authorities, Lithuania's economic growth accelerated significantly in the second quarter of 2005. According to the estimate, Lithuania's GDP expanded by 8.2% compared to the corresponding quarter in 2004, resulting in first-half growth of around 7%. The growth was based on the rapid increase of both in the industrial and service sectors. Lithuanian GDP growth is forecasted to reach a 6-7% rate this year.

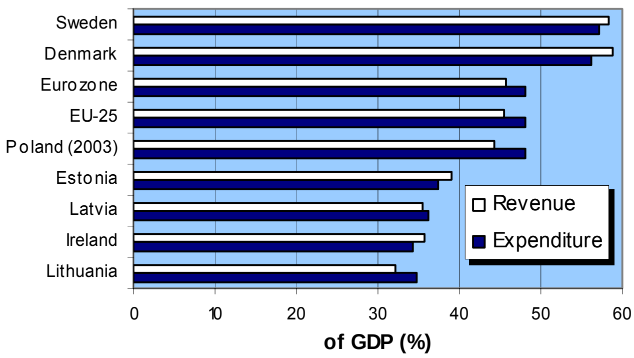
In the second quarter, Lithuania's industrial production expanded by 8.4%, and manufacturing by almost 10% compared to the corresponding quarter a year earlier. The most rapid increase was observed in the manufacturing of other transport equipment, up by 49% y-o-y. Moreover, the manufacturing of rubber and plastic products and the manufacturing of tobacco products both increased over the year more than one third. A notable decrease was observed in the manufacture of office machinery and in the manufacture of radio, television and communication equipment. The slowing trend continued in the manufacturing of clothing and textiles.

The turnover of retail trade enterprises grew by 9.5% y-o-y within the first half of this year. The growth was driven by a 36%-increase in the sales of textiles, clothing and footwear. Furthermore, the sales of restaurants and other catering enterprises expanded by almost 24% y-o-y.

Inflation calms down

Despite inflation pressures caused by extremely rapid economic growth and the rising price of crude oil, Lithuania's annual inflation has been declining during recent months. In July, consumer prices were at 1.8% higher than in the corresponding month in 2004. However, a steep increase was observed in the prices of transport and health care, both of which rose around 8% y-o-y. On the contrary, the prices of communications, furnishing and clothing decreased more than 2% y-o-y. Therefore Lithuania has returned to a modest inflation level, although it experienced the fastest period of price growth since 1998 in January-April this year.

General government revenue and expenditure 2004



Source: Eurostat

In 2004, according to Eurostat, Lithuania's general government sector was the smallest in the EU, when measured by general government revenue and expenditure in relation to the country's GDP. Lithuania was followed by Ireland, Latvia and Estonia. Amongst the EU-25, the largest tax revenues and public spending levels were in the Nordic member states.

Exports increased by 24% in six months

Lithuania's foreign trade turnover increased rapidly during the first half of this year since its exports increased by 24% and imports by 18% y-o-y. The trade deficit accounted for EUR 1.25 bn, which is slightly more than in the corresponding period in 2004.

In the export side, the notable increase was observed in Lithuania's exports to Estonia, which went up by 80% y-o-y. A significant increase was also noticed in Lithuania's exports to Poland (up 69%), to the USA (56%) and to Russia (55%). The export of mineral fuel expanded by 42% y-o-y and accounted for almost 27% of the country's total export value. The export of base metals and related products increased by 34% and the export of food, beverages and tobacco by 29% y-o-y. On the import side, imports from Russia increased by 57% compared to the first six months of 2004. Imports of mineral fuels jumped no less than 74%, explaining the rapid growth of Russian-based imports, and covering a quarter of Lithuania's total imports.

Lithuania most attractive to invest in the EU-25

According to the research conducted by the British private consultancy company, The Centre for Economics and Business Research (CEBR), Lithuania is the most attractive destination to invest in amongst the EU-25 countries. In the CEBR's "EU Regional Investment Index" country rankings, Lithuania was followed by Slovakia, Latvia and Hungary. Poland was ranked at 7th and Estonia in 9th place. On the contrary, the least attractive member states for investments were Malta and Italy. The CEBR's index takes into account economic growth prospects for the region, the level of education of the region's population, market size and eligibility for EU regional funding.

According to the CEBR, the most attractive regions in the EU (at NUTS 2 level) for investments are the Prague region in the Czech Republic, the Budapest region in Hungary and the Bratislava region in Slovakia.

Some business highlights

- Babilonas, the second largest leisure and trade centre in Lithuania was opened in August. The 30,000 square metre centre is located in Panevezys.
- The new Akropolis shopping mall in Kaunas is planned to be opened in 2006. The shopping and entertainment mall will include over 150 shops, a casino, an ice arena and a bowling club. The investment is worth EUR 80 mln.
- Baltic Shopping Centre invests around LTL 200 mln (EUR 58 mln) in Kaunas to a 72,000m^2 trade and leisure centre "Mega" shopping centre.
- Nemuno Banga Group, the leader of Lithuanian PET packaging market, in cooperation with the Spanish-based Interquisa, are to build a new PTA plant in the Klaipeda free economic zone.
- The EBRD has sold its 7.73% stake in Lietuvos Telekomas to international institutional investors. Lietuvos Telekomas is 60%-owned by the Swedish-Finnish operator TeliaSonera.
- Lithuanian knitwear manufacturer Utenos Trikotazas (UT) is to relocate nearly all of its production to Ukraine. UT recently acquired the Ukrainian company Mrija.
- Lithuania earned LTL 138 mln (EUR 40 mln) from the privatisation of state assets in the first 7 months of this year. The State Property Fund concluded 323 privatisations actions.
- Ukio Banko Investment Group is to start construction of the new sport and entertainment centre in Minsk, the capital of Belarus, next year.
- Alstom Power Sweden, a part of the French Alstom Group, has signed a contract to reconstruct the Kaunas hydro power plant for EUR 36 mln. Alstom will also upgrade the Elektranai-based thermal power plant for EUR 170 mln.

Lithuania - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	7.3	-1.7	3.9	6.4	6.8	9.7	6.7	7.0	1-6/2005
Industrial production in sales (y-o-y %-growth)	8.2	-9.9	2.2	16.0	3.1	16.1	10.8	6.3	1-6/2005
Inflation (CPI, end of period, y-o-y %-change)	2.4	0.3	1.4	2.0	-1.0	-1.3	2.9	1.8	7/2005
General government budget balance (% of GDP)	-3.0	-5.6	-2.5	-2.0	-1.5	-1.9	-2.5		1-12/2004
Gross wage (period average, EUR)	208	231	263	274	293	311	335	386	Q2/2005
Unemployment (% end of period, LFS data)	12.6	15.3	16.9	17.9	13.0	11.6	10.6	10.2	Q1/2005
Exports (EUR million, current prices, average exch. rate)		2 583	3 841	4 778	5 526	6 158	7 478	4 186	1-6/2005
Imports (EUR million, current prices, average exch. rate)		4 340	5 650	6 767	7 943	8 526	9 959	5 435	1-6/2005
Current account (% of GDP)	-12.1	-11.2	-5.9	-4.7	-5.2	-6.9	-7.2	-5.6	Q1/2005

Source: Statistics Lithuania, Bank of Lithuania, Eurostat, author's calculations

Poland

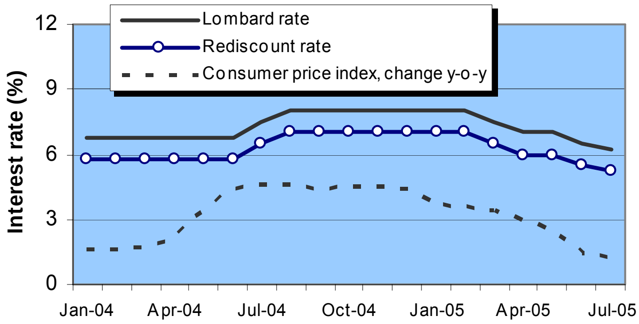
GDP growth accelerates again

After their poor economic development in the first quarter and weak figures in April and May, Poland's economic growth seems to be accelerating again. During the June-July period, industrial production, construction output as well as retail trade volume increased significantly compared to the corresponding period a year earlier. Therefore the recent slowdown in economic growth is predicted to be rather temporary.

However, Poland's GDP growth in the second quarter is disappointing, as it was in the first quarter this year. According to the Polish statistical authorities, GDP expanded by 2.8% y-o-y in the second quarter, thus only slightly more than in the first quarter, when GDP growth recorded 2.1% y-o-y. In the second quarter, investment outlays increased by only 2.6% y-o-y, which was notably less than expected. Moreover, the growth of domestic demand remained feeble.

Based on the weak economic figures within the first months of this year, current GDP growth forecasts have been revised to around 3.8% for the whole year, 2005.

Interest rates and CPI in January 2004 – July 2005



Source: Central Statistical Office of Poland (GUS)

Due to Poland's weakening economic performance along with the decreasing inflation rate, the Monetary Policy Council (RRP) has lowered Poland's main reference interest rates four times this year. The latest 0.25 points-cut was made in July. The weaker than expected GDP figures in the second quarter means that the RRP may implement further cuts in interest rates soon.

A significant fall in inflation during recent months indicates that the EU accession-related price impulse has already disappeared without such an incessant price-impact. In July, Poland's consumer prices increased by 1.3% y-o-y, and this was the lowest annual increase in almost two years. The prices of transports rose by 5.6% compared to July 2004. A significant price decrease was noticed in the clothing and footwear sector, as prices went down by 5.4% y-o-y.

Construction up by 9% y-o-y in seven months

Poland's construction output increased by 9.3% in the first seven months of this year compared to the corresponding period in 2004. This is the steepest increase for many years. Moreover, construction assembly-production increased by 30% y-o-y in June, and 18% in July respectively.

On the contrary, Poland's industrial production increased only by 1.6% y-o-y in the first seven months, and Poland's retail sales volume dropped by 1.0% compared to the corresponding period in 2004.

Net benefit EUR 1.4 bn from the EU in the first half

In the first half of 2005, Poland recorded a positive current account balance with the EU. Transfers from the EU to Poland amounted to EUR 2.5 bn, whilst Poland's payment to the EU stood at EUR 1.1 bn. Almost half of the EU transfers to Poland was due to the Common Agricultural Policy.

Poland's current account recorded a 0.7% surplus as of GDP in the first quarter this year supported by the narrowing trade deficit. In the first seven months of this year, Polish exports grew by 4.1% y-o-y whilst imports decreased by 5.3%, when measured in zloty terms, compared to the corresponding period in 2004.

Privatisation revenues 22% of the target in 7 months

The treasury minister reported that gross privatisation revenues accounted to PLN 1.27 bn (EUR 310 mln) during the first seven months of this year. According to the ministry, 45 privatisation actions have been carried out from the beginning of the year. This revenue represents only 22% of the full-year target of PLN 5.7 bn, set in the budget. The ministry has recently estimated that privatisation revenues will amount to PLN 4.6 bn this year. However, the gap will be covered by the higher than expected dividends from the companies' having state shareholding. In 2004, privatisation revenues amounted to PLN 10.3 bn.

During the forthcoming months, roughly PLN 2 bn is expected from the deals already completed this year, such as a 61%-sale of the Polmos Białystok vodka producer and an 85%-sale of the power company Zespół Elektrociepłowni. Another PLN 1bn is expected to be earned from the sale of shares in some other power companies. The planned privatisation of the gas monopoly PGNiG and the Lotos Oil Group through the sales of their minority stakes on the Warsaw bourse might increase privatisation revenues remarkably. PGNiG is set to debut on the Warsaw Stock Exchange on 23rd September.

Some business highlights

- The Nordic Investment Bank (NIB) has signed a loan agreement worth EUR 140 mln with Gdansk Transport Company S.A for the financing of the Gdansk-Nowe Marzy motorway. The project will cost around EUR 500 mln.
- The German lorry manufacturer MAN has selected Polish Niepołomice (close to Krakow) for its new truck production facility. The company is to invest around EUR100 mln in the new plant and aims to produce 15,000 trucks a year.
- Italian-based Fiat, the largest carmaker in Poland, plans to start production of a new version of Fiat 500 model in the carmaker's existing plant in Tychy.
- Nafta Polska, the state-owned fuel and chemicals agency, plans to sell 80%-stakes of four chemical companies – ZA Kędzierzyn, ZA Tarnów-Mościce, ZCh Zachem and ZCh Organika-Sarzyna – in late 2005 or early 2006.
- Polish defence contractor Bumar has signed two new contracts with the Iraqi government for armoured cars and vehicles worth around USD 150 mln. The company has signed some 35 deals in Iraq worth over USD 400 mln.
- US-based CEDC's acquisition of the Polish vodka producer Bols Sp. Z o.o. has been approved by the Polish competition authorities. CEDC was also selected to purchase a 61%-share in another vodka manufacturer Polmos Białystok through its recent privatisation action.
- Wizz Air, the Hungarian discount airline, plans to launch new routes. The company will start regular flights from Warsaw to Kowno, Budapest and Dortmund. Other new routes are Gdansk-Stockholm, Poznan-London and Katowice-Amsterdam.
- The Irish low cost airline Ryanair plans to start flights from 7 Polish airports this autumn. Currently the company operates on the Wroclaw-London route.

Poland - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	4.8	4.1	4.0	1.0	1.4	3.8	5.4	2.4	1-6/2005
Industrial production (y-o-y %-growth)	3.5	3.6	6.7	0.6	1.1	8.3	11.7	1.6	1-7/2005
Inflation (CPI, end of period, y-o-y %-change)	8.6	9.8	8.5	3.6	0.8	1.7	4.4	1.3	7/2005
General government budget balance (% of GDP)	-2.1	-1.4	-0.7	-3.9	-3.6	-4.5	-4.8		1-12/2004
Gross wage (period average, EUR)	314	401	472	557	544	497	505	561	Q2/2005
Unemployment (%, last survey in the year, LFS data)	10.6	15.3	16.0	18.5	19.7	19.3	18.0	18.9	Q1/2005
Exports (EUR billion, current prices, average exch. rate)	25.1	25.7	34.4	40.4	43.4	47.5	60.0	33.5	1-6/2005
Imports (EUR billion, current prices, average exch. rate)	41.5	43.2	53.1	56.2	58.3	60.3	71.8	37.5	1-6/2005
Current account (% of GDP)	-4.1	-7.6	-6.0	-2.9	-2.6	-2.2	-1.6	0.7	Q1/2004

Source: Polish Official Statistics, National Bank of Poland, Eurostat, author's calculations

Lithuania – Ambitious Plans in the New Space

by Kęstutis Daukšys

Successful Reforms

This last decade has seen a number of important economic reforms in Lithuania, which have undoubtedly paved the way for the country's successful integration into the EU.

Lithuania's economic progress has received high marks from foreign experts. For instance, the World Bank report on the investment climate in 145 countries, 'Doing Business in 2005', ranks Lithuania at no. 6 among the world's best reformers. Also, Leszek Balcerowicz, President of the Na-tional Bank of Poland, noted at the beginning of this year that Lithuania was pursuing the best fiscal policy in Eastern Europe. Moreover, the German Economic Institute in Cologne, Germany (Institut der deustchen Wirtschaft Köln) has recently declared that at present Lithuania is the only one of the new EU member states fully satisfying all 4 Maastricht criteria that countries claiming membership in the Eurozone must satisfy. Finally, the European Commission acknowledged that among all the countries of the EU, Lithuania has been the most successful in incorporating EU internal market directives into national law.

Fast Growth

Lithuania's GDP jumped 9.7% in 2003 and 6.7% in 2004 while the country's industrial sector grew 10.8%.

In 2004 Lithuanian exports increased by 21% and cumulative FDI rose by 18.2%. Furthermore, the listed securities market managed by the Vilnius Stock Exchange, which along with the other Baltic as well as Scandinavian exchanges is part of OMX Exchanges, grew by 68% on average in 2004. Moreover, mobile network penetration in Lithuania today exceeds 100% while Internet penetration grew from 11% in 2002 to 39% at the beginning of 2005.

During the first half of 2005, the Lithuanian economy jumped another 7%. According to International Monetary Fund forecasts, Lithuania's GDP will increase 7% in 2005 and 6% in 2006. The prevailing opinion of the experts holds that Lithuania is not in danger of economic overheating because a lot of room for further development still exists.

Favourable Business Environment

Lithuania offers a harmonious combination of favourable investment conditions. The country produces almost half the GDP of the Baltic States and has the largest and most diversified supply chain in the Baltic States.

Moreover, the results of a survey conducted by the World Bank and published in its recent report 'Doing business in 2005: Removing Obstacles to Growth' show that Lithuania, compared to the other new EU members, provides the easiest conditions for starting and developing a business. In addition, Lithuania invites foreign investors and businessmen to use its investor-friendly tax system (for example, corporate tax is only 15% regardless of how the profits are allocated.) as well as a 16-year tax break in the country's two free economic zones (enterprise zones), one near the ice-free port of Klaipėda and the other at the international logistics centre in Kaunas, which is near an international airport and the north-south highway connecting Scandinavia with Central Europe.

Rapidly developing production clusters in electronics, mechatronics, biotechnology, laboratory and industrial lasers, the logistics and distribution networks, and the shared services and research centres, create an extremely favourable environment for foreign investors.

In order to attract new investments and encourage the expansion of existing ones, the industrial infrastructure necessary for developing greenfield investments is being rapidly developed. Target incentives and support for new investment projects are also planned. The development of promising businesses is also actively supported by EU funds.

Baltic Region of the Future

Lithuania's aims for the future are ambitious but well-grounded. First of all, Lithuania is seeking to become a member of the Eurozone by the beginning of 2007, one of the earliest of the new EU states. Moreover, the country plans to maintain the pace of their economic growth and join the club of advanced EU countries. Lithuania has also set its sights on becoming the regional leader in the field of knowledge economy.

The basis of Lithuania's ambitions consists of sustainable effort and rapid development, which has been widely commented on. For example, at the end of 2004 'FDI Magazine' of the Financial Times group surveyed 140 European cities and regions and named Vilnius, the capital of Lithuania, the Eastern City of the Future, and the Kaunas and Vilnius region the Baltic Region of the Future. These and other positive assessments are the result of the successful reforms made in Lithuania as well as country's ambitious plans for future development.

People keep asking: "What is the secret of Lithuania's rapid growth and what distinguishes it from the other Baltic States and Eastern European countries?" One of the most specific features of Lithuania, one which its people are deservedly proud of, is the extremely high level of education, which enables the country to produce greater added value and is ensuring the rapid development of the national economy.

Another precondition for the country's successful progress is Lithuania's continuing close economic integration with its Scandinavian and other Baltic Sea neighbours. Danish, Swedish, German, Russian, Finnish, and Norwegian businesses are the biggest investors in Lithuania. They, along with Polish companies, are also among Lithuania's most important foreign trade partners.

Mr. Kęstutis Daukšys

Minister of Economy
Republic of Lithuania

Baltic Banking is Modern and Concentrated

by Mart Sörg

The introduction of a market economy in the Baltic States during the last two decades took place simultaneously with structural and legal reforms. Development of the financial sector has been one of the more difficult areas of reform, since at the start of transition economy there were no relevant benchmarks for the market economy financial institutions and markets.

Reforms in the Baltic banking sectors started in 1988, three years before the restoration of political independence. Baltic countries preferred to introduce commercial banking. They had one more aim in reconstructing their banking systems – to restore financial independence from Moscow. As a consequence, Baltic Republics became pioneers in reforming the banking system in the former USSR. After the hyperinflation of 1991, which had reduced the real value of the obligatory initial capital of commercial banks by several times, a boom in establishing a new type of bank was observed. The first stage of development of new banking ended in banking crises: in Estonia 1992-1994, in Latvia 1995-1996 and in Lithuania 1995-1996. The banking crises in the Baltics were imminent, because the reorganisation of banking coincided with a time of reforms in the monetary and economic systems as well as with deep economic crises. In addition, the risk management systems of the new banks did not conform to the real needs. The crises resulted in the bankruptcy and mergers of banks, and the arrival of foreign banks as strategic investors for Baltic banks. The crises cleared the Baltic banking sectors from weaker links and presented both the central banks and the managements of operating banks with directions for improving the banking regulation and management practices.

As can be seen in Table 1, according to EBRD calculations, the banking sector reform in Estonia is practically finished, but the index of reform of non-bank financial institutions is lower – 3.3. Compared with Estonia, the success of reforms in other Baltic States is slightly smaller, which motivated the Hansapank Group to expand from Estonia to Latvia's and Lithuania's market and to improve the financial sector performance in these countries. The concentration of banks is very high in the Baltics. In the Baltics we have 43 operating banks for a population of ca 7 mln. For example, in Finland 5 mln inhabitants are serviced by almost 350 banks. Banking sector concentration is the highest in Estonia, where Hansapank's market share, by assets, is over 50%, and the share of the next biggest bank, Eesti Ühispank, is approximately 30%. A third of the Baltics' banking market, by assets, is in the hands of Swedish-origin SEB (Eesti Ühispank, Latvias Unibanka and Vilniaus Bankas) another third is in the hands of Swedbank via the Hansapank Group. Domestic banks and other foreign bank branches (from Finland, Germany and others) provide considerable competition for the two leading bank groups in several fields of activity.

Table 1. Banking sector indicators in 2004

	Estonia	Latvia	Lithuania
EBRD index of banking sector reform (1 min, 4 max)	4.0	3.7	3.0
EBRD index of reform non-bank financial institutions	3.3	3.0	3.0
Number of banks	7	23	13
Total assets (% of GDP)	76	84	33
Market share of the 5 largest banks (%)	98	63	82
Foreign-owned bank assets in (%)	97	47	91
Non-performing loans of total assets (%)	0.8	1.8	na
Return on equity, ROE (%)	23.0	21.4	13.0

Source: EBRD Transition report 2004, Part 3; ONB WP 96, 2005, p.5., Eesti Pank

The assets of the Baltic banks have grown much faster than GDP in the Baltic States. One reason for this is the enormous potential for growth. Banking assets in the Baltics stand at levels well below 100% per GDP – far from the level achieved in the Eurozone, where it was more than 260% in 2003. Despite the decrease, the interest rates and interest margins of Baltic banks are continuously highly profitable. High profit and expanding ambitions require developments in the banks' management systems and the introduction of new products and services.

For the aforementioned reasons the payment environment in the Baltics is mostly electronic, and instead of less efficient payment instruments, Internet banking and debit orders are widely used. The speed of development of electronic banking has high growth rates. For instance, the number of bank cards issued in Estonia has reached one card per inhabitant. The number of points of sale (POS) accepting card payments has also increased 3.4 times during last five years.

From Table 2 we may see that the number of card payments per capita in Estonia is several times higher than in other new EU members, former socialist economy countries (except Slovenia). Good automated teller machines (ATM) and points of sale (POS) network is the basis of this success. The development of electronic banking in Latvia and Lithuania is also quickly going up.

Table 2. Use of cash and payment cards in 2003

	Cash in circulation/ GDP	Number of card payments, per capita	Number of payment cards, per capita	Number of ATMs and POS terminals, per 1 mln inhabitants
Czech Republic	9.20	5.50	0.62	3.268
Estonia	6.10	35. 20	0.88	7.260
Hungary	7.30	7.00	0.66	2.702
Latvia	10.20	10.20	0.77	4.789
Lithuania	8.30	7.30	0.62	3.475
Poland	6.20	4.07	0.39	2.389
Slovakia	8.00	5.60	0.56	2.852
Slovenia	2.70	49.00	1.70	16.674

Source:European Central Bank. Blue Book. February 2005.

Foreign businessmen and visitors to the Baltics have expressed the opinion that our banks are operating in accordance with modern market economy patterns in every respect. The above-presented indicators demonstrate the same fact: Baltic banks have achieved the level of trustworthiness, novelty of products, and standards characteristic of banks of the developed countries. Accession to the EU a year ago gave us hope that the extremely high concentration in the Baltic banking sector will decrease in the future, as it is likely that several big European banks will try to enter our prosperous emerging market. The first signs thereof are applications to our Financial Supervision Authorities to establish representative offices in the Baltics and the boost of share prices in the Baltic Stock exchanges. For instance, in Vilnius the Stock Exchange share price of Ukio Bankas rose by the middle of August more than double compared with the last two months. And in August 23rd this year Svenska Handelsbanken, which has one of the highest ratings in Europe and is operating in 18 European countries, informed the market that they have a strategy to establish a branch-office in Tallinn in first half of 2006. Planned head of the Tallinn Office, Harri Tuohimaa, already is preparing the branch activities in temporary rented rooms in Tallinn.

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The Position of Southwest Finland as a Baltic Growth Centre

by Juho Savo and Hannu Elo

The most important growth centres in the Baltic region and current position of Southwest Finland

Definition of the Baltic region

Herein, we confine the provinces and corresponding areas bordering the Baltic as those comprised within the Baltic region. The criterion, therefore, is marine traffic contact with the Baltic Sea. In this respect, the Baltic region includes, for instance, Hamburg but not Berlin, the Turku area but not that of Tampere, etc. This selection may, of course, be criticized as excessively limited. On the other hand, it is consistent, as it closely combines the concept of the Baltic region with the Baltic Sea itself.

Population centres in the Baltic region

The number of inhabitants is regarded as one of the ordinary specification criteria for centres. On this basis, two metropolitan areas in the Baltic region stand out in the highest class: St Petersburg and Hamburg, which have millions of residents.

The capitals of the Baltic nations are comprised within the next class. Including the surrounding cities, the number of inhabitants in the areas of the capitals is roughly in the order of one million residents, an exception being the Stockholm area, where 1.7 million inhabitants live.

Those Baltic cities whose population figures vary approximately between 100,000–400,000 are included within the third group. The largest urban areas in this group, Kaliningrad and Göteborg, are actually considerably larger than this.

The large cities and urban areas of the Baltic region, 2002-2004

	City	Urban area
St Petersburg	4 565 000	5 410 000
Hamburg	1 729 000	2 515 000
The capitals and capital city areas of the Baltic region		
Stockholm	762 000	1 684 000
Riga	733 000	..
Copenhagen	502 000	1 086 000
Helsinki	559 000	976 000
Vilna	542 000	..
Tallinn	397 000	..
The other largest cities and urban areas in the Baltic region		
Kaliningrad	427 000	950 000
Göteborg	478 000	810 000
Gdansk	461 000	..
Szczecin	415 000	..
Århus	294 000	..
Malmö	267 000	..
Kiel	230 000	..
Lubeck	220 000	..
Rostock	197 000	..
Klaipeda	192 000	..
Turku	175 000	260 000
Oulu	126 000	..

Turku's twin cities, Göteborg and Århus, which are in close marine contact with the Baltic Sea via the Straits of Denmark, are included here as borderline cases.

If the number of inhabitants were the most essential criterion in the competition between the cities, Turku would belong to the tail-end of the third class. Fortunately, this is not the case.

The most important areas for production in the Baltic region

The strength of Baltic centre areas can also be measured by the areas' production, which tells more about their accomplishments. These areas are clearly grouped in a different sort of order of magnitude to that of number of inhabitants.

Clearly, the most vigorous and prosperous areas for production in the Baltic region are Hamburg and the county of Stockholm. These are followed by the region of Uusimaa, the counties of South Sweden and the region of Copenhagen. However, already after these come the region of Århus and Southwest Finland, which is in eighth place. For instance, the Baltic urban areas of North Germany (with the exception of Hamburg) and the capital areas of the Baltic nations remain far behind in this comparison. Nevertheless, the comparison only indicates the general trend, since the area-related concepts do not completely conform to each other. Information on the St Petersburg area has not been available.

Area	GNP 2002 in bn euros
Hamburg	76.3
County of Stockholm	73.1
Region of Uusimaa	49.5
County of Westrogothia	42.0
County of Skåne	30.6
Region of Copenhagen	27.4
Region of Arhus	19.7
Region of Southwest Finland	13.0
Pomerania (in Poland)	11.5
North Ostrobothnia	9.0
Western Pomerania (in Poland)	8.9
Kiel	8.3
Lubeck	5.9
Region of Riga	5.7
Vilna	5.2
Rostock	4.9
Northern Estonia	4.4

On the basis of the grouping according to production level, Southwest Finland and Turku are able to reach substantially more significant business partners than that indicated by the population figure.

Research and product development in the Baltic region

If the relative position of Baltic region centres is assessed from the perspective of developmental possibilities, their essential importance appears to be their investment in research and product development. According to the statistics for 2003, the investment of the Baltic nations in research and product development as a share of the Gross National Product (%) was as follows:

R&D investments as of GNP in 2003

Sweden	4.27
Finland	3.51
Denmark	2.60
Germany	2.50
EU-25	*1.93*
Estonia	0.77
Lithuania	0.68
Poland	0.59
Latvia	0.39

Finland's investment in research and product development was, after Sweden, the world's second highest and relatively multiple by reference to, among others, the Baltic nations. This offers potential for the preservation of a competitive position in the future. At the same time, it must be remembered that the new member countries of the European Union shall receive increasing investment as EU support also for research and product development, which shall improve their possibilities for success.

The significance of universities and institutions of higher education from the perspective of the areas' position

Three universities function in Southwest Finland: namely, the University of Turku, Åbo Akademi University and the Turku School of Economics and Business Administration, in addition to the country's most comprehensive polytechnic institute. As a result, the area has, in total, approximately 40,000 students in attendance at university and other institutions of higher learning. The universities referred to have a very broad international cooperation network in both the Baltic sphere and the entire world. This means considerable resources with ensuing development in mind, and will raise on their part the relative position of Turku and Southwest Finland amongst the Baltic centres above and beyond the statistical figures listed. More than anything else, the trump for the Southwest Finland region in competition amidst the Baltic areas is quality rather than quantity.

Ensuing possibilities within the Baltic sphere for Southwest Finland

Southwest Finland, with over 450,000 inhabitants, is a vital region demarcated within the Baltic. In addition to agriculture, industry and education, the area is particularly profiled by its high expertise, communications technology and the biosciences. The region's enterprises with a competitive edge, globally speaking, are the Nokia cellular phone assembly facilities in Salo, the Aker Finnyards shipbuilding docks in Turku, Raisio Group food production plant in Raisio, Valmet Automotive motorcar assembly in Uusikaupunki and both the Schering and Orion pharmaceutical companies in Turku.

The area's three large ports — Turku, Naantali and Uusikaupunki — enjoy good connections all round the Baltic and inland on a secondary basis as well as to the capital district and further onwards from there to Russia, into St Petersburg's economic region. Turku has air service via Helsinki, Stockholm and Copenhagen throughout the world. Turku's urban area is, due to its location and favourable connections, a significant logistics centre for the Baltic region.

The ensuing possibilities for Southwest Finland within the Baltic sphere are largely based on its current points of departure, on the foundation of which plans and programmes oriented towards the future have been brought into being.

Goals of the regional plan and regional programme

The vision for Southwest Finland's regional plan for the year 2020 is:

The region of Southwest Finland shall be a competitive, European district centre whose strengths rest in logistics and interaction. The backbone of commercial life shall be the area's industry, the fields relying on new information technology, the biosciences, and tourism. The educational standard shall be high and the region capable of being proud of its university and educational concentration. The appeal of the region shall be centred on the Turku and Salo area.

For the 2005-2008 period on its part, the points of emphasis for the regional programme have been selected as follows:

1. *The region's competitive edges shall be ensured by means of expertise and creativity*
2. *The region's success shall be safeguarded by developing its economic life*
3. *A significant Baltic region centre shall be developed out of Southwest Finland*
4. *Active functions are to be added to assure welfare*
5. *The environment shall be made the factor of attraction for the region*

In the consideration of ensuing development, it is especially important to assure the instruction-based and research-related resources for the region. In particular, the resources and initiation sites for the fields of emphasis — for instance, the biosciences, mathematics, process chemistry, medicine and dentistry, pharmaceutics, welfare and health, ICT and maritime and metal industry, culture and comprehensive education in the arts — should be safeguarded. Most recently, the pharmaceutical development unit of VTT Technical Research Centre of Finland as well as the functional foods development centre at the University of Turku have initiated operations in Turku. Extensive international exchange between institutions of higher education is also being maintained.

Southwest Finland's centre of expertise operations is being looked after by Turku Science Park, which transmits and applies new data and know-how for the requirements of business life as well as establishing the prerequisites for innovations. *The Regional Council of Southwest Finland proposes Turku as the city-based location for the new Nordic research and innovation center, Nordforsk.*

Turku is being developed as the nation's second most significant cultural city. *The City of Turku has set a goal to be the EU's European City of Culture for 2011. Cooperation is being built with, among other places, Estonia's European Capital of Culture.*

Southwest Finland's objective is to further strengthen its best production clusters. Successful product development and profitable business operations represent essential practical aims. The goal is that *The Turku and Salo axis shall be developed into a strong Baltic region centre which is specialized in the metal field as well as in the aspects related to ICT, logistics and environmental, health and technology and their beneficial exploitation in production.*

Above all, the economic advancement of the Baltic area is important to Southwest Finland. Finland's most important commercial partners are Germany, Sweden and Russia, of which the last-mentioned is ascending to first place. Contacts with all Baltic countries must be actively nurtured.

Southwest Finland's international cooperation within the Baltic sphere

Southwest Finland enjoys traditional collaboration with the Nordic countries, Russia, Estonia and North Germany. The most important areas of cooperation are the Stockholm and Mälar Valley area, those of western Estonia, the economic area of St Petersburg and other parts of Northwest Russia, in addition to the state of Mecklenburg-Vorpommern in Germany. Most recently, a cooperation programme was signed with Poland's Pomerania region. The Riga district is recognized for the collaborative potential between the areas.

The international networks of municipal and other local associations further, with their own operations, the internationalisation of the region. For example, the City of Turku functions actively in the Union of the Baltic Cities (UBC), with the University of Turku and Åbo Akademi University coordinating the Baltic university network in the case of the former and the Baltic Programme for education with respect to the latter.

The following are included within Southwest Finland's international objectives:

- *to promote the placement of international businesses in the region*
- *to expand the cooperation between Southwest Finland and the greater Stockholm area with environmental questions as the main point of emphasis*
- *to broaden collaboration with the Baltic nations and Poland, including marine traffic connections*
- *to participate in the Gulf of Finland growth triangle via the South Finland alliance*
- *to further initiatives towards the advancement of Baltic marine traffic connections as part of the pan-European traffic network and especially as respective to the Baltic motorway*
- *to develop Turku Airport into a freight traffic centre as part of Turku's logistics centre as well as ensure connections for the airport's passenger traffic to Helsinki, Stockholm and Copenhagen*
- *the Pro Saaristomeri (Pro Archipelago) environmental programme, the aim of which is to halt the deterioration of the Baltic Sea and improve its condition, requires comprehensive international cooperation within the sphere of the Baltic.*

The Southwest Finland region is ready for all cooperation in the Baltic region which is in accordance with the attainment of the objectives it has set for itself.

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