European Commission Spring Economic Forecasts 2010: "European Commission raises forecasts for CZ, SK, PL, HU und RO"

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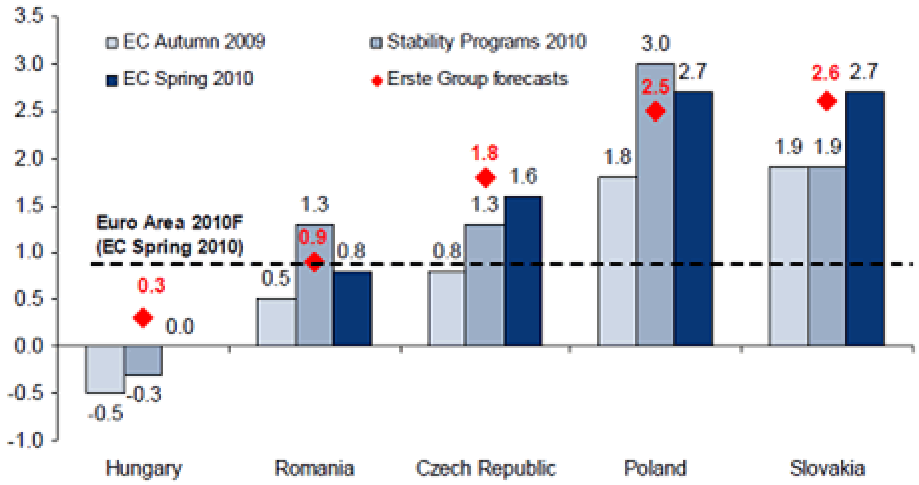
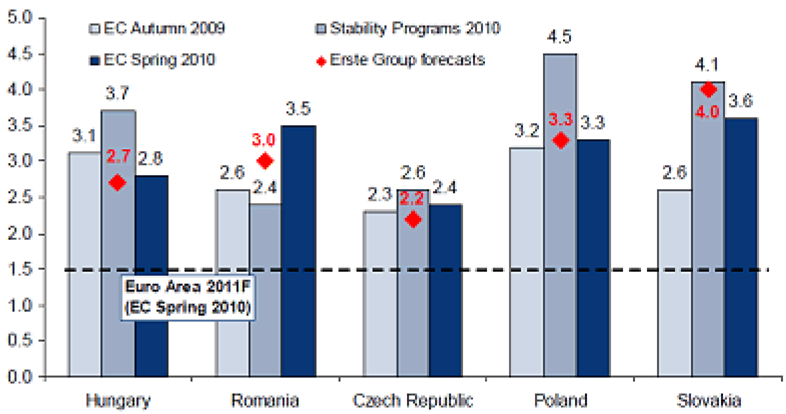


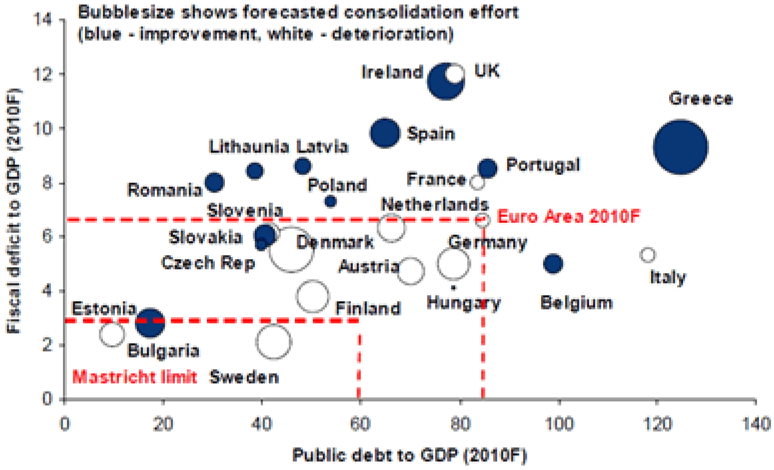
The new Spring Forecasts of the European Commission brought two main implications for CEE5 (the Czech Republic, Slovakia, Poland, Hungary and Romania) countries. The GDP outlook for these countries in 2010 remains much better than those seen in either the EC Autumn Forecasts or Stability Programs submitted by individual countries at the beginning of this year and it is very close to the forecast of Erste Group analysts. Downward growth revision only hit Greece, which has been forced to start earlier with consolidation compared to other Euro Area countries.

GDP growth forecast for 2010



Erste Group analysts share the view with the EC that, among CEE countries, only Poland, Slovakia and the Czech Republic will outperform the growth of the Euro Area in 2010, while Romania will be very close (Romania 2010F EB 0.9/EC 0.8 vs. Euro Area 2010F EB 0.7/EC 0.9). Erste Group analysts forecast (in line with the EC forecast) that, from 2011, the Romanian and Hungarian economies will also outperform the growth of the Euro Area, which is going to be constrained by deferred consolidation

GDP growth forecast for 2010



More interesting than the GDP outlook was the data published on public finances, as deficits remain elevated across all of Europe. Among CEE5 countries, only the Polish and Romanian deficits are expected to exceed the Euro Area average (6.6%), but remain safely below the high deficits seen among the PIGS. Furthermore, the EC assumes that the PIGS will need to deliver a much stronger consolidation effort (reducing the structural balance by 0.8-5.9pp in 2010, compared to the 0.1-1.0pp assumed for CEE5) to meet these forecasts. The consolidation in CEE5 is slightly weaker than outlined in the recently published Stability Reports, but especially in Romania, where, to reach a reduction of the structural deficit of 2pp, greater acceleration in expenditure cuts is needed. Other Euro Area members have planned to start with the consolidation of their budgets not earlier than in 2011, so for some of them, their structural deficit is even going to widen in 2010.

EC forecast on fiscal deficit, public debt and consolidation effort (2010F, % of GDP)

	Debt to GDP	Fiscal deficit	Consolidation effort (change of structural balance)
Greece	124,9	9,3	5,9
Italy	118,2	5,3	-0,3
Belgium	99	5	0,8
Portugal	85,8	8,5	0,8
Euro area	84,7	6,6	-0,3
France	83,6	8	-0,4
Ireland	77,3	11,7	2,7
Hungary	78,9	4,1	0,1
Germany	78,8	5	-1,8
United Kingdom	79,1	12	-0,7
Austria	70,2	4,7	-1,2
Netherlands	66,3	6,3	-1,3
Spain	64,9	9,8	1,8
Poland	53,9	7,3	0,4
Finland	50,5	3,8	-1,7
Latvia	48,5	8,6	0,6
Denmark	46	5,5	-3,6
Sweden	42,6	2,1	-2,1
Slovenia	41,6	6,1	-0,6
Slovakia	40,8	6	1
Czech Republic	39,8	5,7	0,4
Lithuania	38,6	8,4	0,6
Romania	30,5	8	0,9
Bulgaria	17,4	2,8	1,7
Estonia	9,6	2,4	-1,1

The earlier start of fiscal consolidation in CEE and in general much lower level of public debt give the CEE5 countries more room to keep a positive outlook for strong growth in years beyond 2011. The Hungarian public debt to GDP is projected to drop below well below the Euro Area average (79% vs. 85%), while the public debt to GDP of Romania, Slovakia and the Czech Republic is to remain less than half of the Euro Area average. The new EC forecasts reveal a very positive improvement of Hungarian public finances, as their structural deficit is estimated at 2.1% (better than the 3.6% of GDP projected for Germany in 2010), while Romania and Poland have to intensify their consolidation efforts, in order to meet their fiscal consolidation plans.

CEE5 – country by country assessment

Hungary: "Regarding growth figures and the budget balance, the new forecast is broadly in line with what we expect for the Hungarian economy for 2010-11. However, we expect somewhat higher GDP growth this year (0.3% vs. the EC's 0.0% assumption) and the Commission is a bit more optimistic regarding the budget deficit in 2010 compared to our estimate (we forecast a 4.2% budget deficit for 2010). The budget deficit target of Hungary's Convergence Program (submitted in January) of 3.8% for 2010 will be overshot as well, according to the EC, due to possible expenditure slippages. As for 2011, the Commission sees a much more significant difference for the budget deficit vs. the 2.8% forecast in the Convergence Program. The structural budget balance estimate of the EC fully matches that of the Convergence Report's for 2010, but the Commission's estimate for 2011 is much more adverse (-2.3% of GDP vs. the CP's -1.5% assumption). The difference can be explained by the lower GDP growth forecast of the EC (2.8% vs. the CP's 3.7% assumption). This is in line with the Commission's earlier warning of a too optimistic macro forecast by the past government. The EC outlined that, in order to be in compliance with the fiscal framework adopted in November 2008, the year 2011 will be crucial. It is worth mentioning that the EC used a no-policy-change assumption in its forecast, meaning that no possible deficit increasing measures of the future government are taken into consideration." Zoltan Arokszallasi – chief analyst, Erste Bank Hungary

Romania: "The pace of economic growth compared to Stability Program has been reduced to below 1% in 2010, due to the slower recovery of domestic consumption, which is in line with our current forecast. The European Commission sees faster growth in 2011, following a stronger rebound in domestic demand, both consumption and investment. The budget deficit remains a key concern, as public reforms have fallen behind schedule and, according to the current scenario, Romania is pretty unlikely to see fiscal consolidation by 2012 (budget deficit below 3% of GDP ESA), unless the government presses ahead with the public reforms. Given the significant revenue shortfall in the first quarter of 2010 (particularly from VAT, social security contributions and income tax), the IMF could agree to a wider 2010 budget deficit target. The government may be forced to increase VAT and the flat tax to achieve the new deficit target. In our opinion, increasing taxation cannot be a substitute for public reforms - not to mention the upside pressures on inflation." Cristian Mladin – analyst, Banca Comerciala Romana

Czech Republic: "The Czech Republic's latest Stability Program differs from the EC spring forecast in that the EC forecast (-5.7% for both 2010 and 2011) is more pessimistic than the Ministry of Finance's forecast (-5.3% and -4.8%, respectively) regarding the ability of the Czech Republic to bring the deficit on a decreasing path towards the Maastricht limit of 3% anytime soon. Part of the EC explanation (for 2010) is that this is due to "additional expenditure measures approved before elections." It is hard to say what this means, as no such thing has happened here, in our view. Also, the deficit is projected by the EC to stay the same throughout 2010 and 2011, regardless of the pickup in the growth rate of GDP, the fall in unemployment and the pick-up in HH consumption – this seems to suggest that the EC remains convinced that there will be expansion of the expenditures. In our view, however, the problems of Greece will serve as a reminder to any CZ government that unlimited expansion of indebtedness is not exactly the right path. This does not mean that there will be a reduction of the deficit if leftist parties prevail in May – it only means that we do not foresee an increase in spending that is not matched by an increase in taxes, even in this case. Also, the possibility remains of a broad-based rightist government that – if approved – would hopefully go much further with a deficit-cutting strategy. As we largely agree with the EC in terms of GDP expectations, we think that the deficit for 2010 will be well below 5%. The EC understandably walks a safer line here." Martin Lobotka – senior analyst, Ceska sporitelna

Slovakia: "The EC expects an economic picture broadly in line with our view. While the growth is seen as among the highest in the EU, it will still lag the growth of pre-crisis years. The EC sees a higher fiscal deficit than envisaged in the Stability Program for both 2010 and 2011 (at -6.0% and -5.4% of GDP, respectively, i.e. 0.5pp and 1.2pp higher than the government). The EC took into account the higher than planned fiscal deficit in 2009 and assumes lower budget revenues in 2010. Moreover, the EC still assumes upside risks to these figures, namely due to higher electioneering spending and optimistically assumed balanced budgets of local municipalities in the Stability Program. Indeed, this year's development has thus far materialized with these upside risks, in our view (we expect deficits of -7.5% and -6.0% of GDP in 2010-11, respectively). In the view of the EC, the structural deficit is likely to decline, as the output gap should increase this year, and due to the expected consolidation efforts of the government." Maria Valachyova – senior analyst, Slovenska sporitelna

Poland: "Poland's projected GDP path from the Stability Program is more optimistic (especially for 2011) than what is expected in the latest EC report, while the latter is very close to our expectations. The lower projected GDP growth is then also reflected in somewhat higher estimations for the fiscal deficit and debt figures. The Commission points out that the recent sizeable increase in the deficit reflects the operation of automatic stabilizers during the crisis and the impact of stimulus measures (estimated at about 2% of GDP), such as a cut in personal income tax (since Jan09) and an increase of investment in infrastructure. Importantly, the Commission expects that, under current policies and growth forecasts, the headline deficit will stabilize and the structural deficit will modestly decrease (from -7.2% of GDP in 2009 to -5.7% of GDP in 2011) over the projection horizon. Both expenditures and revenues can be expected to grow, reflecting the inflow of EU structural funds (a number of projects are to be finalized before the European soccer championship in 2012). Compared to our prognosis, the Commission is more pessimistic on the development of the headline deficit figure in that it does not expect almost any improvement over the next two years. Even though the government's latest public finance consolidation plan is relatively vague in details, we believe that the law-embedded safety thresholds for the public debt (the first threshold was avoided by a mere 0.1% in 2009 and will not be avoided in 2010, which will trigger automatic savings measures for 2012; whereas breaching the second threshold, which is "only" 5% away, would mean even stricter restrictions) will provide incentives for the government for at least some consolidation. The proximity of general elections (in 2011) will, however, post a risk and likely stand in the way of any dramatic measures." Jana Krajcova – senior analyst, Ceska sporitelna.

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