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Subject: Presidency Conclusions of the Ministerial Dialogue between the Economic and Finance Ministers of the EU and the Accessing and Candidate Countries on 15 May 2012

Delegations will find attached the Presidency Conclusions of the Ministerial Dialogue between the Economic and Finance Ministers of the EU and the Accessing and Candidate Countries on 15 May 2012.

PRESIDENCY CONCLUSIONS
OF THE MINISTERIAL DIALOGUE BETWEEN THE ECONOMIC AND FINANCE
MINISTERS OF THE EU AND THE ACCEDING AND CANDIDATE COUNTRIES
ON 15 MAY 2012

On 15 May 2012, the Economics and Finance Ministers of the EU and the acceding and candidate countries, representatives of the Commission and the European Central Bank and representatives of the central banks of the acceding and candidate countries met for their 14th economic policy dialogue. Ministers welcomed the submission of the 2012 Pre-accession Economic Programmes (PEP) of Croatia (acceding country), Iceland, the former Yugoslav Republic of Macedonia, Montenegro and Turkey and the Economic and Fiscal Programme (EFP) of Serbia which provide important indicators in terms of integrating into the EU's economic and fiscal policies in view of the countries' accession perspectives, and took note of the economic policies regarding economic stabilisation, fiscal consolidation and structural reforms set out in the programmes. The programmes cover the period from 2012-2014.

Overall conclusions

Ministers acknowledged the progress achieved by the acceding and candidate countries in stabilising and transforming their economies.

As regards Croatia, the Ministers welcomed the comprehensiveness of the PEP and, in particular, the emphasis on fiscal consolidation. They also acknowledged the stable monetary and exchange rate policy framework. The macroeconomic scenario is considerably more optimistic regarding GDP growth than the current consensus. The downside risks to the PEP's growth projection are accentuated by the recent deterioration in the outlook for major export markets and the current oil price level and the current account deficit could widen again if growth should develop as projected in the PEP. The challenges related to the fiscal scenario are particularly associated with the need to specify concrete measures to lower expenditures in line with projections. Given the slow pace of the reform process in recent years, the government is encouraged to conduct and speed up structural reforms.

As regards Iceland, the Ministers noted that the economy is recovering from a long and deep recession and welcomed the continuation of fiscal consolidation. However, they stressed that risks to the broadly plausible programme scenario are mostly on the downside. Private consumption has proven surprisingly strong in 2011 on the back of higher wages and social benefits, and other temporary factors, the importance of which is likely to diminish over the medium-term. Investments may remain constrained by the on-going corporate debt restructuring and possible delays in energy-intensive projects. Extensive capital controls are one of the most salient features of the economy and their removal represents a particular challenge. After budgetary slippages last year, and with parliamentary elections in 2013, the consolidation path may weaken further, especially in view of the uncertainty surrounding some of the consolidation measures and the composition of adjustment.

As regards the former Yugoslav Republic of Macedonia, the Ministers stressed the importance of providing a sufficiently specified framework and statistically supported programme in order to have a useful exchange of views. The main risks to the programme are related to lower than expected growth. With respect to structural reforms, the main risks are delayed, stalled or they are only partially implemented. Given the lack of detail with respect to the country's fiscal scenario, it is not possible to assess to which extent the presented structural reforms are in line with the budgetary framework. A better and more concrete integration between the fiscal framework and the reform agenda would have been helpful. With respect to the country's accession perspective, important challenges continue to be to improve the functioning of the labour market, to strengthen administrative capacities and regulatory and supervisory agencies and improve the rule of law and contract enforcement.

As regards Montenegro, Ministers underlined that the objectives of the programme are in line with the accession priorities; i.e. the need to reinforce macroeconomic stability and to maintain the reform momentum. The most immediate threat remains to be the still weak capacity of the economy to refinance debt, risking a build-up of payment arrears due to the illiquidity of firms. The main fiscal risk remains the cost of debt servicing, worsened by the need of additional borrowing for deficit financing and the activation of the substantial state guarantees extended to the aluminium plant.

As regards Serbia, the Ministers acknowledged that the economy continued expanding last year. They welcomed important steps towards transforming the Serbian economy, but noted that a number of structural weaknesses persist, hampering the economic performance. The plausibility of the programme targets is constrained by the need to revise the macroeconomic and fiscal scenario. The programme would benefit from a more detailed description of policies and measures which could forge a structural shift to more sustainable growth based on exports and investment. It remains to be seen how this strategy would unfold, given the absence of binding plans for implementing structural reforms.

As regards Turkey, the Ministers underlined that the programme was supported by a sufficiently comprehensive and broadly consistent macroeconomic framework, which appears however somewhat optimistic, in particular with respect to the balance-of-payments and inflation scenarios. In the light of the programme's growth projections, the fiscal policy objectives appear realistic. The programme's structural and institutional reform agenda appears fragmented and is insufficiently linked to the fiscal scenario and only partly aligned with the reform requirements in view of the country's EU accession perspective.

Overall, the Ministers underlined their commitment to carry on monitoring the progress achieved with respect to macroeconomic, budgetary and structural policies in the candidate countries to ensure continued anchoring of their medium-term economic programmes. Ministers will meet again in the course of 2013 to continue their dialogue. Likewise, the dialogue at the level of the Economic and Financial Committee and its counterparts will continue in 2013.

As regards statistics, the Ministers welcomed the Progress Report of April 2012 on the Action Plan on Economic, Monetary and Financial Statistics in Candidate Countries all candidate countries made progress in fulfilling the Action Plan requirements, but additional efforts in some statistical areas are still needed to achieve a full compliance with the Action Plan requirements.

Conclusions

Croatia

- Croatia's Pre-Accession Economic Programme (“PEP 2012-2014”) presents a comprehensive, though optimistic, medium-term macroeconomic and fiscal framework based on the projection of a gradual recovery from recession and stagnation in the preceding years. The programme’s fundamental objective is to establish a knowledge-based, export-oriented and competitive economy in which output and employment expand and social cohesion is maintained. The document largely complies with the formal requirements and appears consistent with the 2012 state budget which was adopted on 24 February 2012.
- Macroeconomic performance in 2011 was characterised by a stabilisation of the output level following the contraction in 2008-2010. Annual GDP is estimated to have stagnated (-0.0%) in real terms compared to 2010. However, employment continued to fall, pushing up the unemployment rate by 1.7 percentage points. Consumer price inflation rose to an annual average of 2.3% mainly as the result of higher commodity prices, particularly in the food segment. The current account deficit remained unchanged compared to the preceding year at 1% of GDP. Gross external debt, a major challenge for macroeconomic policies, also remained stable at just above 100% of GDP over the course of the year. Looking forward, the PEP projects a macroeconomic scenario for 2012-2014 with moderate output growth and relatively low inflation. Real GDP is seen to accelerate gradually from 0.8% growth in 2012 to 2.5% in 2014. The unemployment rate is projected to rise to 14% in 2012 and only starts to recede from this level in 2014. Consumer price inflation is expected to remain relatively stable at around 2.4%. A small current account surplus is projected until the end of the projection period in spite of the resumption of growth. External debt is projected to decline gradually to around 95% of GDP by 2014. Against the background of significant external vulnerabilities, it would have been appropriate to include an analysis of the external sustainability and of Croatia's cost and price competitiveness. Overall, the macroeconomic scenario is optimistic regarding output growth in the near term and the current account development.

- The fiscal deficit of general government had been planned to be 5.6% of GDP in 2011 and, according to preliminary information from the Ministry of Finance, this budgetary target has been broadly met. The "PEP 2012-2014" plans a significant expenditure-led consolidation of general government finances. The adjustment is frontloaded in 2012. Subsequently, the fiscal deficit is projected to fall more moderately to 3.3% of GDP in 2013 and 2.6% in 2014. It will be highly challenging to implement the envisaged cuts in the public wage bill, health care costs and subsidies, particularly already in the current fiscal year. Furthermore, meeting the fiscal deficit targets requires a return to at least moderate GDP growth.
- Structural obstacles to growth are not appropriately identified, but only alluded to indirectly in the PEP. The programme covers a range of structural reform areas, particularly product and labour markets, various industry and utility sectors, finance, agriculture, public administration, education, health care, social security, the judiciary and environmental protection. To serve as useful guidance for a structural reform agenda, the programme would benefit from the definition of clear objectives, specific measures and concrete time frames for implementation. Intensified efforts to speed up the implementation of reforms, in particular in the areas of enterprise restructuring, education and labour markets would help to increase the economy's growth potential and international competitiveness over the medium and longer term.
- The central bank stepwise reduction of banking system surplus liquidity since the summer of 2011 as a reaction to depreciation pressures on the kuna appears justified, as any disorderly and sustained fall in the currency may entail severe consequences for financial and macroeconomic stability. Reflecting the constraints put on monetary policy by this primacy of the central bank's exchange rate objective, the emphasis of the government on fiscal consolidation and structural reform to revive economic activity is particularly commendable. Indeed, successfully consolidating government finances and structurally improving the business environment would not only contribute towards a more sustainable external position, presently characterised by substantial rollover needs of private and public sector foreign debt in an international setting of repeated bouts of global risk aversion, but also facilitate the conduct of monetary policy.

Iceland

- Iceland's Pre-Accession Economic Programme 2012-2014 (PEP) was submitted in February 2012. Its main objective is to lay the foundations for a sustainable economic recovery after a long and deep recession. It presents a broadly plausible medium-term macroeconomic scenario and a relatively ambitious fiscal scenario, although both subject to non-negligible downside risks. The quality of the programme could be significantly enhanced by adding alternative growth scenarios and a budget sensitivity analysis to better identify and quantify the impact of potential risks. There is also scope for improving the fulfilment of formal and data requirements.
- Since the end of 2010 the economy has started to recover and real GDP grew by a stronger than expected 3.1% in 2011. The situation on the labour market started to improve in mid-2011, although job creation and long-term unemployment remain a serious challenge. Strong domestic demand has pushed inflation up and, despite robust export performance, led to a reduction of the surplus in trade in goods and services. Official gross foreign currency reserves continued to increase, reaching 64% of GDP by the end of 2011.
- The PEP 2012-2014 presents a broadly plausible growth scenario with a modest recovery, driven by private consumption, investments, and exports. Government consumption is set to further decline and to start increasing only in the outer years of the programme. Total investments remain at a historical low of about 14% of GDP but are expected to gain speed as the economy recovers and big energy-intensive projects come out of the pipeline. Domestic demand is projected to drive imports growth, exceeding the growth of exports over the programme horizon. As a result, the external trade surplus is set to fall to below 8% of GDP in 2014. The current account, adjusted for the net factor income of banks in winding-up proceedings, posted a small deficit in 2011 but is expected to turn into a surplus and stay positive over the programme horizon. The programme lacks a detailed assessment of the structure and financing of the current account and an in-depth analysis of the external sustainability, including competitiveness issues.

- Fiscal consolidation has been a success over the recent years. The primary deficit was reduced to around 1% of GDP in 2011 and the increase in the debt-to-GDP ratio has been brought to a halt. However, consolidation efforts slowed down in 2011 and slippages led to a higher than expected budget deficit. In addition, the revision in October 2011 of the medium-term budgetary scenario envisaged a milder medium term adjustment. In view of risks of further fiscal slippages and the already high level of government debt, it will be of utmost importance that the government follows on its ambitious target of bringing the debt level below 60% of GDP by 2020. The credibility of the fiscal programme could have been strengthened by providing more details about the 2011 budget execution and a more elaborated assessment of policies supporting the medium-term budgetary framework, the risks involved, and possible contingency measures to address these risks.
- The PEP covers a broad range of structural reform areas with a view to improving the supply side of the economy and increasing its resilience. However, the level of detail in presenting key policy measures is insufficient and could be improved. The programme would also benefit from providing a clear timeline and sequencing of planned measures, along with information about their estimated budgetary impact.
- In view of the scale of Iceland’s banking and currency crisis, remarkable progress has been made to put the economy back on a path of recovery within the framework of an IMF-supported programme. However, a range of challenges remains. From the perspective of monetary policy, the determined removal of capital account restrictions as swiftly as conditions allow is essential. Turning towards inflation, the central bank’s still growth-supportive stance might have to be re-examined in light of recently re-emerging price pressures and the materialisation of first signs of second round effects. In this respect, particularly the role of participants in private sector wage negotiations needs to be singled out. Finally, redesigning Iceland’s monetary policy framework is of utmost importance.

The Former Yugoslav Republic of Macedonia

- The Pre-Accession Economic Programme for 2012 - 2014 (the "2012 PEP") of the former Yugoslav Republic of Macedonia was submitted on 31 January 2012. Its main objective is to improve the country's competitiveness by a broad range of measures, such as enhancing the business environment, supporting SMEs, improving human capital and the functioning of the labour market. These objectives are in line the country's challenges. The government's expectations for the programme period remain ambiguous and the analysis of the impact of different growth scenarios on other parts of the economy appears incomplete. Overall, the macroeconomic scenario is on the optimistic side. The fiscal strategy is not discernible as neither the public finance path over the years 2012 to 2014 nor the envisaged measures are made explicit. The structural reform agenda is very comprehensive but would have benefitted from a more explicit discussion of policy measures and their estimated impact on fulfilling the programmes objectives.
- Real GDP growth was 2.9% in 2010 and 3% in 2011, mainly thanks to strong growth in the first half of the year. Inflation rose from 1.6% in 2010 to 3.9% in 2011, reflecting high international food and fuel prices. The trade deficit widened from 20.8% of GDP in 2010 to 23% in 2011. In line with the underlying dynamics in the trade balance, the current account deficit rose from 2.1% in 2010 to 2.8% in 2011. FDI inflows rose from 2.3% in 2010 to about 4.2% in 2011. The international investment position appears to have deteriorated markedly in 2011, due to increased reliance on foreign loans for financing mainly public spending. Unemployment dropped slightly, from 32% of the labour force in 2010 to 31.4% in 2011. Despite the overall relatively favourable macroeconomic performance, the key accession-related challenges remain: improve the functioning of the market economy in order to raise the country's potential growth and to reduce the extremely high level of unemployment. This requires further continuous improvements of the business environment, a strengthening of the rule of law and of institutional and administration capacities as well as efforts to enhance the quality of education.

- The medium-term macroeconomic framework for the period 2012-14 is presented in the form of annual ranges for GDP growth. The upper boundary increases from 4% growth in 2012 to 4.7% in 2014. The lower boundary is seen at 3% in 2012, increasing to 4% in 2014. Growth will mainly be driven by domestic factors, in particular private consumption and investment. This appears optimistic, given the limitations of raising disposable incomes. Import growth is seen to remain moderate, supporting a reduction in external imbalances. Inflation is forecast to remain benign, while strong employment growth will help to reduce unemployment. Overall, there is a significant downside risk to the forecast in 2012, while due to expected strong growth in 2013-2014, external imbalances could be much wider. Unfortunately, the programme does not analyse in sufficient detail issues related to the country's external sustainability and competitiveness.
- The preliminary central government deficit was 2.5% of GDP in 2011. Lower than expected revenue growth required adjustments on the spending side to meet the budget target. As in the past, the main adjustment took place in the area of public investment. The budget for 2012 is based on a rather optimistic growth scenario, expecting nominal GDP growth of about 7% and revenue growth of nearly 6%. The budget plans to contain current spending in order to increase capital investment. However, the programme misses details on how exactly this reorientation will be implemented. For 2013-14 the authorities plan a deficit of up to 2.5% of GDP. However, the PEP does not provide sufficient detail, neither on planned revenue and spending scenarios nor on envisaged measures to achieve those deficit targets. The risks to deficit financing are not adequately addressed.
- The programme would have benefited from a more in-depth diagnosis of structural bottlenecks to growth, in line with the Europe 2020 strategy. The main growth challenges appear to be a further improvement of the business environment, strengthening the rule of law, enhancing the judicial, regulatory, supervisory and administrative capacities, and increasing the quality of education of the labour force. The 2012 PEP puts more emphasis on these shortcomings. However, it would have benefitted from a clearer link between identified obstacles and policy measures.

- In an environment of benign macroeconomic conditions, the central bank appropriately maintained the policy rate unchanged at 4% during the course of 2011. International reserves have been at broadly adequate levels and there has been little evidence of significant pressures on the balance of payments. In addition, inflation has been contained, the growth of bank credit and domestic demand has been moderate, and the output gap is still negative. However, uncertainty regarding the financing of the government's budget deficit, which has a direct bearing on the conduct of monetary policy remains a policy challenge. The central bank's cautious approach to banking supervision and regulation has contributed to a sound banking sector. In the near term, the main challenge for banks is credit risk, given the deterioration of the external environment and the weaker domestic economy since the second half of last year. Direct exchange-rate risk is low as the net open foreign exchange position of the banking system is low. In this regard, the central bank's continued measures to reduce unofficial euroisation are commendable and effective.

Montenegro

- Montenegro's first Pre-Accession Economic Programme (PEP 2012-2014) presents a comprehensive medium-term macroeconomic and fiscal framework based on the projection of a mild slowdown of growth in 2012 followed by a gradual acceleration in the outer years. The main objective is to strengthen fiscal and financial stability as a prerequisite for long term economic growth and higher employment. Overall, the programme appears broadly consistent with earlier key policy documents and contributed to the preparation of the 2012 budget law.
- The economy grew by some 2.5% in 2011. Growth was mainly driven by exports and private consumption, both supported by a resilient tourism industry. Inflation remained moderate, at 3% on average, reflecting higher food and transport prices as well as a rise of excises. Bank lending still remained negative. Despite some additional layoffs from heavy industry and mining, the labour market recorded some improvement thanks to the dynamism of the services sector. Employment levels increased by 1% in 2011 and the unemployment rate declined by 1.6 percentage points to 18%. The current account deficit contracted to 19% of GDP in 2011 from 25% a year earlier, but still remains very large despite the correction.

- The macroeconomic scenario projects real GDP growth to accelerate to 4% in 2014, up from 2% in 2012. Over the period 2012-2014 private consumption is seen to be the main contributor to growth. The impact of government consumption is expected to remain weak due to consolidation efforts, while investment growth will remain slightly negative on average. Given the uncertain international environment, the programme – as a useful complement – presents a low-growth scenario. The current account deficit will narrow as the result of a crisis-led adjustment resulting in lower imports due to the contraction of domestic demand. The PEP foresees a further decline of external imbalances in the medium-term, albeit at a modest pace (by 2 percentage points of GDP until 2014). However, the significant size of the external deficit exposes the country to refinancing risks and strong macroeconomic adjustments in case of slowing or reversing capital flows. Against this background, the programme would benefit from an in-depth analysis of the sustainability of the external position, including competitiveness issues.
- To achieve the sustainability of public finances the medium-term fiscal policy presents an expenditure-led consolidation. So far, public spending has been reduced from 47% of GDP in 2010 down to 43% in 2011. The programme projects further consolidation of expenditures in the mid-term, targeting 38% of GDP by 2014. Meanwhile, revenues should remain constant at some 39% of GDP, to reach a balanced budget in 2013 and a net lending position in 2014. The fiscal space thus generated would serve to cut public debt and sustain public investments. However, the achievements of these budget targets appears increasingly unrealistic, given a deteriorating international environment, the contingent liabilities from state guarantees, and still rising tax arrears.
- The PEP covers a broad range of structural reform areas, but this part of the programme would benefit from an assessment of the key structural bottlenecks of growth. Overall, there is a need for improving energy and transport infrastructures to lift potential growth. The restructuring of the metal industry and the continuation of privatisation are also necessary to improve industrial diversification, liberating resources, and to rebalance metal manufacturing towards transport, energy and mineral ore exports. Tourism relies heavily on foreign investment inflows. Further efforts are still required to improve the business environment, notably to solve the issue of delays on project developments.

- The global economic and financial crisis has challenged Montenegro’s policy framework. The fact that Montenegro is using the euro as its sole legal tender, and has therefore given up standard monetary policy tools, leaves fiscal policy as the sole effective macro policy tool with the difficult mission of striking a balance between restoring growth and proceeding with consolidation.¹ Beyond the current economic cycle, it will be crucial to avoid renewed potential boom-bust cycles. Looking ahead, the central bank will continue to face several challenges, as its needs to strengthen the fragile banking sector, to revive credit growth and to closely monitor the still high level of non-performing loans, which act as a drag on growth.

Serbia

- Serbia submitted its Economic and Fiscal Programme covering the period 2012-2014 on 31 January 2012. The country's key medium-term challenge remains to ensure a stable macroeconomic and financial environment conducive to stronger growth, more jobs and an improvement of living standards. The economic recovery continued in 2011, with GDP growth of 1.6%, mainly fuelled by a pick-up in investment activity. However, in the second half of the year growth came under pressure due to the difficult global economic environment. In the face of slowing export growth, the current account deficit widened to around 9.5% of GDP, but inflation began to subside gradually. Although the programme's macroeconomic scenario was revised downwards against the background of an uncertain international environment, its growth projections appear still optimistic, especially for 2012 when economic growth is projected to reach 1.5% before it accelerates quite markedly to 4% in 2014.
- In 2011, a more subdued foreign demand weighed on the external position, which has been maintained in the aftermath of the 2009 crisis. In view of the slowdown ahead, the current account gap is expected to widen temporarily in 2012, but should stay well below the pre-crisis levels as long as import growth lags export growth in 2013 and 2014. Although the external imbalances have been significantly reduced since the 2009 crisis, dependence on external financing remains high. The programme presents a comprehensive overview of past developments based on relevant external vulnerability indicators, which is welcome, but it would benefit from a more forward looking assessment of the country's competitive position.

¹ The ECOFIN Council recalls its 2007 position on unilateral euroisation which should be fully taken into consideration by the Montenegrin authorities.

- The fiscal responsibility legislation, adopted in 2010, compels the authorities to a gradual consolidation of public finances, in line with a set of numerical fiscal rules. Although the medium-term fiscal strategy presented in the programme follows the general guidelines, there are major risks to the realisation of the planned outcomes, not least due to the optimistic underlying macroeconomic scenario. According to the EFP, in 2011 the budgetary deficit reached 4.6% of GDP, which was higher than initially targeted, due to substantial revenue shortfalls amid slowing economic activity. Preliminary actual budgetary figures point to even higher deficit. Over the medium term, a gradual reduction is projected and the fiscal deficit is estimated to reach just below 3% of GDP by 2014. The fiscal strategy foresees as of 2013 an expenditure-led fiscal adjustment through a reduction in the share of general government current expenditures as a percentage of GDP, resulting mainly from restraining pension outlays, payroll as well as public consumption. However, the programme does not provide detailed information on the envisaged fiscal policy measures that will rein in current expenditure. A rigorous implementation of the fiscal responsibility provisions is key in fostering the country's long-term sustainability of public finance. However, further adjustments, with a view to improve the composition and efficiency of general government expenditure, notably in the pension, healthcare and education systems as well as public administration will have to be urgently addressed.
- Serbia has taken important steps towards transforming its economy, but a number of structural weaknesses persist and hamper the economic performance. Broad consensus has been reached on the need to shift to more balanced and sustainable growth, driven by exports and investment, which will bolster export expansion and create new jobs. So far, progress has been limited and further efforts will be necessary for restructuring the economy and improving the business environment, in particular by strengthening the rule of law and removing red tape, enhancing competition and the role of the private sector as well as tackling rigidities on the labour market. The programme would benefit from a more thorough assessment of the structural growth bottlenecks as a basis to refine the country's structural reform agenda.

- The monetary policy path adopted by the central bank in 2011 was broadly appropriate. With the depressed growth rates, stable exchange rate and falling inflation, the central bank reversed to expansionary monetary policy as of June. However, given the external and domestic environment, Serbia might face a number of macro-financial policy challenges in the near future. A careful monitoring of the inflation developments as well as tackling of structural shortcomings are of high importance, in particular the slow price liberalisation. The possible external financing constraints and downward pressures on the domestic currency call for caution, given the high degree of unofficial euroisation. All attempts to increase the use of the local currency and to tackle high level of non-performing loans, especially in the corporate sector, shall be continued with determination, as this will not only improve the stability of country's financial system, but also increase the effectiveness of monetary policy. Further policy actions to strengthen insolvency, debt restructuring and enforcement mechanisms need to be introduced.

Turkey

- Turkey submitted its eleventh Pre-accession Economic Programme in January 2012. The programme's key objectives are to strengthen macro-economic stability so as to ensure sustainable growth leading to convergence of per capita income towards the EU-average. To this end, the monetary and fiscal policy mix aims at continued fiscal prudence while structural reforms are to enhance the role of the private sector, and to improve financial sector intermediation and increase the value of human capital. However, the recent track record and the implementation of structural reforms have been slow and progress has been uneven. An assessment of the sustainability of the external accounts as well as of the main structural growth bottlenecks would have been highly relevant and useful under the current circumstances.
- As recently evidenced by the global financial crisis and the risks of sovereign debt crisis in the euro area, the Turkish economy has increased its resilience. In 2010 and 2011, real GDP growth amounted to respectively 9.2% and 8.5%. The unemployment rate declined by 1.6 percentage points to 9.8% in December 2011. However, the current account deficit edged up rapidly from 6.4% of GDP in 2010 to about 10% of GDP in 2011, in tandem with the widening trade deficit. In addition, headline inflation started to rise markedly in the second half of 2011, from about 6% in mid-2011 to 10% by the end of the year.

- Over 2012-2014, the programme estimates that the Turkish economy will grow at rates around potential, i.e. at around 4-5%. Growth would become more balanced, albeit still driven by gross fixed capital formation (7% annually on average) and to a lesser extent private consumption (3.5%). Exports of goods and services are projected to accelerate gradually. The macroeconomic scenario tends, however, to ignore some major risks such as the widening of external imbalances and the intensification of inflationary pressures. It foresees a reduction of the current account deficit from 9.4% in 2011 to 7% of GDP by 2014. Over the past two years, not only has the current account deficit rapidly and substantially increased but its significant narrowing seems unlikely. Weaker domestic demand may reduce imports somewhat and high energy prices seem to continue to put pressure on imports volume. Short-term capital inflows became the primary source of financing in 2010. On the other hand, the share of portfolio investments and short-term capital inflows in financing sources decreased as opposed to a rise in FDI and long-term capital inflows in 2011.
- In 2011, the general government budget deficit narrowed to about 1% of GDP from 3.5% in 2010 (provisional figure is 2.9% in 2010), thereby performing better than the 2.1% deficit envisaged in the budget, mainly due to strong growth which resulted in higher budget revenues than originally anticipated, and the proceeds of a major tax restructuring scheme. The PEP's medium-term fiscal programme envisages an improvement of the consolidated general government balance, to 0.8% in 2012 and 2013 and 0.4% in 2014, in part due to lower interest payments and primary expenditures. The public debt to GDP ratio is anticipated to fall gradually from 39.8% of GDP in 2011 (realized as 39.4% of GDP) to 32% by 2014. In the light of the programme's growth projections, the fiscal policy objectives appear realistic. As in previous years, the document does not sufficiently elaborate on the policy measures which could support achieving the fiscal targets.
- Like last year, the programme's structural and institutional reform agenda appears fragmented, covers a broad range of issues, and is insufficiently linked to the fiscal scenario. The Turkish economy has benefited from reforms in areas such as banking, energy and education. However, reforms still have to be pursued in several important areas, such as labour markets and the investment climate.

- During 2011 the policy framework of the central bank became increasingly complex, less transparent and less predictable. A key factor behind this development is the shift in direction between the various objectives and targets in the central bank's objective function, partly due to the volatile external environment, which may weaken the inflation-targeting framework. Indeed, the end-2011 inflation target was missed by a wide margin, partly due to factors beyond the control of the central bank, and a significant credibility gap persists. Volatile food and energy prices make up a relatively large share and will continue to represent an additional serious risk. The macro-prudential policies of the central bank, such as the increase in the unremunerated reserve requirement ratios and measures taken by regulation agency, were successful in taming credit growth. The external imbalance leaves Turkey exposed to the negative consequences of sudden increases in global risk aversion, retrenchments in capital flows, sharp volatility in the exchange rate and slower growth due to tighter external financing conditions. In response to the rise in inflation, the central bank should re-establish its anti-inflationary credentials, closing the credibility gap between expected inflation and its central target.

Statistics

In the area of economic statistics, progress has been made in specific areas since 2011 and further working priorities can be summarised as follows:

- National accounts: The main national accounts aggregates are now provided by all acceding and candidate countries, problems persist regarding outdated time series as well as specific expenditure and income components and breakdowns and regarding employment data, further progress is still needed for all countries, including on hours worked. Montenegro has advanced significantly as it started to provide (2000-2010) data for most aggregates but progress of the other candidate countries has been very limited. Iceland has to improve significantly the level of compliance with respect to annual national accounts. Thus, priority must be given to the full implementation of ESA95, NACE Rev.2 and the complete and timely transmission of the main output and expenditure aggregates, gross national income and employment.

- Government deficit and debt statistics: Some improvements could be noted in the area of annual general government deficit and debt statistics, but there are still significant data gaps and methodological issues. Some progress appears to have been made with respect to the measurement of government debt and consistency between EDP tables for Croatia. Iceland noted an improved availability of debt data for the period 2007-2010. For Turkey some progress has been achieved concerning methodology. Montenegro and the former Yugoslav Republic of Macedonia did not submit any fiscal notification and should start doing that.
- Harmonised index of consumer prices (HICP): Concerning the Harmonised index of consumer prices (HICP), the former Yugoslav Republic of Macedonia is already producing experimental HICP indices and transmitting them on test basis to Eurostat. Also Montenegro is publishing experimental HICPs but due to some technical data delivery issues they are not yet delivering them to Eurostat.
- Europe 2020: With regard to the Europe 2020 indicators, the data series provided by Turkey and Croatia are rather extensive, though recent data on some of the poverty indicators is missing for Turkey. Iceland has provided data on the whole set of indicators. The former Yugoslav Republic of Macedonia has provided data on the employment rate, energy intensity early leavers from education and training, and tertiary educational attainment.
- Infra-annual statistics: General improvements in timeliness and coverage were recorded in infra-annual statistics, notably in the area of short-term business statistics. Nevertheless, gaps continue to exist, in particular for employment and short-term public finance statistics, where significant progress needs still to be made. Moreover, the candidate countries are requested to generally enhance efforts to improve availability, coverage and timeliness of short-term indicators. In the area of short-term business statistics, Croatia's level of compliance can be considered as satisfactory; nevertheless important gaps continue to exist.

- Monetary and financial statistics: Ministers welcomed the regular contacts established between the European Central Bank (ECB) and the central banks of acceding and candidate countries, with the aim to raise the awareness in these countries of the ECB's statistical requirements. Some contacts between the ECB's Directorate General Statistics and the central banks of Croatia, the former Yugoslav Republic of Macedonia and Turkey have taken place in past years, with the aim to make them aware of the ECB's statistical requirements, of methodological standards applicable to the national contributions to euro area data and of the working methods of the ESCB structures. An early preparation of European statistics under the responsibility of the European System of Central Banks is welcome.

As regards statistics, the Ministers welcomed the Progress Report of April 2012 on the Action Plan on Economic, Monetary and Financial Statistics in Candidate Countries. All acceding and candidate countries made progress in fulfilling the Action Plan requirements, but additional efforts in some statistical areas are still needed to achieve a full compliance with the Action Plan requirements. With a view to ensuring that acceding and candidate countries are prepared in good time for the new surveillance procedures introduced under the European Semester, Ministers called on the Commission to continue to provide the necessary assistance in this regard.
