ERSTE Group

CEE outlook 2014: uptick in GDP growth supported by increased investments and narrowing fiscal deficits

02.01.2014

GDP growth to increase to 2.2% (from 0.9% estimated for 2013), double the rate expected for the Eurozone

Economic growth shifting to more balanced composition – investments to increase for the first since crisis

Overview of CEE countries in 2014

Croatia: European Commission pushing for more austerity

Czech Republic: Fiscal restriction will cease; new sector tax postponed

Hungary: Parliamentary elections could bring fiscal tightening and final solution on FX loans issue

Poland: Rates might remain unchanged at all-time low for the longest period in history

Romania: Ongoing improvement in EU funds absorption; presidential elections

Slovakia: Fiscal consolidation and public debt to remain key developments

Serbia: EU entry negotiations starting from January to mark a stronger incentive for structural reforms

Erste Group analysts expect GDP growth across CEE7 economies to increase to 2.2% in 2014, from 0.9% estimated for 2013. “The GDP growth of the region will be twice as high as the growth expected for the Euro Area. What is even more important, the growth composition will be more balanced and thus more sustainable. Actually, 2014 will be the first year since the onset of the crisis when investments will be growing in every country”, says Juraj Kotian, Head of CEE Macro/FI Research at Erste Group.

Real GDP growth (%)	2012	2013f	2014f	2015f
Croatia	-2.0	-0.8	0.0	1.0
Czech Republic	-0.9	-1.3	2.0	2.6
Hungary	-1.7	0.8	1.8	1.9
Poland	1.9	1.4	2.9	3.4
Romania	0.7	2.5	2.3	2.9
Serbia	-1.7	1.8	1.0	2.0
Slovakia	1.8	0.7	1.7	2.5
Turkey	2.2	3.8	4.2	5.0
CEE7 average	**0.5**	**0.9**	**2.2**	**2.8**
CEE7+Turkey	**1.1**	**1.9**	**3.0**	**3.6**

Source: Erste Group Research

Fiscal deficits will further narrow and current accounts will remain in check, Erste analysts conclude. Apart from Croatia and Serbia, all CEE countries should be able to comply with the Maastricht limit for their fiscal deficit of 3% of GDP next year. “Hungary and Romania exited the Excessive Deficit Procedure last summer, the Czech Republic and Slovakia are supposed to receive an abrogation this year. Slovakia will likely be asked by the European Commission to submit more details on future consolidation plans before getting an abrogation. Poland has one more year left, but it will run a budget surplus in 2014, due to windfall revenues resulting from the acquisition of a government bond portfolio from open pension funds”, states Kotian.

In many CEE countries interest rates are at an all-time low. The first rate hikes are unlikely before the late summer- actually some central banks may continue with monetary easing until then. The tapering has already been fairly

priced into CEE bonds and therefore financing conditions for CEE7 countries should be only marginally impacted. "It looks like the tapering will be very much a controlled process, as the Fed will try to avoid any excessive increases in US yields so as not to threaten the on-going economic recovery. That also limits the upward risk for CEE bond yields and is why we only expect a very moderate increase of yields in the range of 20-70bp next year," explains Juraj Kotian.

Country overview

Croatia: Erste Group analysts think that the Croatian government response to European Commission fiscal targets will be a driving factor in terms of rating outlook, funding cost, structural reforms and a more prudent fiscal policy outlook. The EDP will hopefully force some consolidation, but also, and more importantly, some constructive structural reforms and finding the right mix between a higher tax burden and necessary permanent expenditure cuts.

Czech Republic: One of the most important events next year will be the end of fiscal restrictions. This was the major negative factor behind the 4Q11-1Q13 recession. Another potentially important event could be related to ANO, a movement that is poised to become part of the next coalition. The most likely sticking points, such as taxes, are being postponed “until later”, potentially creating tensions in the government.

Hungary: The Hungarian government’s ‘unorthodox’ policy is likely to remain the most important factor for 2014. Parliamentary elections in spring 2014 will mark an important event next year. According to the most recent polls, the current government is likely to remain in power. Nonetheless, after the elections, Erste Group analysts do not rule out some fiscal tightening, as there could be risks tied to keeping the deficit under 3% of GDP next year – a likely prerequisite for further EU fund inflows and thus something that is of utmost importance to the Cabinet. On the other hand, we should not forget that the government is planning to give additional aid to FX mortgage loan borrowers, which could have a significant impact on the banking sector, the forint and the whole economy.

Poland*:* Poland is experiencing the second longest period of stable rates at historically low levels. So far, the longest period of flat policy rate was during the crisis (2009 and 2010), when for 19 consecutive months Poland had a stable policy rate. In the baseline scenario, Erste Group analysts expect the first rate hike in 4Q 2014. But the rates may remain stable longer if the inflation rate remains low. To beat the historical record of stable policy rate, the rate would have to stay flat until March 2015, which is possible if the noninflationary environment persist. This would also be the longest period with the lowest short-term rate (3M WIBOR) in history.

Romania: Romania has two more years to spend all of the money allotted by the European Commission for the current financial framework (2007-13). Erste Group models show that the full absorption of EU structural and cohesion funds earmarked for 2007-13 (EUR 19.2bn) could lift potential GDP growth to 4% after 2015. The annual inflow of EU structural funds is going to increase to EUR 5bn in 2014 from an estimated EUR 3bn in 2013, according to Erste Group analysts. Romania will continue to see a stop-and-go pattern in reforming its public and private sectors. The presidential election is undoubtedly the political highlight of next year. The campaign will probably enter its home stretch in late November or early December, unless President Basescu exercises his constitutional right to push it back two months (the duration of the suspension which was seen in 2012). No less interesting will be the European parliamentary elections in May, with each of the two parties in the government (the Social Democrats and Liberals) vying for seats in the EP. A certain amount of political noise is par for the course, especially in election years – not only in Romania, but worldwide. However, remaining politically stable is an essential prerequisite for keeping investor confidence afloat.

Slovakia: The main issue in Slovakia next year will be the ongoing fiscal consolidation and the development of public debt. The government plans to cut the nominal budget deficit to 2.6% of GDP next year, but projects an increase in the structural deficit (as consolidation is mainly done via one-offs or temporary measures). Thus, Slovakia may not be allowed to leave the EDP unless it discloses some further consolidation measures. Besides, public debt is dangerously close to some of the levels specified in the debt brake law. Breaching these levels would trigger automatic budget cuts or other sanctions. Debt is likely to reach just under 55% of GDP by end-2013. Breaching this threshold would lead to 3% across-the-board cuts in all government expenditures. Besides, there is a possibility of breaching the 57% mark by the end of next year, which would mandate the government to present a balanced budget for the following year.

Serbia: Although it is already anticipated, Erste Group analysts are considering the expected kick-off of EU negotiations in January 2014 to be the one of the key events in the whole year. It would ensure that Serbia’s EU prospects remain on track and facilitate a stronger incentive for structural reforms, improving general macro and political stability and going hand-in-hand with improving FDI prospects.

© 2016 Erste Group Bank AG