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# East European and CIS Economies: Diverging Paths

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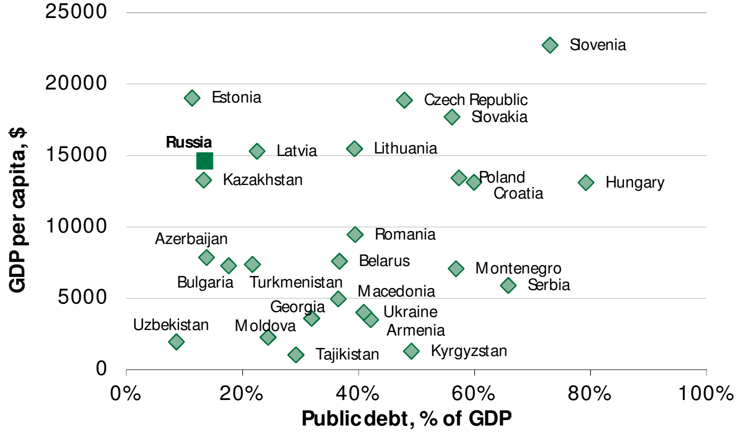
INVESTMENT RESEARCH

# Growth remains slow in most East European economies as external and internal rebalancing gains pace

- Economic performance in East European economies, including those in CIS, differed markedly in the past years and there are little signs of convergence amid an overall slowdown of economic growth in the region. Generally, growth looks stronger in the countries with independent monetary policies.
- Russia seems to be of the least leveraged countries, while GDP per capita is relatively high (on par with much more indebted Latvia and Lithuania) but lower than in Estonia, Slovakia, the Czech Republic and Slovenia, which are also highly leveraged. High debt (public and total foreign)/GDP ratios may become an impediment for long-term growth, which already happened in the Balkan countries, while Russia has no such constraint – Russia's growth is slowing due to a number of macroeconomic policy mistakes.
- Inflation in the CIS area and Turkey is much higher than in the other East European countries, as the latter are more exposed to economic trends of developed European economies.
- Some East European countries faced deflation in 2013-14, which, combined with sluggish growth, aggravates fiscal and debt servicing problems.
- Most East European and CIS countries are demonstrating external rebalancing irrespective of their monetary policies – in some cases, this rebalancing is driven by stronger export growth, while in other countries, external rebalancing is taking place amid shrinking domestic demand and imports.

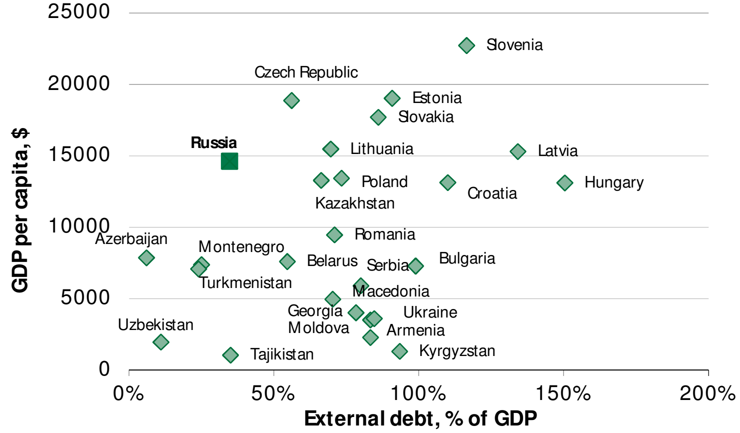
# Russia's indebtedness is low compared with peers, while GDP per capita is high enough

**GDP per capita and gross public debt in East European countries and the FSU, 2013**




*Source: Euromonitor, Sberbank Investment Research*

**GDP per capita and external debt in East European countries and the FSU, 2013**



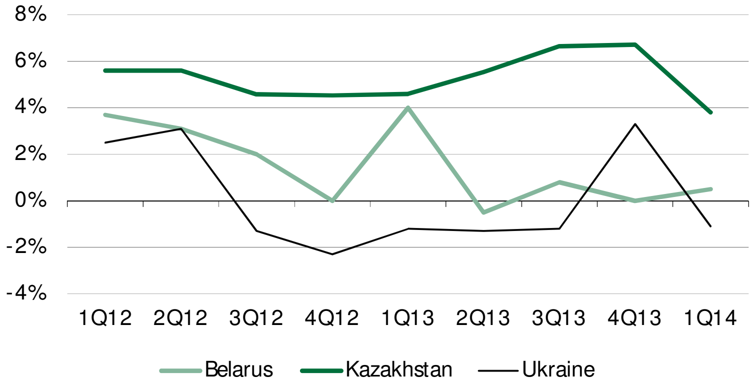

*Source: Euromonitor, Sberbank Investment Research*

# Rebalancing in Belarus, Kazakhstan and Ukraine picks up

- **Belarus.** GDP climbed 1.1% in 4m14, a much stronger result than in 1Q13, when it rose just 0.5%. It appears that in addition to traditionally strong retail growth, GDP was supported by improved (and now positive) industrial performance. Industrial output grew 0.7% y-o-y in both March and April, cutting the y-o-y contraction to just 2.4% in 4m14, from 7.1% in January. The chemical industry, which accounts for a large share of the country's industrial output, expanded 10.2% y-o-y in 4m14 and 25.7% y-o-y in April alone.
- **Kazakhstan.** The short-term economic indicator (which includes output in agriculture, industrial production, construction, retail and wholesale trade, transport and communication, ultimately covering 67-68% of GDP) grew 2.7% y-o-y in 4m14. A year earlier, growth was 3.9%; thus, the economic performance has slowed this year comparatively. The deceleration in growth of the aggregated index was linked to industrial performance (where output contracted 0.1% y-o-y over 4m14 compared with growth of 1.9% a year earlier) and decelerating retail (10% and 12.8%, respectively).
- **Ukraine.** Industrial production has held up remarkably well despite the political instability, output shrinking 5.3% y-o-y in 4m14. Equally remarkably, Ukrainian GDP was down just 1.1% y-o-y in 1Q14, apparently still supported by strong growth in the agriculture sector and, to a lesser extent, trade. Other major sectors, such as construction, contracted. Inflation is accelerating in the country, and the annual figure may hit the double digits

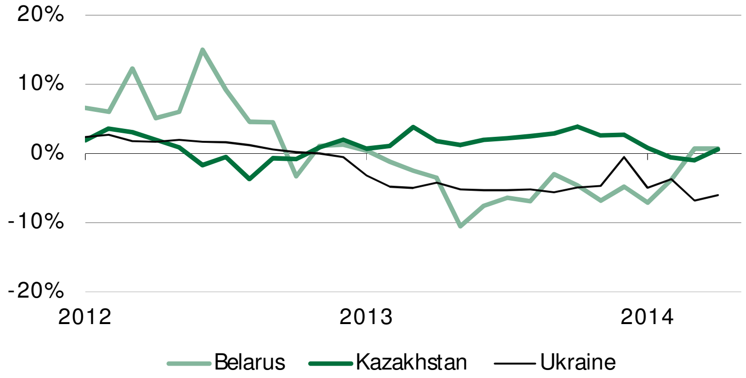
# GDP growth in Ukraine, Belarus and Kazakhstan has been sluggish, while inflation has risen in all three countries

**In 1Q14, real GDP growth slowed in Kazakhstan, improved in Belarus and turned negative in Ukraine, y-o-y**




*Source: National statistics agencies*

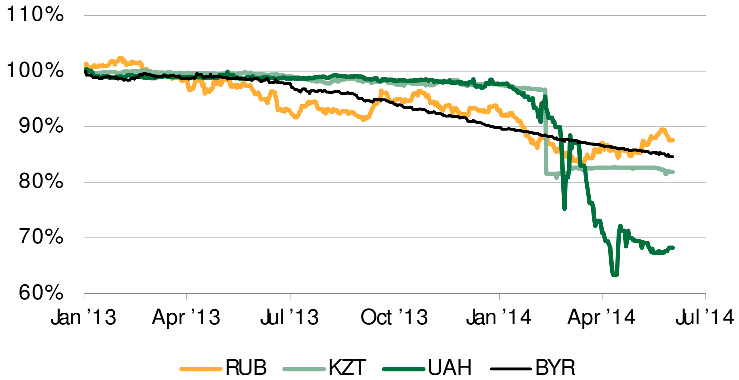
**Industrial output is recovering in Belarus, stagnating in Kazakhstan and shrinking in Ukraine, y-o-y**




*Source: National statistics agencies*

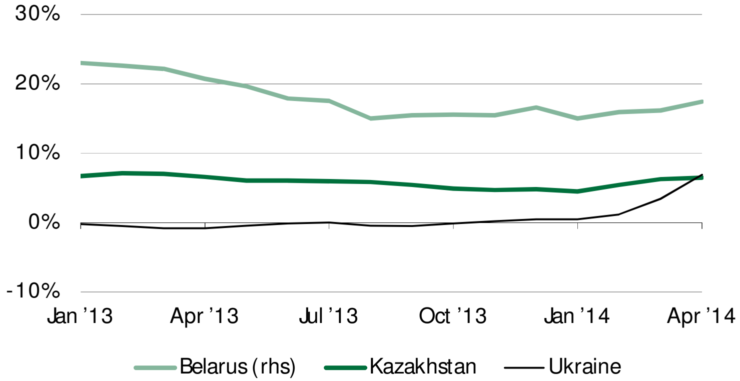
# Currencies have weakened in Ukraine, Belarus and Kazakhstan, while inflation has accelerated

## Nominal exchange rate, January 2013=100%




*Source: National statistics agencies*

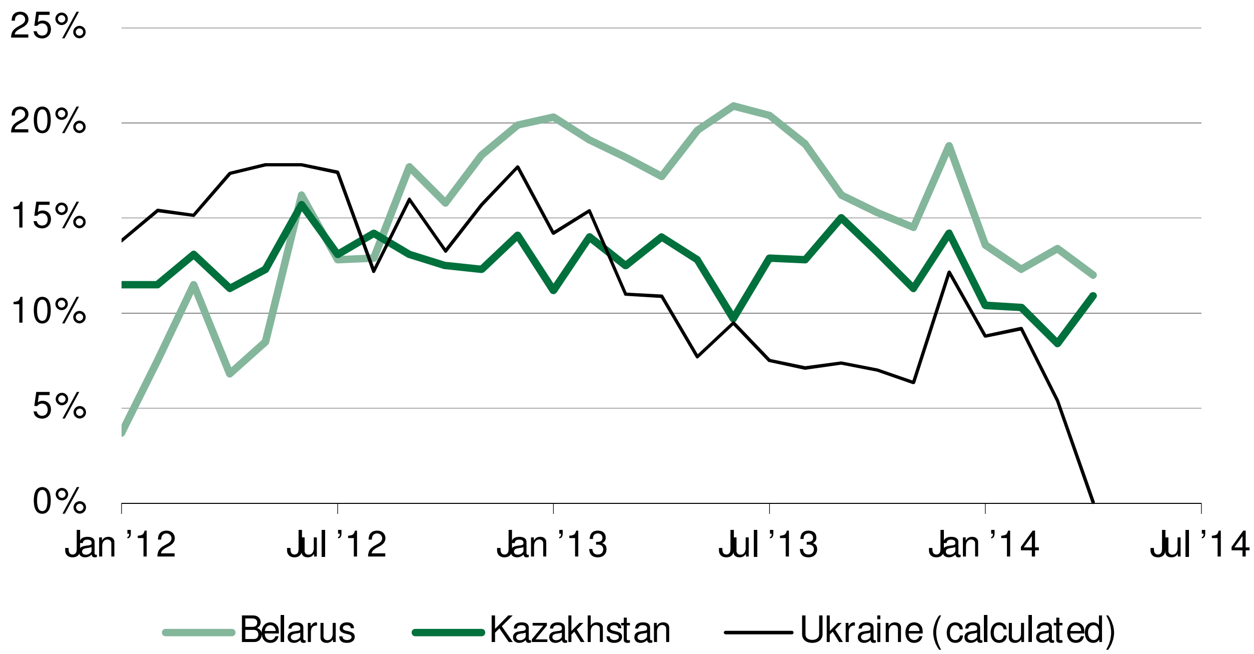
## CPI, y-o-y




*Source: National statistics agencies*

# An era of overheated double-digit retail sales growth is gradually coming to an end in Belarus and Kazakhstan, and has already done so in Ukraine

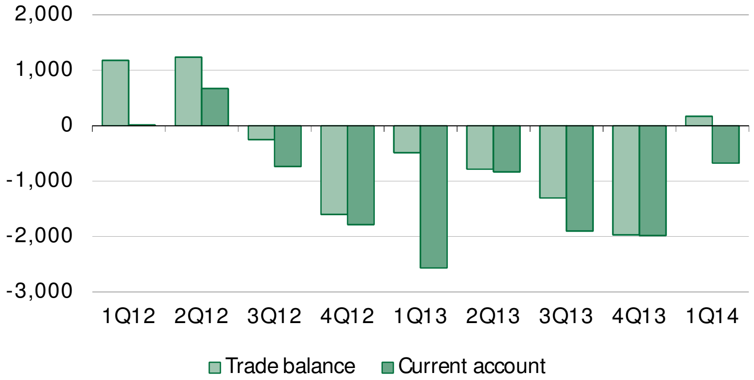
**Retail sales growth is slowing, albeit at different rates, y-o-y**




*Source: National statistics agencies*

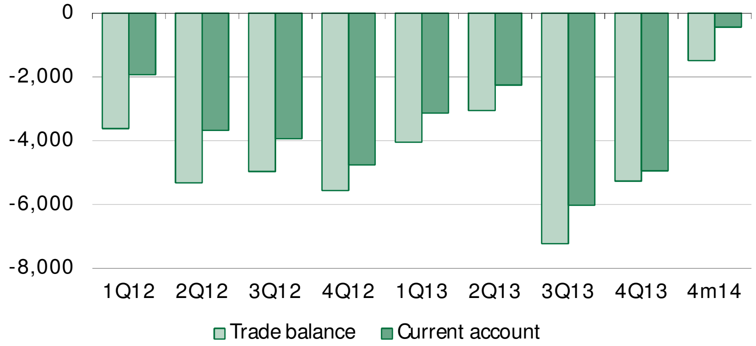
# External rebalancing has continued as well, as the current account deficit narrowed in Belarus (in 1Q14) and in Ukraine (in 4m14)…

### Current account deficit narrowed in Belarus in 2014, $ mln




Note: Last current account figure is for 2m14.
*Source: Belarusian National Bank*

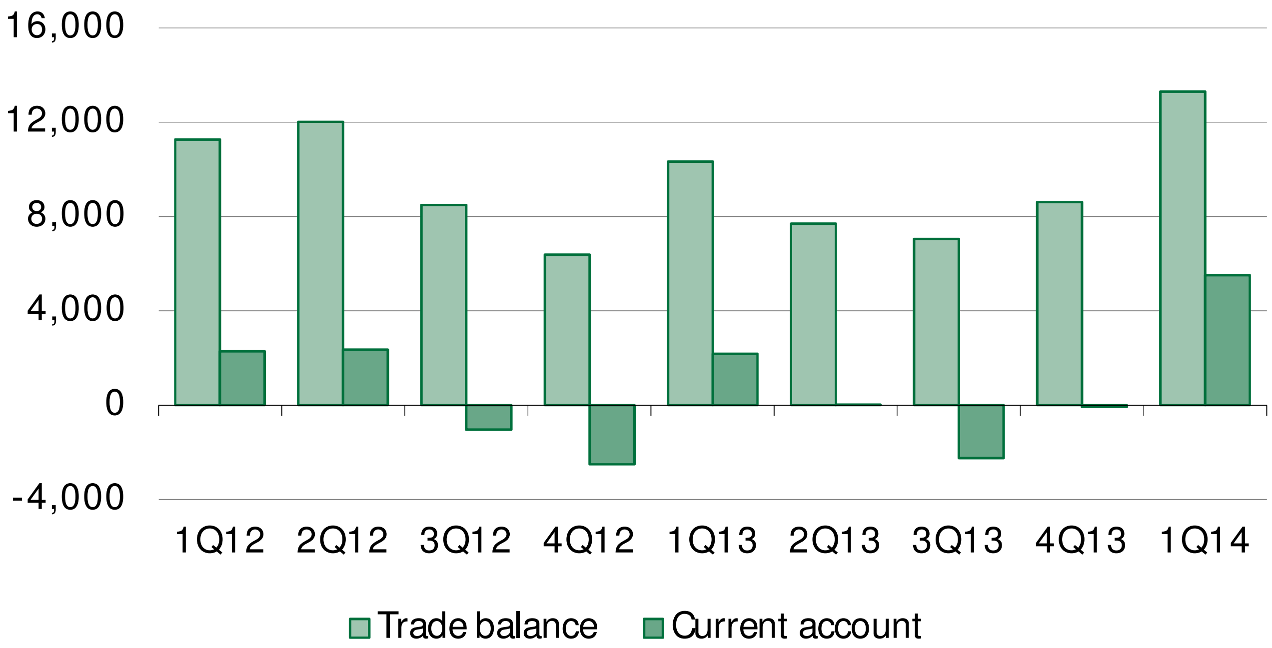
### Current account deficit also narrowed in Ukraine, $ mln




Note: The latest current account figure is for 4m14.
*Source: Ukrainian National Bank*

# …and turned positive in Kazakhstan

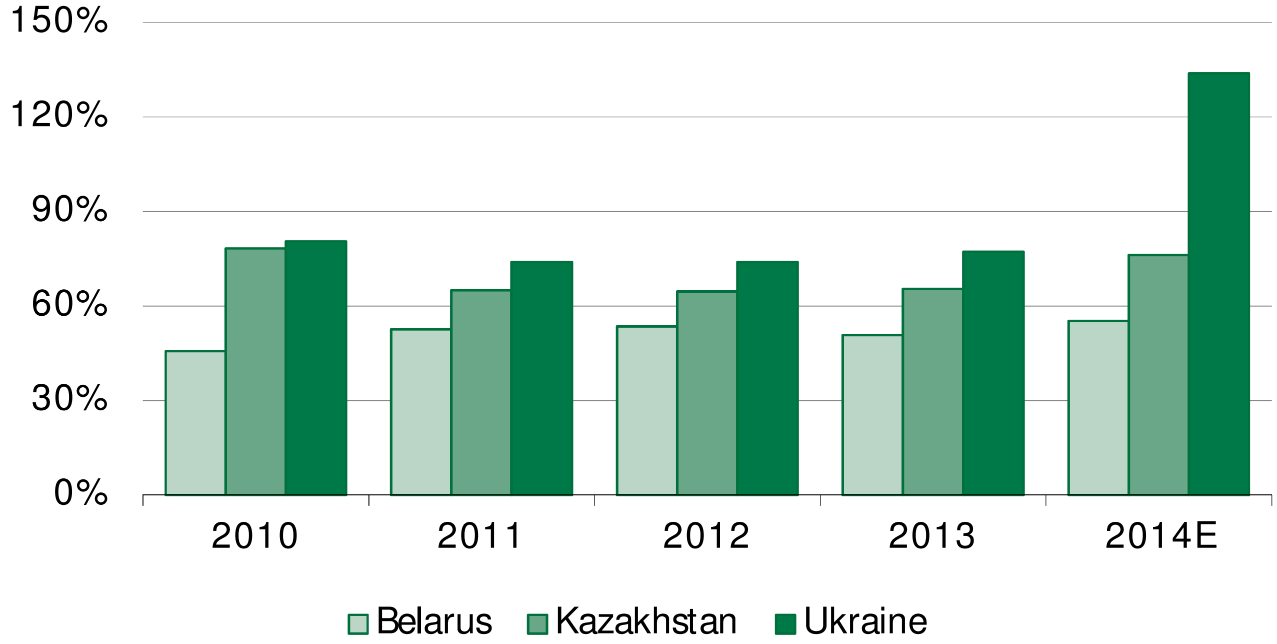
**In Kazakhstan, the current account turned positive in 1Q14, $ mln**




*Source: Kazakh National Bank*

## The external rebalancing looks particularly important for Belarus and Ukraine, as their international reserves shrank last year and in early 2014, while their foreign debt is significant.

**External debt, % of GDP**



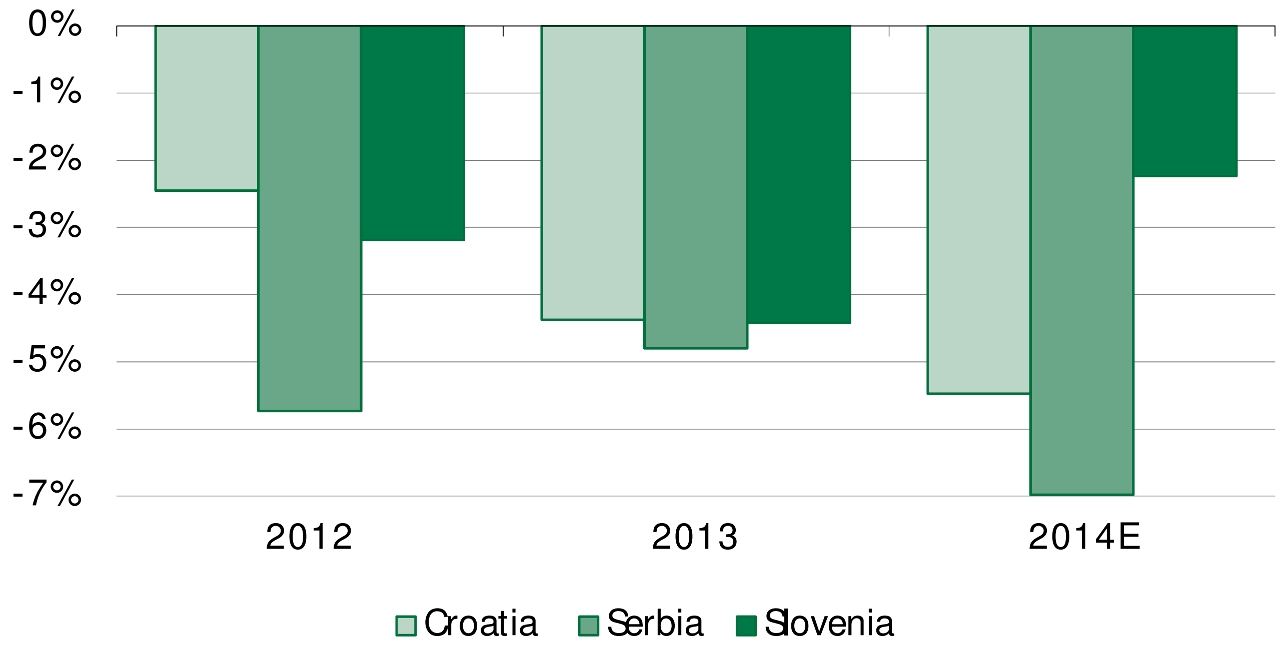

*Source: National banks*

# Disinflation in Croatia, Serbia and Slovenia to Aggravate Fiscal and Debt Problems

- In all three countries inflation will remain at a historically low level this year and in 2015. Inflation decelerated sharply (even turned into deflation in Croatia), as domestic demand was weak amid ongoing private sector deleveraging.
- This disinflation environment may exacerbate problems in the fiscal sphere, especially on the back of the sluggish economic performance. This will be important for Serbia and particularly Croatia, where budget expenditures (and hence deficits) will increase this year. Slovenia, on the other hand, is demonstrating stronger fiscal discipline.
- Amid a relative improvement in the economic situation in the Eurozone (albeit not to the same degree as was expected by many observers) economic performance remained relatively stable in early 2014, although the picture was different in each country. As opposed to Slovenia and Croatia , where industry was in recession last year, but turned positive y-o-y in 1Q14, Serbian industrial growth decelerated from 5.5% in 2013 to around 2% in 1Q14.
- Last year, the GDP of Slovenia and Croatia contracted 1.1% and 1.0%, respectively, while Serbia's GDP was up 2.5%. This year, we expect slightly positive GDP growth in Slovenia, a minor contraction in Croatia (by around 0.5%), and deceleration in economic growth in Serbia to slightly above 1%.
- Given that Serbia, Croatia and Slovenia are well integrated into the EU economy, they are not immune from the EU's (and Eurozone's) problems but also enjoy the advantages. The higher the degree of integration, the greater is the impact of developments in the EU and Eurozone on each individual country. Hence, Croatia still suffers from the recession in Italy and weak economic performance in Slovenia, which are its important trade partners. As economic growth in the Eurozone is set to accelerate slightly next year, the aforementioned economies of the three Balkan countries are expected to deliver better results as well.

# In Croatia and Serbia budget revenues stagnate as expenditures (and hence deficits) increase this year; Slovenia, is demonstrating stronger fiscal discipline

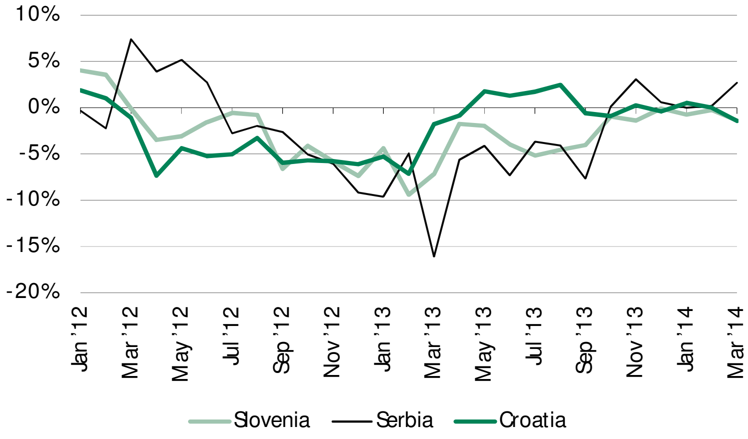
**Budget balance, % of GDP**




Note: For Slovenia, the data exclude spending on bank recapitalization, as this is attributed to operations with financial assets.
*Source: National statistics agencies*

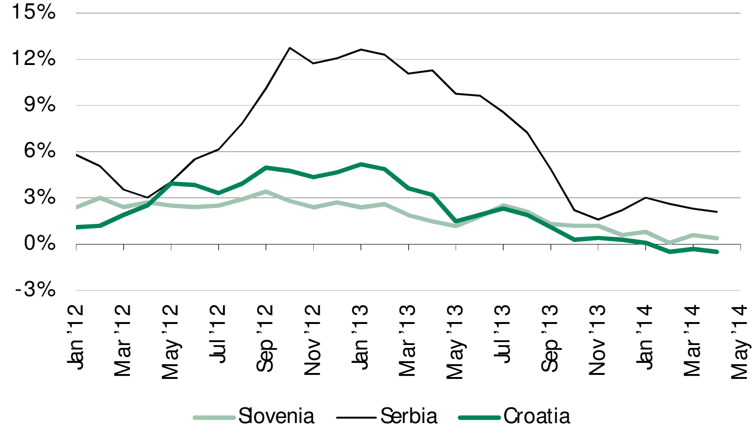
# Disinflation amid austerity in major European economies is one of the most important developments

**Domestic demand is sluggish (retail sales, y-o-y)…**




*Source: National statistics agencies*

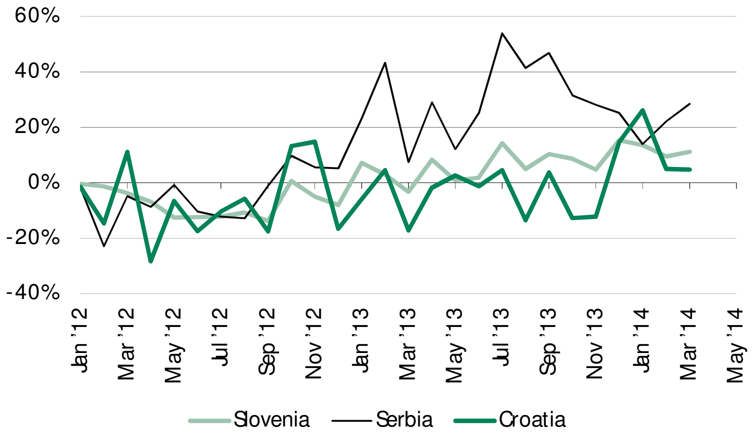
**… as disinflation continues (CPI, y-o-y)**




*Source: National statistics agencies*

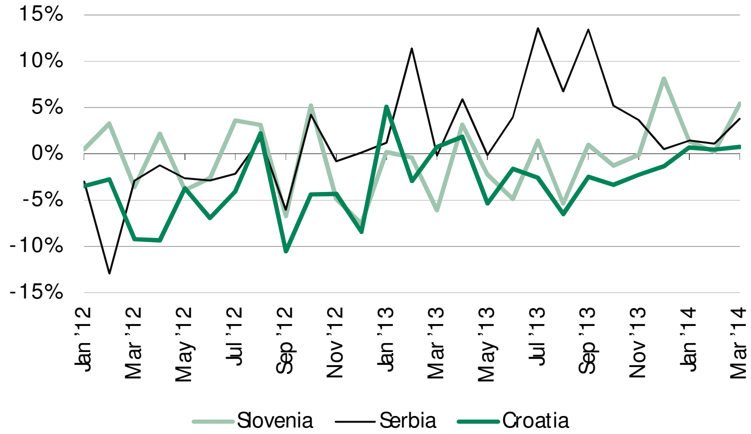
# As domestic demand remains weak, it was external demand and increased exports that pulled Serbia out of recession and in the other two countries helped offset the negative impact of deleveraging

**A recovery in exports pulled Slovenia and Serbia out of recession, y-o-y**




*Source: National statistics agencies*

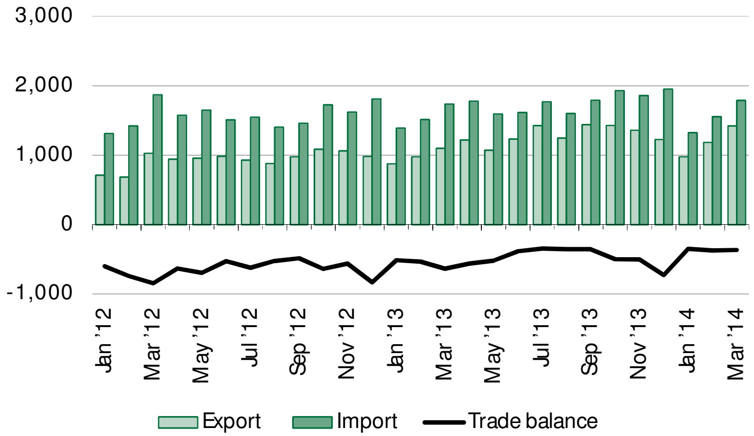
**Industrial growth turned positive in 1Q14 in all three countries, y-o-y**




*Source: National statistics agencies*

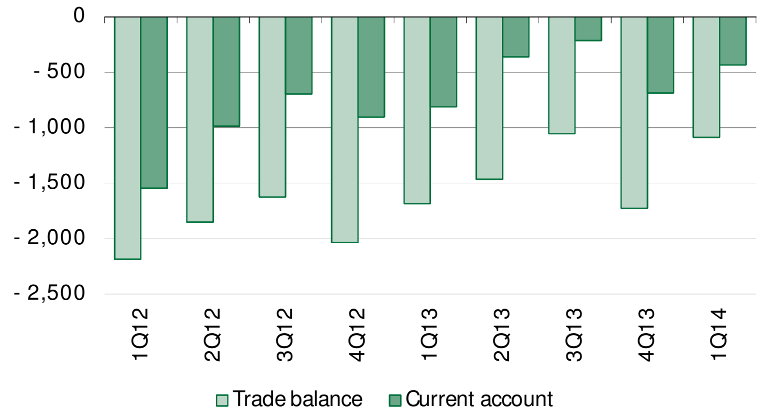
# Serbia: balance of payments improves gradually

**As the trade deficit narrows..., $ mln**




*Source: Serbian National Bank*

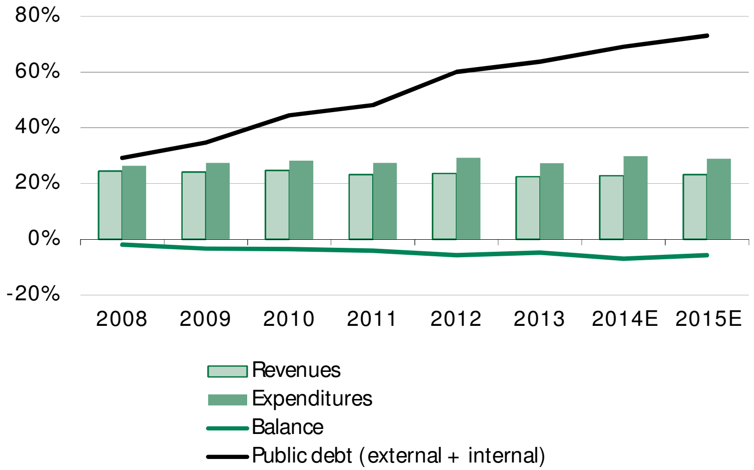
**... so does the current account deficit, $ mln**




*Source: Serbian National Bank*

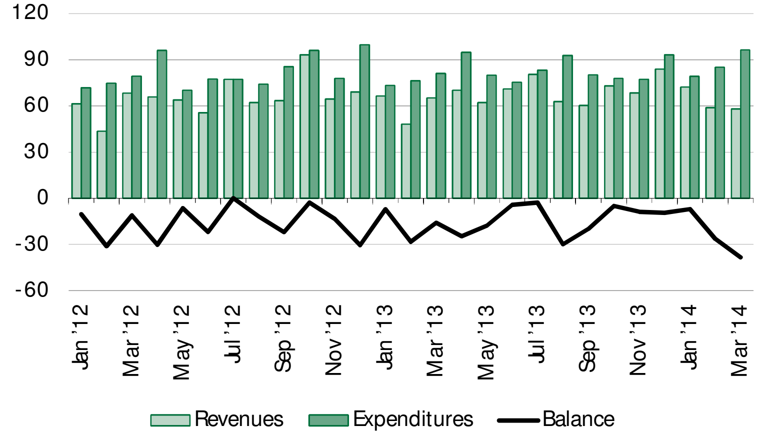
# Although the external balance saw a clear positive adjustment, the fiscal deficit remains a problem for the Serbian government

**Public debt grows as the budget deficit exceeds GDP growth, % of GDP**




*Source: Serbian National Bank*

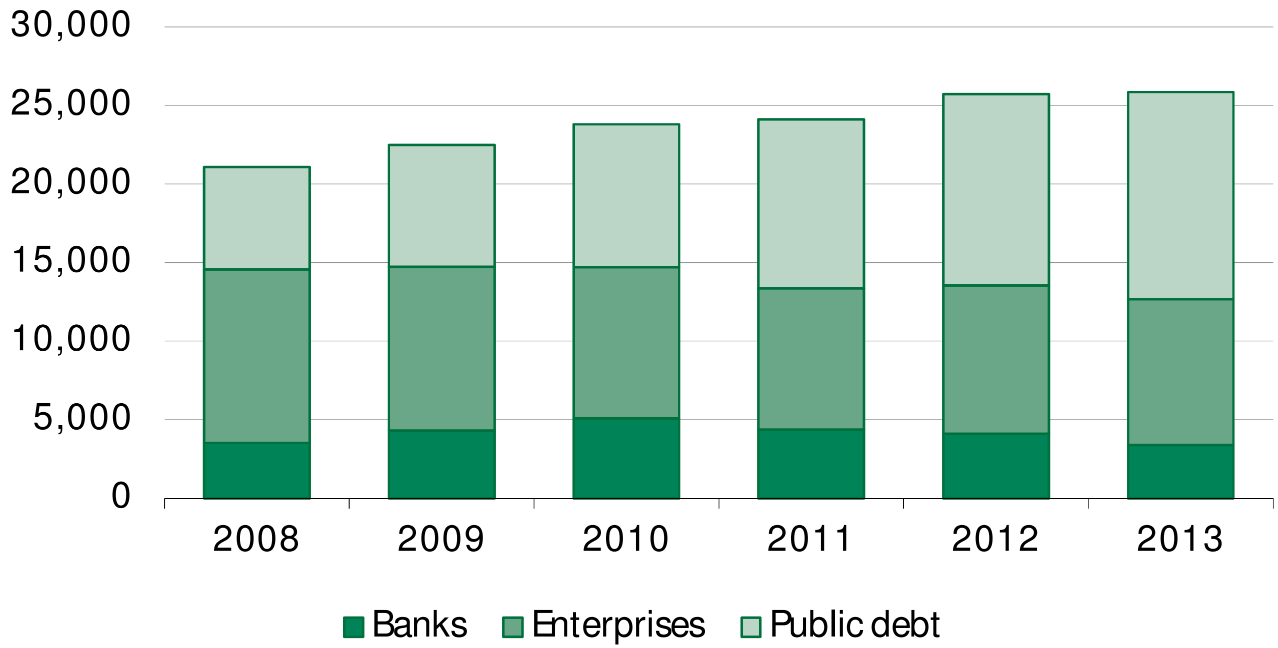
**Budget deficit widened in 1Q14, RSD bln**




*Source: Serbian National Bank*

# Serbia's public debt grows, but debt/GDP ratio will remain lower than in the EU on average

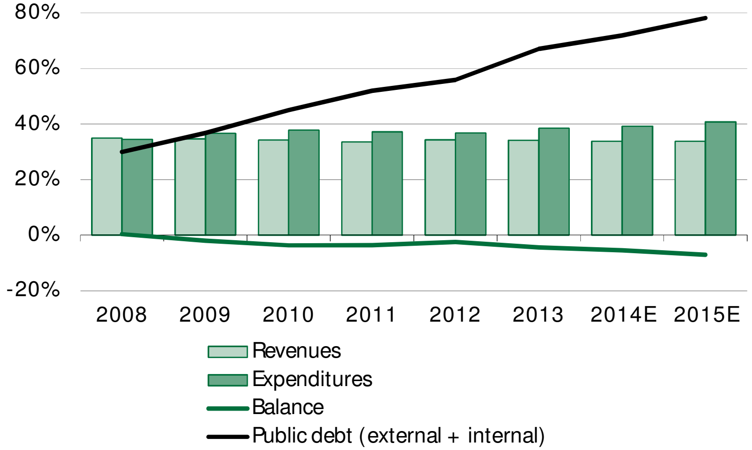
**Non-government foreign debt decreased but may start rising again, EUR mln**




*Source: Serbian National Bank*

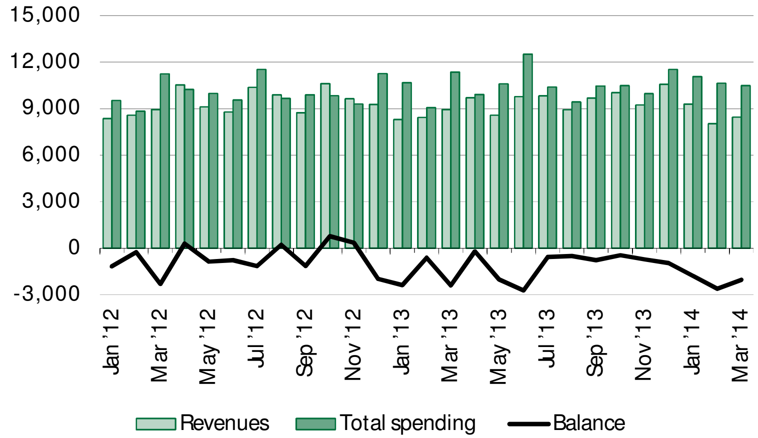
# Croatia: deflation kills fiscal consolidation

## Government debt rises as the economy shrinks amid persistent budget deficit, % of GDP




*Source: Croatian National Bank*

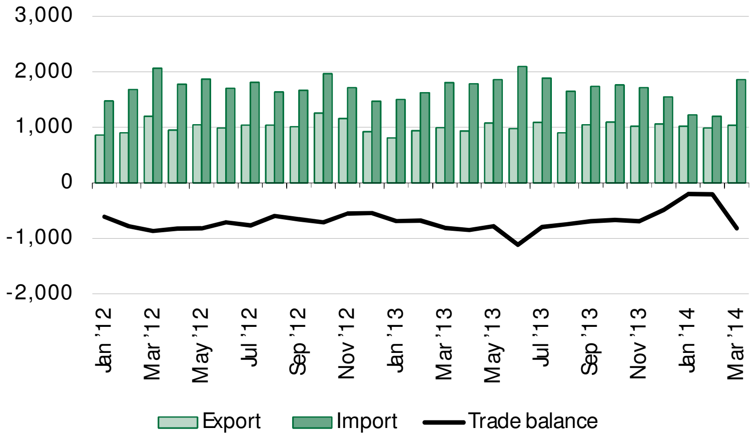
## Revenue collection falls in 1Q14 amid deflation and the budget deficit widening, HRK mln




*Source: Croatian Finance Ministry*

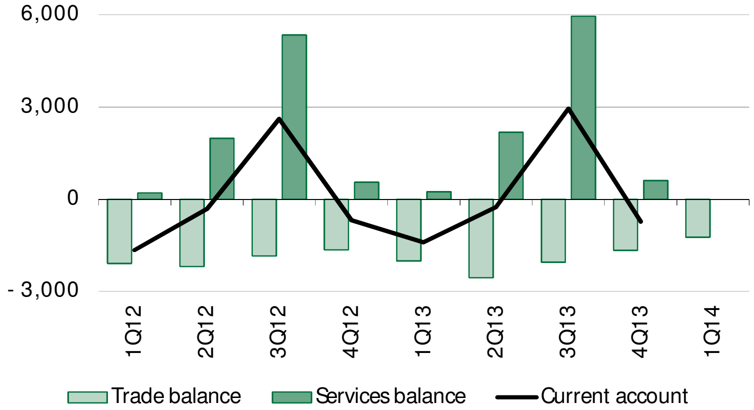
# Steadily shrinking consumption and household deleveraging helped trim Croatia's imports; service balance improves current account

**Trade balance remains negative, albeit less so..., $ mln**




*Source: Croatian National Bank*

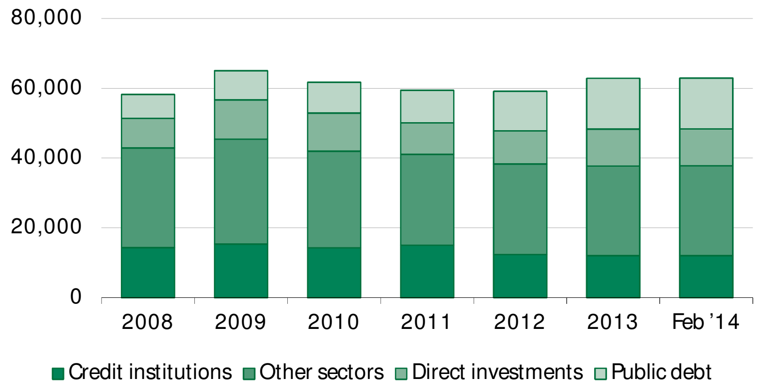
**... while the current account improved thanks to tourism, $ mln**




*Source: Croatian National Bank*

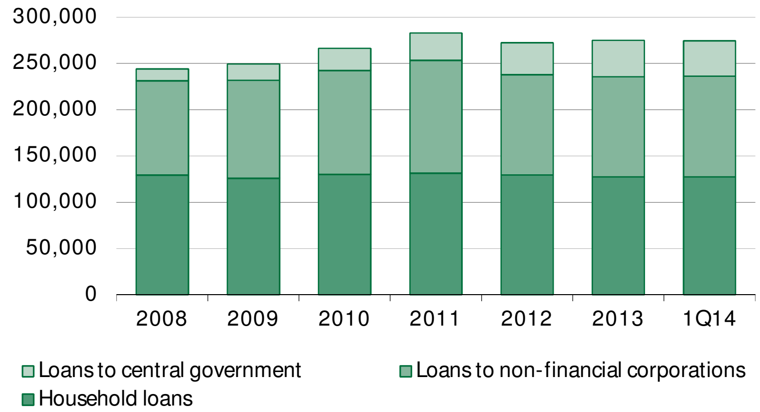
# Croatian total foreign debt changed little in nominal terms (but as the economy contracted, the debt/GDP ratio increased)

**Foreign debt unchanged as the government borrowed while the private sector deleveraged, $ mln**




*Source: Croatian National Bank*

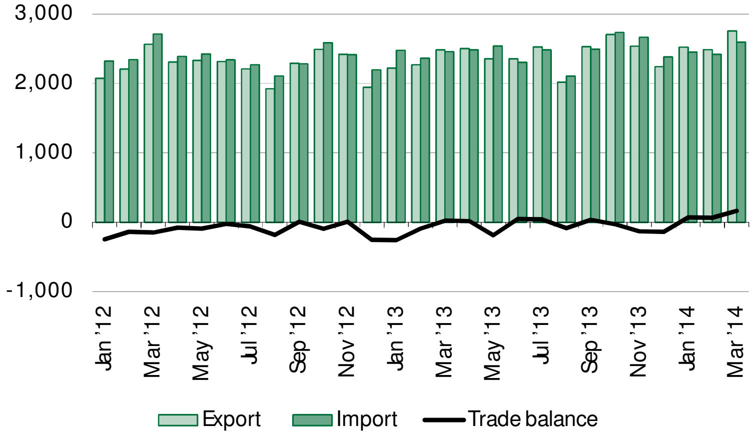
**Domestic borrowing: government debt grows, other sectors reluctant to borrow, HRK mln**




*Source: Croatian National Bank*

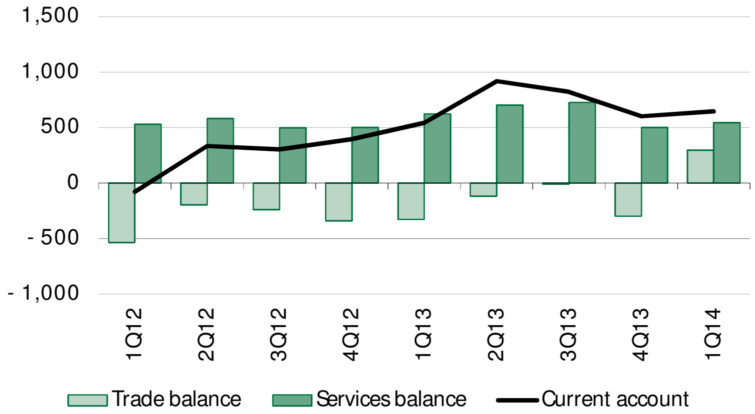
# Slovenia: industrial growth supports external rebalancing but public debt grows

**As the trade balance turned positive in 1Q14..., $ mln**




*Source: Bank of Slovenia*

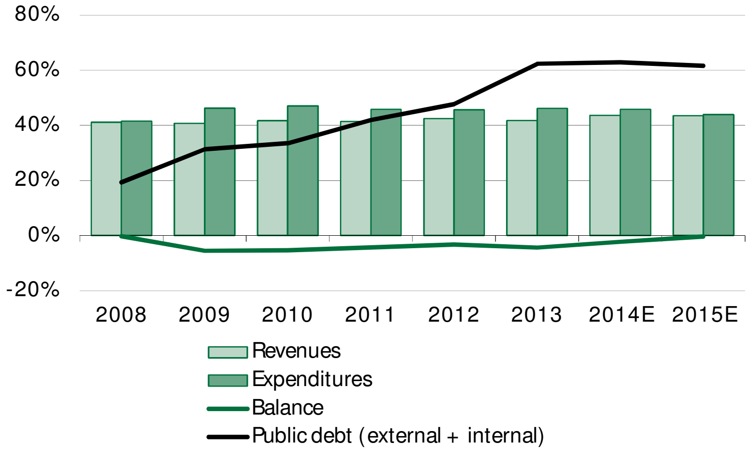
**... the current account strengthened despite decreased services balance, $ mln**




*Source: Bank of Slovenia*

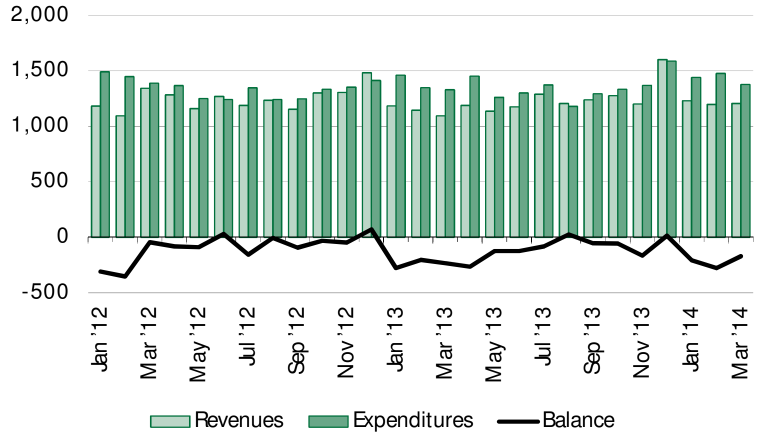
## The strengthening of the Slovenian current account was timely, as government debt increased massively in 2013 due to recapitalization the country's banking sector

**Public debt increased in 2013 as a result of borrowing to recapitalize banks, % of GDP**




*Source: Bank of Slovenia*

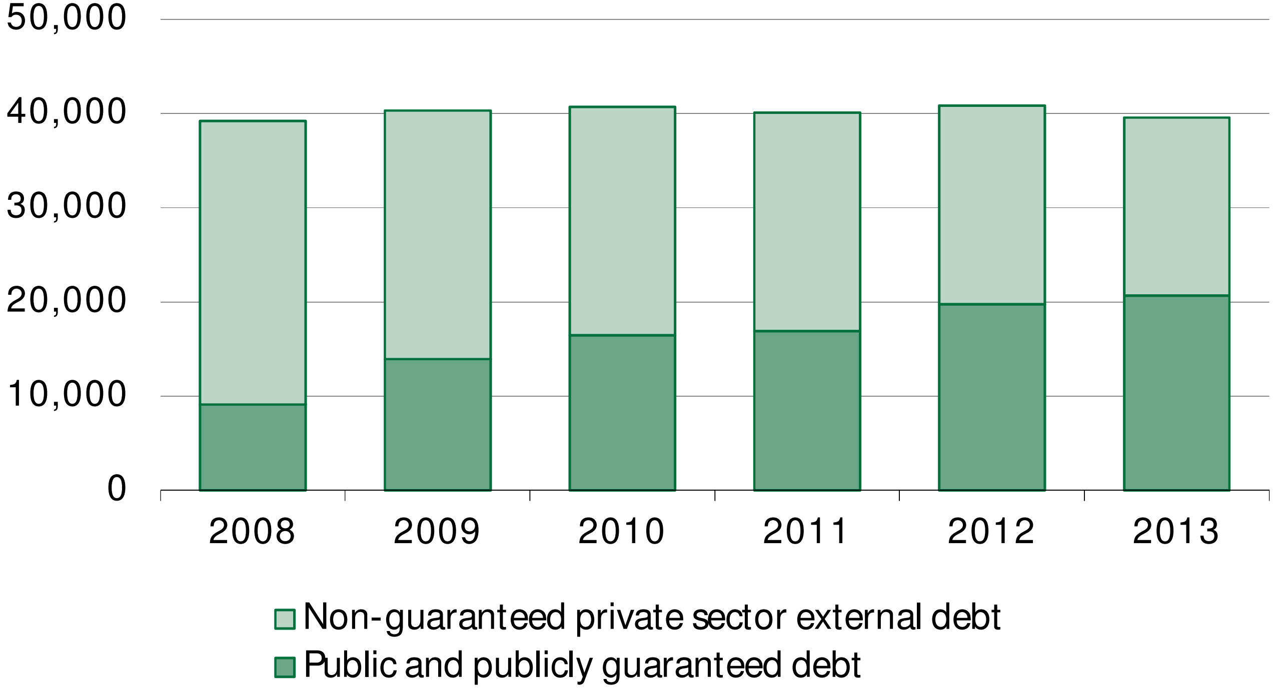
**Budget execution remained unchanged in 1Q14 and the deficit remained moderate, EUR mln**




*Source: Bank of Slovenia*

# Total Slovenian external debt remained relatively unchanged, although economic activity was low during this deleveraging

**Slovenian government borrowing supported private sector deleveraging, EUR mln**



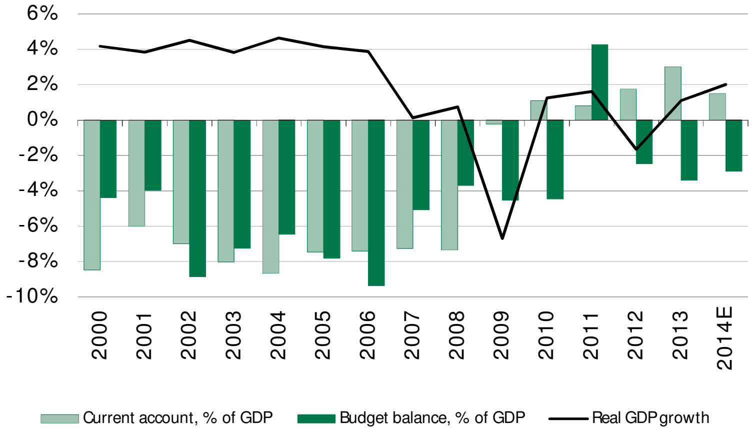

*Source: Bank of Slovenia*

# Medium-term risks in Turkey remain high, as the current account deficit is still significant, inflation is high: risks are lower in Hungary and Romania

- Hungary, Romania and Turkey, which previously had much in common (including huge external imbalances), now seem to be following different paths. Hungary was able to orchestrate a fast but painful transition to a positive current account (and thus stabilized its external debt/GDP ratio), Romania's current account deficit has decreased, although the balance remains negative, and Turkey needed to finance its external deficit of 7.9% of GDP in 2013, which may fall this year to around 6.5% of GDP (or perhaps lower).
- These economies were able to deliver positive growth in 2013, Turkey's GDP growth well exceeding the rates in the other two countries, but this came at the expense of accumulating imbalances. Romania and Hungary continued to successfully eliminate macroeconomic imbalances.
- In all three countries, the monetary authorities significantly missed their inflation targets. In Turkey, however, inflation substantially exceeded the medium-term goal of 5% (and will most likely remain well above this level for some time), while the inflation rates in Romania and Hungary suddenly dropped to historical lows and remain well below medium-term targets.
- Despite stronger growth, we see more medium-term risks in Turkey than in Hungary or Romania, as it is hard to find a trajectory that would enable the country to adjust its current account and bring inflation down. Hungary is still not immune to short-term risks, stemming from the fact that economic growth last year was supported largely by increased government spending, which may prove to be unsustainable. Romania's macroeconomic performance looks more solid.

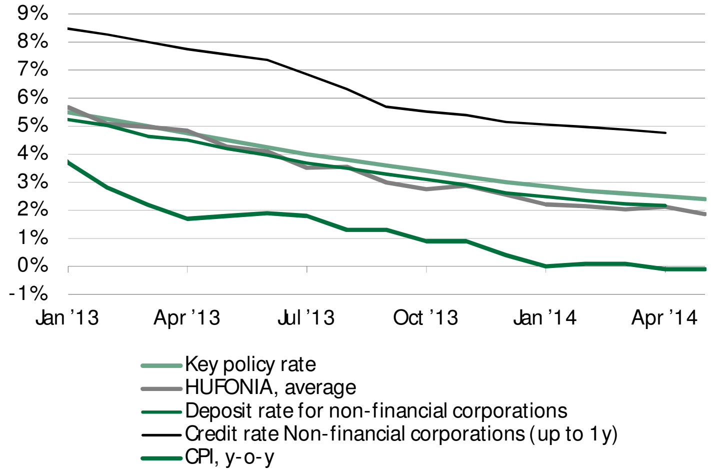
# Hungary: impressive external rebalancing amid steady disinflation

## Hungarian external balance improved




*Source: Hungarian National Bank*

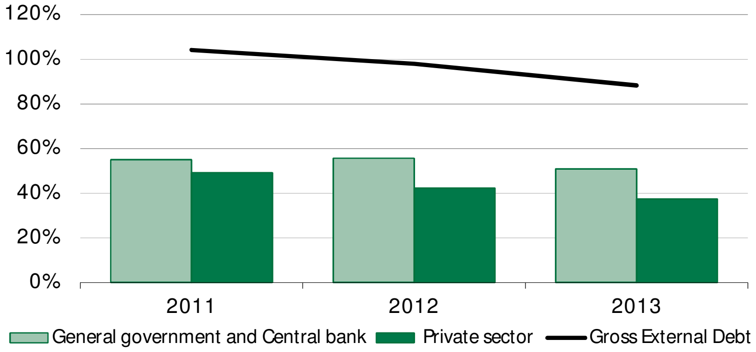
## Hungarian money market interest rates




*Source: Hungarian National Bank*

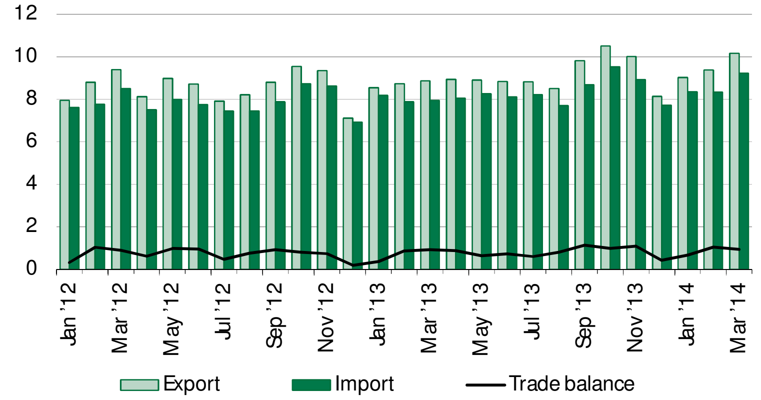
# Hungary: foreign debt decreases as the balance of payments improves

**Hungarian external debt by sector, % GDP**




*Source: Hungarian Finance Ministry*

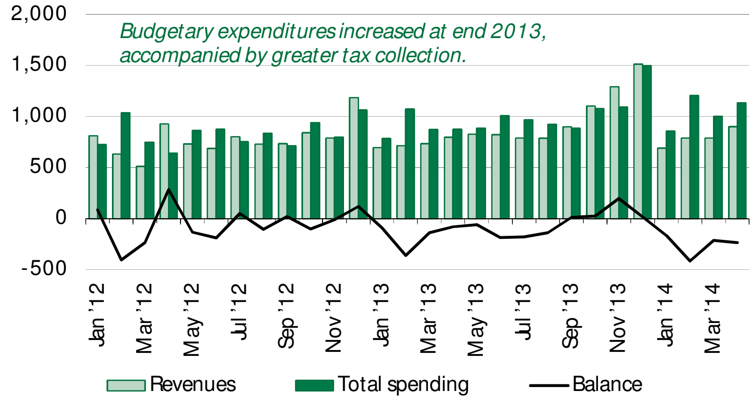
**Hungarian trade balance in surplus, $ bln**




*Source: Hungarian National Bank*

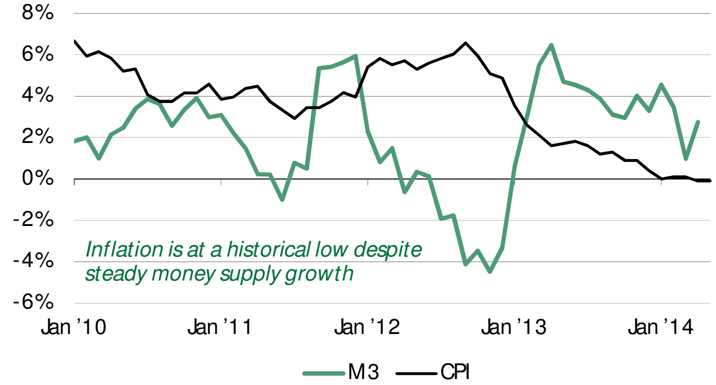
# Hungary: disinflation threatens fiscal consolidation

## Hungarian budget execution, HUF mln




*Source: Hungarian Central Statistical Office*

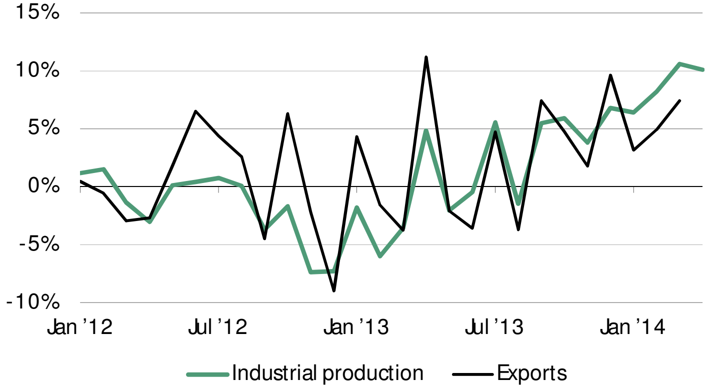
## Hungarian inflation and money supply, y-o-y




*Source: Hungarian National Bank*

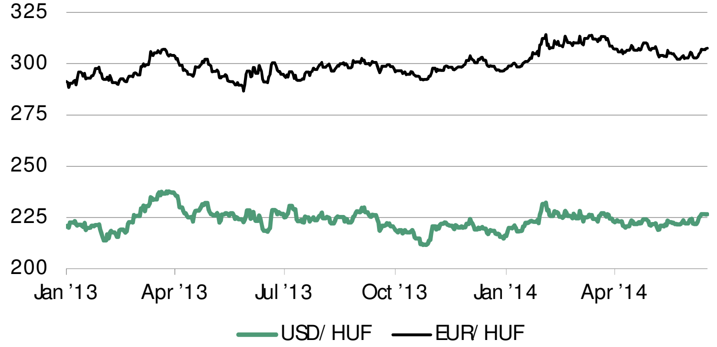
# Hungary: growing exports drive economic recovery

## Hungarian export and industrial output are correlated, y-o-y




*Source: Hungarian Central Statistical Office*

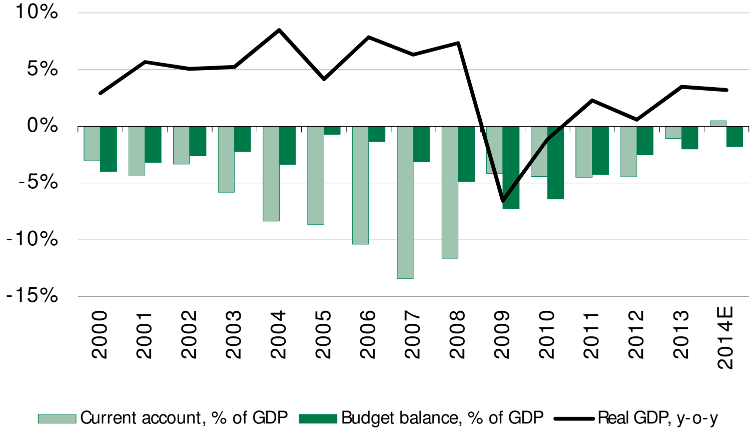
## Nominal HUF exchange rate




*Source: Hungarian Central Statistical Office*

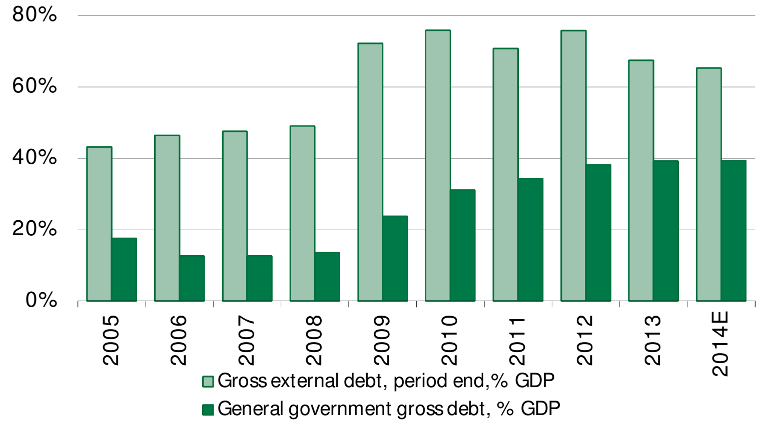
# Romania: gradual external rebalancing helps deleveraging

## Romanian external balance




*Source: Romanian Finance Ministry*

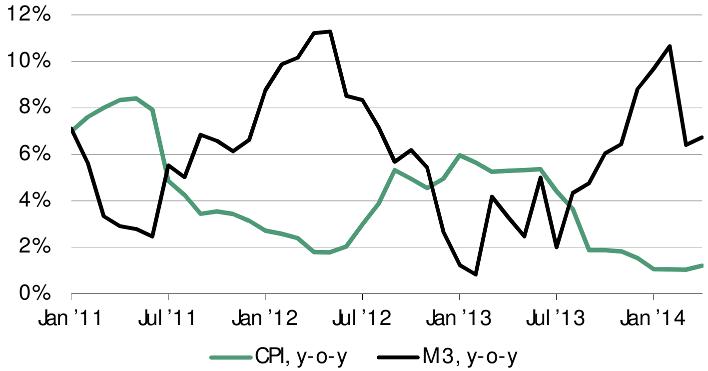
## Romanian general government and external debt, $ bln




*Source: Romanian National Bank*

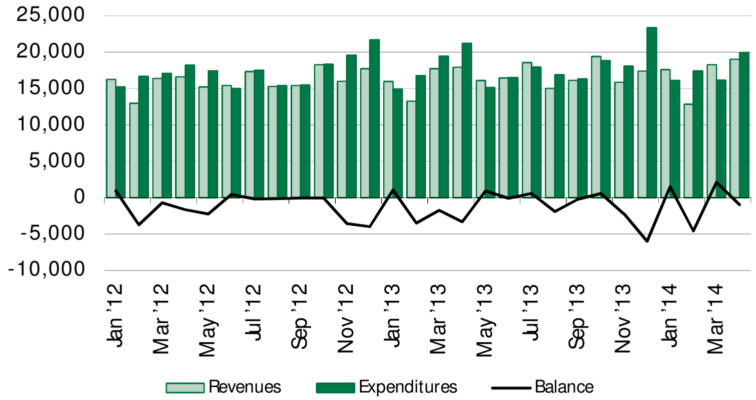
# Romania: budget deficit remains moderate as disinflation (amid abundant liquidity) is offset by strong growth

## M3 and inflation, y-o-y




*Source: Romanian National Bank*

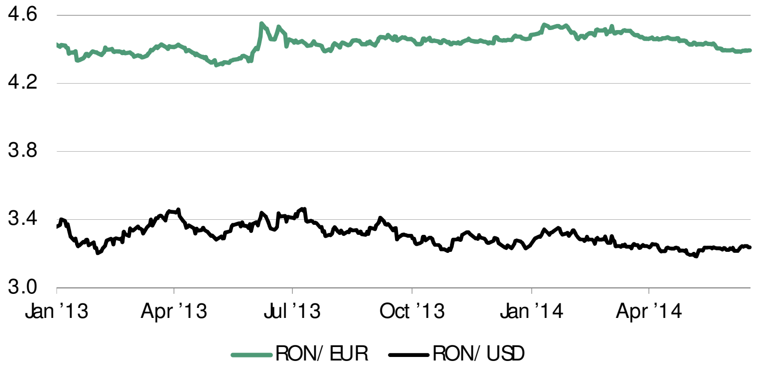
## Central government budget execution, RON mln




*Source: Romanian National Bank*

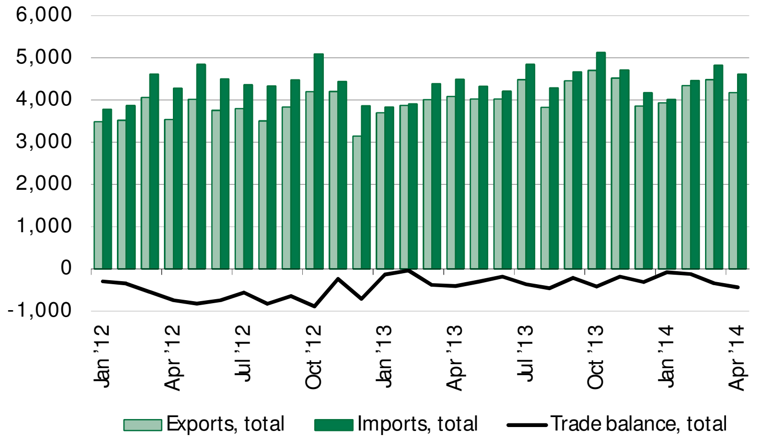
# Romania: currency appreciates, but balance of payments remains stable…

## Nominal RON exchange rate




*Source: Romanian National Bank*

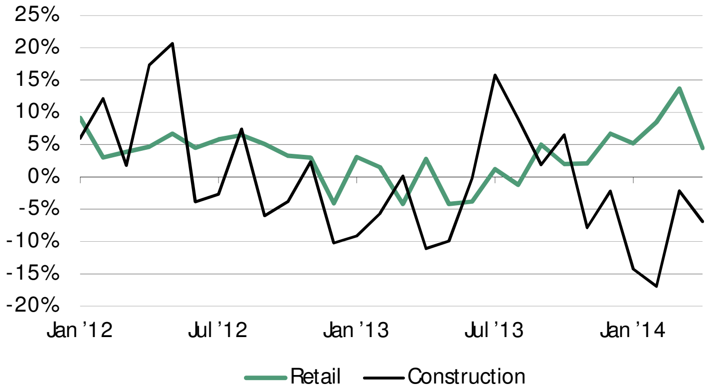
## Romanian foreign trade, EUR mln




*Source: Romanian National Bank|*

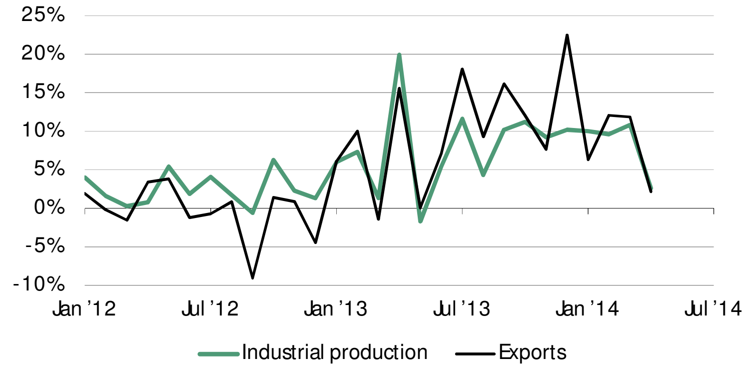
# ... as exports rise driven by strong industrial growth

**Romanian retail and construction works, y-o-y**




*Source: Romanian National Bank*

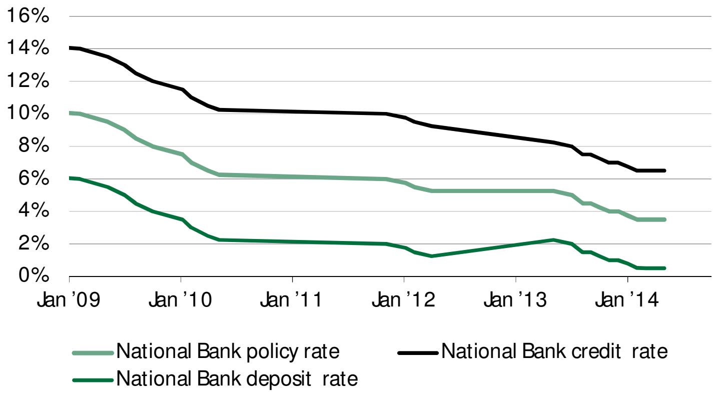
**Industrial output and export are correlated**




*Source: Romanian National Bank*

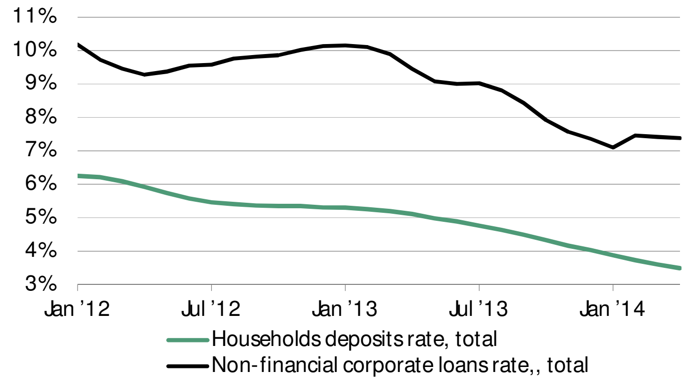
# Romania: rates go down as the economy disinflates

## Money market rates




*Source: Romanian National Bank*

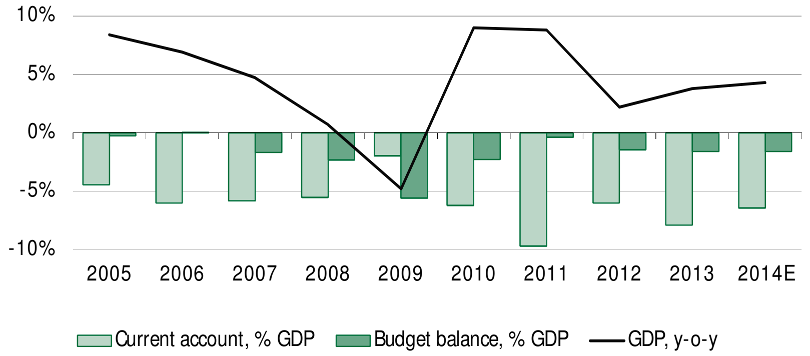
## Retail loans rates




*Source: Romanian National Bank*

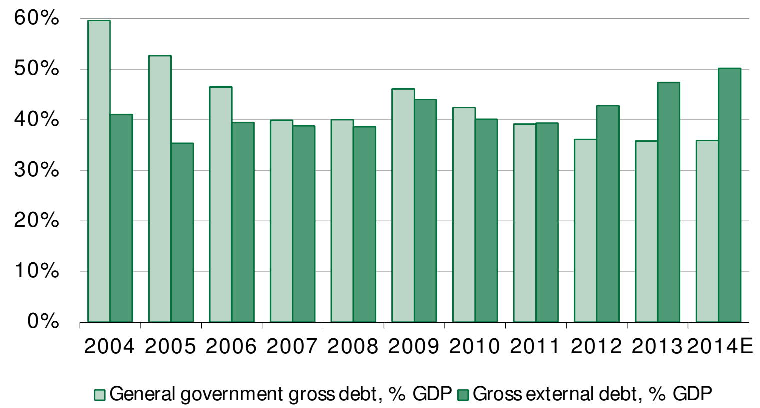
# Medium-term risks in Turkey remain high, as the current account deficit is still significant, inflation is high and external debt is rising

## Turkish external balance




*Source: Central Bank of Turkey*

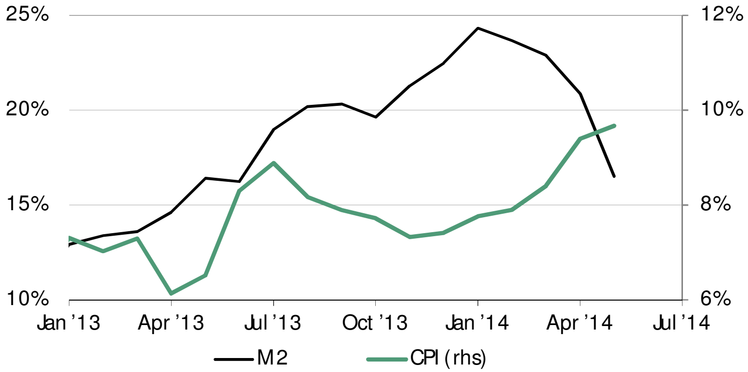
## Turkish general government and external debt, $ bln




*Source: Central Bank of Turkey*

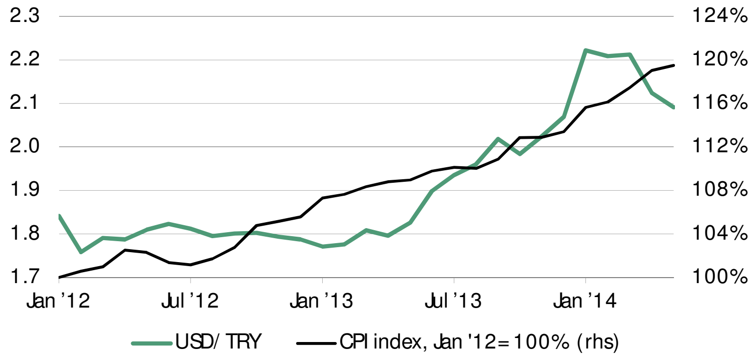
# Turkey: inflation accelerated as the currency weakened

### Turkish M2 and inflation, y-o-y




*Source: Central Bank of Turkey*

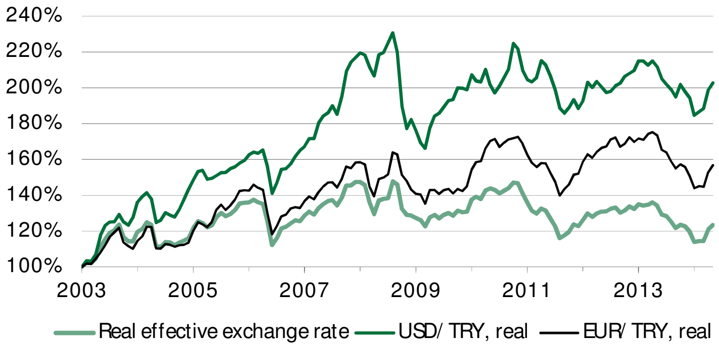
### Nominal TRY exchange rate and inflation




*Source: Central Bank of Turkey*

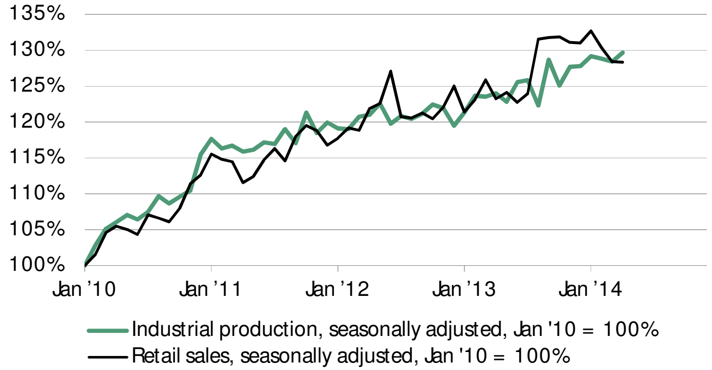
# Turkey: real exchange rate did not appreciate much in recent years, which supported industrial growth

## REER TRY and calculated real exchange rates




*Source: Central Bank of Turkey*

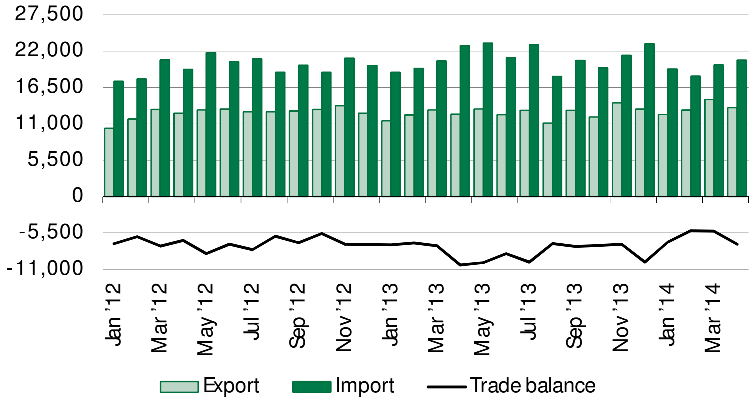
## Turkish industrial production and retail




*Source: Turkish Statistical Institute*

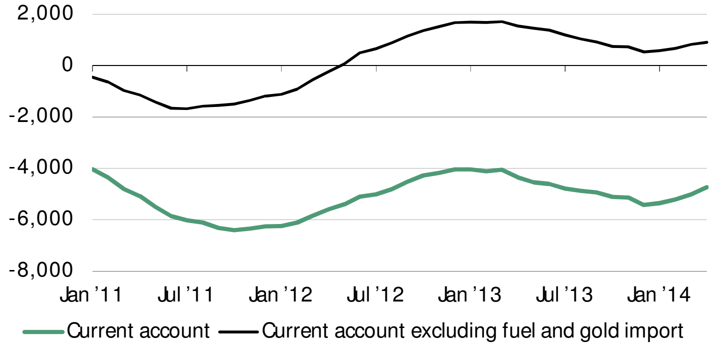
# Turkey: external rebalancing is on track, but the trade deficit remains high as the current account deficit is still significant

**Foreign trade, $ mln**




*Source: Central Bank of Turkey*

**Current account, 12m rolling data, $ mln**



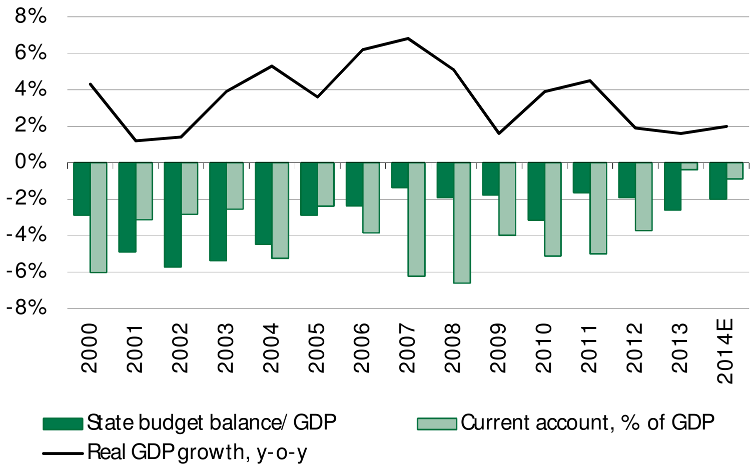

*Source: Central Bank of Turkey*

# Poland and Bulgaria: two different stories

- The Polish economy is growing like a DM economy, while Bulgaria is still in a search of its new growth model.
- As opposed to many other countries, Poland was able to avoid recession in 2008-09, and continues to demonstrate sustainable growth, albeit the threat of deflation exists.
- Polish economic growth is expected to accelerate this year, supported by a rebound in construction.
- Consistent and strong macroeconomic policy kept the country's debt/GDP ratios at bay during the crisis, and contributed to steady deleveraging in recent years.
- Bulgaria's economic growth remains slow, and after a sharp correction in 2009, the economy saw little restructuring in recent years. There has been deflation since mid-2013, but economic growth is set to accelerate this year to around 1.5%, which may somehow offset the negative impact of deflation on the budget.
- Bulgaria's industrial performance improved in 2013-14, but domestic demand has weakened in recent months.

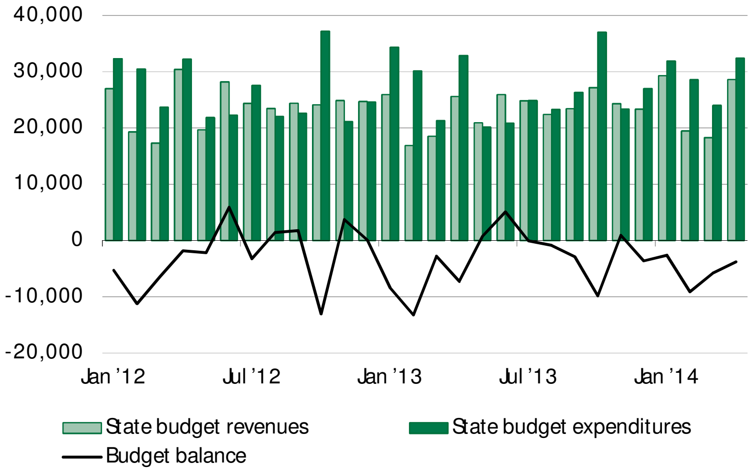
# Poland: sustainable growth amid sound macroeconomic policy

## Polish economic growth is remains stable as deficits shrink




*Source: Polish Finance Ministry*

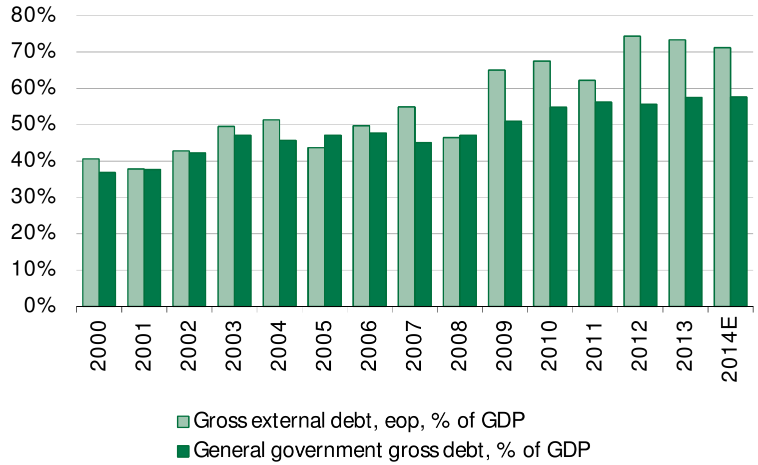
## Polish state budget execution, PLN mln




*Source: Polish Finance Ministry*

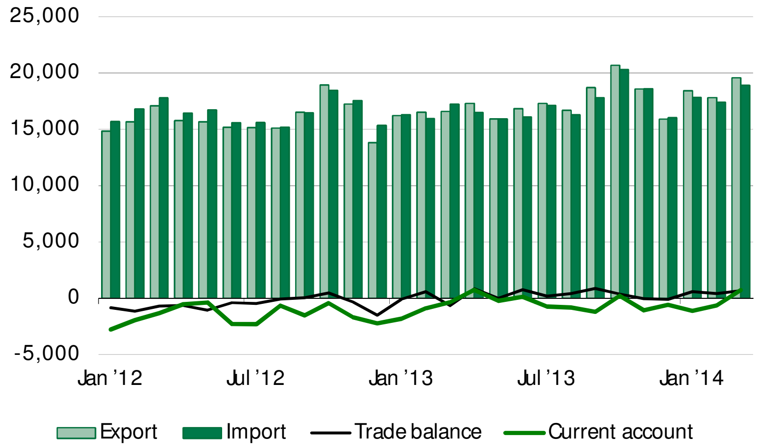
# Poland: steady external deleveraging as the balance of payments remains strong

### Polish foreign debt is not high compared with other Eurozone countries




*Source: Polish Finance Ministry*

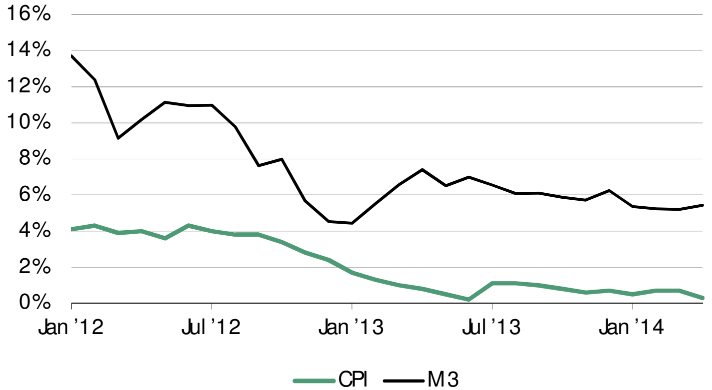
### Polish balance of payments, $ mln




*Source: Polish National Bank*

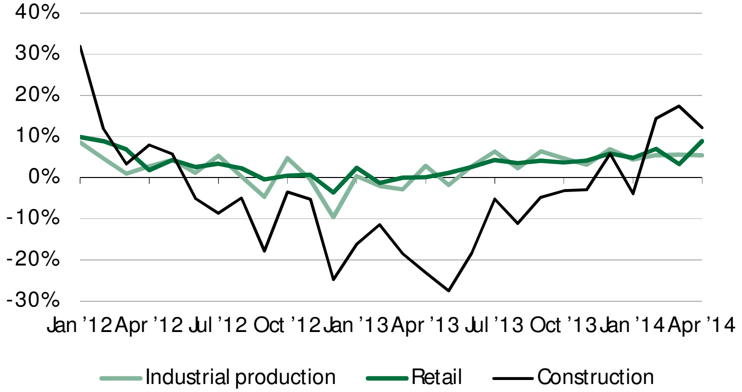
# Poland: growth accelerates while threat of deflation persists

## Polish inflation decelerates, but not yet a deflation, y-o-y




*Source: Polish Finance Ministry*

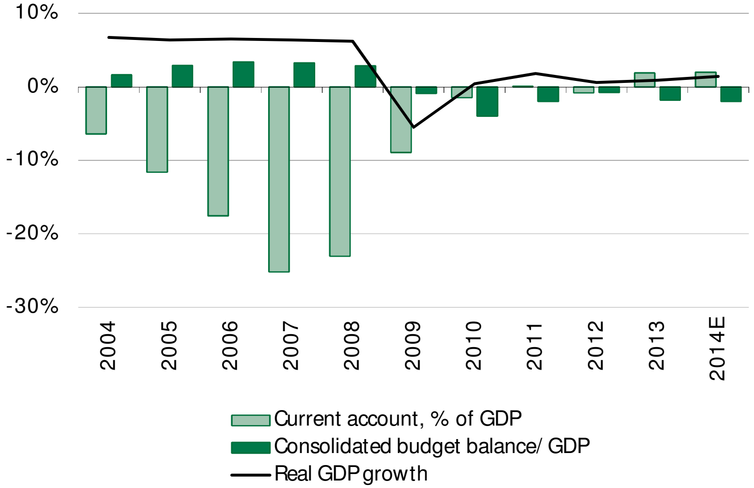
## Polish main economic indicators, y-o-y




*Source: Polish Statistical Office*

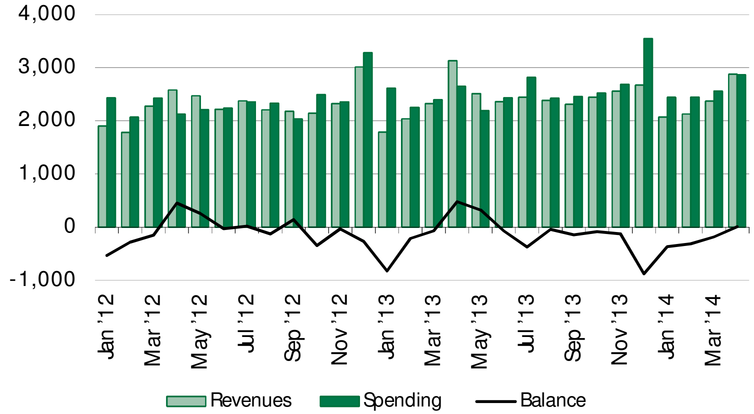
# Bulgaria: economic growth remains slow, but the budget deficit is still moderate

**Bulgarian external balance is improving**




*Source: Bulgarian Finance Ministry*

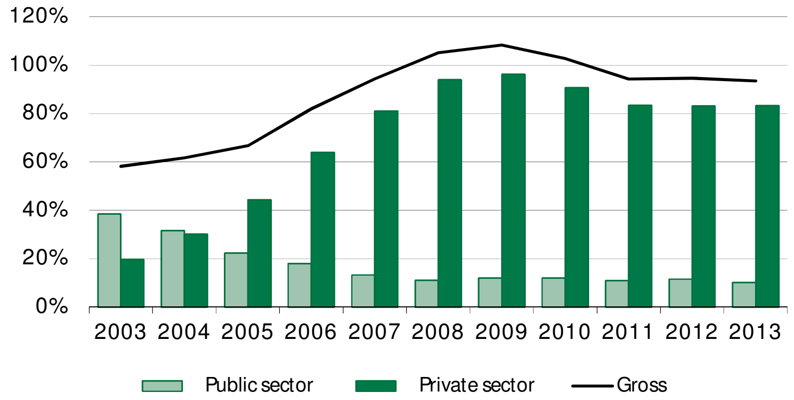
**Bulgarian consolidated budget execution, BGN mln**




*Source: Bulgarian Finance Ministry*

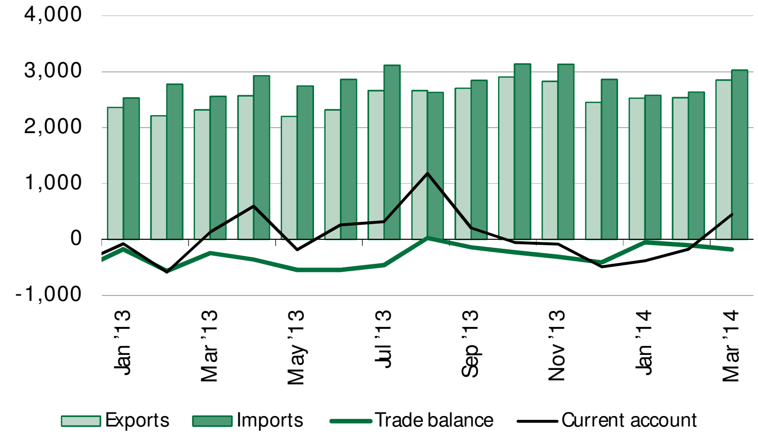
# Bulgaria: foreign debt/GDP ratio has stabilized and the balance of payments remains manageable

## Bulgarian external debt by sector, % of GDP




*Source: Bulgarian Finance Ministry*

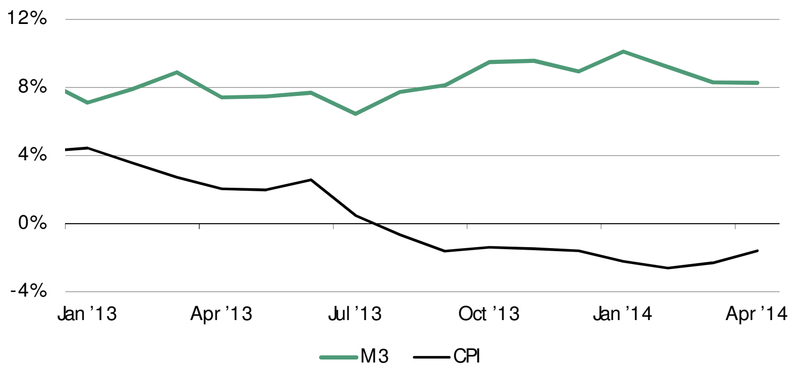
## Bulgarian balance of payments, $ mln




*Source: Bulgarian National Bank*

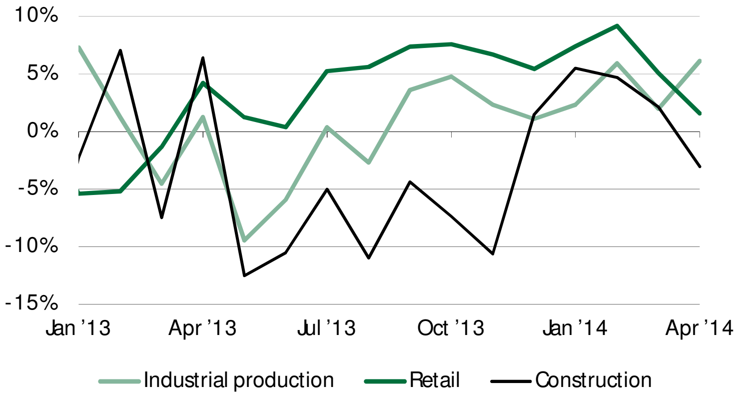
# Bulgaria: deflation and slow growth may hit the budget

### Bulgarian inflation and monetary aggregates, y-o-y




*Source: Bulgarian National Bank*

### Bulgarian main economic indicators, y-o-y




*Source: Bulgarian National Bank*

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