SEE Spotlight

News, research and analysis on south-eastern Europe

Issue No. 5, June 2011

EDITORIAL

Economic performance in south-eastern Europe continues to be rather mixed. The good news is that all countries are likely to see some growth this year, according to the latest forecasts of the EBRD and of most other institutions following the region. The bad news is that the recovery is still rather patchy. The region's largest economy – Romania – posted a slightly stronger than expected growth rate in Q1 2011, and the EBRD's forecast for 2011 growth was raised from 1.1 to 1.8 per cent. The Bulgarian growth forecast was also improved from 2.6 to 3.1 per cent. However, the Croatian economy continues to disappoint, and political tensions could slow down or even threaten the recoveries in Albania and Bosnia and Herzegovina.

As summer is now upon us, this edition of *Spotlight* focuses on the tourism sector. The past decade has seen a major growth in tourism in SEE. The global crisis resulted in a sharp drop in revenues in 2009 but some recovery seems to have taken place in 2010. The challenge now is to build on this for the future by tackling some fundamental competitiveness issues that have held the region back.

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The latest EBRD growth forecasts for the transition region can be found here: http://www.ebrd.com/downloads/research/REP/rep.pdf

European Bank
for Reconstruction and Development

RECENT RESEARCH

R. Ravnik and I. Žilić, "*The use of SVAR analysis in determining the effects of fiscal shocks in Croatia*", Financial Theory and Practise 1/2011, Institute of Public Finance, March 2011, Zagreb.
http://www.ijf.hr/eng/FTP/2011/1/ravnik-zilic.pdf.
The paper provides as analysis of short-term effects of fiscal policy on economic performance, inflation and interest rates. Applying multivariate Blanchard-Perotti SVAR methodology, the author argues that shocks in government spending and revenue collection have relatively the highest effect on short-term interest rates and the lowest on inflation.

H. Vidovic et al., *"Western Balkans: employment in the gas and electricity sectors*", WIIW Research Report No. 370, March 2011, Vienna.
http://www.wiiw.ac.at/?action=publ&id=series&value=2.
This study aims to analyse employment developments in the gas and electricity sector in seven south-eastern European countries that are contracting parties of the Energy Community. Based on interviews with representatives of the energy sector, it assesses the impact of liberalisation and alignment with EU standards of the sector, and particularly focuses on the quality of employment.

N. Altiparmakov, "*Wage Tax Collection and Distribution in Serbia: Looking Forward*", Quarterly Monitor of Economic Trends and Policies in Serbia, Issue 23, Foundation of the Advanced Economies, March 2011, Belgrade.
http://www.fren.org.rs/attachments/093_QM23engleski_lupa2.pdf
The paper discusses an alternative to the current wage tax collection and distribution system in Serbia, which aims to eliminate unnecessary administrative cost for employees and regressivity of the existing system in distributing tax revenues among municipalities. It argues that an automated system could increase revenues of underdeveloped municipalities.

J. Rupnik (ed.), *"The Western Balkans and the EU: The Hour of Europe"*, European Union Institute for Security Studies, Chaillot Papers No. 126, June 2011, Paris.
http://www.iss.europa.eu/uploads/media/cp126-The_Western_Balkans_and_the_EU.pdf
The volume includes a variety of country case studies and overarching themes. It assesses the progress and the current state of the art in the EU integration process of the Western Balkan countries, both from national and supranational perspectives.

RECENT ECONOMIC DEVELOPMENTS

Industrial output remains somewhat unstable. A deceleration in annual growth rates of industrial production (IP) has become apparent in most countries in the first quarter of 2011. IP growth in Montenegro even turned negative in March and April 2011, though mostly attributed to the strong base effect in the previous year. In addition, industrial output also temporarily deteriorated in Serbia as a result of the reduction in output of the national oil refinery, NIS, which is undertaking major maintenance work. Conversely, IP in Croatia turned positive again in April after four consecutive months of negative growth rates.

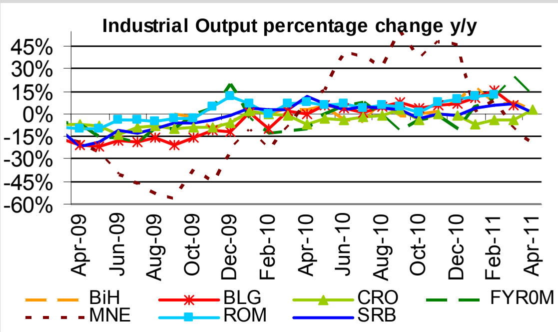
Exports activity maintains momentum. The external sector is performing well as export activity continues to expand across many countries in the region at above 30 per cent y/y. Montenegro in particular recorded high growth in exports in early 2011, primarily owing to a strong performance in the manufacturing of basic metals. In contrast, exports in Croatia contracted again in March, underlining the still subdued trading activity of the country. Imports are also rising and have returned to positive growth rates in all SEE countries, though less pronounced than the export sector.

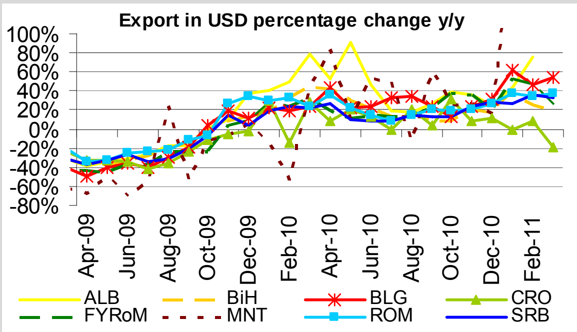
Inflationary pressures on the rise. Prices continued to accelerate in light of the global trend of increasing costs for food and energy, and inflation has reached 14.7 per cent y/y in Serbia in April. But prices have also picked up in other countries that traditionally suffer less from inflationary pressures; the (unweighted) regional average has reached 5.8 per cent y/y. In response, the central banks of the FYR Macedonia, Romania and Montenegro have recently revised upwards their inflation targets for end-2011 from 3 per cent to 4.5-5 per cent, 2.75-4.75 per cent to 3.5-5.75 per cent and 3.6 per cent to 5.1 per cent, respectively.

Risk perceptions almost back to pre-crisis levels. Credit default swaps (CDS) of the most advanced economies in south-eastern Europe continue to fall and stood at below 300 basis points as of the end of May, despite a renewed temporary upheaval of the Eurozone debt crisis. This suggests that confidence of investors in the SEE economies is continuing to recover.

SELECTED MACROECONOMIC INDICATORS

Real Economy

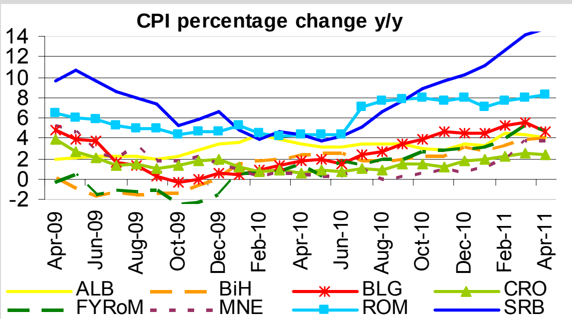


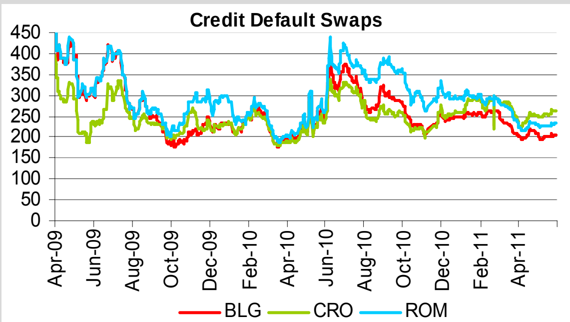


Source: National Authorities.

Source: National Authorities via CEIC Data Service.

Inflation and CDS spreads



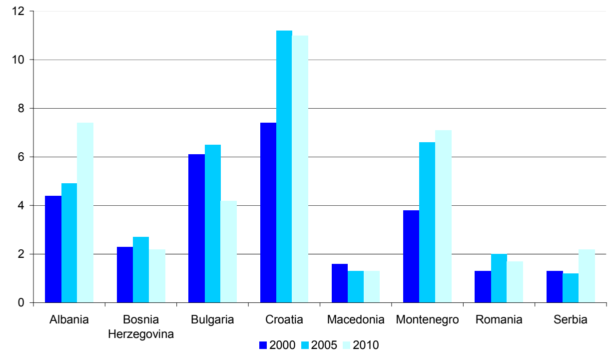


Tourism in south-eastern Europe suffered hugely in the conflicts and upheaval of the 1990s, but has been on a recovery path since then. Anyone who has visited the region knows that it is filled with beautiful and interesting sights and should therefore be a natural tourist destination. But the lack of infrastructure and the (sometimes) low quality of service have prevented the region from achieving its full potential. This note uses some recently published data to answer some questions about the role the tourism sector currently plays in SEE.

How important is tourism for the region's economies?

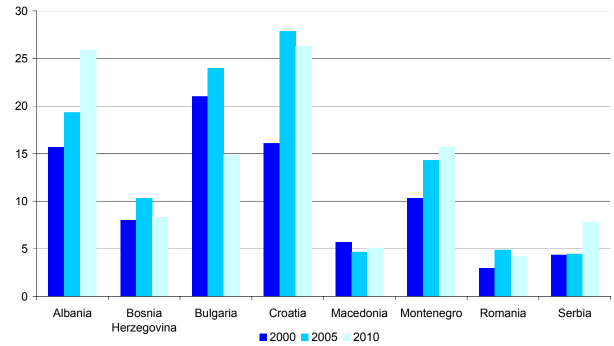
The tourism sector is an important direct and indirect contributor to GDP, according to estimates from the World travel and Tourism Council. In direct terms, it accounts for more than 10 per cent of GDP in Croatia, and more than 5 per cent in Albania and Montenegro (see Chart 1). When indirect linkages are added, tourism is responsible for more than one-quarter of GDP in Albania and Croatia, and more than 15 per cent in Montenegro (see Chart 2). These figures exceed considerably those of 10 years previously. In addition, the sector is also a major source of employment – especially in Croatia where around 12 per cent of total employment is in tourism.

Chart 1: Direct contributions to GDP in %



Source: World Travel and Tourism Council 2011.

Chart 2: Indirect contributions to GDP in %



Source: World Travel and Tourism Coucil 2011.

Where do the tourists come from?

An interesting feature of tourism in the SEE region is the large share of domestic or *intra-regional* tourism. Available statistics (see Table 1) show that only the most advanced economies - Bulgaria, Croatia and Romania - have succeeded in substantially attracting Western European tourists (mostly from Germany) in 2010, whereas in the remaining region the majority of tourist originate from the former Yugoslav republics, or other geographically close countries. Russian tourists account for a substantial share of foreign tourists in Montenegro.[1]

Table 1: Share of international arrivals by country of origin 2010[2]

	FBiH	RS	Bulgaria	Croatia	FYR Macedonia	Montenegro	Romania	Serbia
Country of origin	CRO (15.9%)	SRB (43.0%)	ROM (17.3%)	GER (16.1%)	SRB (15.4%)	SRB (28.9%)	GER (14.2%)	SLO (9.8%)
	SLO (9.6%)	CRO (10.5%)	GRC (12.2%)	ITL (11.6%)	GRC (11.2%)	RUS (13.8%)	ITL (11.1%)	BiH (9.3%)
	GER (7.5%)	SLO (9.6%)	TUR (11.3%)	SLO (10.6%)	ALB (6.7%)	BiH (9.5%)	FRA (7.9%)	MNT (8.3%)

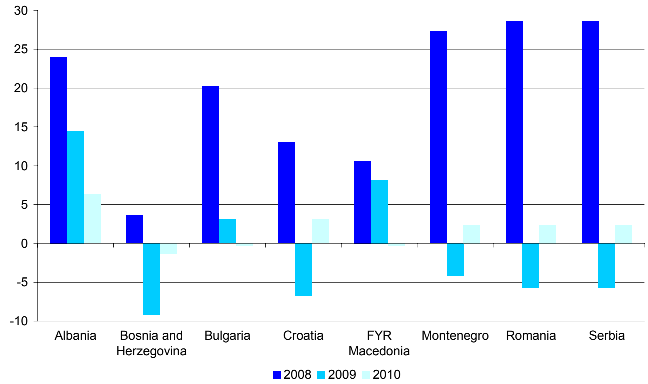
Source: National Statistical Offices.

[1] Montenegro is one of the few SEE countries for which there is no visa-requirement for Russian citizens.
[2] For Albania, no breakdown of arrivals by country of origin is available.

What was the impact of the crisis?

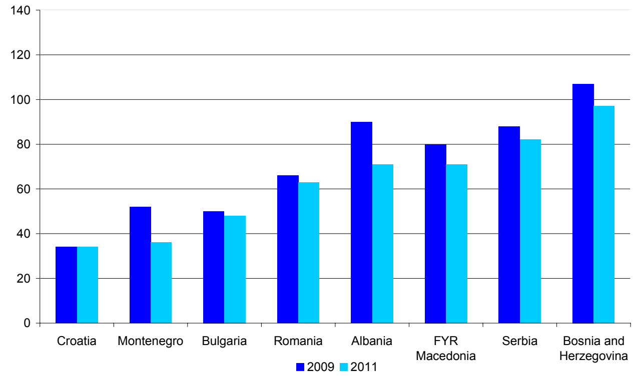
Tourism was starting to boom in SEE before the crisis hit. In 2008, annual tourism revenues rose by more than 25 per cent in Montenegro, Romania and Serbia, with substantial increases also in Albania, Bulgaria and Croatia (see Chart 3). In contrast, revenues dropped in 2009 in five out of eight countries – Bosnia and Herzegovina, Croatia, Montenegro, Romania and Serbia. A modest recovery appears to have taken place in 2010.

Chart 3: Tourism revenues, annual change in %



Source: World Travel and Tourism Council 2011.

Chart 4: WEF T&T Competitiveness Index 2011[3]



Source: World Economic Forum 2011.

Is the region competitive in tourism?

The short answer appears to be – not really. Cross-country competitiveness in the tourism sector can be assessed by using the World Economic Forum's (WEF) Travel and Tourism (T&T) Competitiveness Index 2011, which assesses more than 70 indicators relevant for the tourism industry – ranging from the T&T regulatory framework to T&T infrastructure and cultural, natural and human resources. The index covers 139 economies. In SEE, Croatia and Montenegro are amongst the top 40 economies (ranked in 34th and 36th position, respectively), but the remaining SEE region performs relatively poorly, as indicated in chart 4. In 97th position, the tourism sector of Bosnia and Herzegovina is the least competitive in the region.

Why does SEE lag behind other traditional tourist destinations? A more detailed analysis identifies a similar pattern of shortcomings across the region: Almost all SEE countries seem to suffer from a low quality of infrastructure and an underdeveloped air transport network. But there are also some major discrepancies. Whereas the development of the tourism sector seems a priority in Montenegro, Croatia, and Albania, in Serbia, FYR Macedonia, Romania and Bosnia and Herzegovina, governments seem to focus less on the development of the local tourism sector, according to a recent WEF survey. Overall, the region however is well placed in WEF's ranking in terms of openness and affinity towards international tourism.

In summary, tourism remains an area of great potential for SEE, and could be an important source of growth in the coming years. Governments have recognised the importance of the tourism industries in recent years and have began to implement several measures to support the sector, mostly in the form of promotion of the local tourism abroad. However, more efforts are made to address some of the competitiveness problems identified by the World Economic Forum report, such as investments in infrastructure, in order to tap the full potential of tourism in SEE.

[3] On a range from 1 to 139, with 1 representing the most competitive and 139 the least competitive T&T sector.